JANUARY 2019

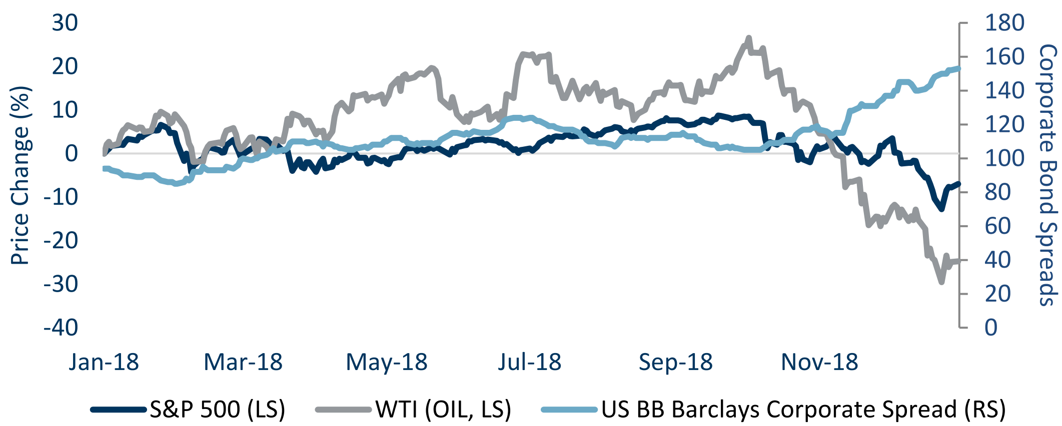
Fourth Quarter Commentary

The fourth quarter of 2018 was characterized by market turmoil, with the S&P 500 Index declining 14% in value. This was largely spurred by concerns surrounding long-term global economic growth and monetary policy. Adding fuel to the fire, the FOMC raised rates to the 2.25-2.50% range. The move was largely anticipated, given the Fed's guidance during the latter half of the year, the low unemployment rate, and all major inflation metrics being around the Fed's 2% target. However, coupled with the aforementioned growth concerns and declining consumer sentiment, the move caused a further decline in the value of risk assets. This flight-to-quality resulted in lower U.S. Treasury rates on the long-end of the yield curve, with 10-year yields falling below 3% to end the year at 2.69%. This was a major reason the Bloomberg Barclays U.S. Aggregate Bond Index returned 1.64%, the largest gain in any quarter of 2018.

The market sell-off was capped by the S&P 500 Index declining 9% during the month of December. While this was prompted by the Fed's rate hike, it coincided with the federal government shutdown which continued through the end of the year. Prior to this, market softness was largely attributable to falling energy prices (oil declined 40% during the quarter) and weak third-quarter GDP prints out of Europe, Japan and China.

All of these events followed a sustained period of investor confidence, fueled by positive economic growth and fiscal stimulus through tax reform. The confluence of negative sentiment caused the market to react very strongly. Compounding this was the fact that it occurred at the end of the year, a time when liquidity in the market typically is relatively low. The decline in equities also fed into spread widening on corporate bonds: Spreads on corporate bonds in the Barclays Aggregate Index widened from 106 basis points to 153 basis points during the quarter.

EXHIBIT 1: The market's risk-off attitude during 4Q18 was reflected in the stock market correction, the drop in oil prices, and widening of corporate bond spreads.



Source: Bloomberg, Barclays

The yield curve flattened during this time period, with the difference between three-month Treasury bill and 30-year Treasury bond yields declining from 1.00% to 0.65%. As we have mentioned in prior commentaries, historically, flat or inverted yield curves develop in the late stages of an economic cycle, a consequence of investors viewing economic growth as more robust in the near-term than the long-term.

The U.S. economy is still on solid footing

Notwithstanding the foregoing, the U.S. experienced solid economic growth in 2018. The full-year 2018 GDP forecast is around 3%, as anticipated for most of the year. ISM Manufacturing surveys continue to be in expansionary territory, and unemployment remains below 4%. Some concerns persist surrounding the housing market, given slower housing starts and a decline in homebuilder sentiment, though we continue to see positive momentum in home prices. The decline in

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consumer sentiment has also been compounded by the sell-off in equities, and is still very high compared to historical levels. Inflation is also expected to continue to creep higher, spurred by wage inflation.

Outlook turning more negative, albeit measured

As we head into 2019, the belief that we are in the late stages of the current economic cycle has influenced the market's consensus forecast. Global economic growth is expected to slow further in 2019, particularly in Europe, Japan and emerging market countries. The latter view is influenced by ongoing concerns surrounding China, with weakening economic data compounded by uncertainty surrounding the effects of U.S.-imposed tariffs. China has the ability to enact stimulus measures to boost economic growth and we are seeing some evidence of that occurring early in 2019. In Europe, concerns surrounding Brexit and the potential for a recession in Italy will likely continue.

The outlook for the U.S. is more positive than the rest of the world, though economic growth is still expected to slow in the second half of 2019. The effects of tax reforms passed at the end of 2017 will likely fade, and there is little ability for the federal government to provide further fiscal stimulus given deficit concerns. Monetary policy will therefore continue to have a strong influence on the markets, as the market doubts the ability of the Fed to raise rates any further during 2019. If guidance from the FOMC turns more dovish, it has the potential to assuage investor fears and reduce volatility in the near-term.

While the events we experienced during the quarter were unforeseen, our approach to portfolio management incorporated the consideration that such a downside event could occur. We had been hesitant to add more risk in the corporate sector, usually doing so in higher-quality names, since the marginal benefit of this addition was not fully pricing in the potential risks. With the equity market sell-off this past quarter, spreads on corporate bonds widened further, making them more attractive on a relative basis. This view is reinforced by our belief that solid economic growth will continue in the near-term. We will continue to look for opportunities to add exposure in the corporate space, while remaining selective in our addition of risk to your portfolio. We also continue to find value in the high-quality securitized and taxable municipal sectors, which add relative value without as much of the volatility we typically experience in the corporate sector.

We remain cognizant of the risks ahead which, if realized, could cause us to change our investment posture. However, given the potential for continued economic growth in the U.S. and current relative value, we are comfortable with our approach.