GIA PARTNERS

3rd Quarter 2019

Highlights

- Financial markets remained captive to trade friction. Weakening data pushed interest rates down, including a record low for the U.S. long bond. Fixed income delivered good absolute returns.
- Global economic data deteriorated even though U.S. numbers outperformed. With trade unsettled and geopolitical worries mounting, it is hard for us to formulate a favorable near-term outlook.
- Volatility in repo markets caused the Fed to intervene for the first time in a decade. Repo rates form the foundation for LIBOR's replacement. Markets will adapt, but changes may alter market dynamics.

Markets

		Returns (%)			
GIA*	Average Quality	3Q19 Gross	3Q19 Net	12 Months Gross	12 Months Net
Core Plus Composite	**(A)**	**2.04**	**1.95**	**9.80**	**9.42**
Global Credit Plus Composite	**(BBB+)**	**2.22**	**2.10**	**10.19**	**9.65**
Emerging Market Debt Composite	**(BB+)**	**1.52**	**1.37**	**11.69**	**11.02**
High Yield Composite	**(B+)**	**0.47**	**0.33**	**6.53**	**5.95**
Benchmark Bonds					
Bloomberg Barclay's U.S. Agg. Index	(AA+)	2.27		10.30	
Treasury	(AAA)	2.40		10.48	
Credit	(A)	2.98		12.63	
Mortgage	(AAA)	1.37		7.80	
Government/Credit	(AA)	2.64		11.32	
ICE BofAML U.S. Corporate & Yankees	(A-)	2.97		12.51	
ICE BofAML U.S. Corporate	(A-)	3.07		12.87	
ICE BofAML U.S. High Yield	(B+)	1.22		6.30	
ICE BofAML EM Corporate Plus	(BBB)	1.90		10.97	
ICE BofAML Global Gov't ex-US	(AA-)	2.43		8.48	
JPM Emerging Markets EMBI+	(BB+)	-1.68		8.20	
JPM CEMBI Broad	(BBB-)	1.97		11.50	
JPM GBI-EM Global Diversified	(BBB)	-0.79		10.13	
Benchmark Equities					
S&P 500	NA	1.19		2.15	
Nasdaq Composite	NA	-0.09		-0.58	
Russell 2000	NA	-2.76		-10.21	
MSCI EAFE	NA	-1.71		-4.27	
Europe	NA	-2.25		-3.77	
Japan	NA	2.24		-6.76	
MSCI Emerging Markets Equity	NA	-5.11		-4.48	

Markets

The third quarter of 2019 gave investors plenty to ponder and ended with more intractable quandaries than when it started. Economic data in the U.S. deteriorated in 2Q, but began to improve during 3Q. That did not help investor sentiment, as European data faltered and global manufacturing activity plunged. The Fed cut rates twice, on July 31st and September 18th. After the first cut, the Chairman startled markets by suggesting they might pause, and shortly thereafter trade frictions between the U.S. and China flared up. This combination initiated a global retreat from risk that took interest rates in developed countries to levels not previously seen, including record low U.S. long bond rates. At quarter-end over 40% of developed government bond yields were negative. While markets calmed in September, geopolitics took center stage with the lethal bombing of Saudi oil facilities, demonstrations expanding in Hong Kong, Brexit plans faltering and other countries facing turmoil. Considering the tumult, returns in the U.S. were relatively healthy, with the S&P gaining 1.19% and core bonds ahead by 2.27%. Away from the U.S., European equity markets were down -1.99% in USD, emerging market equities were down -5.10% in USD, and commodities lost -2.35%.

Investment grade credit delivered a strong quarter benefiting from stable spreads and longer duration. The sharp decline in treasury yields propelled longer duration assets to excellent returns. The investment grade corporate bond index, the ICE BofAML U.S. Corporate Index (C0A0), was up 3.07%, including a 3.04% surge in August. Year-to-date the corporate index was up 12.94%. By comparison, the U.S. treasury index rose 2.51% during 3Q and 7.95% YTD, which included a -0.9% reversal in September. Corporate option adjusted spreads (OAS) narrowed by 1 b.p. to 120 b.p., while the yield to worst of the index declined from 3.20%% to 2.95%. Issuance for the quarter was $385.5 billion, including nearly $190 billion in September, the largest monthly total in over two years. Companies took advantage of the decline in rates to refinance their obligations.

The high yield market continued to perform well on the back of supportive flows and lower rates. However, the sector saw an increase in defaults as lower natural gas prices hit energy companies. The ICE BofAML U.S High Yield Index (H0A0) returned 1.22%, following a strong first half year, but investor apprehension increased as economic worries mounted pressuring commodity prices and margins. Year-to-date high yield still returned a healthy 11.50%. Spreads to worst narrowed by 4 b.p. from 419 b.p. to 415 b.p., while the yield to worst decreased from 6.04% to 5.82%. High yield retail investors added $2.8 billion during the quarter, which included outflows of $5.0 billion in August and inflows of $4.7 billion in September. The default rate increased to 2.52% in September and 2.78% including distressed exchanges. Even though the default rate improved from August, the quarterly default volume was $15.7 billion, the highest quarterly total since early 2018. Despite investor apprehension, the new issue market showed no signs of weakening with $67.7 billion in issuance only slightly less than the $75.2 billion in 2Q. The quarterly total included $30.0 billion in September. Year-to-date total high yield issuance reached $208.2 billion, 24% ahead of last year's pace. Leveraged debt investors continued to shift from loans to fixed rate instruments as short term rates declined.

Emerging markets bonds benefitted generically from the global decline in interest rates, but suffered from weakening currencies and country specific concerns. A notable casualty was Argentina where an August primary-like vote showed clear preference for the party associated with highly damaging economic policies. As a result, Argentina's sovereign bonds lost -41.66% during the quarter and their corporate securities lost -16.6%. Others, like Brazil, continued to implement more orthodox policies and saw their financial markets perform well. For the quarter, the JPM Emerging Markets Bond Index Plus (EMBI+), a dollar denominated sovereign index, was down -1.68%, whereas the JPM Corporate Emerging Markets Broad Index (CEMBI Broad) returned 1.97%, and the JPM Global Bond Index – Emerging Markets

Global Diversified (GBI-EM Global Diversified), a local markets index lost -0.79%. Year-to-date these indexes returned 8.92%, 11.00%, and 7.86% respectively.

Portfolios

Our *Core Plus Composite* consists of portfolios that can hold securities rated below investment grade, but are managed against a Core fixed income benchmark. The Composite underperformed the Bloomberg Barclays U.S. Aggregate Index, net of fees, by 32 b.p. for the quarter, and was behind by 88 b.p. over the last twelve months. The quarter featured a sharp move lower in interest rates, a confidence crisis in Argentina and ongoing angst related to global trade. The portfolio had exposure to emerging markets, including Argentina, and to energy related companies in both investment grade and high yield. Core fixed income markets were propelled forward by the sharp decline in rates, in which the portfolio's out-of-index exposure did not participate. Separately, modest exposure to Argentina and U.S. energy dragged down both high yield and emerging markets performance. Over the past 12 months, the underperformance was due to the portfolio's exposure to below investment grade securities and modestly below-index-duration, which hurt relative performance as interest rates declined.

Our *Global Credit Plus Composite* consists of portfolios holding investment and non-investment grade credit related securities. The Composite is measured against a benchmark consisting 85% of the ICE BofAML U.S. Corporate and Yankees and 15% of the ICE BofAML U.S. Cash Pay High Yield Index. The Composite underperformed the benchmark, net of fees, by 61 b.p. during the quarter and was behind by 194 b.p. over the last twelve months. The portfolios had allocations that favored investment grade over high yield, but included both emerging markets and shorter duration government agencies. For the quarter, the best performing sector was U.S. investment grade credit due to the sector's long duration. The portfolios' were slightly short-of-index duration, and included emerging market names, which underperformed. Over the past 12 months, the portfolios' underweight to investment grade credit, modestly short of index duration and inclusion of underperforming emerging market names caused the underperformance.

Our *Emerging Market Debt Composite* consists of portfolios investing in dollar denominated emerging market credit securities, primarily from corporate issuers. The Composite is measured against the ICE BofAML U.S. Emerging Markets Corporate Plus Index (EMUB). During the quarter the Composite underperformed the benchmark by 53 b.p., net of fees, but was ahead by 5 b.p. over the last twelve months. The portfolio was overweight below investment grade securities, including in Argentina, and did not benefit from the decline in interest rates. Over the last twelve months, the portfolios benefitted from exposures to outperforming countries like Brazil and India. While Argentina's August collapse eroded some of the gains, Latin America was a regional outperformer.

Our *High Yield Composite* consists of portfolios investing primarily in bonds issued by U.S. borrowers with below investment grade credit ratings. The portfolio is measured against the ICE BofAML U.S. High Yield Index (H0A0). The Composite underperformed the benchmark by 89 b.p. net of fees for the quarter and by 35 b.p. over the last twelve months. The portfolio has an allowance for out-of-index exposure and some of that was invested in emerging markets, including Argentina. The quarterly underperformance was primarily attributable to that exposure. Over the last twelve months, the high yield energy space underperformed as natural gas prices sagged. In fact, this industry had most of the third quarter's nearly $16 billion in defaults. The portfolio's aggregate energy exposure exceeded that of the benchmark, causing the underperformance.

Economy

The third quarter of 2019 began with an abundance of economic pessimism driven by the trade conflict, global deterioration in manufacturing and expectations for central bank support. Despite sentiment, economic data during the quarter exceeded reduced expectations. In fact, the Bloomberg U.S. Economic Surprise Index hit a 2019 high in September as the quarter was ending. Nevertheless, the Fed heeded the market's calls and cut rates twice on July 31 and September 18. Oddly, U.S. equity markets, which were near or at record levels in July, came close to those marks again in September. This occurred while U.S. bond markets saw record low 30-year rates and other countries continued to experience negative bond yields.

Economists participating in the WSJ Economic September Survey did not reduce their forecasts for 4Q GDP meaningfully, however over 75% forecast a U.S. recession by 2021. This concern was not reflected in the numbers submitted by respondents and it appears from some of the data that many of the responses may have been returned prior to the sharp decline in long-term interest rates. While trade and global growth received attention, the likely benefits of robust employment and low rates on housing and larger ticket items saw less commentary.

This quarter's review of industries revealed elevated caution amongst executives and a reduction in capital spending, especially from industrials. Having said this, some industries are traversing highly competitive junctures and must continue to invest and innovate to succeed. Industries like autos with electric and autonomous driving, media with content streaming battles and telecom with 5G are examples. Others like utilities and commodities remain engaged in transitions to renewable sources of energy and environmentally sustainable production. While some investments may trim profitability over the short-term, investors and managements understand the inevitability of those outlays.

Away from the U.S., growth deteriorated and authorities were forced into additional stimulus. Europe, in particular, experienced a painful decline in manufacturing that forced the central bank to restore its quantitative easing program. Interest rates in many European countries turned negative causing over 40% of the global government bond market (including Japan) to trade at negative rates. Separately, China was forced to announce additional stimulus measures to retain its ambitious growth plans.

We concluded the U.S. economy shifted to a slower pace of growth, but is not at imminent risk of recession. One meaningful change this quarter is our expectation, for the first time since 2016, that the probability of a worse than forecast outcome exceeds the probability of a better one. While trade frictions persist, we believe the global economic outlook will continue to be dour.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the economy growing about 1.5% 4Q and 1Q 2020. While the U.S. economy has shifted to a slower pace of growth, we believe some of the economic drags could get lifted. In particular, the trade conflict with China could be resolved, vastly altering sentiment and restoring capital investment. In addition, healthy employment and rising wages combined with lower interest rates and tame inflation incent consumers to purchase homes and other large ticket items. External factors are driving concerns for the global economy, but we believe monetary and fiscal authorities are intent on halting economic deterioration. In Europe,

an intractable burden has been Brexit, which may be reaching a compromise. China is eager to retain its growth rate with monetary stimulus, although the country is still likely to move gradually to a lower pace. PROBABILITY 60%

2. A second scenario has the economy declining to a 1.0% or lower growth rate. Global economic pessimism continued to mount during the third quarter, especially in August when data, trade friction, Brexit and other geopolitical events pulled sentiment down. Central banks offered encouragement, but economists have begun to question the efficacy of their aggressive policies. Even areas of strength may deteriorate if consumers display more caution and tariffs continue to escalate. With companies placing investment plans on hold, unemployment could rise and the U.S. economy's most notable success could reverse. PROBABILITY 25%

3. A third scenario has the economy returning to an above-trend growth rate of 3.0% over the next six months. If the U.S. and China announce a comprehensive trade agreement that restores the free flow of goods and services, the confidence effect could be meaningful for the global economy. In addition, with monetary authorities resorting to supplementary stimulus, recent economic sluggishness may prove temporary. PROBABILITY 15%

Market Outlook

During the third quarter, the Fed reduced rates twice, and recognized the levels of longer term global interest rates discounted highly pessimistic expectations. Prolonged trade friction froze manufacturing activity and postponed many companies' investment programs. Aside from healthy U.S. employment and consumption, it is hard to formulate a favorable near-term outlook for the global economy. We believe the U.S. economy will continue to outperform albeit at a slower pace, which will likely keep interest rates low and the Fed in a vigilant, but accommodative, posture. Given this assessment, longer term interest rates should remain range-bound near quarter-end levels, equity markets should remain buoyed by the dearth of yield and credit markets should outperform by delivering their excess spread. In credit, defaults increased, but thus far, they have been concentrated in companies exposed to oil and natural gas prices with few signs of excess leverage across the broader economy.

Commentary – About Repos, SOFR and LIBOR

On September 17, 2019, U.S. overnight repo rates spiked to 9.0%. Historically, repo has been volatile, and previous price sensitivity was somewhat predictable around known high cash demand dates, in many cases from banks around quarter ends. Also, the magnitude of the jump was unusual and it occurred in mid-September one day before the Fed cut the Fed Funds rate for the second time in 2019. Markets were surprised and the Fed was forced to inject liquidity via the repo market for the first time in over a decade. What happened and why does it matter?

The repo market is like the financial market's lubricant. Banks, broker/dealers, hedge funds, money market funds and other holders/borrowers of cash use the repo market to move liquidity from those who have it to those who need it. Repos are secured loans (mostly with U.S. treasury as collateral) generally conducted overnight, though some agreements extend over longer periods. As a secured rate, it trades at or slightly below the Fed Funds rate, but the market's liquidity conditions may alter that relationship for a few days, as occurred the week of September 16th. For the

Fed, it is essential the repo rate trades at or near the Fed Funds rate so that monetary policy objectives can be transmitted to the economy through adoption by financial markets.

After the financial crisis in 2008, the Fed flooded the market with liquidity. When it commenced quantitative easing (QE), banks acquired massive excess reserves, which provided plentiful liquidity to money markets. Upon starting their balance sheet normalization in 2017, bank reserves began to decline, reaching levels in 2019 that were commensurate with levels in existence prior to the crisis. In effect, the central bank's liquidity subsidization was wound down, and the money market was forced to operate independently. A "perfect storm" of cash needs came together on September 16th that took liquidity out of the market. The coincident settlement of a large U.S. treasury refunding and corporate tax obligations on the 16th, the Fed's policy meeting on the 18th and the proximity of quarter-end combined to create a sudden rush for cash. Prior to 2008, the Fed monitored liquidity daily and intervened as necessary to ensure the smooth functioning of the cash market. By September 18th, away from the policy action, the Fed was forced to return to the repo market to provide liquidity and ensure the market's enforcement of their policy.

Financial markets and money market specialists were startled by the move in repo rates, although more by the magnitude of the move than by its occurrence. Volatility at this juncture raises consternation because global markets are in the midst of a major transition away from a universally used short term rate, LIBOR (the London Interbank Offered Rate). The interest rate currently proposed to replace LIBOR for U.S. dollar instruments is the Fed's Secured Overnight Funding Rate (SOFR), a rate derived from repo markets. SOFR has not been actively used for most financial instruments, yet it is expected to be the benchmark rate to price nearly $300 trillion of financial obligations by 2021. Should events like September 17th's sudden repo spike give investors pause over LIBOR's replacement?

LIBOR is an interest rate that is determined by the Intercontinental Exchange (ICE) under the auspices of the UK Financial Services Authority (FSA). The rate is derived daily based on the average of quotes submitted to ICE by various global banks. Banks are supposed to calculate their rates from actual transactions executed with other banks for loans over various relatively short time periods. Prior to the financial crisis in 2008, the interbank market was liquid and active giving participating institutions numerous observations from which to calculate their lending rates. In 2012, some participating institutions were accused of manipulating LIBOR by colluding with others and misrepresenting their rates. As a result, banking regulators began to question the legitimacy of the rate and its calculation methodology. In addition, changes in regulation and market dynamics led many banks to withdraw from the short-term interbank market and the volume of transactions declined. The FSA decided that absent sufficient market-based observations, LIBOR may not be able to be struck in the future. After consultation, the authority decided to abandon publication of the benchmark rate by 2022.

Global financial regulators began the painstaking process of identifying suitable alternatives for LIBOR (and the equivalent in other currencies). In the U.S., the Federal Reserve Bank of New York established the Alternate Reference Rate Committee (ARRC) to prepare the financial system for the transition. The ARRC recommended SOFR become the alternative rate to LIBOR and began to promote its use among financial intermediaries for instruments like interest rate swaps, loans, floating rate notes and other derivatives.

LIBOR's demise illustrates an unintended consequence of regulation. Changes in capital and liquidity requirements effectively killed the interbank market, yet the rate setting process for LIBOR continued. Not surprisingly, regulators and market participants became concerned that rates applied to trillions of dollars in obligations were increasingly NOT market determined. Now regulators are moving to impose a new market determined rate on the financial system. Having a

market determined benchmark seems appealing, but repo markets are likely to again feature prominently in the Fed's policy arsenal. So, while repo volumes exceed $1 trillion per day, a critical participant (the Fed) enters for rate-setting purposes rather than to sell or buy liquidity for commercial purposes and thus changes the market determined nature of SOFR.

As we move toward replacing LIBOR, numerous tasks remain. Many of these involve methodology and logistics associated with changing LIBOR for SOFR. One significant limitation, for example, is that there is no three-month SOFR. While three-month LIBOR continues to be struck daily, the eventual SOFR equivalent is still under development. Additionally, LIBOR is an interbank rate which includes a credit spread, while repo is deemed a risk-free rate, so markets are still determining the proper spread to apply. We are confident that market participants will resolve the limitations, especially pricing credit spreads and developing term SOFR. In time, all U.S. dollar denominated financial instruments will reference SOFR or SOFR based rates. What may eventually get the market's attention, however, is that they substituted a privately determined rate for a policy managed one. In this respect, the Fed will be able to directly and immediately alter interest payments on trillions in financial transactions by intervening in the repo market.

October 15, 2019

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Management Fees, as well as account minimums and other important information are described in GIA's Form ADV - Part IIA. Since management fees are deducted quarterly, the compounding effect will be to increase the impact of such fees by an amount directly related to the account's performance. For example, an account with a 10% gross annual return and a 1% annualized management fee that is deducted quarterly will have a net annual return of about 8.9%.

Index Definitions

Bloomberg Barclays U.S. Aggregate Index

The Barclays U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Bloomberg Barclays U.S. Treasury Index

This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Bloomberg Barclays U.S .Government/Credit Index

The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Bloomberg Barclays U.S. Credit Index

This index is the U.S. Credit component of the U.S. Government/Credit index. Publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

Bloomberg Barclays U.S. Mortgage Backed Securities Index

This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

ICE BofAML U.S. Corporate & Yankees Index

The ICE BofAML U.S. Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

ICE BofAML U.S. Corporate Index

The ICE BofAML U.S. Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

ICE BofAML U.S. High Yield Index
The ICE BofAML U.S. High Yield Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

ICE BofAML Global Government Excluding the U.S. Index (N0G1)
The ICE BofAML Global Government Excluding the U.S. Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency. N0G1 excludes U.S. government bonds.

JP Morgan Corporate Emerging Markets Bond Index Broad (CEMBI Broad)
The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. Both indices are also available in Diversified versions.

JP Morgan EMBI+ Index
The EMBI+ tracks total returns for U.S-dollar-denominated debt instruments of the emerging markets: Brady bonds, loans, Eurobonds. The EMBI+ currently covers 104 instruments across 15 countries.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)
The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

S&P 500 Index
An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index
An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI EAFE- Europe Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe.

MSCI EAFE- Japan Index
The index is a capitalization weighted index that monitors the performance of stocks from Japan.

MSCI Emerging Markets Equity
The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.