INVESTMENT COMMENTARY

The second quarter saw wider spread vaccination, continued monetary and fiscal stimulus and a further re-opening of the economy. Concerns about the Delta variant of the Covid-19 coronavirus have not slowed down overall sentiment, as the Consumer Confidence Index increased to 127.3. From an economic standpoint, real gross domestic product (GDP) accelerated and grew at an annual rate of 6.4% for the prior quarter. The unemployment rate continued to decline to 5.8%, according to the Bureau of Labor Statistics (BLS). However, concerns about inflation continue as the Consumer Price Index (CPI) increased to 5.0% and the Core PCE Deflator rose to 3.4%. Against this backdrop, the S&P 500 returned 8.55% during the quarter and the tech-heavy NASDAQ 100 bounced back and returned 11.38%. The bond markets made up some of their prior quarter losses thanks to a decrease in long-term interest rates and spread tightening, as the Bloomberg Barclays U.S. Aggregate index returned 1.83% for the second quarter.

The Federal Reserve signaled higher expectations for "transitory" inflation and an earlier timeline for interest rate hikes. According to Bloomberg, "The Federal Reserve's so-called dot plot, which the U.S. central bank uses to signal its outlook for the path of interest rates, shows that officials expect no change in policy this year, while leaning toward two rate increases by the end of 2023, based on median estimates." Federal Reserve Chair Jerome Powell also said in June that "You can think of this meeting that we had as the 'talking about talking about' meeting", which was in reference to whether the Fed will begin talking about tapering its bond-buying program. The yield curve flattened as the two-year Treasury yield climbed 9 basis points to 0.25%, while the yield on the 10-year Treasury dropped by 27 basis points to 1.47%, thus mitigating the dramatic steepening from the prior quarter. Investment grade (IG) corporate bonds rebounded during the second quarter returning (+3.55%), while high yield bonds continued to generate positive returns (+2.74%). Most other investment grade bond sectors underperformed Treasuries (+1.75%) on an excess return basis, while producing positive 2Q21 returns; U.S. Agency Securities (+0.86%), Mortgage-backed Securities (+0.33%), Commercial MBS (+1.87%), and Asset-backed Securities (+0.34%).

The PIA Investment Strategy Group (ISG), using the 10-year Treasury as a proxy for market interest rates, adjusted our 2021 estimated yield range upward to 1.40% – 2.10%. On the surface bond market investors are growing more accepting of the Fed's outlook for growth and inflation, including the transitory nature of the current post-pandemic hyper-inflation. However, investor concerns may be shifting toward the Fed's monetary policies, specifically current quantitative easing (QE), i.e., bond purchases with newly minted money. JP Morgan projects the balance sheets of developed nation's central banks will have grown by more than $11 trillion during the 2020-21 period to roughly $28 trillion. In spite of strong market returns, meaningful increases in job creation and GDP growth, a substantial pick-up in all measures of inflation and an unusually strong housing market, the Fed continues its $40 billion monthly Mortgage-backed Securities purchases and remains the largest buyer of Treasuries with no projected near-term end in sight. With the lingering painful memories of the 2013 Bernanke "taper tantrum", we can appreciate Chairman Powell's temperance and prudence toward QE removal. After all, it was Ben Bernanke who estimated that for every $500 billion of QE, 10-year Treasury yields were reduced by 0.2%. There is good reason to believe the Fed has embraced the key tenets of Modern Monetary Theory (MMT), which, in short, believes that borrowing in your own national currency at very low interest rates is an intelligent use of deficit spending to produce aggregate demand without meaningful inflation risk. However, we believe U.S. asset prices in the stock market, housing and bond markets are hovering near all-time highs, largely as a result of highly accommodative QE policy and near zero interest rates. We agree with the Fed that much of the current elevated levels of growth and inflation are transitory. Payroll employment is still roughly 7.5 million jobs below pre-pandemic levels, but it's unclear that there's a path to return to the previous levels of "full employment" using standardized measurement. However, we're confident that productivity growth will continue, while the global economy reopens at an uneven pace. With that said, we remain vigilant regarding an upward creep in interest rates and/or widening of historically tight credit spreads.

In the second quarter, PIA portfolio duration remained short relative to our respective benchmarks. We continue to overweight corporate debt, 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 we believe offer attractive compensation for their sector volatility. In our Plus strategies, we maintained our high yield credit exposure as these spreads continue to offer relative value, given accommodative policy. The Fixed Rate Mortgage-backed Securities sector posted a negative excess return during the 2nd quarter, despite the Feds continued $40 million monthly MBS purchase program. We maintain a modest overweight to Agency MBS, as we believe the sector offers long-term value on a risk-adjusted basis.

PIA Investment Strategy Group

KEY RATES

	6/30/21	3/31/21	12/31/20
Fed Funds Target Rate	**0.0-0.25%**	**0.0-0.25%**	**0.0-0.25%**
3 Month LIBOR	**0.15**	**0.19**	**0.24**
On-the-run Treasuries:			
3 Months	**0.04**	**0.02**	**0.06**
6 Months	**0.05**	**0.03**	**0.08**
2 Years	**0.25**	**0.16**	**0.12**
5 Years	**0.89**	**0.94**	**0.36**
10 Years	**1.47**	**1.74**	**0.91**
30 Years	**2.09**	**2.41**	**1.65**

Source: Bloomberg

KEY ECONOMIC INDICATORS

as of	6/30/21	6/30/20
U.S. $ (DXY)	**92.44**	**97.39**
Oil	**73.47**	**39.27**
Gold	**1,770.11**	**1,780.96**
CRB	**213.39**	**137.97**
GDP	**6.4**	**-5.0**
CPI	**5.0**	**0.1**
Core (Ex - Food & Energy)	**3.4**	**1.0**
Unemployment Rate	**5.8**	**13.3**
Consumer Confidence	**127.30**	**98.10**
S&P/Case-Shiller – Comp-20	**14.88**	**3.98**

Source: Bloomberg

INDEX RETURNS

	2Q'21	YTD	1-Year
Bloomberg Barclays –			
Universal	**1.96%**	**-1.15%**	**1.12%**
Aggregate	**1.83**	**-1.60**	**-0.33**
Gov-Credit	**2.42**	**-1.96**	**-0.39**
Int. Gov-Credit	**0.98**	**-0.90**	**0.19**
Corporate	**3.55**	**-1.27**	**3.30**
Treasury only	**1.75**	**-2.58**	**-3.22**
1-3 year Gov	**-0.04**	**-0.09**	**0.06**
ICE BofA – 1-yr T-Note	**0.02**	**0.09**	**0.22**
High Yield	**2.74**	**3.62**	**15.37**
International Debt	**0.92**	**-4.42**	**4.60**
Emerging Markets Debt	**2.99**	**-0.59**	**6.34**
S&P 500	**8.55**	**15.24**	**40.77**
DJIA	**5.08**	**13.79**	**36.34**
NASDAQ 100	**11.38**	**13.34**	**44.36**
MSCI EAFE	**5.35**	**9.21**	**33.04**

Source: Bloomberg Barclays

SECTOR RETURNS

2Q'21	Total Return	Excess Return
U.S. Treasuries	**1.75%**	**0.00%**
Government-related U.S. Agency	**1.72**	**0.25**
Government-related Credit	**2.03**	**0.29**
Corporate	**3.55**	**1.12**
Corporate Financials	**2.66**	**1.06**
Corporate Industrials	**3.90**	**1.17**
Corporate Utilities	**4.21**	**0.98**
Corporate AAA-rated	**4.74**	**0.66**
Corporate AA-rated	**3.60**	**0.76**
Corporate A-rated	**3.23**	**0.90**
Corporate BBB-rated	**3.75**	**1.36**
Corporate High-Yield	**2.74**	**2.01**
Mortgage-backed Securities-FR	**0.33**	**-0.61**
CMBS	**1.87**	**0.82**
ABS	**0.34**	**0.24**

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.

ICE BofA 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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