Potential Opportunities For Income

· Emerging Market Corporate Bonds
· High-Yield Municipal Bonds
· International Real Estate

Weaker Opportunities For Income

· International Sovereign Bonds
· Treasurys

MARKET REVIEW

Bonds Continue to Slide

Historically, September and October tend to be the weakest months for stocks, but this year has been different as global stocks increased by 2.08% in October. The gains were broad based, with Japan increasing by 4.61% following Prime Minister Shinzō Abe's reelection and emerging markets (EM) increasing by 3.51%. Other major markets gained as well, with U.S. stocks increasing by 2.33% and European equities gaining 0.47%. Small-cap stocks underperformed large-cap stocks, increasing by 0.85% and underperforming the S&P 500. Gains in foreign markets overcame weakness in the euro and yen relative to the dollar, which gained slightly less than 1% compared to other major developed currencies.

Weakness in the bond market continued into October with the global bond market declining by 0.38%—the second monthly decline. Once again, the primary detractor to the overall bond market was the international sovereign bond sector, which fell -0.72%, underperforming international Treasurys which declined -0.12%. The credit markets performed better, with high-yield corporate bonds gaining 0.42%, EM corporate bonds gaining 0.83% and high-yield municipal bonds gaining 0.27%. The 10-year Treasury yield increased to 2.46% in October, decidedly breaking out of a range that had been in place since Q1 2017. While yield pulled back, this environment could be a set up for higher future rates and the continuation of the reflation theme that dominated the latter part of 2016 and the early part of 2017. It is too early to make that an official stance, but we think it is worth watching. Should the 10-year Treasury hold above 2.30% and then advance past 2.46%, it would be wise to consider taking on some inflation-oriented positioning.

STOCKS vs. BONDS

The Global Economy Supporting Stocks

The JPMorgan Global Manufacturing Purchasing Managers' Index (PMI) increased by 0.2 points to 53.5, remaining around the highest level since 2011. Additionally, all but one of the component indices increased with new orders and new exports accelerating the most, hitting multiyear highs. All of this information tells us that the folks controlling the order flow of global manufacturers expect business to expand over the next several months, which would mean the economy would expand as well. The next several readings from this group of purchasing professionals are going to send some signals about the structure of the world economy going forward. Since the 2008-2009 fiscal crisis, the PMI hasn't maintained readings above 53 for very long, but that doesn't necessarily mean it has peaked. Prior to the fiscal crisis, the PMI could reach as high as 57, which leaves room for more growth currently. A move toward 57 would perhaps act as evidence of our economy returning to a more normal state. There was another interesting feature of this month's report: more than 90% of the reporting global economies are registering a reading higher than 50, indicating an expanding global economy. The highest readings are coming from developed European countries, with some weakness from emerging economies due to impact from certain monetary policy changes in the respective countries.

The U.S. employment picture is strong, with the unemployment rate at 4.30%—the lowest point since 2001. Wage growth is also starting to recover, which has been one of the most sluggish economic indicators of U.S. growth. The current level of economic growth is at 3.6%, just below the 4% experienced before the 2008-2009 financial crisis. This also translates to higher economic growth with average forecasted Q4 2017 gross domestic product (GDP) growth at 3.4%—once again another multiyear high. While valuations are stretched for stocks, robust growth could help normalize those valuations. As of right now, there is no reason to pull back on stock allocations.

OUTLOOK

Looking Back, the Forward

Let's look at some of our past positioning and recommendations and see how the year is going. This year, we have largely recommended an overweight to stocks, specifically EM stocks, and a tilt toward credit in your bond portfolio, specifically EM corporate bonds, high-yield corporate bonds and high-yield municipal bonds. The overweight to stocks has been a successful call, as global stocks have increased 19.68% for the year ending 10/31/17 while global bonds have gained 5.84% during the same time. EM equities have surpassed global bonds, increasing by 32.26% for the year. Credit has done well with EM corporate bonds, high-yield corporate bonds and high-yield muni bonds increasing by 8.7%, 7.5% and 8.0%, respectively, and all outperforming global bonds. Next, let's look at how the report card scoring system has worked this year.

Carry for Bonds	Return	Risk	Yield
A	8.4%	2.1%	5.6%
B	4.4%	1.6%	3.4%
C	5.2%	1.9%	3.6%
D	5.5%	1.9%	2.9%
F	4.5%	3.0%	1.4%
Global Bonds	5.8%	3.0%	1.6%

Carry for Stocks	Return	Risk	Yield
A	-0.5%	6.2%	4.5%
B	12.9%	5.4%	5.8%
C	7.6%	6.4%	3.6%
D	17.2%	5.4%	2.7%
F	27.1%	6.8%	2.4%
Global Bonds	19.7%	3.1%	2.3%

Trend for Bonds	Return	Risk	Yield
A	8.4%	2.1%	5.6%
B	7.1%	2.1%	5.1%
C	4.4%	1.6%	2.7%
D	2.6%	1.8%	1.8%
F	4.4%	2.8%	1.5%
Global Bonds	5.8%	3.0%	1.6%

Trend for Stocks	Return	Risk	Yield
A	19.0%	6.5%	2.8%
B	16.9%	6.7%	2.7%
C	7.3%	5.8%	3.9%
D	9.5%	3.7%	4.7%
F	7.3%	7.5%	7.5%
Global Bonds	19.7%	3.1%	2.3%

There is quite a bit to unpack here. The trend and yield environments have been generally synchronous all year as investors have sought out higher yielding bonds. The resulting carry and trend grades give comparable results: investors who bought high-yielding and high-performing asset classes would have been able to handily beat the global bond market while also generating a very high stream of current income. Stocks are a little different. Trend has worked well for stocks, but has mostly kept up with the market, not really outperforming. Meanwhile carry for stocks has been the inverse of what we would desire, which makes sense since markets have shunned value and dividend-paying stocks. When we introduced the report card, it was suggested that an investor could buy a basket of A- and B-rated stock and bond asset classes in order to build a good high-income portfolio. This portfolio would have delivered 9.5% return with a 2.8% standard deviation and a current income of 4.4%. A 50% global stock and 50% global bond portfolio would have delivered a return of 12.8% with a standard deviation of 3.1% and a current yield of 2.0%. Anyone who followed this structure would have underperformed the market, but still generated a great return with a yield more than 2x the benchmark.

FUN FACT

A Story with a Twist

Jeremy, the left-coiled brown garden snail, died in October. Jeremy had a genetic mutation that caused his shell to twist to the left instead of the right because all his internal organs twisted left instead of right. Scientists at the University of Nottingham have been trying to explain whether the anomaly was genetic or environmental. To prove it was genetics, Jeremy needed a left-twisting mate, which required a large public outreach via social media. After several years of searching, six left coiled snails were discovered. Jeremy successfully created a brood just days before his passing, but none are left-twisting, leading researchers to believe that it may take several generations for the anomaly to reappear.

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 Bond
Municipal Bonds	Bloomberg Barclays U.S. Municipal Bond
High-Yield Municipal Bonds	Bloomberg Barclays U.S. Municipal High Yield
U.S. High-Yield Corporate Bonds	Bloomberg Barclays U.S. Corporate High-Yield Bond
Emerging Market Corporate Debt	CS Emerging Markets Corporate Bond
Emerging Market Sovereign Debt	Bloomberg Barclays EM Sovereign Bond
International Sovereign Debt	Bloomberg Barclays Global Treasury ex-USD
Mortgages	Bloomberg Barclays U.S. MBS
Short-Term Treasurys (Cash Proxy)	Bloomberg Barclays U.S. Treasury Bond 1-3 Year Term

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

Income Report Card: Stocks

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

U.S. Stocks

Yield: 1.93% **Risk:** 7.25%

TREND	CARRY
C	D

U.S. stocks continue to outperform, eroding the income we are looking for. U.S. stocks provide one of the worst absolute levels of income in our stock universe. We see U.S. stocks as a solid total return option and can be used as a good hedge against inflation and rising rates with regulatory changes on the horizon.

International Stocks

Yield: 3.03% **Risk:** 5.67%

TREND	CARRY
A	B

International stocks benefited greatly by the significant decline in yields throughout the region. Even with the strong U.S. dollar performance, international stocks saw an improved carry grade and continue to be a great diversifying option since U.S. stocks are so expensive.

Emerging Market Stocks

Yield: 2.29% **Risk:** 9.21%

TREND	CARRY
A	F

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

U.S. Real Estate

Yield: 4.10% **Risk:** 8.42%

TREND	CARRY
C	C

The positive correlation with bonds should be taken seriously in this asset class, especially for any investor with a large position in fixed-rate bonds.

Master Limited Partnerships (MLPs)

Yield: 7.80% **Risk:** 15.27%

TREND	CARRY
F	C

Volatility has increased once again after a brief window where this asset class might have come back into favor. We are still waiting on an improving market for this asset class.

Preferred Stocks

Yield: 5.32% **Risk:** 2.07%

TREND	CARRY
D	A

We see preferred stocks as the asset class to own for safe U.S.-based income. The asset class does have a positive correlation to bonds, but the higher income stream should help protect it from changes in rates. The recent resurgence in bank stocks could find its way to preferreds in the near term.

Utilities

Yield: 3.29% **Risk:** 9.30%

TREND	CARRY
B	D

As rising rates continue, we see carry downgraded as earnings multiples and long-term growth prospects continue to be weak in this asset class. We think preferred stocks are a better option for an income portfolio.

International Real Estate

Yield: 4.04% **Risk:** 6.26%

TREND	CARRY
D	A

Volatility has been declining and the carry is looking very attractive at this point. The asset class has also lagged other international assets, so there may be some relative value that could provide some good capital appreciation as well.

EM Infrastructure

Yield: 3.67% **Risk:** 7.04%

TREND	CARRY
B	B

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.

Source: Bloomberg, Salient Partners, L.P., as of 10/31/2017. The performance quoted represents past performance, does not guarantee future results and current performance may be lower or higher than the data quoted. This material is distributed for informational purposes only and should not be considered as investment advice, a recommendation of any particular security, strategy or investment product, or as an offer or solicitation with respect to the purchase or sale of any investment.

Income Report Card: Bonds

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

U.S. Treasurys

Yield: 2.03% **Risk:** 2.86%

TREND F CARRY 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. If you must hold Treasurys, we believe short duration/cash-like or muni bonds are best.

U.S. Investment Grade Credit

Yield: 3.09% **Risk:** 2.93%

TREND D CARRY D

The rapid increase in rates this month is putting pressure on all fixed-rate asset classes. A short-term bear market might be forming for bonds, which makes high yield even more attractive on a relative basis.

Municipal Bonds

Yield: 2.25% **Risk:** 1.34%

TREND C CARRY C

Muni bonds offer an attractive yield relative to Treasurys. 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 a better position than Treasurys.

High-Yield Municipal Bonds

Yield: 5.31% **Risk:** 2.09%

TREND B CARRY 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, we think this asset class is likely the best opportunity.

U.S. High-Yield Corporate Bonds

Yield: 5.43% **Risk:** 1.42%

TREND B CARRY A

In the month of October, the U.S. 10-year Treasury saw a sizeable increase, possibly signaling the rising rates we have been waiting for. With only a slight decrease in trend, we still believe this is a great asset class, but will be watching rates as we move forward.

Emerging Market Corporate Debt

Yield: 5.75% **Risk:** 1.09%

TREND A CARRY A

EM corporate debt has also been 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 did last year, but higher income may offset any increased rates.

Emerging Market Sovereign Debt

Yield: 4.87% **Risk:** 2.72%

TREND A CARRY C

If you absolutely need government bonds, we see this asset class as your best bet. However, spreads are now at pre-crisis levels and the great returns here might not warrant the risk. Again, we'd suggest credit over sovereign bonds.

International Sovereign Debt

Yield: 0.72% **Risk:** 6.86%

TREND C CARRY F

This asset class has been a great performer this year, but has volatility similar to stocks and a yield that offers very little cover in the case of rising interest rates, which have been going up. A pullback in currency values could lead to a very sharp decline, such as the near 4% drawdown in September.

Mortgages

Yield: 2.86% **Risk:** 1.75%

TREND D CARRY D

Mortgages continue to struggle in a rising-rate environment. We have seen a downgrade in trend as the course of interest rate increases becomes more visible. Due to this macro trend, mortgages most likely do not belong in an income portfolio.

Short Term Treasurys (Cash Proxy)

Yield: 1.60% **Risk:** 0.62%

TREND F CARRY B

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

Source: Bloomberg, Salient Partners, L.P., as of 10/31/2017. The performance quoted represents past performance, does not guarantee future results and current performance may be lower or higher than the data quoted. This material is distributed for informational purposes only and should not be considered as investment advice, a recommendation of any particular security, strategy or investment product, or as an offer or solicitation with respect to the purchase or sale of any investment.

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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.

CBOE Volatility Index is a popular measure of market risk and is constructed using the implied volatility of S&P 500 index options.

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 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.

NYSE Advance/Decline Indicator is a technical indicator that charts the difference between the number of advancing stocks and declining stocks on the NYSE in a given market on a given day.

NYSE New Highs/Lows is a technical indicator that charts the highest and lowest prices over 52 weeks of NYSE stocks in a given market on a given day.

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.

Not FDIC Insured | No Bank Guarantee | May Lose Value

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