



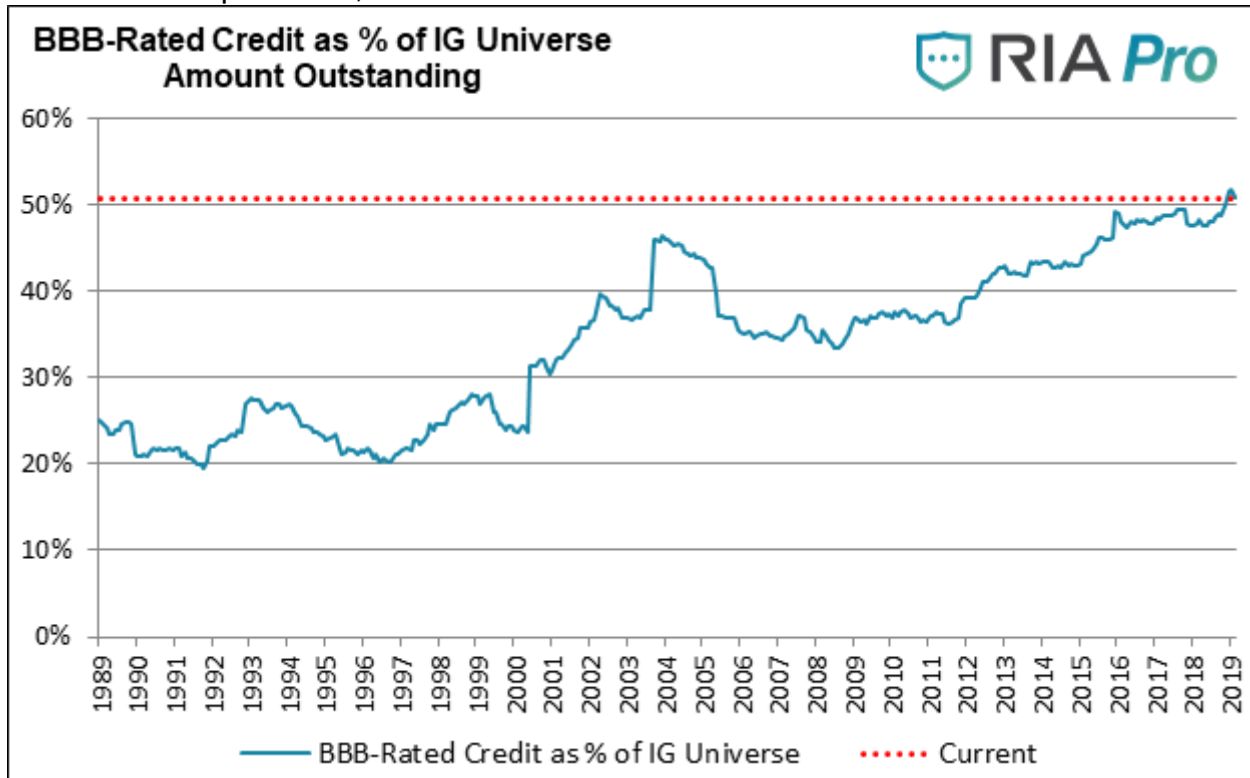
The rebound in credit markets has been remarkable since the Christmas eve lows however it appears as though the fuel for the rally, optimism of a softened stance by the Federal Reserve (Fed) and a pending trade deal with China, is being priced in multiple times over. Every time a new headline about a trade deal, or dovish Fed-speak hits the wire, the market spikes (we probably have the genius of artificial intelligence and computer-driven algorithmic traders to thank for that). Since late December, the Fed has clearly eased their outlook for future rate hikes and balance sheet reduction but they have yet to formalize a new stance. That may be coming in two weeks, as it appears likely that at the March 20th FOMC meeting a schedule for eliminating QT will be discussed. As things stand now, the data on which the Fed claims to be dependent, says unemployment is at a historical low 4% and inflation is hovering around their 2% target. As an aside the deflationary ghost that seems to justify the Fed's lust for more inflation has not been seen since the 1930's. •?Crosscurrents? that also concern the Fed as mentioned by Powell in last week's testimony likely include the usual suspects of China and Europe. In the month of February, similar to what we saw in January, riskier fixed-income categories outperformed higher-quality categories. The best performing categories were high yield and emerging markets. Meanwhile, treasuries and mortgages posted a negative total return for the month.

 RIA Pro	MTD Total Return	3 Month Total Return	YTD Total Return	12 Month Total Return	Current Yield to Worst
U.S. Aggregate	-0.06	2.84	1.00	3.16	3.21
Agg. Treasury	-0.27	2.35	0.20	3.23	2.63
Agg. Investment Grade - Corp.	0.22	4.04	2.57	2.66	3.91
Agg. High Yield - Corp.	1.66	4.04	6.18	4.39	6.54
Agg. Securitized (ABS, MBS, CMBS)	-0.05	2.53	0.75	3.57	3.35
Agg. Investment Grade - Muni.	0.54	2.49	1.29	4.07	2.53
Agg. Emerging Markets	0.80	5.35	3.99	3.10	5.45
Data as of 2/28/2019					

With the exception of the investment grade corporate sector, ETF performance was generally in line with the indices.

 RIA Pro	MTD Total Return	3 Month Total Return	YTD Total Return	12 Month Total Return
AGG (U.S. Aggregate)	-0.11	2.79	0.80	3.08
GOVT (Agg. Treasury)	-0.26	2.26	0.75	3.08
LQD (Agg. Investment Grade - Corp)	-0.20	5.07	3.16	2.78
HYG (Agg. High Yield - Corp.)	1.21	4.00	6.22	4.93
MBB (Agg. Securitized (ABS, MBS, CMBS))	-0.07	2.51	0.74	3.43
MUB (Agg. Investment Grade - Muni.)	0.54	2.28	0.92	3.67
EMB (Agg. Emerging Markets)	0.40	7.20	5.20	2.31
Data as of 2/28/2019				

In the name of prudence, it should be obvious that the levels at which riskier credits are trading

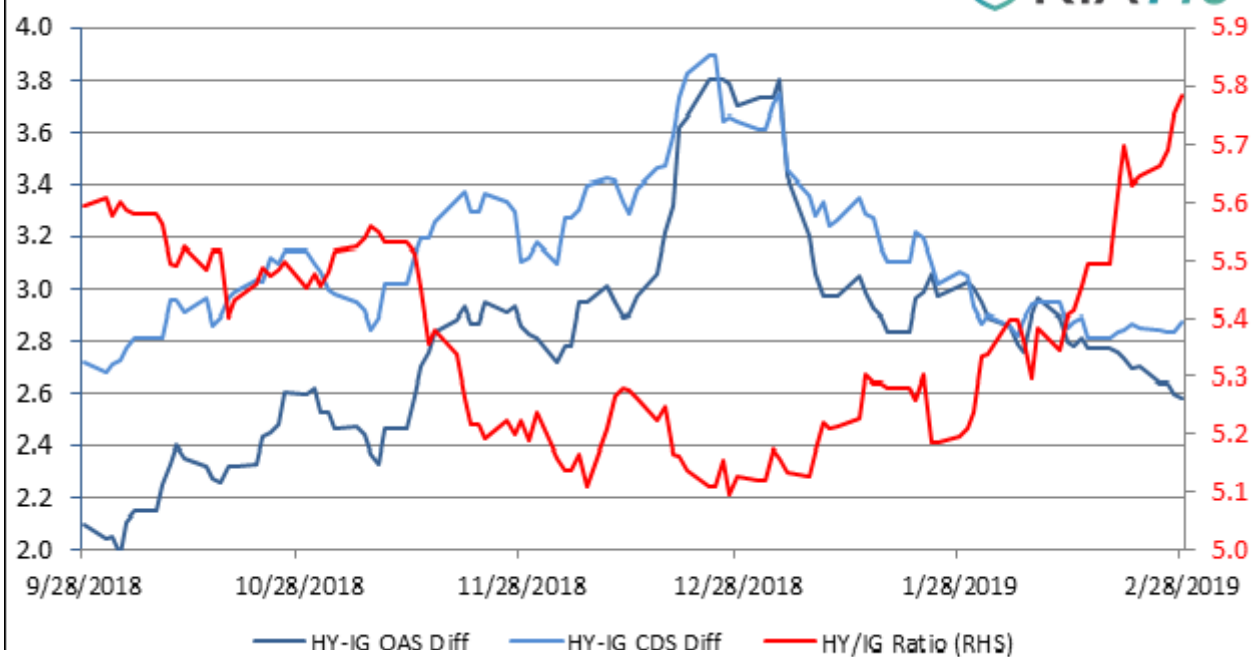


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weaker credit characteristic of the investment grade universe is bearing out in its performance. In the chart below, the dark blue line shows the difference between high yield (HY) and IG option-adjusted spreads. The light blue line is the difference between HY and IG credit default swap (CDS) pricing. CDS spreads are important because these are the instruments most heavily used by broker-dealers and other institutional accounts to hedge their corporate bond holdings. The chart shows HY spreads in both cases widening by more than IG which is to be expected. However, since October 2018 when turbulence hit the markets, if we look at the CDS *ratio* (HY CDS divided by IG CDS), IG underperformed high yield as credit spreads widened (red line). In other words, as HY CDS (the numerator) rose through December, IG CDS (the denominator) rose comparatively by more causing the ratio to drop from 5.6 to 5.1 (see table below).

Investment Grade Vs. High Yield Performance



HY/IG CDS Ratio

	9/28/2018	12/24/2018	2/28/2019
IG CDS	59.18	94.91	60.16
HY CDS	331.01	484.93	347.86
Ratio	5.59	5.11	5.78

This behavior is atypical as better credit quality

generally outperforms weaker credits in a spread widening environment. •Higher credit quality should widen by comparatively less keeping the ratio somewhat stable. Since year end, IG has outperformed as the market recovered. As the table and ratio changes reflect, IG CDS is trading with a higher beta to HY CDS. How else to explain this except to observe that so much more of the index is perched dangerously close to junk ratings and at a greater risk of losing investment grade status. Economic stagnation would likely send a sizable portion of the triple-B rated bonds into Junkville. That would then create a problem in the credit slums as a large amount of newly rated junk bonds would cause spread widening in a land that is highly sensitive given current valuations. This is our assessment as to why we have seen the recent elevated ratio volatility between IG and HY bond CDS spreads. The bottom line is that with the uncertainty in the current outlook, the length of the current recovery and the sudden, almost irrational bounce off the Christmas Eve lows, does taking risk in the credit sector make sense? We argue no and recommend either liquidating at these valuations, moving up in credit, or sit patiently on cash. Now is not a time to acquire credit risk.