Chilton Investment Services
Weekly Update
July 5th, 2017

Visit our website!

www.chiltoninvestmentservices.com

Please feel free to reach out to us. We look forward to your phone call.

Timothy W.A. Horan
CIO-Fixed Income
646-443-7748
thoran@chiltontrust.com

Gregg Manjerovic, CFA
Taxable Portfolio Manager
646-443-7768
gmanjerovic@chiltontrust.com

Laura Ridolfi
Associate Portfolio Manager
646-443-7792
lridolfi@chiltontrust.com

Stephen Stowe, CFA
Head of Credit Research
646-443-7866
sstowe@chiltontrust.com

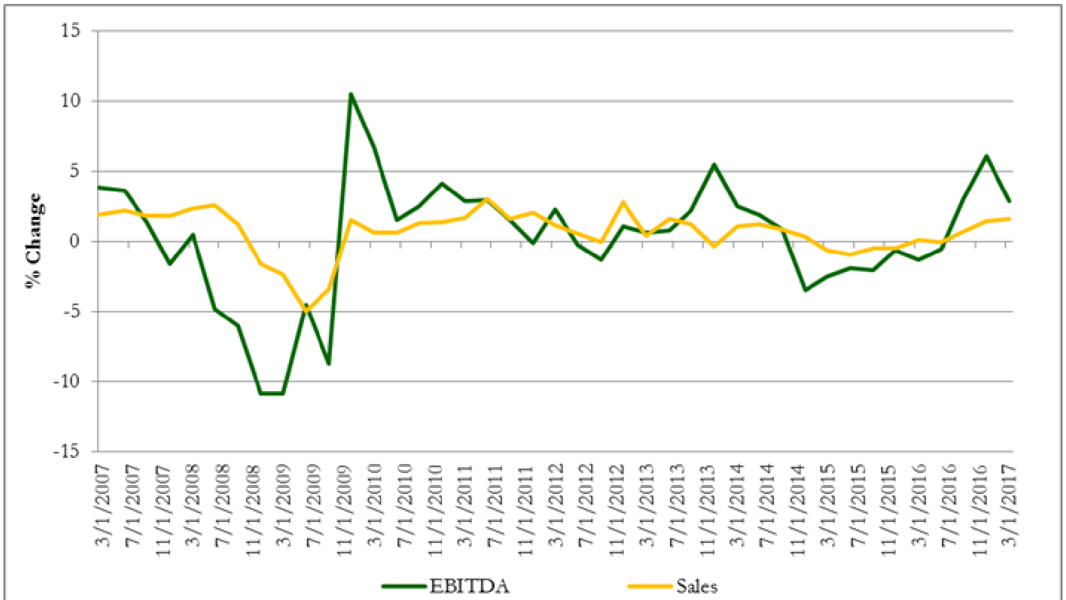
Francesca Genovesi
Credit Research Analyst
646-443-7776
fgenovesi@chiltontrust.com

Eamon Marley
Credit Research Analyst
646-443-7745
emarley@chiltontrust.com

Improving Corporate Credit Conditions Fully Reflected In Valuations

In a continuation of the trend we noted at the beginning of the year, corporate credit conditions continue to improve. Energy sector concerns have abated and revenue and profit growth has continued a modest multi-quarter recovery (Chart 1).

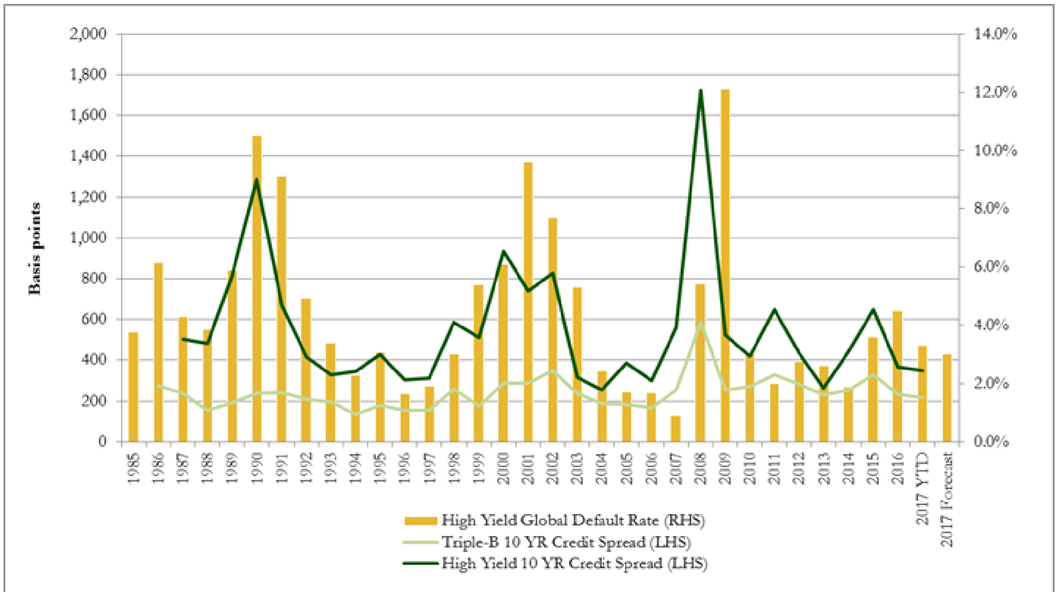
Chart 1: Sales & EBITDA* Growth for S&P 500 Companies Continues Positive Trend



Source: S&P 500 Index (SPX) * Earnings before Interest Taxes Depriciation and Amoritization

Moody's Investors Service reports that the US default rate is expected to decline to ~3.3% by the end of 2017[i] (from 4.5% in 2016) as the energy default wave recedes (Chart 2). A major shift from our January outlook has been a reduced expectation of stimulus from fiscal or tax policy, though we do expect the business climate to benefit from reduced regulatory burdens. Leverage remains at multi-decade highs following heavy issuance in recent years and credit quality in the corporate market has declined accordingly and 46% of the investment grade market is now comprised of BBB-rated debt versus 39% in 2012. In the first quarter of 2017, corporate financial policies show some improvement as share buybacks fell 17.5%[ii] and balance sheet cash levels have improved from a recent trough in the 1st quarter of 2015. Capital expenditure growth has been modestly positive for several quarters, in no small part due to the stabilization of the energy and mining sectors. Capital market conditions are positive with strong global demand for US credit based on the relative yield advantage and fundamental prospects.

Chart 2: Energy Default Cycle Has Passed



Sources: Bloomberg LP, Barclays Bank PLC, Moody's Investors Service

Industry Outlooks

Our long term portfolio industry allocations are based on fundamental outlooks over a multi-year time frame while recognizing the current phase in the credit cycle for each industry. We continue to allocate portfolio credit exposures with consideration of the following underlying trends:

- Geographic focus remains on the U.S. economy with some exposure to global markets via certain industries
- Demographic shift as Baby Boomer generation retires
- Long term shift of the U.S. economy towards increasingly service-based composition and away from goods-based

Our industry outlooks have converged towards an increasingly neutral posture (Table 1), reflecting the benign economic environment.

Table 1: Industry Outlooks Reflect Benign, Balanced Environment

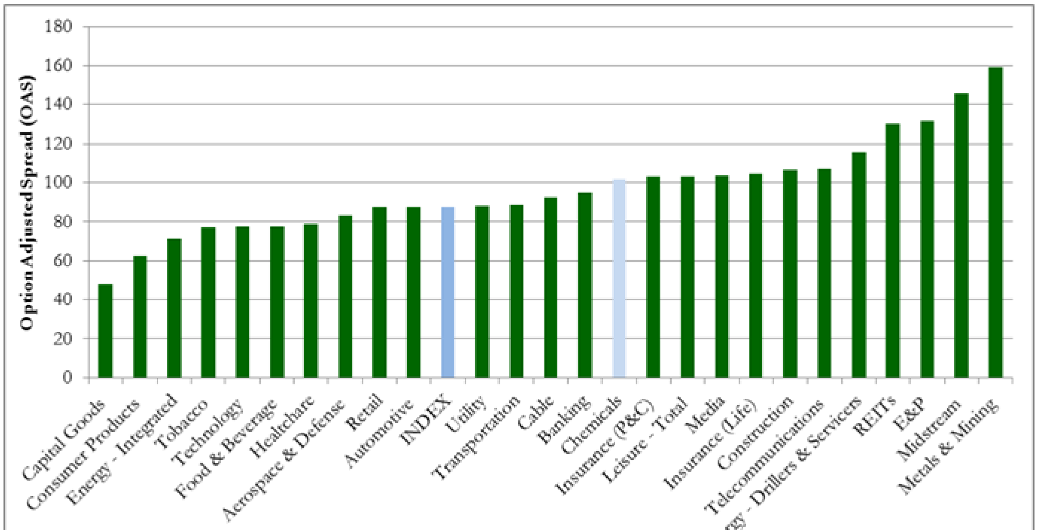
Positive	Neutral	Negative
Banking Cable Construction Healthcare Leisure Midstream (Energy) Telecommunication	Aerospace & Defense Automotive Capital Goods Chemicals Consumer Durables Exploration & Production (Energy) Food & Beverage Insurance (Life) Insurance (P&C) Media Metals & mining REIT Technology Tobacco Transportation Utilities	Drillers & Servicers (Energy) Integrated (Energy) Retail

Source: Chilton Investment Services

A few of our notable industry outlook updates since January 2017:

- We changed our outlook on Chemicals to Neutral from Negative as many of the large M&A transactions announced over the last couple years complete or inch closer towards completion. As the M&A activity has involved more than half the chemicals component of the BAML 1-10 year Corporate and Yankee bond index, we anticipate deal completion to lead to a phase of integration, cost cutting, synergy realization, and deleveraging within the sector, although the potential for additional deal making remains. In certain sub-industries, such as Specialty Chemicals (including coatings & paint), and Polymers (PVC & plastics) the fundamental backdrop is favorable as the U.S. housing recovery supports spending on home improvement. Separately, fertilizers appear to be near a trough. In Petrochemicals, the expected timing of capacity expansion among certain chains should lend near term support to prices, though longer term additional capacity should lead to some softness. Chlorine derivatives stand to benefit from capacity rationalization and environmental enforcement. Note that chemical sector spreads remain above-average versus the index, potentially offering opportunity (Chart 3).

Chart 3: Improved Outlook for Chemical Industry Offers Modest Opportunity

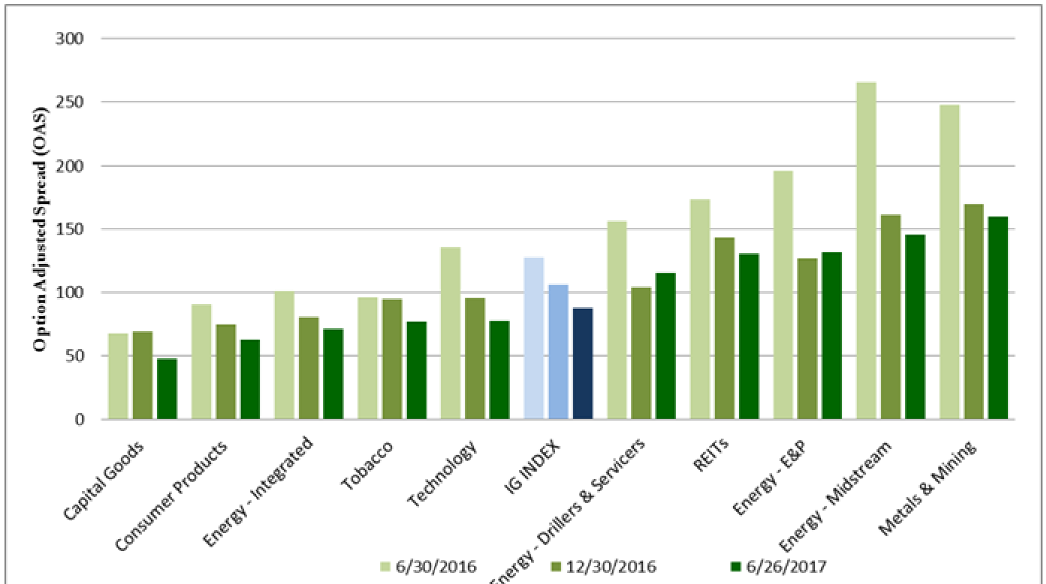


Source: Bank of America Merrill Lynch 1-10 Year US Corporate & Yankees Index

- Neutral from Negative on Capital Goods. Equipment manufacturers have benefited from continued strength in the US housing market and global aerospace. In addition, the outlook for defense spending is improving. Finally, a number of cyclical sectors (energy / metals & mining / agriculture) are bottoming. The JP Morgan Global Manufacturing PMI has steadily increased over the past year, rising to 52.6 as of May 17 versus 50.1 in May 2016. One potentially weak end-market is the auto sector which appears to be peaking after a period of strong multi-year growth. We believe trade restrictions are a diminished risk for the sector given the slow pace of major legislative activity in Washington.
- Neutral from Positive on REIT's. Vacancy rates and leverage ratios are at cycle lows however several REIT subsectors have begun to show signs of peaking. Most notably, the retail segment has faced increase cyclical and secular headwinds. As result, same store net operating income has continued its slide from 2016 and occupancy rates have fallen modestly. Offsetting the decline in retail has been improvement in the industrial REIT subsector. Supply chain expansion and upgrades due to e-commerce have driven strong demand for high-tech warehouses, driving rent growth in prime properties and reconfiguration of existing second tier sites. Finally, in the apartment and office segments, rent growth is likely to decelerate in the latter half of 2017, due to significant new supply entering the market. Apartment affordability has become a concern in higher end markets such as San Francisco and New York, while office supply has drastically increased in cities such as San Jose, Austin, Raleigh, Dallas and Charlotte. In the healthcare space, the continuing shift to outpatient care has helped drive rent growth although this trend has been partially offset by challenges that continue to plague the skilled nursing sector.
- Life Insurance to Neutral from Positive. Despite maintaining strong balance sheets and reserve levels, the prospect of higher interest rates has not come to fruition. As a result, life insurers have continued investing in riskier asset classes such as private placements, mortgage loans and mezzanine debt. Additionally, the prospect of reduced regulation by the Trump administration, specifically as it relates to the fiduciary rule, has not materialized, which has hurt annuity sales. Finally, while removal of the SIFI designation for certain insurers has gained some traction in Congress, significant work still needs to be done in order for the legislation to become law.

While credit quality is not pristine (as outlined above), fixed income investors continue to favor US corporate credit, leading to spread compression across sectors over the past year (Chart 4). In this environment, name and security selection are increasingly important.

Chart 4: Spread Compression Reduces Differential between Richest and Cheapest Sectors*



* Showing change in Option Adjusted Spread (OAS) over past year for top 5 richest and cheapest sectors
Source: Bank of America Merrill Lynch 1-10 Year US Corporate and Yankees Index

---

[i] "Global speculative-grade default rate continues downward trend in May", Moody's Investors Service, 9 June 2017

[ii] "S&P 500 Buybacks Fall 17.5% Year-over-Year to $133.1 Billion for Q1 2017",S&P Dow Jones Indicies, 21 June 2017