FIXED INCOME STRATEGY HIGHLIGHTS

JANUARY, 2020

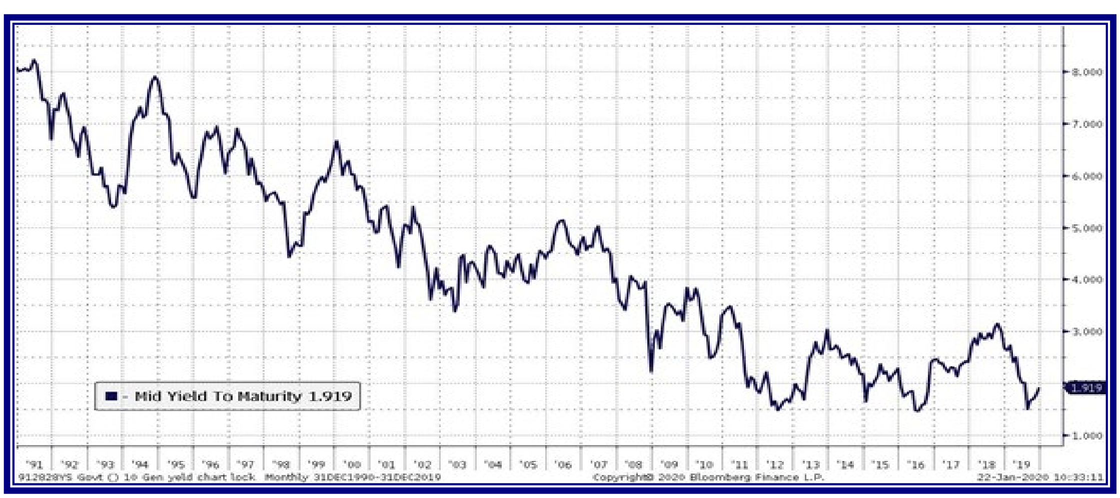
IN BRIEF: The U.S. Fixed Income Markets

The U.S. economy expanded 2.1% in the fourth quarter of 2019, at a seasonally adjusted annual rate, according to U.S. Commerce Department data on real gross domestic product (GDP). This followed increases of 2.1% in the third, 2.0% in the second quarter and 3.1% in the first quarter. Consumer spending was a bright spot, up 1.8% at an annual rate, while capital expenditures fell -1.5%, down for the third quarter in a row. Meanwhile, the Conference Board Leading Economic Index® (LEI) declined .03% in December, following three out of four consecutive monthly declines, suggesting modest growth for the U.S. economy going into 2020. Inflation pressures remained muted, as measured by the Personal Consumption Expenditures Price Index (PCE), the Fed's preferred gauge. On a year-over-year basis, the Core PCE Price Index, which excludes food and energy prices, was up 1.6% in December (source: Bureau of Economic Analysis).

Yields on longer-dated U.S. Treasury securities moved higher during the quarter, as investors became more constructive on trade and the economy. The yield on the benchmark 10-year note rose 24 basis points to 1.92% (one basis point is a hundredth of a percentage point). The price of crude oil increased in the fourth quarter. West Texas Intermediate (WTI) crude, the domestic benchmark, was up 13% to $61.06 a barrel. For the year, WTI climbed 34%. Nonfarm payrolls posted a gain of 145,000 in December. The average monthly gain for 2019 was 176,000, somewhat less than the 2018 figure of 223,000. Meanwhile, the unemployment rate ended the year at 3.5% (sources: Bureau of Labor Statistics).

In December, the Federal Open Market Committee (FOMC) cut the federal funds rate by 0.25%, leaving the rate within a target range of 1.50% to 1.75%. This was the third 0.25% rate reduction in 2019. In his press conference, Federal Reserve Chair Jerome Powell indicated that monetary policy was "in a good place," meaning the FOMC may keep rates at current levels for some time. You may recall that the FOMC had last raised rates in December 2018 and then "pivoted" toward a more accommodative stance at the beginning of 2019, which helped spark this year's stock market rally.

Ten Year Generic Treasury Yield



Source: Altman Investment Management Research and Bloomberg

Bond Market Performance:

Fixed Income Sector Performance – Q4 2019

Fixed Income Sector Performance – 2019 Q4 - Sector	Rating	Maturity	Duration Mod Adj	Yield	Spread	Price	Trailing12 Month Total Return
Treasury (Intermediate)	Aaa/AAA	4.0	3.7	1.7%	N/A	$102.3	5.1%
Agency	Aaa/AA+	3.3	2.7	1.8%	10	$102.3	5.6%
MBS	Aaa/AAA	3.7	3.4	2.1%	40	$ 102.4	7.4%
Municipal	Aa3/A+	4.9	3.6	1.2%	0	$112.6	5.1%
Corporate (Intermediate)	A2/A-	4.9	4.2	2.5%	90	$ 104.8	10.2%
High Yield	B1/B	6.0	3.1	4.5%	280	$ 103.6	15.1%

Source: Altman Investment Management Research and Bloomberg

CLOSE-UP:

➢ Government Bonds

After a steep decline in the 10-year U.S. Treasury yield during August, rates bounced off a low of 1.47% in early September to over 1.8% in the course of a week. This reversal was sparked by economic data that suggested inflation and gross domestic product (GDP) growth in the U.S. may be stronger (or just not as weak) than expected, along with the view that "trade peace" could break out soon between the U.S. and China. While this intense rotation has extended into quarter-end, we do not believe it is a lasting one for this reason: upcoming third-quarter earnings reports are coming and, in our view, they likely will remind investors where there is, in fact, earnings growth and stability.

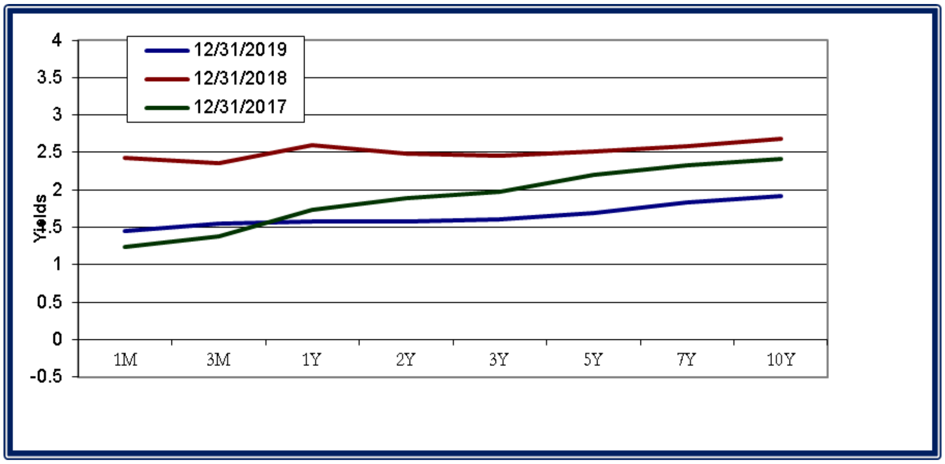
Some combination of higher rates, trade war uncertainty, and disappointing growth elsewhere in the world (Europe, in particular) has led investors to worry that the U.S. might not be too far from a recession. Even if a recession doesn't materialize, investors who are worried about it tend to invest conservatively, which definitely has an impact on the valuation of risky assets overall and on the relative pricing of risk across sectors with different sensitivity to economic growth. In our opinion, the U.S. economy is not in imminent danger of recession, but the fact that so many people are worried is definitely affecting valuations.

Against a backdrop of modest economic growth and contained inflation, we believe the short end of the yield curve will remain anchored around current levels, while long-end rates are likely to fluctuate within the range of 1.50-2.25%.

U.S. Government Index 7-10 year

Source: Altman Investment Management Research and Bloomberg

Active Government Yield Curves



Source: Altman Investment Management Research and Bloomberg

➢ Investment-Grade Corporate Bonds

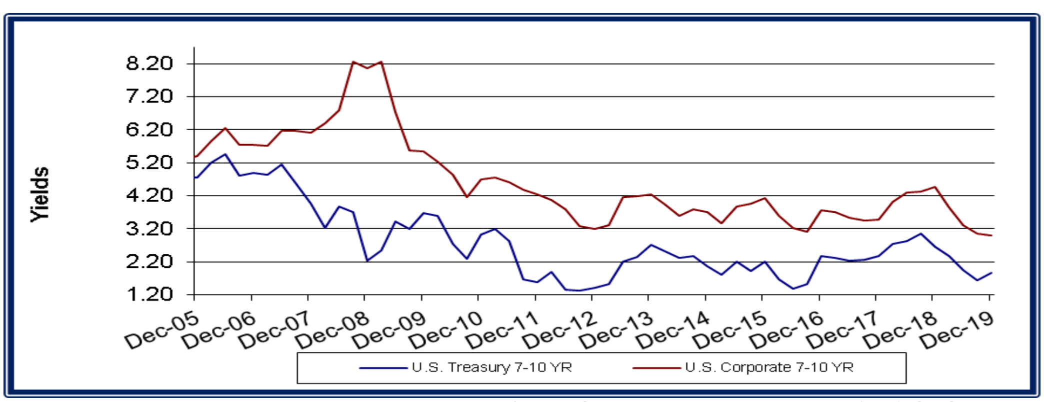
Favorable trends that characterized most of 2019 continued to benefit investment grade (IG) corporate bonds during December and the fourth quarter. Corporate spreads tightened 22bps in Q4, ending the quarter at 93bps which is the lowest level since February 2018, according to Bloomberg Barclays data. The BBG U.S. IG Corporate Index generated 119bps of excess return for December and 242bps of excess returns in the quarter, leaving year-to-date excess returns at 676bps.

Bonds of lower quality and longer maturities outperformed other quality and maturity sectors. For the month, the best performing sectors included Energy and Basic Industry while Capital Goods and Banking lagged. The best performing sectors for the quarter were Basic Industry and Communications while Capital Goods, Consumer Cyclical, and Banking lagged.

Index-eligible IG corporate fixed-rate supply was $993 billion in 2019, up by 8 percent year-over-year, while IG fixed-rate net supply of $350 billion was up 26 percent in 2019, per Barclays data.

Corporate credit fundamentals remained mixed with high leverage partially offset by strong margins. Debt used in mergers has declined in recent years and deleveraging should continue among larger borrowers. As it relates to environmental, social and governance (ESG) factors, IG issuers are devoting an increasing amount of attention to sustainability.

U.S Corporate 7-10 year versus U.S. Treasury 7-10 year



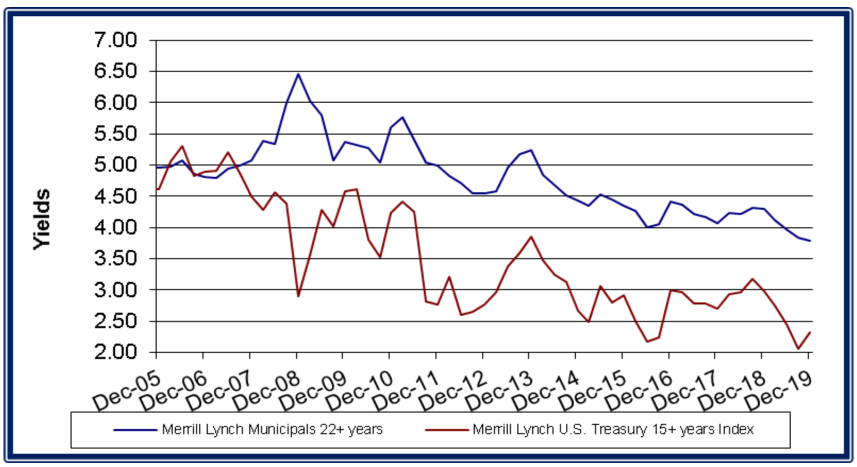
Source: Altman Investment Management Research and Bloomberg

➢ Municipal Bonds

The positive technical environment (high mutual fund flows absorbing consistent new municipal bond issue supply) was a persistent influence throughout 2019. Municipal bond mutual fund inflows for 2019 topped the prior record set back in 2009, with a full year of positive flows totaling a staggering $93.6 billion, as reported by Lipper on January 1, 2020. Data from *The Bond Buyer* showed new issue supply closed the quarter at $143 billion, a 54% jump from the same quarter last year, pushing supply to $422 billion for the full year, 22% higher than 2018. Perhaps the most compelling aspect of new muni bond supply in 2019 was high taxable municipal bond issuance, which closed the year at $70 billion, a 115% increase year-over-year, marking the highest yearly total since 2010 when the Build America Bond program expired.

While returns slowed from the strong pace earlier in the year, municipals posted positive returns for the month, quarter and the year. The Bloomberg Barclays (BBG) Municipal Bond Index returned 0.31% for the month of December, 0.74% for Q4 and 7.54% for the year. The BBG Municipal 1-10 Year Blend Index gained 0.30% for the month of December, 0.86% for Q4 and 5.63% for the year. Municipal credit fundamentals remained broadly stable amid slowing economic growth and lingering structural issues. Top-line indicators of credit stability - the economy, tax receipts and debt service coverage in the revenue sector - suggest a continuation of the benign credit environment.

Long Term Municipal to Treasury Yield Spreads



Source: Altman Investment Management Research and Bloomberg

A Note on The Effects of the Coronavirus:

The 10-year U.S. Treasury bond yield fell as low as 1.51%, as January drew to a close, down 42bps from a recent high of 1.93% on 12/23/19. Chairman Jerome Powel implied in his remarks at his testimony on monetary policy to Congress that the Fed remains on standby. He said, "some of the uncertainties around trade have diminished recently, but the risks to the outlook remain. In particular, we are closely monitoring the emergence of the coronavirus, which could lead to disruption in China that spill over to the rest of the global economy." Is the bond market signaling a recession to come? We don't believe so. The yield-curve spread between the 10-yr bond yield and the federal funds rate has remained positive. The credit-quality spread between the corporate 7-10 and the 10-yr Treasury has remained relatively narrow since the coronavirus outbreak. In our opinion, the bond market is signaling that the Fed won't be raising interest rates this year, especially if the recent virus outbreak proves hard to contain and depresses global economic growth, which has been showing some signs of improving lately.