INVESTMENT COMMENTARY

As we closed out the year of 2014 we were reminded that all is not well with the global economy. In the fourth quarter we witnessed continued strength in the US dollar, and a spectacular collapse in oil prices. Greece held elections in January, resulting in Euro uncertainty as well as a decline in emerging market debt prices. The resulting increase in global risk did not produce a commensurate increase in equity risk premiums, as the S&P500 added an additional 13.7% in 2014, following a 32% return in 2013. We believe this exuberance in the equity markets can be traced to a statement made on December 17, where the FOMC stated that with the recent market volatility they will be patient on their timing of their first rate increase. In just 5 trading days the S&P500 was up 5.5%, producing double-digit equity returns for 2014, while the strike price of the Yellen S&P put moved much higher.

To reiterate a statement from our last commentary, we believe that while the Fed might do a token rate increase sometime during the second half of 2015, they will likely monitor the impact of any such rate move on the economy for a considerable period before any subsequent rate increases.

In our last commentary we were also perplexed by the Euro trading in the 1.25 range to the dollar. Sure enough, it closed the year close to 1.21, which is still a perplexing premium. Greece is set for a legislative election on January 25, 2015. The leftist party of Syriza, which has made Greece's debt renegotiation a cornerstone of its campaign is maintaining a modest lead in the polls. ECU officials are calmly proclaiming that a Greek exit from the euro is not the issue that it used to be; apparently believing that all it will take would be for Mario Draghi to say again "we will do whatever it takes". However, this leaves us wondering about the foundations of such a currency and its role as a dollar contender.

With all the central banks having morphed into a group of bond traders buying assets left and right, and their mandates apparently having changed to issuing equity market puts in the name of maximizing employment, one has to wonder when and how all this is going to end. The how we believe will not be good. The when is anybody's guess.

For the first quarter of 2015:

The duration of our portfolios is expected to remain close to their respective benchmarks, and our yield curve positioning to have a more barbelled structure. Despite another year of doomsday bond market predictions, we believe that the global uncertainties will provide support to the long end of the yield curve and most "prognosticators" will be wrong once again.

Very selective credit overweight continues to be the primary theme of adding value during the 1st quarter. We maintain our significant overweight in industrial bonds, which provide our portfolios with additional yield; while we have a neutral allocation to financials, as we believe that the spreads offered by the financial sector barely compensate for the sector volatility. Despite the fourth quarter widening in some of our energy related holdings we maintain our allocation to the energy sector; where our emphasis is on companies that can not only withstand years of reduced oil prices, but those that have also shown the commitment to maintain their ratings or to reduce leverage. We maintain a neutral allocation in agency MBS, as the overall MBS valuations still do not offer sufficient compensation given their extension risk and negative convexity impact on portfolios. We maintain our allocation to high yield with an emphasis on strong businesses and companies that exhibit balance sheet strength, which should perform well in a period of slow economic growth. Lastly, we remain underweighted in the emerging markets sector, as growth uncertainties stemming from the potential removal of Fed liquidity, and subpar global economic growth should continue to weigh negatively on sector spreads going forward.

Evangelos Karagiannis
Senior Vice President,
Senior Portfolio Manager

KEY RATES

	12/31/14	9/30/14	12/31/13
Fed Funds Target Rate	0-0.25%	0-0.25%	0-0.25%
3 Month LIBOR	0.26	0.24	0.25
On-the-run Treasuries:			
3 Months	0.04	0.02	0.07
6 Months	0.12	0.03	0.09
2 Years	0.67	0.57	0.38
5 Years	1.65	1.76	1.74
10 Years	2.17	2.49	3.03
30 Years	2.75	3.20	3.97

Source: Bloomberg

KEY ECONOMIC INDICATORS

as of	12/31/14	12/31/13
U.S. $ (DXY)	90.27	80.04
Oil	53.27	98.42
Gold	1184.86	1205.65
CRB	229.96	280.17
GDP	5.0	4.1
CPI	1.3	1.2
Core (Ex - Food & Energy)	1.4	1.1
Unemployment Rate	5.8	7.0
Consumer Confidence	92.60	78.10
S&P/Case-Shiller – Comp-20	4.50	13.61

Source: Bloomberg

INDEX RETURNS

	4Q'14	YTD	1-Year
Barclays –			
Universal	1.34%	5.56%	5.56%
Aggregate	1.79	5.97	5.97
Aggregate ex-credit	1.81	5.34	5.34
Gov-Credit	1.82	6.01	6.01
Int. Gov-Credit	0.89	3.13	3.13
Corporate	1.77	7.46	7.46
Treasury only	1.93	5.06	5.06
1-3 year Gov	0.19	0.64	0.64
BofA Merrill – 1-yr T-Note	-0.07	0.18	0.18
High Yield	-1.00	2.45	2.45
International Debt	-2.99	-3.08	-3.08
Emerging Markets Debt	-1.72	4.76	4.76
S&P 500	4.93	13.68	13.68
DJIA	5.20	10.04	10.04
NASDAQ	4.98	19.49	19.49
EAFE AWI	-3.45	-4.20	-4.20

Source: Bloomberg & Barclays

SECTOR RETURNS

4Q'14	Total Return	Excess Return
U.S. Treasuries	1.93%	0.00%
Government-related U.S. Agency	1.52	-0.47
Government-related Credit	1.73	-0.77
Corporate	1.77	-1.12
Corporate Financials	1.78	-0.29
Corporate Industrials	1.54	-1.61
Corporate Utilities	3.41	-0.88
Corporate AAA-rated	3.18	-0.64
Corporate AA-rated	1.99	-0.42
Corporate A-rated	2.20	-0.64
Corporate BBB-rated	1.23	-1.80
Corporate High-Yield	-1.00	-2.32
Mortgage-backed Securities-FR	1.81	-0.01
Mortgage-backed Securities-Hybrid	0.44	0.07
CMBS	1.45	0.23
ABS	0.55	0.08

Source: Barclays

Pacific Income Advisers, Inc. (PIA) is an autonomous investment management firm registered under the Investment Advisers Act of 1940. PIA manages a variety of fixed income, equity, and balanced assets for primarily United States clients.

BENCHMARK DESCRIPTION

Barclays U.S. Universal Index represents the union of the U.S. Aggregate Index, U.S. Corporate High-Yield Index, Investment-Grade 144A Index, Eurodollar Index, U.S. Emerging Markets Index, and the non-ERISA eligible portion of the CMBS Index. The index covers USD-denominated, taxable bonds that are rated either investment-grade or below investment-grade. Some U.S. Universal Index constituents may be eligible for one or more of its contributing subcomponents that are not mutually exclusive. These securities are not double-counted in the index. You can not invest directly in an index.

Barclays U.S. Aggregate Bond Index is an unmanaged index that covers the investment grade fixed rate bond market with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. The issues must be rated investment grade, be publicly traded, and meet certain maturity and issue size requirements. You can not invest directly in an index.

Barclays U.S. Aggregate Ex-Credit Index (LB Agg (Ex-Credit)) The index covers the U.S. investment grade fixed rate bond market, with index components for government, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis. You can not invest directly in an index.

Barclays U.S. Government/Credit Bond Index includes securities in the Government and Credit Indices. The Government Index includes treasuries (i.e., public obligations of the U.S. Treasury that have remaining maturities of more than one year) and agencies (i.e., publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government). The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements. You can not invest directly in an index.

Barclays U.S. Intermediate Government/Credit Bond Index is the Intermediate component of the U.S. Government/Credit index. The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries (i.e., public obligations of the U.S. Treasury that have remaining maturities of more than one year) and agencies (i.e., publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government). The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements. You can not invest directly in an index.

Barclays U.S. 1-3 Year Government Bond Index consist of securities in the U.S. Government Index with a maturity from 1 up to (but not including) 3 years. Securities issued by the U.S. Government (i.e., securities in the Treasury and Agency Indices). Inclusions: Public obligations of the U.S. Treasury with a remaining maturity of one year or more. Publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government. You can not invest directly in an index.

Barclays U.S. Treasury Index includes public obligations of the U.S. Treasury. Treasury bills are excluded by the maturity constraint but are part of a separate Short Treasury Index. In addition, certain special issues, such as state and local government series bonds (SLGs), as well as U.S. Treasury TIPS, are excluded. STRIPS are excluded from the index because their inclusion would result in double-counting. Securities in the Index roll up to the U.S. Aggregate, U.S. Universal, and Global Aggregate Indices. You can not invest directly in an index.

Barclays U.S. Corporate Bond Index covers USD-denominated, investment-grade, fixed-rate, taxable securities sold by industrial, utility, and financial issuers. It includes publicly issued U.S. corporate debentures and secured notes that meet specific maturity, liquidity, and quality requirements. Securities in the index roll up to the U.S. Credit and U.S. Aggregate indices. The U.S. Corporate Index was launched on January 1, 1973. You can not invest directly in an index.

BofA Merrill Lynch 1-Year US Treasury Note Index is comprised of a single issue purchased at the beginning of the month and held for a full month. At the end of the month that issue is sold and rolled into a newly selected issue. The issue selected at each month-end rebalancing is the outstanding Treasury note that matures closest to, but not beyond, one year from the rebalancing date. To qualify for selection, an issue must have settled on or before the month-end rebalancing date. You can not invest directly in an index.

Barclays Corporate U.S. High Yield Index - covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets (e.g., Argentina, Brazil, Venezuela, etc.) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included. The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility, and Finance, which include both U.S. and non-U.S. corporations. The Yankee sector has been discontinued as of 7/1/00. The bonds in the former Yankee sector have not been removed from the index, but have been reclassified into other sectors. You cannot invest directly in an index.

Barclays Global Aggregate Index provides a broad-based measure of the global investment-grade fixed-rate debt markets. The Global Aggregate Index contains three major components: the U.S. Aggregate Index (USD 300 million), the Pan-European Aggregate Index (EUR 300 million), and the Asian-Pacific Aggregate Index (JPY 35 billion). In addition to securities from these three benchmarks (94.4% of the overall Global Aggregate market value), the Global Aggregate Index includes Global Treasury, Eurodollar (USD 300 million), Euro-Yen (JPY 35 billion), Canadian (CAD 300 million), and Investment-Grade 144A (USD 300 million) index-eligible securities not already in the three regional aggregate indices. The Global Aggregate Index family includes a wide range of standard and customized subindices by liquidity constraint, sector, quality, and maturity. The Global Aggregate Index is a component of the Multiverse Index. You can not invest directly in an index.

Barclays Global Emerging Markets Index consists of the fixed and floating-rate USD-denominated U.S. Emerging Markets Index and the primarily EUR and GBP-denominated fixed-rate Pan-European Emerging Markets Index and includes emerging markets debt from the following regions: Americas, Europe, Asia, Middle East, and Africa. For the index, an emerging market is defined as any country that has a long term foreign currency debt sovereign rating of Baa1/BBB+/BBB+ or below using the middle rating of Moody's, S&P, and Fitch. The index does not overlap with the U.S. Corporate High-Yield Index or the Pan Euro Corporate High-Yield Index, but may overlap with other investment-grade Aggregate Indices if the securities meet their index eligibility rules. You can not invest directly in an index.

S&P 500 Index – The S&P 500 index includes 500 leading companies in leading industries of the U.S. economy. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe. You can not invest directly in an index.

The NASDAQ-100 Index is a modified capitalization-weighted index of the 100 largest and most active non-financial domestic and international issues listed on the NASDAQ. No security can have more than a 24% weighting. The index was developed with a base value of 125 as of February1, 1985. Prior to December 21, 1998 the Nasdaq 100 was a cap-weighted index. You can not invest directly in an index.

The Dow Jones Industrial Average (DJIA) is an index used to measure the performance of the U.S. financial markets. Introduced on May 26, 1896 by Charles H. Dow, it is the oldest stock price measure in continuous use. Over the past century "the Dow" has become the most widely recognized stock market indication in the U.S. and probably in the entire world. Most of the stocks included in the index are listed on the New York Stock Exchange, and are all large blue-chip companies that reflect the health of the U.S. economy. All but a handful of these have major business operations throughout the world, thus providing some insight into the economic well-being of the global economy. You can not invest directly in an index.

MSCI EAFE Index is a capitalization weighted index that monitors the performance of stocks from Europe, Australiasia, and the Far East. You can not invest directly in an index.

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