FIXED INCOME ASSET ALLOCATION INSIGHTS NOV: 2016

A DECEMBER FED HIKE COULD SPUR VOLATILITY

Robert Vanden Assem, CFA,
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Our target allocations remain unchanged. We continue to favor investment grade credit and securitized products and remain underweight high yield and emerging markets (EM) debt. Credit spreads remain well supported by an extended search for yield, with levels now at or near the year-to-date tights. However, we see the potential for volatility ahead amid a climb higher in Treasury rates, retail outflows from mutual funds and ETFs, lower oil prices, and uncertainty in the US about the elections on 8 November and the Federal Reserve meeting on 14 December. Given this backdrop, we believe high yield and emerging markets debt asset classes may provide more attractive entry points in the months ahead.

US Macro View

Markus Schomer, CFA, Chief Economist

Central case
We expect moderate US GDP growth of 1%-3% and inflation in a similar range, trending around the Fed target. The main drivers are robust consumption and housing, modestly positive fiscal spending, and a moderate rebound in business investment. Employment has remained stable, with the labor market at or below full employment and a gradual increase in wage growth.

Market movers
Steeper developed market sovereign yield curves and the likelihood of a Fed rate hike by year-end are both driving the US dollar to the higher end of its 2016 range. We expect the dollar's rise to continue as domestic yields rise, while political risks and the likely extension of quantitative easing (QE) hold the euro down.

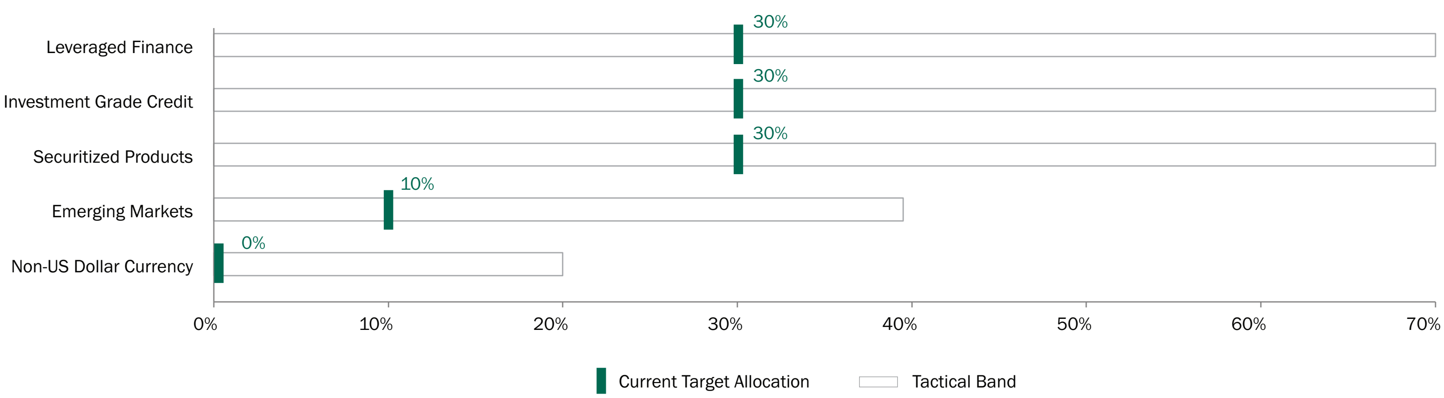
Despite earlier signals of an imminent rate hike, the Fed made no changes in policy during November's Federal Open Market Committee (FOMC) meeting. Barring a Trump victory, we think the Fed will next hike rates in December. Thereafter, we expect one rate increase in 2017 and two in 2018.

With the labor market close to full employment, a gradual increase in wage growth is likely, and businesses may be starting to invest in capital expenditures. A rebound in business

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.

Target Portfolio Allocations (as of 24 October 2016)



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investment should kick-start headline GDP growth and improve the dismal productivity growth trend.

Leveraged Finance

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

Fundamentals
Estimates now point to a fourth-quarter inflection point where fundamentals begin to improve, though we expect solid third-quarter earnings. Improving fundamentals should work broad leverage statistics back toward market averages over the next three to four quarters.

Valuations
Sentiment is improving as macroeconomic conditions strengthen. Default rates should settle to a more normal ~3% forecast, with fair value spreads of 425 OAS (+/-50 bps) resulting in a 4%-7% return range over the next 12 months. For bank loans, repricing risk will largely offset spread compression. Attaining coupon value plus a full return for bond prices requires a strong tailwind in fundamentals, which seems a likely upside/base case.

Technicals
New issue supply in US high yield, loans, and EM corporate bonds is running lower than last year. Improving fundamentals should be positive alongside the hunt for yield. That should support the intermediate term trend, although we expect volatility from the potential Fed interest rate reset, and we believe net supply will remain low.

Allocation Decision
We maintain our 30% allocation. Spreads on US high yield bonds are approaching fair valuation levels. However, the positive earnings trend among the issuer base and relatively light supply should keep the market well anchored. We would look to increase our allocation if we were to see a meaningful spread widening.

Investment Grade Credit

US Dollar Investment Grade Credit

Dana Burns, Portfolio Manager
US Dollar Investment Grade Fixed Income

Fundamentals
While fundamentals have deteriorated modestly, they remain solid across most sectors and credits. Mergers and acquisitions risk remains but is less of a concern because of increased regulation. We expect shareholder-friendly activity to persist.

Valuations
Valuations remain attractive in select sectors and credits, but it is difficult not to acknowledge the impact that central bank activities have had on spreads.

Technicals
Low rates, courtesy of central banks, continue to drive investors into the US investment grade credit markets. Should the Fed raise rates in December, demand may take a pause.

Non-US-Dollar Investment Grade Credit

Roberto Coronado, Portfolio Manager, Non-Dollar Credit

Fundamentals
Earnings season has started without any surprises, but it is too early to draw conclusions. Although banks continue to strengthen their capital base, the market is waiting for regulators to levy more fines. We continue to like bank fundamentals.

Valuations
Credit spreads have been stable with a bias to tightening. Spreads continue to trade tighter than in the last seven years, and we see limited value given European macroeconomic risks.

Technicals
Technicals are strong because of manageable primary supply and larger-than-expected purchases from the European Central Bank (ECB) and Bank of England (BOE). We remain cautious on financials since supply could be high in the fourth quarter. We are more comfortable with non-financials, as the ECB and BOE continue buying investment grade bonds.

Allocation Decision
We maintain our 30% allocation to IG credit given strong market technicals and the longer duration profile of the asset class in the current negative rate environment. Valuations remain attractive in select sectors and credits despite the rally investors have seen this year in broad spread levels.

Emerging Markets

Sovereigns

Anders Faergemann, Portfolio Manager
Emerging Markets Fixed Income

Fundamentals
China's macroeconomic numbers have stabilized a bit in recent months, suggesting that authorities will hit their target growth of 6.5%-7% for the year because the property sector is showing signs of recovery. Brazil's growth outlook has also improved in recent months from a very weak base, yet economic growth in Latin America as a whole is still not showing signs of a sustainable recovery, and overall fundamentals remain fairly weak in emerging markets.

Valuations
EM spreads have remained in a fairly tight range between 325 bps and 350 bps since the middle of August, showing some resilience in the face of higher global yields and curve steepening.

Technicals
Capital inflows into EM have abated since the spike in July/August, but we see no signs of a reversal, in spite of global yields ticking higher and abundant issuance in recent weeks appearing to have been easily absorbed.

Corporates
Steven Cook, Portfolio Manager, Emerging Markets Fixed Income

Fundamentals
The fundamental picture still looks largely stable, with mixed second-quarter and first-half 2016 results in Asia and the Central and Eastern Europe, Middle East, and Africa (CEEMEA) regions largely beating estimates. Still, the outlook is not overly bullish. Latin America is on a more positive trajectory. While some of this is due to base effects, Brazil's scandal-related issues have diminished. In all of these regions, fundamentals are still largely being ignored, as technical supply dynamics dictate flows.

Valuations
Despite a slight widening, valuations are still high, led by high yield (now an impressive 194 bps tighter year to date) – especially in Latin America (163 bps tighter). With supply having ramped up ahead of the Saudi Arabia sovereign bond offering, we are seeing very few deals that meet our fair value target.

Technicals
From an issuance and supply perspective, technicals have slightly weakened as the primary issuance pipeline has opened again in earnest after the end of the northern hemisphere summer.

Allocation Decision
We maintain our 10% allocation. With a couple of bumps on the road into year end, particularly the potential for a December Fed rate hike, the risk/reward for adding to emerging markets at this stage appears very unattractive. We would be more comfortable buying EM if spreads were to widen to around 380-400 bps.

Securitized Products
Andrew Budres, Portfolio Manager, Securitized Products

Fundamentals
There is nothing on the horizon that would indicate a change to credit availability, housing finance reform, or banks' willingness to chase mortgage rates into deep rallies.

Valuations
The slight selloff in rates in October spurred a new low in spreads.

Technicals
Each month more data are coming in that support strong demand from overseas buyers, as well as additions to US banks' balance sheets.

Allocation Decision
We maintain our 30% allocation. By most metrics MBS valuations seem rich. Is this the new normal given the demand from US banks and foreign investors? Its more likely a recalibration of a new fair value until the Fed, banks, or housing policy (supply) has a major change.

Non-US Dollar Currency
Anthony King, Portfolio Manager,
Non-US Dollar High Grade Fixed Income

Fundamentals
The US Fed is still expected to hike rates before year-end. This fact, coupled with attractive yield and growth differentials, leads us to favor the US dollar most among the G3 currencies.

Valuations
The US dollar index (DXY) has traded higher in recent weeks. However, it remains well below levels investors saw earlier in 2015.

Technicals
Recent International Money Market (IMM) data suggest that we have seen an unwinding of US election risk hedges with broad

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On Average, Our Scenario Probabilities Were Unchanged Month-Over-Month

Fixed Income Scenario Probabilities – Next 12 Months (as of 24 October 2016)

Increase | Decrease | Unchanged

Scenario	US GDP Growth	Inflation	USD Basket	Avg. Scenario Probability	Scenario Probabilities: USD Inv. Grade	Securitized Products	Leveraged Finance	EMD	Non-USD IG
Recession; Deflation	<1 %	< 1%	Breaks 5% band on the downside	**24%**	35%	25%	10%	30%	20%
Central Case	1-3%	1-3%	Maintains -5 to +5% band	**65%**	60%	65%	70%	60%	70%
High Growth; Inflation	> 3%	>3%	Breaks 5% band on the upside	**11%**	5%	10%	20%	10%	10%

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.

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US dollar positioning seeing an improvement. To the extent this trend continues, it could provide a tailwind for the greenback.

Allocation Decision

We maintain our 0% allocation. We remain most constructive on the US dollar among the G3 currencies and continue to own very limited non-dollar exposure in the portfolio.