Core Fixed Income Commentary

Q3 2017

MARKET REVIEW

The Bloomberg Barclays U.S. Aggregate Index return of 0.85% for the third quarter was almost entirely due to interest income as U.S. Treasury yields remained nearly unchanged. Quarterly returns for Treasuries across the maturity spectrum from 3-months to 30-years ranged between 0.2% and 0.3%, while U.S. Corporate bonds outperformed Treasuries for the 8th consecutive quarter. Investment-grade corporate bond spreads tightened by 8 basis points this quarter, resulting in a 1.3% return. Investment-grade corporate bonds now trade at an average spread of 106 basis points, which matches the low in June 2014, but otherwise is the tightest since 2007. Among investment-grade corporates, the best performing industries included Basic Industry, Energy, REIT's, Utilities, and Banks. Industry laggards included Capital Goods, Communications, Transportation, Consumer Non-Cyclical, and Consumer Cyclical. Lower quality bonds outperformed as the Bloomberg Barclays High Yield index returned 2% for the quarter and 7% year-to-date. Mortgage-backed securities outperformed Treasuries this quarter with a return of 1.0% after three consecutive quarters of underperformance.

PORTFOLIO REVIEW

During the quarter, we maintained our defensive posture. Our positioning reflects the interplay between current valuations and our expectations for the economy. Today our concerns are based on the combination of higher valuations on spread product. Corporate bond spreads are at the tightest level since 2007 and we are concerned about risks regarding the macroeconomic environment and the geopolitical situation as the uncertainty regarding Trump policies continues to unfold in 2017.

In terms of the economy, we are in the eighth year of an economic expansion that began as we excited one of the most severe recessions since the 1930s. Yet despite an extraordinary amount of fiscal and monetary stimulus, the U.S. economy has averaged a modest real growth rate of about 2% since the beginning of 2010. While the job market has largely recovered and continues to maintain a moderate level of growth consistent with maintaining today's low unemployment rate, wage growth remains stubbornly depressed. Additionally, inflation remains low, generally below the Federal Reserve's target level, and productivity has been expanding at its slowest rate in the post-World War II era.

With this as a backdrop, the Federal Reserve is reducing accommodation through a combination of a higher Fed Funds rate, three increases over the past eight months, and a plan to reduce the level of quantitative easing though the reduction of reinvestment of principal and interest payments. Yet even before the impact of higher rates gains traction, certain segments of the economy have suggested concerns

Today, investment grade corporate bond valuations as measured by the BAML corporate bond index are near the lowest level since June 2007 and likewise volatility as measured by the Chicago Board Options SPX Volatility Index remains near its lowest point since the peak in 2007. In our opinion, the market is pricing in expectations for stable-to-increasing growth and a benign geopolitical situation. In contrast, as we described above, we believe that we may be headed for lower growth and increasing volatility.

We are suspect of the seemingly high degree of euphoria reflected in market prices and increased expectations for higher economic growth resulting from a variety of policy initiatives under the new administration. Especially concerning is we do not see clear and consistent policy proposals across both the legislative branch and executive branch of government. We also are concerned about the administration's approach to trade and foreign policy which may alienate the U.S. while also risking our legacy of global leadership. As example, our engagements with Europe and NATO have unnecessarily raised tensions with our strongest allies, the saber rattling on NAFTA risks disrupting trade with two of our largest trading partners and the grave risk of North Korea continues to grow.

Given the low level of compensation offered by higher beta securities and our concern about underlying economic fundamentals, we continue to focus on ways to reduce our exposure to lower rated and historically more volatile corporate bonds.

PRODUCT OVERVIEW

The Core Fixed Income strategy seeks to benefit from opportunities arising from changes in interest rates, volatility, credit and sector spreads and the shape of the yield curve in constructing a portfolio that seeks to outperform the Barclays U.S. Aggregate Bond Index over time. Our process is based on the belief that fixed income markets are inefficient and that active management which emphasizes sector and security selection can generate superior long-term results.

TOP FIVE CONTRIBUTORS (%)

Security	Portfolio Impact	Excess Return Contribution
Ensco PLC	0.05	0.049
Ford Mtr Co Del	0.06	0.046
Macy's Retail Hldgs Inc.	0.04	0.031
Petro-CDA	0.04	0.030
BHP Billiton Fin USA L FXFLT	0.03	0.030

TOP FIVE DETRACTORS (%)

Security	Portfolio Impact	Excess Return Contribution
Dow Chemical Co.	0.00	(0.010)
Johnson & Johnson	0.00	(0.008)
21st Centy FOX Amer Inc.	0.00	(0.003)
United States Treasury Note	0.02	(0.001)
United States Treasury Note	0.01	0.000

CHARACTERISTICS

	Portfolio	Benchmark
Average Maturity	6.52 yrs	7.73 yrs
Effective Duration	5.11 yrs	5.82 yrs
Average Quality	Aa3	Aa2
Yield to Maturity	2.56%	2.49%
Average Coupon	3.34%	3.06%

Data for the above commentary is from Bloomberg and Barclays as of September 30, 2017.

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*As of 10/31/2017

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Information presented for Top Contributors and Detractors is based on a representative account within the Core Fixed Income Composite, and on a trade date basis. As of September 30, 2017, the composite consists of equal to or less than ten accounts, and represents 3.34% of the total firm assets. The minimum portfolio size for inclusion in the composite is $3 million. The benchmark for the composite is the Barclays Capital (BC) U.S. Aggregate Bond Index, which is composed of U.S. securities in Treasury, Government-Related, Corporate, and Securitized sectors. All securities included in the index are of investment-grade quality, have at least one year to maturity, and have an outstanding par value of at least $250 million. Benchmark returns do not reflect the deduction of advisory fees, custody fees, transaction costs, or other investment expenses. The benchmark returns assume the reinvestment of dividends and other earnings. An investor cannot invest directly in an unmanaged index.

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