FIXED INCOME ASSET ALLOCATION INSIGHTS DEC: 2016

FUNDAMENTALS FOR HIGH YIELD ISSUERS MAY BE HEADING UP

Robert Vanden Assem, CFA,
Head of Investment Grade Fixed Income and Chairman of Fixed Income Asset Allocation Team

In our most recent fixed income asset allocation team meeting, we decided to reduce the securitized products target allocation to 25% from 30% and to increase the high yield target allocation to 35% from 30%. We remain overweight on investment grade credit, with a target allocation of 30%, and underweight on emerging markets (EM) debt, with a 10% target allocation. Subsequent to the US presidential election, sharply higher Treasury rates and heavy outflows from retail mutual funds and exchange-traded funds (ETFs) have pressured high yield bond prices. However, in our view, high yield fundamentals stand to benefit under a Trump administration through tax cuts and increased infrastructure spending, as well as a firmer commodity backdrop.

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 2017 US GDP growth of 1% to 3% and inflation in the same range, trending around the Federal Reserve target. Robust consumption and housing, modestly positive fiscal spending, and a moderate rebound in business investment will be the main drivers. The US labor market is likely to be at or below full employment, with a gradual increase in wage growth. We expect the Fed to gradually raise interest rates, with one or two hikes in each of the next few years.

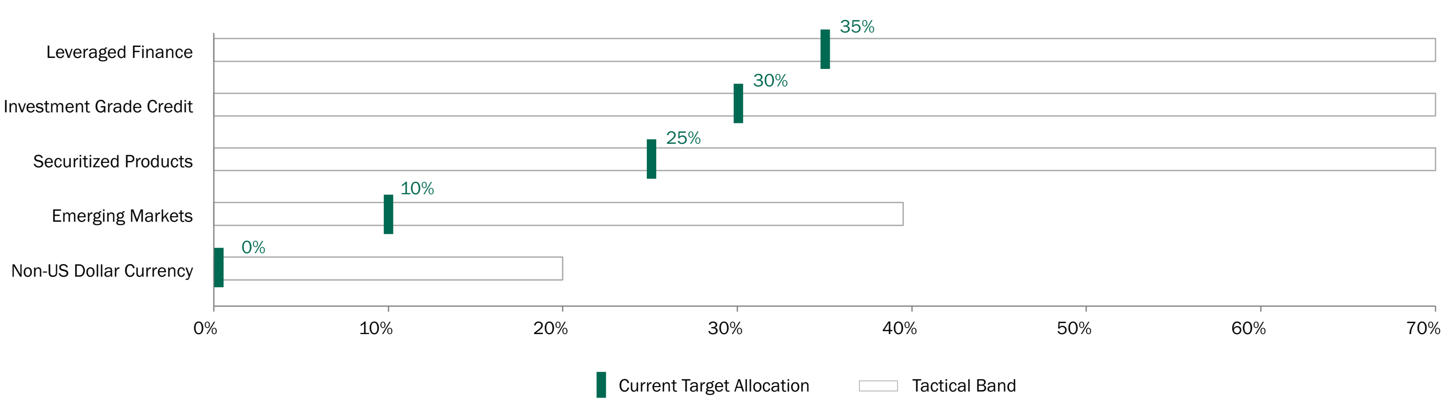
Market movers

The relatively tempered market reaction after the US election and steady macroeconomic data should justify a Fed rate increase in December. Investors expect at least one rate hike in 2017 but not the three the Fed had previously signaled.

The recent trade balance and retail sales releases suggest stronger growth in the third quarter than the advance report estimated. The 2.9% initial estimate will likely be revised up, and Atlanta Fed estimates show fourth-quarter growth on track to at least maintain robust growth momentum.

The Atlanta Fed Wage Growth tracker jumped to 3.9% in October, a cycle high. Other labor market indicators suggest that employers will raise wages to find the right workers in a tight

Target Portfolio Allocations (as of 21 November 2016)



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labor market. As labor costs increase, some firms may spend more on capital investments – a step towards improving the weak trend in business investment.

Leveraged Finance

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

Fundamentals
Despite solid third-quarter earnings, the stronger fundamentals some forecast didn't materialize. Estimates point to a fourth-quarter inflection point for improvement. Stronger fundamentals should work broad leverage statistics back toward market averages over the next three to four quarters.

Valuations
Interest rate volatility is pushing spreads wide to fair value. The default rate forecast of ~3% results in fair value option-adjusted spreads of 425 basis points (bps) (+/-50 bps) with a 4%-7% next-12-months' return range and an upside if US Treasury rates retrace. Loans are at fair value with spread compression largely offset by repricing risk. Base returns now equal coupon rates, and spread tightening should offset rate increases.

Technicals
New issue supply in US high yield, loans, and EM corporates is running lower than last year, but improving fundamentals should be positive on balance due to the hunt for yield. We expect Fed interest rate increases to create some volatility and net supply to remain low.

Allocation Decision
We increased our target allocation from 30% to 35%. The US elections outcome of a Republican sweep of the Senate, House, and Presidency is likely to be pro-growth for the US economy and generally support corporate earnings. Given this backdrop, high yield bond spreads look attractive from a relative value standpoint, given the stable to declining default rate.

Investment Grade Credit

US Dollar Investment Grade Credit

Dana Burns, Portfolio Manager
US Dollar Investment Grade Fixed Income

Fundamentals
The fundamental outlook has improved under the prospects of a Trump administration; however, a more protectionist stance may dampen the positive effects.

Valuations
Valuations remain attractive in select sectors and credits, and the impact of the new administration will likely serve as a near-term tailwind for credit.

Technicals
Negative rates courtesy of central banks continue to drive investors into the US investment grade credit markets, and should the Fed raise rates in December, demand would get a boost.

Non-US-Dollar Investment Grade Credit

Roberto Coronado, Portfolio Manager, Non-Dollar Credit

Fundamentals
Earnings season slightly exceeded analysts' expectations, though many had lowered their forecasts. Bank earnings surprised to the upside thanks mainly to a good quarter in fixed income trading. The sector continues to be one of the few that is reducing debt, and current market conditions (steeper curves) should be favorable.

Valuations
Credit spreads have widened over the last couple of weeks but remain tight relative to the last 12 months. Hence we feel that, given the macroeconomic background, downside risk is higher.

Technicals
Low primary supply and larger-than-expected purchases from both the European Central Bank and Bank of England have resulted in strong technicals. Despite the selloff in rates, the asset class remains stable with no material outflows.

Allocation Decision
We maintain our 30% allocation to investment grade credit. While spreads are now approaching fair valuation, we continue to find abundant relative value opportunities in the asset class.

Emerging Markets

Sovereigns

Anders Faergemann, Portfolio Manager
Emerging Markets Fixed Income

Fundamentals
China's macroeconomic numbers have found a degree of stability in recent months and the property sector is showing signs of recovery, suggesting China is likely to hit its target growth rate for the year of between 6.5% and 7%. Brazil's growth outlook has also improved in recent months, although from a very weak base. Yet economic growth in Latin America as a whole is still not showing signs of a sustainable recovery. If politics don't affect trade, we believe EM countries will get a boost from weaker currencies.

Valuations
EM spreads widened briefly to 383 bps, as banks marked bonds down while refusing to provide any liquidity. Spreads subsequently eased to 360 bps, making valuations better but not yet very attractive.

Technicals
Are recent outflows just a blip? We've seen retail investors pull some money from EM, but institutional investors are still interested. Despite the volatility, there's a pipeline of new issues in the Asian market.

Corporates

Steven Cook, Portfolio Manager, Emerging Markets Fixed Income

Fundamentals
EM corporate fundamentals have gradually improved through 2016, and we have a stable outlook on 63% of our coverage

universe, with 24% negative and 13% positive. Third-quarter results in the Asia/Central and Eastern Europe, Middle East, and Africa regions have been mostly in line with expectations. Latin America has, at the margin, beaten estimates. Our longer-term outlook is stable, and we expect defaults to remain subdued.

Valuations
Post the US elections, we tightened spreads, but we have subsequently widened a bit. This has created pockets of value, enabling us to move our relative valuation score from slightly expensive to slightly cheap, particularly in investment grade.

Technicals
The market volatility after the US elections is affecting technicals. The positive impact is that in the near term we are likely to see less supply/issuance. On the flip side, we could see some outflows from the asset class if investors look to book profits into year-end or repatriate to equities.

Allocation Decision
We maintain our 10% allocation. While we continue to find select opportunities in EM debt attractive, we are waiting to see where shifts in US political and trade policies are likely to land before increasing our allocation.

Securitized Products

Andrew Budres, Portfolio Manager, Securitized Products

Fundamentals
With more of the outstanding mortgage-backed securities universe out of a refinance window, prepayment optionality becomes less of a concern.

Valuations
Mortgage spreads appear to have tightened, but they haven't really outperformed. As durations extend, they map to different parts of the yield curve, and spread movements can be misleading.

Technicals
Technicals shouldn't change much even with higher rates. US bank demand should continue to be strong. Additionally, higher rates should start to slow new mortgage supply.

Allocation Decision
We have reduced our target allocation from 30% to 25%. We continue to believe valuations look attractive versus swaps, and higher rates should reduce net issuance. However, we reduced our allocation modestly because we are finding more attractively priced high yield credits.

Non-US Dollar Currency

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

Fundamentals
The US dollar strengthened post Trump's election victory with talk of fiscal stimulus and tax cuts, trade protectionism (less so now), and reflation paving the way for higher US yields and monetary policy divergence with Japan and the eurozone.

Valuations
The US dollar index (DXY) is trading higher than peak 2015 levels. Until the magnitude of fiscal stimulus and the pace of future Fed rate hikes becomes clear, the dollar's broad gains could hit new cycle highs.

Technicals
International Monetary Market data suggest dollar positioning is near recent highs but still well below year-end 2015, when investors were anticipating four 2016 fed funds rate hikes.

Allocation Decision
We maintain our 0% allocation. Our intermediate- to longer-term view remains that the US dollar is likely to continue to benefit from attractive growth and interest rate differentials, and we own very few unhedged non-dollar positions.

On Average, Our Bear and Central Case Scenario Probabilities Decreased in Favor of an Increase in our Bull Case

Fixed Income Scenario Probabilities – Next 12 Months (as of 23 November 2016)

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	**21%**	25%	20%	10%	30%	20%
Central Case	1-3%	1-3%	Maintains -5 to +5% band	**63%**	65%	60%	70%	50%	70%
High Growth; Inflation	> 3%	> 3%	Breaks 5% band on the upside	**16%**	10%	20%	20%	20%	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.