FIXED INCOME ASSET ALLOCATION INSIGHTS JUN: 2018

SUSTAINED OPPORTUNITY IN EMERGING MARKETS DEBT

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Waning investor appetite for emerging markets (EM) debt against a backdrop of a stronger dollar and pockets of heightened geopolitical risk, as well as negative fund flows, have caused the asset class to underperform and spreads to widen. While this creates a possibly attractive entry point for select sovereign or corporate credits, we are modestly reducing our allocation from 30% to 25% and increasing our allocation to investment grade credit from 20% to 25% since we see the medium-term potential for risks associated with US trade policy announcements and several key political election outcomes. We are still constructive on emerging market debt, but have reduced the magnitude of our overweight allocation.

ABOUT THIS REPORT

Fixed Income Asset Allocation Insights is a monthly publication that brings together the cross-sector fixed income views of PineBridge Investments. Our global team of investment professionals convenes in a live forum to evaluate, debate, and establish top-down guidance for the fixed income universe. Using our independent analysis and research, organized by our fundamentals, valuations, and technicals framework, we take the pulse of each segment of the global fixed income market.

US Macro View

Markus Schomer, CFA, Chief Economist

Central case

We expect moderate GDP growth and inflation, both at 1% to 3%. The main drivers are moderate consumption and housing demand, modestly positive fiscal spending, and a rebound in business investment. We expect a labor market at or near full employment, with a gradual increase in wage growth. We see the Federal Reserve gradually lifting rates (with two to three hikes in each of the next few years) continuing alongside a gradual balance sheet tapering, with the equilibrium real funds rate at 0%-0.50%.

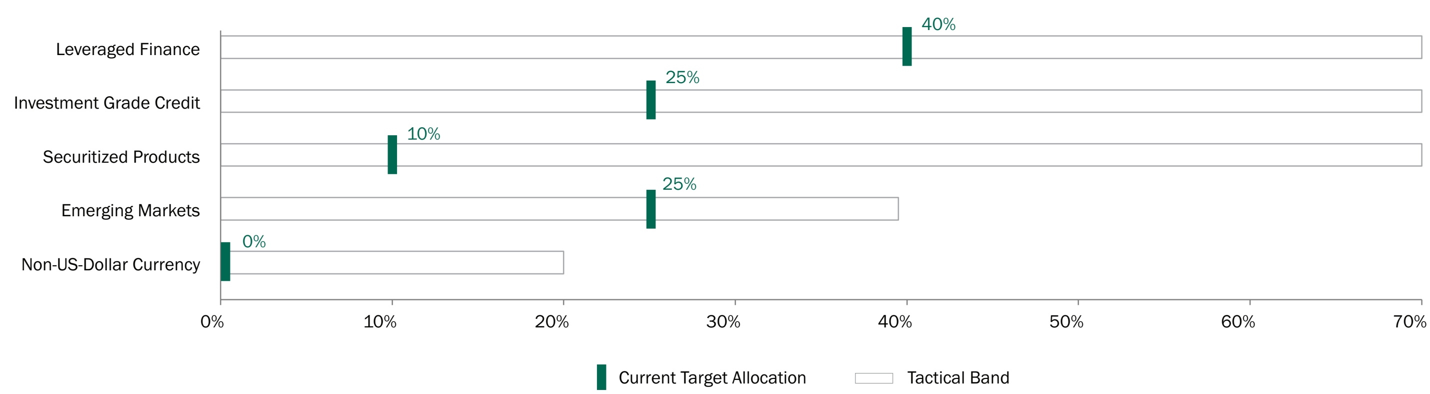
Market movers

Growth rebound. Evidence the US economy is rebounding from the first quarter slump confirms our 2018 forecast of 3.5% to 4.0% growth through the summer on strong consumption and business investment. The key question is, can that momentum be sustained through December?

Fed's reaction to rising global risk. So far the Fed has brushed aside episodes of financial market volatility, maintaining that policy accommodation must be withdrawn. Any sense the Fed could pause or slow its current pace of rate hikes in response to greater market volatility could be a major boost for bond markets.

Job markets. With unemployment now below 4% and tighter job markets boosting consumer confidence and soon, perhaps, sales, tightness may reach a level that finally reignites the wage growth this recovery has lacked.

Target Portfolio Allocations (as of 29 May 2018)



For illustrative purposes only. We are not soliciting or recommending any action based on this material. There can be no assurance that the above allocations will be in any account at the time this information is presented. This material must be read in conjunction with the Disclosure Statement.

Leveraged Finance

John Yovanovic, CFA, Portfolio Manager, High Yield Bonds
Julie Bothamley, Portfolio Manager, Leveraged Loans

Fundamentals
Tax tailwind and general economic vigor should produce healthy first quarter earnings, with commodity strength benefitting associated sectors. The increase in LIBOR has put some pressure on loan-issuer cash flows.

Valuations
With option-adjusted spreads (OAS) at 351 over fair value, loan values are fair, though most of the market remains priced above par; repricing activity remains elevated. BBB-rated collateralized loan obligations (CLO) were fair value on a Z–score basis compared to high-yields and loans, while BB/B tranches remained cheap on an historic basis compared to BBB tranches. We anticipate wider spreads in June as supply increases.

Technicals
Small outflows but light new issuance leads to moderately positive technical support and elevated volatility for high yield (HY). High secondary-market loan prices suggest continued strong demand, with returns driven by interest payments rather than price appreciation, aside from stressed names. CLO pipeline looks robust over the next few months as the repeal of US risk retention should increase the number of issuers seeking to refinance or reset terms.

Allocation Decision
We are maintaining our 40% allocation. Spreads are slightly wider than when we entered 2018, yet strong earnings lead us to expect a continuation of the benign default environment for all but select larger capital structures.

Investment Grade Credit

US Dollar Investment Grade Credit

Dana Burns, Portfolio Manager
US Dollar Investment Grade Fixed Income

Fundamentals
Corporate fundamentals remain sound, but concerns over rising input costs, trade wars, European political problems, and rising rates have combined to dampen the appetite for risk.

Valuations
Select credits remain attractive on a relative value basis. However, spreads may continue to push wider in the current risk-off environment.

Technicals
The current market is marked by few strong technical forces, save near-term demand for US dollar credit from traditional buyers (pension funds and insurers), especially given higher yields.

Non-US-Dollar Investment Grade Credit

Roberto Coronado, Portfolio Manager, Non-Dollar Credit

Fundamentals
Fundamentals remain neutral. There are no major changes in credit metrics in Europe, as leverage has not increased and M&A activity and shareholder-friendly policies remain under control. Banks retain their strong capital bases and generally have been reporting stable results.

Valuations
Valuations are neutral as credit spreads at index level have widened considerably over the last two months. We continue to prefer the banking sector due to improving fundamentals, potential for de-regulation, and attractive yields, but are mindful of the political risk.

Technicals
Technicals are neutral. While the market prepares for the end of quantitative easing, central bank purchases continue to support the euro, which could see inflows from foreign investors.

Allocation Decision
We are increasing our allocation to 25% from 20%. Since financials have underperformed industrials so far this year, we now see some compelling valuations in banking sector credits.

Emerging Markets

Sovereigns

Anders Faergemann, Portfolio Manager
Emerging Markets Fixed Income

Fundamentals
EM fundamentals remain largely unchanged; recent numbers may have softened a bit, but growth remains strong and inflation low. Chinese growth will likely slow in a controlled way, as the government treads softly while deleveraging. The rest of Asia is doing well, with several countries growing by around 5%. EMEA shows fairly stable growth, with only Turkey vulnerable because of the recent foreign exchange volume. Similarly, Latin America's recovery is likely to continue, even if at a slower pace.

Valuations
Spreads are 10 basis points (bps) wider on the month and back to their post-crisis +325 bps average. That's not outright "cheap," but certainly a better value, in our view, with attractive valuations in individual countries as well.

Technicals
Flows into EM have been mixed: short-term outflows have not spooked real-money investors who appear to be on the sidelines waiting for stabilization. The near-term issuance pipeline is very light, after nearly $110 billion done so far this year.

Corporates

Steven Cook, Portfolio Manager, Emerging Markets Fixed Income

Fundamentals
In the majority of cases, first quarter results have been positive to neutral, making for continuing good/strong fundamentals. Corporate outlooks for the year as a whole remain positive.

Valuations
On a yield basis, valuations have become more attractive, moving back to 2016 levels. On a spread basis, HY looks attractive, as do investment grades to a lesser extent. The recent selloff has been exaggerated and presents an opportunity.

Technicals
Supply has tailed off amid current market volatility. When volatility declines, we expect supply to pick up, creating a potential negative head wind short term. Long-term technicals are still positive, with asset allocators looking to add to EM at now-attractive levels. Asset managers are accumulating cash.

Allocation Decision
We are reducing our weight from 30% to 25%. EM debt has performed poorly this year and while valuations are now enticing, we are cautious due to the potential for volatility as a result of US trade policy and elections in EM nations including Argentina, Brazil, and Mexico.

Securitized Products

Andrew Budres, Portfolio Manager, Securitized Products

Fundamentals
Negative convexity is extremely low, historically speaking, because interest rates have risen sufficiently to take most of the MBS universe out of the refinance zone.

Valuations
In today's changed mortgage market, spreads are wider than their tight post-crisis range, but not as wide as in 2010 when the Fed had stopped reinvesting.

Technicals
A key part of mortgage demand will hinge on regulatory changes to bank capital rules, which could spark very strong demand from banks.

Allocation Decision
We are maintaining our allocation of 10%. MBS-Treasury OAS have widened about 10 bps so far this year. While valuations have improved on the margin, we still favor the carry and rolldown of credit.

Non-US-Dollar Currency

Dmitri Savin, Senior Vice President, EM Fixed Income Portfolio Strategy/Risks

Fundamentals
The combination of ongoing global cyclical disappointment and relative US outperformance continues to fuel the US dollar rally. The Italian political storm has sent the euro to its lowest level in 10 months compared to the US dollar.

Valuations
While the DXY index is now at year-to-date highs, levels remain well below where they were at the end of 2016 and early 2017.

Technicals
The most recent IMM data suggest that 70% of the US dollar short positioning has been covered. This has provided a significant technical tailwind over the last few weeks.

Allocation Decision
We maintain our 0% non-dollar allocation. We expect the upward trend in the US dollar to continue, supported by US interest-rate and growth differentials relative to other major developed economies.

Our Scenario Probabilities Were Unchanged During the Month

Fixed Income Scenario Probabilities – Next 12 Months (as of 29 May 2018)

Increase | Decrease | Unchanged

					Scenario Probabilities				
Scenario	US GDP Growth	Inflation	USD Basket	Avg. Scenario Probability	USD Inv. Grade	Securitized Products	Leveraged Finance	EMD	Non-USD IG
Recession; Deflation	< 1%	< 1%	Breaks 5% band on the downside	**15%**	15%	10%	25% (Increase)	10% (Increase)	15%
Central Case	1-3%	1-3%	Maintains -5% to +5% band	**65%**	75%	65%	60%	55%	70%
High Growth; Inflation	> 3%	> 3%	Breaks 5% band on the upside	**20%**	10%	25%	15% (Decrease)	35% (Decrease)	15%

Source: PineBridge Investments. For illustrative purposes only. Any opinions, projections, forecasts, and forward-looking statements are based on certain assumptions (which may differ materially from actual events and conditions) and are valid only as of the date presented and are subject to change.