Potential Opportunities For Income	Weaker Opportunities For Income
· Emerging Market Corporate Bonds	· International Sovereign Bonds
· High-Yield Corporate Bonds	· Treasurys
· High-Yield Municipal Bonds	

MARKET REVIEW

Pivoting from Monetary to Fiscal Policy

Emerging market (EM) stocks increased by 5.48% during the month of January, as measured by the MSCI Emerging Markets Index. This gain is a continuation of the strong performance in 2016 and helps bolster the case that the emerging markets may be heading toward a better return cycle relative other markets. International stocks outperformed U.S. stocks, which increased by 2.91% and 1.90% respectively. Small cap stocks, as measured by the Russell 2000 Index, took a bit of a breather in January following their post-election rally and increased by 0.39%. Global bonds, as measured by the Bloomberg Barclays Global Aggregate Bond Index, increased in January by 1.13%. However, the more credit-centric Bloomberg Barclays U.S. High Yield Corporates increased by 1.45% and Emerging Market Corporates increased by 1.17%.

Generally speaking, it appears that the market is pivoting toward an environment that is less focused on central bank action and more focused on government policy. For instance, the market reaction following the Brexit vote, Italian constitutional referendum and U.S. election. In each case, the respective stock market of each country rallied following these votes, which helped outline substantive changes in monetary policy of each government. This concept is further reinforced by the collective yawn heard from investors following the December 2016 U.S. interest rate hike.

Nowhere is fiscal policy going to be more prominent than in China. President Trump indicated that he would move forward with labeling China a currency manipulator and, to date, the president has made good on many of his campaign promises, so there is no reason to think this will be different. China has been working hard to keep the value of currency higher than a free float value by using currency reserves. As a result, the reserves fell from a high of roughly $4 trillion to a value of roughly $3 trillion at the end of December. Experts seem to agree that it isn't a problem until those reserves fall to a minimum of $2 trillion. The drawdown in reserves has been ongoing since 2014, so China is probably on safe ground until 2018.

STOCKS vs. BONDS

Bumpy Road Ahead

Most investor sentiment indicators show that there is widespread enthusiasm in the global stock markets. In the short term, this optimism could lead to a mild sell-off of risk assets, such as stocks. However, strength in the economy and general strength in stock markets don't seem to indicate that this bull market is over. It might be wise to rebalance out of any larger-than-expected stock allocations. However, if you missed the fourth quarter rally, then maybe this is an opportunity.

The general opinions of stock investors do seem to indicate some worry, but there is an old Wall Street axiom that "stocks climb a wall of worry," and that seems appropriate for today.

OUTLOOK

High-Yield Bonds & Emerging Markets

There are three asset classes that we believe will be relative outperformers in 2017. For stocks, the emerging market asset class offers the best relative value in terms of price-earnings ratio and, at the end 2016, many EM countries were top performers globally. This combination of value and momentum tends to provide a good indication of future returns. The month of January supported our thesis, with strong performance in the asset class relative all other regions of the world. This outperformance happened in an environment that was positive for most stock asset classes and where the political tone was somewhat negative, which helps underline the potential strength of the asset class.

High-yield corporate debt and EM corporate debt are also part of our 2017 performance thesis. Rising interest rates and a healthy global economy should put these asset classes in a place where they are relative outperformers. In January, both asset classes outperformed global bonds during a period of falling interest rates, which helps underscore our belief that as long as the economy stays healthy, these assets should be relative outperformers, regardless of the direction of interest rates.

While not directly part of our 2017 thesis, we currently believe high-yield municipal bonds can add value as they offer a current yield higher than high-yield corporate bonds (before factoring in any tax benefit). This asset class also performed better than global bonds in January. Barring any dramatic change in tax policy, now could be a good entry point into this asset class as well.

FUN FACT

Never Before Seen

In January, scientists at Harvard University created metallic hydrogen for the first time ever. Metallic hydrogen is the rarest and potentially most valuable material on the planet. The material had only been a theory first proposed in 1935 and, if other properties turn out to be true, could revolutionize energy, transportation and electronics of all sorts. The material is believed to be an extremely efficient superconductor allowing for a dramatic reduction in the amount of energy lost during transmission. Additionally, it is believed that the material would be an extremely powerful rocket fuel, which may change the limitations of space exploration. Real world application is likely far away since the only metallic hydrogen on earth is squished between the tips of two diamond anvils.

Methodology

To learn more about the methodology visit the Salient Partners *Income Investing* blog series Part 1 and Part 2. You can also follow us on Twitter at @nrowader and @NicMillikan for live updates on the Income Report Card.

Asset Class Key

Bonds

U.S. Treasurys	Bloomberg Barclays U.S. Treasury
U.S. Investment Grade Credit	Bloomberg Barclays U.S. Credit
Municipal Bonds	Bloomberg Barclays Municipal Bond
High-Yield Municipal	Bloomberg Barclays Muni High Yield
U.S. High-Yield Corporate	Bloomberg Barclays U.S. Corp High Yield
Emerging Market Corporate	CS Emerging Markets Corporate Bond
Emerging Market Sovereign	Bloomberg Barclays EM Sovereign
International Sovereign	Bloomberg Barclays Global Treasury ex USD
Mortgages	Bloomberg Barclays U.S. MBS
Short Term Treasurys (Cash Proxy)	Bloomberg Barclays US Treasury 1-3 yr

Stocks

U.S. Stocks	S&P 500 Index
International Stocks	MSCI EAFE
Emerging Market Stocks	MSCI Emerging Markets
U.S. Real Estate	Dow Jones US Real Estate
MLPs	Alerian MLP Infrastructure
Preferred Stocks	BofA Merrill Lynch Fixed Rate Preferred Securities
Utilities	S&P 500 Utilities Sector
International Real Estate	Dow Jones Global Select ex US Real Estate Securities
EM Infrastructure	MSCI EM Infrastructure

FEBRUARY 2017

Income Report Card: Stocks

U.S. Stocks

Yield: 2.05% **Risk:** 8.33%

TREND	CARRY	
B	D	This asset class continues to be middle of the road in terms of income, but this income is at a reasonable level of risk and has a low overall correlation to bonds. The low volatility and possible changes to the regulatory environment make this asset class fairly attractive.

International Stocks

Yield: 3.18% **Risk:** 9.65%

TREND	CARRY	
C	B	The trend is improving thanks to a bit of a sell-off in the U.S. dollar. Volatility has come down, making it a better option for income investors, but we would still take the U.S. over international stocks today. The change in trend and carry does indicate a possible improvement down the road.

Emerging Market Stocks

Yield: 2.50% **Risk:** 12.20%

TREND	CARRY	
A	D	Emerging market stocks still produce low income, but the asset class offers strong diversification away from the U.S. economic environment. Furthermore, the asset class continues to be one of the most reasonably valued equity asset class in terms of earnings. The strong trend, valuation and possible change in the long-term cycle all favor this asset class.

U.S. Real Estate

Yield: 4.59% **Risk:** 14.95%

TREND	CARRY	
B	B	The positive correlation with bonds should be taken seriously, especially for any investor with a large position in fixed-rate bonds. This asset class is probably a good speculative position on the basis of a rebound off the recent lows, but not a good long-term core position for now.

Master Limited Partnerships (MLPs)

Yield: 6.81% **Risk:** 19.47%

TREND	CARRY	
A	A	Despite the higher level of price volatility, MLPs have continued their strong 2016 performance into 2017. Growth investors with less exposure to bonds should look at this asset class as a high-yield proxy within their stock portfolio.

Preferred Stocks

Yield: 4.98% **Risk:** 7.45%

TREND	CARRY	
F	A	Preferred stocks are the asset class to own for safe U.S.-based income. It does have a positive correlation to bonds, but the higher income stream should help protect it from changes in rates. Plus, as bank stocks rallied, the bank-heavy preferred market declined. This space could be a good way to play financials as they start their recovery.

Utilities

Yield: 3.52% **Risk:** 17.51%

TREND	CARRY	
C	F	Like real estate, utilities sold off as investors weighed the impact from rising rates. This provides an attractive way to get low volatility U.S.-based income. However, the earning multiples of this space and long-term growth prospects are fairly weak signals. We think investors may want to look to Preferred Stocks instead of Utilities.

International Real Estate

Yield: 3.72% **Risk:** 13.25%

TREND	CARRY	
D	C	Like real estate, utilities sold off as investors weighed the impact from rising rates. This asset class provides an attractive way to get low volatility U.S.-based income. However, the earning multiples of this space and long-term growth prospects are fairly weak signals. We think investors may want to look to preferred stocks instead of utilities.

EM Infrastructure

Yield: 3.25% **Risk:** 12.54%

TREND	CARRY	
D	C	If EM stocks are too volatile, we believe this asset class is a great way to access the economic growth of the emerging markets with some decent income and lower volatility. Additionally, most of these stocks are backed with hard assets and positive cash flow.

Grades: Quintile rankings of asset classes
Downgrade Upgrade No Change

Trend: 12 month momentum
Carry: Current Yield / Current Std. Deviation

Risk: Based on 60-day std. deviation

Sources: Bloomberg, Salient Partners L.P., as of 01/31/17. The performance quoted represents past performance, does not guarantee future results and current performance may be lower or higher than the data quoted.

Income Report Card: Bonds

U.S. Treasurys

Yield: 1.88% **Risk:** 4.33%

TREND	CARRY	
F	F	Treasurys may be the purest way to express an interest rate position. As a result, this asset class represents the tip of the spear on the future of interest rates. The recent collapse in trend and carry demonstrates the sharp reversal in fortune for any interest rate sensitive asset class. If you must hold Treasurys, short duration/cash-like is best.

U.S. Investment Grade Credit

Yield: 3.27% **Risk:** 4.89%

TREND	CARRY	
B	C	The trend is favorable for credit, but given the overall strength in the economy, investors are likely to get better rewards by taking more credit risk. Look to high-yield corporate bonds instead.

Municipal Bonds

Yield: 2.54% **Risk:** 4.13%

TREND	CARRY	
D	D	Muni bonds offer an attractive yield relative to Treasurys and the trend does appear to be improving. However, the low likelihood of recession favors taking more credit risk. Look to high-yield municipal bonds instead.

High-Yield Municipal Bonds

Yield: 6.33% **Risk:** 6.11%

TREND	CARRY	
C	B	This asset class is riskier than rated muni bonds, but barring a recession (which seems unlikely at this juncture) we believe high-yield municipal bonds are a good alternative to any investment grade holding. If you are looking for safe cash flow, this asset class is your best bet.

U.S. High-Yield Corporate Bonds

Yield: 5.85% **Risk:** 3.30%

TREND	CARRY	
A	A	Given the stability of the economy and the likelihood of increasing interest rates down the road, U.S. high-yield corporate bonds are one of our favorite asset classes. We expect this asset class to be a relative outperformer for the year.

Emerging Market Corporate Debt

Yield: 6.36% **Risk:** 3.91%

TREND	CARRY	
A	A	EM corporate debt is also one of our favorite asset classes for 2017. The low price volatility and high current income makes this asset class very attractive. We don't expect this asset class to deliver total return like it has over the past year, but rising oil prices and higher income will offset any increased rates.

Emerging Market Sovereign Debt

Yield: 5.35% **Risk:** 8.94%

TREND	CARRY	
B	D	In terms of income, EM sovereign debt is a good asset class, but the strong dollar has put pressure on government balance sheets, which has been reflected in the price volatility of the asset class. Investors that hold government debt might prefer this over EM corporate debt.

International Sovereign Debt

Yield: 0.75% **Risk:** 13.54%

TREND	CARRY	
F	F	International sovereign debt is one of the riskiest asset classes out there today. The extremely low level of income can't offset changes in rates. It also appears that both Europe and Japan are slowing their monetary easing and actual inflation is on the horizon. These factors put enormous pressure on this asset class.

Mortgages

Yield: 2.90% **Risk:** 3.61%

TREND	CARRY	
D	C	Mortgages are a tough asset class in a rising rate environment. There has been some bounceback here as the course of interest rate increases is starting to become a little more visible. In general though, the macro trend is against this asset class, so it probably does not belong in an income portfolio.

Short Term Treasurys (Cash Proxy)

Yield: 1.19% **Risk:** 0.90%

TREND	CARRY	
C	B	Right now we would prefer credit risk over short duration, but in the event of a recessionary environment, cash is starting to look very attractive.

Grades: Quintile rankings of asset classes
Downgrade Upgrade No Change

Trend: 12 month momentum
Carry: Current Yield / Current Std. Deviation

Risk: Based on 60-day std. deviation

Sources: Bloomberg, Salient Partners L.P., as of 01/31/17. The performance quoted represents past performance, does not guarantee future results and current performance may be lower or higher than the data quoted.

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Nathan J. Rowader is a registered representative of ALPS Distributors, Inc.

Definition of Terms

Alerian MLP Infrastructure Index is the leading gauge of large- and mid-cap energy master limited partnerships (MLPs). The float-adjusted, capitalization-weighted index includes some of the most prominent companies and captures approximately 75% of available market capitalization.

Bloomberg Barclays EM Sovereign Bond Index is a rules-based market-value weighted index engineered to measure the fixed-rate local currency sovereign bonds issued in emerging markets as identified by Bloomberg.

Bloomberg Barclays Global Treasury ex-USD Index is an unmanaged index composed of those securities included in the Barclays Global Aggregate Bond Index that are Treasury securities, with the U.S. excluded while hedging the currency back to the U.S. dollar.

Bloomberg Barclays U.S. Aggregate Bond Index represents securities that are U.S. domestic, taxable and dollar denominated. The index covers the U.S. investment-grade, fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities.

Bloomberg Barclays U.S. Corporate High-Yield Bond Index covers the USD-denominated, noninvestment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

Bloomberg Barclays U.S. Credit Index is an index composed of corporate and non-corporate debt issues that are rated investment grade (Baa3/BBB) or higher.

Bloomberg Barclays U.S. Mortgage Backed Securities (MBS) Index tracks the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC).

Bloomberg Barclays U.S. Municipal Bond Index covers the USD-denominated, long-term tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and pre-refunded bonds.

Bloomberg Barclays U.S. Treasury Index is an unmanaged index of public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Bloomberg Barclays U.S. Treasury Bond 1–3 Year Term Index is an unmanaged index of public obligations of the U.S. Treasury with a maturity between one and up to (but not including) three years.

BofA Merrill Lynch U.S. Core Fixed Rate Preferred Stock Index consists of investment-grade, fixed and fixed-to-floating rate U.S. dollar-denominated preferred securities.

Brexit a term for the potential or hypothetical departure of the United Kingdom from the European Union.

Credit Suisse Emerging Market Corporate Bond Index consists of U.S. dollar-denominated fixed-income issues from Latin America, Eastern Europe and Asia.

Dow Jones Global ex-U.S. Select REIT Index measures the performance of equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded globally, excluding the U.S.

Dow Jones U.S. Real Estate Index measures the performance of the real estate industry of the U.S. equity market.

JPMorgan Global Manufacturing Purchasing Managers Index is a composite index that serves as a global economic indicator by measuring different business conditions in 24 countries, including global manufacturing output, new orders and employment across the global manufacturing sector.

MSCI EAFE (Europe, Australasia and Far East) Index is a stock market index that is designed to measure the equity market performance of developed markets outside of the U.S. and Canada.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

MSCI Emerging Markets Infrastructure Index captures the global opportunity set of companies that are owners or operators of infrastructure assets.

MSCI World Index is a free float-adjusted market capitalization index designed to measure equity market performance in the global developed markets.

Max drawdown is the percentage of loss that an asset incurs from its peak net asset value to its lowest value.

Price-earnings (P/E) ratio is a measure of the price paid for a share of stock relative to the annual income or profit earned by the company per share. A higher P/E ratio means that investors are paying more for each unit of income.

Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index. The Russell 3000 Index represents approximately 98% of the investable U.S. equity market.

S&P 500 Index is an unmanaged index of 500 common stocks chosen to reflect the industries in the U.S. economy.

Sharpe ratio is a ratio developed by Nobel laureate William F. Sharpe to measure how a fund performs relative to the risk it takes.

Standard deviation measures the degree to which a fund's return varies from its previous returns or from the average of all similar funds.

Yield is the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost or on the U.S. government's debt obligations.

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