LOOMIS | SAYLES

MUTUAL FUND COMMENTARY

Q3 2018

Core Plus Bond Fund

FUND FACTS

OBJECTIVE

Seeks high total investment return through a combination of current income and capital appreciation

Share class	Y
Inception	12/30/1994
Ticker	NERYX
CUSIP	63872R764

Market Conditions

- Upward pressure on rates continued, leaving interest rates higher across the yield curve (a curve that shows the relationship among bond yields across the maturity spectrum). US Treasury total returns were negative, but investment grade and high yield corporate bonds posted gains. The Federal Reserve (Fed) hiked rates in September as core PCE inflation remained close to its target rate of 2%. US dollar strength persisted, undermining emerging market performance for US-dollar-based investors. Speculation increased regarding the potential implications of US trade negotiations—especially those with China—on US markets.
- US interest rates advanced during the third quarter, reflecting persistent economic growth, a stable inflation rate and a steady pace of Fed rate hikes. US interest rates remain above those of other developed countries where monetary policy has been more accommodative.
- US core PCE inflation trended close to the Fed's target of 2%. Meanwhile, emerging market inflation continued to trend lower, narrowing the spread between emerging market and developed market inflation.
- Investment grade corporate bonds posted positive performance. The asset class outperformed duration-matched Treasurys (duration refers to a security's price sensitivity to interest rate changes), but underperformed high yield corporate bonds. From a sector perspective, communication companies posted healthy gains while utilities declined.
- Securitized assets outperformed duration-matched Treasurys. Commercial mortgage-backed securities (CMBS) performed particularly well, posting positive total and absolute returns.

CLASS Y PERFORMANCE AS OF SEPTEMBER 30, 2018 (%)

	CUMULATIVE TOTAL RETURN		AVERAGE ANNUALIZED RETURN			
	3 MONTH	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEAR
FUND	0.51	-0.75	-0.02	3.69	3.11	6.39
BENCHMARK	0.02	-1.60	-1.22	1.31	2.16	3.77

Performance data shown represents past performance and is no guarantee of, and not necessarily indicative of, future results. Investment return and value will vary and you may have a gain or loss when shares are sold. Current performance may be lower or higher than quoted. For most recent month-end performance, visit www.loomissayles.com.

Additional share classes may be available for eligible investors. Performance will vary based on the share class. Performance for periods less than one year is cumulative, not annualized. Returns reflect changes in share price and reinvestment of dividends and capital gains, if any. You may not invest directly in an index.

Gross expense ratio 0.48% (Class Y). Net expense ratio 0.48%. As of the most recent prospectus, the investment advisor has contractually agreed to waive fees and/or reimburse expenses once the expense cap of the fund has been exceeded. This arrangement is set to expire on 1/31/2019. When an expense cap has not been exceeded, the fund may have similar expense ratios and/or yields.

The Class Y inception date is 12/30/1994. Class Y shares are sold to eligible investors without a sales charge; other Classes are available for purchase.

- Buoyed by favorable economic growth and corporate earnings strength, high yield credit posted gains in the quarter. With durations on the shorter end of the spectrum, the asset class is less sensitive to upward pressure on rates. Technical support also played a role, with healthy demand relative to supply.
- While weakness was seen across emerging market assets, major moves to the downside were generally contained to the countries facing the most intense political and financial pressure. The stronger US dollar weighed on many emerging market currencies, and country-specific events further dampened risk appetite for the asset class.

Portfolio Review

- The fund outperformed its benchmark, the Bloomberg Barclays US Aggregate Index, primarily due to sector allocation.

Contributors

- Non-US dollar exposure, particularly to the Mexican peso, was the largest contributor to absolute and relative performance.
- An out-of-benchmark allocation to high yield industrial names was additive as high yield corporate bonds continued to be one of the top-performing sectors in fixed income.
- An underweight to the US Treasury sector was additive as risk assets outperformed. While the fund held approximately 9% in nominal Treasurys, the fund also held approximately 9% in US Treasury inflation-protected securities (TIPS), comprised of 10- and 30-year TIPS (skewed to 30-year). TIPS exposure benefited relative performance as inflation breakeven levels (the difference between yields on nominal Treasurys and TIPS of the same maturity) rose during the period.

Detractors

- Our nominal duration was slightly longer than the benchmark, but continued to trend closer to neutral versus the benchmark; our empirical duration is currently about 0.75 years shorter than the benchmark. Yield curve positioning slightly detracted from relative performance.
- An underweight to industrial investment grade corporate issuers was also a drag as the sector rallied during the quarter.
- Sector allocation within asset-backed securities (ABS) was a very modest detractor on overall relative return.

Outlook

- We believe that the Fed will tighten monetary conditions in a gradual and measured way as aggregate demand remains healthy, with another hike likely coming in December 2018.
- Corporate fundamentals continue to indicate the US is in the late expansion phase of the credit cycle,[1] with slowing margin growth, increased mergers and acquisitions and rising leverage. Our view is that the cycle will continue to evolve slowly. Asset classes like corporate credit are supported by US tax reform and fiscal stimulus from the Trump administration. Corporate credit remains in demand due to a need for yield, fundamentals

[1] *A credit cycle is a cyclical pattern that follows credit availability and corporate health*

like improving corporate earnings, and technical factors such as lower bond supply. We continue to favor corporate credit over risk-free assets. We believe the primary risks to the credit markets include the pace of global growth, the timing of Fed tightening, increasing concerns about a protracted trade war and a significant uptick in inflation.

- We continue to overweight high-quality ABS, CMBS and high yield. We are underweight to investment grade credit and remain underweight in the more interest-rate-sensitive government sectors like agency mortgage-backed securities (MBS), as we believe these sectors are more fully valued.
- We have approximately 8% of the portfolio allocated in high yield corporate bonds and bank loans. We favor these assets because they typically offer additional income over investment grade corporate bonds and we expect default rates to remain benign. In addition, we believe bank loans offer front-end yield and can help protect against rising rates; we currently view secured better-quality high yield loans as the most attractive.
- We have a 9% allocation to TIPS. We continue to find breakeven inflation levels on 10- and 30-year TIPS attractive relative to historical levels and versus our inflation and rates expectations. We expect TIPS to provide an attractive alternative to long-dated US Treasurys going forward.
- Our relative portfolio duration is approximately 0.4 years longer than the benchmark on a nominal basis, but we expect it to behave about 0.75 years shorter, largely due to our TIPS, high yield and other out-of-benchmark positions.
- Our non-US dollar exposure is approximately 3.5% of total market value, comprised primarily of the Mexican peso and a small allocation to the Uruguayan peso. Our focus has been on more pro-cyclical economies and foreign currencies tied to the improving global growth story.
- We believe our higher-than-benchmark yield, in combination with our underweight to the government sector, should help minimize interest rate risk.
- We may opportunistically add exposure back to investment grade credit, high yield credit and emerging market debt and currencies in the coming months, as valuations permit. Given our position in the credit cycle, we are unlikely to return to the levels of overall credit exposure that we carried in recent years without a significant repricing of credit markets or a more significant improvement in the US and global economic outlook.

About Risk

Fixed income securities may carry one or more of the following risks: credit, interest rate (as interest rates rise bond prices usually fall), inflation and liquidity. **Mortgage-related and asset-backed securities** are subject to the risks of the mortgages and assets underlying the securities. Other related risks include prepayment risk, which is the risk that the securities may be prepaid, potentially resulting in the reinvestment of the prepaid amounts into securities with lower yields. **Below investment grade fixed income securities** may be subject to greater risks (including the risk of default) than other fixed income securities. **Foreign and emerging market securities** may be subject to greater political, economic, environmental, credit, currency and information risks. Foreign securities may be subject to higher volatility than US securities due to varying degrees of regulation and limited liquidity. These risks are magnified in emerging markets. **Currency** exchange rates between the US dollar and foreign currencies may cause the value of the fund's investments to decline. **Inflation-protected securities** move with the rate of inflation and carry the risk that in deflationary conditions (when inflation is negative) the value of the bond may decrease.

The Bloomberg Barclays US Aggregate Bond Index *represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the US 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. Indexes are unmanaged and do not incur fees. It is not possible to invest directly in an index.*

Outlook as presented in this material reflects subjective judgments and assumptions of the portfolio team and does not necessarily reflect the views of Loomis, Sayles & Company, L.P. There is no assurance that developments will transpire as stated. Opinions expressed will evolve as future events unfold.

Before investing, consider the fund's investment objectives, risks, charges, and expenses. Please visit www.loomissayles.com or call 800-225-5478 for a prospectus and a summary prospectus, if available, containing this and other information. Read it carefully.

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