INVESTMENT COMMENTARY

The third longest U.S. economic expansion on record continued as U.S. GDP grew at a 2.0% rate for the 12 months ending March 31st. CPI climbed to 2.8%, while Core Inflation (ex-food and energy) was measured at 2.0%. Wage growth continues at a more tepid pace, despite the lowest unemployment rate (3.8%) in two decades sparking some inflation concerns. Trade war fears subsided briefly during the quarter when U.S. Treasury Secretary Steven Mnuchin stated in late May that the U.S. was "putting the trade war on hold". However, the White House continued to publicly discuss a series of economic actions and tariffs against key trading partners, which portend commensurate retaliatory measures by significant global economic partners. As previously stated, we estimate a global trade war could reduce U.S. GDP by as much as 50 basis points. The Federal Reserve continued with incremental rate hikes, raising the Fed Funds Target Rate by 25 basis points to 1.75 - 2.00% and signaling additional rate hikes in response to continued economic strength and rising inflation. The yield on the 2-year Treasury climbed 26 basis points to 2.53% resulting in additional flattening of the yield curve, albeit less dramatic than in the previous quarter. The yield on the 10-year Treasury increased by 12 basis points to 2.86%, producing a negative quarterly return (-0.28) for the benchmark Treasury. However, positive returns in short and long Treasury maturities allowed the overall Treasury sector to generate a 0.10% quarterly return. U.S. Agency Securities underperformed (-0.19%) as did investment grade Corporate bonds (-0.98%) as investment grade corporate spreads widened by 13 bps to 126 bps, while Mortgage-Backed Securities (+0.24%) and Asset-Backed Securities (+0.42%) were the strongest performing sectors of the U.S. investment grade bond market. High Yield corporate bonds outperformed (+1.03%) relative to investment grade bonds as their shorter duration, incremental yield and lack of rating migration were positives.

Our economic and interest rate outlooks remain cautious as we weigh strong corporate earnings, employment and the capitalization of the U.S. economy against the efficacy of current U.S. policy. While investors seem intent on navigating the Harry Potter-like twists and turns of the current administration's rhetoric, an increasing number of companies have considered delays in investment and hiring due to uncertainties surrounding the on-again off-again proposed tariffs with several key U.S. trading partners including Canada, China and the EU. To further complicate our concerns, trade tariffs are clearly inflationary. A median measure of the goods currently subject to the proposed tariffs is roughly 5% of Core CPI, which means a 10% tariff could add 0.5% to the Core CPI Index. We believe fiscal policy aimed at attacking the trade deficit is economically misguided, as these deficits are essentially a mirror image of the capital account surplus. Given the obvious economic risks, we remain cautiously optimistic that trade tariff talks will prove more bark than bite, but the potential for additional inflation pressure lends some explanation to why Chairman Powell's statement following the June 12-13 FOMC meeting appeared a bit more hawkish than market consensus. Chairman Powell remained on message by reaffirming the Fed's projected gradual rate path of four rate increases in 2018 (two remaining), while also affirming the Fed's commitment to their program to reduce the Fed's balance sheet. The Fed Chairman's statement referenced continued strength in labor conditions, solid GDP growth with expectations of 2.8% growth in 2018 and 2.4% growth in 2019, driven largely by a bounce in household spending. Additionally, the Chairman credited the growth trend to both tax cuts and increased spending. While the positive economic backdrop outlined by the Fed has raised concerns of inflation, we believe the global demand for long-term safe assets accompanied with very low government bond yields worldwide may continue to keep the longer end of the yield curve range bound. As such, we remain hopeful the Fed will soften from the current 2.4% median fed funds year-end target rate, as we continue to believe a flat or inverted yield curve portends a real risk to our capital intensive economy.

Our portfolio duration is slightly short relative to our respective benchmarks. We anticipate continued near-term market volatility due to the potential risks of additional Fed rate hikes, escalating global trade tensions and increasing M&A activity. We've structured a modest maturity barbell within the Government sector, while also reducing our Credit sector duration. We believe the risk of recession remains low over the next twelve months, but we have started to reduce our Credit overweight to improve the overall credit quality of our portfolios, given risk-adjusted valuations. While corporate issuance remains strong, we believe the rise in overall corporate leverage is manageable for high quality investment grade borrowers with strong revenue/EBITDA growth. We continue to overweight Industrial credits that provide incremental risk-adjusted yield and also seek to selectively invest in high-quality, senior Financial credits that we believe offer attractive compensation for the sector volatility. For Core Plus clients, we continue to maintain our weighting to high yield corporate bonds, given current expectations for GDP growth along with the high relative yields and shorter duration of the sector. Lastly, we remain modestly overweight agency mortgage-backed securities, as sector valuations continue to offer value on a risk-adjusted basis.

PIA Macro Strategy Group

KEY RATES

	6/30/18	3/31/18	12/31/17
Fed Funds Target Rate	**1.75 - 2.0%**	**1.5 - 1.75%**	**1.0 - 1.25%**
3 Month LIBOR	**2.34**	**2.31**	**1.69**
On-the-run Treasuries:			
3 Months	**1.91**	**1.70**	**1.38**
6 Months	**2.11**	**1.91**	**1.53**
2 Years	**2.53**	**2.27**	**1.88**
5 Years	**2.74**	**2.56**	**2.21**
10 Years	**2.86**	**2.74**	**2.41**
30 Years	**2.99**	**2.97**	**2.74**

Source: Bloomberg

KEY ECONOMIC INDICATORS

as of	6/30/18	6/30/17
U.S. $ (DXY)	**94.47**	**95.63**
Oil	**74.15**	**46.04**
Gold	**1,253.17**	**1,241.55**
CRB	**200.39**	**174.78**
GDP	**2.0**	**1.4**
CPI	**2.8**	**1.9**
Core (Ex - Food & Energy)	**2.0**	**1.4**
Unemployment Rate	**3.8**	**4.3**
Consumer Confidence	**126.40**	**118.90**
S&P/Case-Shiller – Comp-20	**6.56**	**5.67**

Source: Bloomberg

INDEX RETURNS

	2Q'18	YTD	1-Year
Bloomberg Barclays –			
Universal	**-0.27%**	**-1.67%**	**-0.28%**
Aggregate	**-0.16**	**-1.62**	**-0.40**
Aggregate ex-credit	**0.15**	**-1.01**	**-0.30**
Gov-Credit	**-0.33**	**-1.90**	**-0.63**
Int. Gov-Credit	**0.01**	**-0.97**	**-0.58**
Corporate	**-0.98**	**-3.27**	**-0.83**
Treasury only	**0.10**	**-1.08**	**-0.65**
1-3 year Gov	**0.21**	**0.06**	**0.03**
BofA Merrill – 1-yr T-Note	**0.40**	**0.65**	**0.92**
High Yield	**1.03**	**0.16**	**2.62**
International Debt	**-4.76**	**-1.31**	**2.78**
Emerging Markets Debt	**-2.40**	**-3.84**	**-1.04**
S&P 500	**3.43**	**2.65**	**14.36**
DJIA	**1.26**	**-0.73**	**16.31**
NASDAQ 100	**7.27**	**10.65**	**26.01**
MSCI EAFE	**-1.06**	**-2.40**	**7.40**

Source: Bloomberg Barclays

SECTOR RETURNS

2Q'18	Total Return	Excess Return
U.S. Treasuries	**0.10%**	**0.00%**
Government-related U.S. Agency	**-0.28**	**-0.37**
Government-related Credit	**-0.38**	**-0.44**
Corporate	**-0.98**	**-1.00**
Corporate Financials	**-0.64**	**-0.67**
Corporate Industrials	**-1.11**	**-1.13**
Corporate Utilities	**-1.33**	**-1.37**
Corporate AAA-rated	**-0.34**	**-0.41**
Corporate AA-rated	**-0.33**	**-0.42**
Corporate A-rated	**-0.90**	**-0.94**
Corporate BBB-rated	**-1.17**	**-1.17**
Corporate High-Yield	**1.03**	**0.96**
Securitized	**0.23**	**0.15**
Mortgage-backed Securities-FR	**0.24**	**0.15**
CMBS	**-0.06**	**0.00**
ABS	**0.42**	**0.17**

Source: Bloomberg 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

Bloomberg 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.

Bloomberg 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.

Bloomberg 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.

Bloomberg 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.

Bloomberg 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.

Bloomberg 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.

Bloomberg 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.

Bloomberg 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.

Bloomberg 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.

Bloomberg 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.

Bloomberg 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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