U.S. Fixed-Income Quarterly Overview

Second Quarter 2019

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Macroeconomic review

as of June 30, 2019

Highlights

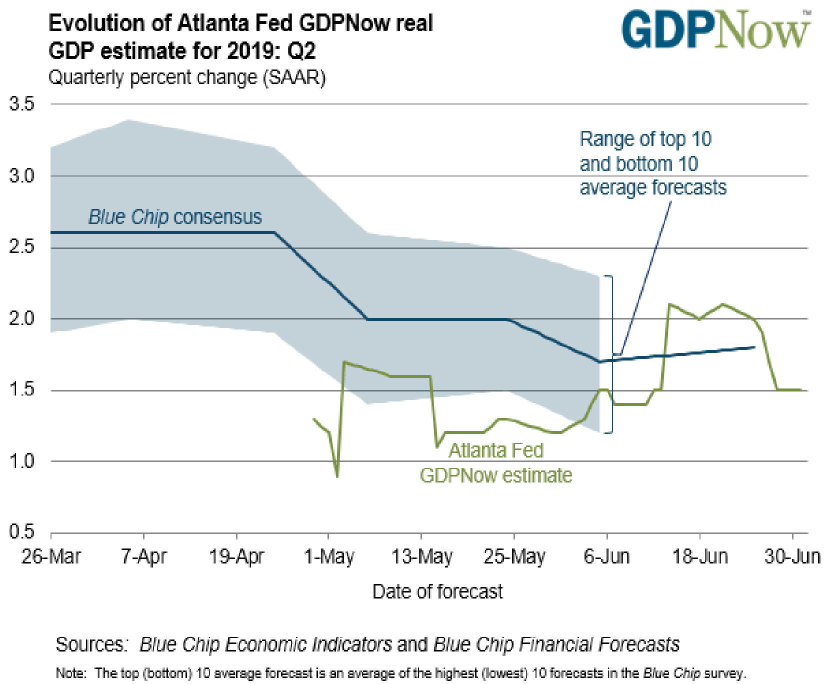
U.S. GDP growth

- U.S. fixed-income markets delivered broad-based positive returns in the second quarter as the FOMC had indicated that further increases in its benchmark overnight lending rate were on hold given continued below-target inflation and weak global growth.
- Headline PCE marked down to 1.5% by year-end, down from 1.8% in March (transitory inflation factors now permanent) coupled with positive unemployment and household spending.
- Credit sentiment wavered in May as President Trump announced plans to impose a 25% tariff on $200 billion in imports from China. In the wake of this escalation in the United States-China trade war, expectations increasingly shifted toward one or more cuts in the fed funds rate before the end of 2019.
- The change in the outlook for Fed policy fueled a strong rally in bonds over the final weeks of the quarter.

Rates and Fed policy

- As expectations were lowered for 2019, the Federal Reserve left the Fed Fund's rate unchanged in June, citing global economic uncertainty and muted inflation coupled with positive unemployment and household spending drove the decision. The lack of inflation is a major concern.
- Dovish language in statement moves market towards a rate cut. Easing now in the Dot Plot expecting two rates cuts by the end of 2020.

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 June 30, 2019

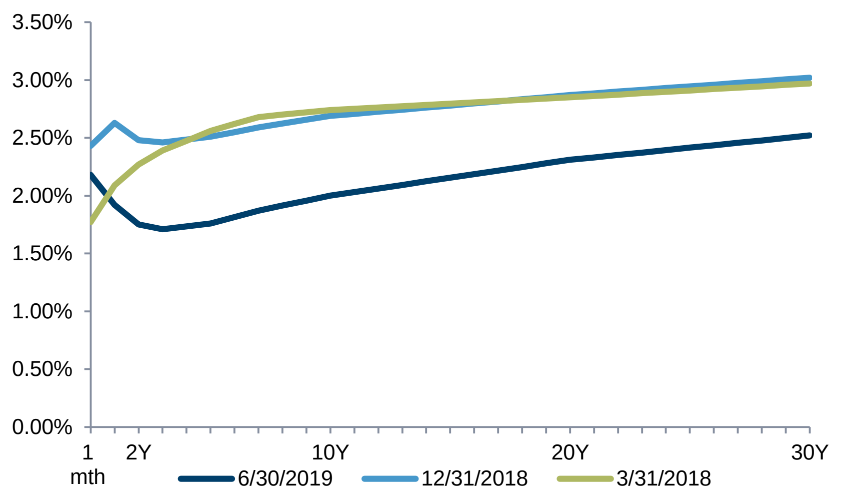
Highlights

- A dovish Federal Reserve and slowing economic growth in the United States and abroad drove Treasury yields down in the second quarter.
- For the second time this year, the yield curve inverted and remained solidly so at the end of the quarter. Even though an inverted yield curve has historically raised the possibility of a recession, most key economic indicators remain in positive territory.
- Markets expectations and slowing global economic data prompted the Federal Reserve to incorporate talks of potentially reducing Fed's fund rate as early as summer, which would have the potential to normalize rates rather quickly.
- For the three months ended June 30, 2019, yields declined along the length of the U.S. Treasury curve and the curve steepened, with the two-year yield falling by 52 basis points from 2.27% to 1.75% and the 30-year yield falling by 29 basis points from 2.81% to 2.52%.
- With two-year yields declining 52 basis points and 10-year Treasuries falling 41 basis points in the 2nd quarter. Declining rates further inverting the yield curve, a graphic depiction of rates at different maturity levels.
- Trade talks appear to be pivotal to economic prospects and to sentiment going forward.

U.S. Treasury market performance

		QTD		12 Month	
	Yield	Yield Change	Total Return	Yield Change	Total Return
U.S. Treasury Bellwethers	1.98%	-42 bps	2.65%	-46 bps	5.68%
2 Year Bellwethers	1.74%	-55 bps	1.37%	-79 bps	3.82%
5 Year Bellwethers	1.76%	-47 bps	2.80%	-97 bps	7.35%
10 Year Bellwethers	2.00%	-41 bps	4.22%	-85 bps	10.38%
30 Year Bellwethers	2.53%	-29 bps	6.76%	-45 bps	12.87%

U.S. Treasury yield curve



Source: U.S. Department of the Treasury.

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Fixed-income market review
as of June 30, 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 3.08% for the quarter and 6.11% for the year.

Sectors

- Riskier market segments were the best performers, led by long-term U.S. corporate credit and investment-grade corporate bonds, which gained 7.23% and 4.48% as measured by their respective Bloomberg Barclays indices.
- Securitized assets (which includes mortgage-backed securities, asset-backed securities and commercial mortgage-backed securities) posted positive returns while lagging corporates and Treasuries.
- The 2.50% return for high-yield corporate bonds, as represented by the Bloomberg Barclays U.S. Corporate High-Yield Index, trailed that of their investment-grade counterparts, as weakening oil prices negatively impacted prospects for energy-related issuers in the category.
- Returns for floating rate bank loans were modestly positive but dampened by the prospect of stable-to-declining short-term interest rates. The tax-free bond market returned 2.14% 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	3.08%	17 bps	6.11%	103 bps
Bloomberg Barclays U.S. Treasury	3.01%	n/a	5.18%	n/a
Bloomberg Barclays U.S. Aggregate Government-Related	2.97%	19 bps	6.18%	140 bps
Bloomberg Barclays U.S. Investment Grade Corporate	4.48%	104 bps	9.85%	391 bps
1-3 Year U.S. Corporate	1.55%	14 bps	3.40%	99 bps
Intermediate U.S. Corporate	3.13%	62 bps	7.08%	280 bps
Long U.S. Corporate	7.23%	191 bps	15.77%	640 bps
Industrials	4.75%	113 bps	10.51%	425 bps
Utilities	4.67%	46 bps	9.45%	210 bps
Financials	3.92%	99 bps	8.71%	368 bps
AAA Corporate	5.04%	62 bps	10.31%	256 bps
AA Corporate	3.43%	35 bps	7.24%	199 bps
A Corporate	4.18%	77 bps	9.08%	317 bps
BBB Corporate	4.86%	138 bps	10.87%	485 bps
Bloomberg Barclays U.S. Securitized	2.04%	-33 bps	4.31%	1 bps
Bloomberg Barclays U.S. MBS	1.96%	-39 bps	4.17%	-11 bps
Bloomberg Barclays U.S. CMBS	3.28%	31 bps	6.62%	154 bps
Bloomberg Barclays U.S. ABS	1.67%	11 bps	3.17%	53 bps
Bloomberg Barclays U.S. High Yield Corporate	2.50%	39 bps	9.94%	626 bps
Bloomberg Barclays Global Aggregate	3.29%	45 bps	5.57%	120 bps
Bloomberg Barclays EM Hard Currency Aggregate	3.74%	75 bps	8.85%	404 bps
Bloomberg Barclays Municipal Bond	2.14%	n/a	5.09%	n/a

Sources: Bloomberg Barclays as of 6/30/2019
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 June 30, 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 June 30, 2019

Review

The U.S. credit sector (as measured by the Bloomberg Barclays U.S. Investment Grade Corporate Index) outperformed again this quarter, generating 104 bps in excess return. From a spread perspective, the index compressed 5 bps and all sectors, quality and maturity ranges generated positive excess returns.

- Spreads were slightly wider for the 1-5 year index (+2 bps) and tighter in the Intermediate and Long sectors, narrowing by 2 bps and 12 bps, respectively.
- All Index industries generated positive excess returns for the quarter. Outperforming industries include Food & Beverage, Communications, and Life Insurance returning 2.37%, 1.87%, and 1.87% of excess return, respectively.

Valuations

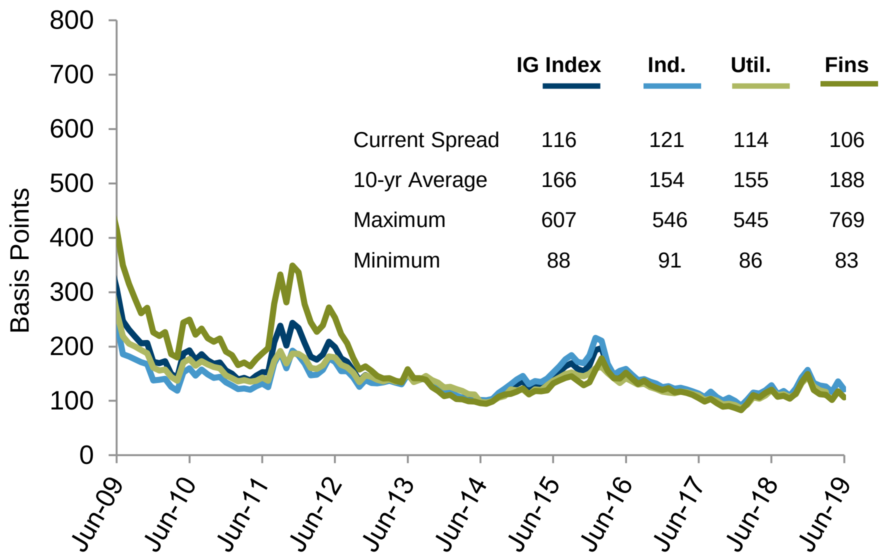
The Bloomberg Barclays U.S. Aggregate Corp Index OAS ended Q2 4 bps narrower at 109 bps.

- The Bloomberg Barclays U.S. Corporate Investment Grade Index is yielding 3.16% - down from 3.63% at December 31st as rates rallied and spreads tightened slightly .
- Year to date IG gross new issue supply of $610 billion is below last year's pace by -12.5% while net supply is -10.5% below the same period in 2018. Seasonally lower supply in July and August should be supportive of spreads.

Outlook

- While the OAS of the Index ended the quarter tighter at +115 bps, we believe there is still some room for corporate spreads to tighten further. However, we have decreased our spread duration overweight to a neutral position relative to the benchmark.
- We believe relative value opportunities remain among our favored credits. However with tighter spreads, we have trimmed our exposure at the margin. We also find dislocations in various credit curves, which are a function of absolute yield levels, shape of the treasury curve and investor segmentation.

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 June 30, 2019

Review

- **MBS:** Agency MBS generated -39 bps of negative excess returns (vs. similar-duration Treasuries) as Treasury-yield volatility increased.
- **CMBS:** CMBS generated 31 bps of positive excess returns, as the demand for risk assets continued in the second quarter.
- **ABS:** ABS excess returns were positive at 11 bps.
- **CLO:** Spreads have stabilized with better tone in the market.

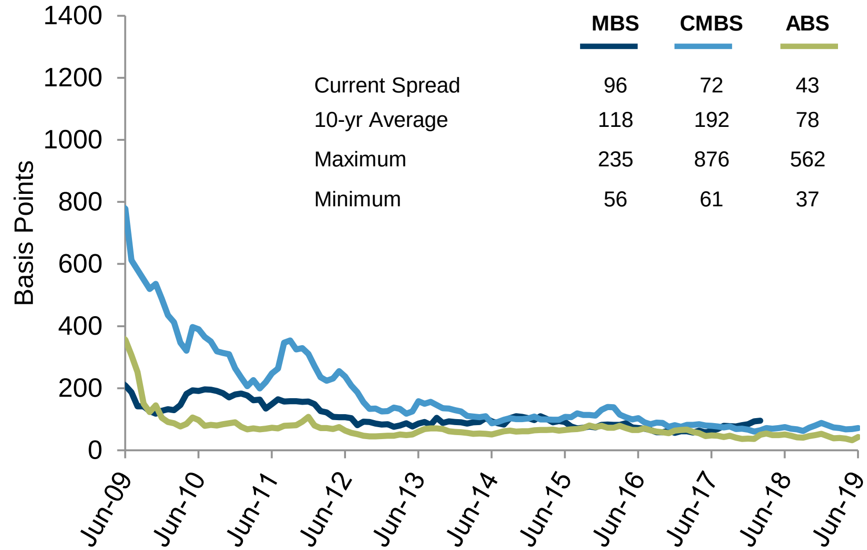
Outlook

- **MBS:** Valuations remain 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.

Valuations

- **MBS:** Spreads widened as U.S. Treasury yields moved significantly lower and interest-rate volatility spiked higher. Spreads are now at the higher range of recent history.
- **CMBS:** AAA spreads have tightened after a number of new issues attracted buyers. They have lagged IG corporates and are slightly cheaper.
- **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.

Historical spreads



	MBS	CMBS	ABS
Current Spread	96	72	43
10-yr Average	118	192	78
Maximum	235	876	562
Minimum	56	61	37

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 June 30, 2019

Review

- The ICE BofA Merrill Lynch U.S. High Yield Constrained Index returned 2.57% in the second quarter (ICE BofAML).
- Higher-quality bonds outperformed. BB, B and CCC rated issues returned 3.16%, 2.31% and 0.55%, respectively for the quarter (ICE BofAML).
- The high-yield market delivered a solid return over the quarter despite the heightened trade tensions and volatile equity prices, oil prices and asset-class flows.
- YTD new issuance totals just over $140 billion, which is +11% compared to prior year on a gross basis but +3% net of refinancing (J.P. Morgan).
- J.P. Morgan's par-weighted bond default rate increased over the quarter to 1.55% from 0.94% in March '19. J.P. Morgan expects the default rate to end 2019 at 1.5%.

Valuations

- High-yield valuations have tightened with moderating trade tensions and expectations for Fed easing leading to higher equity and oil prices and inflows to the asset class. Valuations are approximately 90 bps inside of historical medians on a spread basis, but the market is higher quality and shorter duration than at other points in time with the weight of CCCs and effective duration of the market near 10-year lows, partially justifying tighter spread levels.
- High-yield bond yields have decreased 189 bps year-to-date to end the quarter at 6.02% (ICE BofAML).
- High-yield spreads have tightened 117 bps year-to-date to +417 bps (ICE BofAML).

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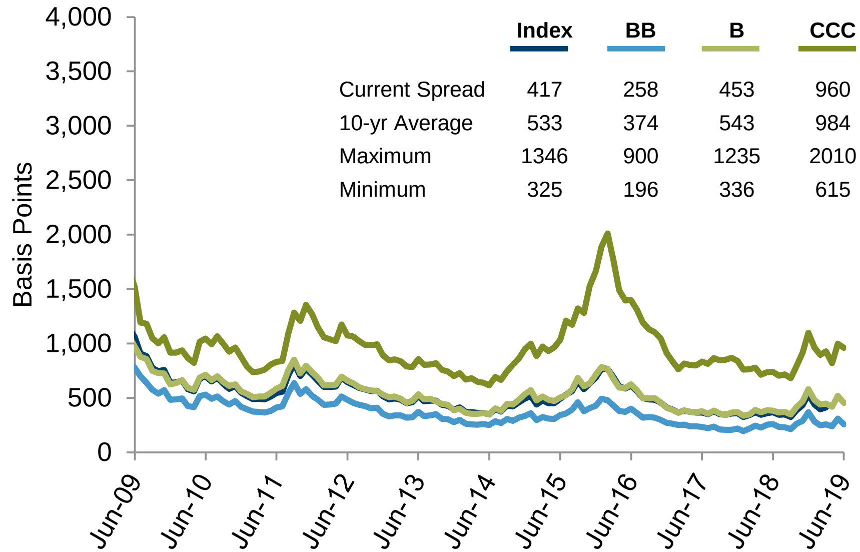
Outlook

- Valuations have tightened with moderating trade tensions and expectations for Fed easing, leading to higher equity and oil prices and inflows to the asset class. Given the strong returns over the first half of the year combined with tangible and anecdotal evidence of a slowing economy, a coupon-like return could be challenging without a more permanent resolution to trade related uncertainty.   While tensions have moderated, the ultimate outcome of trade negotiations will be a meaningful factor in the market. We continue to believe that no deal is negative for all sides and that should provide an incentive to come to a resolution, although the timing and path is difficult to predict.

Historical spreads



	Index	BB	B	CCC
Current Spread	417	258	453	960
10-yr Average	533	374	543	984
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.

Municipal market sector review

as of June 30, 2019

Performance

- The municipal market (Bloomberg Barclays Municipal Bond Index) returned 2.1% in the second quarter. This continued a strong run of eight consecutive months of positive performance, with munis returning 7.5% over that period.
- While all maturities posted positive returns in the quarter, longer maturities generally outpaced the shorter end of the curve.
- Lower-quality bonds outperformed their lower-yielding, higher-rated counterparts as investors continue to search for yield. While all quality categories posted positive returns, BAA bonds generated 2.9%, besting high-yield muni bonds at 2.7%.

Fundamentals

- Municipal credit fundamentals remain solid, as the U.S. economy continued to gradually grow. Trade war and geopolitical uncertainties have slowed global growth, to the extent domestic growth is affected, this could negatively impact the strength of tax collections at the state and local levels.

Technicals

- Demand for municipals remained strong, with the end of June marking 25 consecutive weeks of inflows into the municipal market. On the supply side, issuance declined for the third consecutive month. Tax-exempt issuance for June totaled $30.3 billion[1], 3.8% higher than June 2018. Year-to-date issuance is slightly ahead of last year's pace.
- A seasonal wave of coupon payments over the summer months will most likely result in investors looking to reinvest billions of dollars back into 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 continue searching for muni's attractive tax-exempt income.

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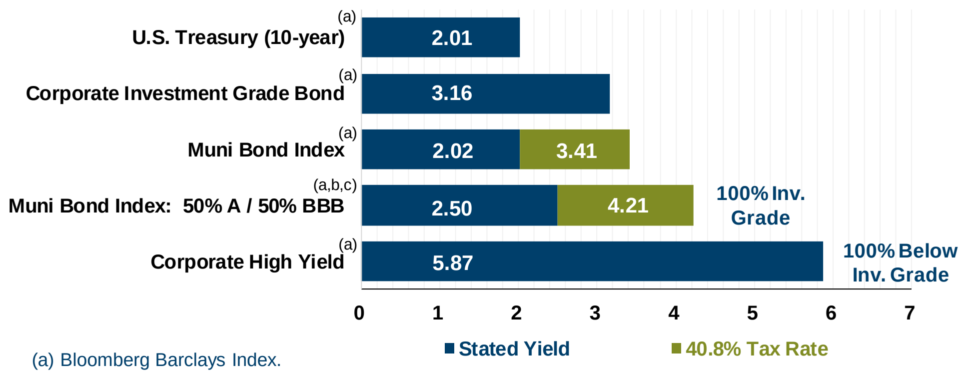
Valuations

- As muni yields lagged the move lower in Treasuries, muni/Treasury ratios cheapened across the curve. While the short and intermediate parts of the curve moved higher by multiple percentage points the 30-year ratio was relatively unchanged at 91%.
- Tax-adjusted muni yields remain attractive, particularly for those in higher-tax brackets.
- Given relatively tight credit spreads, we anticipate that income/carry will drive performance for the remainder of the year.

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.
(1) Source: MMD
Sources: Bloomberg (U.S. Treasury 10-year), Bloomberg Barclays and Columbia Management Investment Advisers, LLC, as of June 30, 2019.

Disclosures

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