INCOME RESEARCH + MANAGEMENT

MARKET UPDATE 2014 REVIEW

January 21, 2015

US Economy + Treasury Rates

- The US economy strengthened throughout 2014 as labor-market data improved and consumer spending increased[1]
    - Unemployment dropped 1.1% to 5.6%, increasing consumer confidence
- The Treasury curve flattened as investors gauged the impact of future changes to monetary policy – the gap between 2- and 10-year rates fell 113bp to 1.50%[1]
- The Fed ended asset purchases, noting "substantial improvement in the labor market " and "sufficient underlying strength in the broader economy"

Investment-Grade Corporate Sector

- The corporate sector performed well for the first half of the year, but spreads widened after June amid falling oil prices and heavy new issuance[2]
    - Spreads started the year at 114bp, reached a low of 97bp in late June, and closed the year at 131bp
- 2014 gross issuance surpassed $1 trillion, compared to $900 billion in 2013[3]
- Credit quality improved modestly, but shareholder-friendly activity increased

Securitized Sectors

- Securitized sectors generally posted positive excess returns, benefiting from low correlation to declining commodity prices
- Securitized demand kept pace with supply, with money managers picking up slack from the decreasing role of the Fed
- The Fed's well-telegraphed ending of asset purchases supported low volatility
- CMBS outperformed Treasuries, but new issues revealed underwriting deterioration

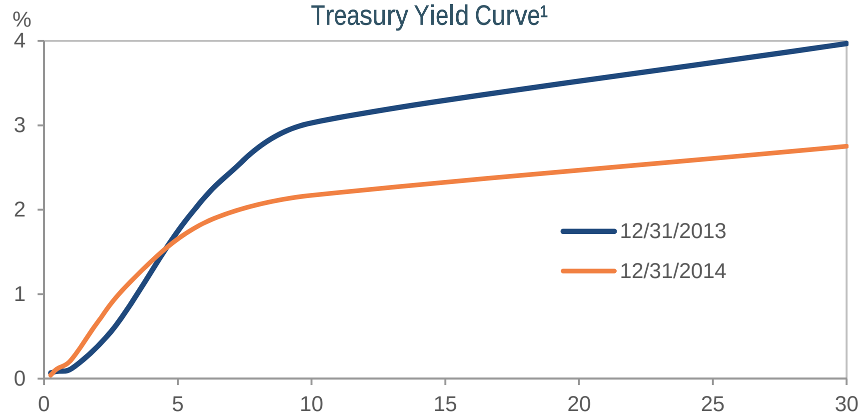
Municipal Sector

- The Barclays Municipal Index posted 12 consecutive months of positive returns in 2014, the longest streak in over two decades[2]
- With expectations that rates will rise in 2015, municipal supply increased throughout 2014 as issuers looked to lock-in low rates
    - Despite a pick-up in issuance, 2014 net supply of municipals was negative
- Municipal credit quality largely remained healthy; however, falling oil prices started to impact energy-dependent areas such as Alaska

IR+M Performance Themes

+	Broad strategies generated positive excess returns in 2014*
=	Overweight to corporate bonds hurt performance on the long-end of the curve, but was additive in short and intermediate portfolios
+	Risk reduction efforts in 2014 positively influenced performance as lower-quality generally underperformed higher-quality
+	Allocation to high-quality Agency-backed securities, CMBS, and ABS positively impacted performance
–	Underweight to non-corporate sectors negatively impacted performance as foreign sovereigns outperformed Treasuries and corporate bonds
–	Underweight to Agency MBS detracted from relative performance

Treasury Yield Curve[1]



Spreads + Excess Returns[2],**

Market Sector	Spread Level (bp) 12/31/2013	Spread Level (bp) 12/31/2014	Excess Returns 2014
Corporates	114	131	-0.48
MBS Pass-Throughs	48	59	0.39
CMBS	126	98	1.08
Taxable Municipals	177	150	2.89

As of: 12/31/14 Sources: 1. Bloomberg 2. Barclays 3. JPMorgan *Broad strategies include 1-3 Year, Intermediate Government/Credit, Aggregate, and Long Government/Credit. These strategies have also outperformed over the 3-, 5-, 7-, and 10-year periods. **Excess returns are the curve-adjusted excess return of a given index relative to a term structure-matched position in Treasuries.

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MARKET UPDATE 2015 OUTLOOK

INCOME RESEARCH + MANAGEMENT

US Economy + Treasury Rates

- The improving labor market, coupled with lower energy prices, should benefit consumer spending and economic growth
- Investors believe the fast-improving US economy will lead the Fed to raise rates twice in 2015, starting in July[1]
- Inflation is anticipated to continue dropping in 2015 – lower prices should be a positive for the US economy, encouraging more discretionary spending

Investment-Grade Corporate Sector

- Corporate gross issuance is expected to have another record year in 2015, with estimates surpassing $1 trillion[3]
- Corporate fundamentals are expected to move sideways – moderate top-line growth with flat to slightly higher leverage
- Historically, corporate spreads have tightened in periods where US Treasury yields moved higher, a trend investors anticipate this year

Securitized Sectors

- Estimates call for approximately $130 billion in securitized gross supply this year, versus $104 billion in 2014[3]
- Within Agency MBS, spreads have potential to widen as the market anticipates the Fed will dial back reinvestment
- New issue CMBS underwriting will likely continue to be more aggressive

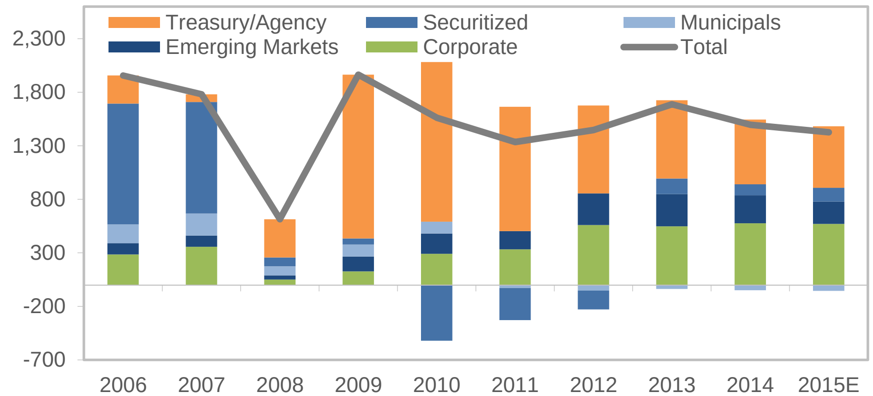
Municipal Sector

- Gross new issue supply is anticipated to increase year-over-year to $360 billion, mainly due to the healthy economy and growing infrastructure funding pipeline[3]
- Municipal credit quality is stable to improving as the US economy and job growth continue to recover

IR+M Positioning Themes

–	Underweight Treasuries in broad strategies given better relative value elsewhere
+	Overweight spread product with better carry and spread tightening potential as economy improves
–	Remain cautious heading into 2015, with the expectation that shareholder-friendly, idiosyncratic events will persist
+	Overweight more defensive sectors in credit
–	Underweight Agency MBS due to uncertain outlook
+	Overweight best ideas in seasoned CMBS with attractive yield
+	Overweight senior tranche ABS with strong fundamentals

Fixed Income Net Issuance[3]



In the fourth quarter, longer-dated Treasury bonds rallied while the investment-grade bond market faltered amid weakness in the energy sector and heavy new issuance. In a press conference following the Fed's December policy meeting, Chairperson Janet Yellen indicated the Committee will likely hike rates in the second half of 2015, but will be "patient" in their approach. Inflation continues to trend below the Fed's 2% target, which gives the Committee more flexibility as to the timing of policy changes. We remain cautious entering the new year and believe market volatility could persist. We strive to add value through careful, bottom-up security selection and look to take advantage of market dislocations that arise during periods of market stress.

As of: 12/31/14 Sources: 1. Bloomberg 2. Barclays 3. JPMorgan