



Portfolio Commentary

Navigator® Fixed Income Total Return

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The “Everything Rally”

2019 began with investors reeling from the 20% decline in the fourth quarter of 2018, but it sure did end on a high note. The markets posted strong gains across the board, which were helped by the Federal Reserve's about-face, the now longest U.S. economic expansion on record, and the recent cooling in the U.S. trade war with China.

We would call the market environment in 2019 the “Everything Rally”, with asset classes across the board participating in the risk-on rally. Even fixed income posted strong gains as interest rates fell to near record lows before drifting higher. Corporate credit led the way with investment grade and high yield bonds gaining over 14% for the year.

We enter 2020 with the equity markets primed to build on their secular bull market gains. A lot of the uncertainties that investors have been concerned about have faded into the background as the yield curve has steepened, the trade war with China seems to be deescalating with a Phase One trade deal, political divisiveness in the U.S. has not impeded the market's trajectory higher, and recession fears have turned into growing optimism in the U.S. economy.

Fourth Quarter Attribution

Fixed Income Total Return remained fully allocated to high yield throughout the fourth quarter as a risk-on market environment persisted into the calendar year end. For the quarter, the strategy slightly underperformed the Bloomberg Barclays Corporate High Yield Bond Index on a gross and net basis and outperformed the Bloomberg Barclays Aggregate Bond Index on a gross and net basis.

For the calendar year, the strategy underperformed both the Bloomberg Barclays Corporate High Yield Bond Index and the Bloomberg Barclays Aggregate Bond Index on a gross and net basis. Through the first nine months of the year, there were several risk-on/risk-off trades as the yield curve inverted, then un-inverted, and trade tensions kept the markets zigzagging. As a result, the strategy made several reallocations that gave up some upside, but sought to reduce risk in uncertain periods.

This changed in the fourth quarter when trade tensions seemed to cool with an agreement on a Phase One trade deal and the Federal Reserve cut rates for a third time and signaled a commitment to keeping rates low. High yield bonds responded in kind, and the strategy participated in the advance during the quarter.

Outlook

High yield credit spreads contracted significantly from a high of 812 basis points in December 2018 to close 2019 at 327 basis points. The credit markets enter the New Year with a risk-on tone and our Fixed Income Total Return portfolio is fully allocated to high yield.

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We believe corporate credit remains richly priced with spreads historically tight across both investment grade and high yield bonds. The yield on the Bloomberg Barclays Intermediate-Term US Corporate Bond Index and the US Corporate High Yield Index ended the year at 2.42% and 5.19%, respectively. For high yield, this was nearly a record low yield.

Yields have only been lower for a brief period in the summer of 2014. We believe low yields and tight spreads indicate up-

side potential is limited and bonds are priced for perfection. However, there have been many instances in the past where spreads have remained tight for long periods of time.

In our opinion, the positive U.S. economic outlook and improving global economy, in addition to continued central bank liquidity and investor search for yield, should support credit in 2020.

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The Bloomberg Barclays US Intermediate Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers that have between 1 and up to, but not including, 10 years to maturity.

The Bloomberg Barclays U.S. Corporate High-Yield Index covers the U.S. dollar-denominated, non-investment grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below.

Bloomberg Barclays U.S. Aggregate Bond Index: The index is unmanaged and measures the performance of the investment grade, U.S. dollar denominated, fixed-rate taxable bond market, including Treasuries and government-related and corporate securities that have a remaining maturity of at least one year.

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