Investment Process:
Global Macroeconomic / Fundamental

Total Firm Assets: $5.64 Billion

LM CAPITAL GROUP
GLOBAL BOND MANAGEMENT

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Q3 in a Nutshell

Bond markets were strikingly calm in the third quarter after an initially negative market reaction to the surprise Brexit vote. That passed quickly however, as markets kicked off the third quarter by returning to the more familiar ground of assessing policy moves from the world's major central banks. Domestic economic data during the quarter was yet again mixed. Economic reports showed a mixed trend but was still biased to continued stability – auto sales were yet again strong and housing data remained solid, but durable goods reports and several purchasing manager surveys underwhelmed. Come September, the Federal Open Market Committee left rates unchanged but members were split on whether or not to raise rates. Last week's November FOMC meeting produced a similar result, as the committee again left rates unchanged though laid the groundwork for a possible hike in December.

The pickup in yields toward the latter half of the quarter didn't have a meaningful impact on bond investors, as most fixed income sectors finished with positive absolute returns. As a result, the Emerging Market Debt (+3.13%), Corporate (+1.41%), High Yield (+5.55%) and Agency Mortgage Backed Securities (+0.60%) sectors outperformed the broader Barclay's US Aggregate Bond index return of +0.46%. The Treasury (-0.28%) and US Government Agency Securities (+0.14%) sectors underperformed the broader index's return.

Portfolio Impacts

Throughout the third quarter, we remained committed to an overall neutral-to-mild underweight duration portfolio position and continued exposure to the plus sectors. With the expectation of a coming interest rate hike and in accordance with the investment strategy group's current trend identification score, our strategy remained slightly defensive. Our underweight Treasury sector allocation and duration across the Core and Core+ strategies created a drag on performance in both strategies as spreads tightened during the period. However, our selective plus sector allocations providing a strong boost to performance which ultimately compensated for the drag in our overall duration position. In addition, our non-dollar sector performance amongst Core+ portfolios provided a further lift to returns.

Portfolio Impacts (con't)

Looking forward, we think macroeconomic and policy conditions will continue to offer support for the coming rate-hike cycle, favoring our underweight portfolio duration and the attractive return potential offered by the spread sectors. In the high-yield bond market, which has enjoyed particularly robust returns year to date, we expect the sector to continue to generate attractive yields in an environment of below-average defaults. While we expect near term volatility in markets as investors react to Presidential election polling and results, our continued long-term approach calls for patience and observation. With these factors in mind, we continue to favor our current allocations to EM and High Yield products while tactically rotating our Treasury and Mortgage Back Securities to maintain the desired duration effect. Careful security selection and market timing will also remain critical to performance over the foreseeable future. Finally, we continue to closely monitor the depth and breadth of liquidity within the fixed income markets. Should any of the situations deviate from our baseline scenarios, action in the portfolio may be taken.

EMD Update

Returns across the Emerging Market debt asset class have been robust, led by credits across Latin America and the recovery in many commodity centric industries. Specifically, Brazil has been a stand out performer as the country successfully moved past its political crisis with the impeachment of former President Dilma Rousseff. Brazil has also benefitted from the recovery in commodity prices, namely oil's move higher from the earlier in the year lows. Argentina also benefited from a new political regime as the country won back investors' confidence with more market friendly policies and Mauricio Macri administration's ability to reach a settlement on Argentina's past defaulted securities. Mexico has and will continue to be an interesting story. The country has been caught in the crossfire of the US Presidential election resulting in the dramatic depreciation of the Mexican Peso during the month of September as US Presidential polls showed Donald Trump narrowing the gap on Hillary Clinton. As a result, while Mexican assets have done better than the broader emerging market debt index, they have lagged other Latin American countries. LM Capital believes the Mexican Peso's depreciation presents an opportunity as the Central Bank has raised interest rates, the country's reserve balance is high and the export orientated country will respond positively to the currency's depreciation. While certain countries have had positive political and macroeconomic developments, other countries have not fared as well. For example, in Venezuela, the country continues to suffer from political instability, hyperinflation and human rights violations. The country has averted a default by successfully

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EMD Update (con't)

exchanging near term debt maturities for longer dated instruments by pledging its ownership in Citgo Petroleum to bondholders but the longer term outlook for the country is grim. Low yield levels and macroeconomic challenges across the Asia and Middle Eastern regions of the Emerging Market debt marketplace have led to their underperformance. Over the near term, we expect the Middle East and Asia regions to continue their underperformance. In general, we still favor export oriented companies who benefit from weakened exchange rates and corporate credits where valuations continue to be compelling (higher all in yields and spreads).

What to Watch

September's economic performance (steady payrolls and solid auto and housing reports) was consistent with our second half 2016 outlook. The pace of US economic activity is likely to ebb and flow as inventory and trade data swing the overall GDP prints. The consumption (consumer, final sales) trend should remain stable as job growth continues to expand at a reasonably steady pace. We also expect an increase of the Fed's overnight lending rate, likely at its December meeting. One and done is the likely Fed trajectory on rate rises as global factors and dollar strength could tighten financial conditions for them.