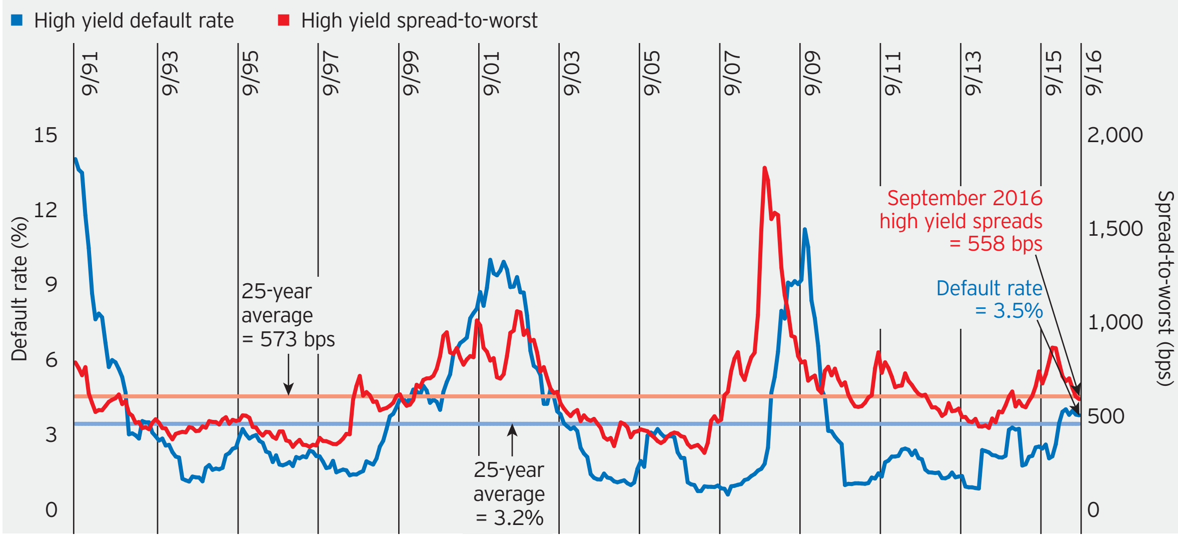
High Yield Snapshot

Monthly high yield bond market update: October 2016

High yield returns moderated in September, with the Bloomberg Barclays US Corporate High Yield 2% Issuer Capped Index gaining 0.67%. While there was some volatility during the month centered around central bank meetings, the markets recovered by month's end to post positive gains. We continue to see inflows into the asset class as global investors search for yield. Per JP Morgan, spreads ended the month at 558bps, which is just inside of the 20-year median spread level. The five-year and 10 year Treasury bonds were mixed when compared to August, with the five-year moving to 1.15%, compared to 1.20% the month prior, and the 10-year to 1.59% compared to 1.58%. With high yield market spreads and yields nearing the lows of the year, we believe future gains will be tempered relative to those in recent months.

Defaults have been a lagging indicator of performance



Source: JP Morgan, as of Sept. 30, 2016

Performance by ratings[1]

Within the ratings categories:

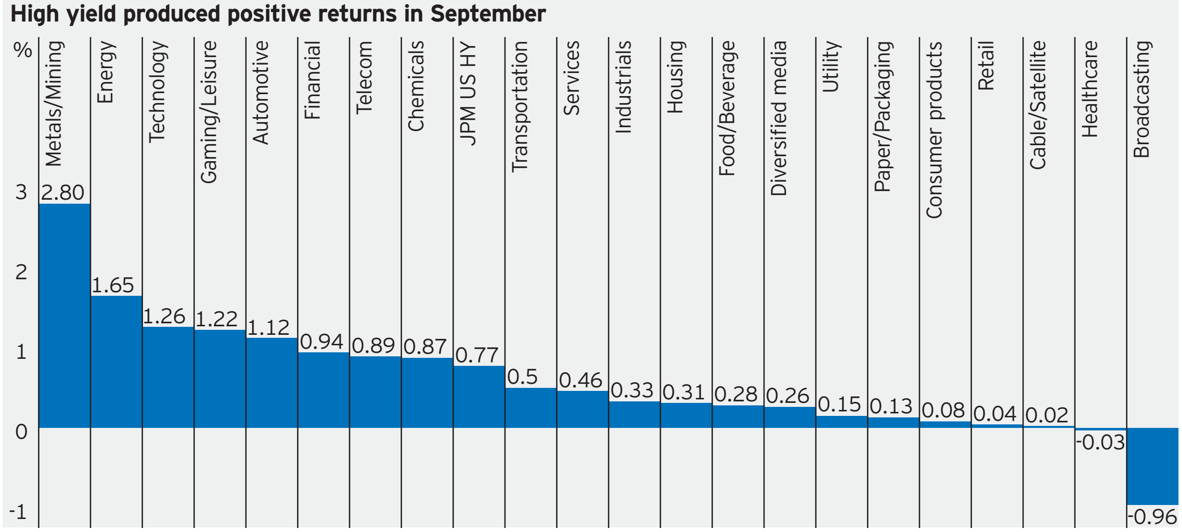
- BB-rated securities returned 0.35%
- B-rated securities generated returns of 0.53%
- CCC-rated securities returned 1.77%

Earnings trends

We are nearing the beginning of third quarter earnings season. As for fundamentals overall, here are several themes we are monitoring:

- We believe earnings woes will continue for the healthcare space. We've seen weaker admissions impact revenues and higher operating costs negatively impact earnings. In the pharmaceutical space, mounting pressure to lower drug prices and increasing generic drug competition will continue to weigh on results. We believe these trends are likely to continue in the coming quarters.
- The transportation sector has seen its share of weak earnings as well. We believe continued pressure on heavy truck orders is unlikely to change in the coming months.
- Metals and mining results have been under pressure, but with a rebound in some base metals prices, results have been better than feared. While a number of companies have raised new equity or sold assets to bolster liquidity, not all companies have those options and are subject to volatility, both in base metals pricing and the market overall.

High yield produced positive returns in September



Source: JP Morgan US High Yield Bond Index, as of Sept. 30, 2016

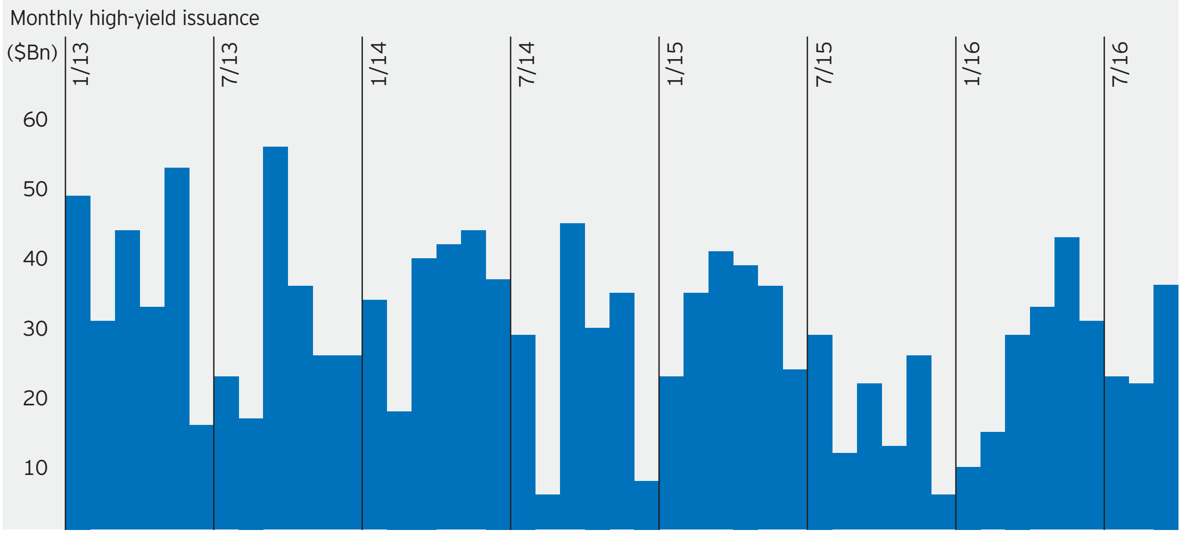
Fundamentals

- The Bloomberg Barclays US Corporate High Yield 2% Issuer Capped Index finished the month with a yield-to-worst of 6.10%, a modified duration of 4.04, an option-adjusted spread of 468 bps, and an average price of 99.7.
- There were only three defaults in September in the high yield market which caused the par-weighted default rate to fall to 3.54% from 3.57% in August. Excluding energy, and metals and mining, the default rate is only 0.49%.
- Credit metrics for the overall market continue to reside in a healthy zone, in our opinion.
- Recent leverage statistics continue to increase. This increase is being driven by poor earnings within energy, and metals and mining. We don't see this trend reversing in the near-term.

Technicals[2]

- High yield mutual funds reported $105 million of outflows in September, which follows a $943 million inflow in August. Year-to-date, inflows have totaled $9.6 billion compared to 2015 when outflows totaled $16.6 billion.
- New issuance for September came in at $35.2 billion, representing the first monthly increase since May. Year-to-date, there has been $233 billion in new issuance compared to $251 billion in the first nine months of 2015.
- New issuance was led by refinancing activity, which represented 70% of new deals followed by 17% for general corporate purposes. Year-to-date, new issuance has been led by refinancing activity, accounting for 57% of the total volume, followed by general corporate purposes which represented 23% of the total.

New issuance volume rose in September



Source: JP Morgan, as of Sept. 30, 2016

Relative value

- The spread between high yield and investment grade is greater than the historical median, creating an opportunity for yield pick-up given a manageable default risk.
- High yield offers a relatively lower duration and a higher coupon, which reduces its sensitivity to interest rate movements.
- The escalation of risk premiums due to declines in commodity prices and pressure on the energy sector has created value in the overall market.

Index returns (%)

	5/16	6/16	7/16	8/16	9/16	YTD 2016
Bloomberg Barclays US HY 2% Issuer Cap Index	0.62	0.92	2.70	2.09	0.67	15.11
Bloomberg Barclays US Aggregate Bond Index	0.03	1.80	0.63	-0.11	-0.06	5.80
Bloomberg Barclays US Treasury 5-10 Year Index	-0.14	2.52	0.21	-0.79	0.16	6.03
JPM EMBI Global Diversified Index	-0.18	3.37	1.80	1.79	0.40	14.77
S&P 500 Index	1.80	0.26	3.69	0.14	0.02	7.84
S&P/LSTA Leveraged Loan Index	0.89	-0.15	1.64	0.70	0.60	8.49

Source: Barclays, JP Morgan, and Standard & Poor's, as of Sept. 30, 2016.

1 Barclays
2 JP Morgan

About risk

Fixed income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating. Junk bonds involve a greater risk of default or price changes due to changes in the issuer's credit quality. The values of junk bonds fluctuate more than those of high quality bonds and can decline significantly over short time periods.

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