Bradford & Marzec

Now part of **Tortoise Credit Strategies**

Portfolio strategy summary & outlook

July 2016

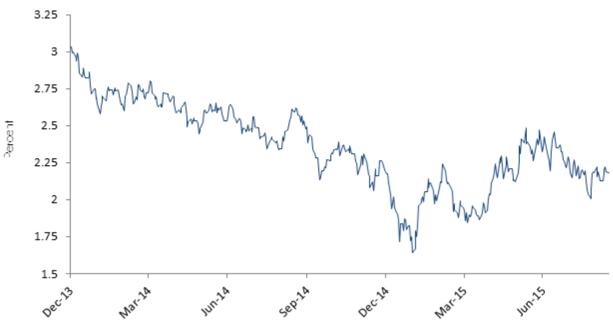
U.S. interest rates

U.S. interest rates: rally to multi-year lows in yield

Performance

- Interest rates rallied strongly across the entire yield curve during the month of June with the major catalyst being the U.K. vote to leave the European Union (EU) known as Brexit. The Treasury component of the Barclays U.S. Aggregate Index returned +2.2% for the month of June.
- The yield curve bullishly flattened as 2-year notes rallied by 30 basis points (bps), while both 5-year and 10-year note yields were lower by 37 bps. This left the 2/10-year curve at +89 bps, which is a post-crisis low.

U.S. Treasury 10-year



Source: Bloomberg as of 6/30/2016.

- Brexit was clearly the biggest event of the month, however, before Brexit, markets absorbed news that May non-farm payrolls reported in June were far below trend and expectations. This report made bonds rally and continued through month end.

Valuations: *negative*

- A lack of inflation pressures in the U.S. and abroad continue to make Treasury inflation protected securities (TIPS) unattractive.

Outlook

- Global headwinds and uncertainty persist, not the least of which will be the U.K. and Europe navigating their way through Brexit.
- At the very least, we feel this will maintain downward pressure on interest rates globally for the near term.
- Given the historically low interest rates in the market, we are not comfortable going long on our benchmark index durations at this point, but we will be closely monitoring market conditions with an eye toward possibly reducing interest rate risk.

Securitized products

Summary

Our securitized strategy remains defensive based primarily on poor valuations and waning fundamentals. The agency mortgage-backed securities (MBS) sector has held up very well given the rally in interest rates, but provides limited upside potential. Similarly, in the commercial mortgage-backed securities (CMBS) market, valuations look rich and are vulnerable to the end of the commercial real estate cycle.

Agency MBS: underweight 22% vs. 28% in index

Performance

- Agency mortgages held up reasonably well in June given the sharp rally in U.S. Treasuries, but still lagged with negative 30 bps of excess return.

Fundamentals

- Refinancing risk is a short-term concern with the 30-year mortgage rate around 3.5%.
- We expect interest rate volatility to remain subdued, which should support valuations.

Technicals

- Supply in the short term should be heavy, given lower mortgage rates and improved housing markets.
- Demand from overseas investors and domestic banks continues to support the market.

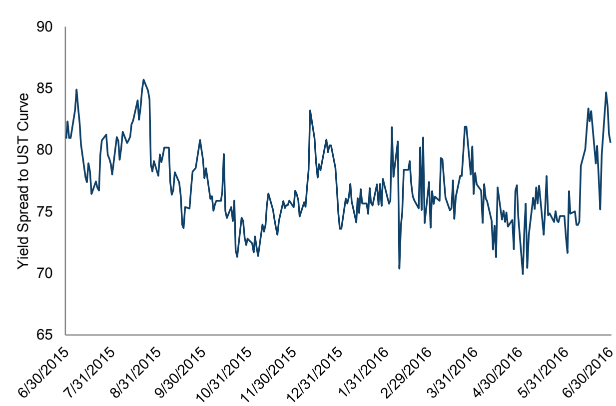
Valuations: improving

- Valuations have improved, but have traded in a very narrow range over the past year.
- Given the recent decline in interest rates, mortgage pricing is vulnerable to a potential increase in refinancing risk and new issue supply.

Outlook

- Valuations should be supported in the near term, given the very dovish commentary in recent Federal Reserve (Fed) statements and continued domestic bank demand.
- We still like 20-year agency securities and selective new issue non-agency bonds and are underweight in both Government National Mortgage Association (GNMA) and 15-year MBS.

Agency MBS current coupon spread to U.S. Treasury



Source: Bloomberg as of 6/30/2016.

CMBS: target 4% vs. 2% in index

Performance

- CMBS suffered from volatility and a flight to quality in June and underperformed U.S. Treasuries by 31 bps.

Fundamentals

- The fundamentals for commercial real estate are still favorable, driven in large part by strong labor markets, but they are approaching late cycle conditions in select markets.
- Supply estimates have been slashed from $75 billion to $50 billion for 2016. Net supply is running around negative $25 billion year-to-date.

Technicals

- Spreads have recovered from their post Brexit widening, as supply has remained very manageable.

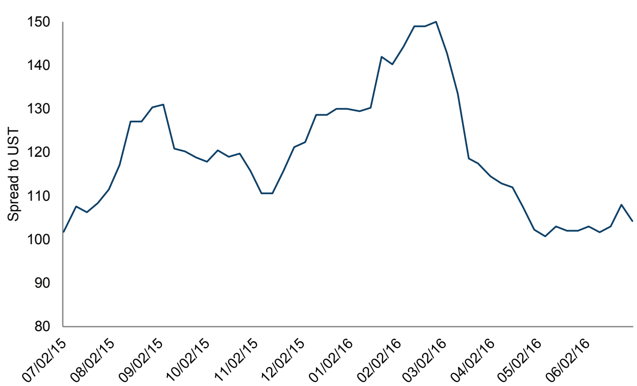
Valuations: negative

- In our view, valuations are not attractive, given spreads are near the 1-year tight levels and the global economic outlook is weakening.

Outlook

- We still prefer higher quality new issue senior bonds, subordinate agency and single-asset CMBS.

CMBS new issue 10-year AAA to U.S. Treasury



Source: J.P. Morgan as of 6/30/2016.

Asset-backed securities (ABS): overweight and positive with a target allocation between 8% to 10%

Performance

- The ABS sector outperformed U.S. Treasuries in June by 10 bps. The sector benefited from high quality and low supply.

Fundamentals: positive

- The fundamentals for consumer finance are very favorable, supported by strong employment growth and elevated savings rates.

Technicals: neutral

- Supply should be very manageable for the rest of the year, with most new issuance coming in the prime and sub-prime auto market.

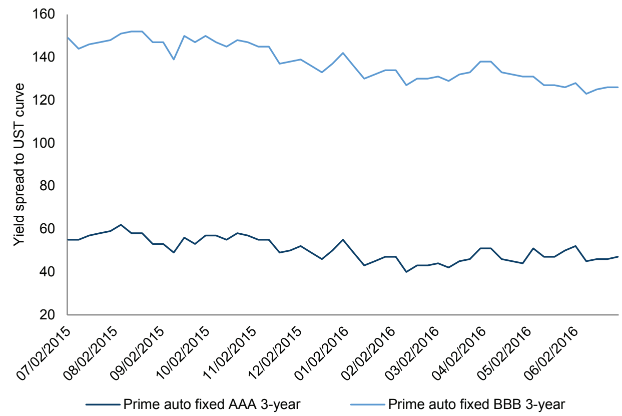
Valuations: attractive

- We like prime and sub-prime auto ABS subordinate classes due to attractive valuations and strong structural support. We also favor timeshare and whole business ABS.

Outlook

- Our outlook is positive due to improving fundamentals and high quality assets.
- We are targeting an 8% to 10% allocation.

Auto ABS spreads



Source: Barclays as of 6/30/2016.

Investment grade credit

Summary

We are maintaining a stable outlook based on positive technicals and reasonable valuations offset by deteriorating fundamentals. Credit spreads continue to improve despite Brexit and appear to be near fair value, yet all-in yields remain very attractive to non-U.S. buyers. Credit fundamentals and corporate profitability continue to deteriorate in some industries; we expect this to continue. Technicals are positive due to strong demand from non-U.S. investors as a result of interest rate differentials and foreign central bank quantitative easing (QE). U.S. and global growth concerns, the anti-EU movement, devaluation of the Chinese renminbi, Fed policy uncertainty, the U.S. presidential election and depressed commodity prices may keep spread volatility high.

Performance

- The Barclays Credit Index returned 2.3% in June and 7.5% year-to-date.
- Excess return to similar maturity Treasuries totaled -0.3% in June and 1.2% year-to-date.

Fundamentals: deteriorating yet adverse incentives slowing

- 1Q16 revenue growth of -9.5% year-over-year; excluding energy and metals/mining -0.3%[1].
- 1Q16 Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) growth of -8.7% year-over-year; excluding eEnergy and Metals & Mining -0.1%[1].
- 1Q16 net leverage of 2.4x, up from 2.2x in 4Q15[1].
- 1Q16 interest coverage of 10.4x, down from 10.9x in 4Q15[1].

[1]JP Morgan

Technicals: positive

- Accommodative European and Japanese central bank policy, low global yields and a strong U.S. dollar (USD) are forcing non-U.S. investors into USD assets.
- 35% of global government bonds have negative yields, and only 20% yield more than 1%.
- Year-to-date mutual fund inflows are $66 billion[1].
- Gross new issuance is up 1.5% year-over-year, yet down 5% excluding ABIBB record issuance.
- The mergers and acquistions (M&A) funding pipeline is shrinking, and new M&A will slow amidst government intervention.

Valuation: fair, yet cheap versus many foreign options

- The Barclays U.S. Credit Index spread was 147 bps at the end of June, 52 bps wide of the 2014 tights and 53 bps tighter than February 2016 wides. The index was 5 bps tight of the 25-year average, and BBB-rated securities were 10 bps tight of the 25-year average.
- The effective yield of 2.8% is uninspiring and within 20 bps of the historic low, yet still very attractive for many non-U.S. investors.
- Spread as a percentage of all-in yield is at 52.9% versus 15% pre-crisis (2/28/2005).

Financials: mixed

- U.S. banks: we are seeing increased regulation, improved capital and asset quality, and less shareholder activism, yet we expect constrained earnings growth due to increased regulation and low interest rates.
- Euro banks: the anti-EU movement and high non-performing loans (NPLs) are creating potential problems.
- Insurance: the life insurance industry is difficult due to long-tail liabilities, low rates and annuity businesses.
- Real estate investment trust (REITs) and nonbank financials: these are positive due to asset quality and strong consumer balance sheets.

Industrials: mixed

- Shareholder activism in the form of share buybacks, higher dividends and M&A activity should diminish.
- Industry and issuer selection is of the utmost importance.
- Fundamentals are deteriorating within Energy and Metals & Mining (exploration and production (E&P) and oil field services).

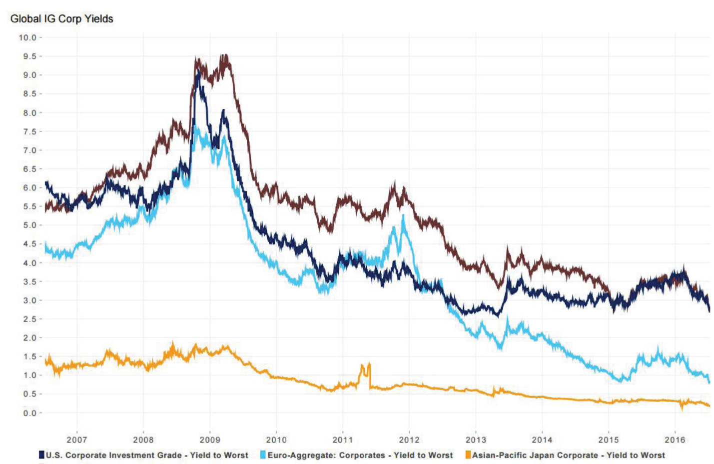
Outlook

- We expect macro sentiment, supply/demand technicals, non-U.S. investor buying, and industry and issuer selection to drive returns in the intermediate term. Credit fundamentals and corporate profitability, however, continue to deteriorate among various industries, and we expect this to continue.
- Spread volatility is expected to be exaggerated due to diminished market liquidity.
- Commodity-based industries will likely continue to struggle.
- Decelerating global growth and minimal productivity enhancements will pressure corporate earnings and U.S. manufacturing, yet a reversal of USD strength could help multi-nationals.
- We expect M&A and share buybacks to slow, as government intervention is preventing some M&A and companies are not being rewarded as much by the equity market for share buybacks.
- We anticipate continued strong demand from overseas investors, given large global yield differentials.

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

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

Global investment grade coporate yields



Source: Barclays as of 7/8/2016.

[1]JP Morgan

High yield

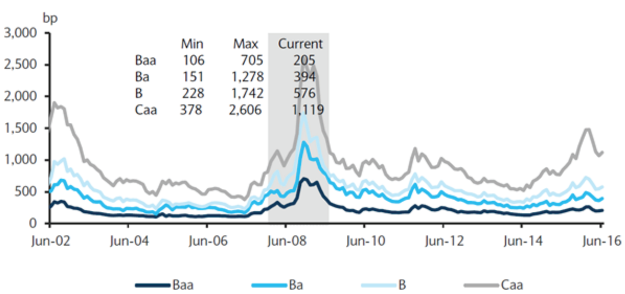
Summary

High Yield (HY) valuations remain relatively attractive against a backdrop of low (or negative) global interest rates. Although leverage metrics of HY issuers appear to be trending up, fundamentals are supportive in most industries, and the commodity price rebound has stabilized the Energy and Metals & Mining sectors. HY provides diversification benefits, given its low long-term historical correlation to interest rates.

Performance – High yield rally undeterred by Brexit

- The Barclays (full-quality) HY Index produced a total return of 0.9% in June, as the rally in Treasury rates offset modest spread widening during the month.
- Lower-quality bonds continued to outperform the overall market, with the CCC-rated portion of the Barclays HY Index (+1.5%), outperforming BBs (+0.7%) and Bs (+0.8%). Year-to-date, CCCs (+16.0%) remain well ahead of BBs (+7.6%) and Bs (+7.4%) on a total return basis.
- While mostly positive, sector returns were more mixed in June than in recent months. Commodity industries (i.e. Energy and Metals & Mining) continued their strong run (both up over 3% during the month), while Pharmaceuticals (-1.5%) and Banking (-0.7%) were among the largest underperforming sectors during the month.

High yield spreads by credit quality

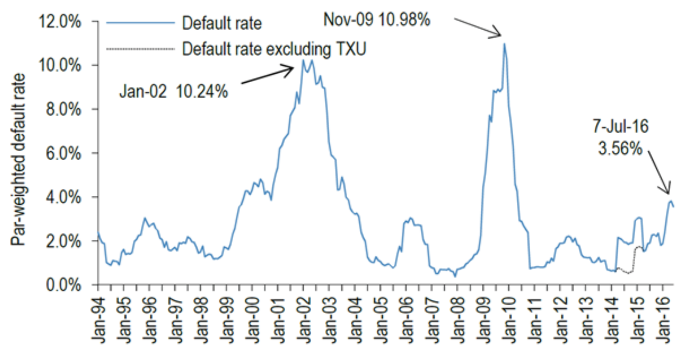


Source: J.P. Morgan as of 6/30/2016.

Fundamentals – rising default trend takes a breather in June

- Default activity slowed for the third consecutive month in June, lowering the last 12-months (LTM) default rate to 3.6% from 3.8%. 37 companies have defaulted on a total of $43.8 billion of bonds and loans year-to-date, which already exceeds 2015 totals. Excluding Energy and Metals & Mining, the default rate is just 0.5%.
- The year-to-date upgrade-to-downgrade ratio stood at 0.50:1, indicating more downgrades than upgrades at the end of June. On a dollar-value basis, upgrades outpaced downgrades 1.7:1 during the month. U.S. fallen angels (downgrades from Investment Grade to HY) total $128 billion year-to-date, nearing the record $141 billion in 2009. 19 of 28 fallen angels in 2016 are in the Energy sector.

LTM default rate (par-weighted)



Source: J.P. Morgan as of 7/7/2016.

Technicals – outflows continued in June, but supply is light too

- At -$3.4 billion, HY mutual fund flows were negative again in June, following May's -$5.0 billion. Year-to-date flows remain positive at $3.6 billion, ahead of $0.1 billion in the first half of 2015.
- Brexit and the July 4th weekend led to slower new issue activity in June. Forty-two new bonds priced for a total of $30 billion, down from 62 ($41.8B) in May. At $155 billion, year-to-date issuance is down 19% year-over-year.

Valuation – market appears fairly valued post rally

- HY bond yields declined 16 bps in June to 7.7%, but the average spread rose 15 bps to 669 bps. June saw intra-month volatility with yields bottoming at 7.5% on June 8, widening 50 bps to 8.0% post-Brexit, and then tightening 35 bps in the last three days of the month.
- 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.

Outlook

- We expect that the low-interest rate environment will continue to drive a strong technical bid for the U.S. high yield market, even as valuations become less attractive.
- With many large, on-the-run HY issues appearing fully valued, we will continue to look for opportunities to add value in select credits in both the primary and secondary markets.

Overweight: Airlines, Autos, Banking, Consumer Products and Media

Underweight: Retailers, Healthcare, Energy and Metals & Mining

Leveraged loans

Summary

The leveraged loan market experienced its first losing month since February, as heavy repricing activity capped the upside price to the market. The Credit Suisse Institutional Leveraged Loan Index (CSILLI) returned -0.2% in June. Technicals were mixed during the month, as retail loan funds saw outflows return, however, collateralized loan obligation (CLO) prints jumped to a year-to-date high. While the LTM default rate declined marginally, we would expect that trend to reverse again in the coming months, led by continuing challenges in the Energy and Metals & Mining sectors.

Performance – first monthly loss since February

- The CSILLI year-to-date return as of June 30 was 3.3%.
- Lower-quality loans outperformed in June, with CCCs returning 0.4% vs. Bs returning -0.3% and BBs returning -0.2%. The CSILLI average price fell 0.7 points in June, as heavy repricing activity pressured prices. Less than 20% of the loan market now trades above par, down from approximately 40% prior to the recent wave of repricings.

Fundamentals – defaults ease in June

- The leveraged loan default rate declined slightly to 2.2% in June, although the rate is just 0.9% excluding commodity sectors. Default rates are likely to trend up in the near term, but fundamentals remain fairly supportive outside of the commodity sectors.
- Sector returns were mixed in June; Energy (+0.4%) and Metals & Mining (+1.1%) were the strongest industries again, while Retail (-0.6%), Healthcare (-0.4%) and Media, Non-cable & Telecom (-0.4%) posted the largest losses for the month.

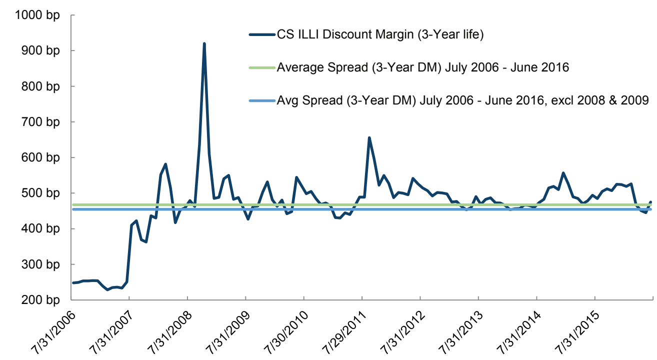
Technicals – outflows resume in June, but CLO activity picks up

- May's inflow (+$220 million) – the first in a year for retail loan funds – was short lived, as June saw a return to outflows (-$556 million) that have resulted in over $23 billion leaving the market since May 2015. On a year-to-date basis, loan funds have reported outflows of -$6.7 billion as compared to a -$6.6 billion outflow during the first half of 2015.
- CLO activity accelerated to a year-to-date high in June, as 17 deals priced for $7.0 billion, up from 12 deals for $5.4 billion in May. However, at $27.1 billion, the year-to-date volume remains over 60% lower than during the same period of 2015.
- Loan new issuance accelerated again in June, driven by a large jump in repricing activity, as many loans climbed above par in May. June's $73 billion in new issuance was the third largest month on record with over 60% comprised of repricings or refinancings. Despite the robust June, year-to-date volume remains down over 20% from 2015.

Valuation – June's spread widening narrows differential to HY

- The average nominal spread for loans increased 1 bp to 385 bps at month-end, while the 3-year discount margin (DM) widened 30 bps from 445 bps (the lowest level in five years) to 475 bps.

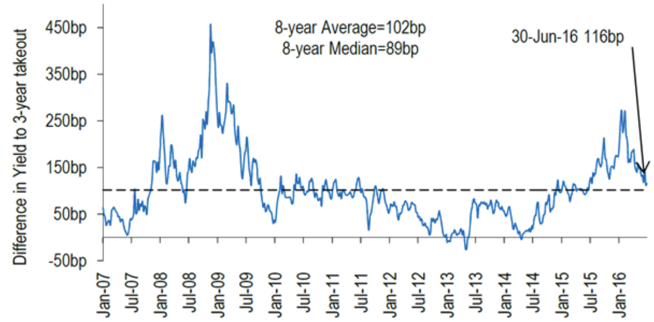
Leveraged loan 3-year discount margin



Source: J.P. Morgan as of 6/30/2016.

- Following several consecutive months of strong returns in the HY market, the excess spread of HY relative to Leveraged Loans has tightened considerably since the market turbulence in January and February. As of the end of June, HY bonds offered approximately 116 bps of excess spread vs. Leveraged Loans, down from over approximately 225 bps earlier in the year (the widest level since the 2008/2009 period).

Relative value between HY bonds and leveraged loans



Source: J.P. Morgan as of 6/30/2016.

Outlook

- We believe the primary loan market currently offers more value than the secondary market, as most performing loans are trading north of par (and above call prices, in some cases). There does not appear to be many remaining opportunities to buy good credits at a discount to par in the secondary market without dipping into stressed sectors (e.g., Retail, Energy, Metals & Mining).
- Against a backdrop of solid loan demand and a lack of significant new supply (M&A and leveraged buy-out (LBO) activity remains lackluster), we would expect to see more loan issuers test the market with repricing transactions that compress the spread on existing loans.

Overweight: Consumer Products, Healthcare/Pharmaceuticals, and Media, Non-cable & Telecom

Underweight: Food & Beverage, Energy, Financials and Retail

Non-dollar

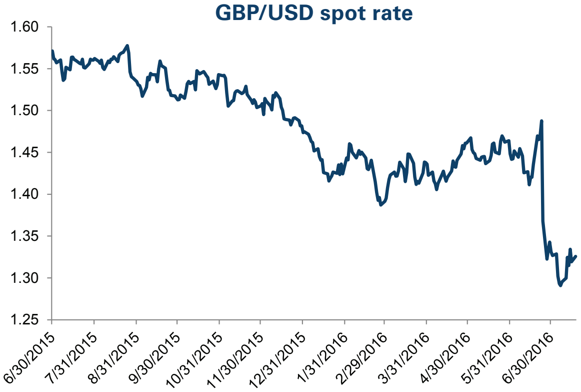
Summary

The USD strengthened in June with Brexit being the source of major volatility and demand for the greenback, as sterling and the euro sold off. The USD was whipsawed in June, as the first half of the month saw relative USD weakness. However, following the Brexit vote, the USD gained immense strength. Post-Brexit, the euro and especially the British pound sterling had a massive selloff. The euro has since stabilized and sterling appears to be close to finding a bottom.

Europe

- The euro pulled back 3% to 4% in June after the Brexit vote and stabilized around the 1.10 (EUR/USD) level. The Great British Pound (GBP), however, fell over 13% post-Brexit before stabilizing near 1.29 (GBP/USD).

GBP/USD spot rate



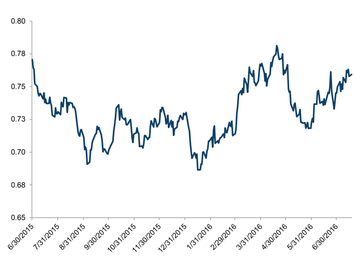
Source: Bloomberg as of 7/8/2016.

Rest of the world

- Spreads remained firm in June, as the New Zealand dollar (NZD) and Australian dollar (AUD) continued their relative strength.
- After bottoming in May, Australia and New Zealand currencies have begun to rebound, while Canada remained range-bound in June.
- The Japanese yen (JPY) strengthened with the USD. It began the month at 110.73 (USD/JPY) and ended at 103.20.

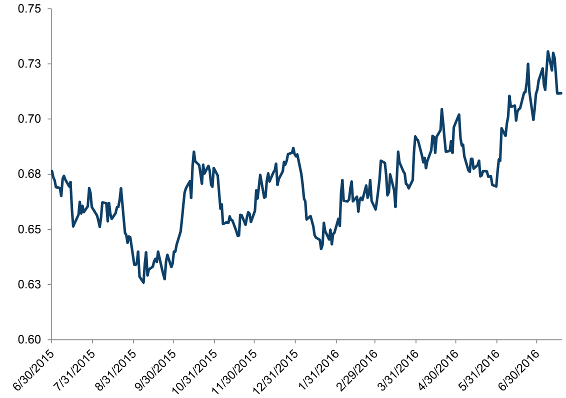
Canadian dollar

Australian dollar



Source: Bloomberg as of 7/8/2016.

New Zealand dollar



Source: Bloomberg as of 7/8/2016.

Outlook

- 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.

Benchmark performance as of 6/30/2016

Total return	MTD	YTD
Barclays US Aggregate	1.8%	5.3%
Barclays US Treasury	2.2%	5.4%
Barclays US TIPS	2.1%	6.2%
Barclays US Credit	2.3%	7.5%
Barclays US ABS	0.8%	2.5%
Barclays US MBS	0.8%	3.1%
Barclays US CMBS	1.7%	5.9%
Citigroup BB/B ex-split B/CCC Index	0.8%	7.4%
Credit Suisse Institutional Leveraged Loan Index	-0.2%	3.3%
Citigroup Non-USD World Government Bond (50% hedged)	3.4%	10.5%
Yield	**May 31**	**June 30**
US 10-Year Treasury yield	1.8%	1.5%

Disclaimers