INVESTMENT COMMENTARY

Although the economy continues to expand and corporate earnings continue to grow, albeit at a slower rate, the equity markets had a swift and dramatic correction. The selloff accelerated into the last month of the year as the S&P 500 had its worst monthly decline since February 2009 and the DJIA had its worst December since the Great Depression. The Federal Reserve continued with incremental rate hikes, raising the Fed Funds Target Rate by 25 basis points to 2.25-2.50%. The raise was met with broad criticism, but strong employment and wage increases at bellwether retailers like Target continue to provide concern regarding future inflationary pressures. As mentioned last quarter, the potential for a trade war with China poses risks to the economy, and technology stocks suffered during the quarter, given the ongoing trade dispute regarding intellectual property rights and conditions necessary for U.S. tech firms to access the Chinese market.

Given the risk-off trade and the flight to quality, the 2-year Treasury decreased 36 basis points to 2.49% while the yield on the 10-year Treasury decreased by 38 basis points to 2.68%. Thanks to the non-correlating nature of bonds and the resulting declining yields, the Treasury sector generated a 2.57% quarterly return. Investment grade spread sectors underperformed US Treasuries for the quarter with Investment Grade corporate bonds (-0.18%), Asset-Backed Securities (+1.25%), Agency Securities (+1.13%) and Mortgage-Backed Securities (+2.08%) all lagging on an absolute return basis. Lipper reported that investment grade bond funds saw outflows of $4.4 billion for the week ending 12/26, which accelerated spread widening as bond fund liquidations from credit funds were heightened in a risk-off environment. High Yield corporate bonds erased gains from the year in the market selloff and were down (-4.53%) for the quarter.

The PIA long-term economic outlook continued to trend negative through the fourth quarter. Additionally, our 2019 economic outlook turned less positive following a downturn in some important economic indicators, an elevated risk of fiscal policy mistakes and the Federal Reserve's intention to continue removing liquidity. There were bright spots: a potential trade resolution with China, overall strength in the commodity complex, and ongoing strength in both labor market and wage growth (two closely followed lagging economic indicators) provided investors with optimism for sustainable growth and expectations of growing inflation. However, we're concerned with the downward trend in several leading economic indicators including the equity markets, inventory levels, the housing market and new business start-ups. The Consumer Confidence Index declined to 128.1, albeit from an elevated 138.4 at the end of 3Q18. The Pending Home Sales Index ended 2019 at its lowest level since 2014, with a year-over-year decline of 7.7%, following eleven consecutive months in decline. Coincidentally, there is a strong historical correlation between peaks in the housing and business cycles. Oil and copper prices, key industrial commodities, ended the year down roughly 40%. Lastly, after stripping out the increase in inventories and based on final sales, strong third quarter GDP growth of 3.5% is reduced to approximately 1.2%.

While the global economy is clearly slowing, most notably in China and the Euro region, we still see reasonable growth potential in the U.S. economy and continue to believe the greatest risk is that of fiscal and/or monetary policy mistakes. Trade tariffs are inflationary and produce a negative drag on the global economy and although the damage to the U.S. economy is quantifiably ambiguous given only about 8% of U.S. GDP is export driven, U.S. exports have declined eleven months in a row (another leading indicator). Another concern is the growing level of debt service at a time of economic uncertainty. In 2019, it's been reported that corporate debt re-financings may top $1 trillion. While we believe this historic level of corporate refinancing portends a potential period of corporate deleveraging, any meaningful increase in corporate debt service may create a crowding out effect on capital spending, which would be an added headwind to economic growth and development. Coincidentally, the U.S. budget deficit continues to rise at a time when the Federal Reserve is actually tightening monetary policy. We've seen a direct correlation between the increase in national debt and GDP growth, which raises concerns about the efficacy of conflicting fiscal and monetary policies. As a result, our near-term interest rate outlook remains in a modest trading range.

We continue to maintain our moderately short duration position relative to our respective benchmarks, given our intermediate/long-term interest rate outlook as continued robust Treasury issuance and Fed balance sheet unwinding combined with moderating yet persistent economic growth place upward pressure on the Treasury curve and term-premia normalization. We continue to expect heightened near-term rate volatility due to market uncertainty surrounding additional Fed rate hikes going forward, as concerns surrounding economic growth surface, persistent global trade uncertainty remains and overall market volatility continues into the first half of 2019. Given more attractive credit valuations after the meaningful spread widening that occurred during 4Q18, we maintain our modest corporate overweight, as we believe the risk of recession remains low over the next twelve months. Additionally, we maintain our focus on high quality corporate names, given the current level of market volatility, with an emphasis on corporations that have plans to actively deleverage during 2019. We continue to overweight Industrial credits that provide incremental risk-adjusted yield and also seek to selectively invest in high-quality, domestic focused 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 our current GDP growth expectations and the historical return potential of the sector, given current yield levels. 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**

	12/31/18	9/30/18	12/31/17
Fed Funds Target Rate	**2.25 - 2.5%**	**2.0 - 2.25%**	**1.0 - 1.25%**
3 Month LIBOR	**2.81**	**2.40**	**1.69**
On-the-run Treasuries:			
3 Months	**2.36**	**2.20**	**1.38**
6 Months	**2.48**	**2.36**	**1.53**
2 Years	**2.49**	**2.82**	**1.88**
5 Years	**2.51**	**2.95**	**2.21**
10 Years	**2.68**	**3.06**	**2.41**
30 Years	**3.02**	**3.21**	**2.74**

Source: Bloomberg

KEY **ECONOMIC INDICATORS**

as of	12/31/18	12/31/17
U.S. $ (DXY)	**96.17**	**92.12**
Oil	**45.41**	**60.42**
Gold	**1,282.45**	**1,303.05**
CRB	**169.80**	**193.86**
GDP	**3.4**	**3.2**
CPI	**2.2**	**2.2**
Core (Ex - Food & Energy)	**1.9**	**1.5**
Unemployment Rate	**3.7**	**4.1**
Consumer Confidence	**128.10**	**122.10**
S&P/Case-Shiller – Comp-20	**5.03**	**6.38**

Source: Bloomberg

INDEX **RETURNS**

	4Q'18	YTD	1-Year
Bloomberg Barclays –			
Universal	**1.17%**	**-0.25%**	**-0.25%**
Aggregate	**1.64**	**0.01**	**0.01**
Aggregate ex-credit	**2.33**	**0.93**	**0.93**
Gov-Credit	**1.46**	**-0.42**	**-0.42**
Int. Gov-Credit	**1.65**	**0.88**	**0.88**
Corporate	**-0.18**	**-2.51**	**-2.51**
Treasury only	**2.57**	**0.86**	**0.86**
1-3 year Gov	**1.31**	**1.58**	**1.58**
BofA Merrill – 1-yr T-Note	**0.78**	**1.86**	**1.86**
High Yield	**-4.53**	**-2.08**	**-2.08**
International Debt	**0.91**	**-2.15**	**-2.15**
Emerging Markets Debt	**-0.18**	**-2.46**	**-2.46**
S&P 500	**-13.52**	**-4.39**	**-4.39**
DJIA	**-11.31**	**-3.48**	**-3.48**
NASDAQ 100	**-16.76**	**0.04**	**0.04**
MSCI EAFE	**-12.49**	**-13.32**	**-13.32**

Source: Bloomberg Barclays

SECTOR **RETURNS**

4Q'18	Total Return	Excess Return
U.S. Treasuries	**2.57%**	**0.00%**
Government-related U.S. Agency	**1.22**	**-1.20**
Government-related Credit	**1.02**	**-1.52**
Corporate	**-0.18**	**-3.10**
Corporate Financials	**0.27**	**-2.33**
Corporate Industrials	**-0.46**	**-3.50**
Corporate Utilities	**0.20**	**-3.25**
Corporate AAA-rated	**1.43**	**-2.08**
Corporate AA-rated	**1.08**	**-1.49**
Corporate A-rated	**0.27**	**-2.66**
Corporate BBB-rated	**-0.82**	**-3.77**
Corporate High-Yield	**-4.53**	**-6.75**
Securitized	**2.05**	**-0.56**
Mortgage-backed Securities-FR	**2.08**	**-0.53**
CMBS	**1.72**	**-1.12**
ABS	**1.25**	**-0.16**

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.

P I A

Pacific Income Advisers

1299 Ocean Avenue Second Floor Santa Monica California 90401

telephone 310.255.4488 facsimile 310.434. 0100

www.pacificincome.com