Market Overview

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Shorter-end rates drifted higher during the month as market participants reassessed the possibility of a Fed hike closer to mid-year rather than year-end. The release of the minutes from the Federal Reserve's April meeting prompted a hasty recalibration of the odds of a near-term policy move which pressured rates higher on the short-end and buoyed the dollar. Price movement overall was relatively muted however, as markets reacted to adjusting expectations rather than evolving fundamentals and the sideways, consolidating nature of interest rate moves continued to form the market narrative for the near-term. While rate moves were limited in magnitude, domestic yield curves continued to display a pronounced inclination toward flattening with long-end yields declining amid steady demand for incremental income and strong 'carry' when compared to ultra-low and even negative yields in Developed Markets abroad. Taxable spread sector returns were mixed and municipals largely tracked Treasury movements over the period. Equities worked back toward their recent highs and crude oil, the catalyst for much of the directional momentum in the capital markets this year, continued to trade higher. Crude prices have nearly doubled since their double-bottom in February.

While market participants focus on the Fed, there is also increasing nervousness ahead of the June 23rd UK 'Brexit' Referendum on European Union Membership. Opinion polls have shown recent momentum for the 'Leave' camp but as with any close ballot, the outcome will ultimately pivot on which way the undecideds break. If populist sentiment pushes the UK to leave, it can be expected to increase tension in the capital markets in the form of currency and equity volatility and a heightened flight-to-quality bid. While the UK is not a member of the monetary union that comprises the Eurozone, its departure from the EU would be precedent-setting and could raise the specter of a so-called 'peripheral' country voluntarily choosing to exit the Euro if economic and fiscal conditions worsen. The UK is the second largest economy in the EU, and the recent tightening in the polls is expected to be a factor under consideration as the Fed convenes its June 14-15 Policy Committee Meeting. If the 'Remain' forces are victorious it will likely be met with a sigh of relief by investors and viewed as a vote for near-term stability. In either eventuality, negotiations over long-term policy options will continue as the EU attempts to respond effectively to economic challenges and the refugee crisis that continues to strain member countries to the breaking point.

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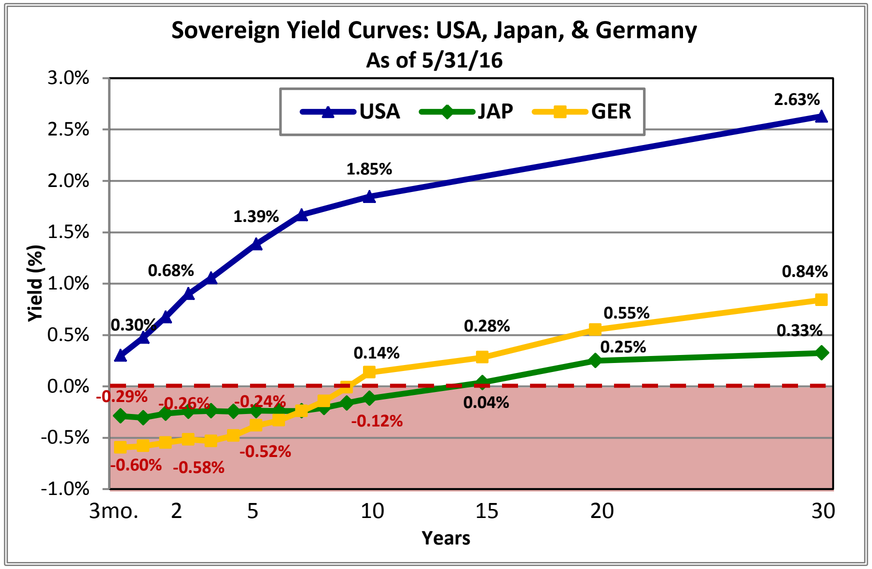

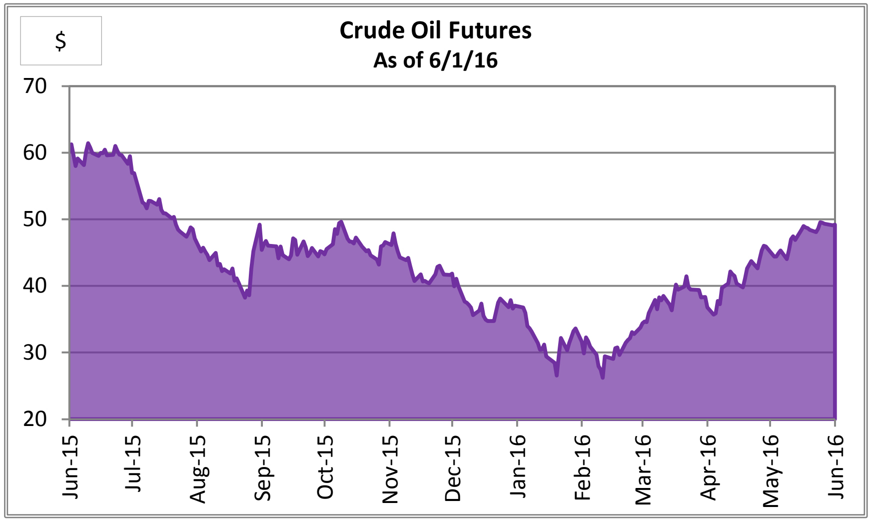

Source: Bloomberg
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- Treasury rates rose across intermediate maturities and the yield curve flattened as investors priced in a greater likelihood of a mid-year rate hike from the Federal Reserve.
- Municipals traded in tandem with Treasuries and the market experienced strong demand and relatively modest issuance.
- Taxable spread sectors were mixed, with Taxable Municipals producing the strongest absolute and relative returns for the period.
- The US Dollar strengthened against most currencies during the period, ending a four-month downdraft.
- Negative corporate yields in Europe in secondary market trading appeared for the first time, and ultra-low global sovereign rates continued to keep US rates in check.

Rounding toward mid-year, market pricing is reflective of an expectation set which is reluctant to fully embrace the possibility that the Fed will re-embark upon its desired path toward normalization. Economic growth is estimated to have expanded at a modest 0.8% during the first quarter, and most estimates range in the 2% area or perhaps just shy of that level for the full year. Domestic economic fundamentals are for the most part sound, but the global outlook is less sanguine. In addition to the UK Referendum, there are longer-term concerns about the determination of China to fully embrace its economic reform agenda. It is troubling that despite its stated intention to rebalance its growth model toward encouraging consumption and limiting the oversized role of capital investment in the economy; China has recently engineered a significant expansion of credit to counter economic deceleration. This provides a short-term boost to growth but increases the challenges of effecting the stabilizing reforms necessary to move the world's largest Emerging Economy along the path toward becoming a more fully developed economy over the long-term.

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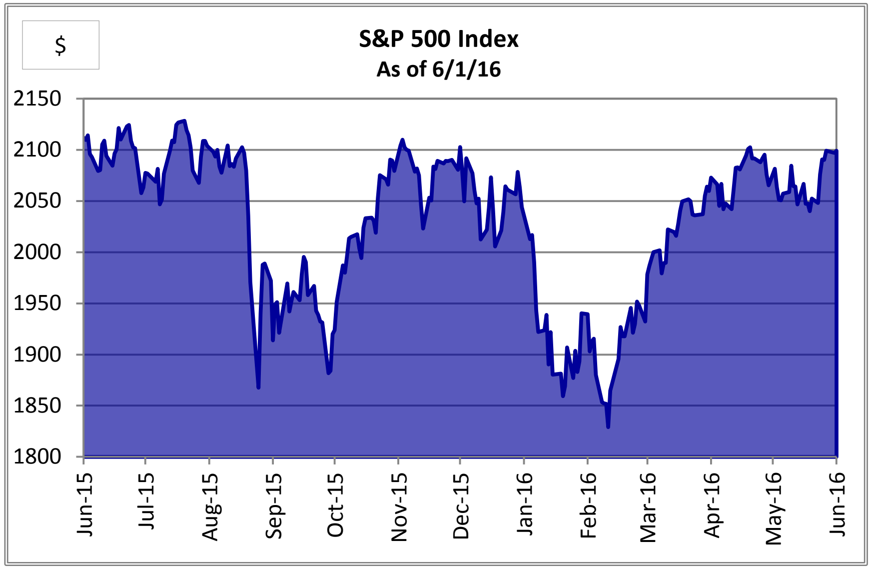

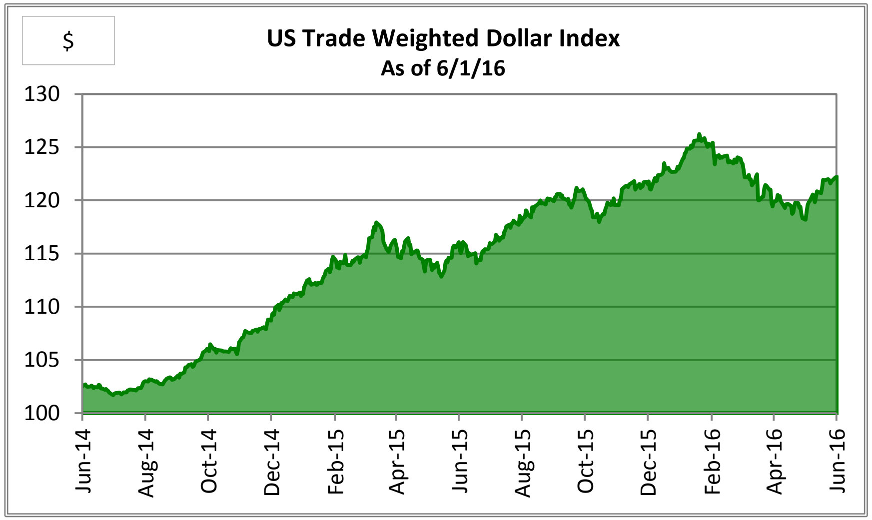

Source: Bloomberg
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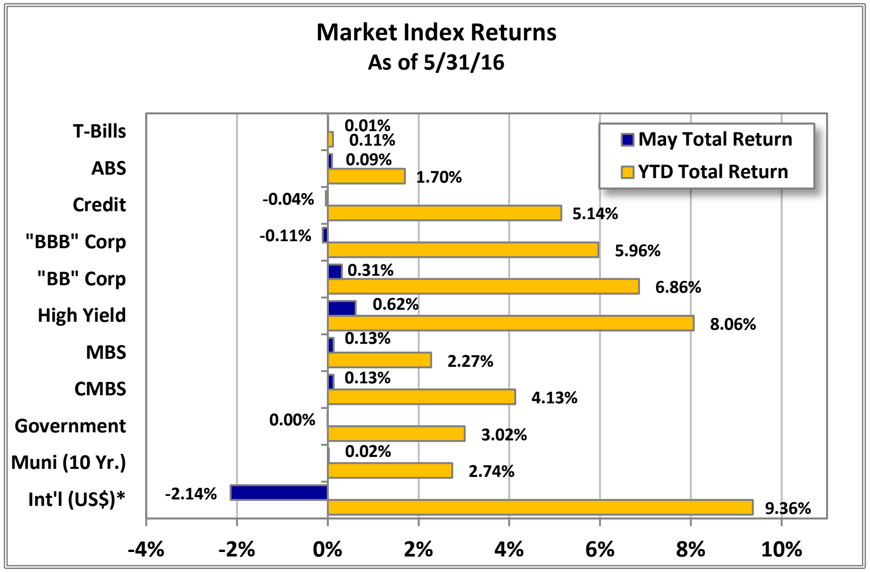
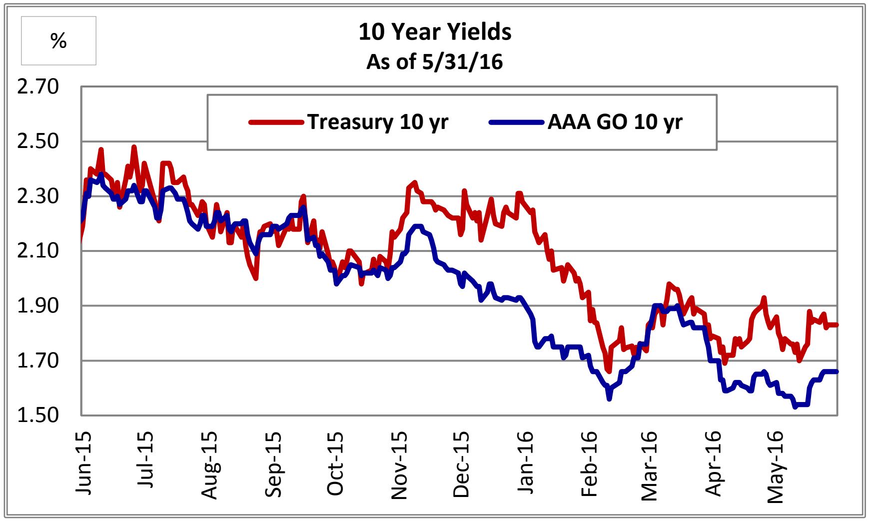
Despite the potential obstacles facing the global economy, we expect moderate growth domestically, a gradual rise in rates from the Federal Reserve, limited directional movement in the overall US rate structure and a tendency for the yield curve to flatten. Over the near-term, strength in consumer spending, aided by continued growth in employment, should help the economy weather choppiness in the capital markets if it were to develop. Longer-term economic challenges, both domestically and internationally, remain a significant headwind against a meaningful acceleration of growth however. Weak aggregate demand remains the order of the day. Central banks have approached exhaustion on the policy front, while legislators remain too timid to use fiscal policy in the face of restive electorates. If economic policymakers ultimately garner a mandate to boost growth, it will likely take the form of either expanded government investment in infrastructure or initiatives designed to bolster income to households with a high propensity to consume. Initiatives on these fronts could help generate greater and hopefully self-sustaining momentum for the economy.





*Source: Bloomberg; Barclays; *Merrill Lynch.*
All indices, other than those noted, are Barclays indices. Please refer to the Notes and Disclosures on the last page for additional information.

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