

# Our highest-conviction views for 2016 revisited

We review our top ideas for this year so far and make some important changes.

We presented our highest-conviction views in *Outlook 2016* to highlight the asset classes and assets where we saw solid return opportunities with various implementation possibilities. Several months later, we revisit and review these ideas. Despite many unexpected twists and turns in the market this year, many of our views remain intact. But we also now make some important changes, most notably to two of our oil-price related ideas.

## View in late 2015

## Update as of 1 June 2016

Long Eurozone equities, manage Euro exposure	Remain overweight, but reduce scale
Long selective US equities, such as high-growth transformative sectors	Remain overweight, but reduce scale
Long Japanese equities, manage yen exposure	Reduce overweight substantially
Position for flatter US and UK yield curves	Maintain, but expect delay from Fed uncertainty
Long-term municipal bonds attractive for US taxpayers	Reiterate our view
Manage exposure to oil-price victims in credit markets	Reverse position after oil-price drop
Short Euro/US dollar	Maintain, but expect delay
Long volatility in crude oil	Reverse position after oil-price drop
Buy distressed assets low-cost oil producers via private equity	Reiterate our view
Long income-producing real estate, especially in key global cities	Reiterate our view

**Manage exposure to oil-price victims;  
Buy distressed assets of low-cost-oil  
producers via private equity**

Our view to avoid the debt of more vulnerable oil-drillers was borne out as high-yield energy bonds fell to a low of 52% of their par value in mid-February. This implied a massive rise in defaults and low recovery-rates for US oil-drillers' debt. Given forward-looking fundamentals, however, we now believe that the drop went too far. Global oil-exploration activity has fallen nearly 60% from its highs, with an accelerated decline over the past year. Today's mothballed production and investment-cuts may boost the oil price in 2017 and beyond. This also reinforces our call to buy distressed energy assets via private equity. While we are not suggesting exposure to every security in the sector, we are reversing our stance and are starting to look opportunistically at particular credits and would consider increasing exposure to high quality energy-producer equities.

**Long crude oil volatility**

Crude-oil volatility spiked early this year, as we were expecting. But when it did so, we did not believe that the fundamental outlook pointed to another halving of the oil price from its lows of around \$28, as some options

transactions were implying. Instead, we thought the sharp volatility spike created a potential income-generating opportunity. We continue to see this as the case. We therefore recommend potentially generating yield through a short crude volatility position.

**Position for flatter US and UK  
yield curves**

Our view that yield curves in the US and UK would flatten this year has also proved correct. However, short-term rates have risen slightly less than we would have expected, as both the Federal Reserve and Bank of England have scaled back tightening plans. The flattening has occurred by way of US and UK 10-year yields falling 45 and 65 basis points respectively relative to their corresponding 1-year yields. While yield curves may not flatten dramatically over the remainder of 2016, we reiterate our original view for the longer term.

**Short Euro/US dollar**

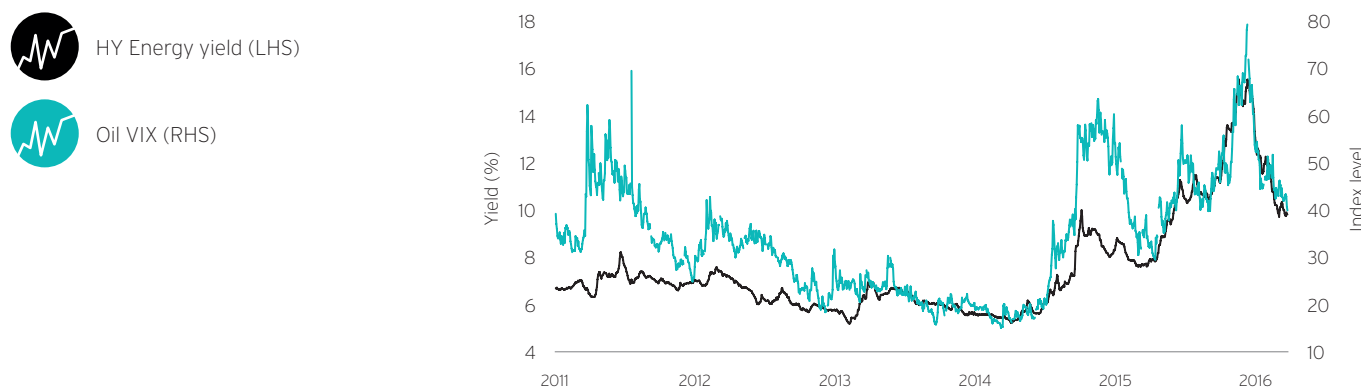
As we expected, the European Central Bank implemented a multi-year Quantitative Easing program in early 2016. Base money creation is running at a pace of nearly 9% of GDP a year, and is set to propel the ECB's balance sheet towards the size of the Fed's next year. However, owing to the steps

taken to limit to currency impact and the unwinding of short positions, the Euro has strengthened since we published our view. But we still see the single currency as ultimately likely to head lower against the US dollar. Admittedly, there are risks to this view, especially should the Fed reverse its tightening plans earlier than we expect. So, we reiterate our original view, although it may take longer to come about than we previously thought.

**Reducing equity exposure:  
Eurozone, Japan, and US**

Going into 2016, we thought that differences in the monetary policies of leading central banks were likely to influence financial markets significantly. Specifically, we saw Eurozone and Japanese equities as potential beneficiaries of this. We therefore recommended long positions in these markets, coupled with management of exposure to the Euro and Japanese yen, which we expected to weaken. While the central banks have taken measures to limit the impact of their divergent monetary policies on exchange rates and both the Euro and Japanese yen have strengthened in 2016. However, their efforts to boost domestic economic growth are even more important than exchange-rate effects.

Figure 1. High Yield Energy Bond Price Index and crude oil 3-month implied volatility



Source: Yield book, Bloomberg Jan-2011-April 2016. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only. Past performance is no guarantee of future returns. Real results may vary.

We still see a positive case for Eurozone equities. They trade at a large valuation discount to US peers based on cyclically-adjusted earnings. Also, the Eurozone is at an earlier stage of its economic revival and corporate earnings have more room to recover. But we would stress that Eurozone equities' potentially stronger returns are only proportional to their greater risks. We now recommend slightly reducing exposure to currency-managed Eurozone equities while maintaining an overweight.

We noted at the start of the year the extremely strong tendency of Japanese equities to move in the opposite direction to the Japanese yen. Rather than weakening, as we had expected, the yen has strengthened sharply amidst heavy short-covering. In line with the established pattern, equities have sold off substantially - **figure 2**. While the Bank of Japan is set to pursue further substantial monetary easing, which could well benefit local equities, we have already twice lowered our overweight position in 2016. We advocate substantially reducing exposure to currency-managed Japanese equities while still expecting the return environment to turn positive once more.

## The persistence of very low and even negative interest rates across much of the world reinforces our case for holding selective income-producing properties.

We also recommended being long of selective US equities, such as high-growth transformative sectors. Our suggestion was to combine long-term secular growth equities - such as healthcare and staples, especially those with exposure to emerging markets - and high-quality dividend payers. We continue to stress the likelihood of falling correlations between individual stocks, which calls for greater selectivity - see *Selectivity is key*. In line with our moves in overall equity weightings in 2016, we advocate slightly reducing exposure here too.

### Long-income producing real estate, especially in key global cities

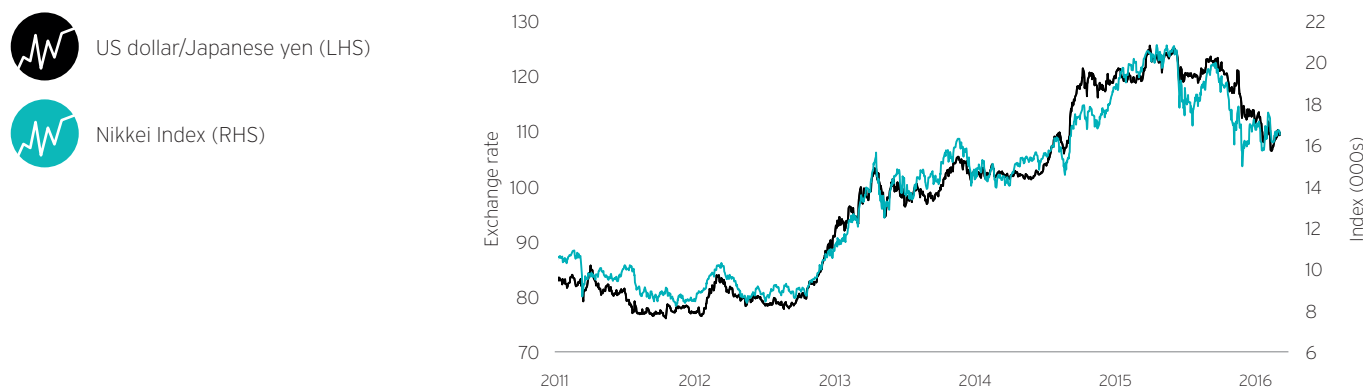
The persistence of very low and even negative interest rates across much of the world reinforces our case for holding selective income-producing properties. Some such properties

can offer an attractive spread over financing costs, particularly those located in gateway cities, while new supply has lagged behind the economic recovery in some locations. We reiterate our original recommendation.

### Long-term municipal bonds attractive for US taxpayers

Given the late stage of the business cycle, we previously pointed out the potential for risk-adjusted returns on longer-term municipal bonds to outperform US equities. In 2016 to date, the former have produced a tax-equivalent return for US income-taxpayers of 5.2%, compared to 1.5% for the latter. We continue to see long-term munis as attractive for US taxpayers owing to their yields and higher-quality credit ratings and therefore reiterate our original recommendation.

Figure 2. Stronger yen, weaker stocks



Source: Bloomberg, as of 5 May 2016. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only. Past performance is no guarantee of future returns. Real results may vary.

## Asset class definitions

Global Developed Market Equity is composed of MSCI indices capturing large-, mid- and small-cap representation across 23 individual developed-market countries, as weighted by the market capitalization of these countries. The composite covers approximately 95% of the free float-adjusted market capitalization in each country.

Global Emerging Market Equity is composed of MSCI indices capturing large and mid-cap representation across 20 individual emerging-market countries. The composite covers approximately 85% of the free float-adjusted market capitalization in each country. For the purposes of supplemental long-term historical data, local-market country indices are used, wherever applicable.

Global Equity is represented by the MSCI ACWI Index, capturing all sources of equity returns in 23 developed and 23 emerging markets.

Global Developed Investment Grade Fixed Income is composed of Barclays indices capturing investment-grade debt from twenty different local currency markets. The composite includes fixed-rate treasury, government-related, and investment grade rated corporate and securitized bonds from the developed-market issuers. Local market indices for US, UK and Japan are used for supplemental historical data.

Global Fixed Income is represented by the Barclays Multiverse Index, with returns hedged into US dollars.

Global High Yield Fixed Income is composed of Barclays indices measuring the non-investment grade, fixed-rate corporate bonds denominated in US dollars, British pounds and Euros. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging market debt. Ibbotson High Yield Index, a broad high yield index including bonds across the maturity spectrum, within the BB-B rated credit quality spectrum, included in the below-investment-grade universe, is used for supplemental historical data.

Global Emerging Fixed Income is composed of Barclays indices measuring performance of fixed-rate local currency emerging markets government debt for 19 different markets across Latin America, EMEA and Asia regions. iBoxx ABF China Govt. Bond, the Markit iBoxx ABF Index comprising local currency debt from China, is used for supplemental historical data.

Cash is represented by US 3-month Government Bond TR, measuring the US dollar-denominated active 3-Month, fixed-rate, nominal debt issues by the US Treasury.

Hedge Funds is composed of investment managers employing different investment styles as characterized by different sub categories - HFRI Equity Long/Short: Positions both long and short in primarily equity and equity derivative securities; HFRI Credit: Positions in corporate fixed income securities; HFRI Event Driven: Positions in companies currently or prospectively involved in wide variety of corporate transactions; HFRI Relative Value: Positions based on a valuation discrepancy between multiple securities; HFRI Multi Strategy: Positions based on realization of a spread between related yield instruments; HFRI Macro: Positions based on movements in underlying economic variables and their impact on different markets; Barclays Trader CTA Index: The composite performance of established programs (Commodity Trading Advisors) with more than four years of performance history.

Private Equity characteristics are driven by those for Developed Market Small Cap Equities, adjusted for illiquidity, sector concentration, and greater leverage.

Real Estate contains all Equity REITs (US REITs and publicly-traded real estate companies) not designated as Timber REITs or Infrastructure REITs: NAREIT US REIT Index, NAREIT Canada REIT Index, NAREIT UK REIT Index, NAREIT Switzerland REIT Index, NAREIT Euro-zone REIT Index.

Commodities contains the index composites - GSCI Precious Metals Index, GSCI Energy Index, GSCI Industrial Metals Index, and GSCI Agricultural Index - measuring investment performance in different markets, namely precious metals (e.g. gold, silver), energy commodity (e.g. oil, coal), industrial metals (e.g. copper, iron ore), and agricultural commodity (i.e. soy, coffee) respectively. Reuters/Jeffries CRB Spot Price Index, the TR/CC CRB Excess Return Index, an arithmetic average of commodity futures prices with monthly rebalancing, is used for supplemental historical data.

## Index definitions

The Bloomberg-JPMorgan Asia Currency Index (ADXY) is a US dollar tradable index of emerging Asian currencies, which serves as a benchmark for monitoring Asia's currency markets on an aggregate basis. It is a spot index of emerging Asia's most actively traded currency pairs valued against the US dollar.

The Bovespa Index is a market-capitalization weighted index of around 50 stocks that trade on the São Paulo Stock, Mercantile & Futures Exchange.

The CBOE Crude Oil ETF Volatility Index ("Oil VIX", Ticker - OVX) measures the market's expectation of 30-day volatility of crude oil prices by applying the VIX® methodology to United States Oil Fund, LP (Ticker - USO) options spanning a wide range of strike prices.

Commodity Index is the S&P Gold Sachs Commodity Index (S&P GSCI), a composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures that is broadly diversified across the spectrum of commodities.

The CBOE Volatility Index (VIX) is a measure of expectations of near-term volatility based on S&P 500 stock index option prices.

The Citi US High-Yield Market Index is a US Dollar-denominated index which measures the performance of high-yield debt issued by corporations domiciled in the US or Canada. Recognized as a broad measure of the North American high-yield market, the index includes cash-pay, deferred-interest securities, and debt issued under Rule 144A in unregistered form. Sub-indices are available in any combination of industry sector, maturity, and rating.

The CSI 300 is a capitalization-weighted index compiled by the China Securities Index Company Ltd and tracks 300 stocks traded on the Shanghai and Shenzhen stock exchanges.

The Currency Volatility Index (CVIX) seeks to provide a benchmark for currency market participants, representing investors' expectation of future volatility, and is calculated as the arithmetic average of the 3-month level of implied volatility for all the major currency pairs.

The DAX 30 is an index of the 30 most actively traded German blue chip stocks on the Frankfurt Stock Exchange. The value of the index is based on a free-float weighted system and average daily volume.

The Deutsche Bank Currency Volatility index (CVIX) is a measure of investors' expectations of future volatility, and is calculated as the arithmetic average of the 3-month level of implied volatility for all the major currency pairs.

The Dow Jones Industrial Average – commonly known as the Dow – is a price-weighted stock market index that tracks the performance of 30 large US companies chosen by a committee.

Emerging market currencies are represented by the OITP (Other important trading partners) index is a weighted average of the foreign exchange values of the U.S. dollar against a subset of currencies in the broad index that do not circulate widely outside the country of issue. The weights are derived by rescaling the currencies' respective weights in the broad index so that they sum to 1 in each sub-index.

European equities are represented by the MSCI Europe index, which captures large- and mid-cap representation across 15 Developed Markets (DM) countries in Europe. It covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.

The Euro Stoxx 600 is an index representing the performance of 600 large-, mid-, and -small capitalization companies across 18 countries across Europe.

The FTSE 100 is a capitalization-weighted equity index representing the performance of 100 large-capitalization companies listed on the London Stock Exchange.

Gold is represented by the commodity futures price for gold.

The Hang Seng index is a free-float adjusted market capitalization stock market index in Hong Kong, which aims to represent the leading companies in that country.

The High Yield Energy Bond Price index measures the price performance of US bonds with ratings below investment grade comprising energy and natural resources industries.

Japan equities are represented by the MSCI Japan index, which is designed to measure the performance of the large- and mid-cap segments of the Japanese market. It covers approximately 85% of the free float-adjusted market capitalization in Japan.

The MOVE (Merrill Lynch Option Volatility Estimate) Index measures the implied volatility of US Treasury markets based on options pricing.

The MSCI All Country World Index represents 48 developed and emerging equity markets. Index components are weighted by market capitalization.

The MSCI Asia ex-Japan index has large and mid-cap representation across 2 of 3 Developed Markets countries and 8 Emerging Markets countries in Asia. It captures approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI China index has large- and mid-cap representation across China H shares, B shares, Red chips and P chips. With 139 constituents, it covers about 85% of this China equity universe.

The MSCI Emerging Markets Index represents the performance of large- and mid-equities from 23 emerging countries, covering approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI KLD 400 Social Index is a capitalization-weighted index of 400 US securities that provides exposure to companies with outstanding Environmental, Social and Governance (ESG) ratings and excludes companies whose products have negative social or environmental impacts. The parent index is MSCI USA IMI.

The MSCI Emerging Markets (EM) Latin America Index captures large and mid cap representation across 5 Emerging Markets (EM) countries\* in Latin America. With 121 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI USA Investable Market Index (IMI) measures the performance of the large, mid and small cap segments of the US market. With 2,469 constituents, the index covers approximately 99% of the free float-adjusted market capitalization in the US.

The MSCI World Index represents the performance of more than 1,600 large- and mid-cap stocks across 23 developed markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI World ex-USA Index represents the performance of large- and mid-cap representation across 22 of 23 developed markets countries excluding the United States. With 1,005 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The Nikkei 225 tracks the performance of 225 leading stocks on the Tokyo Stock Exchange (TSE). The components of this index are reviewed yearly. Since it is a price-weighted index, the movement of the stocks is weighted without regard to their market capitalization.

Oil is represented by the West Texas Intermediate Crude Oil price.

The Oil VIX - ticker OVX - measures the market's expectation of 30-day volatility of crude oil prices by applying the VIX methodology to United States Oil Fund, LP - ticker USO - options, spanning a wide range of strike prices.

The Standard & Poor's 500 Index is a capitalization-weighted index that includes a representative sample of 500 leading companies in leading industries of the US economy. Although the S&P 500 focuses on the large cap segment of the market, with over 80% coverage of US equities, it is also an ideal proxy for the total market.

US Investment Grade Corporate Debt Total Return Index is an index made up of investment-grade debt issued by US companies, measured on a total return basis.

USD vs developed currencies is a broad weighted average index of the foreign exchange values of the US dollar against the currencies of a large group of major U.S. trading partners.

USD vs emerging markets = The OITP (other important trading partners) index is a weighted average of the foreign exchange values of the US dollar against a subset of currencies in the broad index that do not circulate widely outside the country of issue.

Citi Private Bank Hedge Fund categorizations

Diversifier, Return Enhancer and Volatility Dampener are internal descriptors based on a fund's strategy and objective that HFRM has developed and uses to categorize

hedge funds. Such descriptors have not been approved by the relevant portfolio managers. The internal classification noted above is subject to change without notice to investors. Many portfolio managers offer multiple products that could have a different objective or classification from that of the fund identified herein. Diversification does not ensure against loss of principal invested.

Volatility Dampeners are hedge funds that typically are expected by HFRM to have low to moderate correlation and/or beta to traditional markets and seek low volatility and relatively consistent returns. The portfolio managers of such funds often attempt to eliminate a substantial portion of market risk via hedges and trade construction. This classification is based on the analysis and subjective views of HFRM. The internal classification is subject to change without notice to investors and there is no guarantee that the funds will perform as described above. It is important to note that the market strategy described above may not completely eliminate market risk. There is no guarantee that hedge funds classified as "Volatility Dampeners" will perform as described above. Hedge funds should not be invested in based on their classification as "Volatility Dampeners" and other assets in a client's overall portfolio should be taken into consideration before an investment is made.

Diversifiers are hedge funds that typically are expected by HFRM to display low or negative correlation and/or beta to traditional asset classes though they may display significant degrees of market correlation at certain points of the investment cycle. The portfolio managers of such funds are often long volatility and generally may provide attractive diversification benefits to a client's portfolio though returns are often "unpredictable" and can be volatile. This internal classification is based on the analysis and subjective views of HFRM. The internal classification is subject to change without notice to investors and there is no guarantee that the funds will perform as described above. It is important to note that the market strategy described above may not completely eliminate market risk. There is no guarantee that hedge funds classified as "Diversifiers" will perform as described above. Hedge funds should not be invested in based on their classification as "Diversifiers" and other assets in a client's overall portfolio should be taken into consideration before an investment is made.

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#### Other terminology

Adaptive Valuations Strategies is Citi Private Bank's own strategic asset allocation methodology. It determines the suitable long-term mix of assets for each client's investment portfolio.

Alpha is a measure of absolute positive or negative performance, adjusted for risk. It is commonly seen as a way of capturing an investor's skill in generating returns.

Beta is a measure of the relationship between one asset class and another. It compares the average change in the return of one asset class relative to the average historical change in another. The beta of High Yield would be 0.5x to Equities if, on average, High Yield rises by 5% whenever Equities rise by 10%.

Correlation is a statistical measure of how two assets or asset classes move in relation to one another. Correlation is measured on a scale of 100% to -100%. A correlation of 100% implies perfect positive correlation, meaning that two assets or asset classes move in the same direction all of the time. A correlation of -100% implies perfect negative correlation, such that two assets or asset classes move in the opposite direction to each other all the time. A correlation of 0% implies zero correlation, such that there is no relationship between the movements in the two over time.

Extreme Downside Risk (EDR) is a measure used to estimate the risk of an asset allocation. EDR seeks to estimate the typical type of loss, over a 12-month time horizon, that an asset allocation may experience in a period of extreme market stress. It is calculated using a proprietary methodology and database. For a given asset allocation, this approach estimates the loss, over a 12-month time horizon, that the asset allocation may have experienced during historical periods of extreme market stress. EDR is calculated by taking the average loss in the worst 5% of this historical periods of extreme market stress. EDR does not estimate the maximum possible loss. Potential losses for a given asset allocation may exceed the value of the EDR.

Strategic Return Estimates are Citi Private Bank's forecast of returns for specific asset classes over a 10-year time horizon. The forecast for each specific asset class is made using a proprietary methodology that is appropriate for that asset class. Equity asset classes are forecast using a proprietary methodology based on the calculation of valuation levels with the assumption these valuation levels revert to their long-term trends over time. Fixed Income asset classes are forecast using a proprietary methodology based on current yield levels. Other asset classes have other specific forecasting methodologies. Please note that hedge funds, private equity, real estate, structured products and managed futures are generally illiquid investments and are subject to restrictions on transferability and resale. Each SRE is gross of actual client fees and expenses. Components of the methodology used to create the SREs include the rate of return for various asset classes based on indices. Termination and replacement of investments may subject investors to new or different charges. Past performance is not indicative of future results. Future rates of return cannot be predicted with certainty. Investments that pay higher rates of return are often subject to higher risk and greater potential loss in an extreme scenario. The actual rate of return on investments can vary widely over time, especially for long-term investments. This includes the potential loss of principal on your investment. It is not possible to invest directly in an index.

Tactical asset allocation looks to adjust the strategic asset allocation of a client's investment portfolio to incorporate shorter-term market insights.

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Bonds are affected by a number of risks, including fluctuations in interest rates, credit risk and prepayment risk. In general, as prevailing interest rates rise, fixed income securities prices will fall. Bonds face credit risk if a decline in an issuer's credit rating, or creditworthiness, causes a bond's price to decline. High yield bonds are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues. Finally, bonds can be subject to prepayment risk. When interest rates fall, an issuer may choose to borrow money at a lower interest rate, while paying off its previously issued bonds. As a consequence, underlying bonds will lose the interest payments from the investment and will be forced to reinvest in a market where prevailing interest rates are lower than when the initial investment was made.

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Alternative investments referenced in this report are speculative and entail significant risks that can include losses due to leveraging or other speculative investment practices, lack of liquidity, volatility of returns, restrictions on transferring interests in the fund, potential lack of diversification, absence of information regarding valuations and pricing, complex tax structures and delays in tax reporting, less regulation and higher fees than mutual funds and advisor risk. Asset allocation does not assure a profit or protect against a loss in declining financial markets.

## REITS

REITs are subject to special risk considerations similar to those associated with the direct ownership of real estate. Real estate valuations may be subject to factors such as changing general and local economic, financial, competitive, and environmental conditions. REITs may not be suitable for every investor. Dividend income from REITs will generally not be treated as qualified dividend income and therefore will not be eligible for reduced rates of taxation. There may be additional risk associated with international investing, including foreign, economic, political, monetary and/or legal factors, changing currency exchange rates, foreign taxes, and differences in financial and accounting standards.

## Master Limited Partnership

- Energy Related MLPs May Exhibit High Volatility. While not historically very volatile, in certain market environments Energy Related MLPs may exhibit high volatility.
- Changes in Regulatory or Tax Treatment of Energy Related MLPs. If the IRS changes the current tax treatment of the master limited partnerships included in the Basket of Energy Related MLPs thereby subjecting them to higher rates of taxation, or if other regulatory authorities enact regulations which negatively affect the ability of the master limited partnerships to generate income or distribute dividends to holders of common units, the return on the Notes, if any, could be dramatically reduced.
- Concentration Risk. Investment in a basket of Energy Related MLPs may expose the investor to concentration risk due to industry, geographical, political, and regulatory concentration.
  - The price and dividends paid by Energy Related MLPs may be affected by a number of factors, including:
    - Worldwide and domestic supplies of, and demand for, crude oil, natural gas, natural gas liquids, hydrocarbon products and refined products;
    - Changes in tax or other laws affecting MLPs generally;
    - Regulatory changes affecting pipeline fees and other regulatory fees in the energy sector;
    - The effects of political events and government regulation;
    - The impact of direct government intervention, such as embargos;
    - Changes in fiscal, monetary and exchange control programs;
    - Changes in the relative prices of competing energy products;
    - Changes in the output and trade of oil and other energy producers;
    - Changes in environmental and weather conditions;
    - The impact of environment laws and regulations and technological changes affecting the cost of producing and processing, and the demand for, energy products;
    - Decreased supply of hydrocarbon products available to be processed due to fewer discoveries of new hydrocarbon reserves, short- or long-term supply distributions or otherwise;
    - Risks of regulatory actions and/or litigation, including as a result of leaks, explosions or other accidents relating to energy products;
    - Uncertainty or instability resulting from an escalation or additional outbreak of armed hostilities or further acts of terrorism in the United States or elsewhere;
    - General economic and geopolitical conditions in the United States and worldwide.

Mortgage-backed securities ("MBS"), which include collateralized mortgage obligations ("CMOs"), also referred to as real estate mortgage investment conduits ("REMICs"), may not be suitable for all investors. There is the possibility of early return of principal due to mortgage prepayments, which can reduce expected yield and result in reinvestment risk. Conversely, return of principal may be slower than initial prepayment speed assumptions, extending the average life of the security up to its listed maturity date (also referred to as extension risk).

Additionally, the underlying collateral supporting non-Agency MBS may default on principal and interest payments. In certain cases, this could cause the income stream of the security to decline and result in loss of principal. Further, an insufficient level of credit support may result in a downgrade of a mortgage bond's credit rating and lead to a higher probability of principal loss and increased price volatility. Investments in subordinated MBS involve greater credit risk of default than the senior classes of the same issue. Default risk may be pronounced in cases where the MBS security is secured by, or evidencing an interest in, a relatively small or less diverse pool of underlying mortgage loans.

MBS are also sensitive to interest rate changes which can negatively impact the market value of the security. During times of heightened volatility, MBS can experience greater levels of illiquidity and larger price movements. Price volatility may also occur from other factors including, but not limited to, prepayments, future prepayment expectations, credit concerns, underlying collateral performance and technical changes in the market.

Please read offering documents and/or prospectus information carefully for the risks associated with the particular MBS security you are purchasing.

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