IR+M INCOME RESEARCH + MANAGEMENT

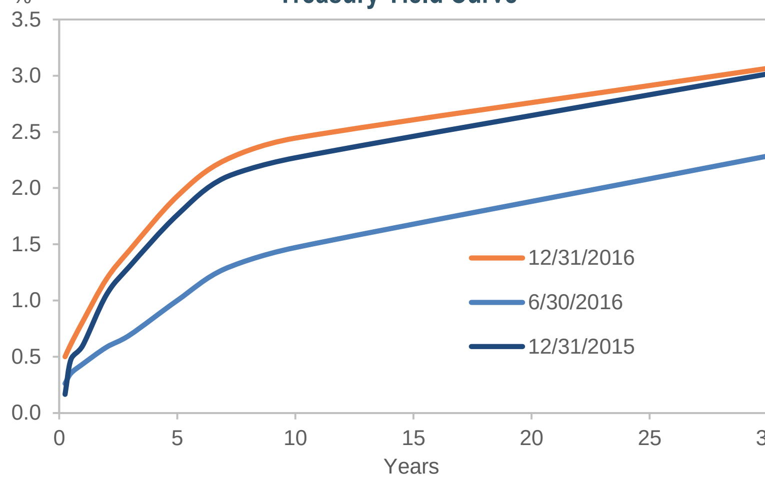
IR+M MARKET UPDATE
2016 REVIEW + 2017 OUTLOOK

January 25, 2016

2016 RECAP

- Over the course of the year, uncertain economic conditions drove volatility in the US bond market
- Treasury rates rallied through July, fueled by post-Brexit fears, only to reverse course as Donald Trump's presidential win triggered a risk-on trade[1]
  - The 10-year Treasury traded in a 124bps range during 2016, but finished just 17bps higher at 2.45%
- Despite the rate selloff, the investment-grade corporate bond market finished the year in positive territory and outperformed Treasuries
- The pace of corporate issuance slowed in the fourth quarter, totaling $195 billion, and supply continued to attract strong demand from yield-hungry foreign buyers[2]
  - Positive technical conditions drove investment-grade spreads 15bps lower to 123bps[1]
- In the securitized market, the Treasury selloff in the second half of the year negatively impacted mortgage-backed sectors, as higher mortgage rates triggered a reduction in refinancing and prepayment activity

Treasury Yield Curve[1]

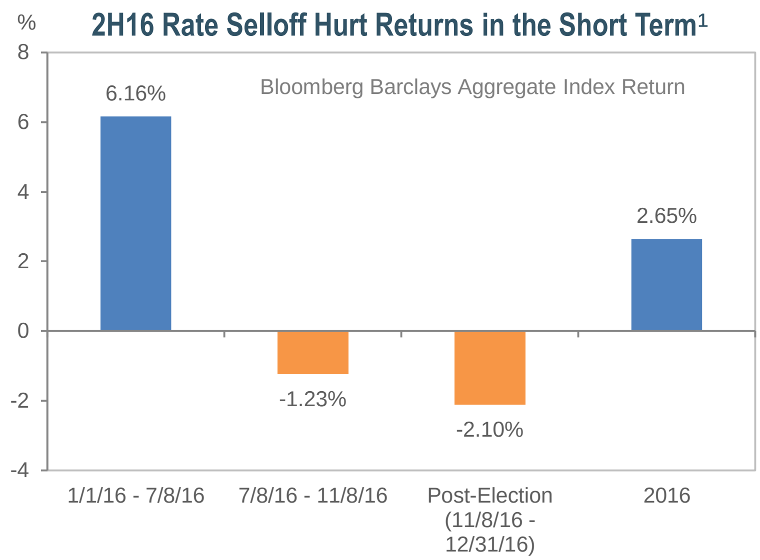


Market Sector	Excess Returns[1,3] (%)		Yield Differential over Treasuries[1,4] (bp)	
	4Q16	2016	12/31/2015	12/31/2016
Corporates	1.85	4.93	165	123
MBS Pass-Throughs	-0.39	-0.11	58	51
MBS Hybrid ARMs	-0.29	0.27	41	30
ABS	0.03	0.95	72	59
CMBS	0.46	2.36	121	75

2017 GOING FORWARD

- Fixed income returns suffered in the second half of 2016, but investors with long-term time horizons may start to benefit this year through higher return from income
- Rate volatility is expected to continue, as the Fed monitors economic conditions in anticipation of additional rate hikes in 2017[1]
  - The market-implied probability of at least three hikes in 2017 has risen close to 50%
- In corporate sectors, promises of deregulation and increased stimulus under Donald Trump's administration should support investment-grade spreads
- The commercial mortgage-backed (CMBS) sector may continue to make headlines, as new deals will contain regulations that require sponsors to retain at least 5% of the credit risk of the underlying assets[1]

2H16 Rate Selloff Hurt Returns in the Short Term[1]



In the current environment, we remain overweight corporate bonds across our portfolios, with well-diversified exposure across sub-sectors. In the securitized market, we remain underweight agency mortgage-backed securities as a further reduction in Fed stimulus may strengthen extension fears. We believe bottom-up fundamental analysis and active security selection will provide superior results over the long term.

As of: 12/31/16 Sources: 1. Bloomberg Barclays 2. JPMorgan 3. Excess returns are the curve-adjusted excess return of a given index relative to a term structure-matched position in Treasuries. 4. Option-Adjusted Spread. The views contained in this report are those of IR+M and are based on information obtained by IR+M from sources that are believed to be reliable. This report is for informational purposes only and is not intended to provide specific advice, recommendations for, or projected returns of any particular IR+M product. No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission from Income Research & Management.

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