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## HIGHLIGHTS

- Volatility returned, as a sharp spike in bond yields triggered concerns around slowing profit growth, while the ongoing trade dispute with China renewed worries about synchronized global growth.
- As equity markets entered correction territory, investment grade corporates suffered their worst decline since February and yields in the high yield space reached their highest level since 2016.
- Commentary from the FOMC turned slightly more hawkish as some participants weighed the possibility of temporarily exceeding the longer-run neutral rate for fed funds.

## RATES

Interest rates rose sharply during the opening days of the month, with 10-year yields reaching a 7-year high in response to a record service sector reading, a 48-year low in the unemployment rate, and signs of healthy wage gains. Ironically, this sudden jump in yields, combined with lackluster data out of the retail and housing sectors, drove an uptick in volatility that led investors to seek refuge in the rates market. Ultimately, the yield on the 10-year rose 8 basis points on the month.

Commentary from the Federal Reserve reaffirmed expectations of several more rate hikes over the next year. Members of the FOMC continue to see a strong economy, with some going so far as to propose modestly restrictive policy for a time. This incrementally hawkish shift put upward pressure on short rates, while increased issuance from the Treasury weighed on the long end, leading to a bear steepening of the yield curve.

### U.S. Treasury Market - October 31, 2018

Maturity	10/31/18	Yield Change (bps)			Performance		
	Yield	MTD	QTD	YTD	MTD	QTD	YTD
2-year	2.87%	+5	+5	+98	0.14%	0.14%	0.26%
5-year	2.98%	+2	+2	+77	0.07%	0.07%	-1.28%
10-year	3.15%	+9	+9	+74	-0.61%	-0.61%	-4.32%
30-year	3.39%	+18	+18	+65	-3.62%	-3.62%	-9.93%

Source: Bloomberg, FactSet

Performance represents total returns of the Bloomberg Barclays U.S. Treasury Bellwethers Index for the maturities shown

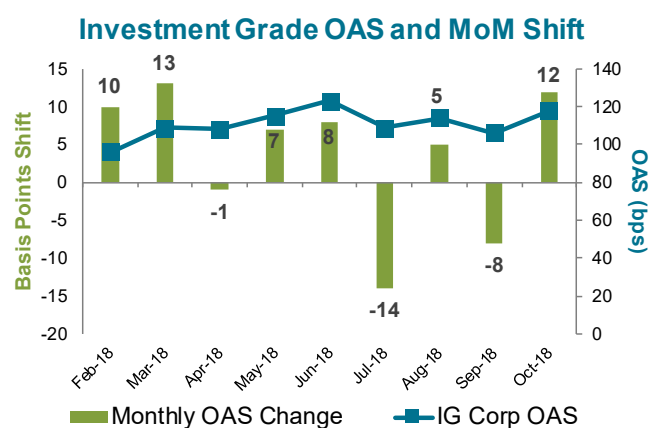
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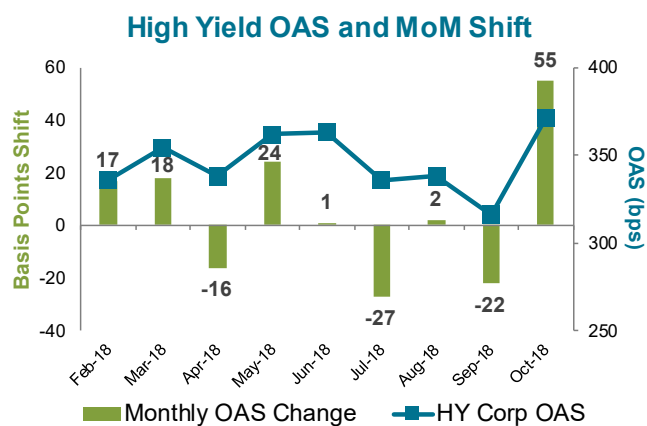
## CREDIT

Corporate spreads widened amid growing concerns about the end of the cycle, peak earnings and trade wars. The selloff in high yield was particularly sharp, given that spreads briefly touched their tightest level in more than a decade before jumping to their year-to-date wides. Investment grade struggled amid higher rates and worries about the credit quality of BBB-rated credits, which now represent 50% of the investment grade market. Preferred securities were negatively impacted by the selloff in risk assets, given their longer duration and lower seniority in the capital structure.

Lower-rated and more cyclically exposed credits underperformed. Higher interest rates weighed on housing and autos, while Chinese trade concerns put downward pressure on industrials and commodities. Nevertheless, the default rate at 3.1% remains at its lowest level since 2014 and is expected to decline to 1.7% by June 2019.



Source: FactSet



Source: FactSet

## MORTGAGES

Mortgage-backed securities had their worst month of relative performance since November 2016. The sector did not benefit from the flight to quality in the risk-off environment due to deterioration in the technical backdrop. The Fed entered the final stage of its balance sheet normalization, letting \$20 billion of mortgage-backed securities mature each month without replacement and thereby solidifying their absence in the market. At the same time, foreign buyers and banks have also stepped away on higher hedging costs and more lucrative opportunities in the commercial lending market. This leaves the market uncertain as to who will step in to fill the void.

## OUTLOOK

We maintain our view of a strong U.S. economy and continue to believe that the Fed's normalization of rate policy will not derail it. With credit fundamentals still on solid footing and valuations more attractive following the recent selloff, we are constructive on corporate spreads in the near term. That said, as the cycle matures we intend to continue moderating our credit exposure by moving up in quality. Rates are likely to be range-bound as strong economic growth is tempered by a vigilant Fed. As a result, we are keeping duration close to neutral. Within the mortgage-backed securities sector our allocation is also neutral, with a bias in favor of seasoned mortgage pools that should better withstand the runoff in the Fed's balance sheet.

## INDEX CHARACTERISTICS AND PERFORMANCE

October 31, 2018	CHARACTERISTICS			PERFORMANCE		
Index	Yield to Worst	OAD (Years)	OAS (bps)	MTD	QTD	YTD
Bloomberg Barclays U.S. Aggregate Bond	3.59%	5.99	44	-0.79%	-0.79%	-2.38%
U.S. Treasury	3.03%	5.89	0	-0.48%	-0.48%	-2.14%
Bloomberg Barclays U.S. Government Related	3.66%	5.26	64	-0.87%	-0.87%	-1.80%
Bloomberg Barclays U.S. Corporate Investment Grade	4.28%	7.09	118	-1.46%	-1.46%	-3.76%
Bloomberg Barclays U.S. Mortgage-Backed Securities	3.74%	5.45	34	-0.63%	-0.63%	-1.70%
Bloomberg Barclays U.S. Asset-Backed Securities	3.30%	2.18	43	0.07%	0.07%	0.59%
ICE BofAML Fixed Rate Preferred Securities	5.06%	5.59	149	-1.62%	-1.62%	-1.39%
Bloomberg Barclays High Yield	6.86%	3.91	371	-1.60%	-1.60%	0.93%
Bloomberg Barclays High Yield - BB	5.62%	4.35	248	-1.37%	-1.37%	-0.87%
Bloomberg Barclays High Yield - B	6.89%	3.63	372	-1.46%	-1.46%	1.67%
Bloomberg Barclays High Yield - CCC	10.06%	3.39	693	-2.46%	-2.46%	3.39%
Bloomberg Barclays High Yield BB 1-5 Year	5.07%	2.51	206	-0.81%	-0.81%	1.09%

Source: FactSet

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