U.S. Fixed-Income Quarterly Overview

Fourth Quarter 2019

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Macroeconomic review
as of December 31, 2019

Highlights

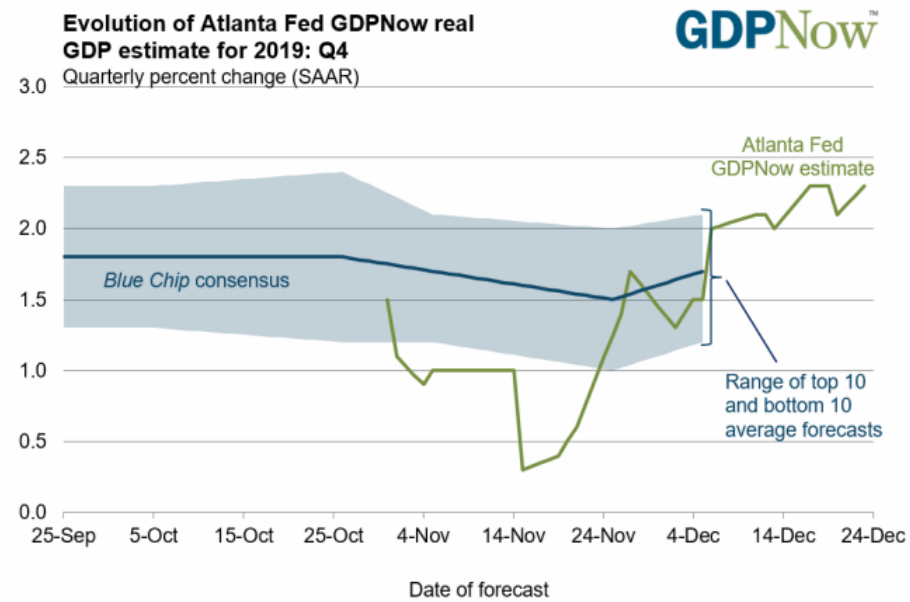
U.S. GDP growth

- As it was through most of the year, U.S.-China trade negotiations drove asset prices throughout the quarter. An agreement on a Phase One trade deal and a rollback in existing tariffs pushed up Treasury yields and credit assets.
- This year's trend of deteriorating industrial data and a relatively healthy consumer and labor market continued. Industrial production continued to contract for most of Q4 compared to prior year despite overall job gains being resilient during the GM strike.
- After beginning open market operations to provide liquidity to the repo market in September and increasing its capacity ahead of year end, worries about dislocations in the repo market in December subsided.
- Against this backdrop, the U.S. fixed-income market performance was mixed in the fourth quarter. More credit-sensitive areas of the market outperformed for the quarter on signs of stronger economic growth and an improved tone on trade negotiations.

Rates and Fed policy

- The Federal Reserve implemented a quarter-point reduction in the benchmark fed funds rate at its October 30 meeting, leaving the target range at 1.50% to 1.75%.
- At its December meeting, the Fed signaled that this move will likely represent the end of its mid-cycle downward adjustment in rates, as they left rates unchanged.

Atlanta Fed GDP Forecast



Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*

Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

Source of macroeconomic highlights: Bureau of Labor Statistics

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Chart image source: Federal Reserve Bank of Atlanta.

U.S. Treasury yield curve review

as of December 31, 2019

Highlights

- The Federal Reserve implemented a quarter-point reduction in the benchmark fed funds rate at its October 30 meeting, leaving the target range at 1.50% to 1.75%.
- After three interest-rate cuts occurring in October, the Fed maintained the target range for the federal funds rate when it met in December. The Fed signaled that this move likely represented the end of its mid-cycle downward adjustment in rates, leading to a cooling in bond market returns.
- The interest rate cuts have had a significant impact on the shape of the Treasury yield curve, which normalized during the period. One-month interest rates ended the year approximately 30 basis points (bps) lower than 10-year rates.
- In Q4, yields rose on longer maturity Treasuries and the curve steepened 32 bps) between 2 and 30 years, as short yields remained relatively anchored.
- The curve continued to steepen during the quarter as the 2-year yield fell 5 bps from 1.63% to 1.58%, the 10-year yield rose 24 bps from 1.68% to 1.92% and the 30-year yield rose 27 bps from 2.12% to 2.39%.
- The Fed emphasized that it would be willing to tolerate an overshoot in inflation vs. its 2% target given the extended period it has not achieved its target. After beginning open market operations to provide liquidity in the repo market in September and increasing its capacity ahead of year end, worries about dislocations in the money market in December proved to be overblown.

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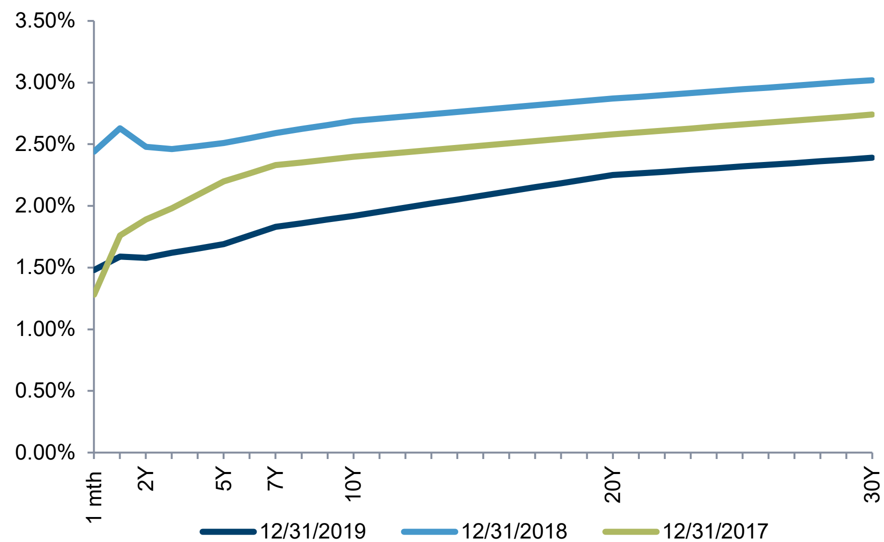
U.S. Treasury market performance

		QTD			12 Month	
	Yield	Yield Change	Total Return	Yield Change	Total Return
U.S. Treasury Bellwethers	1.72%	-3 bps	-0.33%	-85 bps	6.60%
2 Year Bellwethers	1.56%	-6 bps	0.41%	-94 bps	3.31%
5 Year Bellwethers	1.68%	13 bps	-0.28%	-83 bps	5.82%
10 Year Bellwethers	1.91%	24 bps	-1.77%	-78 bps	8.90%
30 Year Bellwethers	2.38%	26 bps	-4.88%	-64 bps	16.43%

U.S. Treasury yield curve



Source: U.S. Department of the Treasury.

Fixed-income market review
as of December 31, 2019

Highlights

Bloomberg Barclays U.S. Aggregate Bond Index

- The Bloomberg Barclays U.S. Aggregate Bond Index, a broad measure of government and investment-grade corporate bonds, edges up 0.18%.

Sectors

- Riskier market segments were the best performers, led by the high-yield corporate bond market, which gained 2.61% as measured by the Bloomberg Barclays U.S. High Yield Corporate Bond Index.
- Securitized assets (which includes mortgage-backed securities (MBS), asset-backed securities (ABS) and commercial MBS) posted modest positive returns. U.S. Treasury returns were in negative territory against a backdrop of rising yields.
- The 2.61% return for high-yield corporate bonds as represented by the Bloomberg Barclays U.S. High Yield Corporate Index, exceeded that for its investment-grade counterparts as the segment benefited not only from the outlook for an even more extended credit cycle but also from its relative lack of sensitivity to rising interest rates.
- Returns for floating-rate bank loans were supported by optimism over the economy as well. The tax-free bond market returned 0.74% for the quarter, as gauged by the Bloomberg Barclays Municipal Bond Index.

Sector performance

	QTR		YTD	
	Total Return	Excess Return	Total Return	Excess Return
Bloomberg Barclays U.S. Aggregate	0.18%	83 bps	8.72%	199 bps
Bloomberg Barclays U.S. Treasury	-0.79%	n/a	6.86%	n/a
Bloomberg Barclays U.S. Aggregate Government-Related	0.23%	88 bps	9.01%	269 bps
Bloomberg Barclays U.S. Investment Grade Corporate	1.18%	242 bps	14.54%	676 bps
1-3 Year U.S. Corporate	0.86%	35 bps	5.30%	169 bps
Intermediate U.S. Corporate	1.10%	121 bps	10.14%	454 bps
Long U.S. Corporate	1.33%	461 bps	23.89%	1160 bps
Industrials	1.20%	262 bps	15.48%	728 bps
Utilities	0.03%	213 bps	14.38%	474 bps
Financials	1.43%	211 bps	12.84%	623 bps
AAA Corporate	-0.18%	214 bps	14.75%	461 bps
AA Corporate	0.20%	128 bps	10.53%	356 bps
A Corporate	0.81%	205 bps	13.18%	544 bps
BBB Corporate	1.68%	290 bps	16.26%	841 bps
Bloomberg Barclays U.S. Securitized	0.63%	57 bps	6.44%	68 bps
Bloomberg Barclays U.S. MBS	0.71%	62 bps	6.35%	61 bps
Bloomberg Barclays U.S. CMBS	-0.33%	6 bps	8.29%	181 bps
Bloomberg Barclays U.S. ABS	0.39%	-3 bps	4.53%	71 bps
Bloomberg Barclays U.S. High Yield Corporate	2.61%	251 bps	14.32%	934 bps
Bloomberg Barclays Global Aggregate	0.49%	57 bps	6.84%	216 bps
Bloomberg Barclays EM Hard Currency Aggregate	2.30%	284 bps	12.13%	629 bps
Bloomberg Barclays Municipal Bond	0.74%	n/a	7.54%	n/a

Sources: Bloomberg Barclays as of 12/31/2019
Excess returns are vs. similar-duration government bonds.

Past performance is not a guarantee of future results.

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Barclays sector excess returns
as of December 31, 2019

Quarter

Year to date

Excess returns are vs. similar-duration government bonds.
Source: Barclays

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Investment-grade corporate sector review
as of December 31, 2019

Review

The U.S. credit sector (as measured by the Bloomberg Barclays U.S. Investment Grade Credit Index) had a robust quarter, generating 221 bps of excess return vs. similar-duration Treasuries. From a spread perspective, the index OAS was tighter by 19 bps, ending the year at 90 bps, and all sector-, quality- and maturity-range results were strong.

- Lower quality outperformed in the quarter with BBB rated recording +2.95% of excess return versus +1.06% and +1.97% for AA and A rated corporates, respectively.
- Outperforming industries include wirelines (4.17%), refining (4.16%), supermarkets (3.86%) and life insurance companies (3.75%) among others. Underperforming industries include construction mach. (1.05%), consumer prods. (1.39%) and Banking (1.88%), among others.

Valuations

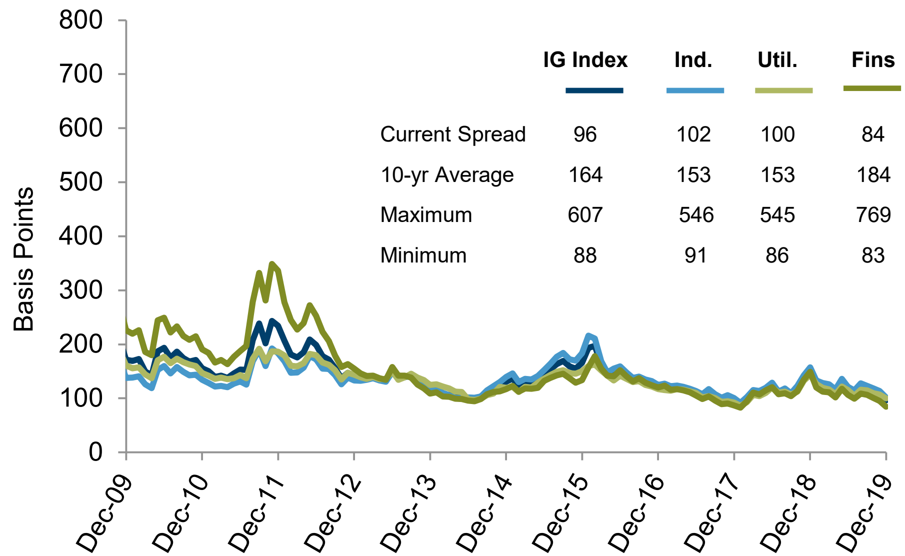
The Bloomberg Barclays U.S. Corporate Investment Grade Index OAS was 22 bps tighter this quarter, ending at 93 bps.

- The Bloomberg Barclays U.S. Corporate Investment Grade Index is yielding 2.86%, falling 5 bps during the quarter.
- To begin 2020, spreads are widening slightly given (1) the strong finish to 2019; (2) new geopolitical events; and (3) start of the January new issue calendar this week.

Outlook

- Fundamentals do not show signs of imminent crisis, but several of the tailwinds are fading. Valuations look a bit more offsides when taking this into account. However, beneficial technicals from low and negative yields globally continue to funnel cash to the market. With spreads near their five-year tights, we are maintaining our underweight in credit.
- We continue to believe relative-value opportunities remain among our favored management teams to execute on their individual strategies and focus on debt reduction.

Historical spreads



Source: Barclays. IG Index represents the Bloomberg Barclays U.S. Investment Grade Corporate Index.

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Structured asset sector review

as of December 31, 2019

Review

- **MBS:** Agency MBS generated 62 bps of positive excess returns (vs. similar-duration Treasuries) as Treasury volatility decreased from its elevated level from August and September
- **CMBS:** CMBS generated only 6 bps of excess returns, due to wider swap spreads.
- **ABS:** ABS excess returns were negative at 3 bps also due to wider swap spreads.
- **CLO:** Spreads have stabilized with better tone in the market.

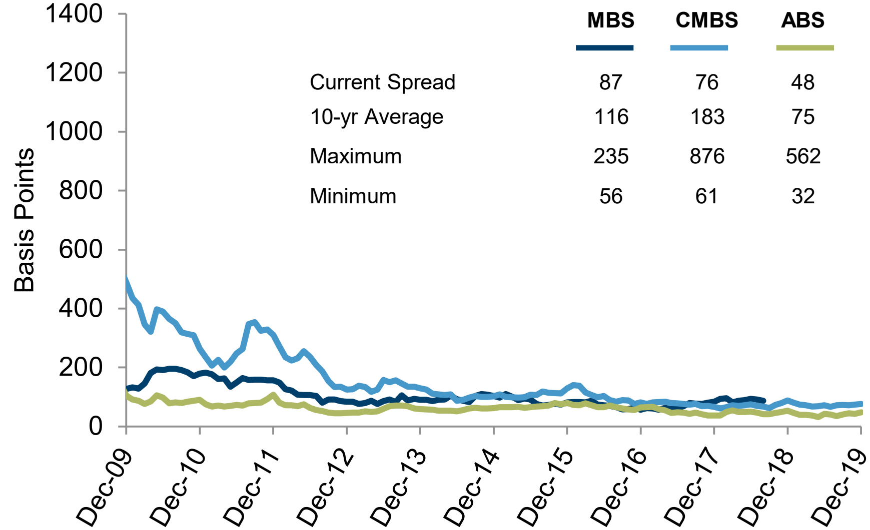
Outlook

- **MBS:** Valuations are closer to fair value now. Supply headwinds continue but a more stable and higher rate environment should help MBS marginally outperform U.S. Treasuries.
- **CMBS:** There is still value in single-asset CMBS and single family rental structures when available. Conduit deals will perform along with the market and competing sectors.
- **ABS:** Strong consumer balance sheets should continue to support the asset class.
- **CLO:** Senior bonds look attractive relative to other structured product sectors. The continued low default rate is also supportive of the asset class.

Valuations

- **MBS:** Spreads recovered from their widening in August through October. Interest-rate volatility decreased and yields stabilized late in the quarter, which helped the sector. Spreads are now back to almost where they were in the summer.
- **CMBS:** AAA spreads are a little wider due to swap spreads, which are 10 bps wider from the beginning of the quarter. Compared to investment-grade credit, CMBS look attractive
- **ABS:** Spreads are wider along with swap spreads. Compared to high-quality, front end investment-grade credit, ABS also looks attractive
- **CLO:** Spreads are still on the wide end and the sector remains attractive.

Historical spreads



	MBS	CMBS	ABS
Current Spread	87	76	48
10-yr Average	116	183	75
Maximum	235	876	562
Minimum	56	61	32

Source: Barclays.
MBS, CMBS and ABS are all components of the Bloomberg Barclays U.S. Aggregate Bond Index.

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High-yield corporate sector review
as of December 31, 2019

Review

- The ICE BofA Merrill Lynch U.S. High Yield Constrained Index returned 2.59% in the fourth quarter (ICE BofA).
- Lower-quality bonds outperformed. BB, B and CCC rated issues returned 2.37%, 2.89% and 3.32%, respectively, for the quarter (ICE BofA).
- High yield delivered a solid return with December's rally following two months of modestly negative price movement. Spreads were volatile over the first two months of the period amid the cross currents of mixed economic data, record new issuance, volatile rates, optimism around U.S./China trade and retail inflows, but tightened sharply in December, ending just wide of YTD lows.
- YTD new issuance totals $287 billion, which is +28% y/y net of refinancing (J.P. Morgan).
- J.P. Morgan's par-weighted bond default was unchanged over the quarter at 2.84%. Notably, the rate decreases to 1.2% if energy is excluded.

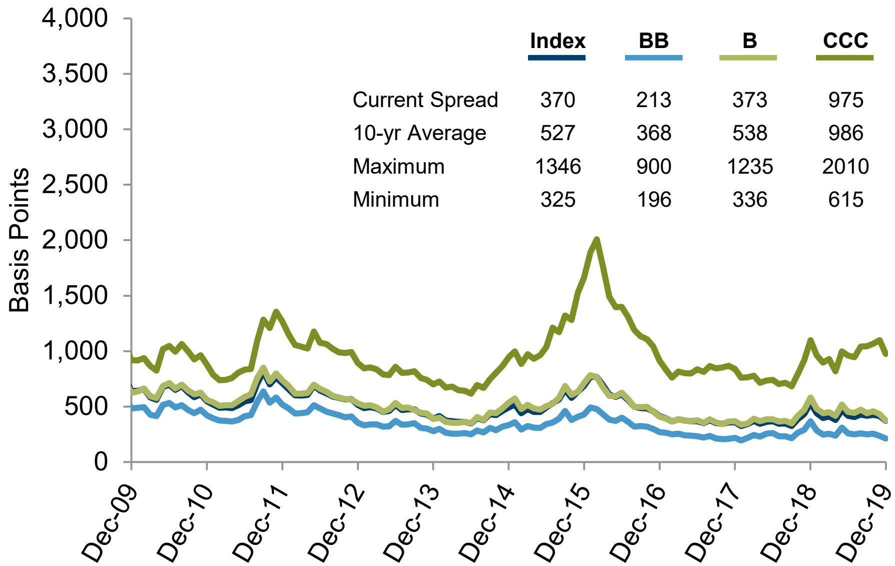
Valuations

- Valuations have tightened sharply over the last month, led by lower-rated issues, driven by long awaited progress on U.S./China trade negotiations and higher oil prices.
- High-yield bond yields have decreased 252 bps year-to-date to end the quarter at 5.39% (ICE BofA).
- High-yield spreads have tightened 164 bps year-to-date to +370 bps (ICE BofA).

Outlook

- Valuations tightened sharply recently, led by lower-rated issues, driven by long awaited progress on U.S./China trade negotiations and higher oil prices. While the pending Phase 1 trade agreement is unlikely to accelerate growth, it does remove some uncertainty from the U.S. economy and likely pushes a potential recession further into the future. However, valuations generally reflect this outcome with ex-energy spreads near their tights over the last three years, offering modest compensation for increased geopolitical risks. Fundamentals are stable but we see limited room for significant spread tightening from here. At the same time, we do not see a catalyst for a meaningful draw down from a fundamental perspective.

Historical spreads



	Index	BB	B	CCC
Current Spread	370	213	373	975
10-yr Average	527	368	538	986
Maximum	1346	900	1235	2010
Minimum	325	196	336	615

Source: Bank of America Merrill Lynch. Index is the ICE BofAML U.S. HY Cash Pay Constrained Index.

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Municipal market sector review
as of December 31, 2019

Performance

- The municipal market (Bloomberg Barclays Municipal Bond Index) returned 0.74% in the quarter and 7.54% on the year. Market performance was positive in 11 months and the yearly return was the best since 2014.(1)
- While all maturities posted positive returns in the quarter, the intermediate space outperformed its shorter and longer counterparts.
- In addition, all quality buckets produced positive returns, with lower-rated BBB and high-yield bonds outperforming their higher-rated counterparts, as investors continue to search for yield.

Fundamentals

- Muni credit fundamentals remain relatively strong as tax revenue collections remain robust.
- Economic data appears to have stabilized recently and fears of recession among market participants have begun to fade.
- Absent further geopolitical shocks, we anticipate rates to remain range bound, but recent optimism could see a drift toward the upper end of our range.

Technicals

- Demand for municipals remains strong. According to Lipper, 2019 saw 52 straight weeks of muni fund inflows, totaling over $93 billion and surpassing the annual record from 2009.
- While full-year new issuance was higher by nearly 12%, closing the year at $329.6 billion, record demand for munis was able to easily digest the additional supply. A resurgence of taxable municipal issuance occurred in 2019 as yields declined.
- Near-term technicals should remain favorable for municipals as January and February typically bring higher redemptions and investors look to reinvest proceeds into the new issue calendar. Also, demand is likely to remain strong as investors — particularly those in high-tax states and who are no longer benefiting from the SALT deduction — continue to find value in munis.

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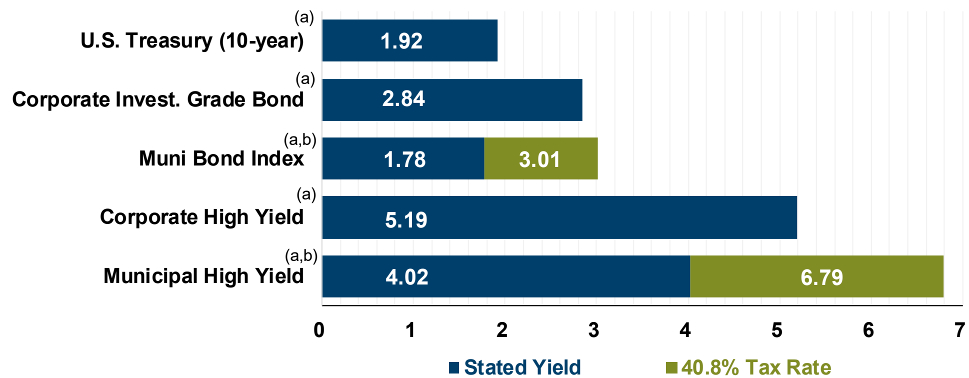
Valuations

- As munis outperformed Treasuries, muni/Treasury yield ratios declined, with the 2-year, 10-year and 30-year ratios ending the period at 67%, 75% and 88%, respectively.(3)
- Tax-adjusted muni yields remain attractive, particularly for those in higher tax brackets and impacted by the SALT cap.

Munis provide attractive levels of income
Keep what you earn – in any tax bracket



(a) Bloomberg Barclays Index.
(b) Assumes a 2019 federal income tax rate of 40.8% (37.0% income tax rate + 3.8% Net Investment Income Tax rate). Other taxes are possible. The effect of potential federal income tax phase outs of personal exemptions and itemized deductions is excluded from this schedule. Had they been included, the reported tax rate would have been higher which would then increase the municipal taxable equivalent yield, for any given municipal stated yield. State income taxes may be applicable and can further reduce the after-tax returns of some municipal bond investments (depending on the state of residence). Income from certain tax-exempt securities may be subject to the federal and/or state alternative minimum tax for some investors. In addition, federal and state income tax rules will apply to any capital gain distributions and capital gains or losses on sales. When investing in municipal securities, investors in higher tax brackets can receive a greater tax benefit than those in lower tax brackets. Municipal bonds provide income exempt from federal and, in some cases, state income taxes.
(c) Assumes a 50/50 allocation to Barclays Bloomberg Muni Bond Single-A and BBB indexes.
Sources: Bloomberg (U.S. Treasury 10-year), Bloomberg Barclays and Columbia Management Investment Advisers, LLC, as of December 31, 2019.
(1) Source: Barclays Live, (2) Bloomberg, (3) MMD and Bloomberg.

Disclosures

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