FUNDMARKET INSIGHT REPORT

THOMSON REUTERS LIPPER RESEARCH SERIES – FIXED INCOME SUMMARY QUARTER-END ANALYSIS

SEPTEMBER 30, 2017

World Income Funds Lead the Gains in the Fixed Income Sector

EXECUTIVE SUMMARY

Fixed income funds continued to prosper in Q3 2017, with the group posting a positive return of 1.11% on average. This solid performance was uniform across the fixed income asset classes; all five fund macro-groups were in the black for the quarter, paced by World Income Funds (+2.32%). The positive performance was so consistent that, of 47 Thomson Reuters Lipper fixed income peer groups, only two did not record a gain for Q3.

Investor demand was strong for fixed income funds from a fund-flows perspective as well. Overall, fixed income funds took in $64.3 billion of net new money during Q3. The taxable bond fund peer groups (+$57.0 billion) accounted for the lion's share of the net positive flows, while tax-exempt funds contributed $7.3 billion. For the year to date fixed income funds had net inflows of $239.3 billion, which put them on track for their best annual net inflows since 2012 (+$345.6 billion).

Credit spreads continued to tighten in the third quarter. As yield spreads narrow, riskier assets became more attractive, since the reduction in the spread implies the market is factoring in less risk for these assets in an improving economy. The BofA Merrill Lynch US Corporate BBB Options-Adjusted Spread narrowed 9 bps in Q3 (its seventh-straight contraction) and closed down over 100 bps from its recent peak of 2.41% at the end of 2015. The spread currently sits at 1.37%. The BofA Merrill Lynch US High Yield Option-Adjusted Spread tightened for the sixth straight quarter in Q3; it narrowed 21 bps to close the quarter at 3.56%. Overall, the spread was down almost 3.50 percentage points from its recent high of 7.05% at the end of Q1 2016.

The Federal Reserve left a large footprint on the economic news for the quarter, as it usually does. The Fed announced after its mid-September policy meeting that it would start to unwind its $4.5-trillion balance sheet in October in a gradual and predictable manner. The Fed's bloated balance sheet, which was less than $1 trillion prior to 2008, is the result of its extended quantitative-easing program following the global financial crisis. The Fed did not raise interest rates in September but did release a forecast calling for one more rate hike this year and three next year. If the Fed raises rates again this year, it will meet its projection of three rate hikes for 2017. The Fed is moving ahead with its rate hike program despite inflation being well below the Fed's target rate of 2.0%. Inflation did manage to breach the 2.0% threshold briefly earlier this year but is now down to 1.4%. Federal Reserve Chair Janet Yellen went so far as to say in her post-meeting press conference that the reason for the dip in inflation this year is a "mystery" to the Fed.

Third Quarter Highlights:

- World Income Funds (+2.32%) outperformed all other macro-groups, led by Emerging Markets Local Currency Debt Funds (+3.27%).
- General Domestic Taxable Fixed Income Funds gained 1.34% as riskier assets continued to reap the benefits of narrowing credit spreads.
- Municipal debt funds appreciated 0.85% on average, paced by High Yield Muni Debt Funds (+1.61%) and New Jersey Muni Debt Funds (+1.10%).
- Investment-grade corporate debt funds returned 0.75%, driven by the Corporate Debt Funds BBB-Rated (+1.25%) and Corporate Debt Funds A-Rated (+0.98%) peer groups.
- Government/Treasury funds returned 0.55% as the yield curve flattened for a third straight quarter.

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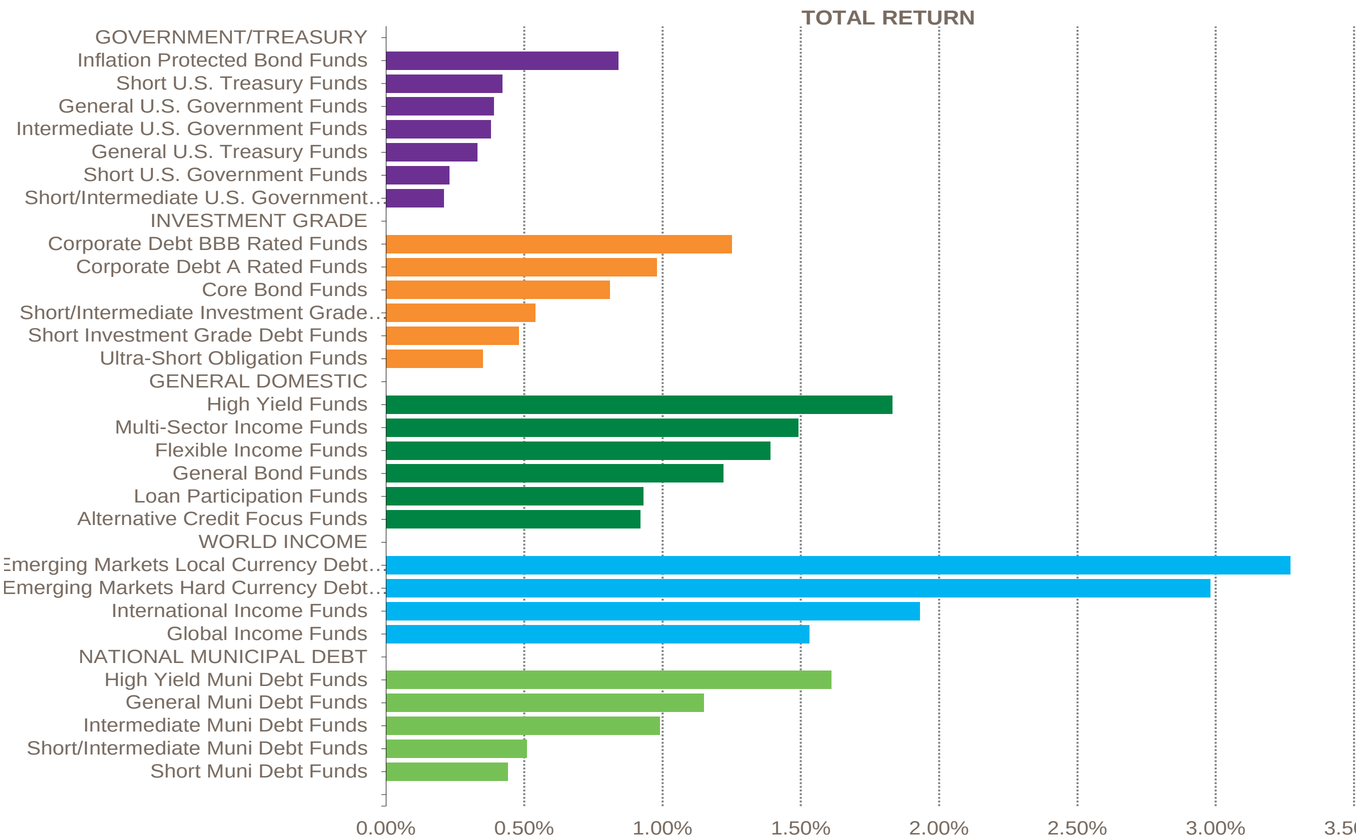
FIGURE 1 LIPPER FIXED INCOME FUND CLASSIFICATION RETURNS, THIRD QUARTER 2017



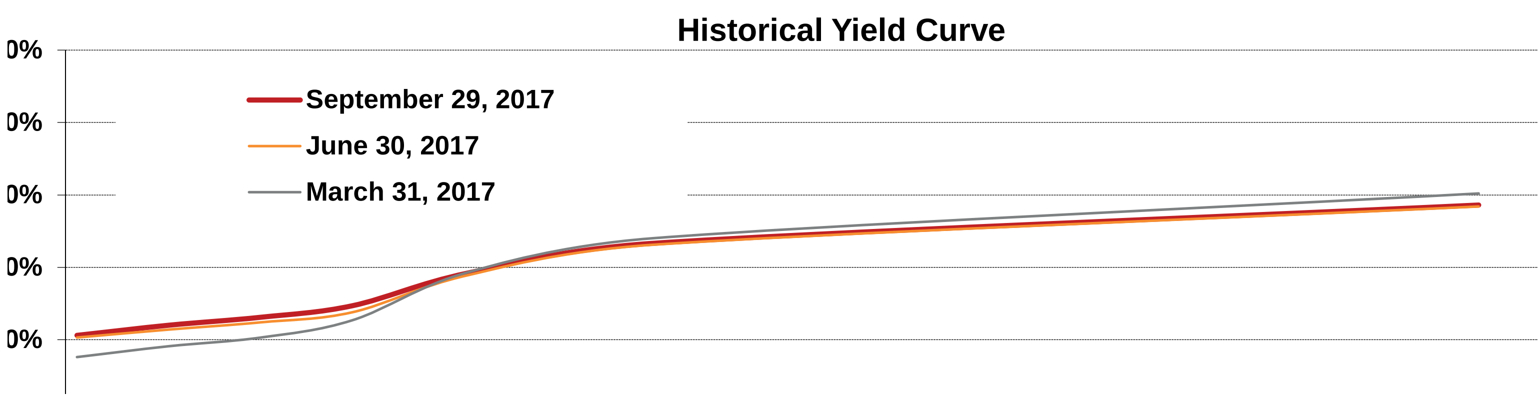
Source: Thomson Reuters Lipper

GOVERNMENT/TREASURY FUNDS SUMMARY

The yield curve flattened in Q3 for the third consecutive quarter. The two-/ten-year spread narrowed another 7 basis points (bps) in Q3 and was down a total of 39 bps since the end of 2016. The majority of the narrowing was attributable to the growing yield of the two-year Treasury note, which closed the quarter at 1.47%—its highest level since October 2008. The yield on the two-year Treasury note is sensitive to the market's expectations for the Fed's interest rate policy. The Fed indicated at its latest meeting that it anticipates raising rates in December for a third time this year, meeting its projection of three interest rate hikes in 2017. The Fed also forecasted that it believes three more rate increases in 2018 would be appropriate under current market conditions. Since the Fed started its interest rate-hike program (Q2 2016), the yield on the two-year Treasury note has risen 89 bps from 0.58%.

The government/Treasury funds macro-group appreciated 0.55% on average for Q3, a slightly better result than its 0.30% gain for Q2. The quarterly return for the group was paced by the Inflation-Protected Bond Funds (+0.84%) peer group, which was somewhat curious considering the current run of weak inflation data has given the Fed caution (at least temporarily) about its interest rate-hike program. The positive return for the Inflation-Protected Bond Funds peer group was accentuated by the group's taking in over $2.0 billion of net new money for Q3, for its eighth straight quarter of net inflows for total positive flows of almost $28.5 billion. The remainder of the peer group also posted positive returns for the quarter.

FIGURE 2 TREASURY YIELD CURVE



Source: U.S. Department of the Treasury

INVESTMENT-GRADE CORPORATE BOND FUNDS SUMMARY

The investment-grade corporate bond funds macro-group grew 0.75% on average during Q3, down somewhat from its 1.27% increase for Q2. For the second straight quarter long-term debt peer groups outperformed the shorter-term categories. Corporate Debt Funds BBB-Rated (+1.25%) and Corporate Debt Funds A-Rated (+0.98%) posted the highest returns in the macro-group for the second straight quarter. These two categories do not have any requirements for the dollar-weighted average maturity of the funds; therefore, we typically see funds in these categories with dollar-weighted average maturities greater than ten years. The Q3 results for the rest of the macro-group followed this rule, the longer the average dollar-weighted maturity of the peer group the better the return. The Core Bond Funds group (dollar-weighted average maturity requirement between five and ten years) gained 0.81% on average, Short-Intermediate Investment Grade Debt Funds (between one and five years) were up 0.54%, Short-Investment Grade Debt Funds (between one and three years) gained 0.48%, and Ultra-Short Obligation Funds (less than a year) appreciated 0.35%.

GENERAL DOMESTIC TAXABLE BOND FUNDS SUMMARY

The general domestic taxable bond funds macro-group gained 1.34% on average for the quarter, which was approximately the same (+1.41%) as for Q2. The macro-group was paced by the High Yield Funds (+1.83%) and Multi-Sector Income Funds (+1.49%) categories. Both of these categories (as well as the macro-group as a whole) continued to benefit from the tightening of credit spreads. Overall, the macro-group had net positive flows of $7.1 billion for Q3, almost entirely attributable to Multi-Sector Income Funds' net inflows of over $8.7 billion. Conversely, the High Yield Funds group suffered net outflows of over $1.5 billion.

WORLD INCOME FUNDS SUMMARY

World Income Funds (+2.32%) was the best performing Lipper fixed income macro-classification for a third straight quarter. Not coincidentally, the value of the trade-weighted U.S. dollar index fell for a third straight quarter. This index measures the value of the U.S. dollar relative to a weighted average of the currencies of the United States' major trading partners. Therefore, a decline in the index makes ex-U.S. investments more attractive. The index fell 2.43 points for Q3 (down to 88.11) and was off 7.65 points since the end of last year. This past quarter's performance was led by the Emerging Markets Local Currency Debt Funds peer group, which appreciated 3.27% on average. Not too far behind was the Emerging Markets Hard Currency Debt Funds category, with a gain of 2.98%. The World Income Funds macro-group also experienced positive net flows for Q3, taking in over $4.3 billion of net new money. The net inflows for the macro-group were driven by the International Income Funds category, which had net positive flows of $3.5 billion for the quarter.

MUNICIPAL DEBT FUNDS SUMMARY

Municipal Debt Funds appreciated 0.85% on average for Q3. While a positive return, it represented approximately only half the average gain (+1.63%) for Q2. For Q3 the national municipal debt fund peer group (+1.06%) outperformed the single-state municipal debt fund peer group (+0.67%). The only two negative quarterly performances among the fixed income peer groups came from the single-state municipal funds group, with the largest net reimbursement belonging to the Other States Short/Intermediate Municipal Debt Funds category, which lost 0.15% for Q3. Among the national municipal debt fund peer groups, the High Yield Municipal Debt Funds (+1.61%) category posted the best result, while New Jersey Municipal Debt Funds (+1.10%) had the best return on the single-state side. For the quarter the national municipal debt fund peer group took in $7.3 billion of net new money, while the single-state group saw $73 million leave.