DECEMBER 2018

PACIFIC ASSET MANAGEMENT

THE INVESTOR Compass

NAVIGATING THE CREDIT MARKETS

Twelve for '18

2018 was a year in which risk was on... until it wasn't. The last quarter of 2018 wiped away the gains, and memory, of the first nine months of the year. This is in stark contrast to 2016 & 2017, where almost all broad indices had positive returns. As we enter the last week of 2018, bank loans were one of the only asset classes to have a positive return, which could turn negative with a couple of weak days.

Most of 2018 had a positive fundamental backdrop, supported by strong corporate earnings and continued U.S. economic growth. The technical environment was also favorable, with investor flows into risk assets, robust corporate debt issuance, and a generally positive market sentiment. The valuation equation, which had been mixed in our minds for some time, became increasingly challenged as asset prices, leverage, and the fed funds target rate continued moving higher.

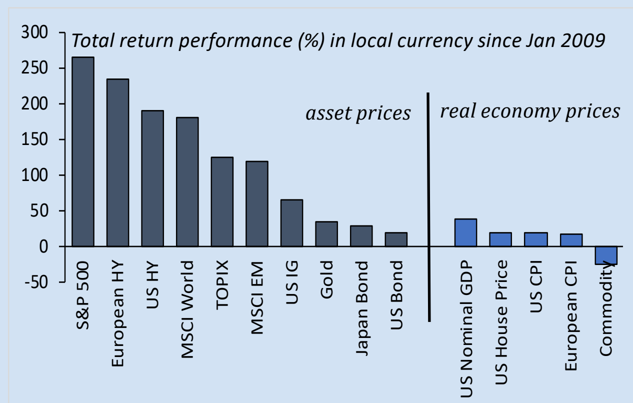
At this point, many of us simply want 2018 to end. While it is unclear if 2019 will be better, valuations are certainly more interesting (in a positive way). Implied defaults are much higher today than forecasted. Issuance should be more debt friendly than in previous years, and real yields are significantly higher. In the near-term, macro-risks and negative investor sentiment may continue to outweigh more attractive valuations. However, we believe with a relatively high level of conviction that this market should create very nice entry points into certain areas of credit and risk.

In the meantime, and consistent with other years, we end the year by sharing some of our favorite charts. A little central bank, asset class, credit, and miscellaneous flavors. Thank you again for your time and have a safe and happy New Year.

Pacific Asset Management
December 2018

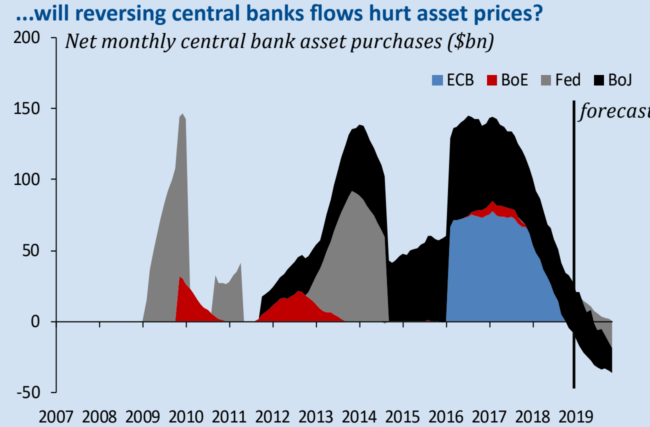
Central Bank World?

Central banks have certainly helped asset prices...



Source: GS Global Investment Research, as of November 2018

...will reversing central banks flows hurt asset prices?



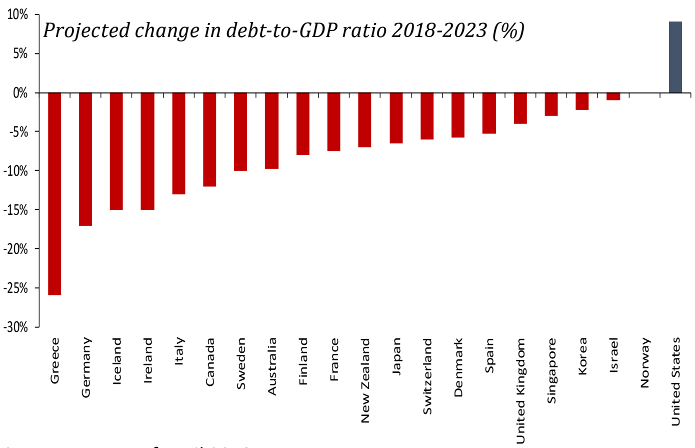
Source: St. Louis Federal Reserve, as of November 30, 2018

Table 1: Challenges were present across fixed income in 2018

Index	Duration	Yield	3mo Return	YTD Return
Bank Loans	0.25	7.67	-3.14	1.05
US MBS	4.83	3.44	1.81	0.72
Treasury	6.09	2.66	2.31	0.61
Aggregate	5.89	3.32	1.39	-0.23
Int Corporate	4.20	3.92	0.38	-0.43
High Yield	3.97	7.98	-4.68	-2.23
Corporate	7.10	4.24	-0.43	-2.75

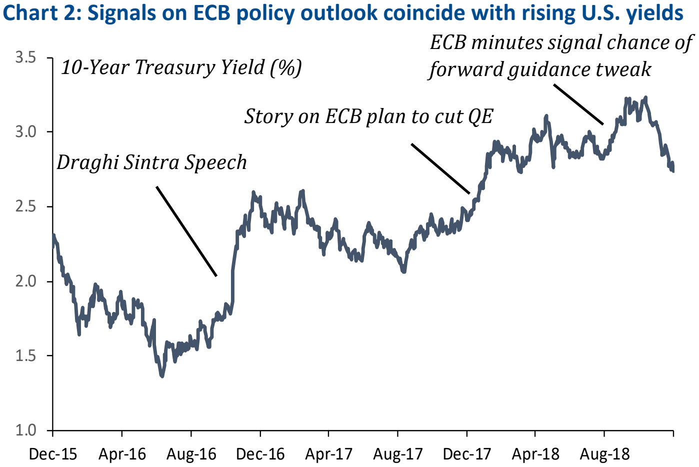
Source: Barclays, Credit Suisse, as of December 28, 2018

Chart 1: America first? We appear to be the outlier in fiscal policy.



Source: IMF, as of April 2018

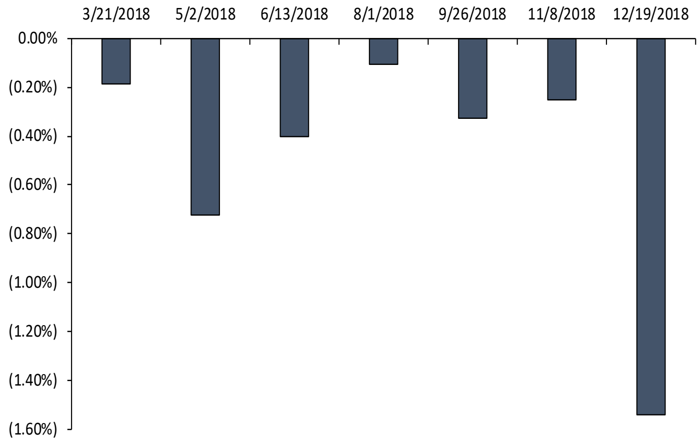
Chart 2: Signals on ECB policy outlook coincide with rising U.S. yields



Source: Barclays, as of December 26, 2018

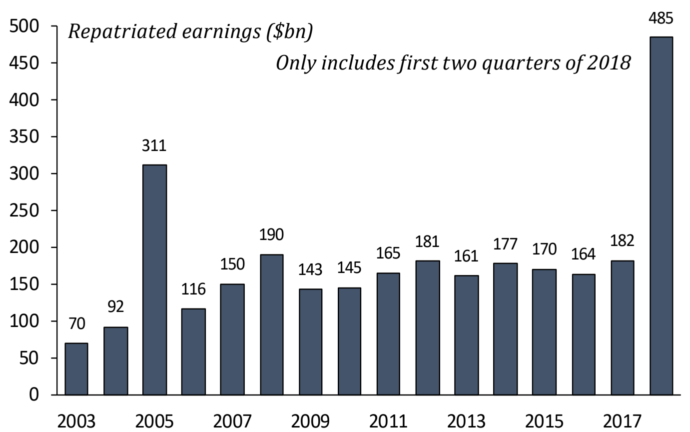
Chart 3: Wanna fight the Fed?

% Change in the S&P 500 on days of FOMC Meeting Announcements



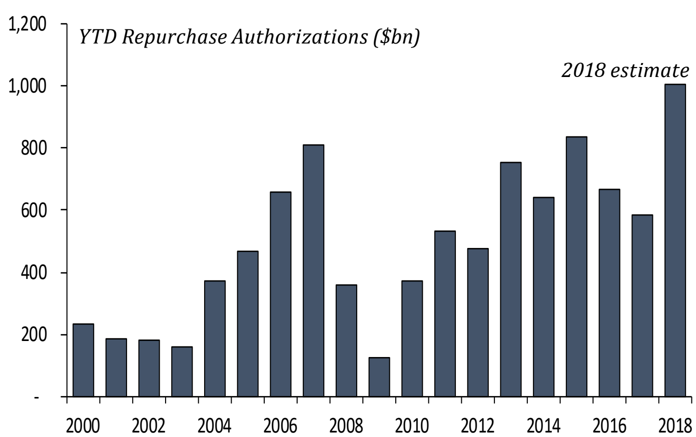
Source: Bloomberg, Pacific Asset Management

Chart 4: Companies have utilized tax changes to bring dollars onshore



Source: DB Global Research, as of June 30, 2018

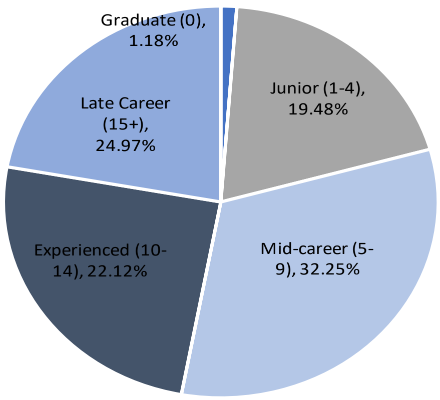
Chart 5: Which helped fuel over $1trn in share buybacks



Source: GS Global Investment Research, as of August 2, 2018

Chart 6: Less than half of fund managers have been through a bear market.

Experience level of fund managers



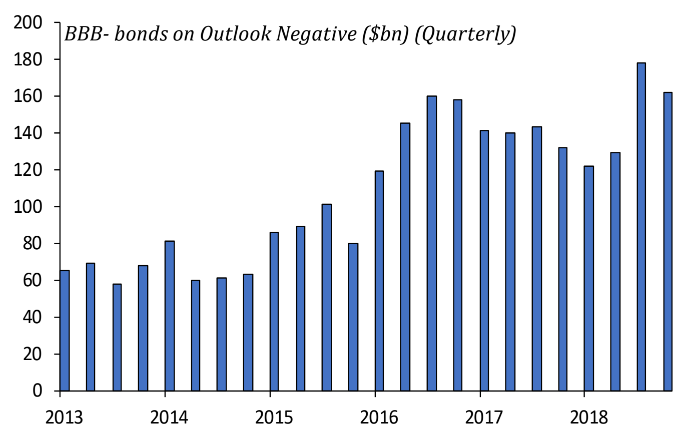
Source: Emolument survey of fund managers. 1st Quarter 2018.

Chart 7: Loan only issuers have grown, most likely fueled by private lending and CLO issuance

Bond Only Issuers	Bond/Loan Issuers	Loan Only Issuers
$721bn/622 Issuers	$513bn/303 Issuers	$588bn/755 Issuers
57% of Outstanding	33% of HY Bond Issuers	53% of outstanding
67% of Issuers	29% of Loan Issuers	71% of Issuers

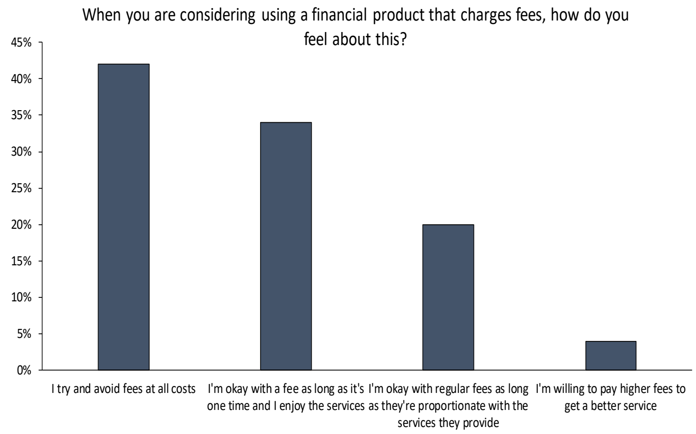
Source: Wells Fargo Securities, Bloomberg, L.P., S&P LCD

Chart 8: With M&A and leverage increasing in the BBB- rated space, rating agencies have addressed this with Negative Outlooks the last 2 years but downgrades are still muted.



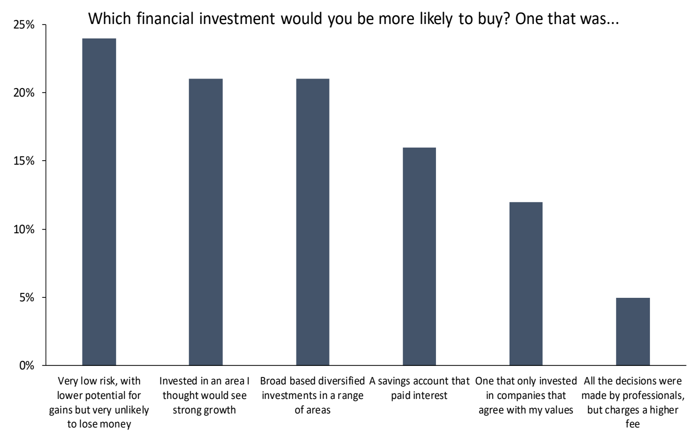
Source: GS Global Investment Research, as of November 20, 2018

Chart 9: The future of fees? Over 70% surveyed either avoid fees at all costs, or want a fee just one time.



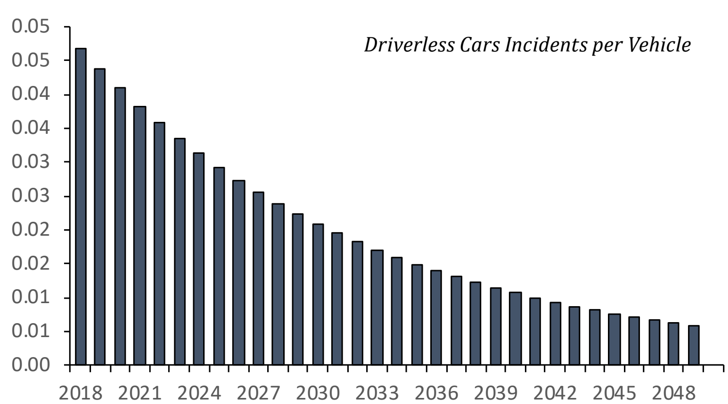
Source: Goldman Sachs Global Investment Research, Millennial Survey

Chart 10: The future of risk?



Source: GS Global Investment Research, Millennial Survey

Chart 11: The future of insurance premiums? Driverless cars could materially impact accidents per vehicle.



Source: KPMG's Automobile Insurance in the Era of Autonomous Vehicles, October 2015

Chart 12: 2018 has proven to be one of the toughest years to make money

Positive (Green) and negative (Red) total returns of various asset classes over the past ten years

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Emerging Markets	Aggregate	Emerging Markets	Russell 2000 Growth	Aggregate	Emerging Markets	Russell 2000 Growth	S&P 500 Growth	S&P 500 Growth	Russell 2000 Value	Emerging Markets	Bank Loans
World ex USA	High Yield	High Yield	Russell 2000	High Yield	Russell 2000 Value	Russell 2000	S&P 500	S&P 500	Russell 2000	S&P 500 Growth	Aggregate
S&P 500 Growth	Bank Loans	Bank Loans	Russell 2000 Value	S&P 500 Growth	S&P 500 Value	Russell 2000 Value	S&P 500 Value	Aggregate	S&P 500 Value	World ex USA	S&P 500 Growth
Russell 2000 Growth	Russell 2000 Value	Russell 2000 Growth	Emerging Markets	S&P 500	World ex USA	S&P 500 Growth	Aggregate	Bank Loans	High Yield	Russell 2000 Growth	High Yield
Aggregate	Russell 2000	World ex USA	High Yield	Bank Loans	Russell 2000	S&P 500	Russell 2000 Growth	Russell 2000 Growth	S&P 500	S&P 500	S&P 500
S&P 500	S&P 500 Growth	S&P 500 Growth	S&P 500 Value	S&P 500 Value	S&P 500	S&P 500 Value	Russell 2000	World ex USA	Russell 2000 Growth	S&P 500 Value	Russell 2000 Growth
S&P 500 Value	S&P 500	Russell 2000	S&P 500	Russell 2000 Growth	High Yield	World ex USA	Russell 2000 Value	S&P 500 Value	Emerging Markets	Russell 2000	Russell 2000
Bank Loans	Russell 2000 Growth	S&P 500	S&P 500 Growth	Russell 2000	S&P 500 Growth	High Yield	High Yield	Russell 2000	Bank Loans	Russell 2000 Value	S&P 500 Value
High Yield	S&P 500 Value	S&P 500 Value	Bank Loans	Russell 2000 Value	Russell 2000 Growth	Bank Loans	Bank Loans	High Yield	S&P 500 Growth	High Yield	Russell 2000 Value
Russell 2000	World ex USA	Russell 2000 Value	World ex USA	World ex USA	Bank Loans	Aggregate	Emerging Markets	Russell 2000 Value	World ex USA	Bank Loans	World ex USA
Russell 2000 Value	Emerging Markets	Aggregate	Aggregate	Emerging Markets	Aggregate	Emerging Markets	World ex USA	Emerging Markets	Aggregate	Aggregate	Emerging Markets

Source: Callan Periodic Table of Returns for major asset classes, updated through December 21, 2018

ABOUT PACIFIC ASSET MANAGEMENT

Founded in 2007, Pacific Asset Management specializes in credit oriented fixed income strategies. Pacific Asset Management is a division of Pacific Life Fund Advisors LLC, an SEC registered investment adviser and a wholly owned subsidiary of Pacific Life Insurance Company. As of September 30, 2018 Pacific Asset Management managed approximately $10.6bn.

FOR MORE INFORMATION

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