Salient®

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

MARKET REVIEW

Europe Takes a Breather and Yields End With a Bang

June was a bit mixed for foreign stocks. Emerging market (EM) stocks led the way with a gain of 1.04% for the month followed by Japanese stocks, which increased by 0.96%. U.S. stocks pulled ahead of Europe this month, posting a gain of 0.62% while European stocks declined by -0.45%. Currency continued to play a vital role in performance as the U.S. dollar declined relative other major currencies. In fact, European stocks did far worse in their local currency, posting a decline of -2.53% in euro terms. Bonds had a wild ride in June with the 10-year Treasury beginning the month at 2.21% and gradually sliding down to 2.14% (a year-to-date low), but jumping back up to 2.31% in the final trading days of the month. The move pushes the yield back into an earlier trading range that, if sustained, may see rates increase as much as 0.30%. For the month of June, global bonds fell 0.09% because of the increase in rates, U.S. high-yield corporate bonds increased 0.14% and EM corporate bonds were flat.

The increase in rates can largely be attributed to talks by foreign central banks to begin the tightening process. In recent days, European Central Bank (ECB) President Mario Draghi reported that many signs pointed to a strengthening and broadening recovery of the eurozone. This statement followed similar comments from other policymakers from the ECB. The United Kingdom and Canada's top monetary policymakers also indicated that economic improvements appear to be taking hold, which led many pundits to conclude that tightening might occur soon.

Overall, leading economic indicators continue to show a synchronous expansion of the global economy and EM countries continue to surpass expectations. The JPMorgan Global Manufacturing Purchasing Managers' Index increased from 53.6 to 53.7 (after being revised down from last month), indicating that the global economy is still in a state of expansion. While the service component of the index increased, the manufacturing component declined, but is still well above 50.0 and completes the 17th month of continued expansion.

STOCKS vs. BONDS

Interest Rate Concerns Drive the Market

Despite the run-up in U.S. interest rates at the end of June, rate-sensitive sectors performed well. The S&P 500 Financials Index increased by 6.43% and the MSCI ACWI ex-USA financials sector increased by 2.64%. U.S. technology companies have led much of the S&P 500 Index's gain this year but declined by -2.70% for the month of June. However, despite a rotation toward lagging sectors in the month, previously leading sectors and countries still maintain a wide lead for the year. After June's pullback, tech companies still hold a gain that is at least twice as large as any other sector besides healthcare. Many of the technical indicators appear to support a continued advance for stocks. For example, as the S&P 500 has been achieving new highs (June 19th being the most recent), the NYSE advance-decline line (a measure of the stock market's breadth) has also achieved new highs. This tends to indicate a healthy and continuing bull market for stocks. Concurrent with strength in market breadth is the sustained low level of volatility in nearly every global market. The CBOE Volatility Index (VIX) closed at 9.75 setting yet a new multiyear low in the index. While low volatility always precedes periods of high volatility, the timing of that switch is extremely hard to pinpoint. In fact, periods of low volatility can go on for years and, when accompanied by a bull market, tend to be the best returns investors can earn. In short, there doesn't appear to be a break in investor preference for risky assets like stocks.

On the other hand, the bond market is a bit mixed. Foreign currency strength has been a boon for foreign sovereign debt. Even Treasurys have performed well in an environment that should be unfavorable (i.e., rising rates and rhetoric of increased tightening). Certain market prognosticators have pointed to possible signs of deflation largely driven by the decline in energy prices. However, most economic indicators continue to point toward economic expansion, which should favor credit over duration. While duration has outperformed credit this year, it hasn't been by much, which does indicate a market in flux. Until this becomes clearer, credit is likely to outperform.

OUTLOOK

What Are Rates Telling Us?

One of the indicators that we identified as being an important sign of policy outcome was the tight range of interest rates over the past several months. Since the current administration took office in January, the 10-year Treasury has held to a tight trading range between 2.30%–2.60%. This range fell apart alongside the initial unraveling of the Affordable Care Act (ACA) repeal and replace efforts. Investors clearly thought that fiscal policy changes expected under the new administration would be delayed at best and perhaps canceled altogether. Since that time, an investor could easily pin the direction of rates to the unfolding investigation into possible foreign powers meddling with the election, which was clearly distracting the administration from pushing its agenda forward. However, last week, following some hawkish commentary from top policymakers, the 10-year Treasury shot back up to 2.35% and out of the lower range it had been in for several months. While a new range has yet to be established, this move was also accompanied by renewed hopes of a Senate version of repealing and replacing the ACA. Perhaps Treasury traders have more insight into the likelihood of the latest version and the rates now reflect the inflationary pressures that could result from other administration policies. For example, as rates pushed higher, municipal bonds were one of the worst hit segments of the bond market, which have been trading at a healthy discount to Treasurys. This sell-off only makes sense if investors have a renewed confidence in a tax reform bill that has been at the center of many Republican economic plans. While nothing can be pointed to with certainty, this indicator was important early on this year and perhaps it is coming back into fashion.

One important thing to note on the report card is the rotation in trend and carry toward more defensive stock asset classes like utilities and real estate. There is also some rotation occurring in bonds as well, such as decreasing scores from EM sovereign bonds. This rotation could be signaling a larger shift toward safety and is worth of some further monitoring. This subject will likely be the focus of next month's commentary should this trend continue.

FUN FACT

The World's First Quantum Satellite

China has successfully tested the world's first quantum satellite by sending six million pairs of tiny particles from space to a series of telescopes on Earth. This endeavor is the first successful test of quantum communication that, when developed for practical purposes, could create a nearly indestructible form of cryptography. The success of these tests could also raise the profile of other quantum computing-related projects and help develop the study for a quantum internet and cloud-based computing, which would revolutionize the power of computing and open computer science to an untapped world that would literally defy the laws of physics, at least on paper.

Methodology

To learn more about the methodology visit the Salient Partners blog posting at www.salientpartners.com. 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

JULY 2017

Income Report Card: Stocks

U.S. Stocks

Yield: 1.97% **Risk:** 7.66%

TREND: B CARRY: F

Stocks have continued their strong performance. We think the performance of U.S. stocks may make the asset class a great total return option, but the income has continued to erode as stocks rise.

International Stocks

Yield: 3.15% **Risk:** 9.19%

TREND: A CARRY: D

The general slowdown in bond purchases by international policymakers coupled with a weaker dollar make international stocks more attractive. A weaker carry grade in June indicates it could be time to rotate some asset classes.

Emerging Market Stocks

Yield: 2.45% **Risk:** 9.31%

TREND: A CARRY: D

Emerging market stocks still produce low income, but the asset class offers strong diversification away from the U.S. economic environment. We think the strong trend, valuation and possible change in the long-term cycle all favor this asset class.

U.S. Real Estate

Yield: 4.19% **Risk:** 8.63%

TREND: F CARRY: A

We think the positive correlation of this asset class with bonds should be taken seriously, especially for any portfolio with a large position in fixed-rate bonds. We see the rebound off recent lows, along with the increased carry, as an improving opportunity for income.

Master Limited Partnerships (MLPs)

Yield: 7.11% **Risk:** 18.38%

TREND: C CARRY: C

The declining trend and increasing volatility are the hallmarks of a weak market. We see energy-related stocks as some of the best bargains in the market today, but we would like to see volatility come down.

Preferred Stocks

Yield: 1.85% **Risk:** 1.58%

TREND: D CARRY: A

We see preferred stocks as 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. The asset class has continued to improve on a relative performance basis.

Utilities

Yield: 3.43% **Risk:** 8.40%

TREND: B CARRY: B

Like real estate, utilities sold off as investors weighed the impact from the June rate increase. We see this as an attractive opportunity to get low volatility U.S.-based income especially if a rotation toward safety continues.

International Real Estate

Yield: 3.85% **Risk:** 8.26%

TREND: D CARRY: B

Recently, we think this asset class has become more attractive. The high volatility of the asset class has improved and could provide a good source of income.

EM Infrastructure

Yield: 3.17% **Risk:** 9.03%

TREND: C CARRY: C

If emerging market stocks are too volatile, we believe this asset class is a great way to access to 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

Income Report Card: Bonds

U.S. Treasurys

Yield: 1.90% **Risk:** 3.01%

TREND F CARRY F

The collapse in U.S. Treasury trend and carry has continued. The Federal Reserve (Fed) has most recently announced its plan to reduce its balance sheet, carrying forward the bleak outlook for this asset class. If you must hold Treasurys, we think short duration/cash-like is best.

U.S. Investment Grade Credit

Yield: 3.11% **Risk:** 3.21%

TREND C CARRY D

The downward trend for this asset class has continued. Although rates were raised in June, yield and volatility remain low, reinforcing our belief that high-yield corporates are a better choice for the current economic condition.

Municipal Bonds

Yield: 2.27% **Risk:** 1.75%

TREND D CARRY C

Muni bonds offer an attractive yield relative 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. But, if you must have a high-safety asset class, we think this asset class is your best bet over Treasurys.

High-Yield Municipal Bonds

Yield: 6.10% **Risk:** 2.84%

TREND B CARRY B

High-yield municipal bonds contain more risk than rated municipal bonds, but, barring a recession, we believe high-yield municipal bonds are a good alternative to any investment-grade holding.

U.S. High-Yield Corporate Bonds

Yield: 5.62% **Risk:** 1.46%

TREND A CARRY A

U.S. high-yield corporate bonds continue to be one of our favorite asset classes. Even with the rise in rates from the June Fed meeting, we still see strong trend and carry grades for this asset class.

Emerging Market Corporate Debt

Yield: 6.25% **Risk:** 2.09%

TREND A CARRY A

EM corporate debt is also one of our favorite asset classes for 2017. The low price volatility and high current income make this asset class very attractive. We don't expect this asset class to deliver total return like it has over the past year, as lower oil prices will put continued pressure on the asset class.

Emerging Market Sovereign Debt

Yield: 5.07% **Risk:** 2.64%

TREND B CARRY C

The U.S. dollar has been very weak as of late, which has benefitted EM sovereign bonds. As a result of the increase in price, the yield isn't looking as attractive per unit of risk. We think investors would do better with EM corporate bonds.

International Sovereign Debt

Yield: 0.76% **Risk:** 6.58%

TREND F CARRY F

The slowing of bond buying by international policymakers coupled with the low yield of the asset class make it our least favorite asset class. We believe this asset class should currently be avoided.

Mortgages

Yield: 2.87% **Risk:** 2.41%

TREND C CARRY D

Mortgages have shown resilience after the most recent rise in rates from the June Fed meeting. Although this asset class remains strong, we see mortgages as less attractive for income in the longer term.

Short Term Treasurys (Cash Proxy)

Yield: 1.40% **Risk:** 0.68%

TREND D CARRY B

Currently we prefer credit risk over short duration, but in the event of 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

Investing involves risk, including possible loss of principal. The value of any financial instruments or markets mentioned herein can fall as well as rise. Past performance does not guarantee future results.

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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 US excluded while hedging the currency back to the US 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. Municipal High Yield Index measures the noninvestment-grade and nonrated U.S. dollar-denominated, fixed-rate, tax-exempt bond market within the 50 United States and four other qualifying regions (Washington D.C., Puerto Rico, Guam and the Virgin Islands).

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 includes public obligations of the U.S. Treasury with a maturity between 1 and up to (but not including) 3 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.

Consumer price index (CPI) is an index number measuring the average price of consumer goods and services purchased by households. The percentage change in the CPI is a measure of inflation.

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.

NASDAQ-100 is a modified capitalization-weighted index that includes the largest nonfinancial U.S. and non-U.S. companies listed on the NASDAQ stock market across a variety of industries, such as retail, healthcare, telecommunications, wholesale trade, biotechnology and technology.

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 Financials Index comprises those companies included in the S&P 500 that are classified as members of the GICS® financials sector.

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.

Valuation is the process of determining the value of an asset or company based on earnings and the market value of assets.

VIX (the ticker symbol for the Chicago Board Options Exchange Volatility Index) is a popular measure of market risk and is constructed using the implied volatility of S&P 500 index options.

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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