Investment Process:
Global Macroeconomic / Fundamental

Total Firm Assets: $4.9 Billion

LM CAPITAL GROUP
GLOBAL BOND MANAGEMENT

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2017: New Year, New Direction

First quarter economic data suggested that the global economic recovery has broadened out and picked up some momentum going into 2017. Consumer confidence registered its highest reading last month (125.6) since December 2000 and the manufacturing ISM survey remained at a strong level (57.2 in March vs. 57.7 in February). Generally, these measures of economic activity point to robust real GDP growth, certainly well above the 2.1% annualized gain seen post-Recession. As President Trump nears completion of his first 100 days, all eyes continue to monitor the progress made on his political agenda. Investors and the general public alike will be keen to evaluate his promises of rapid policy change during the coming months. Impacts from the first failure to "repeal and replace" Obamacare will be closely watched during any efforts Republicans make on the tax-reform agenda.

The Fed hiked interest rates by 25bps at the March meeting and remarked on the stability of the jobs and wage market conditions, and painted a more hawkish tone on their expected pace of inflation. The hike was certainly anticipated by the markets, yet it brought unforeseen reactions as investors focused on the Fed's higher inflation expectations. Minutes released from the meeting noted that "nearly all participants judged that the US economy was operating at or near maximum employment." Investors ran the yield on the 10-year U.S. Treasury up ahead of the March Fed decision, only to have it retrace all the way back near the lows of the quarter.

First Quarter Review

Fixed income markets were appearing to lack direction during the quarter until a barrage of hawkish Fed speeches began near the end of February. Despite historically low coupons, the first quarter total return in Treasuries remained positive. Credit markets ended the first quarter on a relatively firm note against the backdrop of fluctuating oil prices and accelerating inflows. Investment Grade credit spreads were range-bound but yields drifted slightly lower, at the same time High Yield credit spreads tightened and yields fell, boosting total returns. Lower rated credit outperformed higher rated instruments and longer duration Treasury and Corporate bonds outperformed while shorter dated instruments underperformed. While producing positive absolute returns, the

First Quarter Review (con't)

Agency Mortgage Backed Securities (+0.47%), Treasury (+0.67%) and US Government Agency Securities (+0.76%) sectors underperformed the broader Barclays US Aggregate Index's return of +0.82%. The Corporate (+1.22%), High Yield (+2.70%) and Emerging Market Debt (+3.28%) sectors outperformed the broader index's return.

Our active portfolio management style allowed us to remain nimble, adjusting duration and sector weightings throughout the quarter leading to relative outperformance versus the benchmark across all strategies with the exception of Opportunistic Credit, whose underperformance was mainly due to the High Yield sector allocation in March. Our Treasury sector positioning across the Core and Core+ strategies led to relative sector outperformance as positions in the 7-15yr maturity outperformed the short end of the curve in both strategies during the quarter. Additionally, our Treasury Inflation-Protected Security (TIPS) position was a strong performer on the quarter. While we selectively trimmed our High Yield allocation, taking advantage of the long run up in the sector, our overall plus sector allocations provided strong alpha in the Core+ strategies, further strengthening overall portfolio performance. We also took advantage of the recent rally in the Mexican Peso during March and exited our last remaining non-dollar position.

2017 Outlook

Looking forward, we think improving macroeconomic and policy conditions will continue to offer support for the continuing rate-hike cycle, favoring our short portfolio duration relative to the index and the attractive return potential offered by the spread sectors. While we expect near term volatility in markets as investors react to the ups and downs of President Trump's administration, our continued long-term approach calls for patience and observation. With these factors in mind, we plan to maintain a lower duration position versus the corresponding indices and will be monitoring economic data and fiscal policy to perhaps reduce the duration differential in the coming quarter. We continue to support our overweight Investment Grade Credit position, monitoring those sectors that may be affected by domestic or global economic forces like energy, materials and defense. We will also be focusing on the Fed's balance sheet reinvestment program and any changes that may affect valuations in the mortgage-backed sector. Careful security selection and market timing will also remain critical to performance over the foreseeable future. Should any of the situations deviate from our baseline scenarios, action in the portfolio may be taken.

Emerging Market Debt Update

After a very solid first quarter the asset class still looks attractive as the fears of the Border Adjustment Tax (BAT) and other proposals by the Trump Administration have diminished after the Affordable Healthcare Act failure. Flows into EMD ETF's were strong with net inflows of over $6 Billion as investors seeking yield without taking extreme risks found good options in the better quality emerging country issuers.

The extended corruption probe in Brazil was again brought to the forefront with the accusations against the meat exporters but in general, financials still look very attractive. The Mexican Peso rebounded to levels last seen around the November US Presidential election, with the peso exchange now at 18.75 after going over 22.00 on talks of the wall, deportations and cancellation of the NAFTA. The election in Ecuador revived the weakened left in Latin America as the conditions in Venezuela keep deteriorating on a daily basis.

China's growth prospects have again been revised downward as the switch of a purely export economy to a combined export/consumption economy, based on higher wages to create more disposable income, is hurting its competitiveness against poorer countries. The Saudis announced a huge debt sale of $17.5 Billion by ARAMCO, their oil company, but it hasn't happened yet and it will be interesting to see the yield and how it is received by investors.

The FOMC rate hike was well received by the Emerging Markets with many of them responding by making similar raises to their interest rates. We remain bullish on EMD particularly on the issuers that generate hard currency through exports or operations abroad and we continue to avoid purely local firms or those that can't afford the increased cost of floating rate indebtedness.

What to Watch

As we look ahead we believe many opportunities exist in the current environment but effective security selection will be critical and will continue to drive returns moving forward. While efforts toward President Trump's pro-growth agenda remain firm, the details of his large-ticket items such as healthcare and tax reform are hanging in the balance. It appears the Fed will stay the course, letting economic data drive monetary policy for the foreseeable future as a gradual rise in rates becomes "par" for the course. Of note, a deeper focus on the pace of inflation has possibly set a more hawkish tone for future meetings this year.

What to Watch (con't)

We believe President Trump's proposed policies have the potential to increase the pace of US economic activity toward 3-4% real GDP growth, up from the recent 1.5-2.5% pace. The consumption (consumer, final sales) trend is beginning to strengthen as job growth continues to expand at a reasonably steady pace. As we evaluate Trump's policy changes, investors will be keen to keep a close eye on Congress and whether the Republican party can come together to get things done or if it seals its own demise through more internal divisiveness.