

Volatility Happens

AAM's Investment Outlook Webinar
Tuesday, January 24, 2017



Insurance Investment Management

Today's Presenters:

Market Outlook



Reed J. Nuttall, CFA
Chief Investment Officer

Macroeconomic Review and Outlook



Marco Bravo, CFA
Senior Portfolio Manager

Corporate Securities



Elizabeth Henderson, CFA
Director of Corporate Credit

High Yield Sector



Scott A. Skowronski, CFA
Senior Portfolio Manager

Structured Products



Scott A. Edwards, CFA
Director of Structured
Products

Municipal Market



Gregory A. Bell, CFA, CPA
Director of Municipal Products
and Municipal Bond Trader

Convertible Market Overview



Tim Senechalle, CFA
Senior Portfolio Manager

Macroeconomic Review and Outlook



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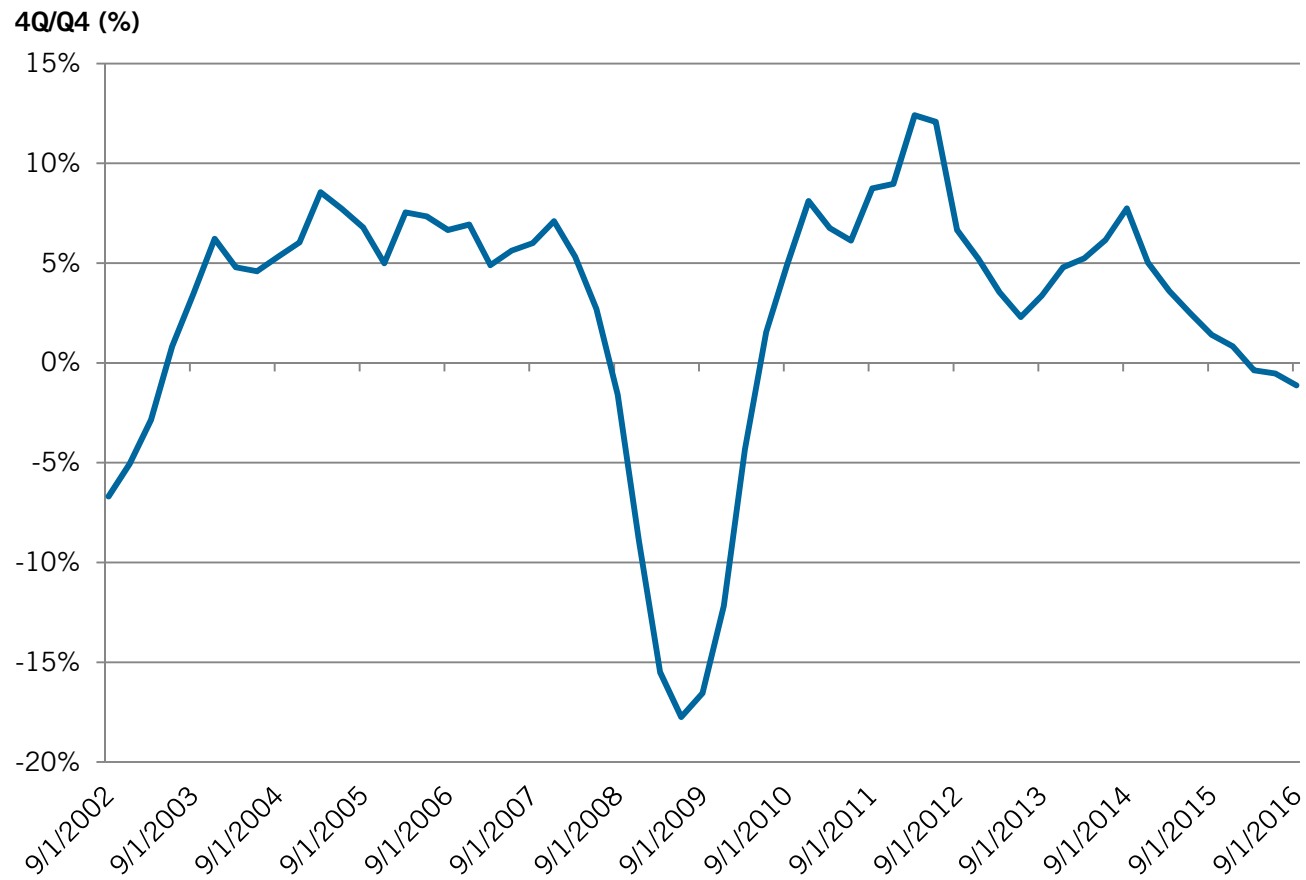
U.S. Economic Outlook

	2015	2016	2017 (est)
Real GDP	1.9%	2.0%	2.4%
Personal Consumption	2.6%	2.8%	2.5%
Fixed Private Investment	2.6%	-1.1%	4.1%
Exports	-2.2%	1.9%	2.4%
Imports	2.5%	1.3%	4.0%
Government Spending	2.2%	0.4%	1.2%

Note: Percentages represent change from fourth quarter to fourth quarter

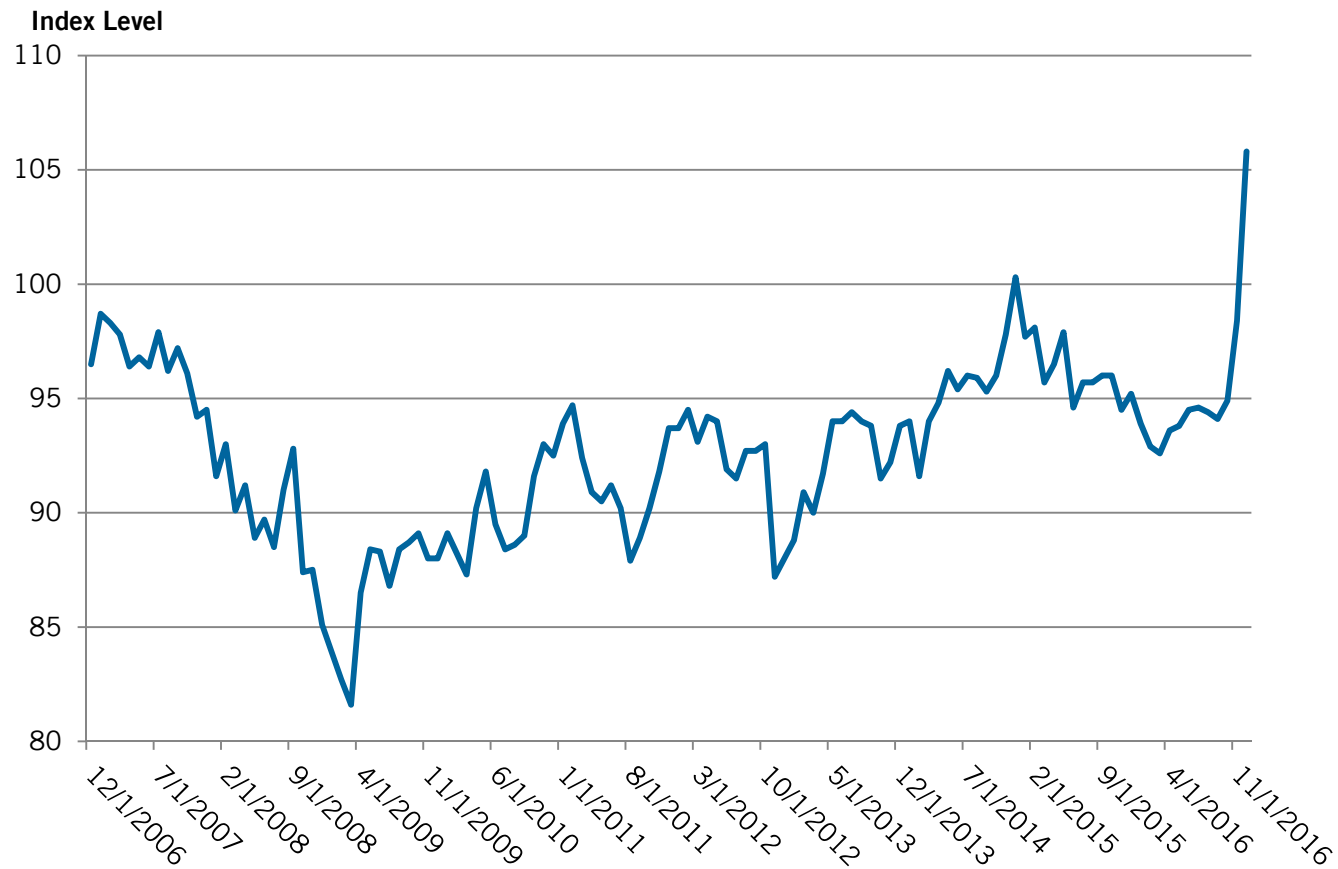
Source: Bureau of Economic Analysis, Bloomberg

Private Non-Residential Investment



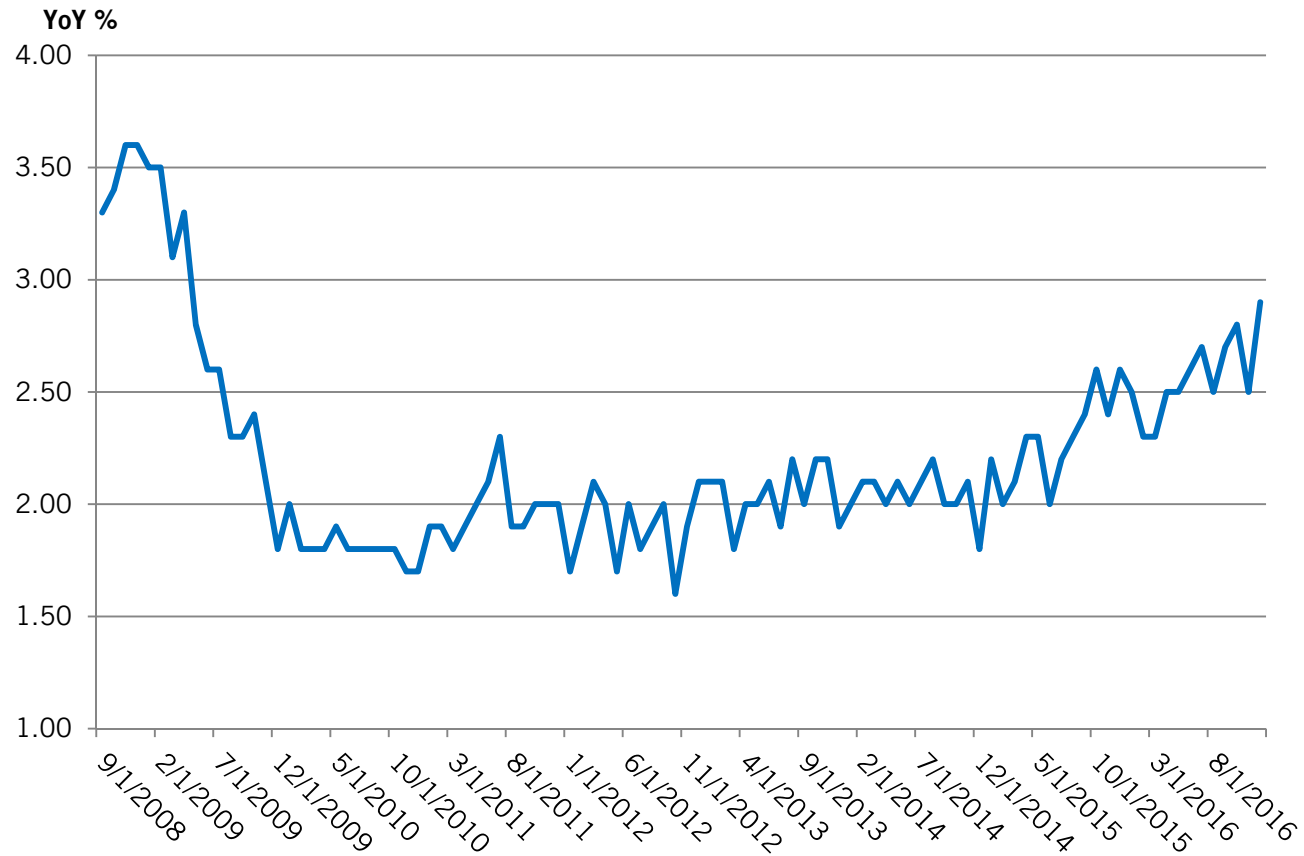
Source: Bureau of Economic Analysis

NFIB Small Business Optimism



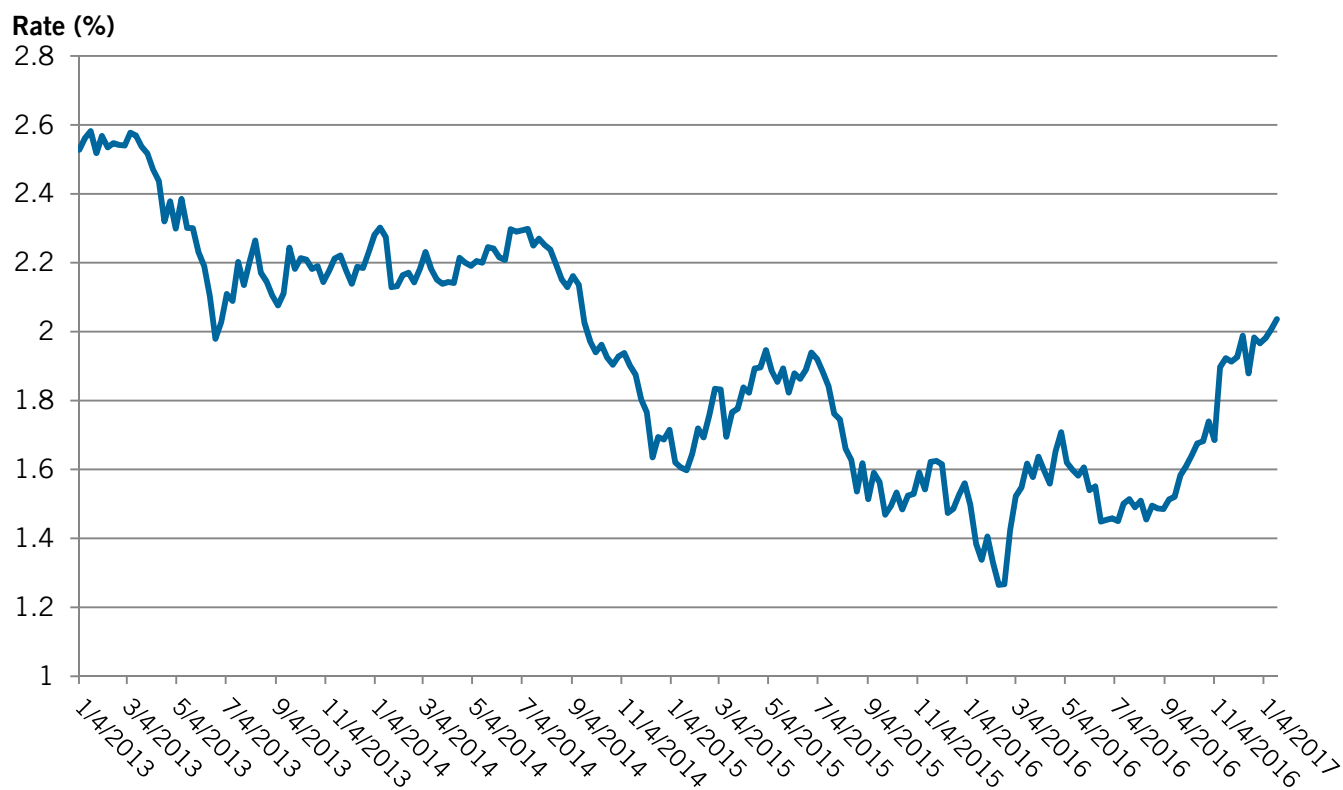
Source: National Federation of Independent Businesses

Average Hourly Earnings



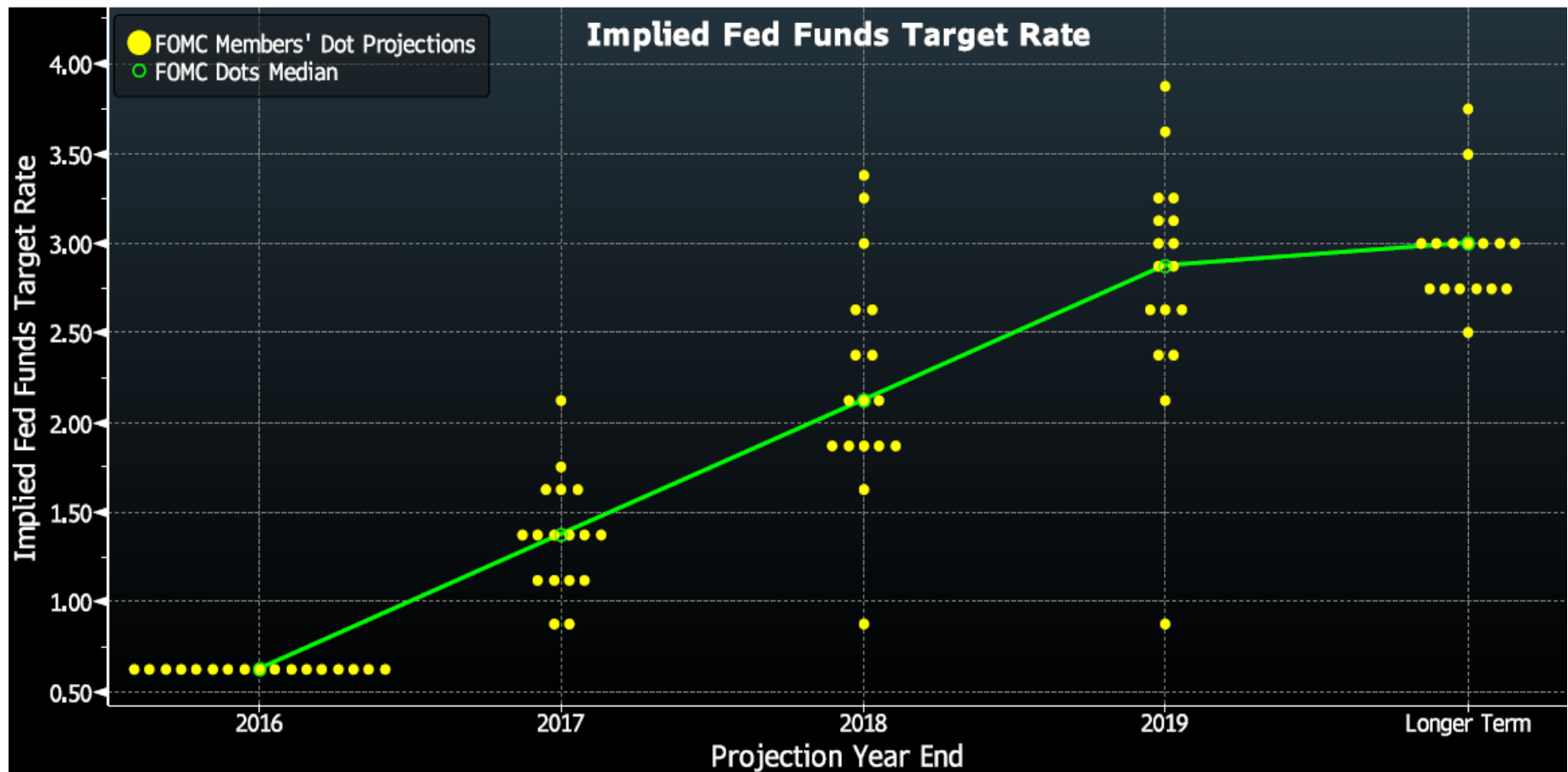
Source: Bureau of Labor Statistics

10 Year Inflation Expectations



Source: US Treasury, Bloomberg.

The Fed's Dot Plot



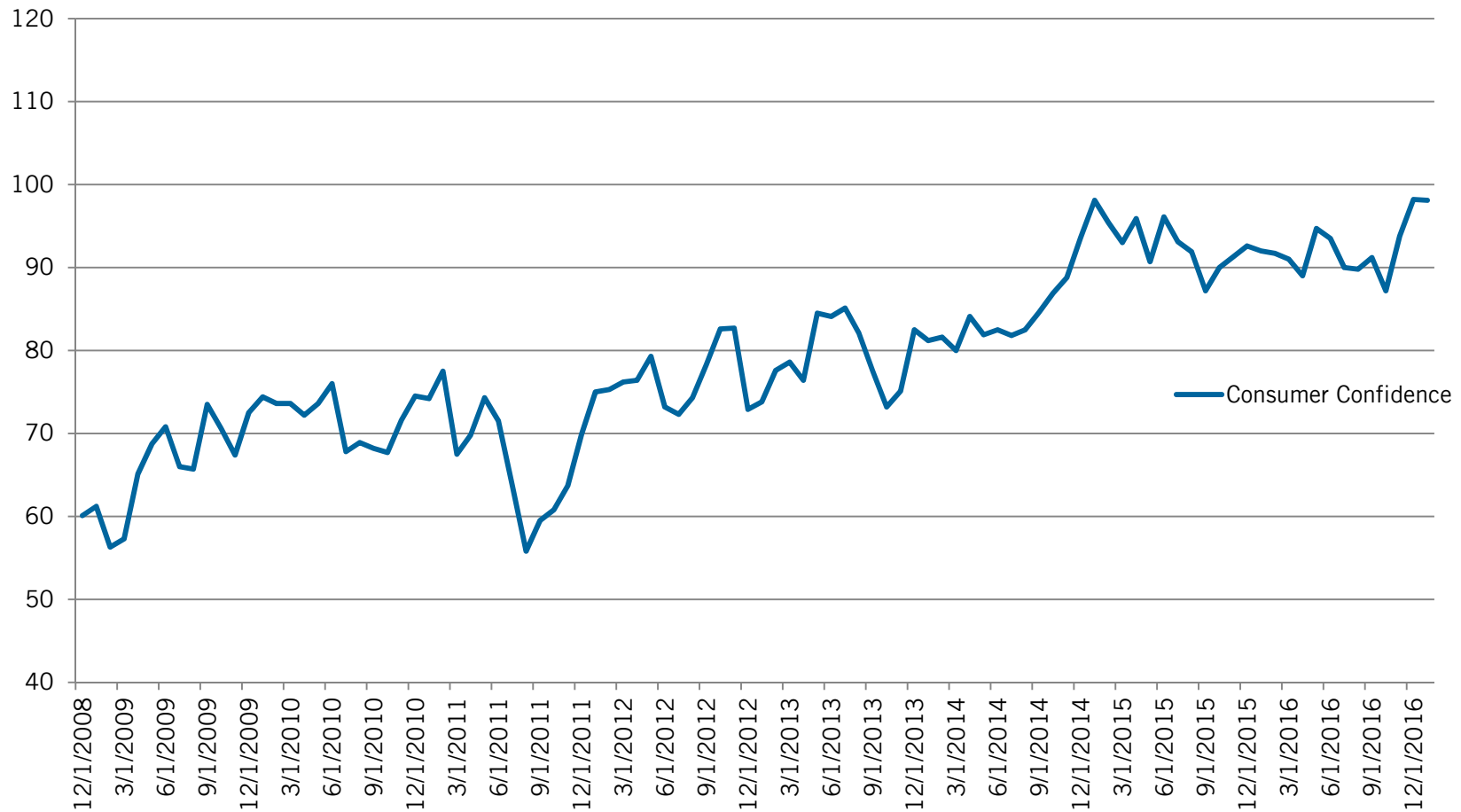
Source: Federal Reserve, Bloomberg.

Market Outlook



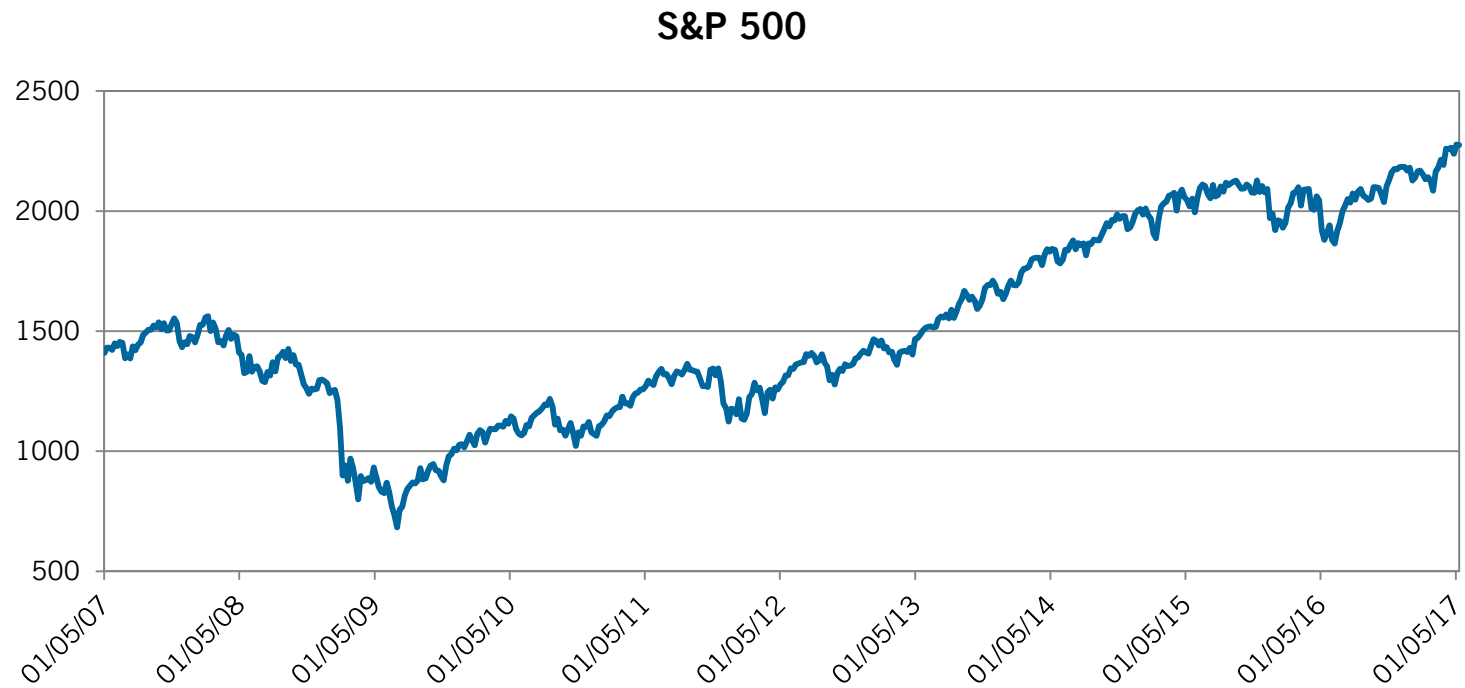
Reed J. Nuttall, CFA
Chief Investment Officer

Consumers Are Optimistic



Source: University of Michigan Consumer Sentiment Index, Bloomberg

Stock Market Returns Above Historical Norms



The Market Is Priced for Tax Cuts and Growth

S&P 500 P/E Ratio



Corporate Securities

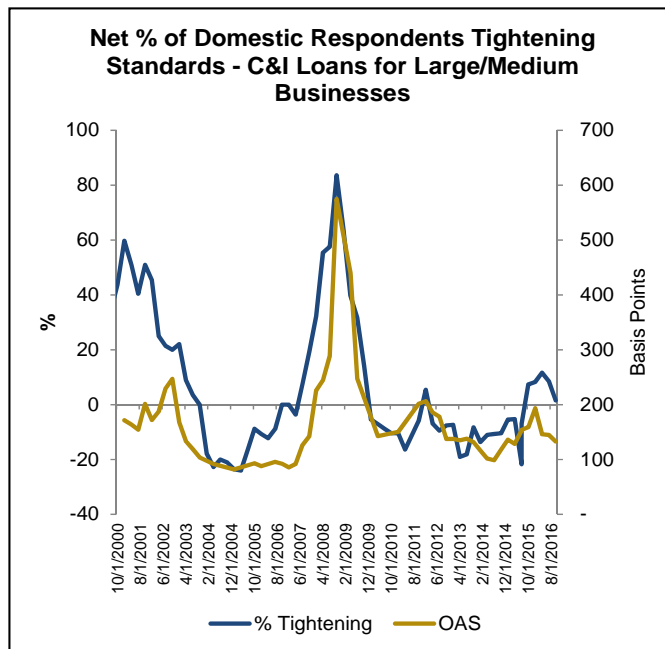


Elizabeth Henderson, CFA
Director of Corporate Credit

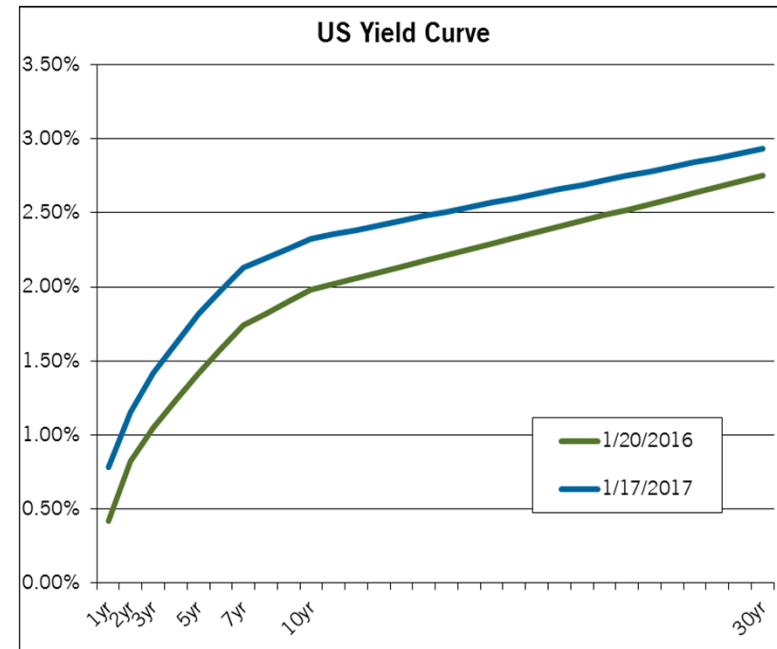
Corporate Sector

Credit cycle indicators have improved

- Fewer banks tightening standards
 - 2017 indicators: Credit Managers Index remains above 50 (expansion), GS Financial Conditions Index elevated but improved year/year
- Yield curve remains steep
 - Slight bear flattener expected in 2017



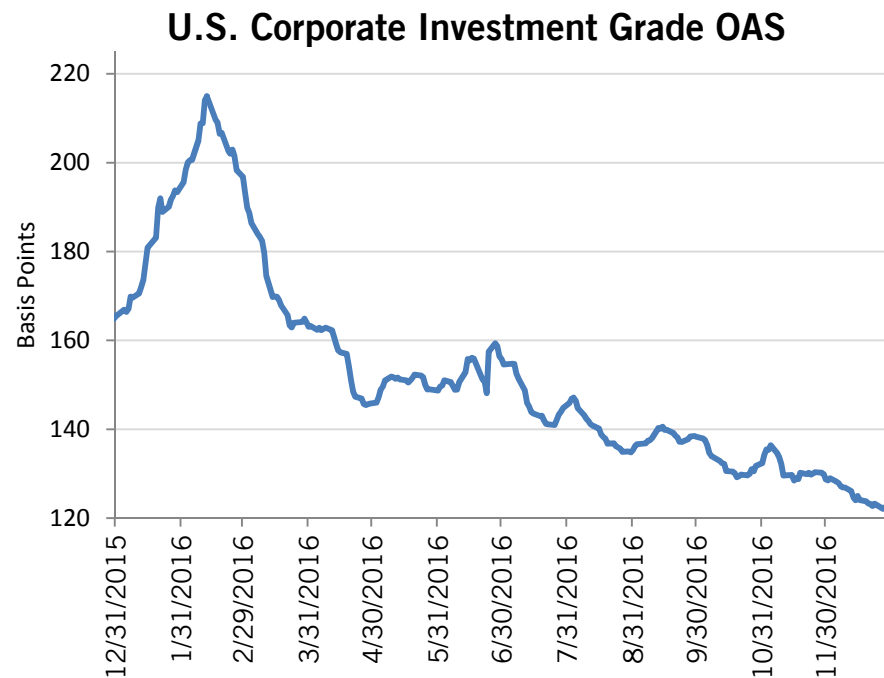
Source: AAM, Bloomberg Barclays Index, Fed



Source: AAM, Bloomberg

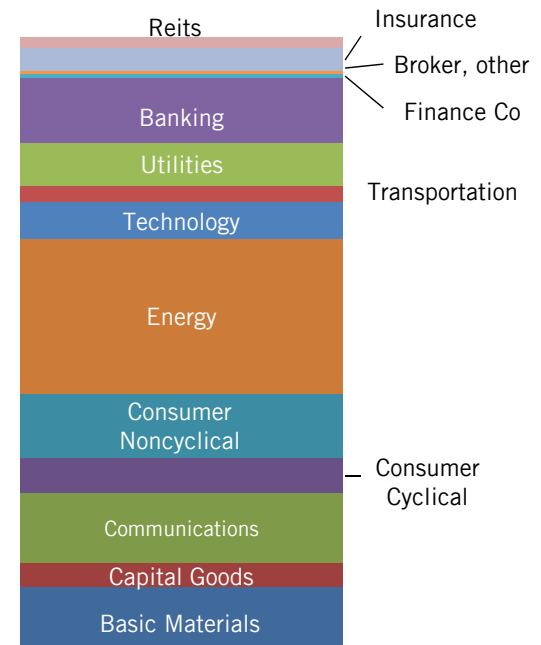
Corporate Sector

OAS tighter with improving commodity prices and economic outlook due to monetary and fiscal stimulus



Source: AAM, Bloomberg Barclays

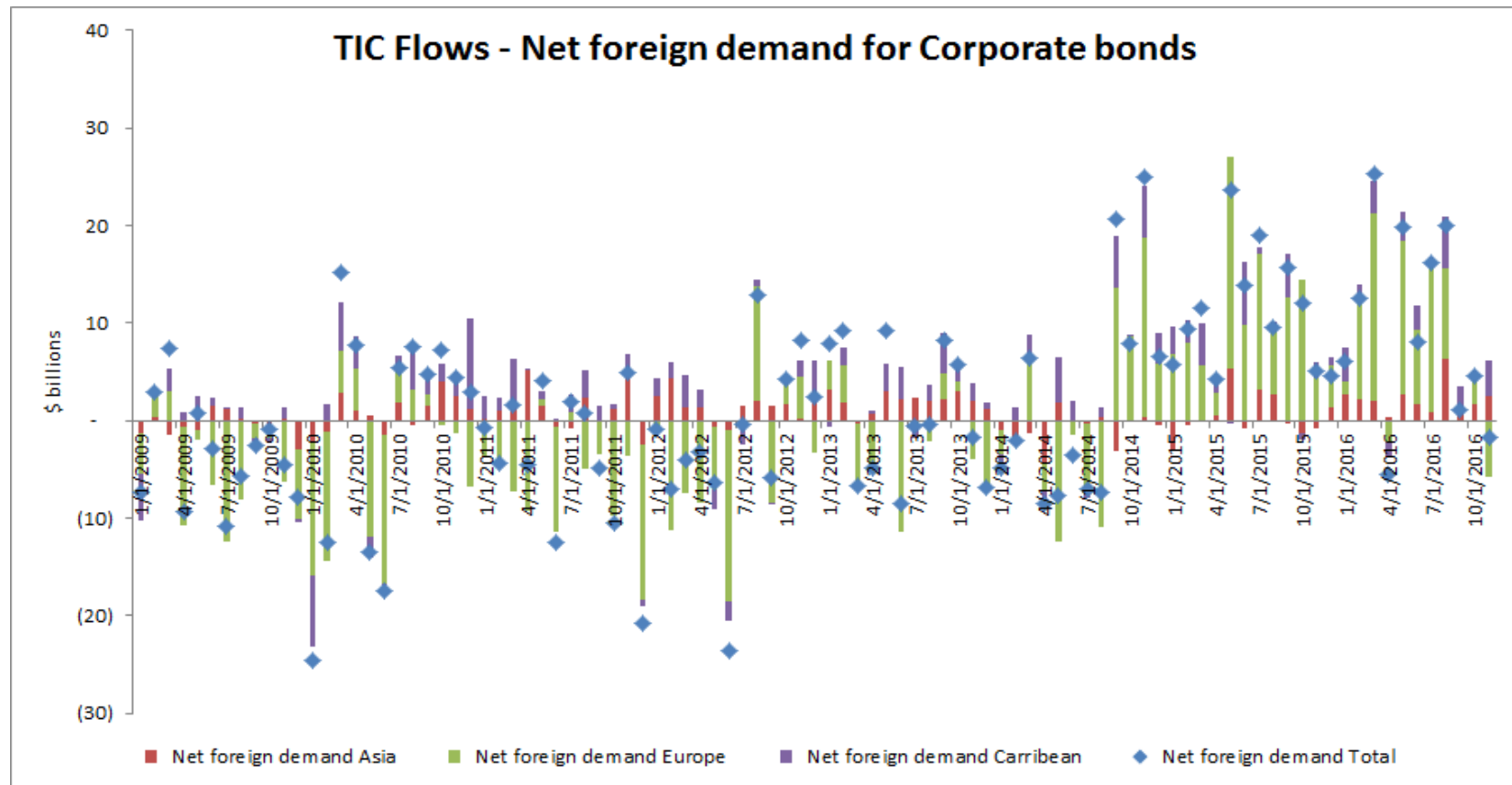
Contributors to IG Corporate Excess Returns 2016



493 basis points

Corporate Sector

Technicals supporting spreads

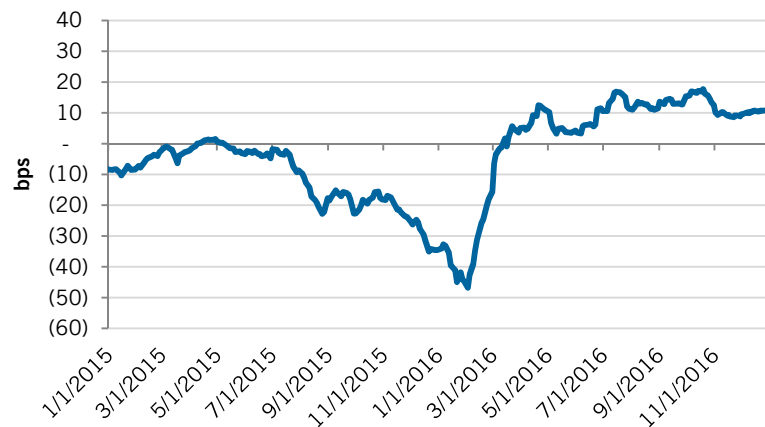


Source: AAM, Bloomberg

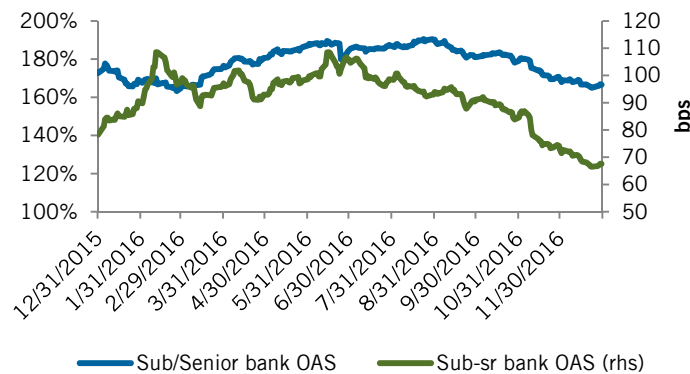
Corporate Sector

Prioritize risk adjusted income – Opportunities in Finance

Finance – Industrials OAS



Sub/Senior bank relationships



AAM comments:

- Interest rate sensitive sectors have outperformed
- Prefer domestic banks (money center), legacy bonds
- REIT spreads approaching cyclical tight and REIT fundamentals have peaked
- Prefer well positioned P&C, brokers, and life insurers
- Community banks remain interesting but must be selective and disciplined with pricing
- Continue to avoid:

Fundamental concerns	Relative value
European banks	Regional banks (senior)
Australian banks	Canadian banks (senior)
BDCs	
Small REITs	

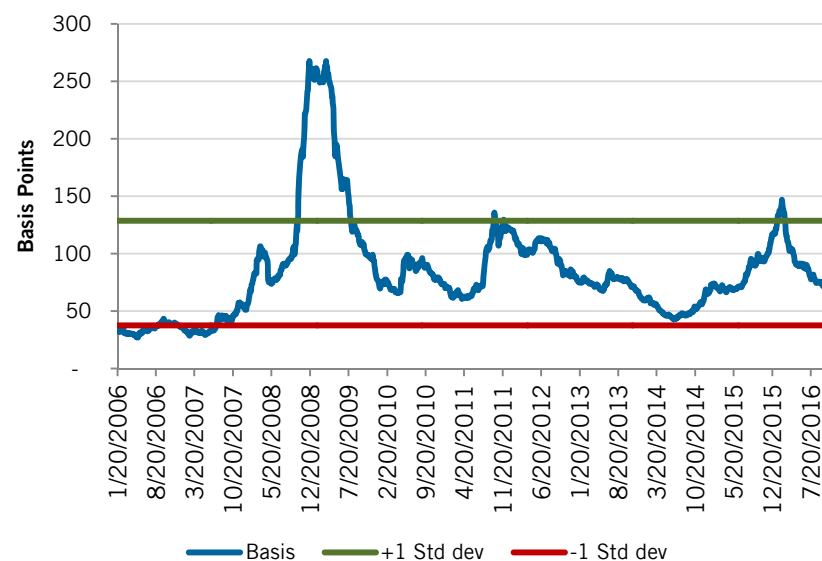
Corporate Sector

Prioritize risk adjusted income – Opportunities in Industrials

AAM comments:

- BBBs offer more value but must be selective at lower end of quality spectrum
- Expect commodity sectors to outperform as well as Aerospace/Defense, Towers, Railroads
- Take advantage of M&A related new issue funding (e.g., Pharma)
- Avoid: Media (smaller networks), Cable, BBB rated Auto/Retail, Refining, Technology, A rated Consumer Products/Food

BBB-A Industrial Rating Basis



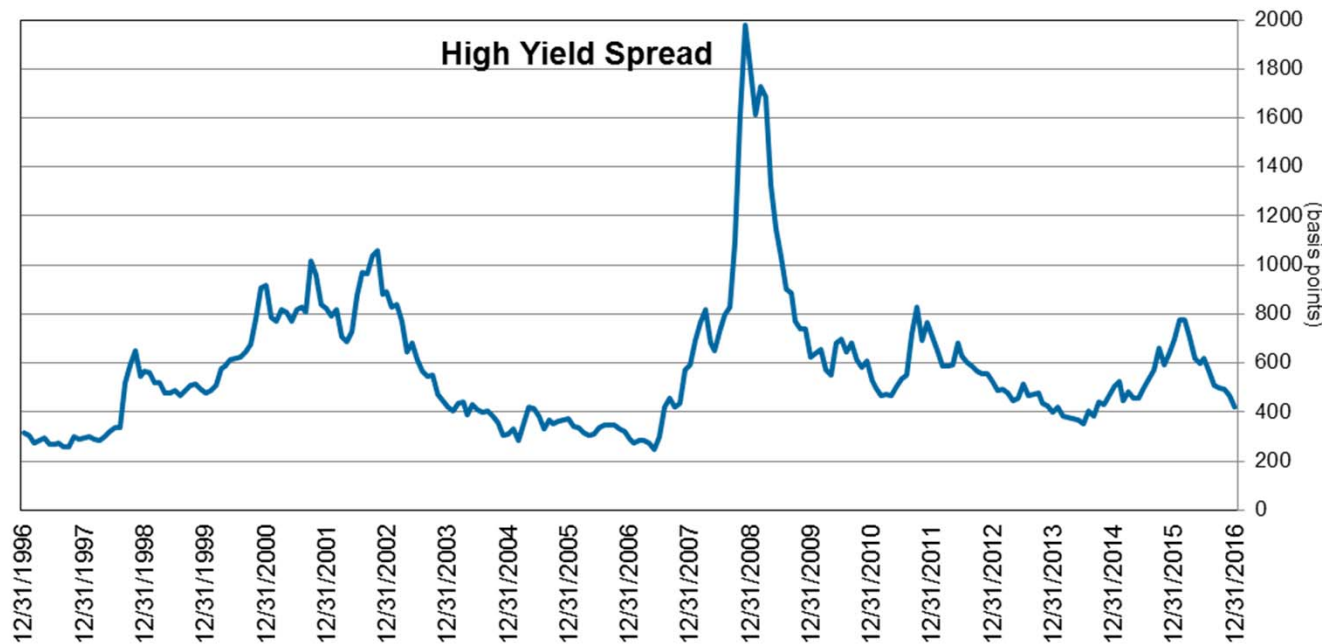
High Yield Sector



Scott A. Skowronski, CFA
Senior Portfolio Manager

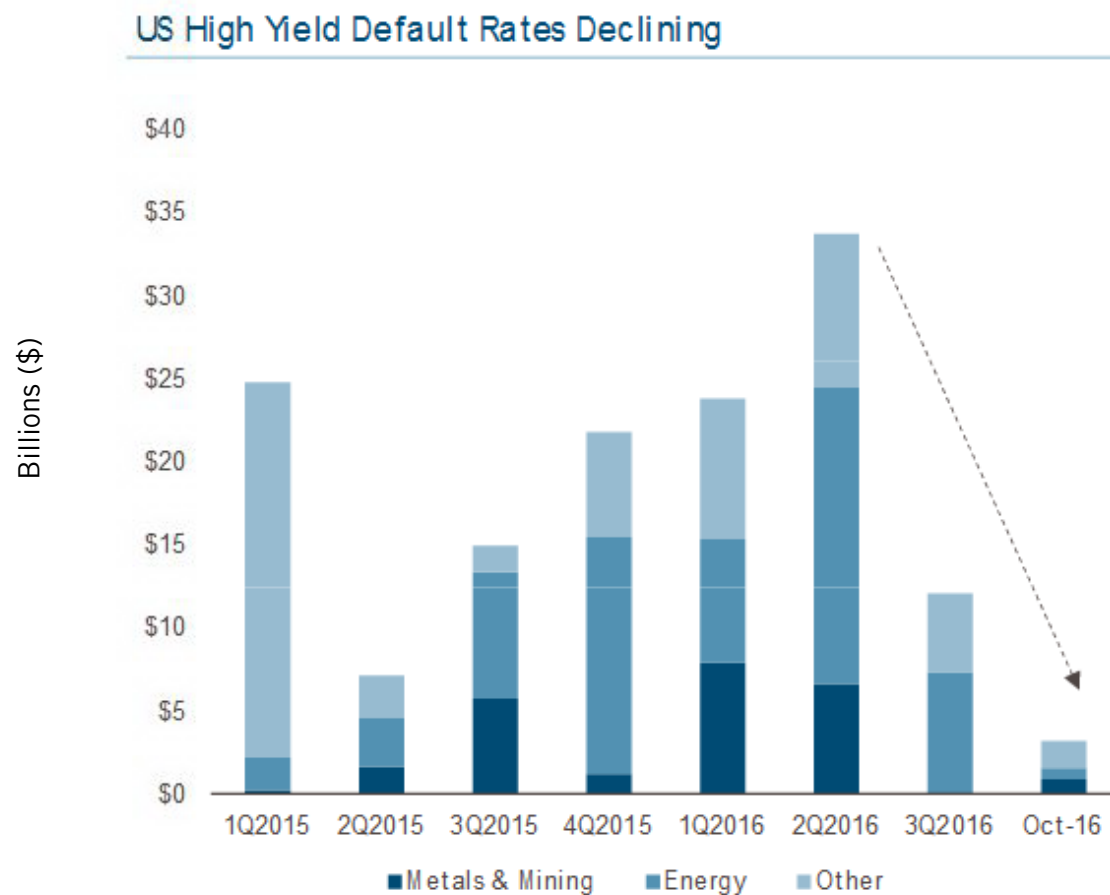
High Yield Market Review: A Strong 2016 as Commodities Stabilized

US High Yield Market Data as of 12/31/2016				
Description	Total Return 2016	Yield	Spread	Spread Change 2016
Broad Market	17.5%	6.17	422	-273
BB/B Rated	14.8%	5.29	330	-223
CCC & Lower	36.0%	11.06	932	-715
Energy	37.4%	6.36	433	-970



Source: Bank of America Merrill Lynch High Yield Indices

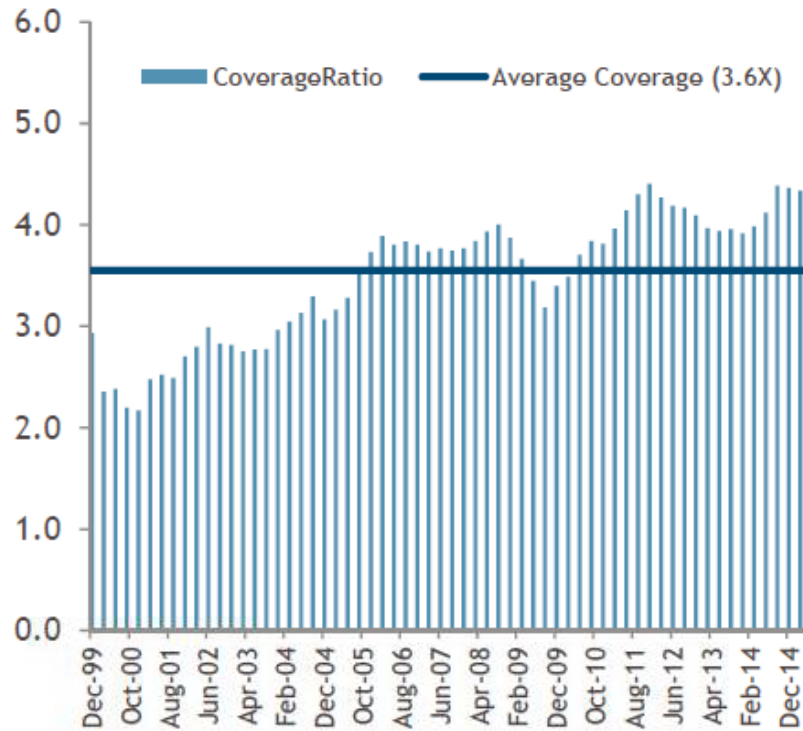
High Yield Default Rates Expected to Decline in 2017



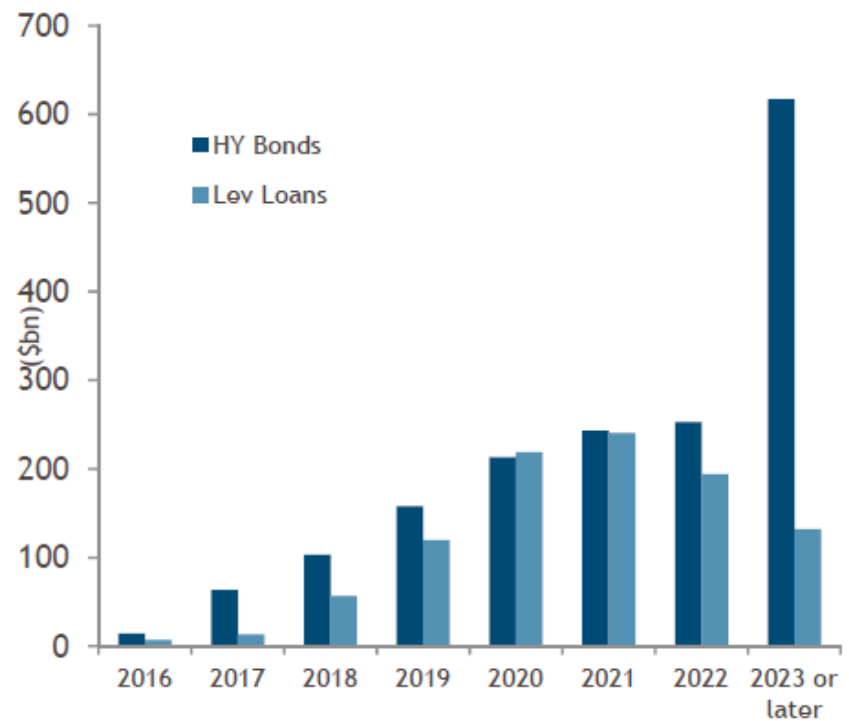
Source: Goldman Sachs

Debt Service Remains Manageable

Interest Coverage Ratio



Debt Maturity Wall



Source: BofA ML Global Research HY Market Stat. Sept. 30, 2016. JP Morgan, Markit as of Aug. 9, 2016.

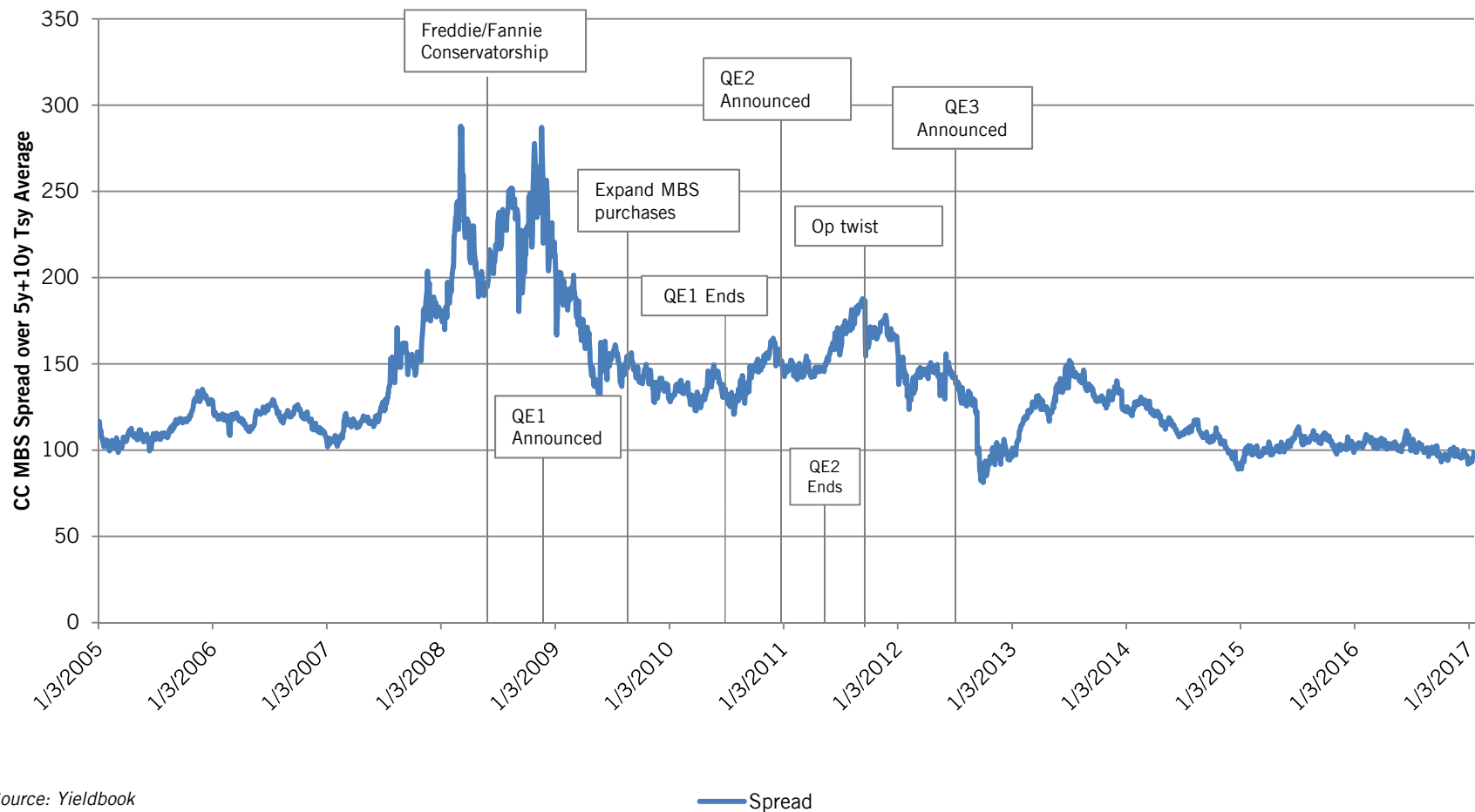
Structured Products



Scott A. Edwards, CFA
Director of Structured Products

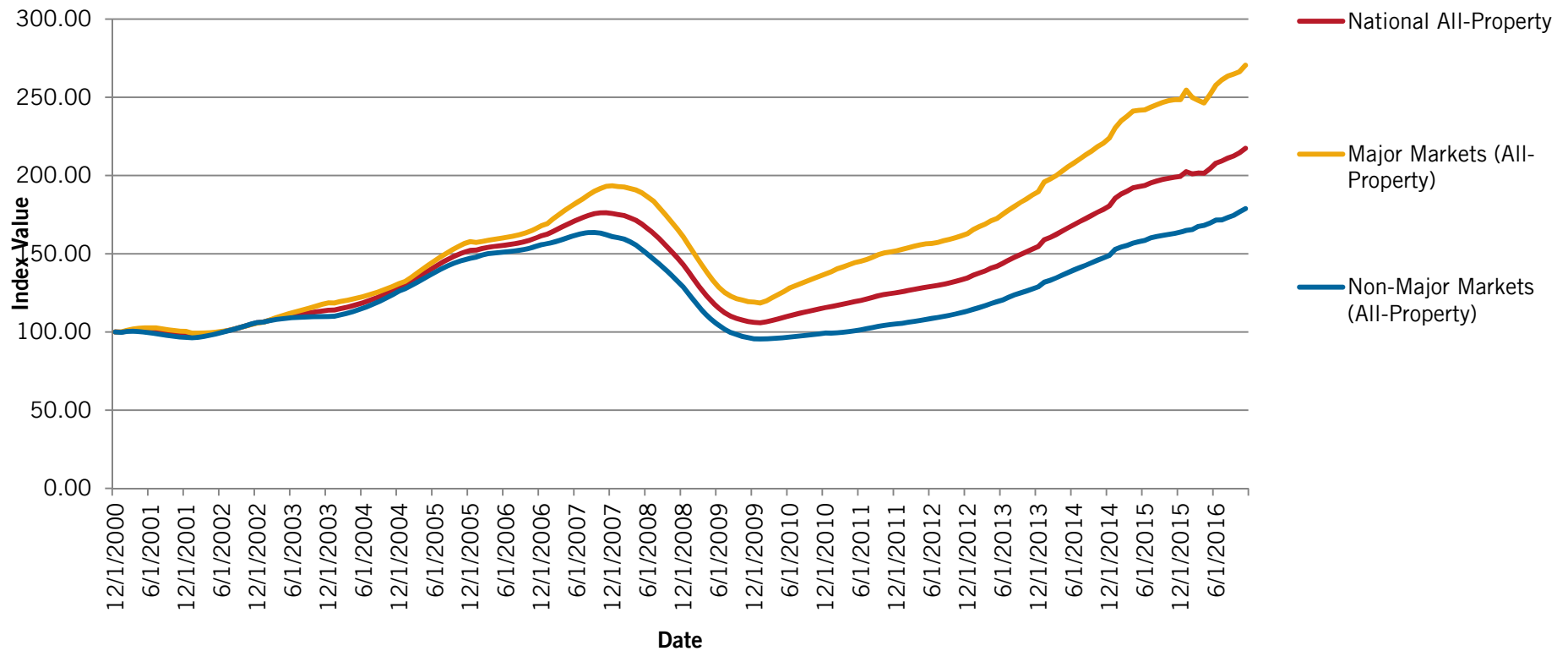
Current Coupon Spreads

Federal Reserve Taper announcement May 22, 2013



Moody's/Real Commercial Property Prices Indices

Moody's Commercial Property Price Indices



Source: Moody's

Vintage UW Spreads

Vintage	Orig. Bal. (\$bil.)	Loan Count	Avg. Loan Size (\$mil.)	Avg. Coupon	Orig. LTV	% of Loans with LTV >74%	Orig. NCF Debt Yield	% of Loans with NCF Debt Yield <9%	Orig. NCF DSCR	Full IO %	Partial IO %	No IO %	% of Loans with Additional Debt	Refinance % / Acquisition %
2004	73.5	6,701	11.0	5.5%	68.7	43.3%	11.1%	21.3%	1.67	14.1%	29.3%	56.6%		
2005	135.5	10,117	13.4	5.4%	69.7	44.4%	10.0%	47.7%	1.59	26.6%	38.3%	35.0%		
2006	161.3	11,701	13.8	5.8%	69.1	42.3%	9.7%	50.9%	1.45	32.1%	41.8%	26.1%		
2007	191.1	11,761	16.3	5.8%	70.0	45.6%	8.9%	64.9%	1.38	56.5%	29.2%	14.3%		
2008	10.7	819	13.1	6.3%	68.1	31.5%	9.5%	46.7%	1.35	31.0%	50.1%	18.9%		
2010	5.4	217	24.8	5.8%	59.2	5.2%	12.4%	2.8%	1.78	6.0%	7.1%	86.9%	20.6%	74.1 / 25.9
2011	24.5	967	25.3	5.5%	62.6	7.2%	10.9%	8.3%	1.61	8.7%	16.2%	75.1%	16.3%	74.9 / 24.8
2012	32.2	1,719	18.7	5.0%	63.5	8.1%	10.5%	18.1%	1.67	11.8%	22.0%	66.2%	10.3%	80.1 / 18.2
2013	53.1	3,050	17.4	4.5%	63.1	10.9%	10.5%	27.4%	1.85	17.0%	32.7%	50.3%	13.5%	71.9 / 26.3
2014	56.8	3,484	16.3	4.7%	65.8	18.1%	10.1%	41.0%	1.71	19.3%	43.8%	36.9%	16.2%	69.0 / 29.1
2015	61.5	4,327	14.2	4.4%	64.8	16.3%	9.8%	46.6%	1.79	23.7%	43.2%	33.1%	11.4%	69.2 / 28.6
2016	47.1	2,792	16.9	4.5%	61.0	7.7%	10.4%	37.4%	1.89	33.1%	33.7%	33.2%	15.1%	67.1 / 26.8
Q1 2015	13.1	908	14.5	4.3%	65.7	18.7%	9.6%	45.9%	1.77	23.4%	45.4%	31.2%	12.6%	61.8 / 35.8
Q2 2015	16.6	1,230	13.5	4.2%	65.2	17.5%	9.8%	50.6%	1.89	28.0%	39.6%	32.4%	10.6%	73.5 / 25.9
Q3 2015	16.8	1,139	14.8	4.5%	64.6	15.1%	10.1%	43.6%	1.79	17.9%	46.5%	35.6%	12.4%	71.1 / 27.0
Q4 2015	14.9	1,050	14.2	4.6%	63.9	14.1%	9.6%	46.0%	1.69	25.8%	41.4%	32.7%	10.0%	68.9 / 26.9
Q1 2016	11.4	716	15.9	4.7%	61.9	9.7%	10.4%	42.4%	1.82	30.5%	41.2%	28.3%	11.7%	63.0 / 33.3
Q2 2016	7.1	464	15.3	4.8%	63.0	9.4%	9.9%	36.7%	1.72	29.2%	40.5%	30.3%	12.5%	62.4 / 32.3
Q3 2016	13.1	751	17.5	4.4%	59.7	5.9%	10.7%	33.5%	2.02	33.8%	30.6%	35.6%	17.3%	68.8 / 22.6
Q4 2016	15.5	861	18.0	4.2%	60.6	7.1%	10.4%	37.2%	1.92	36.2%	27.8%	35.9%	16.9%	70.9 / 23.1

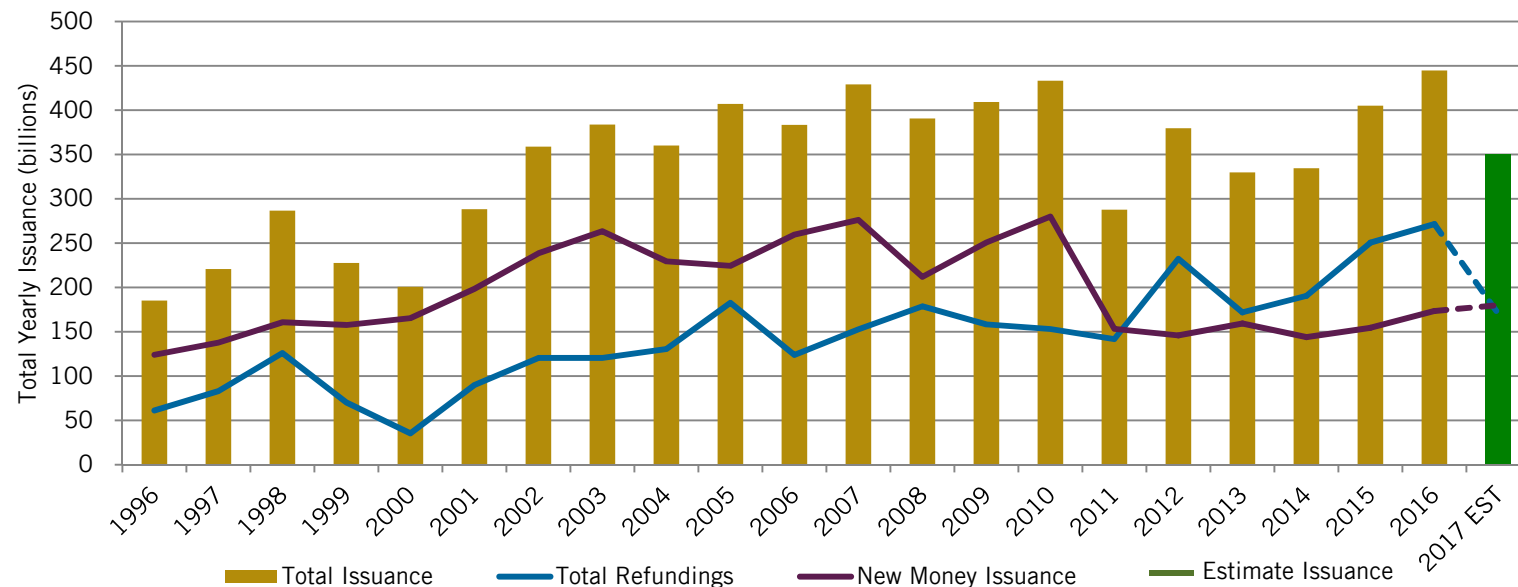
Source: Deal documents, Intex Solutions, Inc., and Wells Fargo Securities.

Municipal Market



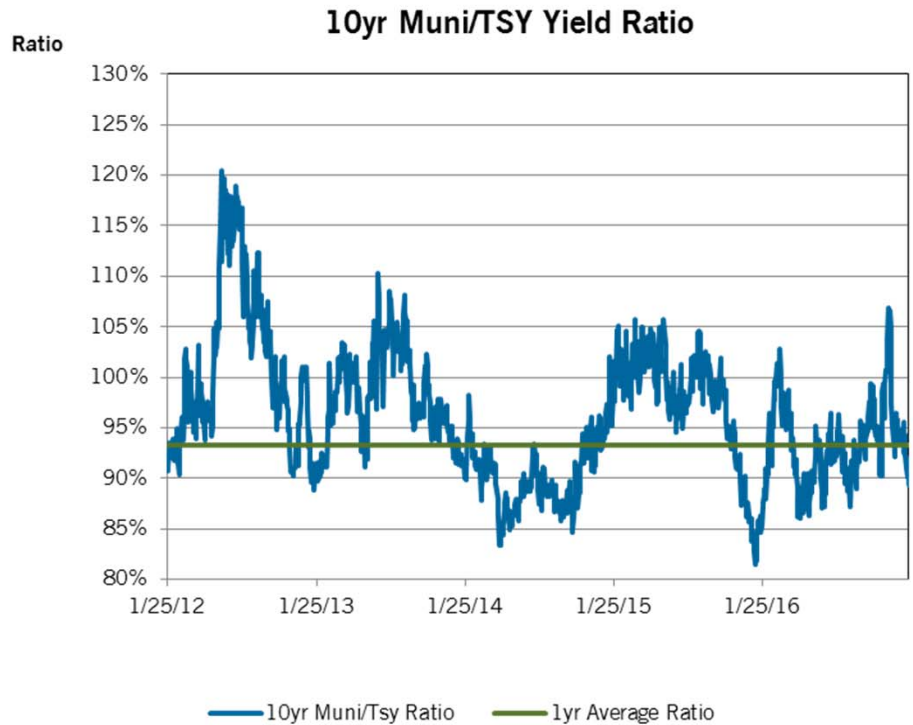
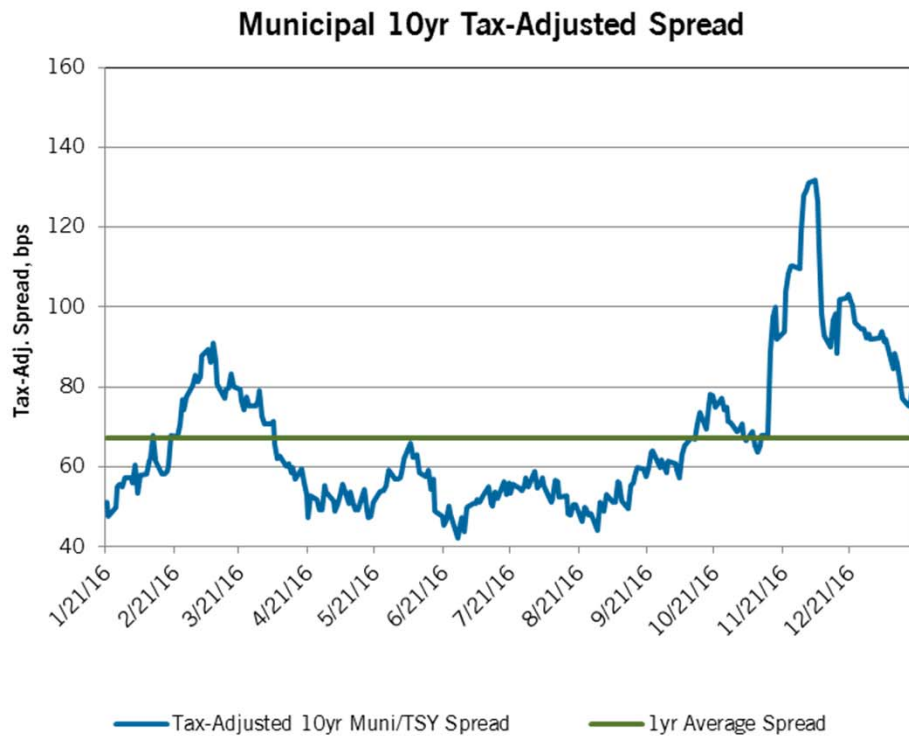
Gregory A. Bell, CFA, CPA
Director of Municipal Products and Municipal Bond Trader

Improved Technicals Should Support Relative Valuations



- New issuance supply expected to reach \$350billion, down \$95billion from 2016's record level
 - Substantial drop in refinancing activity will be the largest driver
 - Infrastructure-related financing expected to remain in line with issuance over last 4 years
- Demand expected to see gradual improvement in rising rate environment
 - Very heavy reinvestment flows from call proceeds should be supportive
 - Mutual fund redemptions expected to be a drag on demand flows as rates rise

Tax-Reform Risks Could Extend Volatility in Relative Valuations



Source: Bloomberg

Convertible Market Overview



Tim Senechalle, CFA
Senior Portfolio Manager

Convertible Gains Were Driven By Strong Equity and Credit Markets



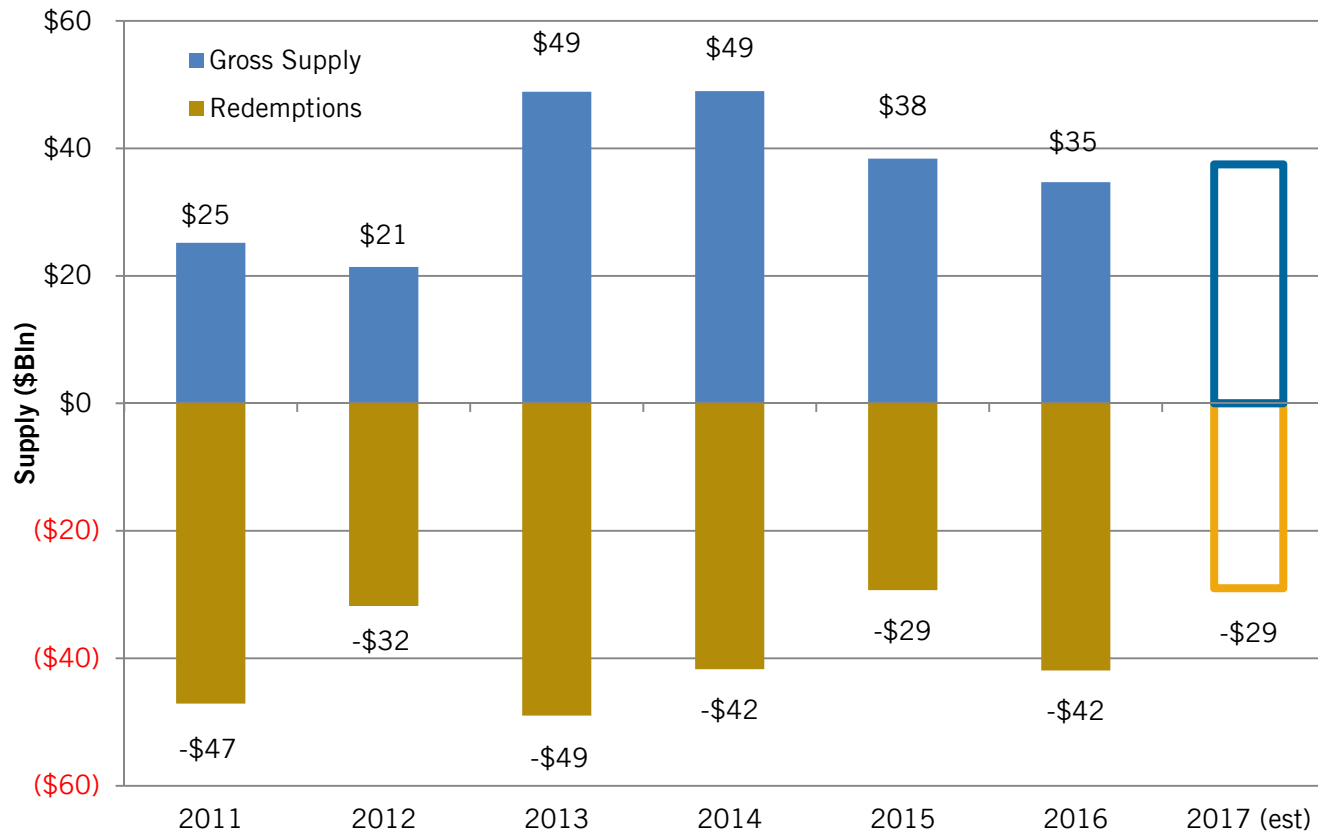
2016 Convertible Performance by Sector

As of 12/31/2016			
Market Sector	BofA Merrill Lynch VXA0 Index Weight	Convertible Sector Total Return	Underlying Equity Total Return
Energy	8.04%	+27.04%	+3.61%
Media	4.47%	+24.86%	+33.48%
Materials	2.07%	+20.90%	+59.10%
Consumer Staples	2.20%	+16.74%	+8.57%
Technology	33.93%	+16.09%	+20.80%
Utilities	5.32%	+12.58%	+15.88%
Financials	15.40%	+8.98%	+17.57%
Telecommunications	3.58%	+8.70%	+11.93%
Transportation	0.33%	+6.49%	+14.00%
Industrials	5.47%	+4.69%	+9.95%
Consumer Discretionary	3.37%	+1.41%	-0.14%
Healthcare	15.81%	-3.56%	-9.88%
Totals	100.0%	+10.43%	+12.19%

Source: Bank of America Merrill Lynch Convertible Research

Market Conditions Are Ripe For Increased New Issuance

Convertible Sector New Issue & Redemption (\$Bln)



Source: Barclays Capital Convertible Research

Managing Risk / Return Paramount Amid Expected Volatility



Equity markets will be the primary driver of returns. Asymmetric risk / return profile is compelling given uncertain market outlook.

Zazove Institutional Blend Composite – 12/31/2016

Typical Number of Positions	~60
Number of Industry Groups	35
Average Credit Quality	BBB-
Adjusted Current Yield	2.94%
Convertible Duration	1.66
Delta	0.55
Investment Premium	28.34%
Conversion Premium	28.41%
One-Year – Stocks up 25%	+16.74%
One-Year – Stocks down 25%	-8.80%
One-Year - Stocks down 25% & Interest Rates up 100 bps	-10.64%

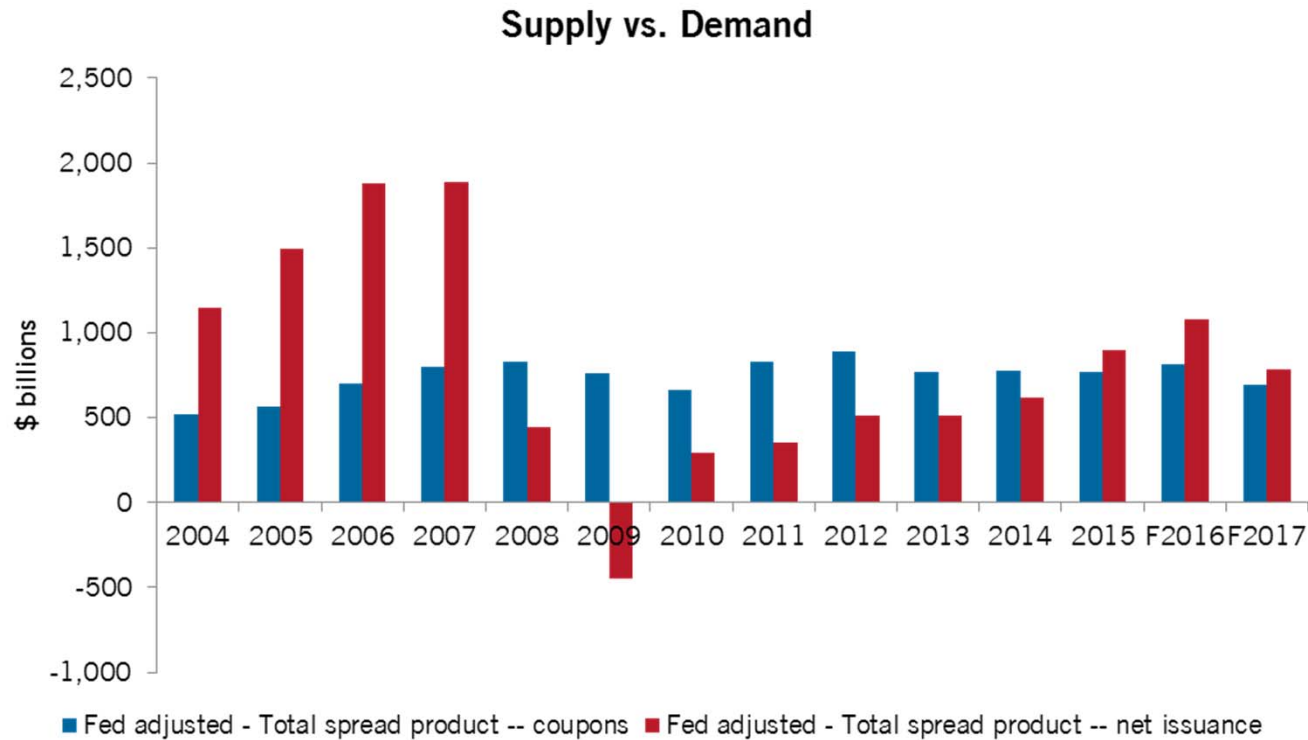
Source: Zazove Associates

Summary



Reed J. Nuttall, CFA
Chief Investment Officer

Issuance of Bonds Up in 2016 Offset by Surge in Demand



Source: JPM, AAM

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Please enter any questions on the top right
hand of your screen