

# Payden & Rygel

## QUARTERLY PORTFOLIO REVIEW

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**3<sup>rd</sup> Quarter 2018**



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## LETTER FROM THE CEO

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October 2018

As we are now in the fourth quarter of the year, investors are focused on “what the future will bring.” Will it be a continuation of the last 12 months? The future obviously won’t resemble the past. However, there are some important trends today that we would like to explore in a positive vein.

The U.S. economy shows great strength. We think the business cycle is far from over. The consumer is strong and corporate balance sheets look healthy. Meanwhile, inflation is still under control.

The big question everyone is asking is: where are interest rates going? Higher interest rates are a good thing if they’re rising for the right reasons. And we think the right reasons are driving both higher rates and higher equity prices: strong economic growth and corporate profits.

Further abroad, we see more challenges. Global economic growth has slowed somewhat this year, and higher interest rates and a stronger U.S. dollar may prove challenging for some economies. Brexit still looms, unfinished and uncertain, and European politics are as vexing as ever. Challenges and risks remain.

September was a reflective month for Payden & Rygel. We opened our doors 35 years ago on September 12, 1983. We’ve grown globally, opening an office in London 20 years ago, in September 1998. More recently we opened a new office in continental Europe in Milan. Despite the changes and expansion, our ownership, governance structure and culture remain the same—quite extraordinary.

My best wishes to you and your family for the coming holiday season.

Health and happiness,

A handwritten signature in black ink that reads "Joan A. Payden". The signature is fluid and cursive, with the first name "Joan" being the most prominent.

Joan A. Payden

President & CEO

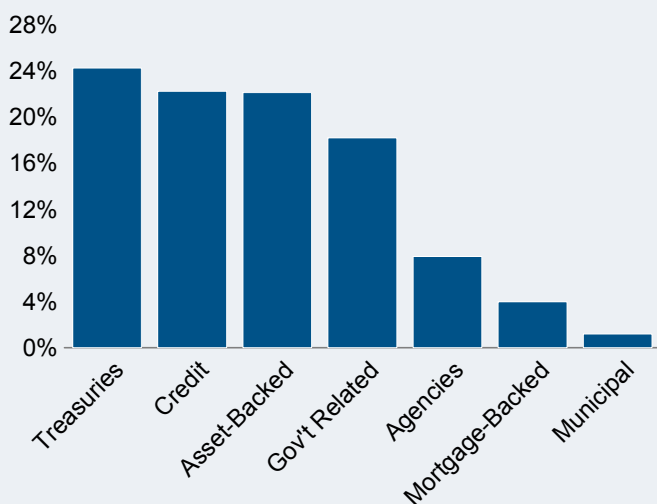
# FLORIDA TRUST SHORT-TERM BOND FUND

## Portfolio Review and Market Update - 3rd Quarter 2018

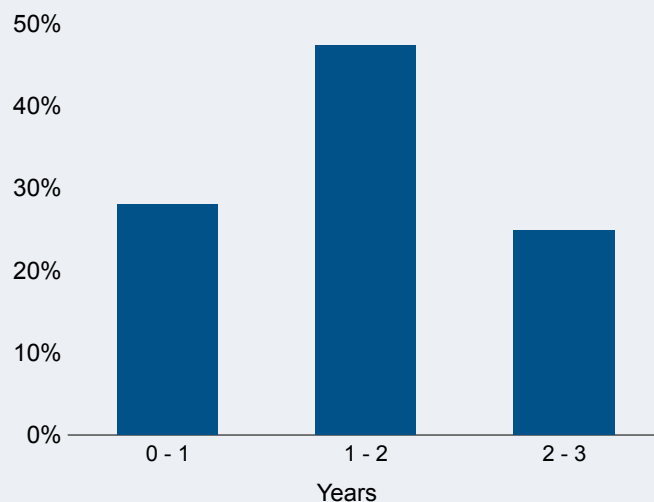
### PORTFOLIO CHARACTERISTICS (As of 9/30/2018)

|   |                 |
|---|-----------------|
| Portfolio Market Value                  | \$872.3 million |
| Weighted Average Credit Quality (Fitch) | AAAf/S1         |
| Weighted Average Duration               | 1.51 years      |
| SEC 30-Day Yield (net)                  | 2.32%           |

### SECTOR ALLOCATION



### DURATION DISTRIBUTION



### PORTFOLIO RETURNS - Periods Ending 9/30/2018

|  | 3rd Quarter  | 2018 YTD     | Trailing 1 Yr | Trailing 5 Yr | Trailing 10 Yr | Since Inception (1/1/92) |
|--|--------------|--------------|---------------|---------------|----------------|--------------------------|
| <b>SHORT-TERM BOND FUND (gross)</b>    | <b>0.44%</b> | <b>0.78%</b> | <b>0.69%</b>  | <b>1.00%</b>  | <b>1.61%</b>   | <b>3.78%</b>             |
| SHORT-TERM BOND FUND (NAV)             | 0.39%        | 0.58%        | 0.43%         | 0.75%         | 1.36%          | 3.45%                    |
| ICE BofAML 1-3 Year US Treasury Index* | 0.19%        | 0.29%        | 0.03%         | 0.56%         | 1.09%          | 3.33%                    |

Periods over one year are annual

\* Taxable money market funds average prior to 02/2000.



## MARKET THEMES

The third quarter was a tug-of-war between robust economic data and persistent geopolitical risk across the globe. The U.S. economy remained the anchor for global growth, with tailwinds coming from strong employment figures and corporate profits. Consequently, the Federal Reserve continued to raise interest rates, notching its eighth hike since the end of 2015. Headwinds outside the U.S. included volatility in emerging markets, overhang regarding Italian politics and the forthcoming departure of the UK from the euro zone. All in all, the tone across risk assets was broadly positive despite volatility in select sectors. Yields moved higher, but corporate credit risk premiums declined and equity prices increased globally. We believe the front end of the yield curve is the most attractive it has been in a decade as yields move up and provide higher total return potential and low return volatility.

## STRATEGY

- The portfolio holds a diversified mix of credit sectors for income generation.
- Corporate and securitized bonds outperformed Treasuries over the quarter as yield premiums fell. We view short credit as attractive given strong fundamentals and yield levels that we have not seen since 2009.
- We remain active in both secondary and primary markets when pricing is supportive.
- We continue to utilize floating-rate coupon bonds across a range of sectors in anticipation of higher front-end rates driven by an active Fed.

## INTEREST RATES

- Short U.S. Treasury yields moved higher by 20 to 30 basis points, with the two-year maturity rising 0.29% to 2.82%. The slope between two- and five-year maturities continued its flattening trend, falling 0.08% to end the quarter at 13 basis points.
- Our underweight duration position was additive to performance as Treasury yields increased.
- Floating-rate positions contributed positively to performance as Treasury yields rose and LIBOR remained range bound. One-month LIBOR rose 0.17% to 2.26% and 3-month LIBOR rose 0.06% to 2.40%.

## SECTORS

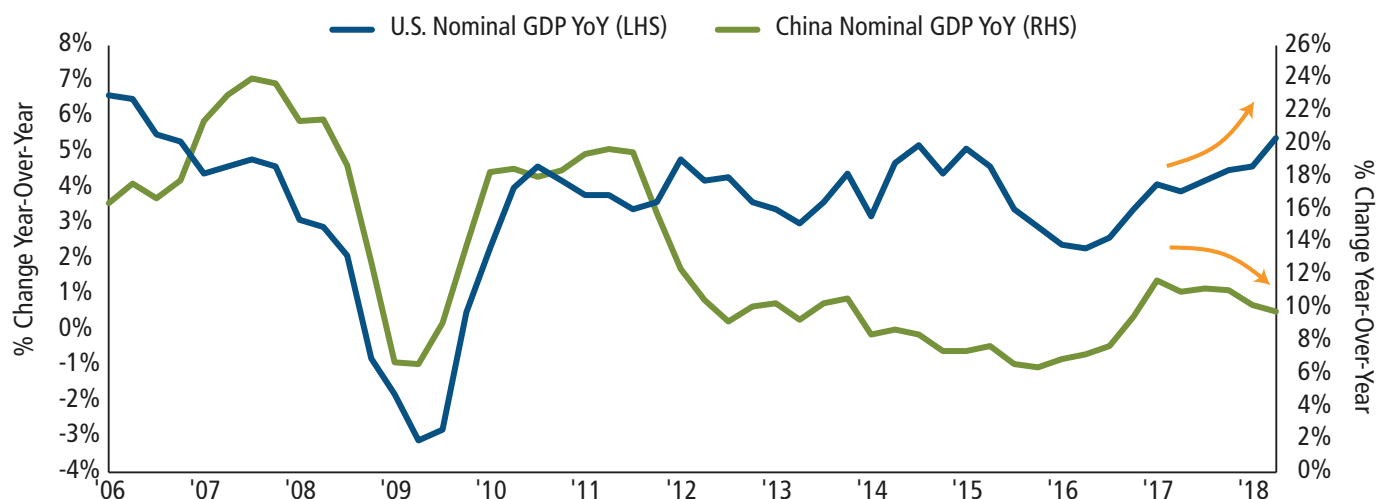
- Corporate securities outperformed Treasuries during the quarter, benefiting from spread compression and yield advantage.
- High-quality asset-backed securities outperformed Treasuries while providing diversification and flexible reinvestment opportunities.
- A modest floating rate mortgage-backed allocation added to performance, as spreads remained stable and LIBOR drifted higher.



## MARKET PERSPECTIVE

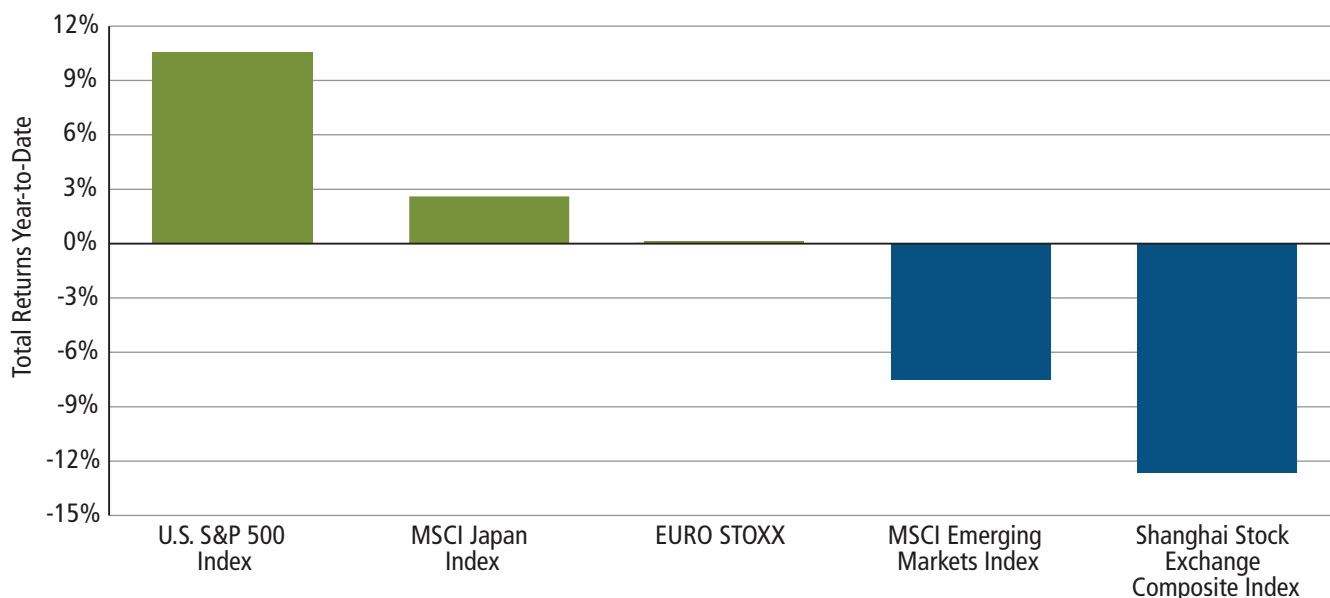
With three quarters of the year in the books, one theme has driven the global economy and financial markets in 2018: *divergence*. U.S. economic growth has accelerated in 2018, while Chinese growth has decelerated (see Chart 1). With the two largest economies in the world moving in different directions, ripple effects were felt around the world. Higher U.S. interest rates, justified by stronger U.S. economic growth, produced knock-on effects in emerging markets. Weaker economic activity out of China also exerted a drag on global activity, from the emerging world to European exports. As a result, the market implications of global divergence appeared most clearly in equity returns. While the U.S. has returned almost 10% year-to-date (see Chart 2), the rest of the world has registered declines (except for Japan). As the U.S. continues to grow above trend for the rest of the year, we will closely watch whether the global divergence theme continues.

**Chart 1: Divergence in 2018 – U.S. Nominal GDP Growth Accelerates as China Slows**



Source: Bureau of Economic Analysis, National Bureau of Statistics of China

**Chart 2: Stock Returns Reflect The Divergence Theme – Major Index Total Returns Year-to-Date\***



Source: Standard and Poor's, MSCI, STOXX, Shanghai Stock Exchange, Bloomberg  
\*As of 9/28/2018



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## US DOMICILED MUTUAL FUNDS

### CASH BALANCE

Payden/Kravitz Cash Balance Plan Fund

### EQUITY

Equity Income Fund

### GLOBAL FIXED INCOME

Emerging Markets Bond Fund  
Emerging Markets Corporate Bond Fund  
Emerging Markets Local Bond Fund  
Global Fixed Income Fund  
Global Low Duration Fund

### TAX-EXEMPT FIXED INCOME

California Municipal Income Fund

### U.S. FIXED INCOME

Absolute Return Bond Fund  
Cash Reserves Money Market Fund  
Core Bond Fund  
Corporate Bond Fund  
Floating Rate Fund  
GNMA Fund  
High Income Fund  
Limited Maturity Fund  
Low Duration Fund  
Strategic Income Fund  
U.S. Government Fund

## DUBLIN DOMICILED UCITS FUNDS

### EQUITY

Global Equity Income Fund  
US Equity Income Fund

### LIQUIDITY FUNDS

Euro Liquidity Fund  
Sterling Reserve Fund  
U.S. Dollar Liquidity Fund

### FIXED INCOME

Absolute Return Bond Fund  
Global Bond Fund  
Global Emerging Markets Bond Fund  
Global Emerging Markets Corporate Bond Fund  
Global Government Bond Index Fund  
Global High Yield Bond Fund  
Global Inflation-Linked Bond Fund  
Global Short Bond Fund  
Sterling Corporate Bond Fund  
U.S. Core Bond Fund  
USD Low Duration Credit Fund

For more information about Payden & Rygel's funds, contact us at a location listed below.

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