LMCG INVESTMENTS

Fixed Income

Q2 2018 REVIEW

FIXED INCOME COMMENTARY: Q2 2018

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Market Highlights

- The second quarter of 2018 started out very much like the first quarter, with fears of higher inflation and tighter Federal Reserve policy pushing yields to their highest levels since 2011. However, a more bullish tone emerged later in the quarter as signs of weakness in the global economy appeared, trade tensions rose, and inflation data stabilized.
- The yield on the 10-year US treasury climbed to 3.12% in May, but then headed lower to end the quarter at 2.86%, just 12 basis points higher than where it began the quarter. US treasury and municipal bonds generated positive returns during the quarter, with municipal bonds the best performer once again.
- The municipal bond market continued to benefit from the new tax laws that have significantly curtailed the amount of new supply. Meanwhile, demand from many states beyond California and New York has increased as individuals are anticipating higher income taxes caused by the tax reform bill that limits the deductibility of state and property taxes.
- High Grade corporate bonds are on track to be the worst performing US asset class this year, with the Bloomberg Barclays US Corporate Index down 1.0% for the quarter and 3.3% for the year. Except for 1984 and 1994, this is the worst first-half return for corporate bonds since the index began tracking data in 1973.
- As expected, the Federal Reserve raised the fed funds rate range for the second time this year to 1.75%-2.0%. Their dot plot was upgraded and reflects two more rate hikes this year, previously only one more was indicated for 2018. Three hikes are still indicated for 2019 and one to two more indicated for 2020.
- In its forward guidance, the Fed acknowledged a little more strength in the US economy and revised 2018 US GDP to 2.8% from 2.7%, Core PCE inflation to 2.0% from 1.9% and the unemployment rate to 3.6% from 3.8%. Economic projections for 2019 and 2020 were unrevised.
- The European Central Bank also made headlines at their June meeting by announcing that a tapering of their bond buying program will start in the fourth quarter of this year. The ECB will continue to reinvest maturities and maintain the size of their balance sheet for an extended period. This essentially follows the same playbook as the US Fed, which announced tapering in 2013.
- In June, the US Supreme Court ruled in favor of South Dakota in the case of South Dakota v. Wayfair, a decision that enables states to pass laws to subject all online retail transactions to sales tax. The decision will impact certain states more than others, positively impacting those states that collect a sales tax. Some states may see their total tax collections increase by 1-2%, according to the US Government Accountability Office estimate.

LMCG Composite Performance

Our Core and Municipal bond strategies rebounded from the first quarter and posted positive returns during the second quarter. However year-to-date total returns remain slightly negative. Our Core Bond strategy outperformed the benchmark index, despite an overweight allocation to credit, albeit lower than it has been in previous quarters. Our positive outperformance was driven by strong security selection that included allocations to taxable municipals, hybrid preferred credits and some variable rate structured bonds. Our Municipal Bond strategy generated stronger absolute returns than our taxable Core strategy, but slightly trailed the broader municipal benchmark index. Lower quality municipal securities continued to outperform higher quality municipal securities and enhanced returns. In fact, high-yield municipal securities were the best performing sector across the fixed income asset class.

LMCG Core Bond Composite Performance

As of 6/30/2018, US Dollar

				Annualized			
	Q2 2018	YTD 2018	1 Yr	3 Yrs	5 Yrs	10 Yrs	Since Inception*
LMCG Core Bond (Gross)	**0.2**	**-0.8**	**0.6**	**2.6**	**2.9**	**4.3**	**4.6**
LMCG Core Bond (Net)	**0.0**	**-1.2**	**-0.2**	**1.8**	**2.1**	**3.5**	**3.8**
Bloomberg Barclays Capital Interm U.S. Gov't/Credit Index	0.0	-1.0	-0.6	1.2	1.6	3.1	3.6

*Inception: June 2006.

Past performance is not indicative of future results. Gross performance returns presented above are net of transaction costs and include the reinvestment of dividends and other earnings but do not reflect the deduction of investment management fees which would reduce returns. Net returns are calculated by applying the investment management fee schedule noted in the composite disclosure to the gross returns of the accounts included in the composite. For information regarding the impact of investment management fees on performance, please refer to the attached composite disclosure.

LMCG Municipal Bond Composite Performance

As of 6/30/2018, US Dollar

				Annualized			
	Q2 2018	YTD 2018	1 Yr	3 Yrs	5 Yrs	10 Yrs	Since Inception*
LMCG Municipal Bond (Gross)	**0.6**	**-0.2**	**0.4**	**1.7**	**2.2**	**3.1**	**3.3**
LMCG Municipal Bond (Net)	**0.4**	**-0.6**	**-0.4**	**0.9**	**1.4**	**2.4**	**2.6**
Bloomberg Barclays Capital 1-10 Yr. Municipal Bond Index	0.8	0.1	0.6	1.9	2.3	3.5	3.6

*Inception: June 2006.

Past performance is not indicative of future results. Gross performance returns presented above are net of transaction costs and include the reinvestment of dividends and other earnings but do not reflect the deduction of investment management fees which would reduce returns. Net returns are calculated by applying the investment management fee schedule noted in the composite disclosure to the gross returns of the accounts included in the composite. For information regarding the impact of investment management fees on performance, please refer to the attached composite disclosure.

LMCG Outlook & Strategy

Inflation expectations and a tighter Fed policy have been the drivers of higher yields in 2018, but recent signs of slowing global growth, trade issues, a stronger US dollar, and heightening geopolitical concerns have pushed more investors into the safety of US Treasuries, causing yields to move lower. Inflation and Fed tightening remain a concern for the bond market, but we think treasury yields are likely to remain in their current range until the growth, trade and geopolitical risks abate.

Some themes guiding our fixed income strategy heading into the third quarter:

- The technical imbalance in the municipal market is likely to continue throughout the rest of the year, thus supporting bond prices. Supply is running about 25-30% below last year's levels and even if there is a pickup during the second half it is unlikely to meet the growing demand by investors seeking tax relief.
- Lower quality and junk municipal and corporate bonds have performed better than their higher quality counterparts this year despite rising interest rates and a late-cycle economy. Supply differentials appear to be the leading factor; while high-grade supply has slowed compared to last year, low-quality supply has been cut back far more dramatically. We believe this technical dynamic is masking some of the deterioration in credit and therefore we maintain our high-quality bias.
- Not every state will benefit from the US Supreme Court decision to allow online sales taxes. Alaska, Delaware, New Hampshire, and Oregon do not collect a sales tax so they may not benefit. All other states that collect a sales tax will see some benefit, but Alabama, Oklahoma, and Colorado will likely see the greatest proportional benefit, according to research conducted by JP Morgan.
- The market's interpretation of the June Fed meeting was perhaps too hawkish, in our opinion. This was driven by the Dot Plot that now indicates two more rate hikes this year instead of one that was indicated following the May Fed meeting. The reason the median plot changed was because just one Fed member moved up his or her 2018 dot projection. Chairman Powell has continued to emphasize a gradual approach to normalizing rates as has the rest of the committee maintained their views and projections. We don't believe very much has changed with the Fed's policy.
- The yield curve has been flattening since 2014 and has accelerated its pace further during the last several weeks. The bond market is signaling that growth may be weaker than many believe and that the Fed's current tightening path may be too aggressive. We think that the probability that the Fed will have to pause rate hikes is growing. Slowing global growth, further turmoil in Europe or the emerging markets, or an escalation of trade tensions are starting to weigh on the Fed's decisions.
- We believe the attractiveness of municipal bonds relative to corporate bonds will continue. Strong tax collections and demand patterns for municipals are in stark contrast to the weakening balance sheets and elevated credit risk in corporates.

Our fixed income strategy has not changed significantly from the first quarter. We continue to pay close attention to the economic data that is showing moderation, as well as the rhetoric surrounding trade wars. Both of these developments would be a negative for stocks and a positive for higher quality bonds. We are also paying close attention to the renewed vigor of the flattening of the yield curve. Many members of the FOMC have already commented that they do not want to see an inverted yield curve due to the negative ramifications for the economy. Yet, the Fed is already less than two rate hikes away from inverting the curve. At this time, we believe a neutral duration position relative to the benchmark index is warranted (currently about four years). We continue to be biased toward taxable and tax-exempt municipal bonds for their stronger technical and credit characteristics relative to corporates, as well as their relatively stronger performance during previous Fed tightening cycles. And finally, we continue to reduce our corporate bond exposure in favor of more defensive type securities that include US treasuries, certificates of deposit and variable rate hybrid securities.

CORE BOND COMPOSITE

Schedule of Annual Returns

January 1, 2008 through December 31, 2017

	Gross Returns (%)	Net Returns (%)	Benchmark Returns[1] (%)	Dispersion (bps)	Composite 3yr Ex Post Standard Deviation[2] (%)	Benchmark 3yr Ex Post Standard Deviation[2] (%)	Number of Accounts	Composite Assets at End of Period ($ millions)	Total Firm Assets ($ millions)
2017	4.0	3.2	2.1	64	1.9	2.1	23	41.5	7,551.3
2016	4.4	3.6	2.1	91	2.1	2.2	23	46.6	7,367.5
2015	1.2	0.4	1.1	81	2.3	2.1	31	41.2	6,786.9
2014	4.7	3.9	3.1	76	2.3	1.9	30	40.3	6,370.5
2013	-0.5	-1.3	-0.9	44	2.3	2.1	26	36.7	5,831.5
2012	5.9	5.1	3.9	62	2.2	2.2	20	33.4	4,402.6
2011	6.3	5.5	5.8	65	2.6	2.6	18	29.8	4,200.7
2010	7.0	6.3	5.9	121	3.8	4.0	17	28.5	4,412.7
2009	9.3	8.7	5.2	124	3.6	3.8	15	27.1	4,365.1
2008	3.2	2.5	5.1	294	-	-	12	40.7	2,527.4

[1] Benchmark returns have been obtained from an independent source and have not been examined by independent accountants.
[2] The three-year annualized standard deviation is not presented for December 31, 2008 because the composite did not have 36 monthly returns in that time period.

Core Bond Composite Portfolios included in this composite seek to earn consistent, above average returns while taking a low risk approach to fixed income asset management. The fixed income investment philosophy focuses on constructing high quality portfolios with an intermediate-term maturity structure. The portfolio invests in taxable fixed income bonds including but not limited to US Treasuries, Agency bonds and corporate bonds. All securities purchased are investment grade. The composite includes fully discretionary bond portfolios. For comparison purposes, the Barclays Intermediate Government/Credit Index is used. The minimum fixed income value requirement for inclusion in the composite is $750,000. The composite minimum prior to January 1, 2013, was $500,000. The inception date of the composite is June 1, 2006. The composite was created in October 2008.

Royal Bank of Canada ("RBC") became LMCG's indirect majority owner in November 2015 when RBC acquired City National Corporation ("CNC"). Effective January 1, 2015, Lee Munder Capital Group, LLC is known as LMCG Investments, LLC ("LMCG"), an investment adviser registered with the Securities and Exchange Commission. In July 2009, the firm was reorganized as an affiliate of CNC and took the name of Lee Munder Capital Group, LLC., prior to which it was known as Lee Munder Investments Ltd. ("LMIL"), which itself was an investment adviser registered with the Securities and Exchange Commission. The firm maintains a complete list and description of composites, which is available upon request.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. The U.S. Dollar is the currency used to express performance. Performance results are presented gross and net of management fees and include the reinvestment of income. Net returns are calculated by applying the investment management fee schedule noted below to the gross returns of the accounts included in the composite. The annual composite dispersion presented is an asset weighted standard deviation calculated for the accounts in the composite the entire year. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The investment management fee schedule is as follows: Beginning January 1, 2011, 0.80% on the first $1 million and 0.77% on assets above $1 million. The prior fee schedule was 0.65% on the first $1 million and 0.62% on assets above $1 million. Actual investment advisory fees incurred by clients may vary

LMCG claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. LMCG has been independently verified for the periods October 1, 2000 through December 31, 2017. The verification report(s) is/are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation. Past performance is not indicative of future results.

MUNICIPAL BOND COMPOSITE

Schedule of Annual Returns

January 1, 2008 through December 31, 2017

	Gross Returns (%)	Net Returns (%)	Benchmark Returns[1] (%)	Dispersion (bps)	Composite 3yr Ex Post Standard Deviation[2] (%)	Benchmark 3yr Ex Post Standard Deviation[2] (%)	Number of Accounts	Composite Assets at End of Period ($ millions)	Total Firm Assets ($ millions)
2017	3.3	2.5	3.5	43	2.3	2.5	62	118.1	7,551.3
2016	0.1	-0.7	-0.1	37	2.3	2.4	57	115.1	7,367.5
2015	2.3	1.5	2.5	22	2.1	2.1	59	105.1	6,786.9
2014	4.3	3.5	4.7	43	2.1	2.2	57	102.4	6,370.5
2013	-0.3	-1.1	-0.3	72	2.3	2.5	51	91.6	5,831.5
2012	3.1	2.3	3.6	55	2.5	2.5	46	86.0	4,402.6
2011	6.8	6.0	7.6	52	3.3	3.2	42	73.0	4,200.7
2010	3.1	2.7	3.1	60	4.2	4.2	32	46.3	4,412.7
2009	6.2	5.8	7.2	132	3.9	3.9	18	18.5	4,365.1
2008	3.9	3.4	4.2	164	-	-	13	12.7	2,527.4

[1] Benchmark returns have been obtained from an independent source and have not been examined by independent accountants.
[2] The three-year annualized standard deviation is not presented for December 31, 2008 because the composite did not have 36 monthly returns in that time period.

Municipal Bond Composite Portfolios included in this composite seek to earn consistent, above average returns while taking a low risk approach to fixed income asset management. The fixed income investment philosophy focuses on constructing high quality portfolios with an intermediate-term maturity structure. Value is added through issue and sector selection. All securities purchased are investment grade. The composite includes fully discretionary, municipal bond portfolios. The minimum fixed income value requirement for inclusion in the composite is $750,000. Prior to January 1, 2012, the composite minimum was $500,000. For comparison purposes, the composite is measured against the Barclays 1-10yr Municipal Bond Index. The inception date of the composite is June 1, 2006. The composite was created in January 2008.

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The investment management fee schedule is as follows: Beginning January 1, 2011, 0.80% on the first $1 million and 0.77% on assets above $1 million. The prior fee schedule was 0.40% on all assets. Actual investment advisory fees incurred by clients may vary.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Account performance is calculated on a total return basis including income and realized and unrealized gains and losses. Composite performance is presented gross and net of management fees. Net returns are calculated by applying the investment management fee schedule noted above to the gross returns of the accounts included in the composite. The annual composite dispersion presented is an asset weighted standard deviation calculated for the accounts in the composite the entire year. The U.S. Dollar is the currency used to express performance. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

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