The domestic fixed Income markets are weathering the headwinds of rising interest rates over the past two years which has put pressure on investment returns. Short Duration strategies have continued to outperform longer duration strategies and high yield has outperformed investment grade over the past year. The Fed raised rates, as expected, for the third time in 2018, to a Fed funds target of 2.25%. The 10-year US Treasury increased from 2.85% to 3.06% in September.

Fixed Income markets across the globe experienced heightened volatility during the 3rd quarter, as domestic and international equity markets sold off, global growth slowed, trade concerns weighted on investors, and tightening Fed monetary policy collided in the cross hairs of the market. In addition, global concerns increased as Brexit negotiations faltered and Italy ratified a budget that shows continued fiscal erosion. Italian bond yields rose 130 bps over the quarter reflecting the country's problems financing its growing debt burden.

Source: Federal Reserve

Index Returns	QTD	YTD	TTM
Bloomberg Barclays U.S. Short-Term Government/Corporate Index	0.53%	1.35%	1.59%
Bloomberg Barclays U.S. Intermediate Aggregate Index	0.11%	-0.86%	-0.93%
Bloomberg Barclays U.S. Aggregate Index	0.02%	-1.60%	-1.22%
Bloomberg Barclays U.S. Governement/Credit Index	0.06%	-1.85%	-1.37%
Bloomberg Barclays U.S. Credit Index	0.89%	-2.12%	-1.10%
Bloomberg Barclays U.S. Corporate High Yield Index	2.40%	2.57%	3.05%
Bloomberg Barclays International Fixed Income (US $)	-0.80%	-2.36%	-1.32%
Bloomberg Barclays Emerging Market Fixed Income (US$)	1.61%	-2.28%	-1.68%

Source: Bloomberg

Investment Grade Credit

Despite rising yields, investment grade credit performed well during the quarter, with a total return of 0.89% for the Bloomberg Barclays U.S. Credit Index. Investment grade spreads tightened 12bps during the quarter, as corporate earnings came in strong and profit margins continued to remain elevated following tax reform. In addition, a decline in corporate supply helped support tighter spread levels over the past quarter.

While investment grade spreads tightened during the third quarter, over the past year spreads have shown some volatility. This past year has been a period for investors to move "up in quality" as AA corporates have widened only 2bps versus 16bps of widening for BBB corporates resulting in more underperformance. Investors are facing mounting risks which include an increase in Merger & Acquisition activity, deterioration in balance sheet quality with increased leverage ratios and, a general trend toward continued stock repurchase programs. *Watch for a shift in the credit cycle as the cumulative effect results in an increase in the number of issuers at risk for a ratings downgrade.*

During the quarter, investment grade bond issuance was significantly lighter than prior years and roughly 25% less than this time last year. We expect bond issuance to decline significantly by mid-November. This will put added pressure in the secondary market and magnify the scarcity issue that is prevalent in the bond market. This will further support tighter spread levels, particularly in BBB credits, as investors continue to reach for yield and the street is eager to reduce their balance sheets going into the end of the year.

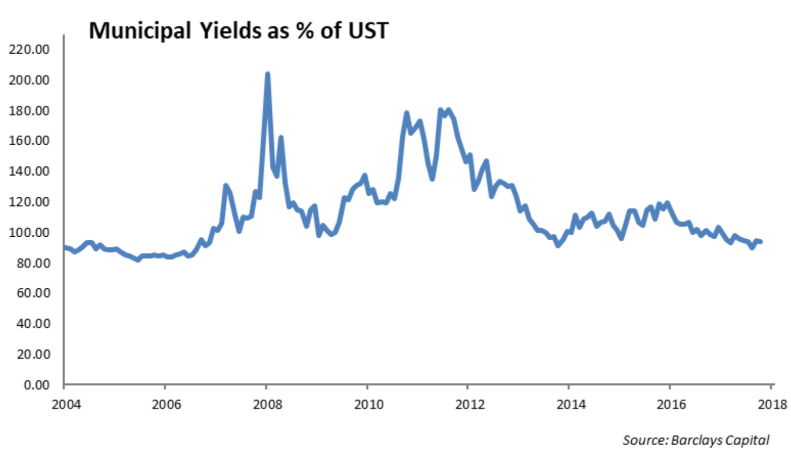
High Yield

High yield credit has been the one bright spot in a year of negative fixed income returns, returning 1.65% in 2018 for the Bloomberg Barclays High Yield Index. Spreads in high yield credit hit their tightest levels in 10-years at 312 bps. High Yield returns have been driven by lower grade credit where CCC have experienced a year-to-date total return of 5.27% versus -0.42% for BB bonds.

The higher relative performance in high yield bonds has come largely as a result in a decrease supply in the primary market, as more companies access the leverage loan market to obtain floating rate interest payments and lighter convents. *In June 2018, the leverage loan market surpassed the high yield bond market at $1.1 trillion in size. The sharp outperformance of CCC rated credit along with the increase in leveraged loan issuance creates a higher level of concern that we are in the late stages of the credit cycle. Investors should begin to consider steps in portfolio structure to mitigate credit risk, particularly in high yield.*

Municipals

Tax reform has had an impact on the municipal bond market as relative yields have declined compared to U.S. Treasury Yields. Municipal bonds continue to offer a stable tax advantage income to investors in higher tax brackets. Interest rates in municipal bond sector rose through the quarter by roughly 30 bps across the yield curve. The 2-year to 10-year muni curve flatten sharply through the quarter from 82bps to 70bps, while the US Treasury curve largely was unchanged. A 10 year AAA rated Municipal bond is currently yielding 2.768% and trading 44bps inside of a 10 year U.S. Treasury. For comparison, since



2009 10 year AAA Municipals have traded at a median spread over U.S. Treasury note yields of 12 bps. Banks and insurer companies continue to reduce their exposure to municipals in 2018 as tax reform and better investment opportunities have decreased the relative value in owning tax-exempt debt. Banks aggressively built their municipal bond portfolios following the Financial Crisis as a safer, more capital efficient alternative to growing their loan portfolio. However, according to the Federal Reserve, Banks have reduced municipal holdings by 5%, totaling $27 billion this year. We believe this will continue, leading to general underperformance relative to corporates. In today's market, there is better relative value in municipal bonds of states such as Ohio, Indiana and Michigan, where new issue concessions can yield above 3% for AA rated 10-year tax-exempt municipals.

Investment Strategy

As we move into the end of the year, we continue to stand behind two investment themes: *Short duration strategies will outperform long duration strategies and credit will outperform US Treasuries.* We believe the Fed will continue to push interest rates higher in the near term. However, as the economy begins to show signs of slowing, we are closer to the time when we will hear the Fed talk of a "pause' in their tightening policy. The recent downturn in interest sensitive sectors including real estate construction and automotive sales are evidence of the start of a slowdown.

As the Fed continues to push its tightening policy near term, the risk of the yield curve inverting is high. The only issues we see standing in the way of a December rate hike are uncertainty around Brexit or an unexpected economic slowdown heading into the holiday shopping season. As the Fed continue to tighten monetary policy, the flattening yield curve will contribute to the dampening of economic activity.