# Enhanced Core Fixed Income

| *Performance | 1Q | YTD |
|---|---|---|
| Pure Gross | -1.20% | -1.20% |
| Net | -1.51% | -1.51% |
| BBIGC | -0.98% | -0.98% |

## PERFORMANCE REVIEW

With a flip of the calendar, there was a new chair of the FED, volatility returned, new trade tariffs, a small U.S. government shutdown, a weaker U.S. dollar (-2% on DXY), and more high level White House personnel changes.

FED Chair Powell started off well in his congressional testimony. The FOMC raised rates by 25 bps at the March meeting. The market is pricing in at least 2 more rate hikes in 2018. U.S. economic data and global growth will determine how the FED moves. They expect inflation with the employment data, but are unsure on how the trade tariffs will ultimately play out.

The treasury curve was volatile with an overall flattening bias around a steepening spike as equity markets sold off in early February. Over the quarter, the 2/10 year curve flattened by 5 bps to 47 bps (with a spike to 78 bps). The longer 5/30 year curve flattened by 12 bps to 41 bps (with a spike to 61 bps).

All fixed income asset class returns were negative in the 1st quarter as measured by the Bloomberg Barclays Indices. Treasury Inflation Protected Securities (TIPS) led the returns contest at -0.83%. TIPS outperformed High Yield (HY) by 3 bps, U.S. Treasuries (T) by 35 bps, Securitized (ABS/CMBS/MBS) by 36 bps, and Investment Grade (IG) by 149 bps.

Credit spreads in High Yield (HY) and Investment Grade (IG) made lows early then widened and diverged as HY tracked equity markets while IG spreads were influenced by reduced foreign (especially Asian) buying on higher currency hedging costs, M&A issuance, and interest rate volatility. High Yield spreads hit the 2018 low of +311 bps on 1/26/18 before moving higher. Investment grade hit a low of +85 on 2/01/18 before going wider. Fears of higher inflation, rising long term rates, trade war, and tighter monetary (4th rate hike in 2018?) policy led to an equity sell-off and credit widening. Dealer inventories also increased and that weighed on spreads as markets were widened to find levels to attract buyers. High Yield spreads peaked at +369 (+58 bps from low) on 2/09/18 (after the DJIA -1,000 points). HY rallied with equities, but not back to January lows as concerns lingered. IG spreads continued to widen out slowly to +109 (+24 bps from low) as growth, supply, and fund flows kept markets unsettled. IG spreads found some traction when all in yield levels were around 4%.

### BBG Barclays High Yield OAS


Source: Bloomberg

### BBG Barclays Investment Grade OAS


Source: Bloomberg

* Returns are presented gross and net of fees and include the reinvestment of all income. PAST PERFORMANCE SHOULD NOT BE CONSIDERED INDICATIVE OF FUTURE PERFORMANCE. Please refer to our 1Q '18 full performance disclosure for additional information. Gross returns are shown as supplemental information, as bundled/wrap fee accounts are stated gross of all fees and transaction costs. Net of fee performance was calculated using the highest applicable annual wrap fee during the applicable performance period, applied monthly. Wrap fee schedules are provided by independent wrap sponsors and are available upon request from the respective wrap sponsor. Other than brokerage commissions, bundled/wrap fees include investment management, portfolio monitoring, consulting services and, in some cases, custodial services. Highest annual wrap fee used for Net of fee performance calculations may differ from fees listed in this paragraph due to the fee schedule of the sponsoring firm.

Enhanced Core Fixed Income (ECFI) underperformed the Bloomberg Barclays Intermediate Government/Credit (BBIGC) Index for the 1st quarter by 22 bps on a gross-of-fees basis. The ECFI strategy underperformed the benchmark by 53 bps on a net-of-fees basis.

Bloomberg PORT Attribution analysis shows -25 bps of active return and -3 bps of excess return over treasuries. The excess return is composed of -17 bps of allocation effect and +14 bps of selection effect. Curve return subtracted 22 bps as the treasury curve closed moderately higher in yields and flatter after increasing in yield by 44 bps to 7 bps (from 1YR to 10YR). This strategy produced +77 bps of Income Return and -212 bps of Price Return.

First quarter credit quality performance for ECFI was led by single Ba-rated issues which beat the Bloomberg Barclays Intermediate Corporate (BBIC) Index by 85 bps and the Bloomberg Barclays Intermediate High Yield (BBIHY) Index by 11 bps as Nokia and Icahn Enterprises outperformed Level 3 Financing and Newfield Exploration. Aaa-rated agencies outperformed the BBIC by 109 bps and the BBIGC by 57 bps on the stability of the short agency issues held. B-rated CNX Resources Corp outperformed the BBIC by 144 bps and the BIHY by 70 bps on relatively stable pricing in volatile oil price and high yield environment. Baa-rated issues underperformed the BBIC by 22 bps on Capital One, Kennametal, LyondellBasell, and Seagate outperformance unable to counter the negative performance from the rest of the Baa issues like Anthem, Jefferies, and Sherwin Williams. A-rated issues round out the credit quality with 280 bps of underperformance versus the BBIC as Pacific Gas & Electric could not counter the negative performance from Aflac, Bank of America, and Goldman Sachs.

Top performing sectors in the 1st Quarter for ECFI versus the Bloomberg Barclays Intermediate Government/Credit (BBIGC) Index sectors were Other Financial (+241 bps), Technology (+141 bps), Electric Utility (+132 bps), and Capital Goods (+95 bps). Weak performers were from Basic Industry (-194 bps), Banking (-151 bps), Finance Companies (-133 bps), and Brokerage/Asset Managers/Exchanges (-39 bps).

The Top Five performers contributed 3.6 bps to 1st quarter's performance. All the issues experienced credit spread tightening and widening with the market depending on maturity, quality, and sector. On top is Icahn Enterprises with a 2 bps contribution. Icahn bonds bounced with earnings, activist investor headlines, and the sale of Federal Mogul to Tenneco. Two short agency issues each added 0.7 bps to the quarter. 2018 FNMA and FFCB issues realized spreads tighter by 4 bps each with stable pricing that received a boost from the flight-to-quality (equity sell-off) period. Kennametal and Seagate combined for a less than 0.5 bp contribution to quarterly performance. The Kennametal matures in 2019 so is subject to the short money market curve fluctuations, but improving results have kept them relatively stable. Seagate was impacted by the volatility of the technology sector, but the spread levels keep the issues on buy lists. The issue only realized a 0.625 point decline over the quarter which was about the same as the Kennametal issue that is 8 years shorter in maturity.

On the flip side, the Bottom Five contributed -45 bps for the 1st quarter. This group is led by Sherwin-Williams which saw spreads widen post earnings for the quarter as revenues were up, but margins down. The remaining bottom issues are all 6 to 9 year financial issues that all realized some tightening in January before their spreads widened with the large bank issuance before a slight tightening into quarter end. Sherwin contributed -12 bps to the quarter's performance. Jefferies Group made a -9 bps contribution for the quarter even with record investment banking revenues offsetting lower trading revenues the issue was weaker with large banks due to the capital markets exposure. Bank of America and Goldman Sachs Group both contributed -8 bps to the strategy's performance. The large and liquid bank issues were all marked down as the banks issued debt in a weaker market that demanded spread concessions to the buyers. Anthem spreads widened on the legal wrangling over the break-up fee on the terminated merger with Cigna and the headlines in the sector from CVS, Walmart, Amazon, etc. The issue contributed -7.5 bps to the quarterly performance.

First quarter transactions were three sales and three buys. Nine to ten year Capital One and Morgan Stanley issues were sold to buy shorter issues. LyondellBasell was sold to buy Pacific Gas and Electric. Net effects of the transactions were to shorten the duration by 0.20 years while maintaining the yield-to-worst (YTW) and Option Adjusted Spread (OAS) advantage over the index.

Enhanced Core Fixed Income portfolio statistics for quarter end were 3.41% YTW (+60 bps to the index), effective duration 4.20 years (+0.29 yrs long the index), and +78 bps OAS (+63 bps versus the index). On a sector allocation basis versus the BBIGC, ECFI is overweight credit, government agencies, and underweight U.S. Treasury notes (no holdings) versus a 15% position in U.S. Treasury Inflation Protected Securities (TIPS). Within the credit sectors, ECFI is overweight Bank/Financials, Communications, Capital Goods, Energy, Basic Industry, and Electric Utility versus underweight in Consumer Non-Cyclical, REITs, Transportation, and Technology.

PAST PERFORMANCE SHOULD NOT BE CONSIDERED INDICATIVE OF FUTURE PERFORMANCE. Please see the last page for additional disclosures.

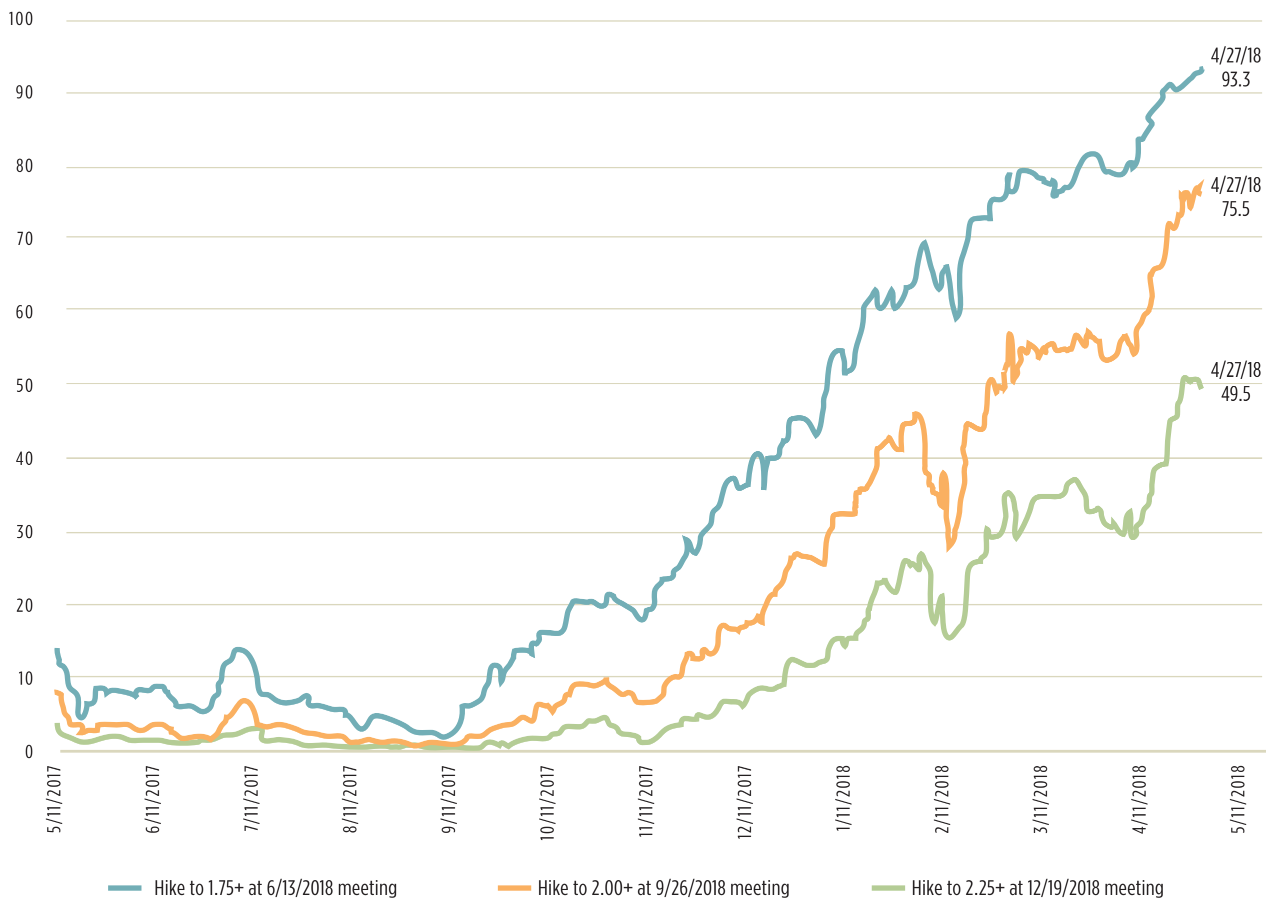
# MARKET OUTLOOK

Looking forward the landscape is one of moderate to improving global economic growth, rising inflation expectations, higher rate (yield curve) expectations, low credit default risk, and attention grabbing headlines out of Washington DC.

The new wild card has become trade tariffs and the possible eruption of a trade war with Asia and/or Europe. As the sanctions have yet to be in effect there is the possibility the issues can be negotiated away before the tariffs are enacted.

New FED Chairman Powell is presiding over an economic expansion which is currently close to the longest in U.S. history if it gets beyond June 2019. Chair Powell feels the labor market is not excessively tight as earnings have not been accelerating as companies find it difficult to fill openings. He will be watching for higher earnings as the jobs market strengthens. Inflation will be firming as the unusual declines (cell phone plans & education) from a year ago drop out of the calculation. Chair Powell feels with the economy growing along its current path, "...further gradual rate increases will best promote these goals."

## Probability of Rate Hikes at 2018 Fed Meetings




Source: Bloomberg, JAG Capital Management

The market is pricing in two additional rate hikes in June and September with the 4th hike a remote possibility now (in the realm of data dependent?). This takes the view that the U.S. is in a Goldilocks economy, with low to increasing inflation expectations, improving labor market, and expanding manufacturing (limited by experienced work force). This could be disrupted by some geopolitical crisis or trade war. Recession is not close even with the treasury curve flattening and even having some inversions. Credit defaults are still low and refinancing options continue to be available to reduce interest costs.

PAST PERFORMANCE SHOULD NOT BE CONSIDERED INDICATIVE OF FUTURE PERFORMANCE. Please see the last page for additional disclosures.

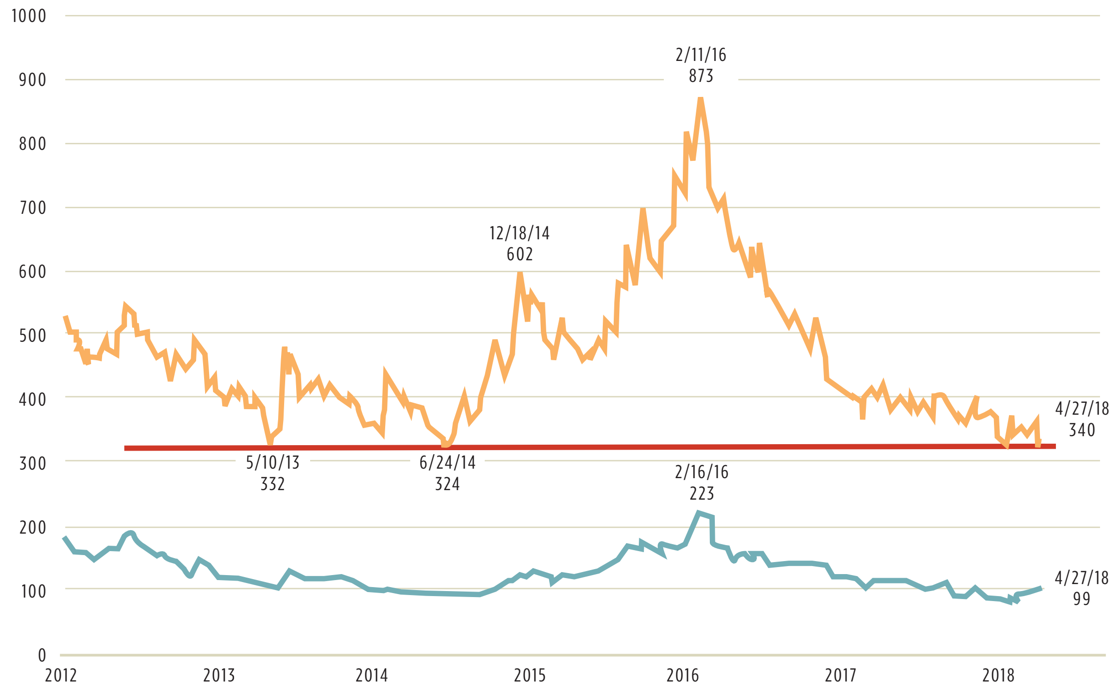
Corporate credit markets will likely be tempered by issuance and some sector specific headwinds. The tax repatriation will take some wind out of the new issue market's sails as companies with large foreign cash will not have to issue debt for shareholder friendly actions and may even reduce some overall debt. Telecom/media (cord cutting), healthcare (generic pricing investigations), and retail (e-commerce and the Amazon effect) sectors are facing secular headwinds which is keeping these sectors from benefitting in the improving economy due to lack of clarity on what's next. HY default rate for the last 12 months of 1.34% is significantly below the 3-3.5% long term average (and well below the 7% rate in the energy crisis of 2016).

Total Returns for credit in 2018 will be less than in 2017 based on lower issuance, narrower starting spreads, and lower coupons. The average coupon for the High Yield Index is 6.33% and 3.94% for Investment Grade. Year-to-date returns through 3/31/18 were -0.86% for High Yield and -2.32% for Investment Grade. For perspective, 2017 the returns were +7.50% and +6.4% and 2016 returns were +17.1% and +6.1% for High Yield and Investment Grade, respectively.

The persistent U.S. Treasury curve flattening may moderate depending on the ability of the market to absorb the increase in treasury issuance across the curve to finance the tax cut and government operations. If significantly higher yields (+50 bps) are required to attract buyers for the issues, then the curve should steepen. If there are small moves in different maturity sectors, then expect a moderate reduction in the flattening bias. Inflation expectations will also impact this as movements in the real yield curve; i.e. TIPS, and the Breakeven Curve can move the nominal curve. Real yields have increased with a flatter TIPS curve. The Inflation Break-Even curve has declined in the short maturity ranges while increasing in the 30yr sector as the curve has steepened.

Portfolio positioning is 0.30 years longer than the Effective duration of the BBIGC at 4.2 years with 60 bps of yield advantage over the index and 63 bps higher Option Adjusted Spread (OAS). The flatness of the treasury curve remains a slight headwind as it continues to be directional; in treasury sell-offs (yield increases) the curve steepens while flattening in rallies (yield decreases). The Inflation Break-Even curve and real yield curve versus nominal yield curve will be monitored for opportunities to increase yield if inflation expectations lag. Intermediate credit performs better in steepening environments. Credit valuations are compelling within the market for return potential. Credit spreads are close to pre-crisis levels, but remain above long-term low ("tights") levels of +233 bps for High Yield and +54 bps for Investment Grade at the quarter end levels of +354 bps and +109 bps, respectively.

## **Option Adjusted Spreads** (OAS) **for All Sectors IG** (blue line) **vs. HY** (orange line)




Source: Bloomberg, JAG Capital Management

JAG's goal will be to increase the yield advantage in the portfolio as yields (presumably increase) with FED rate actions. Through identifying attractive relative value opportunities across asset classes and sectors in the marketplace, JAG stays focused on our value-centric and client focused fixed income investing style.

PAST PERFORMANCE SHOULD NOT BE CONSIDERED INDICATIVE OF FUTURE PERFORMANCE. Please see the last page for additional disclosures.

# PERFORMANCE ATTRIBUTION: 1Q 2018

## Top Performing Sectors by Allocation Effect

| Sector | Allocation Effect (bps) | Average Active Weight | Relative Return |
|---|---|---|---|
| Government Agency | 1.65 | +13.71% | +0.11% |
| Consumer Non-Cyclical | 1.20 | -2.91% | +0.10% |
| Consumer Cyclical | 0.94 | -2.37% | +1.49% |

## Bottom Performing Sectors by Allocation Effect

| Sector | Allocation Effect (bps) | Average Active Weight | Relative Return |
|---|---|---|---|
| U.S. Treasury | -8.46 | -42.72% | -0.02% |
| Insurance | -3.16 | +6.58% | -0.31% |
| Capital Goods | -2.19 | +5.15% | +0.95% |

## Top Performing Sectors by Selection Effect

| Sector | Selection Effect (bps) | Average Active Weight | Relative Return |
|---|---|---|---|
| U.S. Treasury | 14.45 | -42.72% | -0.02% |
| Technology | 5.76 | -0.55% | +1.41% |
| Capital Goods | 3.13 | +5.15% | +0.95% |

## Bottom Performing Sectors by Selection Effect

| Sector | Selection Effect (bps) | Average Active Weight | Relative Return |
|---|---|---|---|
| Basic Industry | -6.82 | +2.92% | -1.94% |
| Banking | -2.23 | +0.28% | -1.51% |
| Finance Companies | -1.74 | +2.15% | -1.33% |

## Top Performing Sectors by Relative Contribution to Return

| Sector | Relative Contribution to Return (bps) | Average Active Weight | Relative Return |
|---|---|---|---|
| U.S. Treasury | +31.54 | -42.72% | -0.02% |
| Consumer Non-Cyclical | +4.91 | -2.91% | +0.10% |
| Technology | +4.17 | -0.55% | +1.41% |

## Bottom Performing Sectors by Relative Contribution to Return

| Sector | Relative Contribution to Return (bps) | Average Active Weight | Relative Return |
|---|---|---|---|
| Banking | -15.72 | +0.28% | -1.51% |
| Broker/Asset Mgr/Exch | -15.06 | +7.61% | -0.39% |
| Basic Industry | -13.72 | +2.92% | -1.94% |

PAST PERFORMANCE SHOULD NOT BE CONSIDERED INDICATIVE OF FUTURE PERFORMANCE. Please see the last page for additional disclosures.

### Top 5 Contributors

| Security | % Return | Contribution (bps) | % Average Weight | Reasoning |
|---|---|---|---|---|
| Icahn Enterprises LP (IEP Ba3/BB+)<br>Sr Unsecured Notes 6.25%<br>Due 2/01/22 | 0.82% | 1.7 | 2.03% | Issue experiences volatility on earnings and activist investor headlines. Issue spread tighter by 6 bps net as price -1.125 pts. Income return +152 bps / price return -70 bps. |
| Fed National Mortgage Assn (FNMA)<br>Unsecured Notes 1.625%<br>Due 11/27/18 | 0.28% | 0.7 | 2.51% | Short agency experiences volatility around equity sell-off buy remains stable. Issue spread tighter by 4 bps net as price -0.125 pts. |
| Fed Farm Credit Bank (FFCB)<br>Unsecured Notes 1.1%<br>Due 11/06/18 | 0.28% | 0.7 | 2.50% | Short agency experiences volatility around equity sell-off buy remains stable. Issue spread tighter by 4 bps net as price -0.0 pts. Income return +28 bps / price Return -0 bps. |
| Seagate Technology PLC (STX Baa3/BB+)<br>Sr Unsecured Notes 4.875%<br>Due 6/01/27 | 0.17% | 0.3 | 2.50% | Improving results and attractive spread levels on issue. Issue spread wider by 23 bps net as price -0.625 pt. Income return +126 bps / price return -109 bps. |
| Kennametal Inc (KMT Baa3/BBB-/BBB)<br>Sr Unsecured Notes 2.650%<br>Due 11/01/19 | 0.09% | 0.2 | 2.22% | Company earnings and guidance maintained has kept bonds stable. Issue wider by 6 bps net as price -0.50 pt. Income return +66 bps / price return -57 bps. |

### Bottom 5 Contributors

| Security | % Return | Contribution (bps) | % Average Weight | Reasoning |
|---|---|---|---|---|
| Sherwin-Williams Co (SHW Baa3/BBB/BBB)<br>Sr Unsecured Notes 3.450%<br>Due 6/01/27 | -4.77% | -11.9 | 2.44% | Revenues increase, but margins contract leads to selling in an issue priced for better. Issue widens by 41 bps post earnings with GT10 up 30 bps in yield. Bond price -5.5 pts. Income return +86 bps / price return -562 bps. |
| Jefferies Group LLC (JEF Baa3/BBB-/BBB-)<br>Sr Unsecured Notes 4.850%<br>Due 01/15/27 | -3.07% | -9.3 | 2.98% | Financial issues widen on large issuance post earnings into a market with buyers demanding greater spread concession. Issue widens by 25 bps net as price -4.5 pts. Income return +114 bps / price return -421 bps. |
| Bank of America Corp (BAC A3/A-/A)<br>Sr Unsecured Notes 3.875%<br>Due 8/01/25 | -3.36% | -8.4 | 2.47% | Financial issues widen on large issuance post earnings into a market with buyers demanding greater spread concession. Issue widens by 34 bps net as price -4.5 pts. Income return +93 bps / price return -428 bps. |
| Goldman Sachs Group Inc. (GS A3/BBB+/A)<br>Sr Unsecured Notes 3.750%<br>Due 5/22/25 | -3.07% | -7.7 | 2.49% | Financial issues widen on large issuance post earnings into a market with buyers demanding greater spread concession. Issue spreads widened by 33 bps net while price -4 pts. Income return +91 bps / price return -398 bps. |
| Anthem Inc. (ANTM Baa2/A/BBB)<br>Sr Unsecured Notes 3.50%<br>Due 8/15/24 | -2.97% | -7.5 | 2.48% | Anthem issues pressured by terminated merger with Cigna and M&A headlines in sector. Issue spreads tighter by 35 bps net while price -4 pts. Income return +86 bps / price return -383 bps. |

## ACTIVITY: 1Q 2018

### Buys

| Security | Motive |
|---|---|
| Capital One Financial Company (COF Baa1/BBB/A-)<br>Sr Unsecured Notes 3.200%<br>1/30/23 | Buy at 3.299% YTW / +85/5yr / add 2 bps to portfolio yield. |
| Morgan Stanley (MS A3/BBB+/A)<br>Sr Unsecured Notes 2.375%<br>Due 7/23/19 | Buy at 2.409% YTW / +29/2yr / add 1 bp to portfolio yield. |
| Pacific Gas & Electric (PCG A3/BBB+/A-)<br>Sr Unsecured Notes 3.750%<br>Due 2/15/24 | Buy at 3.552% YTW / +93/5yr / add 2 bps to portfolio yield. |

PAST PERFORMANCE SHOULD NOT BE CONSIDERED INDICATIVE OF FUTURE PERFORMANCE. Please see the last page for additional disclosures.

## ACTIVITY: 1Q 2018 (continued)

### Sells

| Security | Motive |
|---|---|
| Capital One Financial Company (COF Baa1/BBB/A-)<br>Sr Unsecured Notes 3.750%<br>Due 3/09/27 | Sell to buy COF 3.20 1/23 at 3.973% YTW. |
| LyondellBasell Ind NV (LYB Baa1/BBB+)<br>Sr Unsecured Notes 6.000%<br>Due 11/15/21 | Sell for better yielding opportunities at 3.302% YTW. |
| Morgan Stanley (MS A3/BBB+/A)<br>Sr Unsecured Notes 3.591%<br>Due 7/22/28 | Sell to buy MS 2.375 7/19 at 3.826% YTW. |

PAST PERFORMANCE SHOULD NOT BE CONSIDERED INDICATIVE OF FUTURE PERFORMANCE. Please see the last page for additional disclosures.

## Disclosures

JAG Capital Management, LLC is a Missouri company and a wholly owned subsidiary of J.A. Glynn & Co., registered (not implying a certain level of skill or training) as an Investment Advisor with the Securities and Exchange Commission under the Investment Advisors Act of 1940, as amended. JAG Capital Management, LLC claims compliance with the Global Investment Performance Standards (GIPS®). Returns are presented gross and net of fees and include the reinvestment of all income. A compliant presentation and/or a list of composite descriptions can be obtained from Roberta Maue at **rmaue@jagcapm.com** or **800-966-4596**. The Enhanced Core Fixed Income Composite is comprised of intermediate-maturity fixed income securities with average S&P rating typically of single A. The index comparison is appropriate for the following reason: the Bbg Barclays Intermediate Govt/Credit Bond Index is an unmanaged index that represents securities that are US Domestic, taxable, and dollar-denominated. The index covers the US Intermediate (maturity from 1 year up to (but not including) 10 years) investment grade fixed rate bond market, with index components for government and corporate securities. Performance is reported in U.S. Dollars. Ending 3/31/2018, composite 1 year 0.91% gross, -0.42% net, 0.35% Bbg Barclays Intermediate Govt/Credit Bond Index; composite 3 year annualized 1.73% gross, 0.34% net, 0.94% BBIGC Bond Index; composite 5 year annualized 1.90% gross, 0.53% net, 1.25% BBIGC Bond Index.

This report was prepared by Norm Conley, an investment advisor representative of JAG Capital Management, LLC, a SEC registered investment advisor. The information herein was obtained from various sources believed to be reliable; however, we do not guarantee its accuracy or completeness. The information in this report is given as of the date indicated. We assume no obligation to update this information, or to advise on further developments relating to securities discussed in this report. Opinions expressed are those of the advisor listed above as of the date of this report and are subject to change without notice. Opinions of individual representatives may not be those of the Firm. Additional information is available upon request.

The information contained in this document is prepared for general circulation and is circulated for general information only. It does not address specific investment objectives, or the financial situation and the particular needs of any recipient. Investors should not attempt to make investment decisions solely based on the information contained in this communication as it does not offer enough information to make such decisions and may not be suitable for your personal financial circumstances. You should consult with your financial professional prior to making such decisions. For institutional investors: J.A. Glynn Investments and JAG Capital Management, LLC both have a reasonable basis to believe that you are capable of evaluating investment risks independently, both in general and with regard to particular transactions or strategies. For institutions who disagree with this statement, please contact us immediately.

The Sector Attribution and Top/Bottom Contributors listed within this document have been provided through Bloomberg PORT. Market Index performance statistics are provided by Advent Axys via benchmark data from FT Interactive Data and are presented for the time frame noted. Individuals cannot invest directly in any index. PAST PERFORMANCE SHOULD NOT BE CONSIDERED INDICATIVE OF FUTURE PERFORMANCE. ANY INVESTMENT CONTAINS RISK INCLUDING THE RISK OF TOTAL LOSS.

This document does not constitute an offer, or an invitation to make an offer, to buy or sell any securities discussed herein. J.A. Glynn & Co., JAG Capital Management, LLC and its affiliates, directors, officers, employees, employee benefit programs and discretionary client accounts may have a position in any securities listed herein.

JAG
CAPITAL MANAGEMENT LLC

9841 Clayton Road | St. Louis, MO 63124
**800.966.4596** **www.jagcapm.com**
Securities offered through JA Glynn Investments LLC, Member FINRA and SIPC