Morgan Stanley

INVESTMENT MANAGEMENT

Global Fixed Income Bulletin

Goldilocks Redux?

MACRO INSIGHT | BROAD MARKETS FIXED INCOME TEAM | October 2024

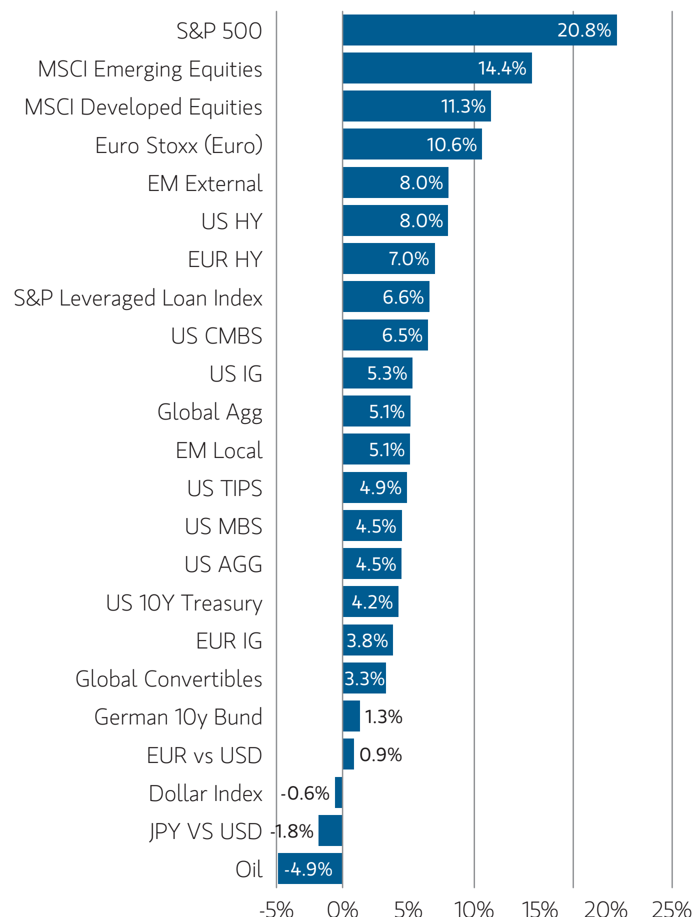
September proved to be a robust month for fixed income returns, as central banks globally either continued or initiated their easing strategies. One of the most significant developments was the Federal Open Market Committee's (FOMC) decision to lower the Federal funds target rate by 50 basis points (bps), rather than the anticipated 25 bps, citing that the risks to achieving its dual mandates of inflation and employment were "roughly in balance."

Throughout the month, other central banks in developed markets, such as the European Central Bank, Swiss National Bank, and the Bank of Canada, also opted to cut rates. In emerging markets, rate cuts were enacted by the central banks of Indonesia, the Czech Republic, Hungary, South Africa, Chile, Mexico, and Peru.

After experiencing initial widening in the first weeks due to increased equity volatility, credit spreads tightened by the end of the month. High-yield corporates outperformed their investment-grade counterparts, with the U.S. outperforming Europe. Additionally, securitized credit and agency mortgage spreads continued to grind tighter. In FX, the dollar depreciated against a basket of currencies, driven by divergent central bank policies and economic conditions.

DISPLAY 1

Asset Performance Year-to-Date



Note: USD-based performance. Source: Bloomberg. Data as of September 30, 2024. The indexes are provided for illustrative purposes only and are not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.** See pages 8-9 for index definitions.

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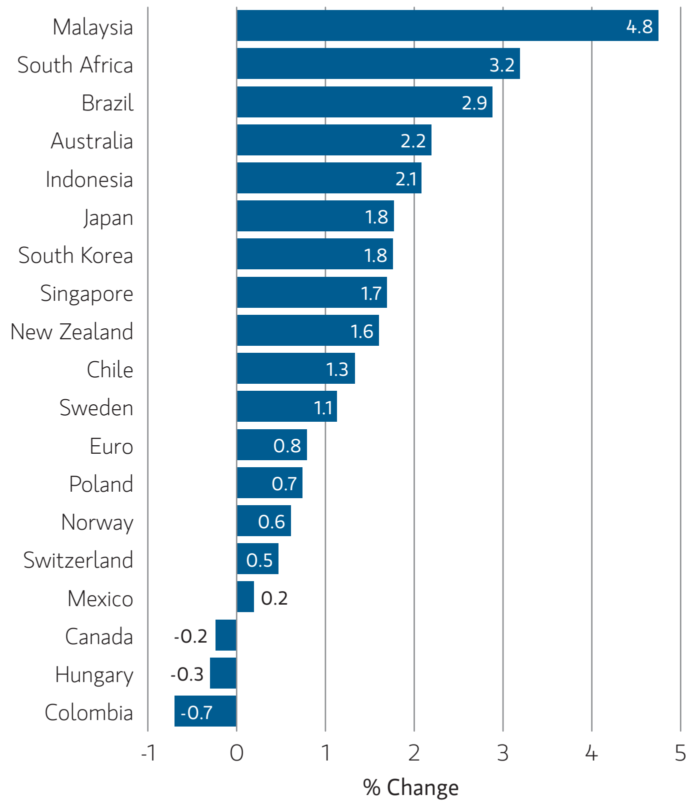
DISPLAY 2

Currency Monthly Changes versus US Dollar

(+ = appreciation)



Note: Positive change means appreciation of the currency against the USD.
Source: Bloomberg. Data as September 30, 2024.

DISPLAY 3

Major Monthly Changes in 10-Year Yields and Spreads

COUNTRY	10-YR YIELD LEVEL (%)	MONTH CHANGE (BPS)	10-YR SPREAD (BPS)	MONTH CHANGE (BPS)
			(SPREAD OVER USTS)	
United States	3.78	-12		
United Kingdom	4.00	-1	22	11
Germany	2.12	-18	-166	-5
Japan	0.86	-4	-292	9
Australia	3.97	1	19	13
Canada	2.96	-20	-82	-8
New Zealand	4.24	-3	46	10
EUROPE			(SPREAD OVER BUNDS)	
France	2.92	-11	80	7
Greece	3.11	-24	99	-7
Italy	3.45	-25	133	-7
Portugal	2.70	-21	58	-3
Spain	2.93	-21	80	-3
EM	**10-YR LOCAL YIELD (%)**	**MTD CHANGE (BPS)**	**SPREAD (BPS)**	**MTD CHANGE (BPS)**
EM External Spreads			341	9
EM Corporate Spreads			219	9
EM Local Yields	6.25	-20		
			(SPREAD OVER USTS)	
Brazil	12.43	21	865	34
Colombia	10.07	-6	629	6
Hungary	6.16	-15	238	-3
Indonesia	6.44	-19	266	-6
Malaysia	3.71	-5	-7	7
Mexico	9.34	-32	556	-19
Peru	6.23	-32	245	-20
Poland	5.24	-18	146	-6
South Africa	10.03	-56	625	-43
CREDIT			**SPREAD (BPS)**	**MTD CHANGE (BPS)**
U.S. IG			89	-4
EUR IG			117	0
U.S. HY			295	-10
EUR HY			345	-1
SECURITIZED				
Agency MBS			129	-8
U.S. BBB CMBS			714	19

Positive Neutral Negative

Source: Bloomberg, JPMorgan. Data as of September 30, 2024.

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Fixed Income Outlook

Bonds maintained their impressive performance throughout September, as yields declined across most government bond markets, accompanied by a modest tightening of credit spreads. In a departure from August, it was the non-U.S. Treasury markets that took the lead, with yields dropping by double digits—except in the UK and Japan. Economic indicators continued to raise concerns, particularly regarding Europe's growth outlook, while the U.S. labor market remained under scrutiny following a disappointing July report. The good news is that the U.S. labor market did not deteriorate further in August; however, it also showed little improvement, leaving market participants anxious about the ongoing downward trend. Historical patterns indicate that once the unemployment rate begins to rise, as it has, it often continues to worsen until the Federal Reserve or other fiscal policies intervene. While we believe there are mitigating factors this time that make the current unemployment rate less alarming, the Fed—being the world's foremost risk manager—should still take heed.

And heed they did. The pivotal news that significantly boosted markets was the Fed's decision to cut rates by 50 bps and to project an additional 50 bps of rate cuts this year. This marked a dramatic shift from June, when they anticipated only a single rate cut of 25 bps in 2024. The market had been bracing for a less aggressive stance, and the Fed's decision underscored their concerns that, with inflation declining and unemployment rising, current policy rates were overly restrictive. Similarly, the European Central Bank also opted for rate cuts, citing improving inflation and a weak growth outlook.

The Fed's action is noteworthy. It signals a proactive approach aimed at easing restrictions before the economy shows signs of significant weakening or unemployment rises well above normal levels. With the U.S. economy increasingly appearing to align with long-term growth and inflation targets, maintaining such tight policy is no longer necessary. In essence, if the economy is performing "normally," shouldn't interest rates reflect that as well? Consequently, the Fed has initiated a recalibration of monetary policy. The pressing question now is: how much recalibration is warranted? The market is anticipating considerable rate cuts in both this year and the next, projecting the Fed funds rate to drop to 3% by early 2026—an ambitious forecast. Given that U.S. inflation remains above target and GDP growth is robust, the extent of necessary rate cuts remains uncertain. Reducing rates by 100 bps is relatively achievable, as even at a 4.5% policy rate, monetary policy is still tight. However, for the Fed to lower rates below 4%, it will require more compelling evidence that labor markets will further deteriorate or that inflation will quickly align with targets. While this scenario is possible, it is not our base case.

With U.S. Treasury yields hovering around 3.8%, about the same level we started the year at, it will be difficult for yields to fall further unless we see a significant deterioration in data (i.e. the unemployment rate going over the peak of the Fed's forecast of 4.4%). Given the amount of cuts the market is already pricing, it is difficult to forecast further drops in yields. On the other hand, the trend in U.S. employment has been weaker, which makes it difficult oppose the Q3 bull market. In either case, volatility will still abound as markets and policy reactions remain data dependent. A neutral to slightly underweight duration position in the U.S. looks appropriate. We see better value outside the U.S. in Europe, where economic growth is anemic and central banks are responding and in Asia, where countries like New Zealand are experiencing weaker growth and are falling behind in the rate cutting cycle.

Credit markets also continue to perform. A combination of strong nominal and real U.S. growth combined with falling inflation, easier monetary policy and evidence of strong productivity growth provides an exceptionally good backdrop. Even given the backdrop, credit spreads, both investment grade (IG) and high yield (HY) are struggling to move lower. Both are at the tight end of their historical ranges (Euro IG looks more attractive) and will be challenged to tighten further. Markets are punishing underperformers, and as credit spreads most likely move sideways over Q4, security selection will be increasingly more important. It will be difficult to make up for losses due to poor security selection.

Our credit market strategy is focused on avoiding those problematic companies and building in as much yield in the portfolio without taking undue risks. There is little reason to believe spreads will materially widen when economic growth is decent and central banks are cutting rates. Yield-oriented buying should contain spread widening, but any pullback in demand could be problematic. This risk is offset, however, by central banks' rate cutting bias which should serve to truncate spread widening risk as it reduces tail

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risks of recession. We remain modestly overweight credit in portfolios with a modest bias to higher quality.

Emerging market (EM) local returns were also quite strong over the month with several countries performing well. Countries with solid economic outlooks, decent growth, falling inflation, and a central bank able and willing to cut rates have tended to perform well. Although, like corporate credit when markets grow disappointed, bonds and currencies can underperform quickly. Country and security selection remain pertinent. We continue to avoid Mexican and Brazilian bonds as their respective markets deal with political uncertainty (Mexico) and fiscal risks (Brazil). We remain focused on idiosyncratic opportunities that feature favorable risk/reward characteristics such as the Dominican Republic, Colombia, and Peru.

The best opportunities remain in securitized credit, particularly in U.S. mortgage-backed securities. U.S. households with prime credit ratings have strong balance sheets, which should continue to be supportive of consumer credit and ancillary structures, especially as house prices remain firm. U.S. agency mortgages remain relatively attractive versus investment grade corporates, at least the higher coupons, and we believe they should outperform U.S. Treasuries. Similarly to our positioning in corporate credit, we are looking to move up in credit quality and out of non-U.S. structures given tighter spreads and increased macroeconomic risks in Europe.

In currency markets, the outlook for the U.S. dollar remains unclear. While it has weakened due to the decline in U.S. interest rates, we are not as confident about the likely extent of future rate cuts. However, it is possible the Fed's commitment to its employment mandate may compel them to adopt a more dovish stance, potentially even more so than other central banks who are faced with weaker economies. Despite the slowdown in the U.S., the economy is still growing faster than most other countries, suggesting that any rate cuts could bolster the U.S. economy and dollar.

As of now, however, it remains unclear who can surpass the U.S. as the global growth leader. Europe and China are facing lackluster cyclical data, compounded by structural challenges. Other emerging market economies continue to be confronted with idiosyncratic challenges. Their currencies continue to be affected positively by easier U.S. monetary policy but remain subject to a variety of local risks which may or may not overcome the risk on bias of G7 central bank easing. We will look to capitalize on idiosyncratic mispricings where there are clear fundamental and value differences.

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Developed Market Rate/Foreign Currency

MONTHLY REVIEW

September was a month of two halves for fixed income markets. First, bond yields fell as investors began to price in more aggressive rate cuts by the Fed, including a greater likelihood of a 50-basis point cut at the September meeting. This was despite activity data coming mostly in line with expectations, and the August Consumer Price Index release showing signs of a rebound in shelter inflation, although the labour market report did confirm previous indications of slowing. At its September meeting, the Fed delivered a 50-basis point cut and underscored its commitment to averting further weakness in employment. At the same time, it maintained its optimistic view on the current labour market and estimates of the policy rate in the longer term—as reflected in the Summary of Economic Projections—shifted higher, leading to a steepening of the yield curve. Longer maturity bond yields also rose in the latter half of September, as economic data including jobless claims came in stronger than expected. Outside the U.S., Eurozone economic data showed further signs of deterioration. PMIs for both manufacturing and services came in materially below expectations, while inflation data was also weaker than expected. Governing Council members including European Central Bank (ECB) President Christine Lagarde acknowledged that disinflation was taking place faster than anticipated. This led to the market pricing that the ECB would cut interest rates more quickly than at the quarterly pace of cuts expected previously.

On foreign exchange, the dollar continued depreciating over the month as rate differentials narrowed between the U.S. and the rest of the world. The rate-sensitive Japanese yen continued to gain against the dollar, while the Canadian dollar continued to underperform. The Antipodean currencies also rallied strongly towards the end of the month following the announcement of significant stimulus plans by authorities in China. We think the dollar could remain strong given the still supportive interest rate differential, resilient U.S. data and the likely outperformance in a severe risk-off environment.

OUTLOOK:

We are neutral on duration in DM ex-Japan and retain our long-standing steepening exposures. Cross market, we favour duration in New Zealand and Canada where we think there is more scope for central banks to cut more than the market is pricing. By contrast, we are short duration in the U.S. and continue to believe that, for the Fed to meet current pricing, economic data will have to deteriorate significantly from its current trajectory. We are also short duration in Japan, where the acceleration in wage growth suggests stronger inflationary trends are becoming entrenched which should lead the Bank of Japan to raise interest rates.

Emerging Market Rate/Foreign Currency

MONTHLY REVIEW:

Performance was strong for EMD markets as EM currencies broadly rallied and sovereign and corporate credit were supported by the fall in U.S. treasury rates. The imminent start of the Fed's cutting cycle was top of mind for investors. At the start of the quarter, a September cut started to be priced into the market and rates consistently fell. A disappointing U.S. jobs number in July caused market volatility but the U.S. dollar weakened, and rates continued to rally, which was supportive for EMD. The Bank of Japan unexpectedly raised rates at the end of July, which caused spillover effects into the broader market as popular yen carry trades fell out of favor and rapidly unwound. EM currencies in general benefitted during this period, but low yielding EM currencies such as Malaysian ringgit and Thai baht rallied as a fallout of the yen carry trade. China announced an assortment of policy measures including rate cuts, bank recapitalizations, facilities to boost the stock market, and fiscal spending. Markets initially reacted positively, especially the Chinese stock market, but these measures are likely not enough to turnaround the economy. The property market in particular needs more investment from the central government. EM central banks continued to cut rates and were further supported by the Fed's 50 bps rate cut. A notable exception was Brazil where the economy is overheated, deficits remain high, and inflation continues to increase. The central bank hiked rates during the quarter and additional hikes are looming. Outflows continued with approximately -$3.1 billion net going out of dedicated-EMD funds globally during the quarter with outflows concentrated in June and July, but flows switched to inflows for both hard currency and local funds in August.[1]

OUTLOOK:

Following the U.S. Fed's 50bps rate cut in September the macro environment is more supportive for emerging markets debt, particularly local currencies and rates. The market

[1] Source: JP Morgan Markets, as of 9/30/2024.

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had been pricing in the Fed's expected cut for some time ahead of the September meeting, which put downward pressure on the dollar and U.S. rates fell. EM central banks will now have more room to ease without putting additional pressures on their currencies which should be helpful for growth. Following China's large stimulus and measures we will continue to monitor the results of these measures and commitment from policy makers to revive the economy. Country level analysis remains pivotal as growth expectations, inflation levels including central bank responses, and policy are quite differentiated across emerging markets.

Corporate Credit

MONTHLY REVIEW:

Heavy primary issuance kept European investment grade credit spreads broadly unchanged in September, while government bonds rallied. Sentiment was dominated by several factors. Firstly, on the data front, European PMIs were once again weaker than expected. The figure for German manufacturing remained firmly in contraction at 40.3 with goods production posting its steepest rate of contraction for 12 months. The services prints were also far weaker than expected with France at 48.3 and the Eurozone Aggregate at 50.5.[2] PMIs in the UK also surprised to the downside. Secondly, Eurozone inflation came in line with consensus, rising 1.8% year-over-year, down from 2.2% in the previous month as energy costs fell sharply. Thirdly, we saw notable profit warnings from the Auto sector leading to Autos being the worst performing sector in September. In Financials, UniCredit acquired a 4.5% stake in Commerzbank from the German government, later disclosing that they have raised their stake to 21%. Finally, primary issuance in August came in much higher than expected at 45bn vs 27bn expected.[3] Despite the higher-than-expected supply, investor demand for risk was strong with large new issue order books and limited new issue concessions. Inflows into the asset class remained strong with investors continuing to reach for the "all-in" yield offered by IG credit.

September was another strong month for the global high yield markets. In the U.S., the balance of inflation data and labor market data generally continued to cool, economic growth largely remained resilient, and risk appetite was bolstered by a 50 bps reduction in the Federal Reserve's key policy rate in September. The performance surge in lower-rated credit continued and CCC-rated bonds returned over five percent in the U.S. Primary issuance in the U.S. high yield market reached a 3-year high amid the Fed rate cut and sharply lower yields. This supply was met with ample demand. Finally, September was again another mild month for default and distressed exchange activity among high yield bond issuers.

Similar to other risk assets, September was a strong month for global convertible bonds. Given the prevalence of U.S. small cap issuers in the universe, the asset class received a boost from the 50bps interest rate cut from the Federal Reserve in the middle of the month. Global convertible bonds were further supported later in the month when the People's Bank of China announced a broad-based stimulus package. Ultimately, the asset class outperformed both global equities and global bonds during the month. New issuance picked up again in September after a typical quiet August. $9.4 billion of convertible bonds priced during the month with over 70% coming from the United States. Year-to-date total issuance now stands at $82 billion, which is 35% higher than the similar time period in 2024.[4]

OUTLOOK:

Looking forward our base case remains constructive for credit supported by expectations of a "soft landing," fiscal policy that remains supportive of growth/employment/consumption and strong corporate fundamentals, supported by corporate strategy that is low risk. Lighter gross issuance in the fourth quarter coupled with strong demand for the "all-in" yield offered by IG credit is expected to create a supportive technical dynamic. When looking at credit spreads, we view the market as offering value relative to the fundamental and technical backdrop but see carry as the main driver of return, with additional gains coning from sector and, increasingly, security selection. Given the uncertain medium term fundamental backdrop, we have less confidence in material spread tightening, therefore leaving spread duration positioned a small, long relative to the benchmark.

Our outlook for the high yield market has improved. While the probability of a soft landing has increased, it appears the preponderance of market participants also share this belief, and this scenario appears to be almost fully priced in at quarter-end. The catalysts with the potential to undermine

[2] Source: Bloomberg, as of 9/30/2024
[3] Source: Bloomberg, as of 9/30/2024
[4] Source: Bank of America, as of 9/30/2024

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this scenario are consistently present and we remain focused on these in a continued effort to position our strategy to outperform, should market conditions deteriorate. These catalysts include the lagged effects of restrictive policy, economic conditions, consumer health and the fundamental health of high yield issuers. The high yield market ended the quarter offering approximately the same average spread with which it began the quarter and an average yield that, while still attractive relative to the ten-year average, was approximately 80 bps lower by quarter-end.

We continue to remain constructive on the global convertible bond market as we enter the fourth quarter. We believe global convertible bonds currently offer their traditional balanced profile of upside equity participation and mitigating downside risk. New issuance through the first nine months was strong and we expect issuance to remain strong despite interest rate cuts from global central banks and potential volatility from the U.S. election and rising geopolitical tensions. A more traditional asymmetric return profile coupled with an expectation of additional new issuance continues to give us optimism for global convertible bonds as we progress through the year.

Securitized Products

MONTHLY REVIEW:

U.S. agency MBS spreads tightened 8 bps in September to +129 bps above the comparable duration U.S. Treasuries. Current coupon agency MBS spreads are now only 9 bps tighter YTD. Given the material tightening in other credit sectors, agency MBS remain one of the only sectors in fixed income with attractive valuations. Lower coupon U.S. agency MBS passthroughs outperformed their higher coupon MBS counterparts as interest rates fell (lower coupons have longer interest rate and spread durations). The Fed's MBS holdings shrank by $18 billion in September to $2.274 trillion and are now down $456 billion from their peak in 2022.[5] U.S. banks' MBS holdings rose by $21 billion to $2.64 trillion in September resuming the upward trend; however, bank MBS holdings are still down roughly $351 billion since early 2022.[6] Securitized credit spreads were slightly tighter in September due to excessive demand in the primary market, even despite a heavy new issuance calendar. Securitized issuance accelerated after a slow August calendar and the supply continues to be well absorbed. Relative to other fixed income sectors, securitized credit sectors performed in line, mainly due to the high cashflow carry, as their relatively shorter interest rate duration does not allow them to benefit as much from falling rates. YTD securitized credit has outperformed most other sectors of comparable credit quality due to their high cashflow carry.

OUTLOOK:

After spreads subsided in August and marginally tightened in September, we expect spreads to remain stable at current levels. Overall demand levels remain strong, but it will be challenging to for spreads to tighten much further from current levels. Performance has started to normalize following strong outperformance over much of the year and we believe further normalization will continue. Returns should be derived mainly through cashflow carry in the coming months. Current rate levels remain stressful for many borrowers and will continue to erode household balance sheets, causing stress for some consumer ABS, particularly involving lower income borrowers. Commercial real estate also remains challenged by current financing rates, and some sectors may see declines in operating revenue in 2024. Residential mortgage credit opportunities remain our favorite sector currently and is the one sector where we remain comfortable going down the credit spectrum. We maintain a slightly positive outlook on agency MBS as valuations are relatively attractive versus investment-grade corporate spreads and versus historical agency MBS spreads, but we believe that agency MBS spreads too have stabilized.

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[5] Source: NY Fed, as of 9/30/2024

[6] Source: Bloomberg, as of 9/30/2024

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Risk Considerations

Diversification neither assures a profit nor guarantees against loss in a declining market.

There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to **market risk**, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g., natural disasters, health crises, terrorism, conflicts, and social unrest) that affect markets, countries, companies, or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g., portfolio liquidity) of events. Accordingly, you can lose money investing in a portfolio. **Fixed-income securities** are subject to the ability of an issuer to make timely principal and interest payments (credit risk), changes in interest rates (interest rate risk), the creditworthiness of the issuer and general market liquidity (market risk). In a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. **Longer-term securities** may be more sensitive to interest rate changes. Certain **U.S. government securities** purchased by the strategy, such as those issued by Fannie Mae and Freddie Mac, are not backed by the full faith and credit of the U.S. It is possible that these issuers will not have the funds to meet their payment obligations in the future. **Public bank loans** are subject to liquidity risk and the credit risks of lower-rated **securities. High-yield securities (junk bonds)** are lower-rated securities that may have a higher degree of credit and liquidity risk. **Sovereign debt securities** are subject to default risk. **Mortgage- and asset-backed securities** are sensitive to early prepayment risk and a higher risk of default and may be hard to value and difficult to sell (**liquidity risk**). They are also subject to credit, market, and interest rate risks. The **currency market** is highly volatile. Prices in these markets are influenced by, among other things, changing supply and demand for a particular currency; trade; fiscal, money and domestic or foreign exchange control programs and policies; and changes in domestic and foreign interest rates. Investments in **foreign markets** entail special risks such as currency, political, economic and market risks. The risks of investing in **emerging market** countries are greater than the risks generally associated with foreign investments. **Derivative instruments** may disproportionately increase losses and have a significant impact on performance. They also may be subject to counterparty, liquidity, valuation, and correlation and market risks. **Restricted and illiquid securities** may be more difficult to sell and value than publicly traded securities (liquidity risk). Due to the possibility that prepayments will alter the cash flows on **collateralized mortgage obligations (CMOs)**, it is not possible to determine in advance their final maturity date or average life. In addition, if the collateral securing the CMOs or any third-party guarantees are insufficient to make payments, the portfolio could sustain a loss.

DEFINITIONS

Basis point (bp): One basis point = 0.01%.

INDEX DEFINITIONS

The indexes shown in this report are not meant to depict the performance of any specific investment, and the indexes shown do not include any expenses, fees, or sales charges, which would lower performance. The indexes shown are unmanaged and should not be considered an investment. It is not possible to invest directly in an index.

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The **Bloomberg Euro Aggregate Corporate Index (Bloomberg Euro IG Corporate)** is an index designed to reflect the performance of the euro-denominated investment-grade corporate bond market.

The **Bloomberg Global Aggregate Corporate Index** is the corporate component of the Bloomberg Global Aggregate index, which provides a broad-based measure of the global investment-grade fixed income markets.

The **Bloomberg US Corporate High Yield Index** measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. The index excludes emerging market debt.

The **Bloomberg US Corporate Index** is a broad-based benchmark that measures the investment grade, fixed-rate, taxable, corporate bond market.

The **Bloomberg US Mortgage-Backed Securities (MBS) Index** tracks agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon, and vintage. Introduced in 1985, the GNMA, FHLMC and FNMA fixed-rate indexes for 30- and 15-year securities were backdated to January 1976, May 1977, and November 1982, respectively. In April 2007, agency hybrid adjustable-rate mortgage (ARM) pass-through securities were added to the index.

Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care.

Euro vs. USD—Euro total return versus U.S. dollar.

German 10YR bonds—Germany Benchmark 10-Year Datastream Government Index; **Japan 10YR government bonds**—Japan Benchmark 10-Year Datastream Government Index; and **10YR US Treasury**—US Benchmark 10-Year Datastream Government Index.

The **ICE BofAML European Currency High-Yield Constrained Index (ICE BofAML Euro HY constrained)** is designed to track the performance of euro- and British pound sterling-denominated below investment-grade corporate debt publicly issued in the Eurobond, sterling.

The **ICE BofAML US Mortgage-Backed Securities (ICE BofAML US Mortgage Master) Index** tracks the performance of US dollar-denominated, fixed-rate and hybrid residential mortgage pass-through securities publicly issued by US agencies in the US domestic market.

The **ICE BofAML US High Yield Master II Constrained Index (ICE BofAML US High Yield)** is a market value-weighted index of all domestic and Yankee high-yield bonds, including deferred-interest bonds and payment-in-kind securities. Its securities have maturities of one year or more and a credit rating lower than BBB-/Baa3 but are not in default.

The **ISM Manufacturing Index** is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

Italy 10-Year Government Bonds—Italy Benchmark 10-Year Datastream Government Index.

The **JP Morgan CEMBI Broad Diversified Index** is a global, liquid corporate emerging markets benchmark that tracks US-denominated corporate bonds issued by emerging markets entities.

The **JPMorgan Government Bond Index**—emerging markets (**JPM local EM debt**) tracks local currency bonds issued by emerging market governments. The index is positioned as the investable benchmark that includes only those

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countries that are accessible by most of the international investor base (excludes China and India as of September 2013).

The **JPMorgan Government Bond Index Emerging Markets (JPM External EM Debt)** tracks local currency bonds issued by emerging market governments. The index is positioned as the investable benchmark that includes only those countries that are accessible by most of the international investor base (excludes China and India as of September 2013).

The **JP Morgan Emerging Markets Bond Index Global (EMBI Global)** tracks total returns for traded external debt instruments in the emerging markets and is an expanded version of the EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million.

The **JP Morgan GBI-EM Global Diversified Index** is a market-capitalization weighted, liquid global benchmark for US-dollar corporate emerging market bonds representing Asia, Latin America, Europe, and the Middle East/Africa.

JPY vs. USD—Japanese yen total return versus US dollar.

The **Markit ITraxx Europe Index** comprises 125 equally weighted credit default swaps on investment grade European corporate entities, distributed among 4 sub-indices: Financials (Senior & Subordinated), Non-Financials and HiVol.

The **Nikkei 225 Index (Japan Nikkei 225)** is a price-weighted index of Japan's top 225 blue-chip companies on the Tokyo Stock Exchange.

The **MSCI AC Asia ex-Japan Index (MSCI Asia ex-Japan)** captures large- and mid-cap representation across two of three developed markets countries (excluding Japan) and eight emerging markets countries in Asia.

The **MSCI All Country World Index (ACWI, MSCI global equities)** is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of developed and emerging markets. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in US dollars and assumes reinvestment of net dividends.

MSCI Emerging Markets Index (MSCI emerging equities) captures large- and mid-cap representation across 23 emerging markets (EM) countries.

The **MSCI World Index (MSCI developed equities)** captures large and mid-cap representation across 23 developed market (DM) countries.

Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector.

The **Refinitiv Convertible Global Focus USD Hedged Index** is a market weighted index with a minimum size for inclusion of $500 million (US), 200 million (Europe), 22 billion Yen, and $275 million (Other) of Convertible Bonds with an Equity Link.

The **Russell 2000® Index** is an index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

The **S&P 500® Index (US S&P 500)** measures the performance of the large-cap segment of the US equities market, covering approximately 75 percent of the US equities market. The index includes 500 leading companies in leading industries of the U.S. economy.

S&P CoreLogic Case-Shiller US National Home Price NSA Index seeks to measure the value of residential real estate in 20 major US metropolitan areas: Atlanta, Boston, Charlotte, Chicago, Cleveland, Dallas, Denver, Detroit, Las Vegas, Los Angeles, Miami, Minneapolis, New York, Phoenix, Portland, San Diego, San Francisco, Seattle, Tampa and Washington, D.C.

The **S&P/LSTA US Leveraged Loan 100 Index (S&P/LSTA Leveraged Loan Index)** is designed to reflect the performance of the largest facilities in the leveraged loan market.

The **S&P GSCI Copper Index (Copper)**, a sub-index of the S&P GSCI, provides investors with a reliable and publicly available benchmark for investment performance in the copper commodity market.

The **S&P GSCI Softs (GSCI soft commodities) Index** is a sub-index of the S&P GSCI that measures the performance of only the soft commodities, weighted on a world production basis. In 2012, the S&P GSCI Softs Index included the following commodities: coffee, sugar, cocoa, and cotton.

Spain 10-Year Government Bonds—Spain Benchmark 10-Year Datastream Government Index.

The **Thomson Reuters Convertible Global Focus USD Hedged Index** is a market weighted index with a minimum size for inclusion of $500 million (US), 200 million euro (Europe), 22 billion yen, and $275 million (Other) of convertible bonds with an equity link.

U.K. 10YR government bonds—U.K. Benchmark 10-Year Datastream Government Index. For the following Datastream government bond indexes, benchmark indexes are based on single bonds. The bond chosen for each series is the most representative bond available for the given maturity band at each point in time. Benchmarks are selected according to the accepted conventions within each market. Generally, the benchmark bond is the latest issue within the given maturity band; consideration is also given to yield, liquidity, issue size and coupon.

The **US Dollar Index (DXY)** is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of US trade partners' currencies.

The **Chicago Board Options Exchange (CBOE) Market Volatility (VIX) Index** shows the market's expectation of 30-day volatility.

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