Bradford & Marzec
GLOBAL FIXED INCOME MANAGEMENT

Investment outlook & portfolio strategy

May 2016

Global economic outlook summary

International

We continue to identify tentative signs of a stabilizing, albeit somewhat soft, global economy. In addition, we expect a modest increase in growth outside of the US in 2H16, as a result of significant 'quantitative easing' policies by major central banks, and more flexible monetary policies in emerging market countries afforded by the weakening US dollar. These same dynamics also support global financial asset prices in the face of weak economic fundamentals. We anticipate a slowing US economy will contribute to volatility in spread markets for the foreseeable future. Despite slightly improving fundamentals in Europe, uncertainty persists as the Brexit vote approaches and anti-eurozone (as distinct from the EU) sentiment emerges in other countries. As a result, European yields should remain low, heavily supported by the expanded ECB bond buying program.

US economy

Economic data reported during the month of April mostly disappointed, signaling a weak finish to 1Q16 and a lack of economic momentum going into 2Q16.

Automobile and home sales fell short of expectations and caused concern among investors as these sectors had previously evidenced strength among consumers and provided support for continued GDP growth.

A weaker US dollar (i.e., down 5.6% year to date) has helped support crude oil and other commodity prices. This has helped lift inflation expectations, and somewhat alleviated the FOMC's concern regarding stagnant prices.

The FOMC met in April and, as expected, left interest rates unchanged. In its post-meeting statement, however, the committee communicated a decidedly dovish tone as it cited a transitory softening in economic growth.

Bradford & Marzec forecasts 2016 US GDP growth in the range of 1-2%.

Portfolio strategy summary

US interest rates and TIPS summary

Interest rates moved modestly higher over the month of April as two-year, five-year and ten-year rates rose 6bps, 9bps and 6bps, respectively. In the month of April, the Barclays US Treasury Index returned -11bps.

Volatility in the US interest rates market has been extremely low as markets anticipate little movement from the Fed and economic data does not seem to support an alternative viewpoint.

We continue to position portfolio duration neutrally versus benchmark durations, as interest rate markets remain mostly trendless and we don't see any catalyst for near-term change.

Securitized products

We remain cautious regarding most securitized sectors, after an extremely volatile start to 2016. We reduced our CMBS target in April from 7% to 5%, based on improved valuations and concern regarding weaker economic growth and uncertain Federal Reserve policy. We retain our modest underweight in Agency MBS, where valuations leave little upside potential. Finally, we reduced our ABS allocation from 10% to 8%, following the sector's strong April recovery.

Investment grade credit

We maintain a stable outlook on investment grade credit, based upon improving technicals and reasonable valuations, offset by somewhat deteriorating fundamentals. Credit spreads tightened significantly in recent months and appear to be near fair value, yet all-in yields remain attractive to non-US investors. Credit fundamentals and corporate profitability continue to deteriorate in some industries in a trend we expect to continue. Technicals remain well supported by strong overseas demand due to interest rate differentials and foreign central bank QE. In addition, while recent issuance has trended flat versus last year, an expectation of a lighter new issue calendar going forward provides additional technical support. US and global growth concerns, a potential UK exit from the EU, Federal Reserve policy uncertainty, the usual post-quarterly earnings issuance spike, and depressed commodity prices may keep spread volatility high.

High yield

We remain constructive on high yield bonds, based on strong fundamentals in most industry sub-sectors, with the exception of Energy and Metals & Mining. High Yield provides diversification benefits, given its low long-term historical correlation to interest rates. Following the strong rally in March and April, the high yield market appears fairly valued.

Leveraged loans

The leveraged loan market posted another solid month in April, although returns continue to lag the rebound in High Yield. The Credit Suisse Institutional Leveraged Loan Index (CSILLI) returned +1.17% in April, following on March's 1.80% gain. Technicals continue to improve, as retail loan funds experienced smaller outflows and CLO issuance resumed. While fundamentals remain broadly supportive, the Energy and Metals & Mining sectors remain severely challenged.

Non-dollar

The US dollar weakened against most major currencies in April, as the expectation diminished regarding further Fed rate hikes in 2016. A weakened US dollar and a sharp rebound in oil off of its February lows suggest talk of a global slowdown appears to be overdone.

Europe

- Polls surveying the upcoming June 23 Brexit vote continue to narrow, with the 'remain' camp possessing a slight edge. However, in the recent past, UK polls have been notoriously unreliable. Indeed, it doesn't appear that markets are discounting the potential for a 'leave' vote and, in that event, market volatility could be severe.
- Generally, UK economic activity has been weakening ahead of the Brexit vote. Sterling has sold off, while Gilts have rallied.
- German factory orders increased sharply on strong global trade activity.
- Uncertainty regarding the Greek bailout continues with rising political unrest. The IMF is arguing with the European Commission for less stringent austerity measures. Greek GDP has once again fallen, after showing signs of a rebound in 2015.

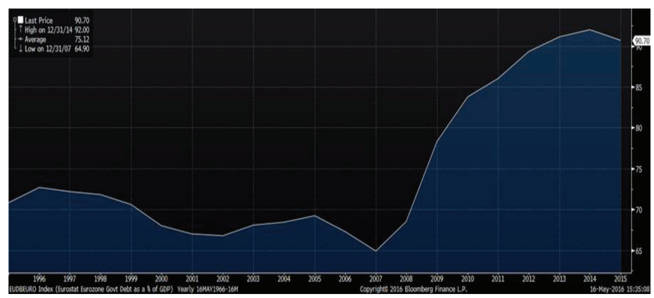
Rest of the world

- Recent Chinese economic data appears mixed, and below expectations if one presupposes a reaccelerating recovery. Trade disappointed in particular, with exports at +1.8% in April and imports reported at -11%. Also, the Caixin China Composite PMI, a consistently impartial indicator of sentiment, is still indicating growth with a reported measure of 50.8 in April.
- 1Q16 Russian GDP came in at -1.2%, beating market expectations of -2.0% and likely reflecting the recovery in the price of oil, which significantly impacts the Russian economy.
- The Royal Bank of Australia cut interest rates, reflecting a very benign inflation outlook. Given its dovish statement, further cuts may be possible in August.
- Political uncertainty in Brazil increased dramatically, as the process to impeach Rousseff moves ahead. Despite deteriorating fundamentals, financial markets are buoyed by the process. Bond prices rallied along with the Brazilian real.

Caixin China composite PMI*

Source: Bloomberg

Eurozone total government debt as % GDP*



During eight years of austerity, Eurozone Debt as % GDP rose until 2015, prompting hope of easier fiscal policies.

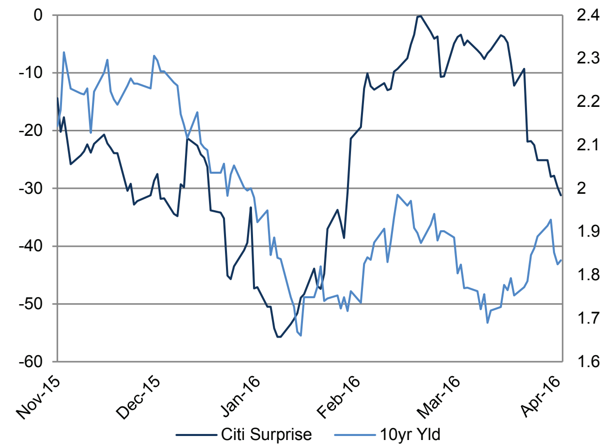
Source: Bloomberg

US economy

Summary

- Economic data reported during the month of April mostly disappointed. The Citi Economic Surprise Index dropped from -.2 at the beginning of the month to -31.2 by month end (see chart at right.)
- Worse than expected reports regarding automobile and housing sales deserve scrutiny, as supportive trends in these statistics have comprised the strongest indicators of consumer strength.
- Crude oil prices continued to recover during April and had the effect of helping to support and raise inflation expectations, which has been a primary concern and goal of the Fed.
- Employment gains remain healthy and the non-farm payroll three-month moving remains above 200,000. The labor participation rate continues to improve, causing the unemployment rate to remain stable at 5%.
- The FOMC met in April and, as expected, left the Fed funds rate unchanged. In its post-meeting statement, the FOMC acknowledged recent softening in economic activity, but described it as transitory, while citing the health of the labor markets as support for future growth.

Citi surprise index and 10-year rates

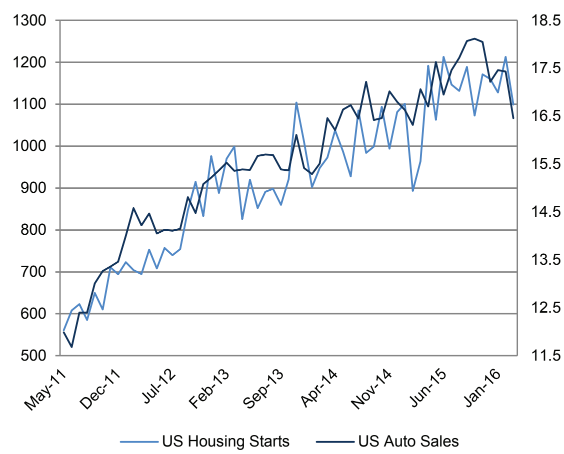


Source: Bloomberg

Outlook

- In our last Investment Committee meeting, the firm officially lowered its expectation for the number or Fed rate hikes in the balance of the year from two to one.
- We continue to anticipate modest GDP growth for the balance of year. Additionally, while a buoyant equity market seems to concern the FOMC, we believe it will act with restraint given its fear that policy action (i.e., a premature rate increase) could significantly re-strengthen the dollar, reduce net trade and disrupt economic growth.
- The weaker dollar, down approximately 5.6% since year end, has helped support both commodity and import prices, and had the effect of stabilizing inflation measures. We do not anticipate higher inflation to be a problem.
- We continue to forecast that GDP growth for the year will be in the 1-2% range.

Housing starts and auto sales



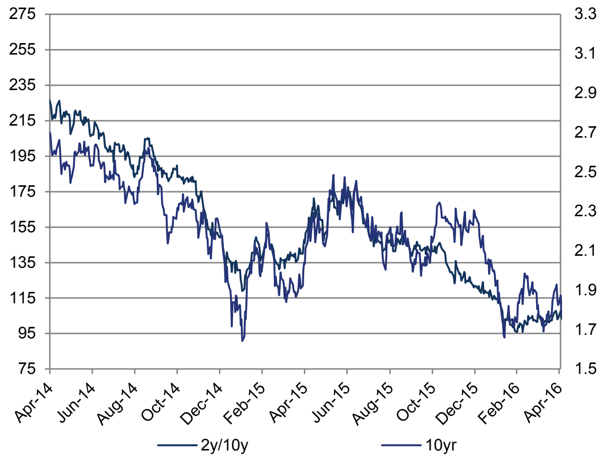
Source: Bloomberg

Portfolio strategy - US interest rates & TIPS

US interest rates: risk off, treasuries rally

- Interest rates moved modestly higher over the month of April as two-year, five-year and ten-year rates rose 6bps, 9bps and 6bps, respectively. In the month of April, the Barclays US Treasury Index returned -11bps.
- The yield curve remained little changed in April, and its slope appears relatively flat in comparison to the last several years.
- Volatility in the rates market remains extremely low, reflecting low investor expectations of a Fed rate increase anytime soon. In addition, fundamental economic data doesn't suggest anything more than baseline GDP growth and therefore can't support an alternative viewpoint.
- The latest implied probability of a June Fed rate increase, as implied by futures markets, is only 4%. Even looking out to December, the market implies only a 56% probability of a rate hike.
- The expectations of an easier Fed have caused real interest rates to fall and break-even TIPS implied inflation to rise, creating a relatively positive year-to-date trend for the TIPS market. We do not believe the trend is sustainable and will continue to avoid the TIPS sector.

10-year yield and 2-year curve

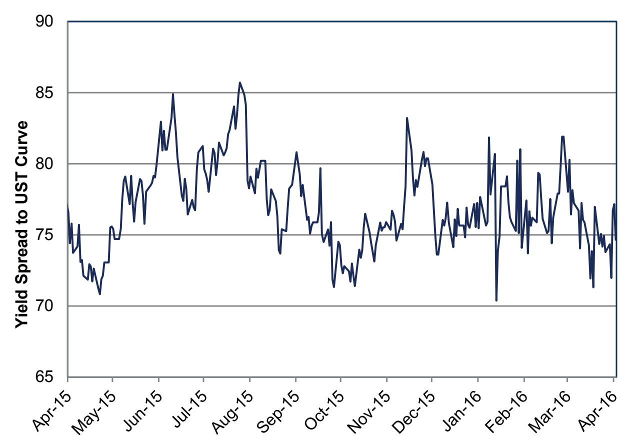


Source: Bloomberg

Agency MBS: modest underweight, 24% versus 28% in the index

- Agency mortgages lagged the broad market returns, but outperformed US Treasuries by 16bps in April.
- The high quality MBS sector was unable to keep pace with the strong rebound in the riskier sectors.
- Valuations remain rich and have traded in a very narrow range over the past year.
- We expect performance to remain very directional with interest rates. Lower rates should drive MBS underperformance and higher rates should lead to outperformance versus Treasuries.
- Valuations appear well-supported in the near term, given the very dovish commentary in recent Fed statements.
- We expect support for high-quality mortgages from foreign investors faced with the prospect of negative interest rates.
- We still like 20-year agency securities and selective new issue non-agency bonds and are underweight both GNMA and 15-year MBS.

Agency MBS current coupon spread to UST



Source: Bloomberg

Portfolio strategy - securitized products

CMBS: lower target to 5%

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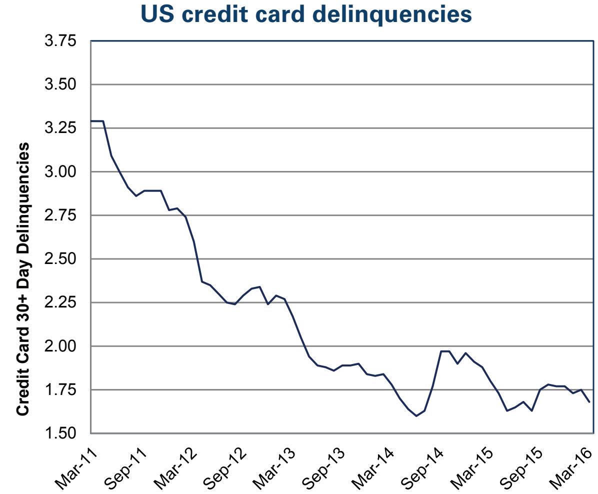
CMBS new issue 10-year AAA to UST

Source: Bloomberg

ABS: favorable view on select market segments

- The ABS sector outperformed US Treasuries in April by 21bps, but lagged the big rebound seen in other, more risky sectors.
- We are positive on the sector due to improving fundamentals and high quality assets. We did, however, reduce our allocation of 8% given the recent outperformance.
- Consumer finance fundamentals, supported by strong employment growth and elevated savings rates, appear very favorable.
- Supply in 2016, supported by strong investor demand, should be very similar to 2015 at around $200 billion.
- We find value in prime and sub-prime auto ABS subordinate classes, due to attractive valuations and strong structural support. We also favor timeshare ABS.

US credit card delinquencies



Source: Bloomberg

Note: Statements expressed are our current opinions as of the date of publication and are subject to change without notice.

Portfolio strategy - high yield

Performance – strong momentum continues into April

- The Barclays (full-quality) High Yield Index produced a total return of +3.92% in April, just shy of the robust +4.44% gain in March.
- As in March, lower-quality bonds posted the strongest returns, with the CCC-rated portion of the Barclays High Yield Index (+7.8%) outperforming BBs (+3.8%) and Bs (+2.6%). On a year-to-date basis, CCCs (+11.8%) are now significantly ahead of BBs (+6.5%) and Bs (+6.3%) on a total return basis.
- Every sector in the Barclays High Yield Index posted a positive return in April, led for the second consecutive month by Energy (+12.7%) and Metals & Mining (+9.9%). REITs (+1.1%), Insurance (+0.8%), and Construction Machinery (+0.8%) proved to be the laggards during the month.

Fundamentals – defaults continue in energy despite oil rally

- The LTM default rate increased from 3.2% to 3.7%, as April marked the sixth consecutive month with over $5 billion in defaults ($7.2B in April). Thus far in 2016, 27 companies have defaulted on a total of $37.6 billion in bonds and loans. Commodity sectors account for 85% of the year's total default volume; and excluding those, the default rate is just 0.42%.
- With the continued rally in April, the high yield distressed rate (bonds trading below 50% of par) fell again to 3.20% from 4.65% at the end of March. Energy and Metals & Mining account for nearly 60% of the distressed universe, down from over 70% last month.
- The rolling 12-month upgrade-to-downgrade ratio continued to deteriorate in April, falling to 0.37:1, indicating more downgrades than upgrades. Despite the decline in the trend, on a dollar value basis, there were more upgrades than downgrades in April, even in Energy.

Technicals – supply accelerates following robust inflows

- High yield mutual funds experienced a third consecutive month of inflows in April, although at $1.7 billion, the pace slowed from March's robust level of $9.0 billion (second largest inflow on record).
- New issue activity increased again in April as 35 new bonds priced for a total of $32.3 billion, the first $30 billion-plus month since May 2015. Year-to-date issuance stands at $83.5 billion, which is still down almost 40%. Nearly 60% of issuance in March and April represents refinancing of outstanding debt.

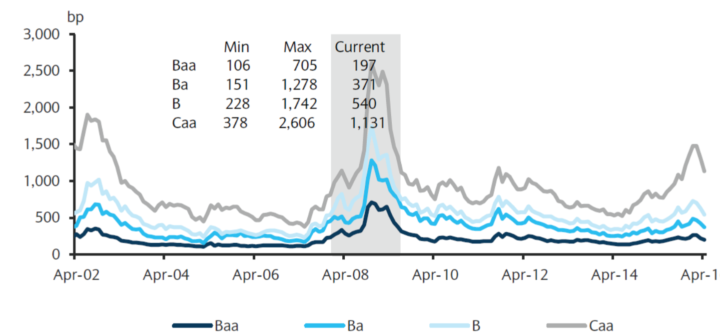
Valuation – market appears fairly valued post rally

- High yield bond yields decreased 75bps in April to 8.05% (ex-Commodities 7.21% yield). The average bond spread decreased 72bps to 681bps in April (ex-Commodities 599bps spread).
- Against a global backdrop of low (or even negative) yields, the high yield market remains attractive even after an impressive bounce from February's low. If risk sentiment and commodity prices remain supportive, it's reasonable to expect a coupon-like return over the remainder of 2016.

Overweight: Airlines, Autos, Consumer Products, and Media

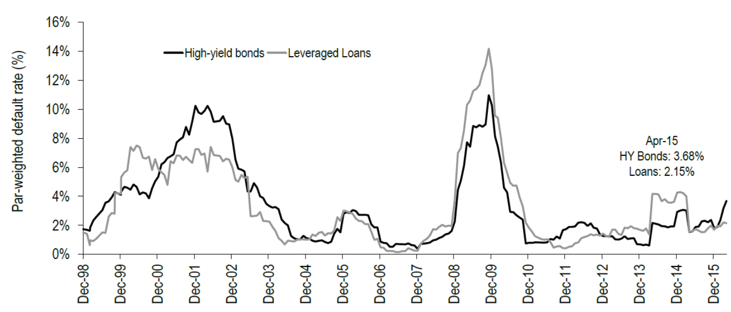
Underweight: Retailers, Healthcare, Energy, and Metals & Mining

High Yield spreads by credit quality



Source: Barclays Research

LTM default rate



Source: JPMorgan

Portfolio strategy - investment grade credit

Stable outlook based on improving technicals and reasonable valuation offset by deteriorating fundamentals.

Performance

- The Barclays Credit Index returned 1.22% in April and 5.19% year to date.
- Excess return to similar-maturity Treasuries totaled 1.34% in April and 1.57% year to date.
- We expect macro sentiment, supply/demand technicals, foreign buying, and industry and issuer selection to drive returns in the intermediate term. However, in a trend we expect to continue, credit fundamentals and corporate profitability continue to deteriorate in various industries.
- Spread volatility is expected to be exaggerated due to diminished market liquidity.

Fundamentals – deteriorating yet adverse incentives slowing

- 1Q16 revenue growth of 0.6% year over year (source: Bloomberg, 466 companies reported)
- 1Q16 EBITDA growth of 1.3% year over year (source: as above)
- 1Q16 net leverage of 1.68x, up from 1.60x in 4Q15 (source: as above)
- Expect M&A and stock buybacks to slow, as antitrust prohibits some business combinations and share purchases fail to drive prices significantly higher.
- Expect commodity-based industries to continue to struggle.
- Decelerating global growth and minimal productivity enhancements to pressure corporate earnings and US manufacturing; yet a reversal of dollar strength should help multi-nationals.

Technicals – improving

- Accommodative European and Japanese central bank policy, low global yields, and a strong dollar are forcing foreign investors into USD assets (i.e., crowding in from overseas QE).
- 25% of global government bonds and 10% of European corporate bonds have negative yields.
- Lipper year-to-date mutual fund inflows of $36 billion.
- Gross new issuance up 3% year over year, but down 6% excluding ABIBB record issuance.
- Expect 2016 gross issuance to decline vs 2015 due to market volatility and an M&A slowdown.
- M&A funding pipeline still large, however, new M&A to slow amidst government intervention.

Valuation – fair

- Barclays US Credit Index spread was 139bps at end of April, 43bps wide of the 2014 tights.
- Barclays US Credit Index 8bps tight of the 25-year average, and BBBs 9bps tight of 25-year average.
- Effective yield of 2.98%, uninspiring, yet very attractive for many non-US investors.
- Spread as a percentage of all-in yield at 47%, versus 15% pre-crisis (2/28/05).
- Long duration and BBB-rated credits offer the most attractive relative value.

Financials – positive

- Increased regulation, improved capital base and asset quality, less exposed to shareholder activism.
- Constrained earnings growth due to increased regulation and low interest rates.
- We believe the sell off in US banks is overdone across the capital structure.

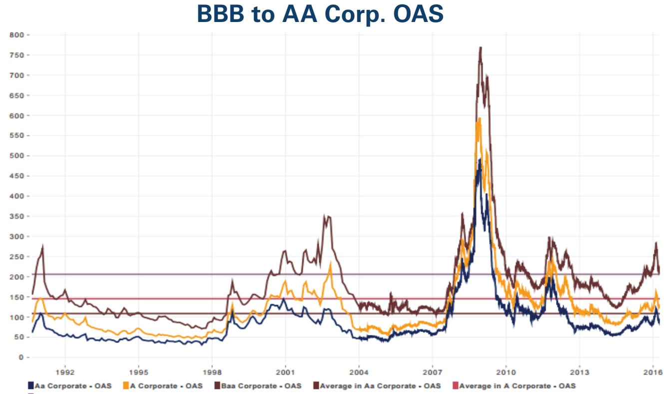
Industrials – mixed

- Shareholder activism in the form of share buybacks, higher dividends, and M&A activity should diminish.
- Industry and issuer selection of the utmost importance.
- Fundamental deterioration within Metals & Mining, and Energy (E&P, Oil Field Services).

Overweight: Banks/Financial, Food & Beverage, Supermarkets, Pipelines, Airline EETCs, Media Non-Cable, Telecom, Technology, Building Materials, post event risk issuers, and BBB-rated credits

Underweight: Metals & Mining, Healthcare, Utilities, Retail, Pharmaceuticals, Chemicals, Insurance, Railroads, Sovereign Debt, and Emerging Markets

BBB to AA Corp. OAS



Source: Barclays

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Portfolio strategy - leveraged loans

Stable outlook based on improving technicals and reasonable valuation offset by deteriorating fundamentals.

Performance – loan returns trail bounce in high yield

- The Credit Suisse Institutional Leveraged Loan Index (CSILLI) posted another solid return (+1.17%) in April following the +1.80% gain in March (the strongest monthly return since October 2011). The year-to-date and trailing one-year return now stand at +2.72% and +2.09%, respectively. Lower-quality loans outperformed during the month, as CCCs returned +2.23%, Bs +1.37%, and BBs +0.97%.
- The CSILLI average price gained another 0.56 points in April after gaining 1.5 points the prior month. At 98.88, the average loan price is now up over two points from February and at the highest level since last July.

Valuation – spreads compress to tightest level in two years

- The average nominal spread for loans increased 4bps to 381bps at month end, while the three-year discount margin (DM) tightened another 16bps to 451bps (-75bps vs. February), the lowest level since April 2014.
- With the high yield market's strong performance in March and April, the excess spread of High Yield relative to Loans tightened sharply to +219bps, down from +307bps at the end of January (the highest level in over six years) but still above the average over the past decade.

Fundamentals – few problems outside of commodities

- The trailing 12-month institutional leveraged loan default rate decreased 14bps to 1.69% in April, while the 12-month recovery rate declined 14bps to 45.1%. Two loans (totaling $1.7 billion face value) defaulted in the month. Default rates will likely trend slightly up over the intermediate term, as fundamentals remain fairly supportive outside of the commodity space.
- For the second consecutive month, every sector in the CSILLI posted positive returns. Energy (+2.46%) and Metals & Mining (+2.25%) were the strongest industries during April, while the more stable Consumer and Food sectors trailed for the month.

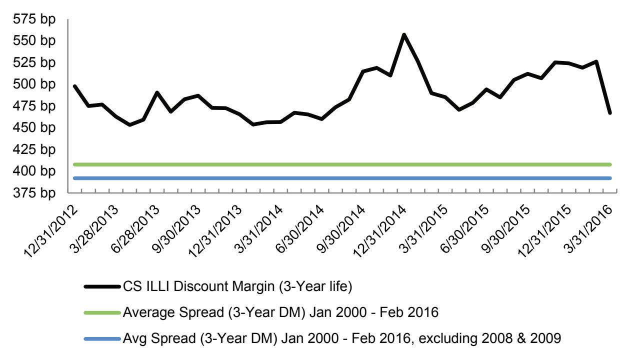
Technicals – CLO issuance creates incremental demand

- Although the pace has slowed in the past few months, April saw an outflow from retail loan funds, the 23rd outflow in the past 25 months (totaling nearly $60 billion over that period). On a year-to-date basis, loan funds have reported outflows of $6.4 billion, in line with the first four months of 2015.
- CLO activity gained momentum in April with 14 deals pricing for a total of nearly $6 billion. However, year-to-date volume of $14.7 billion remains well below (i.e., -67%) last year.
- Issuers met increased demand with nearly $20 billion of new loan issuance during April, the fourth consecutive increase in new deal volume. Acquisition financing represented two-thirds of new issue volume. Year-to-date loan volume stands at $55 billion, down 31% yoy.

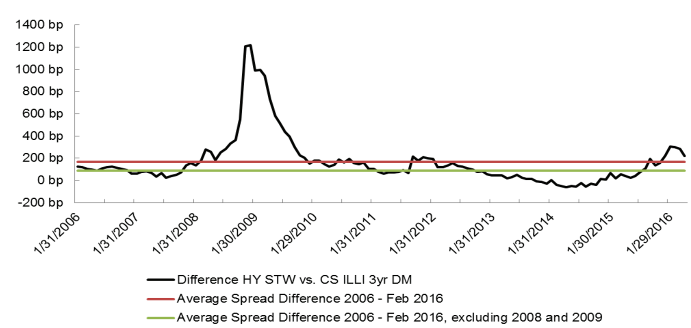
Overweight: Consumer Products, Healthcare/Pharma, and Media & Telecom

Underweight: Food & Beverage, Financials, and Retailers & Restaurants

Leveraged loan three-year discount margin*



Relative value between high yield bonds and leveraged loans



Source: Credit Suisse

Portfolio strategy - non-dollar

In April, the US dollar continued to weaken against most major currencies, providing a boost to oil prices and laying to rest fears of a global recession.

Europe

- The euro pulled back slightly in April; although it has traded in a fairly tight range since opening the year at $1.09. The prospect of Brexit has taken center stage as Britain's vote on EU membership is set to take place on June 23rd.

EUR/USD Spot

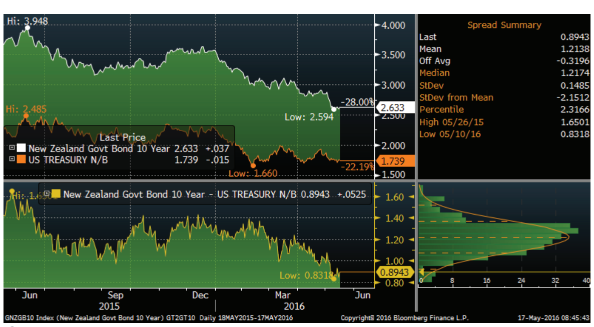
Source: Bloomberg

Other

- Currencies around the globe strengthened against the greenback in April, but may be due for a short reprieve before moving higher.
- In emerging markets, we continue to like Mexico, Brazil and Indonesia on an unhedged basis.
- In developed markets, we have added positions in Australia, New Zealand and Canada.
- Even as world economic growth forecasts are tapered, we believe emerging market currencies will continue to show relative strength.
- We look for the dollar to take a short breather before it continues to weaken versus most major currencies as the pace of Fed tightening is scaled back.

Australia, New Zealand and Canada

- Spreads narrowed moderately in April, even as the currencies stabilized against the dollar.

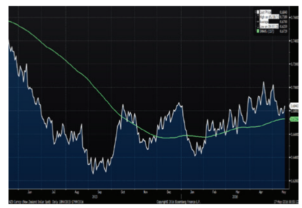


Source: Bloomberg

Currency comment

- Currencies in Australia and New Zealand saw fairly benign moves in April, even as commodity currencies appreciated versus the dollar.

NZD



AUD

Source: Bloomberg

Benchmark performance as of 4/30/2016

Total return	MTD	YTD
Barclays US Aggregate	0.38%	3.43%
Barclays US Treasury	-0.11%	3.09%
Barclays US TIPS	0.35%	4.82%
Barclays Credit	1.22%	5.19%
Barclays US ABS	0.24%	1.60%
Barclays US MBS	0.16%	2.14%
Barclays US CMBS	0.38%	4.00%
Citigroup BB/B ex-split B/CCC Index	3.15%	6.27%
Credit Suisse Institutional Leveraged Loan Index	1.17%	2.72%
Citigroup Non-US$ World Government Bond (50% hedged)	0.85%	7.53%
Yield	**March 31**	**April 30**
US 10-Year Treasury Yield	1.74%	1.83%

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