Performance Review
For the third quarter of 2017, the portfolio outperformed the Bloomberg Barclays 1-5 Year Government/Credit index by 11 basis points (bps). Year-to-date, the portfolio has outperformed the same index by 18 bps.

Interest rate positioning had little impact on performance for the third quarter. The portfolio's generally long duration position was a detractor as interest rates rose. This was offset by a positive contribution for the yield curve positioning that continued to favor 5-year and 10-year rates over 2-year rates.

The portfolio continues to maintain an overweight to investment-grade corporate bonds as fundamentals remain supportive. Our focus has been on industries that continue to repair and strengthen balance sheets such as energy, and metals and mining sectors. We continue to maintain our overweight to financials as the current regulatory landscape should continue to keep bank balance sheets in good shape. Investment in this sector was also additive to performance for the period.

We continue to believe that opportunities exist in the select emerging market (EM) countries and corporate bonds where fundamentals appear sound and spreads remain attractive relative to comparable developed market countries. Based on our conviction, we added approximately 4.0% in dollar-denominated EM corporate bonds to the portfolio.

Investment Outlook
The US economic recovery continues. US unemployment is back to pre-crisis levels at 4.2%, the global economy is finally perking up and the Federal Reserve (Fed) is holding steady on its gradual path to normalization. Core inflation in the US, however, is still refusing to bounce; one might even make the case that inflation is still declining. Our theme has been and continues to be that the inflation bottoming process, in the US and globally, is going to be both long and slow, yet even we have been struck by the truly molasses-like nature of core inflation this year.

The global economy is healing against a muted inflation backdrop that is unlikely to change anytime soon. Central bank policy should remain benign. US spread sectors have performed exceptionally well over the course of the recovery, but their gains should be more limited going forward. We believe the more substantial opportunity lies in EM debt, where both growth and inflation fundamentals are currently favorable.

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