Pacific Income Advisers SECOND QUARTER 2020

INVESTMENT COMMENTARY

The first half of 2020 was certainly one for the history books. Following a record-setting 5% decline in first quarter GDP, the second quarter got off to a rough start with most states imposing shelter-in-place practices that produced an unimaginable rise in unemployment and 2Q GDP estimates ranging from -20% to -40%. Unemployment rose from 3.8% in February to 11.1% in June, peaking at 14.4% in April. Additionally, the 2Q monthly employment reports likely underestimated the job losses due to COVID-19 related “measurement challenges”. To help put the severity of the “Great Lockdown” in perspective, the “Great Recession” lasted from December 2007 to January 2009 with unemployment peaking at 10.6% and GDP declining 2.5%. However, the massive multi-trillion dollar Fiscal and Monetary relief and stimulus efforts have thus far proved profoundly beneficial to both Main Street and Wall Street. Fiscal relief programs, like the CARES Act and supplemental unemployment benefits, resulted in personal savings rates surging from 8% to 33% by April, in spite of the historic rise in unemployment. The Monetary policy response was unprecedented with several bond-buying and Main Street lending programs, as the Federal Reserve balance sheet added roughly $3.5 trillion over the past year, ballooning to more than $7 trillion and projected to grow to roughly $11 trillion by year-end or roughly 50% of estimated U.S. GDP. All told, Fiscal and Monetary financial relief/ stimulus is estimated to account for roughly 38% of 2020 GDP. Additionally, given the perceived market support by the Fed, corporate debt issuance ballooned to more than $1 trillion in the first half of the year, nearly doubling the issuance of the first half of 2019. May and June saw an unexpected rise in new jobs, with 2.5 million and 4.8 million respectively. Nonetheless, following a historic 128-month economic expansion, the NBER declared on June 8th that the U.S. officially went into recession in February. On June 9th-10th, Fed Chairman Powell provided his first economic guidance for 2020 since the Pandemic, projecting -6.5% GDP and 9.3% unemployment.

Although investors re-risked following the March 23 Fed announcement, the impact on Treasury yields was muted. The yield on the 2-year Treasury actually declined 10 basis points to 0.15%, while 10-year Treasury yields dropped by just 1 basis point to 0.66%. The decline in interest rates led to a 0.48% Treasury sector quarterly return. However, all spread sectors outperformed as investment grade corporate bonds returned 8.98% for the quarter, while high yield bonds returned 10.18%. In the investment grade market, U.S. Agency Securities (+2.02%), Mortgage-backed Securities (+0.67%), Commercial MBS (+3.95%) and Asset-backed Securities (+3.54%) lagged the corporate sector.

As a value investor, we’re trying to make sense of the remarkable divergence between the U.S economy and the stock and credit markets. 2Q delivered the biggest quarterly return for the S&P 500 (+19.5%) since the height of the Dot.com bubble in 1998, while simultaneously producing the deepest quarterly economic contraction in history. Market momentum has been fueled by early efforts to re-open the economy, reports of improved COVID-19 testing and prospects for a vaccine and the unexpected improvements in May and June jobs data. Congress delivered a significant and speedy Fiscal response to provide a financial safety net to needy households. However, it was the Fed that did most of the heavy lifting with their stated willingness to do whatever it takes to sustain ample liquidity and prop up stock and bond prices through numerous lending facilities and securities purchase programs. We don’t see any end in sight to the virtually unlimited Fed spending power. However, we’re much less sanguine about the state of the global economy. 2020 started on the backside of a historic U.S. economic expansion following four sequential quarterly declines in corporate profits. With that backdrop, the market has now added economic concerns surrounding the heightened US-China trade tensions, the worst public health crisis in 100 years, historic unemployment and dramatic increases in leverage and debt levels. Lastly, we don’t share the market’s implied optimism regarding a V-shaped recovery in employment or the economy.

The last week in June was the 15th straight week unemployment claims exceeded one million. Approximately 33% of the 22 million jobs lost in March/April have returned to work, while much of the initial resurgence in employment came from four highly Pandemic-sensitive sectors: Leisure, Hospitality, Retail and Healthcare. Restaurants, Travel, Sports, Entertainment and Retail accounted for 12.5% of 2019 GDP and 18% of employment. If 75% of these

Pandemic-sensitive jobs returned, unemployment would still be a little more than 7%. Additionally, State and City governments employ 30 million workers and local government spending was responsible for 10.6% of 2019 GDP. State and City unemployment continues to rise and budgets are under severe pressure due to lost tax revenues, costly safety measures and high benefit payouts. Adding to our concerns is the possibility that the much needed and anticipated Phase 4 Fiscal stimulus will be smaller than originally anticipated due to the unexpected pick up in new jobs reported for May and June. We believe the tenuous U.S. economy and monetary policy will hold down inflationary pressures and continue to keep rates low and within a trading range at least through the Presidential election. Risk assets will continue to be bid up, until they're not. We remain cautiously optimistic about credit, given defaults are on the rise while spreads continue to contract.

In the second quarter, PIA portfolios maintained a modestly short duration relative to our respective benchmarks, as 10-year yields remained relatively range-bound below 1.00%. Subsequent to dramatic spread widening that occurred up to the March 23 Fed announcement, we capitalized on the relative value in the credit market by increasing our BBB credit weighting in various products. We currently maintain a modest overweight in corporate credit, with a focus on high quality credits with strong balance sheets. Our Industrial credits provide incremental risk-adjusted yield and our Financials are senior domestic debt that we believe offer attractive compensation for their sector volatility. After extraordinary high yield spread widening during the 1st Quarter, we increased our high yield exposure and are modestly overweight in our Core Plus portfolios, as spreads moved to attractive risk-adjusted valuation. After unprecedented rate volatility during the 1st quarter, the Fixed Rate MBS sector managed to post a positive excess return during the 2nd quarter, as the Fed continued their MBS purchase intervention and rate volatility subsided. We maintain a modest overweight to Agency Mortgage-backed Securities, as we believe the MBS sector offers long-term value on a risk-adjusted basis.

PIA Investment Strategy Group

KEY **RATES**

	6/30/20	3/31/20	12/31/19
Fed Funds Target Rate	**0.0-0.25%**	**0.0-0.25%**	**1.5-1.75%**
3 Month LIBOR	**0.30**	**1.45**	**1.91**
On-the-run Treasuries:			
3 Months	**0.13**	**0.04**	**1.54**
6 Months	**0.13**	**0.14**	**1.58**
2 Years	**0.15**	**0.25**	**1.57**
5 Years	**0.29**	**0.38**	**1.69**
10 Years	**0.66**	**0.67**	**1.92**
30 Years	**1.41**	**1.32**	**2.39**

Source: Bloomberg

KEY **ECONOMIC INDICATORS**

as of	6/30/20	6/30/19
U.S. $ (DXY)	**97.39**	**96.13**
Oil	**39.27**	**58.47**
Gold	**1,780.96**	**1,409.45**
CRB	**137.97**	**181.04**
GDP	**-5.0**	**3.1**
CPI	**0.1**	**1.8**
Core (Ex - Food & Energy)	**1.0**	**1.6**
Unemployment Rate	**13.3**	**3.6**
Consumer Confidence	**98.10**	**121.50**
S&P/Case-Shiller – Comp-20	**3.98**	**2.54**

Source: Bloomberg

INDEX **RETURNS**

	2Q'20	YTD	1-Year
Bloomberg Barclays –			
Universal	**3.81%**	**5.17%**	**7.88%**
Aggregate	**2.90**	**14.00**	**8.74**
Aggregate ex-credit	**0.68**	**6.53**	**8.43**
Gov-Credit	**3.71**	**7.21**	**10.02**
Int. Gov-Credit	**2.81**	**5.28**	**7.12**
Corporate	**8.98**	**5.02**	**9.50**
Treasury only	**0.48**	**8.10**	**10.45**
1-3 year Gov	**0.26**	**2.99**	**4.12**
BofA Merrill – 1-yr T-Note	**-0.03**	**1.69**	**2.86**
High Yield	**10.18**	**-3.80**	**0.03**
International Debt	**3.38**	**0.61**	**0.71**
Emerging Markets Debt	**10.00**	**-0.43**	**2.96**
S&P 500	**20.54**	**-3.09**	**7.49**
DJIA	**18.51**	**-8.43**	**-0.54**
NASDAQ 100	**30.30**	**16.89**	**33.78**
MSCI EAFE	**15.15**	**-11.03**	**-4.63**

Source: Bloomberg Barclays

SECTOR **RETURNS**

2Q'20	Total Return	Excess Return
U.S. Treasuries	**0.48%**	**0.00%**
Government-related U.S. Agency	**3.36**	**2.88**
Government-related Credit	**4.12**	**3.63**
Corporate	**8.98**	**8.47**
Corporate Financials	**7.87**	**7.32**
Corporate Industrials	**9.41**	**8.91**
Corporate Utilities	**10.31**	**9.88**
Corporate AAA-rated	**4.53**	**4.15**
Corporate AA-rated	**4.83**	**4.41**
Corporate A-rated	**7.18**	**6.68**
Corporate BBB-rated	**11.51**	**10.97**
Corporate High-Yield	**10.18**	**9.66**
Securitized	**0.94**	**0.63**
Mortgage-backed Securities-FR	**0.67**	**0.38**
CMBS	**3.95**	**3.23**
ABS	**3.54**	**3.26**

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 and equity 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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