IR+M INCOME RESEARCH + MANAGEMENT

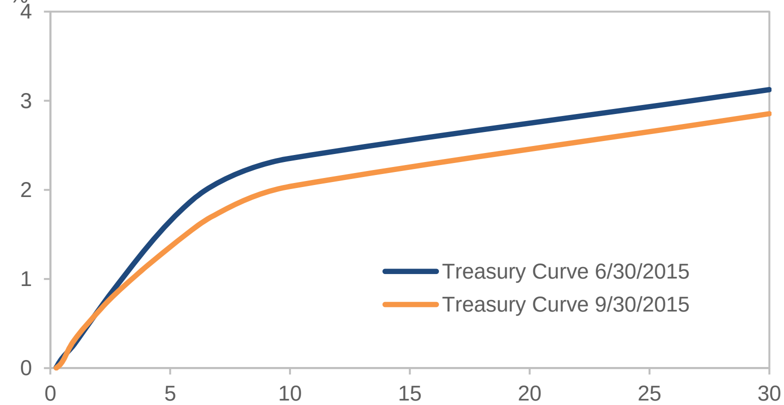
QUARTERLY MARKET UPDATE

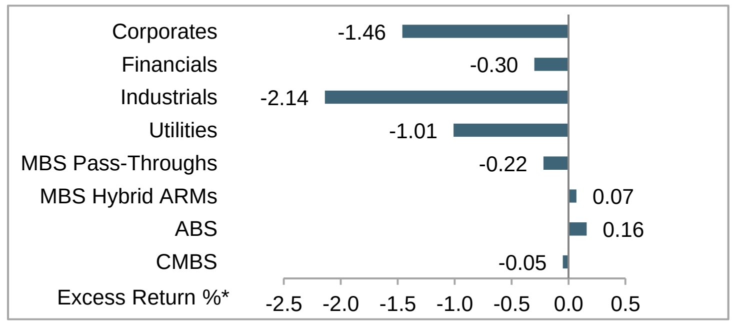
October 16, 2015

THIRD QUARTER RECAP

- The weak economic climate in China and the Federal Reserve's (Fed) decision to not raise rates in September drove strong demand for US Treasuries during the quarter
  - The 10-year Treasury rate fell 31bp to 2.04%[1]
- US economic data showed steady progress, as unemployment fell to 5.1%, the lowest level since before the financial crisis[1]
  - Despite improvement in the economy, the Fed believed volatile financial conditions outside the US justified postponing the first rate hike
- In the corporate market, heavy new issuance continued as companies rushed to bring deals to market in expectations that the Fed will start tightening and borrowing costs increase
  - New issuance totaled nearly $250bn, a 20% increase compared to the same period last year[2]
  - Investment-grade spreads widened 24bps to 169bps as investor demand softened amid the risk-off environment[3]
- High-quality securitized sectors generally outpaced corporate bonds during the quarter, benefitting from a low correlation to international headline risks
- Favorable technicals supported the municipal market during the quarter, as attractive tax-exempt yields generated demand and reduced refunding activity slowed supply

MARKET STATISTICS[1,3]





2015 GOING FORWARD

- In the fourth quarter, uneven global growth and diverging central bank policy will likely drive continued volatility in the US fixed-income markets
- Recent Fed messaging suggests that the committee will start normalizing policy by early 2016
  - Tighter monetary conditions could pressure Treasury rates; however, investors expect changes in Fed policy to come at a slow pace to avoid spooking the market
- Weak commodity prices will continue to weigh on investment-grade corporate bonds, but above-average spread levels may drive yield-buyer demand
- Corporate issuance is expected to pick up in the fourth quarter and top $1 trillion for the year[2]
- The securitized markets have lower issuance expectations through year-end and may benefit from a more favorable supply and demand relationship
- In the municipal market, short-term rate hike fears have subsided, which may drive strong demand from investors seeking stable, tax-free income

IR+M POSITIONING THEMES

–	Underweight Treasuries as compensation remains unattractive relative to high-quality spread sectors
+	Overweight spread product driven by bottom-up security selection across investment-grade sectors
+	Overweight corporate bonds as credit fundamentals remain healthy, and higher Treasury rates could drive increased demand
+	Securitized products have added strong diversification and spread stability despite volatility in other sectors
+	Highly-enhanced, AAA-rated CMBS and ABS continue to be a safe haven in the front end of the curve
–	Underweight Agency MBS given extension risk and the potential end of the Fed's reinvestment program
+	Longer maturity Municipal/Treasury relative value ratios remain attractive at over 100% [3]

At IR+M, our portfolio positioning remains stable throughout 2015 as we focus on investments with long-term fundamental value. We believe our spread product overweight and high-quality bias will benefit our portfolios, earning attractive carry while avoiding exogenous risks.

As of 9/30/15. Sources: 1. Bloomberg 2. JPMorgan 3. Barclays *Excess returns are the curve-adjusted excess return of a given index relative to a term structure-matched position in Treasuries