Tortoise℠
Credit Strategies

Portfolio strategy summary & outlook

Fourth quarter 2016

U.S. interest rates

In the fourth quarter of 2016, the U.S. presidential election dominated news flow. With the benefit of hindsight, it now appears that the post-Brexit lows set by rates in July 2016 represent the absolute low point for this interest rate cycle. Forces driving rates higher built during the late summer and fall, and culminated with the unexpected election of Donald Trump as the next president of the U.S.

With the benefit of hindsight, it now appears that the post-Brexit lows set by rates in July 2016 represent the absolute low point for this interest rate cycle.

We continue to believe that the Trump administration will focus fiscal stimulus efforts in three main areas: 1) corporate and individual tax reform; 2) regulatory reform; and 3) direct government and private sector investment. We believe that investors' expectations regarding economic growth should bias higher as the Trump administration further communicates its plans. Both real interest rates and the expected rate of inflation should move higher as investors embrace increasingly optimistic forecasts regarding future U.S. economic growth. In the fifty-two days following the election, real yields and inflation expectations increased 35bps and 23bps, respectively (see table); we expect this trend to continue.

U.S. Treasury 10-year yield components

	11/8/2016	12/30/2016	Change
Real yield	0.12%	0.47%	+35bps
Inflation break-even as implied by U.S. TIPS	1.74%	1.97%	+23bps
Nominal yield	1.86%	2.44%	

Source: Bloomberg

It's important to note that not all of the Trump administration's new ideas will germinate into governmental policy. Additionally, it may take some time before policies become implemented and finally affect economic growth. For these reasons, we expect bond markets to trade with a negative bias for the intermediate term. Consequently, we moved to reduce the target duration of our portfolios.

We expect bond markets to trade with a negative bias for the intermediate term.

The U.S. Treasury component of the Bloomberg Barclays U.S. Aggregate Index returned -3.84% in the fourth quarter. The entire yield curve sold off to higher rates in a curve-steepening manner. Yields on 2-year, 10-year, and 30-year U.S. Treasury Notes increased 45bps, 88bps, and 79bps, respectively. Finally, and on somewhat of an anticlimactic note, the Federal Reserve raised its federal funds target rate by 25bps to a range of 0.50-0.75%.

Outlook

In the first few months of the Trump presidency, investors will look to Washington, D.C. for clues regarding the new administration's policy efforts. While details currently remain scant, many investors seem to expect that the Trump administration and House and Senate Republicans will act as quickly as possible to pass significant legislation.

Nevertheless, regulatory roll back appears to represent the lowest-hanging fruit, since it doesn't necessarily require any formal vote in Congress. Environmental restrictions, especially in the areas of energy production, appear as one of the most likely areas to be affected by regulatory reform. With respect to financial regulation, any modification that frees up capital or expedites the provision of credit will help create a more pro-business economic climate, as envisioned by Donald Trump. Consequently, financial regulations, especially those related to The Dodd-Frank Wall Street Reform and Consumer Protection Act, will likely receive significant scrutiny.

Infrastructure spending, although potentially a favorite bipartisan idea, could prove difficult to implement, and any related economic benefits could take months or years to materialize.

Income tax reform currently appears as one of the most potentially impactful changes that could emanate from Washington, D.C. Corporate tax reform seems the most likely near-term focus, given the apparent consensus among analysts that U.S. corporate tax rules are widely viewed as uncompetitive on the international stage. In addition, personal tax rules seem well-defended by a myriad of special interests and political loyalties.

Given our view that investors will utilize increasingly favorable economic growth forecasts as the Trump administration communicates its policy initiatives, we believe that interest rates will remain under pressure (i.e., pressured higher) for the time being. As a result, we plan to maintain a duration underweight versus portfolio benchmarks. We will monitor changes to both fiscal and monetary policy and adjust the interest rate sensitivity of the portfolios accordingly in the weeks ahead.

Securitized products

Summary

We maintain our defensive strategy in the securitized products sectors, due primarily to unattractive valuations. The fundamentals for residential housing, commercial real estate, and consumer finance remain positive. Additionally, the Trump administration's pro-growth stance could extend the current economic cycle. Overall supply and demand technicals appear positive for the securitized sectors, as supply should be muted and investor demand for high quality yield remains strong.

Agency MBS: Underweight; 20% vs. 28% in the Bloomberg Barclays U.S. Aggregate Bond Index

Performance

- Agency MBS performed poorly in the fourth quarter of 2016, given the surge in interest rates, which resulted in -39 bps of excess return versus U.S. Treasuries.

Fundamentals: neutral

- We expect muted refinancing risk in 2017, but policy risk could increase with regard to regulation, Federal Reserve MBS reinvestment, and the fate of the GSEs.
- Our concerns include the possibility of increased interest volatility, which could result from uncertainty surrounding the Trump administration's policies and future U.S. Federal Reserve actions.

Technicals: positive

- Agency MBS supply and demand technicals appear extremely favorable, and we observe strong demand from U.S. banks and overseas investors, and reinvestment from the Federal Reserve.
- Higher mortgage rates should cause supply to moderate as the year begins.

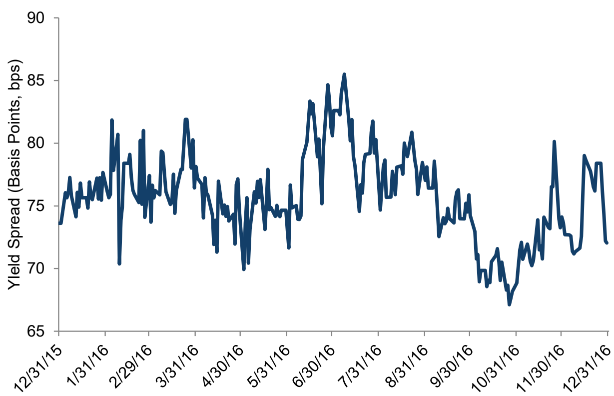
Valuations: negative

- Valuations remain unattractive and leave little potential for upside.
- The sector should benefit from its high quality and strong liquidity.

Outlook

- We recommend a modest underweight, as poor valuations and elevated policy risk offset the favorable technical environment.
- We are focused on higher-coupon 30-year MBS, 20-year MBS, and select non-agency RMBS.

Agency MBS current coupon spread to U.S. Treasury



As of 12/31/2016. Source: Bloomberg

CMBS: 4% target allocation vs. 2% in index

Performance

- CMBS delivered solid performance in the fourth quarter 2016, driven by strong investor demand for yield and limited supply.
- The sector generated excess returns of +46 bps versus comparable duration U.S. Treasuries.

Fundamentals: positive

- Commercial real estate fundamentals remain favorable, driven in large part by the strong labor market.
- As mentioned, Trump's pro-growth policies could extend the current late-cycle economic expansion.

Technicals: positive

- Supply remains modest and risk retention rules could further dampen new issuance.
- We expect strong investor demand for yield in the beginning of 2017.

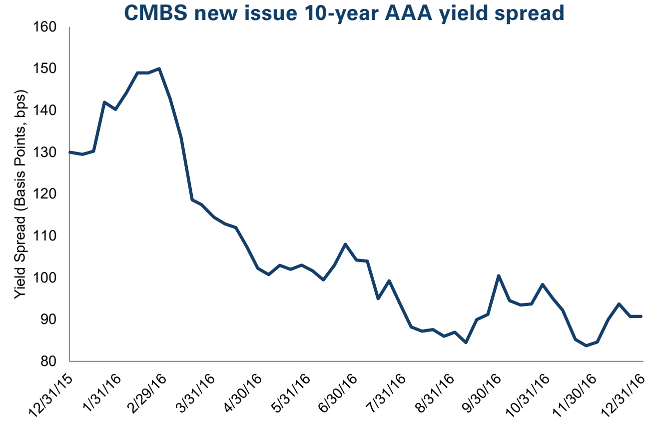
Valuations: negative

- Valuations appear poor, in our opinion, and reside near recent tight levels across the ratings spectrum.
- Relative value versus credit markets has improved as a result of recently strong credit performance.

Outlook

- With the onset of the new year, we adopted a more positive view towards CMBS, given the potential for improved economic growth and an extension of the commercial real estate cycle.
- Strong investor demand for yield will probably overcome poor valuations to start the year.
- We like subordinate new issue conduit securities, short average life senior bonds, and select single-asset subordinate tranches.

CMBS new issue 10-year AAA yield spread



As of 12/31/2016. Source: J.P. Morgan

Asset-backed securities (ABS): overweight with allocation of 10%

Performance

- ABS matched the performance of U.S. Treasuries in the fourth quarter 2016, but lagged the strong performance of the riskier sectors.

Fundamentals: positive

- Fundamentals for consumer finance remain very favorable, supported by the strong labor market and improved consumer balance sheets.
- Tax cuts could add disposable income and increase consumers' ability to service debt.

Technicals: positive

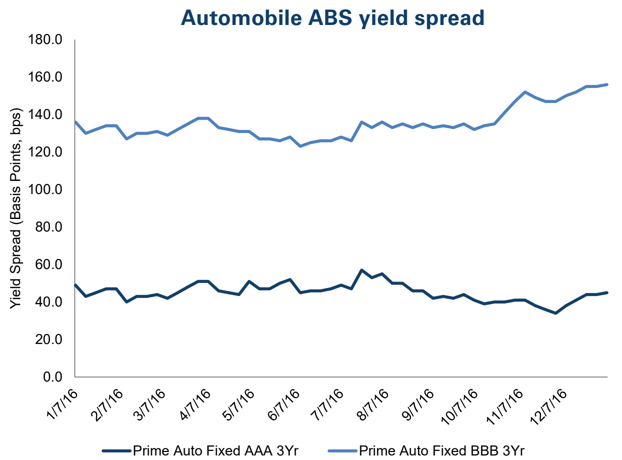
- We believe modest increases in supply in early 2017 will be met with strong investor demand for short-maturity, high-quality ABS.

Valuations: neutral

- Valuations appear fair on a historical basis, but look attractive versus similarly rated short-maturity alternatives.

Outlook

- We maintain a positive outlook and overweight opinion, as the sector should benefit from its high quality and short maturity.
- 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.



As of 12/31/2016. Source: Barclays

Investment grade credit

Summary

Our outlook regarding investment grade credit improved modestly, based on continued strong technicals and an improving view of fundamentals. As a result of large interest rate differentials, foreign central bank quantitative easing (QE) and solid demand from domestic and foreign buyers, technicals remain very robust. Our view of fundamentals view recognizes the stabilization in commodity prices and a potential for an extension of the business cycle that currently seems likely under the Trump administration. Nevertheless, risks remain, and we observe that any balanced view of the market should include consideration of modestly rich valuations, risks that continue to surround certain emerging markets, overall geopolitical risk, and the possibility that the Trump administration will fall short of its initial objectives. In addition, we note that some Trump administration policies, such as Mr. Trump's protectionist mindset, could hinder economic growth and international trade.

Our outlook regarding investment grade credit improved modestly.

Performance

- The Bloomberg Barclays U.S. Credit Index (Credit Index) returned -2.97% in the fourth quarter and 5.63% for 2016.
- Excess return to similar maturity Treasuries totaled 1.56% in the fourth quarter and 4.42% for 2016.
- The best-performing credit industries in the fourth quarter on an excess return basis were Energy (and its subindustries), Banking (Preferred Stock/Tier 1 Capital), Metals & Mining, and Life Insurance. The worst-performing industries were Sovereigns, Home Construction, and Supranationals.
- The best-performing credit industries during all of 2016 on an excess return basis comprised Metals & Mining, Energy (and its subindustries), and Paper. The worst performing industries comprised Supranationals, Banking (Senior Notes), and Home Construction.

Source: Barclays

Fundamentals: forward outlook moderately improved

- Commodity headwinds subsided and contributed to positive year-over-year earnings comparisons for many issuers.
- The strong U.S. dollar will pressure domestic company foreign revenues.
- Companies rated single-A and above continue to increase leverage, while BBB-rated companies appear focused on deleveraging (post-event issuers).
- We believe corporate profitability could improve, to the extent President-elect Trump and a Republican majority in Congress act with reduced gridlock to modify certain governmental regulations, reform corporate and personal tax laws, allow for tax-efficient foreign cash repatriation, and increase fiscal spending.
- If enacted, protectionist policies such as import tariffs and immigration restrictions could pressure profitability for some companies and industries.
- Corporate leverage remains elevated. However, companies have reduced cash payments to shareholders, M&A activity has declined, and interest coverage remains reasonable given low interest rates.

Source: J.P. Morgan

Technicals: remain strong

- Accommodative European and Japanese central bank policy, low global yields, and a strong U.S. dollar are forcing foreign investors into U.S. dollar-denominated assets.
- Strong mutual fund inflows of $131 billion in 2016 significantly exceeded the $55 billion reported for 2015. We believe that flows in 2017 will likely fall short of those reported in 2016, as retail buying subsides coincident with rising interest rates.
- Higher interest rates should attract increased domestic institutional buyers (insurance companies and pension investors).
- In 2016, gross new issuance increased 7.6% to reach an all-time record of $1.435 trillion.
- In 2017, we expect gross and net issuance to decline approximately 10% and 20%, respectively, as a result of a decline in pending M&A transactions, the effect of higher interest rates deterring opportunistic issuers, the potential that foreign cash repatriations reduce funding needs, and an increased amount of bonds maturing in 2017.
- Surveys on investor positioning remain neutral, while surveys on investor sentiment toward credit remain extremely positive.

Source: Barclays, J.P. Morgan

Valuation: modestly rich

- The Credit Index spread reached 118bps at the end of 2016, 22bps wide of the 2014 near-term tights, 37bps wide of the pre-crisis tights, and 82bps tighter than the February 2016 wides.
- At the end of 2016, the Credit Index spread stood 40bps tight of the 25-year historical average; while BBB-rated issue spreads were 51bps tight of the 25-year average.
- An effective yield of 3.29% appears uninspiring, yet remains very attractive for many non-U.S. investors and much improved over the 2.66% Credit Index yield near-term lows achieved in July 2016.
- Spread as a percentage of all-in yield was at 36%, versus the pre-crisis February 28, 2005 level of 15%.

Financials: positive

- Strong asset quality, improved profitability from higher interest rates, robust capital levels, less exposure to shareholder activism, and strong relative valuation contribute to our attractive view of Financials.
- Higher interest rates, foreign cash repatriation, less exposure to shareholder activism and the potential for a relaxation of certain regulations improve the outlook for Insurance.

Industrials: neutral

- Shareholder activism, M&A risk, and political risk remain prevalent. We see improvement within commodity related industries, while companies with significant foreign sales face currency translation pressure and companies with foreign manufacturing face potentially high tariffs.
- Energy and Pipelines exhibit attractive valuations, and should benefit from strong asset values, stable to improving commodity prices, and the potential for a less onerous regulatory environment.
- Industry and issuer selection is of the utmost importance.

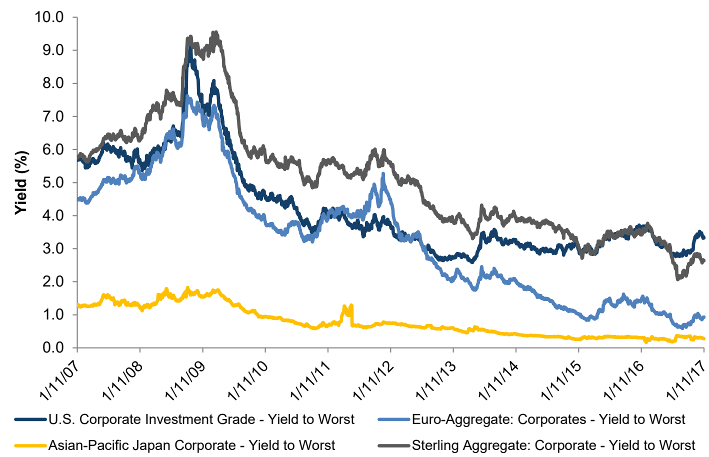
Outlook

- We expect that investment grade credit will continue to provide reasonable excess returns in the near to intermediate term, due to strong technicals and improving fundamentals, as a result of an expected extension of the business cycle. Stretched valuations, risks that continue to surround certain emerging markets, overall geopolitical risk, underachievement on the part of the Trump administration and the potential for negative consequences that could result from some Trump policies remain our largest sources of concern. As such, industry and issuer selection will remain extremely important.

Overweight: Banks, Insurance, Pipelines, Airline Enhanced Equipment Trust Certificates (EETCs), REITs, Food & Beverage, Building Materials, post-event issuers, and BBB-rated credits

Underweight: Utilities, Defense, Retailers, Technology, Railroads, Consumer Products, Autos, Sovereigns, and Emerging Markets

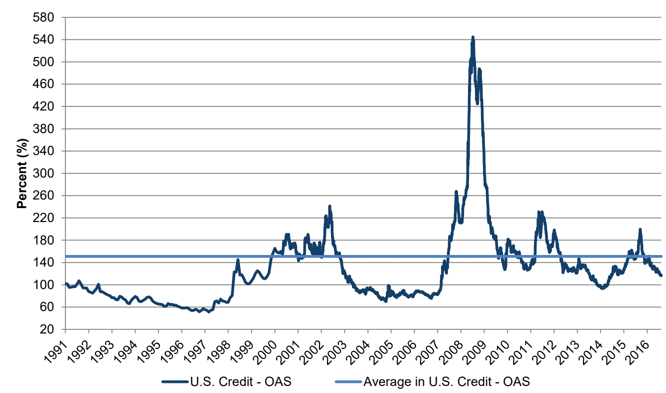
Global investment grade corporate yields



Source: Barclays as of 1/11/2017.

Investment grade credit yields

May 1991 - January 2017



As of 1/10/2017. Source: Barclays

High yield

Summary

Strong performance in December helped the Bloomberg Barclays U.S. Corporate High Yield Bond Index (High Yield Index) post a 17.13% total return in 2016, led by Metals & Mining (+45.49%) and Energy (+37.37%). After hitting a trough in February 2016, the High Yield Index posted gains in ten of the last eleven months, led by lower-quality bonds. CCC-rated bonds (+31.46% in 2016) outperformed higher-quality bonds for ten consecutive months. New issuance slowed at the end of 2016 and was dominated by refinancings. Net new issuance declined nearly 30% in 2016, providing positive technical support that remains in place as we enter 2017. With leverage metrics looking stretched and valuations now at two-year lows, the high yield market appears to be increasingly driven by strong technical demand for yield.

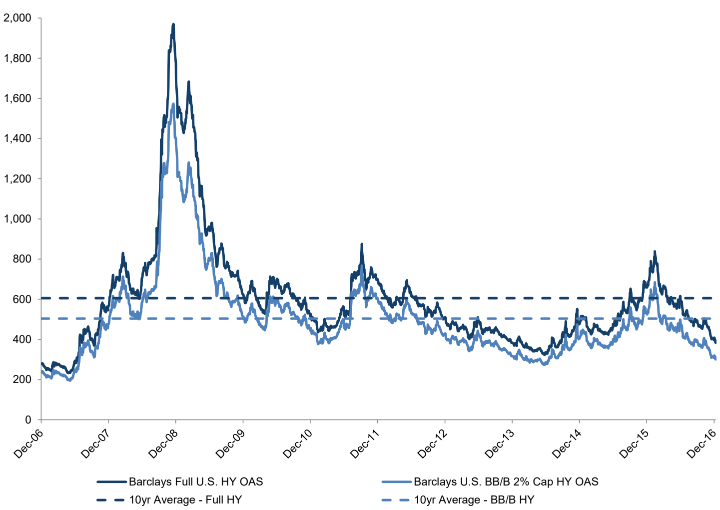
The High Yield Index posted gains in ten of the last eleven months.

Performance

- The High Yield Index returned 1.75% in the fourth quarter of 2016, pushing the full-year 2016 return to a remarkable +17.13%. Since the mid-February trough, the High Yield Index posted a +23.50% return, a figure that compares only with post-recession periods.
- During the fourth quarter, spreads tightened another 71bps (on an OAS basis) to end the year at +409bps, having touched a 27-month low of +397bps on December 27, 2016.
- Lower-quality bonds continued to outperform during the fourth quarter, with CCC-rated bonds posting a gain of +3.30% versus BB-rated bonds at +1.19% and single-Bs at +1.97%.
- The list of top-performing industries during the fourth quarter comprises those that are expected to benefit from the incoming Trump administration's policy efforts, including Energy (+5.82%), Aerospace & Defense (+3.37%), Metals & Mining (+3.10%), Brokerages (+3.05%), and Construction Machinery (+3.01%).
- Pharmaceuticals (-6.57%), Healthcare (-1.13%), Utilities (-0.74%), Retail (-0.55%), and Wireline Communications (-0.44%) were notable underperformers for the quarter.
- With the sharp rally in the Energy and Metals & Mining sectors since February, the yield on the High Yield Index (ex-commodities) was virtually flat to the overall High Yield Index at quarter end, versus 154bps tighter on February 11, 2016.

Source: Barclays, J.P. Morgan

Bloomberg Barclays U.S. Corporate High Yield Index yield spreads

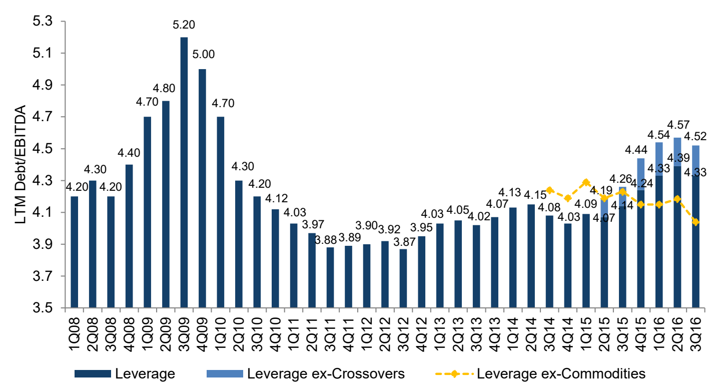


As of 12/31/2016. Source: Barclays

Fundamentals: defaults trending down

- The high yield default rate trended downward again in the fourth quarter, finishing the year at 3.32% (versus 3.54% at the end of September and 1.80% at the end of 2015). Reflecting the continued recovery of commodity prices, defaults totaled $6.5 billion in the fourth quarter, the lowest amount of defaults in any 2016 quarterly period, and the lowest since the first quarter of 2015.
- In 2016, the Energy and Metals & Mining sectors accounted for over 80% of all high yield defaults; excluding these industries, the 2016 default rate was just 0.68%.
- In the fourth quarter, the upgrade-to-downgrade ratio also remained solidly positive at 1.2:1 (indicating more upgrades than downgrades) on a dollar-volume basis. Despite positive ratios in the last three quarters of the year, the massive downgrade activity in the first quarter of 2016 left the annual figure at 0.7:1, including approximately $185 billion of "fallen angel" downgrades from investment grade to high yield (handily surpassing the 2009 record of $150 billion).
- Aggregate credit metrics reported with third quarter 2016 earnings appear somewhat encouraging. According to J.P. Morgan, revenues in the third quarter of 2016 increased 1.7% year-over-year, although EBITDA for the comparable periods fell 1.0%. Excluding commodity sectors, revenues and EBITDA both increased approximately 6% on a year-over-year basis.
- Excluding crossover issuers, leverage (i.e., debt ÷ EBITDA) declined slightly to 4.52x, from the recent peak of 4.57x as of the second quarter 2016. These figures compare to a peak in leverage of 5.20x in 2009, and a trough of 3.87x in 2012.

High yield issuer leverage



As of 9/30/2016. Source: J.P. Morgan, CapitalIQ

Technicals: demand remains firm

- Although flows into high yield mutual funds turned negative (i.e. into outflows) in the fourth quarter, 2016 as a whole experienced solid demand for U.S. high yield bonds, as investors searched for yield globally. Flows into high yield mutual funds totaled $8.2 billion for the year, marking the first positive-flow year for high yield since 2012's $29.0 billion inflow.
- Gross new high yield issuance slowed during the fourth quarter to just over $50 billion, versus nearly $80 billion and $104 billion, respectively, in the third and second quarter of 2016. After taking into account calls, tenders, and maturities, net issuance actually turned negative in the fourth quarter. For 2016 as a whole, gross issuance declined slightly compared to 2015, but net issuance dropped meaningfully (nearly 45%) to just $41.0 billion, the lowest level since the market experienced net outflows in 2008. This trend was partially offset, however, by the aforementioned surge in fallen angels, which totaled a whopping $185 billion (mostly in the commodity sectors).

Net issuance dropped meaningfully (nearly 45%) to just $41.0 billion, the lowest level since the market experienced net outflows in 2008.

Source: J.P. Morgan

Valuation: spreads nearing post-crisis lows

- The U.S. high yield market benefitted from the post-election rally of risk assets, and High Yield Index spreads (OAS) ended the quarter 71bps tighter at +409 bps. This spread tightening was offset, however, by the back-up in risk-free U.S. Treasury rates, leaving the High Yield Index yield-to-worst relatively unchanged at 6.12% (i.e., versus 6.17% at the end of the third quarter 2016). Compared to the trough of the market in February 2016, High Yield Index spreads are approximately 450bps tighter and near 27-month lows.
- After a very strong 2016, in which U.S. high yield outperformed most asset classes, it is difficult to argue that high yield bond valuations are inexpensive in a historical context. At +323bps (High Yield Index as of January 9, 2017), spreads reside well below long-term averages and just 60bps above the post-crisis low. Furthermore, when compared to other credit sectors, namely investment grade credit and leverage loans, high yield spreads appear tight in a historical context.

Source: Barclays

Outlook

- The post-election risk rally has been impressive, but we are once again cautious on high yield valuations as the market awaits details of new fiscal policies that may extend the current economic cycle. While valuations temper enthusiasm for the sector, the technical backdrop remains firm, as investors continue to look to put cash to work in the high yield market, despite the lack of primary issuance to start the year. On a relative value basis, we generally prefer single-Bs over BB-rated bonds, and would look to rotate into floating rate loans where possible.

Overweight: Airlines, Banking, Consumer Products, Media-Cable, and Pipelines/Distributors

Underweight: Financials-Other, Industrial-Other, Retailers & Restaurants, and Technology

Leveraged loans

Summary

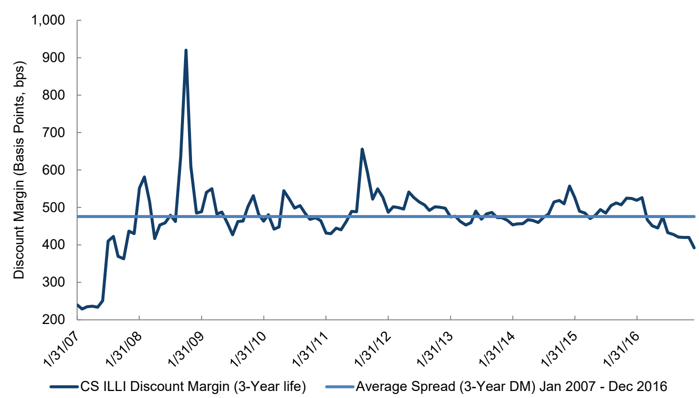
Although leveraged loans returned nearly 8% in 2016 (the best total return since 2012, per the CSILLI), the asset class could not keep up with high yield for the year. However, post-election technicals have been very strong, as the market experiences the largest stretch of retail inflows since the 2013 "taper tantrum". The result of this strong technical picture has been a spike in repricing and refinancing transactions that reset LIBOR spreads lower and likely constrain future returns. Despite this, loan valuations now appear relatively attractive on a historical basis versus high yield bonds, and a more aggressive U.S. Federal Reserve could create added investor interest in the loan market's floating-rate benefits.

Post-election technicals have been very strong, as the market experiences the largest stretch of retail inflows since the 2013 "taper tantrum".

Performance

- The Credit Suisse Institutional Leverage Loan Index (CSILLI) posted another strong return (+1.70%) in the fourth quarter of 2016, bringing the full-year return to +7.65%. Average loan prices edged higher during the fourth quarter, finishing 2016 at $99.95 (+$0.45 versus the third quarter of 2016, and +$2.92 versus the fourth quarter of 2015). Leveraged loan returns trailed other fixed income asset classes in 2016, as price appreciation has been capped by recent repricing activity (loans have weak call protection). At year-end 2016, over 70% of loans traded above par, the highest percentage in nearly two years.
- Lower-quality loans continued to outperform during the fourth quarter of 2016, as CCCs returned +3.5%, Bs +1.8%, and BBs +1.3%. The Energy (+4.0%) and Metals & Mining (+2.6%) sectors outperformed once again, while Retail (+0.4%), Healthcare (+1.1%) and Food/Tobacco (+1.2%) underperformed.

Credit Suisse Institutional Leveraged Loan Index spread

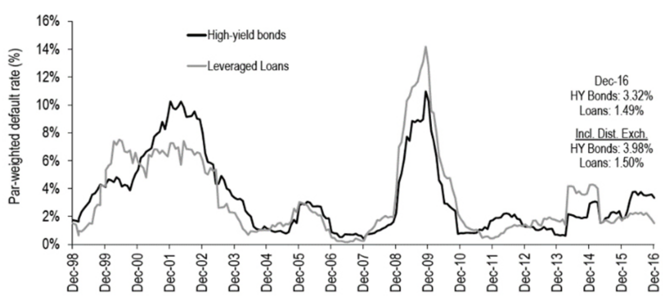


As of 12/31/2016. Source: Credit Suisse and J.P. Morgan

Fundamentals: defaults remain below average

- Leveraged loan defaults remained benign in the fourth quarter of 2016. The trailing 12-month, par-weighted default rate declined from 2.24% at September 30, 2016 to just 1.49% at year-end 2016, the lowest level since March 2014. Excluding commodity sectors, which comprise a significantly smaller portion of the leveraged loan market than the U.S. high yield bond market, the loan default rate ended 2016 at just 0.51%. We do not currently expect a meaningful acceleration of defaults in 2017. As of December 31, 2016, the distressed ratio (loans trading below $80) stood at just 3.62%, with most of those loans concentrated in two sectors (Energy and Retail).

Leveraged loan and high yield bond default rates



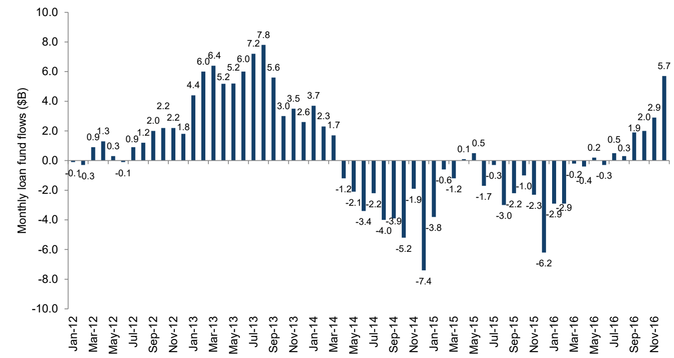
As of 12/31/2016. Source: J.P. Morgan

Technicals: demand outpacing new supply

- Solid demand for loans emerged during the third quarter of 2016, and the technical picture improved even further in the last three months of the year. Retail mutual fund inflows surged to over $10 billion in the fourth quarter of 2016, from just over $2 billion in the third quarter, which was the first positive-inflow quarter since the third quarter of 2014. Full-year 2016 inflows totaled nearly $7 billion, reversing two years of sharp outflows (-$24 billion in 2014 and -$22 billion in 2015). Furthermore, CLO issuance spiked to nearly $58 billion in the fourth quarter of 2016 (from approximately $27 billion in the third quarter and just $25 billion in the first half of 2016), although many of the transactions were refinancings of existing deals.
- Light new loan issuance during the fourth quarter of 2016 failed to meet the strong demand, and triggered a wave of repricing activity that is typical when much of the loan market trades above par. While gross new issuance totaled $194 billion during the fourth quarter, just $31 billion represented new money. During 2016, nearly two-thirds of new issuance was either a refinancing or a repricing of an existing deal, up from approximately 40% in 2015. With the U.S. Federal Reserve seemingly targeting further rate hikes in 2017, solid demand for loans and the overall positive market technicals should continue.

Source: Barclays

Leveraged Loan retail fund flows

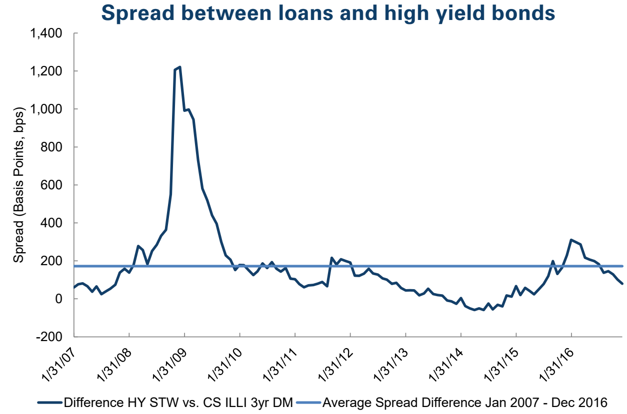


As of 12/31/2016. Source: Credit Suisse

Valuation: attractive vs. high yield

- Despite spread contraction during the period, the average yield (to three-year takeout) for the CSILLI increased 43bps to 5.59% during the fourth quarter of 2016, as leveraged loans benefited from rising LIBOR (the benchmark rate from which loan coupons are calculated). LIBOR now exceeds 1.00%, the most common "floor" used in calculating loan interest coupon rates. The average index spread, or discount margin (DM), tightened 28bps to +392bps in the fourth quarter, the tightest level post-crisis and the lowest since October 2007.
- With the significant spread tightening in the high yield market since the U.S. presidential election, the relative value of loans versus high yield bonds has improved markedly. At +472bps as of year-end (per the Credit Suisse High Yield Index), the average high yield spread is just 80bps wide of the comparable loan spread (as represented by the CSILLI). This difference contracted to 80bps from 146bps at September 30, 2016, and is well inside the +172bps 10-year average. In mid-2014, this spread actually turned negative (i.e., high yield bond spreads were tighter than leveraged loan spreads, on average), so it is possible for spread contraction in high yield to outpace loans.

Spread between loans and high yield bonds



As of 12/31/2016. Source: Credit Suisse

Outlook

- With a significant portion of the leveraged loan market now trading at or above par, the lack of call protection in most loans will likely mute returns going forward. However, both returns and retail flows could experience gains if LIBOR continues to rise. This supportive demand picture, combined with a lack of net new issuance and improved commodity markets, provides a positive technical backdrop. Furthermore, relative to the high yield market, loan valuations appear attractive, and we would be looking to rotate into floating rate loans where possible. Lastly, with new regulations for the CLO market now in place, new CLO creation – and the resulting demand for loans that comprise the underlying collateral – could represent a wildcard for investors this year.

Overweight: Aerospace, Building Materials, Media & Telecom, and Supermarkets

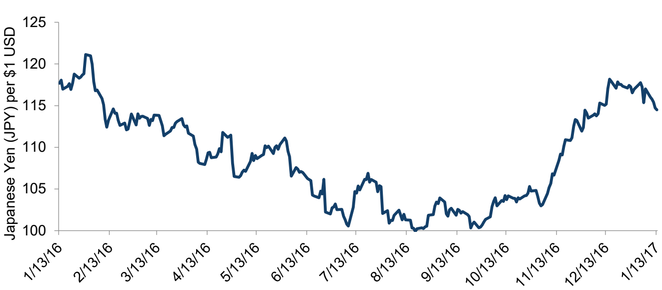
Underweight: Food & Beverage, Gaming & Lodging, Healthcare, and Retail & Restaurants

Non-dollar

Summary

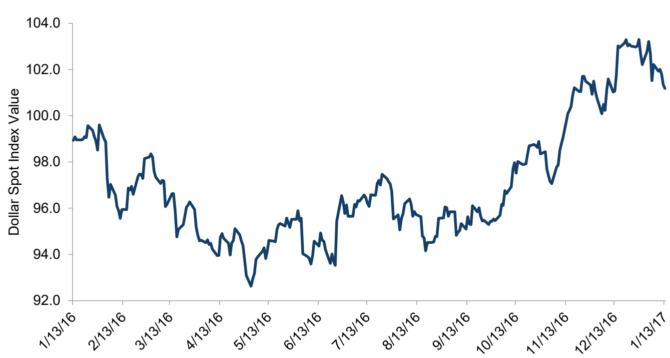
The U.S. dollar strengthened dramatically over the past quarter and we expect this trend to continue into 2017. The economic policies of a new administration, (as currently anticipated) may push U.S. interest rates higher and keep upward pressure on the dollar. The dramatic weakening of the Japanese yen, which in one quarter retraced most of its gains from the first three quarters of 2016, represents the most pronounced recent foreign currency move.

Japan / U.S. Foreign Exchange Rate



As of 1/13/2017. Source: Federal Reserve Bank of St. Louis

U.S. Dollar Index (USDX)

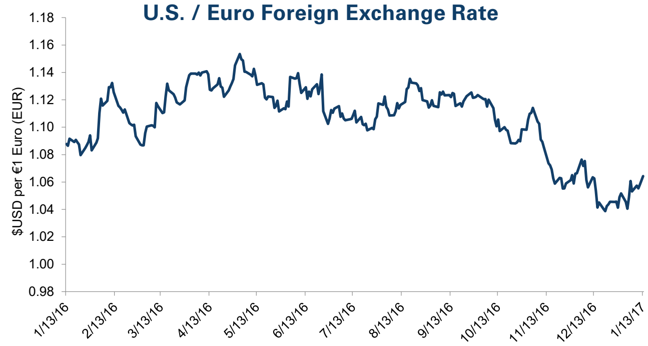


As of 1/13/2017. Source: Bloomberg

Europe

- Interest rates in Europe rose dramatically in the fourth quarter of 2016; the yield on the 10-year German Bund increased more than 30bps over the period.
- Even as European interest rates have risen, the euro has weakened with other major currencies against the U.S. dollar.

U.S. / Euro Foreign Exchange Rate

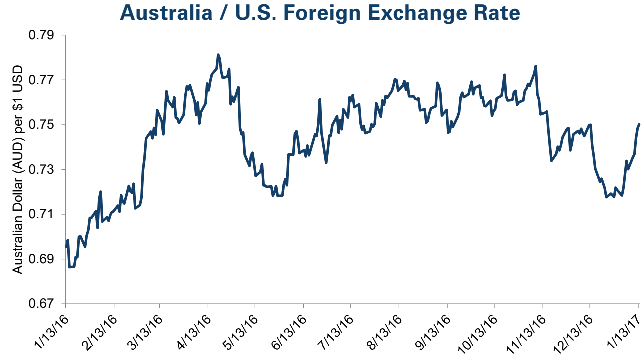


As of 1/13/2017. Source: Federal Reserve Bank of St. Louis

Rest of the world

- We continue to see value in non-dollar government bonds across the globe. Monetary stimulus in Europe, as well as emerging market countries, should bode well for growth in 2017.
- We recommend hedged positions in non-dollar government bonds, as the strength of the U.S. dollar could erode potential spread tightening versus U.S. government bonds.

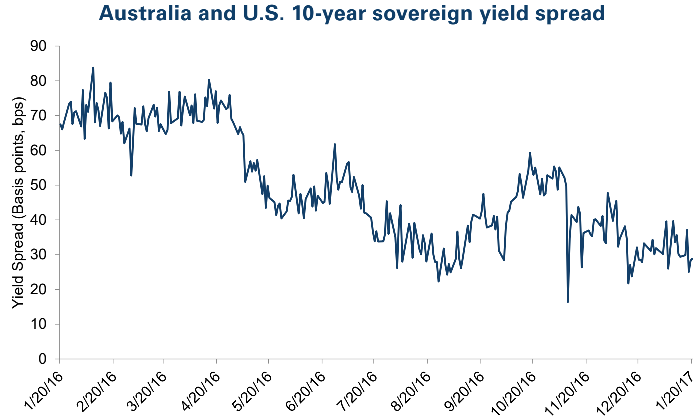
Australia / U.S. Foreign Exchange Rate



As of 1/13/2017. Source: Federal Reserve Bank of St. Louis

- Specifically, yields in Australia and New Zealand remain elevated versus the U.S. and offer the potential for further yield compression in 2017.

Australia and U.S. 10-year sovereign yield spread



As of 1/20/2017. Source: Credit Suisse

Benchmark performance as of 12/31/2016

Total return	QTD	YTD
Bloomberg Barclays U.S. Aggregate	-3.0%	2.6%
Bloomberg Barclays U.S. Treasury	-3.8%	1.0%
Bloomberg Barclays U.S. TIPS	-2.4%	4.7%
Bloomberg Barclays U.S. Credit	-3.0%	5.6%
Bloomberg Barclays U.S. ABS	-0.7%	2.0%
Bloomberg Barclays U.S. MBS	-2.0%	1.7%
Bloomberg Barclays U.S. CMBS	-3.0%	3.3%
Bloomberg Barclays U.S. High Yield Index	1.8%	17.1%
Citigroup BB/B ex-split B/CCC Index	0.9%	13.1%
Credit Suisse Institutional Leveraged Loan Index	1.7%	7.6%
Citigroup Non-USD World Government Bond (50% hedged)	-6.6%	3.5%
Yield		**Dec. 31**
US 10-Year Treasury yield		2.4%

Disclaimers