4Q 2018 | Fixed Income Markets Review

WST CAPITAL MANAGEMENT

Executive Summary

After limping along through most of 2018 fixed income broad markets delivered a strong 4Q to close the year, with yields falling across core indices and sectors as global equities entered a tailspin driven by heavy losses in the US. The global bond rally took flight in December, and the Bloomberg Barclays Global Aggregate Index recovered much of its year-to-date losses, ultimately posting a -1.20% return for 2018. The Bloomberg Barclays US Aggregate Bond Index notched a strong quarterly result (+1.64%) to close out the year flat. Contrary to 2018's overall pattern, which favored shorter-dated and floating-rate fixed income, longer-dated bonds drove positive results during the quarter.

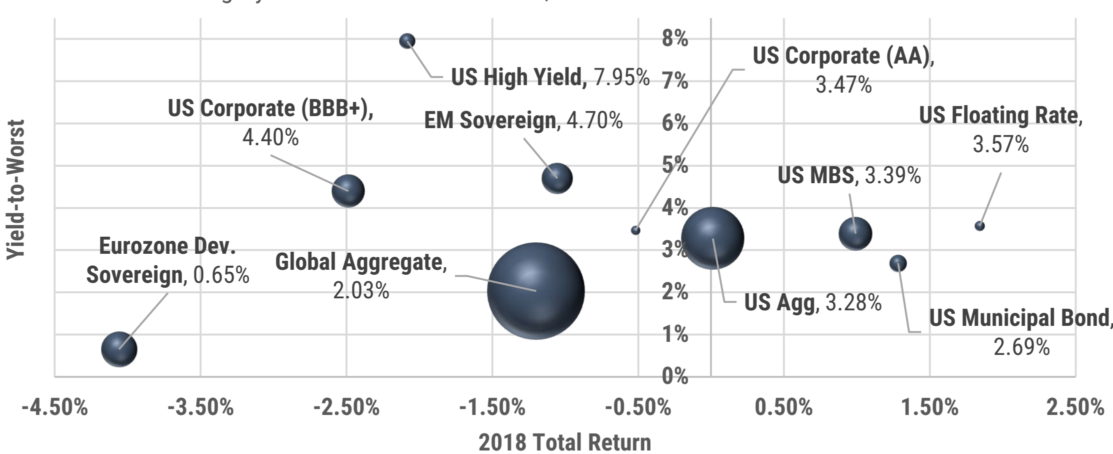
US credit saw mixed results between investment-grade and junk and overall spreads widened significantly in both categories. After coming under some pressure earlier in the quarter due to mounting concerns about credit quality and ballooning corporate debt overall, investment-grade participated in the late rally and the AA corporate segment managed a gain of 108 basis points. Returns were positive, but weaker, further down the rating scale. High yield – which was the best-performing major index headed into 3Q – sold off in tandem with equities and the quarter's heavy losses (-4.53%) ultimately erased the last of the year's gains. The index finished 2018 down 2.07%.

Results were positive outside the US as well. December rallies in Europe overall served to cut quarterly losses, with 4Q setting most indices back by less than 50 basis points. The eurozone saw heavy losses early in 4Q as investors eyed political instability, disappointing economic and a looming fiscal showdown between the EU and Italy, whose debt was docked one notch on the rating scale. Headlines mellowed, however, and the S&P Eurozone Developed Sovereign Bond Index rallied alongside US treasuries and as core inflation fell alongside oil prices and industrial production – factors that, in aggregate, may stall tightening by European central banks.

December capped a breakaway quarter for emerging sovereign bonds; the ICE BofAML Emerging Sovereign Bond Index posted a 3.62% quarterly return and ended the year at -1.05%. Beginning in November, EM prices began to rally off the notion that a moderated course of US Fed rate-hikes might defer global portfolio rebalancing (i.e., into the US and away from higher-risk emerging issues) and soften the dollar in the process. Fed action and the more agreeable currency environment in December further supported a rally in EM sovereigns.

Fixed Income Market by Comparative Size, Yield & 2018 Total Return

Labels Indicate Category & YTW as of December 31, 2018



Source: FactSet for all index and market data, with all index returns shown in US dollars in table as of December 31, 2018.

Index Total Returns (%)	1 Mo.	3 Mos.	1 Yr.
S&P U.S. Current 10-Year Treasury Bond Index	3.00	3.90	0.08
S&P US Treasury TIPS	0.54	-0.44	-1.03
BBg Barc US Aggregate	1.84	1.64	0.01
S&P Global Dev. Sovereign ex-US Bond Index	0.92	1.45	1.07
S&P Eurozone Developed Sovereign Bond	1.78	-0.29	-4.04
S&P Pan-Europe Developed Sovereign Bond	1.81	-0.34	-4.28
ICE BofAML Emerging Markets Sovereign Bond	1.66	3.62	-1.05
BBg Barc Global Aggregate	2.02	1.20	-1.20
BBg Barc Global Aggregate ex-US	2.22	0.91	-2.14
BBg Barc US Corporate (AA)	1.81	1.08	-0.52
BBg Barc US Corporate High Yield	-2.14	-4.53	-2.07
BBg Barc Global Aggregate - Corporate	1.24	-0.81	-3.55
BBg Barc Global Agg Securitized - US MBS	1.81	2.08	0.99
BBg Barc Global Agg Securitized - US ABS	0.79	1.25	1.77
BBg Barc Municipal Bond Index	1.20	1.69	1.28
BBg Barc US Floating Rate Notes (<5 Yr)	-0.15	-0.13	1.83
S&P/LSTA Leveraged Loan	-3.16	-4.41	-0.62

Key Rates (%/ bps)	Current	1 Mo. Change	3 Mo. Change	1 Yr. Change
US 3 Month	2.45	+9	+26	+106
US 2 Year	2.50	-32	-31	+62
US 5 Year	2.51	-34	-44	+30
US 10 Year	2.68	-33	-37	+25
US 30 Year	3.01	-30	-18	+26
1 Month USD LIBOR	2.50	+16	+24	+94
3 Month USD LIBOR	2.81	+7	+41	+111
6 Month USD LIBOR	2.88	-2	+27	+104
12 Month USD LIBOR	3.01	-11	+9	+90

Credit Spreads (bps)	Current	1 Mo. Change	3 Mo. Change	1 Yr. Change
US Corporate OAS	83	+7	+27	+34
US Corporate High Yield OAS	526	+108	+210	+183

Key Indicators	Current	1 Mo. Change	3 Mo. Change	1 Yr. Change
10 Yr-2-Yr Treasury Spread (bps)	18	-1	-6	-37
WTI ($/ bb)	$45.44	-$5.34	-$27.72	-$15.02
Core CPI	259	+.5	+1	+5
Breakeven Inflation: 5 Yr %/ bps	1.51%	-26	-52	-35
Breakeven Inflation: 10 Yr %/ bps	1.71%	-26	-43	-25

4Q 2018 | Credit Select Risk-Managed Review

WST CAPITAL MANAGEMENT

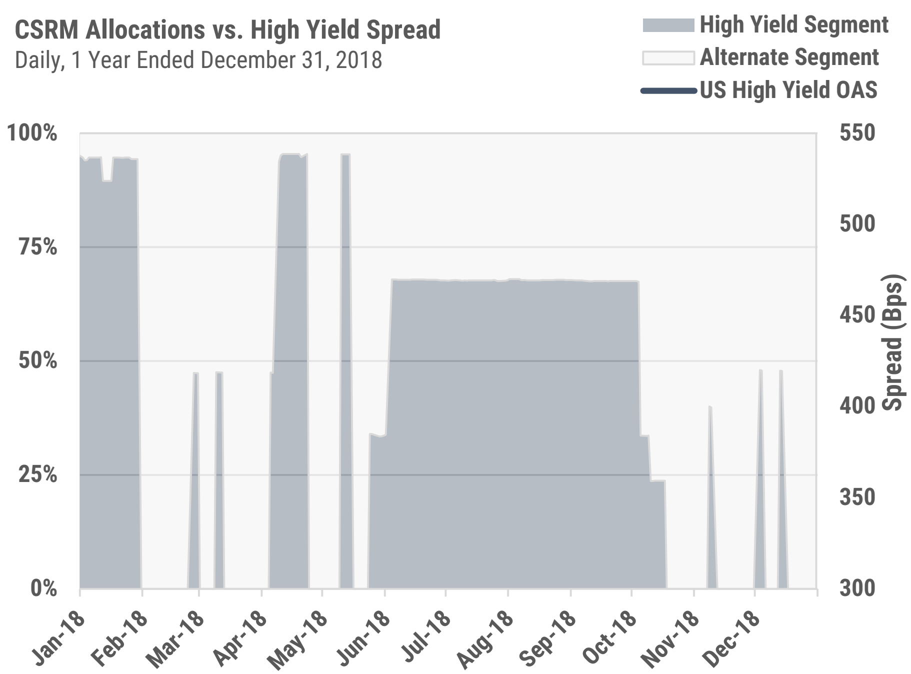
Performance & Positioning Recap

In 4Q18 the Credit Select Risk-Managed (CSRM) strategy returned -2.04% gross (-2.28% net) versus a Bloomberg Barclays High Yield Index that fell 4.53% and a Bloomberg Barclays US Aggregate Bond Index that returned 1.64%. CSRM ultimately returned -0.79% gross (-1.72% net) for the year versus returns of -2.08% return for the high yield index and 0.01% for the aggregate Index.

After spending all of 3Q positioned moderately (i.e., invested around 70% in high yield vs. 30% in floating-rate fixed income and cash), CSRM saw an active fourth quarter with respect to both tactical changes at the asset class level and duration management within the risk-off segment. Just a few days into the quarter CSRM initiated a de-risking sequence that saw high yield exposure reduced first to 25% and then to 0% as junk spreads widened rapidly. As shown in the below chart the CSRM made several brief, partial re-entries into high yield as prices rallied, but overall the strategy spent most of 4Q with a sidelined view of credit markets.

December prompted an adjustment in duration within the risk-off segment, as longer-dated bonds strengthened and floating-rate exposure – which had offered unique stability throughout a largely negative year for duration – began to sell off.

CSRM Allocations vs. High Yield Spread
Daily, 1 Year Ended December 31, 2018



Observations & Outlook

After holding steady for much of the year despite narrow spreads and surging US equity volatility, high yield finally capitulated in 4Q. While junk bonds held up reasonably well (and significantly better than core bonds) during the 1Q equity market sell-off, relative strength began to fade beginning with the October rout in equities. The December fire-sale exemplified a "classic" flight-to-safety rotation, as junk sold off and US core bonds and gold outperformed in earnest.

In our view, underlying high yield's deterioration in December were two key themes: Fed action and growing concerns about quality in credit overall. For much of 2018 junk bonds benefitted from the unappealing prospects for core bonds – and longer duration in general – given anticipated Fed action. Yields also rose in emerging markets and riskier global bond segments that struggled to remain appealing against the backdrop of a stronger dollar and higher rates in the US. Global bonds and higher-duration segments rallied, however, on progressively dovish signals coming from the Fed throughout the quarter, and high yield valuations suddenly felt stretched.

Credit overall was afflicted in 4Q by the risk-off mood and in particular by the Fed chair's comments regarding the swell of corporate debt versus GDP. High yield investors specifically worried about the possibility that just a handful of downgrades in the outsized BBB-rated debt segment could flood the high yield market, resulting in a nasty correction. Ultimately, despite the fact that interest coverage ratios remain high and default remains extremely low, sentiment soured during a rough time for risk-assets overall, resulting in a drawdown within high yield.

We believe that for the vast majority of junk issuers the fundamental picture is mostly unchanged and remains fairly strong. What *has* changed is investor interest in risk vs. return and valuation relative to other opportunities in the market. Given this shift in the fixed income landscape, we believe that high yield spreads will continue to expand their trading range and the market should begin to surface clearer entry opportunities than we saw in 2018. Conversely, we expect to see an increase in downside events and the volatility that tactical strategies are designed to maneuver around.

We maintain high conviction in Credit Select Risk-Managed as a means to harvest high yield upside while managing duration in investment-grade segments. As always, we are grateful for your continued confidence in our strategy and we welcome your questions and feedback.

Source: CSRM model daily allocations for the period 12/31/2017-12/31/2018, summarized by "High Yield" and "Alternate Segment" (investment grade fixed income and cash). Spread measure is the daily option-adjusted spread between Bloomberg Barclays US Corp High Yield Index yield-to-worst and the 10 Yr Treasury Yield.

Notes & disclosures

Index Returns – *all shown in US dollars*

All returns shown trailing 12/31/2018 for the period indicated. "YTD" refers to the total return as of prior-year end, while the other returns are annualized. 3-month and annualized returns are shown for:

- The Barclay's US Aggregate Index, a broad based unmanaged bond index that is generally considered to be representative of the performance of the investment grade, US dollar-denominated, fixed-rate taxable bond market.
- The ICE BofAML Emerging Markets Sovereign Bond Index is a subset of The BofA Merrill Lynch World Sovereign Bond Index excluding all securities with a country of risk that is a member of the FX G10, all Western European countries, and territories of the U.S. and Western European countries. The FX G10 includes all Euro members, the U.S., Japan, the U.K., Canada, Australia, New Zealand, Switzerland, Norway, and Sweden.
- The Bloomberg Barclays Global Aggregate Index, which measures global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.
- The S&P Global Developed Sovereign Bond index includes local-currency denominated debt publicly issued by governments in their domestic markets.
- S&P Eurozone Developed Sovereign Bond - seeks to measure the performance of Eurozone government bonds.
- The S&P Pan-Europe Developed Sovereign Bond Index is a comprehensive, market-value-weighted index designed to track the performance of local currency-denominated securities publicly issued by Denmark, Norway, Sweden, Switzerland, the U.K. and developed countries in the Eurozone for their domestic markets.
- ICE BofAML Emerging Markets Sovereign Bond - tracks the performance of US dollar (USD) and Euro denominated emerging markets non-sovereign debt publicly issued within the major domestic and Eurobond markets.
- The Bloomberg Barclay's US Corporate Bond Index (AA), which measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.
- The Bloomberg Barclay's US Corporate High Yield Index, which covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market.
- Bloomberg Barclay's Global Aggregate Securitized- US Mortgage-Backed Securities, which is a component of the Bloomberg Barclay's US Aggregate Index and measures investment grade mortgage backed pass-through securities of GNMA, FNMA, and FHLMC.
- Bloomberg Barclay's Global Aggregate Securitized- US Asset-Backed Securities, which is a component of the Bloomberg Barclay's US Aggregate Index and includes the pass-throughs, bullets, and controlled amortization structures of only the senior class of ABS issues.
- The Blomberg Barclay's US Floating Rate Notes (<5 Yr) Index, measures the performance of U.S dollar-dominated, investment grade floating rate notes with maturities less than 5 years.
- The Bloomberg Barclay's Municipal Bond Index, which measures investment grade, tax-exempt bonds with a maturity of at least one year.
- The S&P/ LSTA Leveraged Loan Index is designed to reflect the performance of the largest facilities in the leveraged loan market.

Key Rates

Key Rates are shown for US Treasurys and London Interbank Offered Rate (LIBOR), the interest rate at which banks offer to lend funds (wholesale money) to one another in the international interbank market. LIBOR is a key benchmark rate that reflects how much it costs banks to borrow from each other. "Current" refers to the percentage rate as of 6/30/2018, while the rates of change are stated in basis points.

Credit Spreads

Credit Spreads shown comprise the Option-Adjusted Spread of the indices indicated, versus the US 10-Year Treasury Yield. "Current" refers to the spread as of 6/30/2018, while the rates of change are stated in basis points.

Key Indicators

Key Indicators correspond to various macro-economic and rate-related data points that we consider impactful to fixed income markets.

- 2s10s (bps)/ 10 Yr vs 2 Yr Treasury Spread, which measures the difference between yields on 10-Year Treasury Constant Maturity Securities and 2-Year Treasury Constant Maturity Securities.
- West Texas Intermediate, which is an oil benchmark and the underlying asset in the New York Mercantile Exchange's oil futures contract.
- Core Consumer Price Index, which measures the consumer price index excluding food and energy prices. Shown as of the prior month-end.
- Breakeven Inflation: 5 Yr %/ bps, which uses 5-Year Treasury Constant Maturity Securities and 5-Year Treasury Inflation–Indexed Constant Maturity Securities to derive expected inflation.
- Breakeven Inflation: 10 Yr %/ bps, which uses 10-Year Treasury Constant Maturity Securities and 10-Year Treasury Inflation–Indexed Constant Maturity Securities to derive expected inflation.

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Notes & disclosures

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The Credit Select Risk-Managed Strategy has an inception date of March 31, 2006 and consists of fee-paying, fully discretionary accounts under active management at WST that adhere to the Credit Select Risk-Managed strategy. The strategy has the flexibility to invest in any combination of high yield bonds, intermediate U.S. Government securities, and short-term treasuries, or 100% in short-term treasuries. This strategy is generally implemented through the trading of mutual funds or exchange-traded funds. Prior to January 1, 2011 accounts that used exchange traded funds were excluded from the strategy group of accounts, only accounts that traded open end mutual funds were included. Beginning January 1, 2011, the strategy group of accounts includes accounts using open end mutual funds and exchange traded funds. Eligible accounts are included in the strategy group of accounts in the month following the month of account inception. Closed accounts are included through the completion of the last full month. Prior to December 31, 2016, the Credit Select Risk-Managed strategy was known as WST Asset Manager – U.S. Bond. Prior to December, 2009, the Credit Select Risk-Managed Strategy was referred to by WST as the DAA High Yield Strategy, from December 2009 to December, 2012, it was referred to by WST as the WST Dynamic Total Return Strategy, and from December 2012 to May, 2013, as the Dynamic Portfolio Manager – Total Return Bond Strategy. Results portrayed reflect the reinvestment of dividends, capital gains and other earnings when appropriate. During the period(s) shown, there were no material market or economic conditions which affected the results portrayed. With the exception of several market corrections during the period(s), the overall market as measured by the S&P 500 was generally rising. If such trends are broken, the clients may experience real capital losses in their managed accounts. The performance results portrayed during the period: 3/31/2006 (strategy inception)-12/31/2010 relate only to a limited group of the adviser's clients selected based on suitability and risk tolerance. This factor would not have a material effect on performance but could lead to the termination of the strategy group of accounts in the event of significant outflows.

Comparison with market index – The Barclay's U.S. Corporate High Yield Index covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market. The index return assumes reinvestment of interest. You cannot invest directly in an index.

Comparison with market index – The Barclay's U.S. Aggregate Index is a broad based unmanaged bond index that is generally considered to be representative of the performance of the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index return assumes reinvestment of interest. Comparative performance may also be expressed by reference to a ranking prepared by a mutual fund monitoring service or by one or more newspapers, newsletters, or financial periodicals. You cannot invest directly in an index.

Market indices are unmanaged and do not reflect the deduction of fees or expenses. You cannot invest directly in an index such as these and the performance of an index does not represent the performance of any specific investment strategy. We consider an index to be a portfolio of securities whose composition and proportions are derived from a rules based model. Market indices are unmanaged and do not reflect the deduction of fees or expenses. You cannot invest directly in an index such as these and the performance of an index does not represent the performance of any specific investment strategy. We consider an index to be a portfolio of securities whose composition and proportions are derived from a rules based model.

Investment advisory fees are described in Wilbanks Smith & Thomas Asset Management, LLC's Form ADV 2A. To illustrate the possible effect of fees on the total return of an account, what follows is an illustration: A client investing in the comparative index S&P 500 over the last 10 years (as of December 31, 2015) would have earned 7.31% return on an annualized basis. With the effect of fees at 2.00% per year, this client can then expect their net return to be 5.16% per year compounded over the same time period.