FIXED INCOME COMMENTARY

February 5, 2016

KEY TAKEAWAYS

It was a rough start to the year for global equity markets as commodity and global growth concerns continued. The U.S. Treasury market was the recipient of the global equity sell off, with the yield on the 10- year note falling 35 basis points through January. Expectations for continued economic weakness leaves the timing for the next Fed rate hike uncertain.

Key Rates	Jan 31 2016	Dec 31 2015	Dec 31 2014
Treasury Yields			
2 Year	0.77	1.05	0.66
5 Year	1.33	1.76	1.65
10 Year	1.92	2.27	2.17
30 Year	2.74	3.02	2.75
Credit Yields			
BBB Industrial 10 Year	3.79	3.99	3.42
Muni Yields			
AAA 10 Year	1.73	2.00	2.10
Mortgage Backed Securities			
30 Year FNMA Current Coupon	2.70	3.00	2.83

JANUARY IN REVIEW

- Strong rally in the U.S. Treasury market as global equity markets sink.
- The Federal Reserve opts to pass on a second consecutive rate hike.
- Corporate bond spreads widen in January about as much as they did for all of 2015.
- Japan joins the consortium of countries with negative short-term interest rates.

Slowing economic growth, both domestically and internationally, and a horrid start to global equity markets drove interest rates lower in January. The preliminary report on 4th Quarter U.S. GDP came in at a scant 0.7%, producing a 2015 growth rate of 1.8%, year-over-year, down from 2.5% in 2014. The S&P 500 Index returned approximately -5.0%, its worst start since 2009. Equity investors are questioning the sustainability of profit margins in a weakening growth environment. Hardest hit were stocks and bonds of commodity-oriented companies, such as energy and mining, as prices for oil and copper continued to tumble. In fact, many market participants expect the U.S. to slip into recession in 2016.

China, the world's second largest economy, has seen its growth rate basically halved from pre-crisis levels in the double digits to a current projection of 6-to-7% as it transforms from a manufacturing-based economy to a service-oriented one. This has wreaked havoc on commodity prices and thus the economic activity of commodity exporting countries. The inherent forces of global free trade and the Internet implemented over the last couple of decades have proved to be sharply deflationary. Monetary stimulus has been overly aggressive over this time frame and yet global growth has barely gained traction. Interest rates remain at historically low levels with many countries displaying negative short-term rates – including most recently the Bank of Japan. Exhibit 1 highlights current global interest rates.

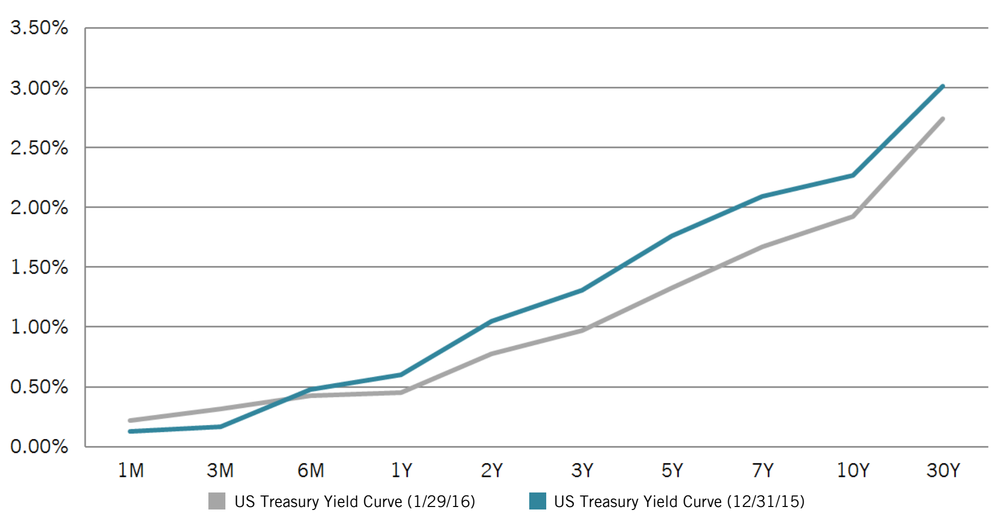
EXHIBIT 1: GLOBAL INTEREST RATES (%)

Yrs.	US	Canada	Germany	France	Italy	Spain	UK	Japan
2	0.72	0.40	-0.50	-0.42	-0.03	-0.04	0.36	-0.18
5	1.28	0.61	-0.26	-0.15	0.42	0.45	0.87	-0.14
10	1.89	1.15	0.27	0.61	1.44	1.55	1.53	0.06
30	2.71	1.97	1.00	1.62	2.63	2.80	2.34	1.07

Source: Bloomberg Financial L.P.

The yield on the U.S. Treasury 10-year note fell 35 basis points in January to 1.92%, from 2.27% at year-end 2015. The Federal Reserve opted to pass on an

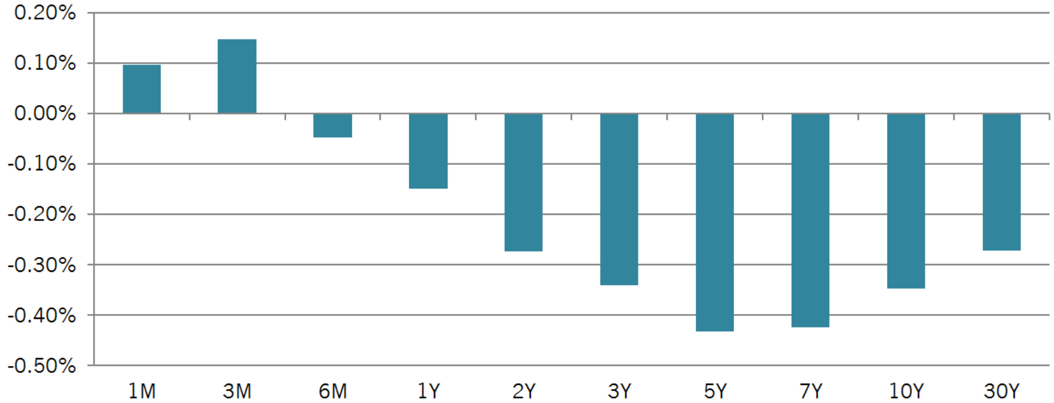
EXHIBIT 2: US TREASURY INTEREST RATE CURVES



Source: Bloomberg Financial L.P.

additional rate rise after December's 25 basis point increase. This continues the mantra of "lower for longer" in the bond market for the foreseeable future. Indeed, the probability of Fed rate hikes has fallen dramatically as implied by the Fed Fund futures probabilities, with a current reading of less than 50% for the remainder of 2016. This has eased pressure on the front end of the U.S. Treasury yield curve as the 2-year Note declined 27 basis points to 0.78% in the month, while the 5-year Note fell 43 basis points to 1.33%. These changes are shown in Exhibit 2 and 3.

EXHIBIT 3: US TREASURY INTEREST RATE CHANGES (1/29/16 vs. 12/31/15)



Source: Bloomberg Financial L.P.

In terms of sector performance within the fixed-income markets, according to the Barclays Indices, U.S Treasuries were by far the best performing sector as the U.S. Treasury Index returned 2.13% in January. The Mortgage-Backed Securities and Municipal Indices returned 1.30% and 1.19% respectively, while the U.S. Credit Index returned 0.52% as credit spreads widened 25 basis points in January.. The High Yield Index posted a loss of 1.61%, as it has a heavy weighting to hard-hit energy bonds. For the broad market indices, the Barclays U.S. Aggregate Index returned 1.38%, while the Intermediate Aggregate Index returned 1.25%.

Going forward, we do not see another Fed rate hike anytime soon. Slumping commodity prices will weigh heavily on relevant sectors in the economy. Ongoing evidence of store closings from high profile retailers (e.g., Wal-Mart, Macy's) suggest the slow-down is affecting consumer-oriented industries, as well. In addition, the volatility in global equity markets should help keep the Fed at bay, at least until markets stabilize for a while. We expect corporate bond spreads to continue to widen given the vast amount of troubled debt. Mortgage-backed securities spreads should remain stable albeit inversely related versus U.S. Treasuries, and, finally, municipal bonds spreads are likely to narrow.

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