National Municipal Bond Strategy

Newfleet ASSET MANAGEMENT
A Virtus Investment Partner

Sector Assessment

FUNDAMENTALS
Fundamentals at the state level have softened as slowing revenue growth faces high fixed cost burdens, pension liabilities, and healthcare expenses. At the local level, fundamentals are generally solid due to rising property values and tax bases.

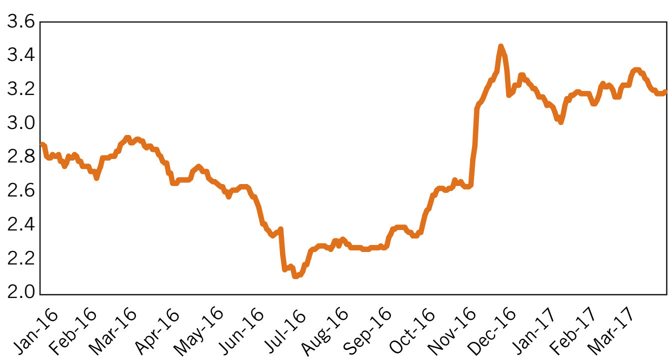
TECHNICALS
Paltry inflows and inconsequential outflows during the quarter reflect the hesitancy of the market in the current environment.

VALUATIONS
Municipal bonds continue to be in a holding pattern until there is more clarity on tax reform.

Important Developments this Quarter

Overview: The tone of the municipal bond market turned positive during the first quarter of 2017, following a volatile end to 2016. Expectations of tax reform and infrastructure spending and their implications for the municipal bond market had weighed on the sector in the aftermath of Donald Trump's election. These concerns have at least temporarily subsided with the new administration's struggle to make progress on its campaign pledges. While investors remain tentative as they await clarity on Trump's legislative agenda, the Bloomberg Barclays Municipal Bond Index generated three months of positive returns to end the quarter up 1.58%. The yield on the 30-year AAA municipal bond ended the quarter at 3.20%, having touched a multi-decade low of 2.11% in early July 2016 and a recent high of 3.47% on December 1, 2016.

30-YEAR AAA MUNICIPAL BOND YIELD (%)

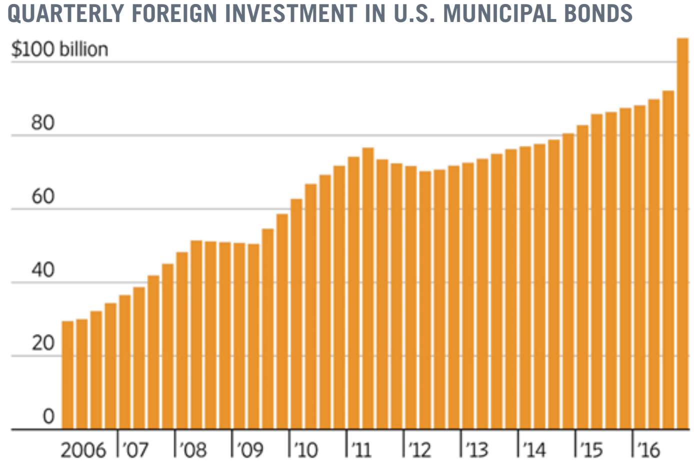


Source: Bloomberg L.P.
Performance data shown represents past results.

Technical conditions improved in the first quarter though they remain fragile. Issuance (supply) is likely to slow from levels reached in 2015 and 2016, when issuers were trying to stay ahead of Federal Reserve hikes and to refinance higher cost debt where they could. Now that the Fed has raised rates by a quarter of a percentage point, issuance likely will diminish as a decrease in the number of refunding deals will dampen supply. Issuance for refinancing purposes decreased from 40% of overall issuance over the past three years to 24% so far in 2017. Finally, another factor that may influence supply is Trump's infrastructure development plans. These plans appear further out in the future than previously anticipated, and may make issuers hesitant to act until there are more details on how the new administration will finance them.

On the demand side, mutual fund flows have been small but mostly positive in the first quarter. They had been vastly negative at the end of 2016, in contrast with substantial flows during the first half of the year. Uncertainty around tax reform, and its implications for the value of municipal bonds, is a significant factor driving fund flows. The ramifications of tax reform are particularly important if one considers the composition of demand for municipal bonds. While households continue to hold the bulk of municipal bonds, banks and insurance companies are a growing source of demand. If tax reform causes these entities to retreat from the municipal bond market, it could put downward pressure on the market. Another small but growing source of demand consists of foreign buyers. According to Federal Reserve data reported in the *Wall Street Journal*, holdings of municipal securities by foreign investors increased 16% in the last quarter of 2016 to $106 billion. While these buyers do not benefit from the tax advantages, they are attracted to the bonds' relative safety, longer duration, yield, and ability to provide diversification.

QUARTERLY FOREIGN INVESTMENT IN U.S. MUNICIPAL BONDS



Source: *Wall Street Journal*, using Federal Reserve data.

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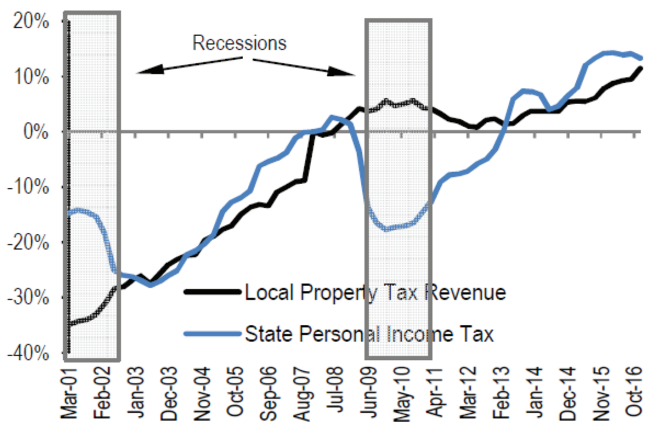
Municipal Credit: Fundamentals are fairly supportive at the local level as a result of rising home prices and improving property tax collections. In contrast, slowing revenue growth at the state level has taken a heavy toll on many states. The oil-producing states have been the hardest hit, but other states have seen their revenues decline on lower income tax collections.

Many states continued to be challenged by rising pension and OPEB (other post employment benefits) costs that are diverting funds away from education, infrastructure, and other more traditional expenditures. States are forecasting weak revenue growth for fiscal year 2017. The impact from tax reform, yet unknown, as well as any resolution to healthcare reform will have a decisive impact on state budgets and state economies.

TOTAL STATE AND LOCAL TAX REVENUE GROWTH (%)



Source: J.P. Morgan, using Census Bureau data. YOY percent change.
As of December 31, 2016.

Municipal Bond Performance Summary

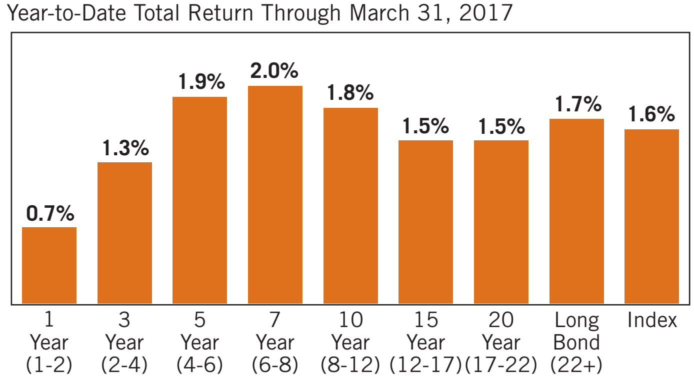
Following the post-election volatility, during which the market penalized long maturity, long duration, lower quality, and sub-5% coupons, the change in the calendar and investment climate signaled an apparent safe return to the municipal bond market. For the first quarter of 2017, the U.S. municipal bond market returned 1.36% as measured by the BofA Merrill Lynch 1-22 Year U.S. Municipal Securities Index (ML Index), which serves as the strategy's benchmark.

Although weaker toward the end of the quarter, the short/intermediate segment of the market was the best-performing maturity range, as investors took refuge in the shorter end of the yield curve amid concerns about rising interest rates. Specifically, the four-to-eight-year range produced the best absolute returns during the quarter. The weaker relative maturities were zero to four years and 15-to-20-year bonds. Like much of the past couple of years (with the exception of the fourth quarter of 2016), lower rated and lower coupon bonds produced stronger relative returns.

After being the worst performer in the fourth quarter of 2016, high yield municipal bonds reversed course in the first quarter of 2017 to be the best performers on a quality basis, with tobacco leading the way (+13%). Excluding Puerto Rico, the high yield segment returned 4.74%.

PERFORMANCE BY MATURITY

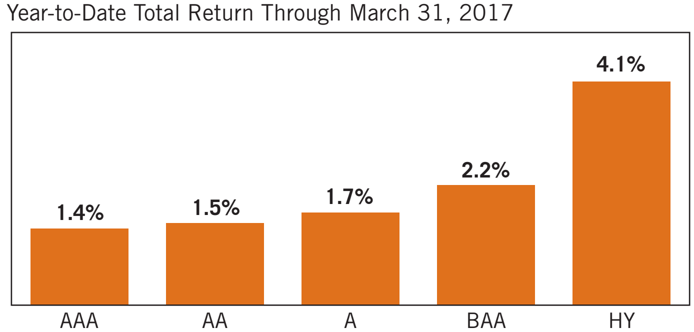
Bloomberg Barclays Municipal Bond Index
Year-to-Date Total Return Through March 31, 2017



Source: Bloomberg Barclays.
Performance data shown represents past results.

PERFORMANCE BY QUALITY

Bloomberg Barclays Municipal Bond Index
Year-to-Date Total Return Through March 31, 2017



Source: Bloomberg Barclays.
Performance data shown represents past results.

HOW THE STRATEGY PERFORMED

Contributors The larger contributors to relative performance were bonds in the four- to 10-year maturity range, and lower quality issues including below-investment grade tobacco bonds bought in November 2016.

Detractors The strategy's smaller allocation to longer maturity bonds compared to its peer group, along with its higher coupon profile, hurt relative performance during the quarter after being a relative outperformer in the fourth quarter of 2016.

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Current Strategy Positioning

The portfolio's duration was 5.4 years on March 31, 2017, compared to that of the ML Index at 5.5 years.

We continue to overweight the five- to 10-year maturity range and bonds rated A-BBB, which we believe offer the best mix of yield and interest rate risk. We also look to add exposure in the 15- to 20-year maturity range. We still believe this area of the curve represents the best value, capturing 88% and 96%, respectively, of the yield available on a 30-year bond with much less duration risk.

Looking Ahead

Our outlook for municipal bonds continues to be cautious as we monitor the development of the new administration's policies and assess their potential impact on the municipal bond market. The failure of Congress to repeal Obamacare suggests that tax reform and the enactment of other fiscal policies may be equally arduous and slow.

Among the topics we are watching, tax reform remains the critical issue. It could have a meaningful impact on demand, especially from growing segments of the market such as banks and insurance companies. Infrastructure spending, with a long timeline to develop and implement, will affect the pace and magnitude of issuance. Though Congress failed to replace Obamacare, discussions remain in the background that ultimately may result in changes that have positive or negative consequences for the states. Finally, the Fed projects two more rate hikes in 2017, which will likely have an impact on bond yields.

The **BofA Merrill Lynch 1-22 Year U.S. Municipal Securities Index** is a subset of the BofA Merrill Lynch U.S. Municipal Securities Index including all securities with a remaining term to final maturity less than 22 years, calculated on a total return basis. The BofA Merrill Lynch U.S. Municipal Securities Index tracks the performance of U.S. dollar-denominated investment grade tax-exempt debt publicly issued by U.S. states and territories, and their political subdivisions, in the U.S. domestic market.

The **Bloomberg Barclays Municipal Bond Index** is a market capitalization-weighted index that measures the long-term tax-exempt bond market. The index is calculated on a total return basis.

The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment.

The commentary is the opinion of the subadviser. This material has been prepared using sources of information generally believed to be reliable; however, its accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice or an offer of securities.

Risk Considerations

Credit & Interest: Debt securities are subject to various risks, the most prominent of which are credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt securities may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **Municipal Market:** Events negatively impacting a municipal security, or the municipal bond market in general, may cause the fund to decrease in value. **Tax Liability:** Noncompliant conduct by a municipal bond issuer, or adverse interpretations, could cause interest from a security to become taxable, subjecting shareholders to increased tax liability. **State & AMT Tax:** A portion of income may be subject to some state and/or local taxes and, for certain investors, a portion may be subject to the federal alternative minimum tax.

For more information on the Newfleet Fixed Income strategies, please contact:

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Past performance is not indicative of future results.