INVESTMENT COMMENTARY

Euripides would have been very proud! In typical Greek tragedy fashion, a referendum was called in Greece. The result of which turned out to be not so much about the terms of any new agreement, or about staying or exiting the euro currency, but on whether member nations of the EU have the right to view the citizens of other EU members as second class citizens and bluntly interfere in their domestic affairs. Economic targets are one thing, but when the European cacophony of no less than fifty statements a day from every known and unknown, elected and non-elected official ranging from stating the obvious to "the end of the world is near" reaches such a climax, one then has to feel sorry about of the state of affairs of the so called "European Union". The concept of a Union is based on the premise that all parties are equal, and while some might have different views as to how the world works, or have better economies than others, or might be more spendthrift than others, in the end there should be an underlying respect and dignity towards all members of a Union.

With elections coming up in Spain and the euro skepticism generally gaining ground, the EU does not want to set a precedent that a change in government or a referendum can lead to an easy solution out of debt and economic restructuring obligations. The European dream sounds more and more like a teacher's nightmare in dealing with a bunch of rowdy kids. And how did Germany and its satellites come to play the teacher role? Yes, it is the economy stupid. But let us not forget that it was the massive debt forgiveness and growth loans of the past that made Germany what it is today. Or for that matter that while the nations of the European south were spending like the nouveau riche, it was Germany that was reaping the economic benefits of low interest rates and exports to these same countries.

Waiting in the wings for another round of European high drama is David Cameron's almost ignored presentation to the European leaders about its need for the EU to be less involved in British domestic affairs or the British people will vote in 2017 to leave or not leave the EU. Whatever damage to the EU caused by Greece's leaving the Euro currency, it would pale next to the effects of a British exit of the EU. Right now, the odds favor Scotland wanting to stay and England wanting to leave.

At the other end of the globe, the Chinese economic bubble appears to have begun the process of bursting, despite the frantic efforts of the government to reflate it. With the slowdown in the Chinese economy coupled with the events in Greece and renewed declines in oil prices, most risky assets underperformed during the second quarter. Fears about the imminent hike in interest rates by the Federal Reserve caused the yield curve to steepen, only for that trend to be recently reversed by the events in Europe.

All this uncertainty is likely to provide support for US assets in general and interest rates specifically. The uncertainty surrounding Europe along with the weakening euro should give the Fed another reason to either delay the hike in rates or limit the pace of the hikes. We still believe a rate hike is not likely before year-end. This uncertainty should also impact financials, as their small spread widening is not commensurate with their increase in risk. Even the unlikely, but ultimate worst case scenario of a "Grexit" should not create an immediate systemic risk (mostly due to the ECB asset buying), but the flight to quality, along with a further increase in volatility and potential speculative attacks on the debt of the countries of the European south should all provide support for US fixed income assets.

For the third quarter of 2015 our strategy is more defensive, electing to add value to our portfolios by selectively investing in high quality corporate bonds, while maintaining the risk of our portfolios at acceptable levels.

The duration of our portfolios remains close to their respective benchmarks, and our yield curve positioning has a more barbelled structure. Global uncertainties about the ability of economies to grow will provide support to the long end of the yield curve. Valuations relative to other foreign government bonds now favor longer maturity US treasuries.

Very selective credit overweight continues to be the primary theme of adding value during the 3rd quarter. We maintain our overweight in industrial bonds, which provide our portfolios with additional yield. We also have a neutral allocation to financials, as we believe that the historically high spreads offered by the sector only fairly compensate for the sector volatility, especially after the recent events in Europe. We maintain our allocation to agency MBS, as sector valuations remain in a fairly valued range.

In spite of potential oil weakness, we are comfortable holding our energy sector selections over the longer term. We believe that they: (1) can withstand years of reduced oil prices, (2) have shown the commitment to maintain their investment grade ratings and (3) have a willingness to reduce leverage.

Evangelos Karagiannis
Managing Director,
Senior Portfolio Manager

KEY **RATES**

	6/30/15	3/31/15	6/30/14
Fed Funds Target Rate	**0-0.25%**	**0-0.25%**	**0-0.25%**
3 Month LIBOR	**0.28**	**0.27**	**0.23**
On-the-run Treasuries:			
3 Months	**0.01**	**0.02**	**0.02**
6 Months	**0.11**	**0.14**	**0.06**
2 Years	**0.65**	**0.56**	**0.46**
5 Years	**1.65**	**1.37**	**1.63**
10 Years	**2.35**	**1.92**	**2.53**
30 Years	**3.12**	**2.54**	**3.36**

Source: Bloomberg

KEY **ECONOMIC INDICATORS**

as of	6/30/15	6/30/14
U.S. $ (DXY)	**95.49**	**79.78**
Oil	**59.47**	**105.37**
Gold	**1,172.42**	**1,327.32**
CRB	**227.17**	**308.22**
GDP	**-0.2**	**-2.9**
CPI	**0.0**	**2.1**
Core (Ex - Food & Energy)	**1.2**	**1.5**
Unemployment Rate	**5.5**	**6.3**
Consumer Confidence	**101.40**	**85.18**
S&P/Case-Shiller – Comp-20	**4.91**	**10.82**

Source: Bloomberg

INDEX **RETURNS**

	2Q'15	YTD	1-Year
Barclays –			
Universal	**-1.40%**	**0.30%**	**1.61%**
Aggregate	**-1.68**	**-0.10**	**1.86**
Aggregate ex-credit	**-1.17**	**0.19**	**2.26**
Gov-Credit	**-2.10**	**-0.30**	**1.69**
Int. Gov-Credit	**-0.62**	**0.82**	**1.68**
Corporate	**-3.16**	**-0.92**	**0.75**
Treasury only	**-1.58**	**0.03**	**2.31**
1-3 year Gov	**0.15**	**0.69**	**0.91**
BofA Merrill – 1-yr T-Note	**0.11**	**0.21**	**0.25**
High Yield	**0.00**	**2.53**	**-0.40**
International Debt	**-0.83**	**-5.43**	**-13.19**
Emerging Markets Debt	**0.45**	**2.76**	**0.20**
S&P 500	**0.28**	**1.23**	**7.42**
DJIA	**-0.29**	**0.03**	**7.21**
NASDAQ 100	**1.74**	**4.42**	**15.58**
MSCI EAFE	**0.80**	**5.93**	**-3.59**

Source: Bloomberg & Barclays

SECTOR **RETURNS**

2Q'15	Total Return	Excess Return
U.S. Treasuries	**-1.58%**	**0.00%**
Government-related U.S. Agency	**-1.38**	**0.06**
Government-related Credit	**-1.81**	**0.09**
Corporate	**-3.16**	**-0.87**
Corporate Financials	**-2.08**	**-0.61**
Corporate Industrials	**-3.50**	**-0.94**
Corporate Utilities	**-5.11**	**-1.41**
Corporate AAA-rated	**-4.49**	**-1.01**
Corporate AA-rated	**-2.44**	**-0.56**
Corporate A-rated	**-2.96**	**-0.76**
Corporate BBB-rated	**-3.47**	**-1.04**
Corporate High-Yield	**0.00**	**0.69**
Mortgage-backed Securities-FR	**-0.75**	**0.05**
Mortgage-backed Securities-Hybrid	**-0.03**	**-0.12**
CMBS	**-1.06**	**-0.31**
ABS	**0.17**	**0.21**

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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