U.S. Fixed-Income Quarterly Overview

First Quarter 2019

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Macroeconomic review
as of March 31, 2019

Highlights

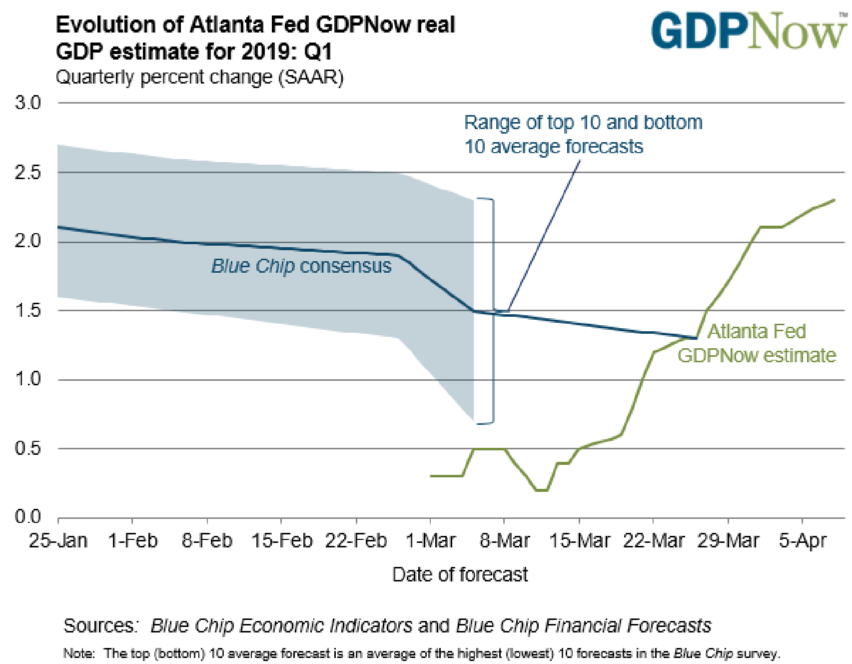
U.S. GDP growth

- Although 2018 was a year of solid domestic economic growth, expectations were lowered for 2019. Declining rates further flattened the yield curve and the yield curve inverted for the first time since 2007.
- There are rising concerns about a U.S. recession, in light of weaker-than-expected labor market data, retail sales and industrial production. However, solid manufacturing data and some better news from housing and construction instilled optimism that the current economic expansion remains on track.
- The final weeks of the quarter saw market volatility pick up on renewed uncertainty about the outlook for global growth. A downward revision in fourth-quarter 2018 growth to 2.2% from 2.6% led markets to anticipate a rate cut from the Fed before year end.

Rates and Fed policy

- As expectations were lowered for 2019, prompting the Federal Reserve to put any further short-term interest rate hikes on hold. A patient Fed spurred rallies in the Treasury market across the yield curve.
- Chairman Powell indicating that the Federal Reserve's policy was not on a fixed course and signaling patience concerning future increases in its benchmark overnight lending rate, markets took the view that the Fed is likely to remain on hold in 2019.

Atlanta Fed GDP Forecast



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 March 31, 2019

Highlights

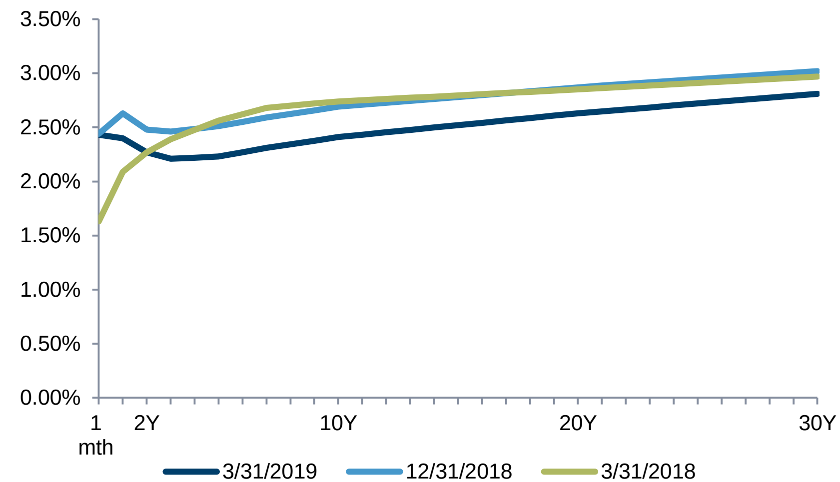
- Risk sentiment rebounded in the quarter after the decline in credit markets seen in late 2018. With Chairman Powell indicating that the Federal Reserve's policy was not on a fixed course and signaling patience concerning future increases in its benchmark overnight lending rate, markets took the view that the Fed is likely to remain on hold in 2019.
- 2019 expectations prompted the Federal Reserve to put any further short-term interest rate hikes on hold. A patient Fed spurred rallies in the Treasury market across the yield curve.
- For the three months, yields declined along the length of the U.S. Treasury curve, with the two-year yield falling from 2.48% to 2.27% and the 30-year yield falling from 3.02% to 2.81%.
- Two-year yields declined 23 basis points and 10-year Treasuries fell 25 basis points between January 1 and March 31, 2019. Declining rates further flattened the yield curve, a graphic depiction of rates at different maturity levels, and the yield curve inverted for the first time since 2007.
- Historically, an inverted curve raises concerns about a U.S. recession.

Source of Treasury highlights: U.S. Department of the Treasury

U.S. Treasury market performance

		QTD		12 Month	
	Yield	Yield Change	Total Return	Yield Change	Total Return
U.S. Treasury Bellwethers	2.40%	-17 bps	1.32%	16 bps	3.38%
2 Year Bellwethers	2.29%	-21 bps	0.97%	2 bps	2.56%
5 Year Bellwethers	2.29%	-22 bps	1.86%	-28 bps	4.37%
10 Year Bellwethers	2.41%	-28 bps	3.08%	-33 bps	5.60%
30 Year Bellwethers	2.82%	-20 bps	4.98%	-15 bps	6.26%

U.S. Treasury yield curve



Source: Barclays Live

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Fixed-income market review
as of March 31, 2019

Highlights

Bloomberg Barclays U.S. Aggregate Bond Index

- As gauged by the Bloomberg Barclays U.S. Aggregate Bond Index, returns for the broad U.S. investment-grade taxable bond market were positive 2.94% for the quarter.

Sectors

- U.S. Treasuries delivered positive returns against a backdrop of declining interest rates. Securitized assets (including mortgage-backed securities, asset-backed securities and commercial mortgage-backed securities) posted modestly higher returns relative to Treasuries. Investment-grade corporates led performance within the investment-grade market, as the asset class benefited from declining Treasury yields and the revived demand for yield.
- High-yield bonds rebounded from the prior quarter's steep losses to return 7.26% as measured by the Bloomberg Barclays U.S. Corporate High Yield Index.
- The CS Leveraged Loan Index had a positive return of 378 bps, with most of this move happening in January.
- The Bloomberg Barclays Municipal Bond Index experienced positive returns for the quarter, earning 2.90%.

Sector performance

Index	QTR		12 Month Trailing	12 Month Trailing
	Total Return	Excess Return	Total Return	Excess Return
Bloomberg Barclays U.S. Aggregate	2.94%	84 bps	4.48%	0.12 bps
Bloomberg Barclays U.S. Treasury	2.11%	n/a	4.22%	0.00 bps
Bloomberg Barclays U.S. Aggregate Government-Related	3.11%	117 bps	4.46%	0.34 bps
Bloomberg Barclays U.S. Investment Grade Corporate	5.14%	273 bps	4.94%	0.27 bps
1-3 Year U.S. Corporate	0.78%	-49 bps	1.57%	-0.07 bps
Intermediate U.S. Corporate	3.82%	210 bps	5.16%	1.17 bps
Long U.S. Corporate	7.97%	412 bps	4.38%	-1.73 bps
Industrials	5.50%	295 bps	4.96%	0.15 bps
Utilities	4.57%	156 bps	3.62%	-1.69 bps
Financials	4.61%	257 bps	5.18%	0.91 bps
AAA Corporate	5.01%	183 bps	6.13%	0.72 bps
AA Corporate	3.69%	157 bps	5.08%	0.83 bps
A Corporate	4.70%	229 bps	4.78%	0.10 bps
BBB Corporate	5.73%	328 bps	4.97%	0.25 bps
Bloomberg Barclays U.S. Securitized	2.22%	34 bps	4.48%	0.15 bps
Bloomberg Barclays U.S. MBS	2.17%	28 bps	4.42%	0.09 bps
Bloomberg Barclays U.S. CMBS	3.24%	118 bps	5.43%	0.87 bps
Bloomberg Barclays U.S. ABS	1.48%	40 bps	3.68%	0.74 bps
Bloomberg Barclays U.S. High Yield Corporate	7.26%	573 bps	5.93%	2.17 bps
Bloomberg Barclays Global Aggregate	2.20%	72 bps	-0.38%	0.27 bps
Bloomberg Barclays EM Hard Currency Aggregate	4.93%	316 bps	2.84%	-0.15 bps
Bloomberg Barclays Municipal Bond	2.90%	n/a	5.38%	n/a

Sources: Bloomberg Barclays as of 03/31/2019
Excess returns are vs. similar-duration government bonds.

Past performance is not a guarantee of future results.

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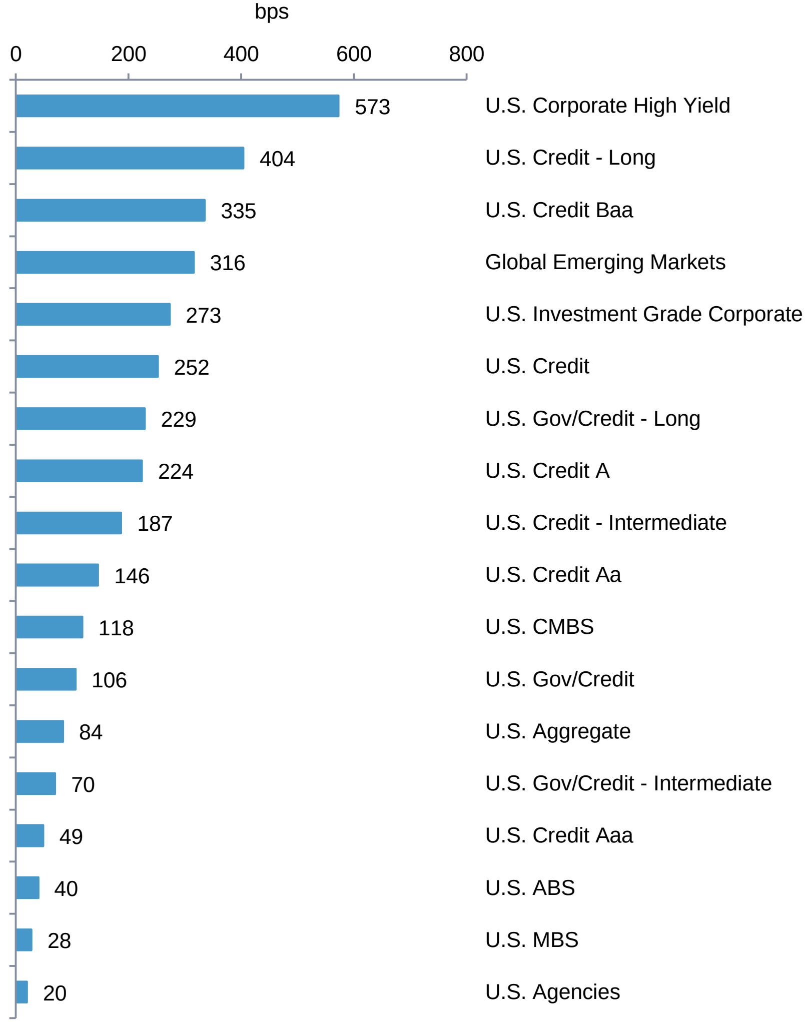
Barclays sector excess returns
as of March 31, 2019

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 March 31, 2019

Review

The U.S. credit sector (as measured by the Bloomberg Barclays U.S. Investment Grade Corporate Index) outperformed this quarter by 273 bps in excess return, reversing most of 4Q18's underperformance. From a spread perspective, the index compressed 34 bps and all sectors, quality and maturity ranges generated positive excess returns.

- Spreads were tighter across all maturities with 1-5 year, Intermediate and Long sectors narrowed by 32 bps, 39 bps, and 28 bps, respectively.
- All Index industries generated positive excess returns for the quarter. Outperformers include Energy, Finance Companies and Communications returning 425 bps, 391 bps, and 372 bps of excels return, respectively.

Valuations

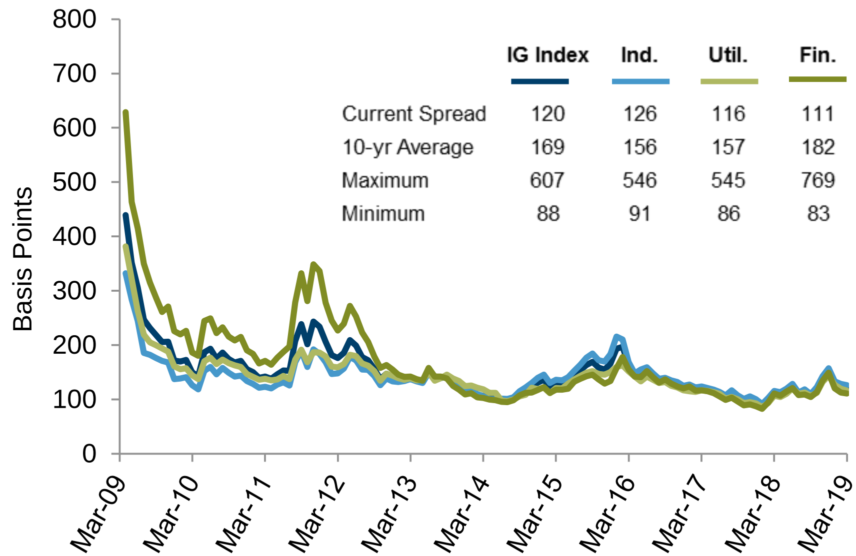
The Bloomberg Barclays U.S. Aggregate Corp Index OAS ended Q1 34 bps narrower at 112 bps.

- The Bloomberg Barclays U.S. Corporate Investment Grade Index is yielding 3.63% - down from 4.20% at December 31st as spreads tightened and rates rallied.
- New issues have come at minimal spread concessions as the calendar ($389.5 billion) is essentially flat to 1Q18 levels while NET volume of $133.0 billion is ~17% below 2018's same period levels.

Outlook

- While the OAS of the Index has tightened by 34 bps YTD and the OAS of BBBs has tightened by 39 bps YTD, we still find value in many of the BBB rated "story bonds".
- We continue to focus credits with strong management teams who are good stewards of their balance sheets and are taking proactive steps to reduce leverage.

Historical spreads



	IG Index	Ind.	Util.	Fin.
Current Spread	120	126	116	111
10-yr Average	169	156	157	182
Maximum	607	546	545	769
Minimum	88	91	86	83

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

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Structured asset sector review
as of March 31, 2019

Review

- **MBS:** Agency MBS generated 28 bps of positive excess returns (vs. similar-duration Treasuries) as Treasury-yield volatility decreased.
- **CMBS:** CMBS generated 118 bps of positive excess returns, as the market for risk assets recovered during the quarter.
- **ABS:** ABS excess returns were positive at 40 bps.
- **CLO:** Spreads stabilized at wider levels.

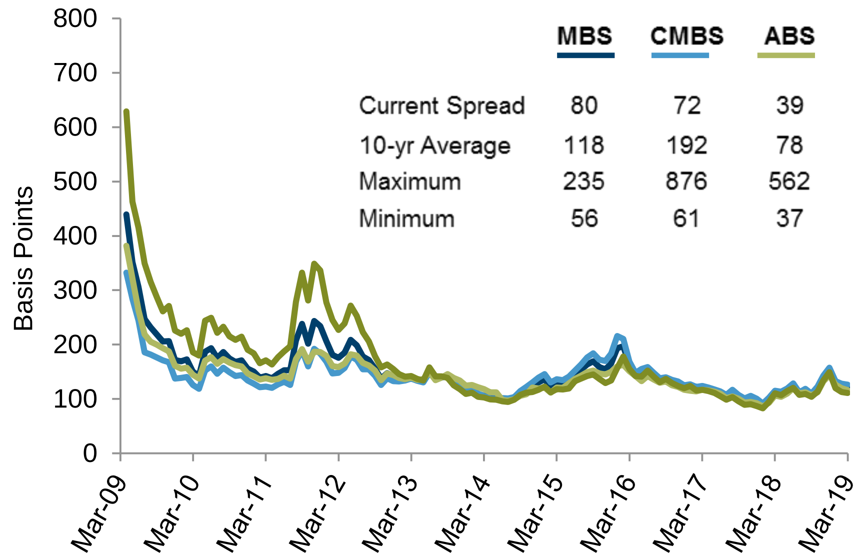
Valuations

- **MBS:** Spreads moved tighter, especially in January as the overall market recovered. As investment-grade credit spreads have retraced most of the Q4 widening, MBS spreads look more attractive now.
- **CMBS:** AAA spreads have tightened in after a number of new issues attracted buyers. They have lagged IG corporates and are slightly cheap.
- **ABS:** Spreads are back to very tight levels. Overall, better value can be found elsewhere in the structured product market.
- **CLO:** Spreads are still on the wide end and the sector remains attractive.

Outlook

- **MBS:** Valuations are slightly attractive. While the headwind of the Fed's balance sheet run off will increase in 2019 and lower rates will spur some refinancing, these factors are well known and should be priced in.
- **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.

Historical spreads



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 March 31, 2019

Review

- The ICE BofA Merrill Lynch U.S. High Yield Constrained Index returned 7.40% in the first quarter (ICE BofAML).
- Lower-quality bonds outperformed modestly with BB, B and CCC rated issues returning 7.36%, 7.35% and 7.84%, respectively, for the quarter (ICE BofAML).
- After widening dramatically in the fourth quarter of 2018, spreads tightened sharply over the quarter and the high-yield market is off to its best ever start to a calendar year as oil and equity prices recovered, the Fed made a dovish pivot and the asset class saw meaningful inflows.
- New issues totaled $65bn over the quarter, 10% below prior-year activity on a gross basis, but 30% higher once adjusted for refinancing (J.P. Morgan).
- J.P. Morgan's par-weighted bond default rate decreased over the quarter to 0.94% from 1.87% in December '18. J.P. Morgan expects the default rate to end 2019 at 1.5%.

Valuations

- High-yield spreads have widened approximately 70 bps from the tights seen in early October, which seems reasonable given slowing global economies and the decline in oil prices. But valuations remain approximately 110 bps inside of historical medians. Notably, the weight of CCCs within the market remains near 10-year lows, partially justifying the tighter spreads.
- High-yield bond yields have decreased 147 bps year-to-date to end the quarter at 6.45% (ICE BofAML).
- High-yield spreads have tightened 128 bps year-to-date to +402 bps (ICE BofAML).

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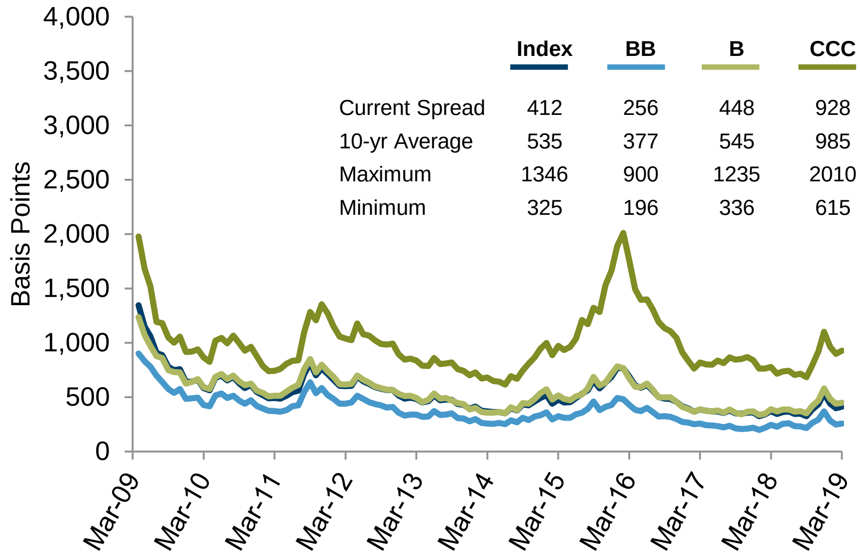
Outlook

- Excluding the energy sector, spreads have retraced nearly all of the late 2018 widening. While the China tariff situation is still unresolved, the market has become more optimistic about some type of agreement being reached and there has been modest progress. Recent strong returns are supported by the dovish Fed pivot and stabilization in oil prices, but fundamentals and forward expectations are not as robust as when valuations were at their recent tights last fall. With market yields and spreads near 6.4% and 400 bps, respectively, we see less tightening potential but it remains reasonable to expect a coupon-like return.

Historical spreads



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

Municipal market sector review
as of March 31, 2019

Performance

- The municipal market (Bloomberg Barclays Municipal Bond Index) had a strong start to the year, returning 2.90% in the first quarter, with all three months producing positive performance.
- While all maturities posted positive returns, the longer the maturity, the better the performance. The one-year maturity space returned 0.81%, 10-year muni bonds 3.15% and the long bond (22+ years) 3.85%.
- Lower-quality bonds outperformed their lower-yielding, higher-rated counterparts as investors continue to search for yield. While all quality categories posted positive returns, bonds rated AAA returned 2.67%, BAA bonds 3.59% and high-yield muni bonds returned 3.83%.

Fundamentals

- Munis continued to be supported by solid fundamentals as the U.S. economy continued to gradually grow. However, if growth slows in 2019, the tailwinds of a supportive economy could begin to slow sales revenue at the state and local levels.

Technicals

- Market technicals remain favorable.
- Municipal bond mutual funds experienced an unprecedented wave of buying to start the year. The market's $23 billion, from thirteen consecutive weeks of fund inflows, was the best start to a year since records began in 1992. Every muni category was saw positive flows.
- Supply is expected to remain relatively muted over the near term.
- Demand is likely to remain supported by seasonals and taxes. A seasonal wave of coupon payments over the next few months will result in investors looking to reinvest billions of dollars in the muni market. In addition, investors - particularly those in high tax states and who are no longer benefitting from the SALT deduction - are likely to realize the value tax-exempt investments provide.

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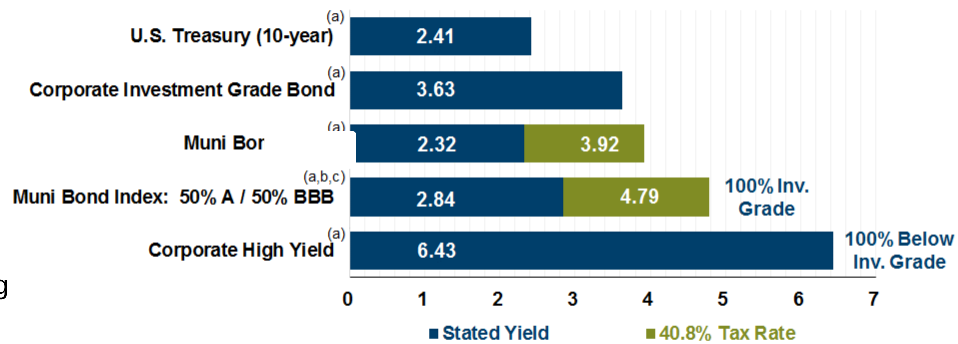
Valuations

- Munis richened over the quarter, relative to Treasuries, as muni yields declined by a greater extent than did Treasury yields. The 2-, 5-, 10- and 30-year muni/Treasury yield ratios ended the quarter at 66%, 70%, 77% and 92%, respectively.
- Tax-adjusted muni yields look attractive, particularly for those in higher tax brackets.
- We anticipate a coupon-like return environment for the remainder of 2019 with lower quality underperforming higher due to relatively tight valuations and an economy potentially nearing its tipping point.

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



(a) Bloomberg Barclays Index.
(b) Assumes a 2018 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 March 31, 2019.

Disclosures

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