INVESTMENT COMMENTARY

As the third longest U.S. economic expansion on record continues, concerns regarding rising inflationary pressures increased. The Consumer Price Index measured 2.7% over a twelve-month period, one of the highest readings since 2012, and while inflation is certainly increasing at the producer level, companies have been seemingly hesitant to pass these costs on to the end consumer in an effort to maintain market share. Global trade war fears, on the other hand, have eased somewhat as the United States, Mexico and Canada announced a plan on September 30, 2018, to replace NAFTA with the United States-Mexico-Canada Agreement ("USMCA") pending legislative approval, which follows a revised trade agreement with South Korea. The administration has been signaling breakthroughs in talks with most major trading partners with the exception of China, which we believe may still pose growth risks.

The Federal Reserve continued with incremental rate hikes, raising the Fed Funds Target Rate by 25 basis points to 2.00-2.25% and signaling additional rate hikes in response to continued economic strength and rising inflation concerns. The yield on the 2-year Treasury climbed 29 basis points to 2.82% resulting in additional flattening of the yield curve. The yield on the 10-year Treasury increased by 20 basis points to 3.06%, producing a negative quarterly return (-1.09%) for the benchmark Treasury. Overall, the Treasury sector generated a -0.59% quarterly return. Investment grade spread sectors outperformed US Treasuries for the quarter with Investment Grade corporate bonds (+0.97%), Asset-Backed Securities (+0.49%), Agency Securities (+0.28%) and Mortgage-Backed Securities (-0.12%) all providing excess returns for the quarter. High Yield corporate bonds were a top performer again (+2.40%), reflecting the strong economic backdrop and correlating, as expected, with the equity market's strong performance.

During the third quarter our long-term economic outlook deteriorated, however our expectations over the next 12-months improved slightly as we continue to observe solid sequential quarter over quarter growth in the US economy and labor force. The Consumer Confidence Index climbed to 138.4 in September, the second highest reading since its inception in 1977, and consumption continued to be strong. Unemployment is at a 50-year low and wages continue to rise, albeit at a tepid pace, as increases in state minimum wages will continue into 2019 for the fourth consecutive year. However, we remain cautious regarding the efficacy of U.S. trade and monetary policy as potential contributors to future economic headwinds. Will we ultimately level the playing field with lower tariffs or will we enter into a protectionist era, driven largely by U.S.-China trade war concerns? U.S. oil exports to China, an industry not directly impacted by trade tariffs, were reduced from 23% of U.S. output to 0% in August, while U.S. soybean exports to China, a key agricultural commodity, were reduced by roughly 95% versus August 2017. The U.S. imposed/suggested trade tariffs represent the ultimate economic wildcard, as they can meaningfully impact both economic growth and price stability. Largely due to tariff-related economic uncertainty, the IMF cut its 2018-19 forecast for global growth to 3.7%, the first such cut in two years. Additionally, the Fed removed the term "accommodative" from their September prepared statement; however the FOMC "dot plot" indicates a high probability of one more rate increase in December, three more rate hikes in 2019 and another in 2020. The Fed also plans to remove another approximately $500 billion from its balance sheet in 2019. It's also important to note that the 10-year treasury yield climbed to the high end of our expected range by quarter end, as we believe this upward move in the long end of the yield curve is important because this could reduce the economic risks associated with a flat or inverted yield curve.

We believe this upward shift in the yield curve may reflect increased potential for sustainability in U.S. growth and employment. However, we believe we are at an inflection point in this economic cycle, where our policy makers can either sustain this attractive slow-growth, modest inflation cycle or bring it to an abrupt end.

We continue to maintain our short duration position relative to our respective benchmarks given our near-term interest rate outlook as strong Treasury supply, sustained economic growth and the gradual normalization of the Fed Fund Rate places upward pressure on the Treasury curve. We expect heightened near-term rate volatility due to market uncertainty surrounding additional Fed rate hikes going forward as the debate surrounding terminal rate levels intensifies. While global trade uncertainty and strong M&A activity persist, we maintain our modest corporate overweight, as we believe the risk of recession remains low over the next twelve months, focusing our opportunity set on high quality corporate names given the relatively tight spread environment. As investors become more selective and risk-reward sensitive, we remain wary of corporations taking on substantial leverage at this point in the market cycle. However, we believe the rise in overall corporate leverage is manageable for high quality investment grade borrowers with strong revenue/ EBITDA growth that have benefitted from low rate issuance and lower corporate tax rates. 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 maintain a modest overweight to agency mortgage-backed securities, as sector valuations continue to offer value on a risk-adjusted basis.

PIA Investment Strategy Group

KEY RATES

	9/30/18	6/30/18	12/31/17
Fed Funds Target Rate	**2.0 - 2.25%**	**1.75 - 2.0%**	**1.0 - 1.25%**
3 Month LIBOR	**2.40**	**2.34**	**1.69**
On-the-run Treasuries:			
3 Months	**2.20**	**1.91**	**1.38**
6 Months	**2.36**	**2.11**	**1.53**
2 Years	**2.82**	**2.53**	**1.88**
5 Years	**2.95**	**2.74**	**2.21**
10 Years	**3.06**	**2.86**	**2.41**
30 Years	**3.21**	**2.99**	**2.74**

Source: Bloomberg

KEY ECONOMIC INDICATORS

as of	9/30/18	9/30/17
U.S. $ (DXY)	**95.13**	**93.08**
Oil	**73.25**	**51.67**
Gold	**1,192.50**	**1,280.15**
CRB	**195.16**	**183.09**
GDP	**4.2**	**3.1**
CPI	**2.7**	**1.9**
Core (Ex - Food & Energy)	**2.0**	**1.3**
Unemployment Rate	**3.9**	**4.4**
Consumer Confidence	**138.40**	**119.80**
S&P/Case-Shiller – Comp-20	**5.92**	**5.81**

Source: Bloomberg

INDEX RETURNS

	3Q'18	YTD	1-Year
Bloomberg Barclays –			
Universal	**0.27%**	**-1.41%**	**-1.00%**
Aggregate	**0.02**	**-1.60**	**-1.22**
Aggregate ex-credit	**-0.35**	**-1.36**	**-1.27**
Gov-Credit	**0.06**	**-1.85**	**-1.37**
Int. Gov-Credit	**0.21**	**-0.76**	**-0.96**
Corporate	**0.97**	**-2.33**	**-1.19**
Treasury only	**-0.59**	**-1.67**	**-1.62**
1-3 year Gov	**0.20**	**0.26**	**-0.01**
BofA Merrill – 1-yr T-Note	**0.41**	**1.07**	**1.08**
High Yield	**2.40**	**2.57**	**3.05**
International Debt	**-1.74**	**-3.03**	**-1.45**
Emerging Markets Debt	**1.61**	**-2.28**	**-1.68**
S&P 500	**7.71**	**10.65**	**17.90**
DJIA	**9.63**	**8.83**	**20.76**
NASDAQ 100	**8.61**	**20.18**	**28.91**
MSCI EAFE	**1.42**	**-0.99**	**3.26**

Source: Bloomberg Barclays

SECTOR RETURNS

3Q'18	Total Return	Excess Return
U.S. Treasuries	**-0.59%**	**0.00%**
Government-related U.S. Agency	**0.37**	**0.74**
Government-related Credit	**0.49**	**0.95**
Corporate	**0.97**	**1.69**
Corporate Financials	**0.93**	**1.35**
Corporate Industrials	**1.07**	**1.90**
Corporate Utilities	**0.23**	**1.44**
Corporate AAA-rated	**-0.02**	**1.36**
Corporate AA-rated	**0.58**	**1.14**
Corporate A-rated	**0.72**	**1.45**
Corporate BBB-rated	**1.29**	**2.00**
Corporate High-Yield	**2.40**	**2.48**
Securitized	**-0.07**	**0.21**
Mortgage-backed Securities-FR	**-0.12**	**0.17**
CMBS	**0.46**	**0.77**
ABS	**0.49**	**0.31**

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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