2018 SECTOR TEAMS' OUTLOOK

THINK BROADLY. ACT DECISIVELY.

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Sector teams are a critical part of the investment process at Loomis Sayles. Composed of **traders, analysts, strategists, and portfolio managers** who are experts within their specific financial **market sectors**, these teams are designed to "separate the wheat from the chaff." Each sector team provides return scenarios and **relative value recommendations** to the firm.

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This outlook reflects the current opinions of the various sector teams as of 12/31/2017; views and opinions are subject to change at any time without notice.

SCOURING THE GLOBE FOR OPPORTUNITIES

We continuously scour global capital markets seeking attractive opportunities for our client portfolios. Each investment opportunity is examined from a top-down and bottom-up perspective in our quest to determine what should drive their return and what risks we might take along the way.

SECTOR TEAMS

Our sector teams bring together experts from research, trading and portfolio management. Every day they're watching their markets, discussing trends and debating the investment opportunity du jour. Every quarter, our sector teams gather for our global asset allocation team (GAAT) process. Our GAAT process sets the stage for delivering our estimated returns and relative value ideas.

THE GLOBAL ASSET ALLOCATION PROCESS

Prepared for a Slow Transition to Higher Rates

Years of monetary policy accommodation have fostered an economic expansion across developed and emerging countries. Given the potential implications for inflation, tighter monetary policy could be on tap, but we believe most asset classes are prepared for a slow transition to higher interest rates. Bond yields are likely headed higher, but at a modest rate that is unlikely to impact risk asset valuations in the near term. Financial conditions should remain favorable, allowing credit to perform well even if spreads do not tighten further. Corporate earnings have reaccelerated globally and the recent US tax reform passage presents an additional upside catalyst to domestic equities and potentially extending the global credit cycle for a couple more years.

Macro Fundamentals Point to Worldwide Growth

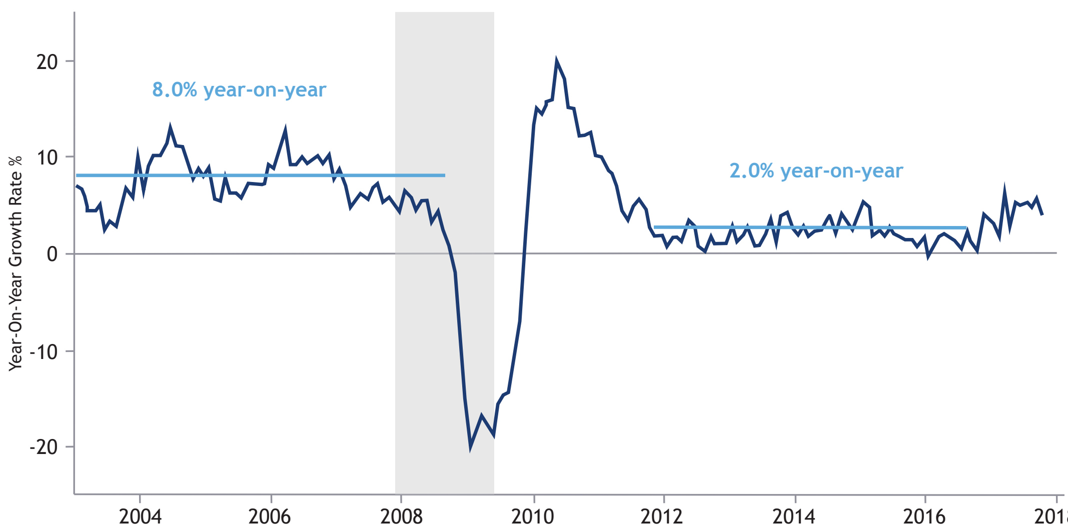
Our base case is for the constructive global growth environment to persist into 2018. Strength in developed and emerging economies has contributed to higher global manufacturing, increased export volumes and a recovery in corporate profits globally. While an easing in economic acceleration cannot be ruled out after such a positive stream of data, our view is that such a slowdown would be temporary and unlikely to derail the broadly positive trends across risk asset markets.

WORLD EXPORT VOLUME % CHANGE

Source: *Thompson Reuters Datastream, CPB, data as of January 5, 2018.*

Shaded areas denote periods of recession.

Year-on-Year Actual Growth
Year-on-Year Average Growth

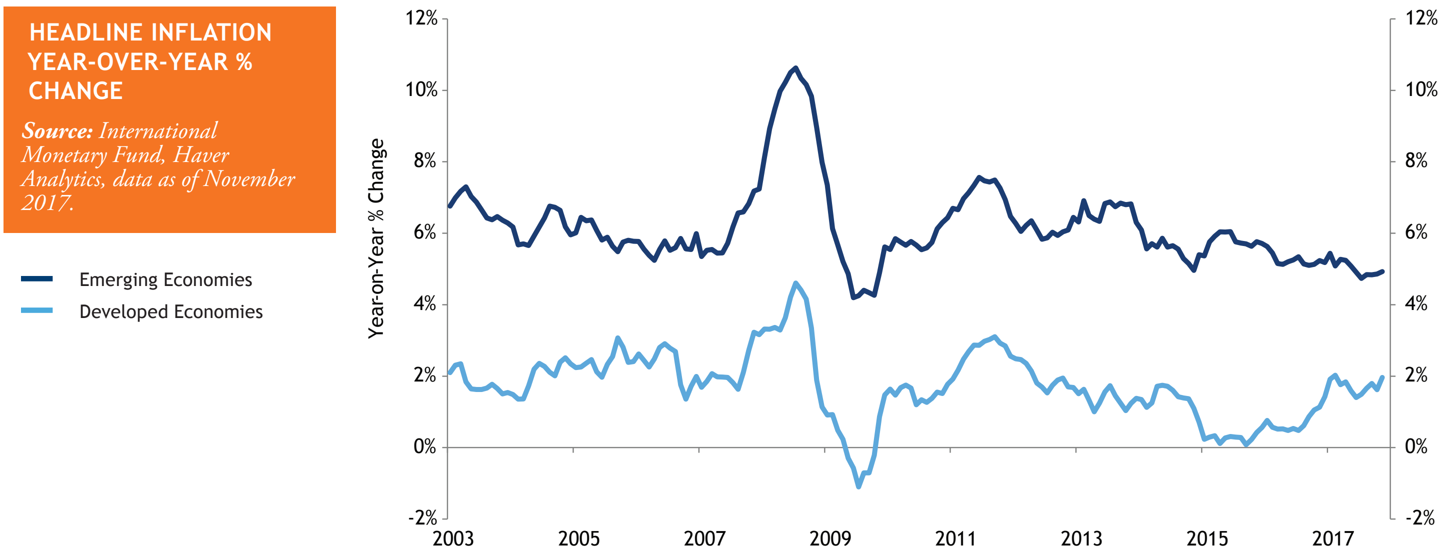


Inflationary Pressure Seems Largely Contained

Signs of inflationary pressure are appearing in developed economies, principally in the US. We expect US inflation to reach, and remain, just above the Federal Reserve's (Fed's) threshold of 2% in the second half of 2019. Given favorable global growth and healthy economic indicators, the central bank is likely to hike at least two or three times in 2018, continuing its established gradual pace. While an additional hike may be justified if the economy accelerates faster than anticipated, we would see such developments as confirmation of a strong economy rather than cause for concern.

HEADLINE INFLATION YEAR-OVER-YEAR % CHANGE

Source: *International Monetary Fund, Haver Analytics, data as of November 2017.*



Euro zone economic activity also picked up markedly in 2017, contributing to headline inflation of more than 1.0% for the first time since 2013—a sign of economic normalization. Consensus expectations are for headline inflation to run near 1.5% from 2017 through 2019. Similarly in Japan, price increases are starting to stick while growth has also picked up. Aggregate emerging market (EM) inflation has been trending lower for well over a decade and is expected to decline marginally in 2018. More specifically, Latin America inflation should be in line with the overall trend lower, but with activity in Asia robust, inflation there is expected to accelerate throughout 2018.

Normalizing Monetary Policy Should Lead to Slightly Higher Bond Yields

In general, we believe developed market (DM) bond yields are set to increase given strong macro fundamentals and monetary policy normalization. However, the extent of the rise will likely be quite modest, making the impact on other risk asset markets limited. At this point, we foresee the long end of the US yield curve remaining fairly stable with the curve flattening very modestly through 2018. We believe European interest rates could adjust slightly higher from extremely low, and in some cases negative, levels. A similar dynamic could play out in Japan where the Bank of Japan could allow government bond yield targets to rise, albeit slightly. Europe, Japan and many emerging markets are in a healthier part of the credit cycle compared to the US and should be willing to let their economies run.

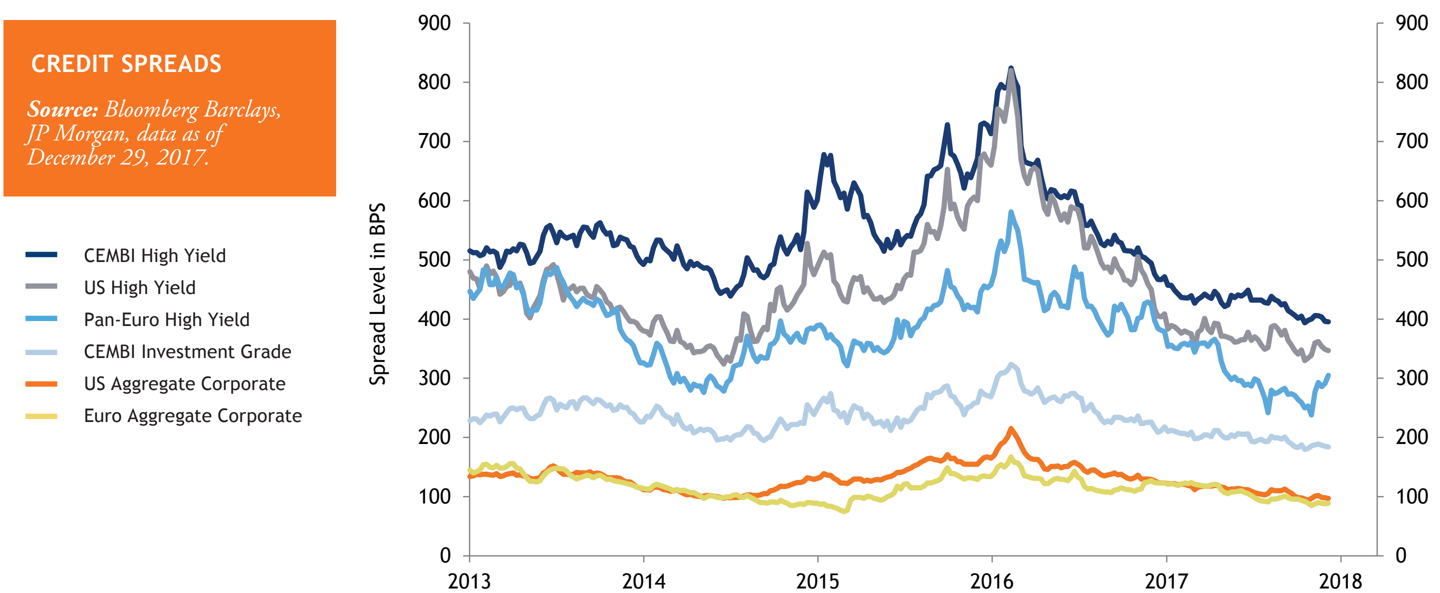
Difficult to Call for Tighter Spreads, but Material Widening Seems Unlikely

With credit spreads in the US and abroad near multi-year lows, we are hesitant to forecast additional tightening. As long as financial conditions remain stable, credit should continue to perform favorably even if spreads do not tighten further. Interest carry relative to that of government bonds continues to make corporates attractive and we see little sign that any particular industry's degree of leverage presents systemic risk. Therefore we find the potential threat of a material spike in defaults to be limited for now.

Profits are critical in driving the cycle so we are very encouraged that the credit cycle can be extended on the back of the global profits rebound. We do believe, however, that the US non-financial corporate sector will lead the next global default wave even if it is a couple years from now. The US is much further ahead in the credit cycle in terms of the borrowing and spending. Leverage has increased in the US compared to some corporate deleveraging we see in Europe, Japan, and several emerging markets. We will be watching the profit cycle diligently to look for warning signs of the next default wave.

CREDIT SPREADS

Source: *Bloomberg Barclays, JP Morgan, data as of December 29, 2017.*

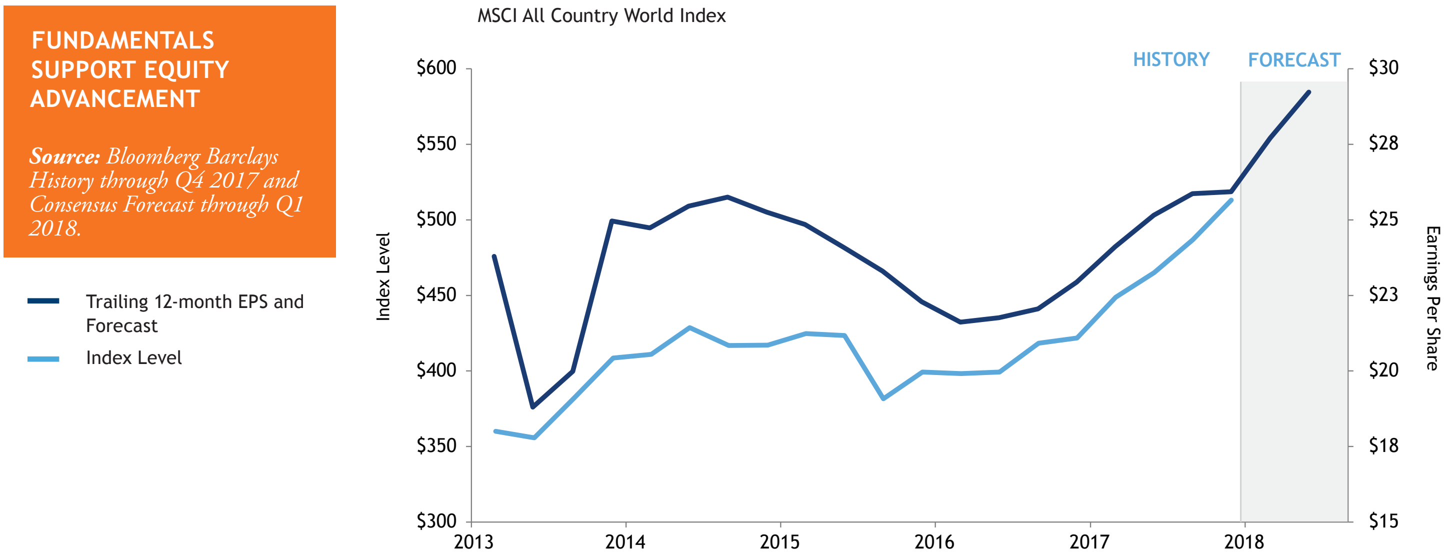


At this Point in the Cycle, Equities May Offer the Highest Return Potential Across Sectors

We are constructive on equities—despite the climb in valuations during recent years. With S&P 500® Index earnings expected to grow nearly 9.0%—even before tax reform considerations—and healthy projected global growth, the building blocks for healthy US equity market performance are in place. The 2017 US tax reform legislation and its prospect for repatriation of corporate liquid assets could further increase earnings estimates, dramatically lowering the forward S&P 500 price-to-earnings multiple. More broadly, EM and Japan trends in upward earnings revisions have been strong and have outpaced those of US companies. Even with the exceptional gains of 2017 considered, EM equities still offer attractive valuations relative to DM equities.

FUNDAMENTALS SUPPORT EQUITY ADVANCEMENT

***Source:** Bloomberg Barclays History through Q4 2017 and Consensus Forecast through Q1 2018.*



Remain Cautiously Optimistic

In terms of risks to financial assets, we believe the implications of tighter lending standards in China and the potential for overly tight Fed policy are worth noting. Geopolitical tensions, including trade negotiations, could also limit risk appetite or lead to periods of weakness. However, global growth and stable inflation are most likely to govern risk asset valuations over the long term, which suggests staying the course.

SECTOR VIEWS

Government and Currencies

Based on favorable macro fundamentals, we foresee global growth continuing into 2018. The Fed will continue to be influenced by economic data and adhere to its measured monetary policy, with at least two or three rate hikes likely in 2018. In our view, bond yields are positioned to rise to a limited degree with minimal impact on risk assets. The US yield curve should remain fairly stable at the long end while flattening very modestly through 2018. In Europe, the market could see extremely low rates shift higher, especially as European Central Bank (ECB) quantitative easing will probably end by the fall of 2018. In terms of the credit cycle, Europe, Japan and many emerging markets are in a healthier position compared to the US, so they're more likely to let their economies run. The dollar was very weak in 2017, driven by a strong rebound in European growth. Additionally, high yields in many emerging economies attracted capital out of the dollar. For 2018, we would expect the dollar to be more range bound but still provide opportunities to invest in local EM bond markets while taking the currency risk.

Mortgage and Structured Finance

We expect that securitized segments will continue to exhibit low volatility in 2018, supported by largely positive fundamentals and low net issuance. With market spreads at, or close to, historic tights, we believe securitized credit products with features such as higher interest carry, shorter spread duration and floating rates present an attractive profile and can outperform despite a flatter interest rate curve. Given the low spread tiering among issuers, credit expertise and security selection will be important drivers of outperformance when the cycle turns. With the Fed's clearly communicated plans to taper agency MBS purchases and the nomination of a Fed chairperson behind us, we believe significant downside risks specific to MBS have been removed. We expect spreads to show limited volatility and agency MBS to outperform Treasurys over a 12-month horizon if rates oscillate within a 70-basis-point range.

Most asset-backed securities (ABS) sectors continue to offer modest yield advantages to similarly rated corporate bonds. Consumer ABS fundamentals remain positive but face headwinds from rising rents and increasing healthcare costs. The sector's short spread duration and low volatility combined with significant demand lead us to expect a continuation in spread tightening in 2018. Commercial ABS fundamentals are mixed with risks to the downside related to global trade, economic growth, and commodity prices. We see tight yields in transportation assets and esoteric ABS, but both asset classes still offer relative value. Security selection is important with consideration to assets and structure, as tight yields leave little room for error. US house prices rose 6% in 2017, and we expect 5% appreciation in 2018 supported by strong demographic demand and lack of new construction supply. However, higher rates and uncertainty in housing policy could create headwinds beyond 2018. Our residential mortgage-backed securities (RMBS) outlook is largely positive as pre-crisis loans are curing and post-crisis underwriting quality remains very strong. Negative net supply and very strong demand from long-term holders should reduce volatility in any macro downside scenario. Commercial real estate (CRE) fundamentals are mid-to-late cycle. While valuations are high, new construction is limited. Continued job growth and declining, but stable, foreign demand should continue to support net operating income growth and modest (0%-2%) price appreciation. Tax reform should be a net positive development. CMBS spreads are near historic tights but are expected to be stable/modestly outperform due to strong demand and limited non-agency gross issuance.

Equities

With companies posting the strongest growth in global earnings since 2011, we remain positive on global equities looking out at 2018. Earnings rose at a double-digit rate in most major equity markets in 2017, and a similar growth rate is anticipated for 2018. Better earnings are the direct result of stronger global GDP growth coupled with a recovery from the energy/commodity downturn of 2014 to 2015. Friendly central bank policies have also been a positive factor, supporting the moderate price-earnings multiple expansion seen in most global equity markets last year. US earnings growth will likely be further boosted in future years by tax reform. The prospect of a lower and more globally competitive corporate tax structure in the US, coupled with the prospect of repatriated earnings, will provide a foundation for earnings-per-share (EPS) growth well into double-digit levels. The two primary risks to our equity market outlook are if the current trajectory of improved earnings growth is derailed, and/or an unexpected shift in the Fed's accommodative monetary policy. Both developments would put downward pressure on equity valuations and impede earnings growth. Geopolitical developments could also present challenges—a permanent unknown. In sum, 2017 was very good for investors worldwide. We are optimistic about 2018, but recognize volatility could increase somewhat. With valuations already reflecting expectations for the strong earnings trend to continue and meaningful benefits from tax reform, any related disappointments could weigh on sentiment.

Investment Grade Corporate Bonds

Investment grade corporate bonds posted another year of healthy returns in 2017, driven by a rebound in corporate profits, continued recovery in commodity-exposed industries, and strong investor demand for yield, particularly from overseas buyers. With 2017 drawing to a close, investment grade (IG) corporates continued to rally on a cut in corporate taxes. We expect the pace of global growth, Fed policy tightening, and progression of the credit cycle to be the biggest drivers of credit spreads in 2018. Our analysts forecast stability and strong free cash flow in the majority of US industries to fuel fundamentals that support credit. While IG corporate leverage remains at historical highs, we expect earnings growth to result in relatively flat leverage comparisons for 2018. Sources of uncertainty for 2018 include the pace of leveraging in mergers and acquisitions and the level of demand for spread product from foreign investors—Asia-based investors in particular.

European Investment Grade Credit

Overall, we believe 2018 could end with spreads slightly wider from where they began the year. We acknowledge that the strong trend in 2017 fund flows is poised to continue into the beginning of 2018 supported by favorable fundamentals, declining leverage, muted capital expenditures and strong interest coverage. However, 2018 could be a tale of two halves, with a shift in sentiment emerging when the ECB announces its plans to end, or further taper, its purchase program—potentially in June or September. We think the market has priced limited tapering into spreads and this announcement could set the market up for an adverse reaction. That said, we think the selloff should be limited given that ECB reinvestment is likely to continue and external demand factors should remain supportive. Our base case is that most of the tapering in January will be outside of the corporate market. Our biggest concerns remain political risk events, the risk of a policy mistake as the ECB tapers, Fed interest rate hikes, potential corporate releveraging and weaker fund flows. In addition, European political concerns will continue to overhang the market, with the Italian election being the biggest issue that could result in short-term volatility.

High Yield

US high yield corporate bond spreads continued tightening throughout 2017 driven primarily by supportive global central bank monetary policy, improved earnings metrics (driven by commodity-sensitive industries) and low default rates. Looking at 2018, we expect the expansion/late cycle environment to continue supporting high yield, although current yields will likely cap broad-based price appreciation. That said, we currently view valuations as fairly priced given low default loss expectations, positive EBITDA growth and growing sales balanced against high cyclical corporate leverage. High yield spreads continue to look attractive relative to global alternatives, which should provide technical support into 2018.

EM Credit, Local Debt and Currencies

We expect a continuation of the positive EM trends of 2016 and 2017, albeit with more modest return, to continue in 2018. An upward trend in growth in the developed and emerging world, continued stability in China's economy, relatively stable commodity prices, broad-based improvement in sovereign and corporate fundamentals and supportive market technicals should result in a benign environment for EM debt and currencies. Although sovereign and corporate credits offer attractive yield pickup when compared with other asset classes, the most attractive segment of EM fixed income is the local currency denominated debt. With inflation stable or coming down and real interest rates (nominal yields minus inflation) relatively high, investors could benefit from high nominal yields and potential price appreciation of bonds.

There are some risks to this benign outlook. The trajectory of G3 central bank interest rates (Europe, Japan and US) and lingering geopolitical events are a source of apprehension for EM investors. A poorly signaled change in the pace of removal of accommodative monetary policies by the G3 would have a negative impact on most EM assets. US trade policy, specifically NAFTA, is going to be at the forefront of issues in the first quarter of 2018 and, depending on the outcome, could have significant impact on Latin America. In addition, EM countries face a heavy 2018 election calendar. Among those with a potentially large impact for EM debt are Mexico and Brazil. (The electoral campaign in Mexico starts at the same time NAFTA negotiations should be close to concluding. This combination of events could be negative for investor sentiment.) Although they have no official elections in the year, Turkey and South Africa are facing political risks that could also weigh on demand.

Bank Loans

With the majority of the bank loan market priced above par in 2017, it was generally a coupon-clipping year. Looking ahead, we expect similar returns in 2018 as corporate fundamentals show limited deterioration and defaults are likely to remain below historical averages due to low forecasted maturities. We expect to see future coupon increases on loans as the Fed raises rates, and for the market to anticipate such increases. CLO issuance forecasts for 2018 are very robust. We believe retail investors will be marginal buyers of bank loans as interest rates increase. There is always a chance that markets in general may turn to risk-off sentiment, temporarily, due to a variety of factors, including the risk of war and trade issues.

Convertible Bonds

After a strong 2017 for convertible bonds, which materially outperformed US high yield, we still see a few positive catalysts for the asset on the horizon, including US tax policy changes and continued strong earnings growth. However, valuation levels temper our outlook for converts in 2018. Security selection will be increasingly important in 2018. We see an opportunity in some of 2017's lagging industries, such as biotechnology and energy. We will also be watching for a potential pullback in stronger areas like technology. Structurally, we prefer balanced converts as they should provide one of the best blends of upside participation with downside protection.

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Disclosure

Past performance is no guarantee of future results.

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All information provided as of December 31, 2017, unless otherwise noted, and is subject to change at any time without notice.

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