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THE LEGACY OF DEBT AND THE CHANGING OF THE GUARD

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REVIEW OF FOURTH QUARTER 2016

A review of the fourth quarter is relatively easy, stocks and spread assets rallied while risk-free rates rose. The stock market was effervescent, particularly small cap stocks as represented by the Russell 2000, where a near 9% total return for the quarter was particularly impressive. Even more impressive was the fact that the Russell's performance was actually negative for the quarter going into Election Day, but the Trump victory and its business-friendly optimism allowed for a reversal of mammoth proportions, with the Russell gaining 13.8% over the post-election period. The large cap market, as represented by the S&P 500, lagged with more muted total return of 3.8% over the full quarter (5% over the post-election period). "The lower the quality, the better the performance" was again the mantra in the bond market, as the high yield market delivered another positive quarter in both total and excess return terms. In fact, high yield produced positive total and excess return for each quarter of 2016. The pro-growth, pro-business agenda the market perceives the Trump administration to be was a theme that persisted through the end of the year, driving interest rates higher for nearly the entire quarter. Rates actually peaked around December 15th before modestly retracing some of the quarter's yield spike in the final two weeks of relative illiquidity that typically accompanies the end of the year. Over the quarter, the ten-year Treasury yield increased about 86 basis points (bps), with 60 bps of that move occurring after the election. Exhibit 1 below offers the return data for the quarter and full year for select Bloomberg Barclays (BB) indices as well as a few other specific risk proxy measures.

The pro-growth, pro-business agenda the market perceives the Trump administration to be was a theme that persisted through the end of the year, driving interest rates higher for nearly the entire quarter.

EXHIBIT 1: RISK ASSETS RALLY IN Q4 ON TRUMP PRO-GROWTH AGENDA

	Q4 TOTAL RETURN	Q4 EXCESS RETURN	2016 TOTAL RETURN	2016 EXCESS RETURN
BB Aggregate	-2.98	0.39	2.65	1.38
BB Treasury	-3.84	n/a	1.04	n/a
BB Agency	-2.10	0.17	2.27	1.21
BB RMBS	-1.97	-0.39	1.67	-0.11
BB ABS	-0.70	0.03	2.03	0.95
BB CMBS	-3.03	0.46	3.32	2.36
BB Corporate	-2.83	1.85	6.11	4.93
BB High Yield Bonds	1.75	4.07	17.13	15.73
HY - Ba/B	1.14	3.58	14.14	12.75
HY - Ba	0.43	3.05	12.78	11.39
HY – B	2.01	4.22	15.81	14.40
HY – Caa	4.70	6.36	31.46	30.00
HY - Ca-D	12.16	13.39	83.14	82.12
CS Instl Lev Loans	1.70	n/a	7.65	n/a
S&P 500	3.82	n/a	11.95	n/a
Russell 2000	8.82	n/a	21.28	n/a

Sources: Bloomberg Barclays, Credit Suisse
Past performance is not indicative of future results.

ABOUT THE BOUTIQUE
SEIX INVESTMENT ADVISORS LLC

SEIX INVESTMENT ADVISORS LLC®

Seix Investment Advisors LLC (Seix) is a fundamental, credit-driven fixed income boutique specializing in both investment grade bond and high yield bond/leveraged loan management. Seix has applied its bottom-up, research-oriented approach to fixed income management for more than 20 years. The firm's success can be attributed to a deep and talented group of veteran investment professionals, a clearly defined investment approach and a performance-oriented culture that is focused on delivering superior, risk-adjusted investment performance for our clients.

The presumption of enactment of the Trump administration's pro-growth initiatives continues to drive the capital markets in early 2017. Risk markets in general remain well bid, and both total and excess returns generically are off to a good start. The lack of detail, however, something we were careful to emphasize in our last market perspective, remains a known unknown. Early initiatives addressed by the new administration have been biased to the social side of the ledger (immigration, Supreme Court nomination, etc.). As for more specific economic initiatives like infrastructure spending and tax reform, we have only seen more declarations that very big plans are in the making. Given that it is only late-February, we are very cognizant of the limitations of any new administration's ability to put forth succinct and detailed fiscal policy initiatives amidst a very busy calendar of cabinet confirmations and sub-cabinet appointments. The disconnect to our way of thinking is the risk market's ability to just forge ahead, absent many of these important details rather than any particular critique of the pace with which the Trump administration has governed since January 21st. Maybe it is that we are just boring "bond geeks" who crave minutiae and detail, but at a certain point you might expect risk markets to periodically get fatigued and find reason for pause, right? Our own survey of the global landscape offers more than a few reasons for caution early on in 2017, but risk markets overall see little to worry about at this point. At this rather late stage of the slowest recovery of the post-war period, such a bias is difficult to embrace especially in the context of valuations and risk premiums.

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UP, UP AND AWAY

Of course, interest rates are poised to rise precipitously. This is a normal time-tested ritual the fixed income market regularly invokes shortly after the noise makers are put away after New Year's Eve. Strategists declare annually that rates have nowhere to go but up, since most invariably view the current term structure of rates as inexplicably low. Given the move up in interest rates in the fourth quarter, the groundswell of support for the higher rate camp feels particularly emboldened in 2017. Positioning proxies, particularly the U.S. Commodity Futures Trading Commission reporting on the speculative community, supports a rather strong bias for the expectation of higher rates. Contrarians are careful to take note of such lopsided positioning given the potential for short covering rallies in rates irrespective of the data. In last quarter's Perspective, we acknowledged the upward pressure the rates market may be under by highlighting a widening of our anticipated trading range for the ten-year Treasury to 1.5% to 2.5% (from 1.5% to 2%) immediately after the election. Short-term flurries of selling, magnified by a volatility induced risk parity selloff, could certainly prompt a breach of the upper end of that range and some short-term impulse like this would not surprise us in the first half of 2017. But at the risk of repeating ourselves, that would likely be a buying opportunity as we still see the landscape through the prism of "lower for longer." Structural impediments such as excessive debt, excess global capacity, aging demographics and low productivity growth will remain powerful forces restraining potential growth while also containing the periodic impulses for significantly higher interest rates. The global relative value framework will also continue to offer support to domestic yield levels should they continue to rise. Active interest rate repression continues with the European Central Bank (ECB) and the Bank of Japan (BoJ) still expanding their balance sheets in their respective home markets, furthering yield differentials. As an example, investing in a ten-year Treasury over a ten-year "bund" and picking up additional yield of over 200 bps.

Market pundits have recently seized on these international flows in a negative way, pointing to the selling by prominent foreign holders, with particular emphasis on Japan and China. While we acknowledge the limitations of the data series (based solely on where transactions take place versus an investor's actual domicile), the most recent release of the Treasury's International Capital Statistics (or TIC data as it is more popularly known) show that Japan and China have been sellers recently and over the past 12 months. Over the last year, investors from Japan have sold just under $73 billion of U.S. Treasury notes/bonds while China was a seller of nearly $159 billion. Large numbers for sure with these two countries making up a significant share of the nearly $343 billion sold by all foreign holders of Treasuries. Both Japan and China still hold over $1 trillion of U.S. Treasuries each, as prominent and largely permanent allocations within their official international reserve portfolios. Considerable ink has been spilled over these sales as if these countries are strategic hedge funds front running the Federal Reserve Board (Fed) before they tighten monetary policy over the course of 2017. Monitoring these cross border capital flows is important, however, there is another interesting development in the U.S. Treasury market that has occurred over the last few years and supports our domestic market, leaving it less dependent on such foreign investment to finance the chronic deficits that our nation continues to accumulate.

The Office of Debt Management releases auction allotment data by investor class for all Treasury coupon securities issued throughout the year, with the release dates coming several weeks after each auction cycle. Looking back to the auction cycles of 2010 and forward, the allotment data show an interesting dichotomy between foreign participation and domestic investment fund auction participation. Exhibits 2 and 3 below will go a long way in illustrating what has changed over the last seven years. A "takedown" rate represents the amount of any auction that is awarded to specific market participants tracked by Treasury.

EXHIBIT 2: AVERAGE FOREIGN TAKEDOWN IN TREASURY AUCTIONS

	2YR	3YR	5YR	7YR	10YR	30YR
2016	17.2%	18.1%	16.3%	19.1%	22.0%	10.9%
2015	16.9%	18.7%	16.5%	18.8%	25.9%	11.6%
2014	18.1%	20.3%	15.7%	16.1%	18.8%	12.3%
2013	13.6%	15.7%	13.4%	15.5%	17.5%	10.4%
2012	16.8%	17.4%	18.0%	19.1%	19.4%	11.1%
2011	19.0%	22.0%	26.7%	24.3%	28.5%	17.9%
2010	22.1%	30.0%	25.0%	27.0%	23.5%	11.5%

Source: Office of Debt Management, Seix Investment Advisors

As the table above depicts, since 2010, the average auction takedown by foreign investors has declined for most of the domestic auction cycles. The declines have been more pronounced in the shorter- and intermediate-Treasury benchmarks, while the longer benchmarks (10s/30s) have seen only small declines.

Now consider the same takedown statistics of domestic investment funds over the same time period.

EXHIBIT 3: AVERAGE INVESTMENT FUND TAKEDOWN IN TREASURY AUCTIONS

	2YR	3YR	5YR	7YR	10YR	30YR
2016	36.7%	40.8%	48.0%	53.6%	47.8%	56.9%
2015	39.5%	38.9%	46.2%	44.9%	42.1%	51.3%
2014	25.6%	24.5%	40.4%	43.2%	38.5%	47.5%
2013	21.8%	23.6%	36.1%	35.9%	36.2%	37.0%
2012	19.2%	16.6%	28.4%	28.7%	28.3%	30.1%
2011	13.3%	14.1%	17.7%	21.4%	22.3%	24.8%
2010	15.1%	14.0%	18.7%	25.1%	22.2%	28.3%

Source: Office of Debt Management, Seix Investment Advisors

Auction takedowns for the domestic investment fund community increased considerably in all auctions across the entire yield curve. In fact, isolating the specific change from 2010 to 2016, the averages have at least doubled in each particular coupon auction, with certain maturities on the curve seeing even greater participation by domestic investors. This dynamic was a function of a powerful and overwhelming bias exhibited by mutual fund investors for increased fixed income exposure in the aftermath of the financial crisis. There are many sources of fund flow data, each with varying degrees of sector specificity, but using Investment Company Institute (ICI) data, the decade leading up to 2017 saw over $1 trillion flow into taxable bond funds, while a similar amount flowed out of domestic equity funds. This preference for fixed income exposure provided the buying power for the investment fund complex to play a critical role in the financing of our country's chronic deficits, as government debt almost doubled in the last eight years (more on that later).

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Oftentimes over the years, there has been talk of a pending "great rotation" whereby fund flows would reverse direction and move from the fixed income complex back into the domestic equity complex. Each time this prediction has been rolled out, it has been proven to be false. Domestic equity funds have suffered net redemptions in nine of the last ten years, with 2013 being the sole year of a marginal net inflow. Taxable bond funds have experienced net inflows in eight of the last ten years, where only 2013 and 2015 saw modest net outflows. It is only February, so we would caution everyone to avoid annualizing any trends seen in early 2017, but fund flows are following this same pattern with inflows into taxable bond funds and outflows from domestic equity funds.

It goes without saying that international participation in the Treasury's coupon auction cycle remains a significant and important dynamic for our market and the financing of our annual deficits. However, mutual fund flows into the taxable bond market have proven to be a formidable force that helps to offset the influence the more dynamic and volatile flows emanating from the international investor community, particularly in light of the myriad of influences driving these international flows. Consider the dynamics underlying some of China's recent flows. Chinese authorities are trying to manage their exchange rate as to minimize capital flight; a dynamic China has been wrestling with for several years. Considerable attention has been focused on China as a currency "manipulator" in that they were known to keep the value of their currency artificially low as to benefit their export sector in the global trade market. In more recent years, as the Chinese people have shown a growing desire to move wealth out of the country, the dynamic has been the exact opposite. In addition to outright capital controls designed to limit the amount of capital outflow, Chinese authorities have taken to "manipulation" that has actually strengthened their currency (yuan). By artificially strengthening the yuan, it is believed the rate at which capital outflows occur is minimized, while also limiting the amount of speculation that takes place to profit from a large currency devaluation (either voluntary or in response to market pressure). Clearly there is a lot going on behind the scenes as it relates to the flow of capital between China and the U.S., hence the caution in interpreting or extrapolating the recent Chinese selling of U.S. Treasuries.

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NATIONAL DEBT UPDATE

It's been a while since we've updated readers on the status of our national debt level, but given the seasonal impulse to focus on interest rates and the recent selling by foreigners, a refreshed review seems appropriate. Our nation's total debt is just under $20 trillion, made up of two primary components of which the majority is publicly held debt, while the balance is privately held debt. Publicly held is fairly obvious in that it is held by a broad spectrum of investor types both domestically as well as internationally. Private debt, or "intra-governmental holdings" as it is referred to by the Treasury, is essentially debt held as an investment in a government trust fund (like the Social Security Trust Fund) and is therefore commonly referred to by many as "money we owe to ourselves." By virtue of this distinction, many analysts and market strategists will often ignore this portion of our cumulative debt and focus only on the publicly held portion. The publicly held debt level at the end of 2016 stood at $14.435 trillion while the intra-governmental holdings were at $5.542 trillion, thereby adding to a total of $19.977 trillion. Exhibit 4 on page 4 shows these components of our national debt and their growth over the last 20+ years.

EXHIBIT 4: STATEMENT OF THE DEBT OF THE UNITED STATES (TRILLIONS)

	PUBLIC	% CHANGE	INTRA	% CHANGE	TOTAL	% CHANGE	NOMINAL GDP	PUBLIC DEPT/GDP	TOTAL DEPT/GDP
12/31/1995	3.307		1.657		4.964		7.664	**43%**	**65%**
12/31/1996	3.460	4.6%	1.857	12.1%	5.317	7.1%	8.100	**43%**	**66%**
12/31/1997	3.457	-0.1%	2.038	9.7%	5.495	3.3%	8.609	**40%**	**64%**
12/31/1998	3.355	-2.9%	2.250	10.4%	5.605	2.0%	9.089	**37%**	**62%**
12/31/1999	3.281	-2.2%	2.485	10.5%	5.766	2.9%	9.661	**34%**	**60%**
12/31/2000	2.967	-9.6%	2.651	6.7%	5.618	-2.6%	10.285	**29%**	**55%**
12/31/2001	3.394	14.4%	2.549	-3.9%	5.943	5.8%	10.622	**32%**	**56%**
12/31/2002	3.648	7.5%	2.758	8.2%	6.406	7.8%	10.978	**33%**	**58%**
12/31/2003	4.044	10.9%	2.954	7.1%	6.998	9.2%	11.511	**35%**	**61%**
12/31/2004	4.408	9.0%	3.188	7.9%	7.596	8.5%	12.275	**36%**	**62%**
12/31/2005	4.715	7.0%	3.456	8.4%	8.170	7.6%	13.094	**36%**	**62%**
12/31/2006	4.901	3.9%	3.779	9.4%	8.680	6.2%	13.856	**35%**	**63%**
12/31/2007	5.136	4.8%	4.093	8.3%	9.229	6.3%	14.478	**35%**	**64%**
12/31/2008	6.369	24.0%	4.330	5.8%	10.700	15.9%	14.719	**43%**	**73%**
12/31/2009	7.811	22.6%	4.500	3.9%	12.311	15.1%	14.419	**54%**	**85%**
12/31/2010	9.390	20.2%	4.635	3.0%	14.025	13.9%	14.964	**63%**	**94%**
12/30/2011	10.448	11.3%	4.775	3.0%	15.223	8.5%	15.518	**67%**	**98%**
12/31/2012	11.582	10.9%	4.851	1.6%	16.433	7.9%	16.155	**72%**	**102%**
12/31/2013	12.355	6.7%	4.997	3.0%	17.352	5.6%	16.692	**74%**	**104%**
12/31/2014	13.024	5.4%	5.117	2.4%	18.141	4.5%	17.393	**75%**	**104%**
12/31/2015	13.673	5.0%	5.250	2.6%	18.922	4.3%	18.037	**76%**	**105%**
12/31/2016	14.435	5.6%	5.542	5.6%	19.977	5.6%	18.567	**78%**	**108%**
10-YEAR GROWTH	11.4%		3.9%		8.7%		3.0%		

Source: U.S. Treasury, Seix Investment Advisors

Looking at the ten-year annualized growth rates at the bottom of Exhibit 4 shows the excessive rate of debt growth over the last decade. Publicly held Treasury debt has grown at an annualized 11.4% rate while the total Treasury debt stock has grown at an annualized 8.7% rate. At the same time, the economy as represented by nominal gross domestic product (GDP), experienced just 3% annualized growth. This has led to a significant expansion of our nation's debt-to-GDP ratio over this decade. Publicly held debt-to-GDP expanded from 35% at the end of 2006 to 78% at the end of 2016. Total debt-to-GDP over the same time span went from 63% to 108%. Given the low level of interest rates that have prevailed for the better part of the last decade, this excessive debt has not come with an exorbitant interest expense relative to GDP. Over the last decade, the annual interest expense has averaged about 2.6% of GDP, which is actually modestly below the 3.3% average of the prior decade. Given the dramatic ramp up in absolute debt over the last ten years, the fact that this debt service ratio was still able to decline is a reminder of just how beneficial low interest rates have been to our nation's finances.

Growth in debt trajectories, similar to what we have seen in the U.S., are a risk to long-term growth and stability.

These trends are clearly unsustainable and should serve as a vivid reminder to all that while there has been some deleveraging in the economy, particularly at the household level, the same cannot be said as it relates to government sector debt. Yes, government sector debt does traditionally increase during times of economic hardship, and the Great Recession was a downturn not seen since the Great Depression. That being said, the recovery's duration is now approaching the eight-year mark and while the rate of increase has slowed, these debt ratios continue to expand much faster than the economy. As 2017 gets underway, the new Trump administration is on the brink of proposing new fiscal spending initiatives to jump start growth, an outcome that will further weigh on these debt metrics. Economic studies have shown that excessive debt ratios approaching and exceeding the 90% of GDP level serve as a significant headwind to growth and this is not the first time we have highlighted these risks. This debt problem and consequential impact on growth was prominently featured in our Q2 2011 Perspective titled "It's the Debt, People!" (https://www.ridgeworth.com/assets/files/8v8/seixperspective2q11.pdf) and the aforementioned data in Exhibit 4 is an update of this dynamic that sadly illustrates that little has changed over the five plus years that have elapsed since we first highlighted this debt problem.

Early on in the current economic recovery the work of Carmen Reinhart and Ken Rogoff, through their compendium titled "This Time Is Different: Eight Centuries of Financial Folly," received significant attention for their research of financial crises and the relationship between growth and public liabilities in the aftermath of financial crises. Their studies found that growth in debt trajectories, similar to what we have seen in the U.S., are a risk to long-term growth and stability. Reinhart and Rogoff specifically referenced debt burdens above 90% of GDP as particularly troublesome and associated with lower future median growth rates. Clearly the experience of the current recovery has played out in accordance with this research, when you consider that despite trillions of dollars of monetary stimulus via zero interest rates and quantitative easing, the economy has managed only 2.1% annualized growth over the seven and one-half years for which GDP data is available.

REGIME CHANGE

In last quarter's Perspective, we briefly talked about the opportunity President Trump will have to revamp the complexion of the Board of Governors of the Federal Reserve. Developments since have further highlighted the near certainty that this will happen. In that prior missive, we pointed out the obvious facts as it relates to the current vacancies on the current Board (two seats are open), as well as the likelihood that upon completion of their leadership roles both the Chair and Vice-chair would likely depart (first half of 2018 events). Earlier this year, we learned that Governor Daniel Tarullo has decided to resign effective this April. Hence, by the middle of this year, we anticipate President Trump to have nominated three new members to the Fed's board. Furthermore, there is consistent speculation that Governor Lael Brainard is not long for remaining on the Board. Recall that Brainard was near the top of the short list for Treasury Secretary in a Hillary Clinton administration, a turn of events that probably enabled a premature separation from her responsibilities at hand as a Fed Governor. Given the likely changes the Board will see with the forthcoming nominations, the "chatter" emanating from Washington regarding Brainard's potential resignation is plausible. Should this come to pass, President Trump could be appointing up to four of the seven Board of Governor positions in his first year in office. Fast forward to 2018 when the leadership roles come up for appointment, and suddenly that tally becomes six of seven in the first 18 months. That is nothing less than a complete regime change for the Federal Reserve.

Our base case assumptions about what to expect are nominees that lean less academic with more accomplished business and/or banking experience.

The first round of nominations from the President will be very informative. Our base case assumptions about what to expect are nominees that lean less academic with more accomplished business and/or banking experience. Some affirmation regarding this pending ideological shift for the Board of Governors will be welcome. Regular Perspective readers will know that we have been highly critical of the neoclassical economic groupthink that has dominated the Federal Reserve over the years and see this potential pivot for the Board of Governors as a highly positive potential outcome. Time will tell, but fortunately it may be only weeks before nominations are finally released.

PORTFOLIO POSITIONING & OUTLOOK

The new calendar year always brings with it tremendous optimism. Expectations are high for growth, earnings and of course capital market performance. As intimated in our introduction, an expectation for higher interest rates typically accompanies this seasonal optimism. 2017 is no exception to this rule, with the only difference this year being that much of this seemingly played itself out in the immediate aftermath of the election. The euphoria has proven to have some endurance, however, as it has persisted early on this year.

Entering 2017, our portfolio sector weightings to the primary spread sectors (residential mortgage-backed securities and corporate bonds) are not far from the index weighting. To differentiate our posture somewhat, portfolios lean slightly overweight in corporate credit versus slightly underweight in residential mortgage-backed securities exposure. Little has changed regarding valuations (fair to rich across most spread product) hence our active decision to avoid large overweights. Given the age of the spread cycle as well as the business cycle (third longest expansion of the post-war period), our style naturally guides us to not aggressively reach for yield as many investors are prone to do at the end of the cycle. Having buying power and the ability to offer liquidity in more trying market conditions is the strategy we have deployed to start this year. Consistent with this core spread approach, our core plus mandates remain void of any strategic non-investment grade exposures. We are comfortable swimming against the tide amidst the euphoria of the Trump reflation trade given valuations and relative value analysis.

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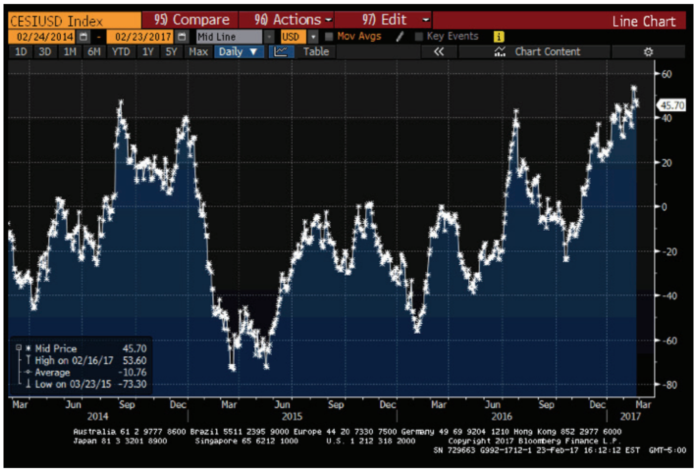
Away from the pure politics that seem to be at the heart of all current market commentary, we remain astutely concerned about many issues the market once pretended to fear. Consider some of the issues the market was more than a bit disjointed about just one year ago. The strong dollar due to monetary policy divergence was exerting considerable pressure on emerging markets in early 2016. This year, the dollar is actually even stronger, and the monetary policy divergences more pronounced, with the Federal Reserve having hiked rates again last year with more to come this year while the BoJ, ECB and the Bank of England are all engaging in additional quantitative easing and/or negative interest rate policies. Never mind concern this year as the MSCI Emerging Market Stock Index was up 8.7% in January and February following an 11.5% total return in 2016. How about the imbalances threatening China's stability? In early 2016, this was the major concern to global risk markets. Fast forward to 2017 and those imbalances are even greater, as Beijing opted to use old fashioned credit driven fiscal pump priming in massive amounts to defer any further economic weakness, either real or perceived. This essentially further exaggerated what were already egregious debt and leverage metrics while extending valuation concerns across several regions and sectors of the Chinese economy. But bearishness doesn't sell as it relates to China, as most analysts typically accept whatever economic narrative Beijing chooses to promote. Clearly China's economic slowdown is going to be as smooth on the way down as it was on the way up, until of course the air exiting the balloon begins to accelerate. Capital controls and tighter currency manipulation appear to have things under control, but this complex balancing act seems wholly unsustainable. As with anything unsustainable, it works until it doesn't work.

Domestic economic conditions, at the ground level where the rubber meets the road, remain mired in the same low growth recovery we've written about for the past seven plus years. 2016 proved consistent with many prior years, with a very weak first half of the year followed by a modest second half rebound ultimately producing about 2% of real growth. Recent economic "outperformance" as depicted by Citigroup's Economic Surprise Index has many strategists and market pundits hopeful that the momentum of 2016 will carry into 2017. The Index captures the degree to which economic data releases exceed consensus expectations over time. Exhibit 5 chronicles this "surprise" index over the last three years.

EXHIBIT 5: CITI ECONOMIC SURPRISE INDEX AT 3YR HIGH



Source: Bloomberg

This optimism needs to be tempered due to the dichotomy of the actual data performance, as the outperformance has been driven more by "soft data" that is survey-based (small business survey, Institute for Supply Management surveys, Regional Fed surveys, etc.) versus "hard data-based" releases (industrial production, personal consumption, personal income, etc.). Regardless, given the time of the year in tandem with the pro-growth business agenda, many (including ourselves) anticipate from the Trump team higher growth expectations have become the whisper consensus in 2017. While we still lack much of the detail of the President's plans, it's difficult to argue that to some degree the animal spirits of capitalism have been stirred, as evidenced by the move in asset prices since the election.

This optimism extends to the Eurozone as well, and a three-year graph of the same Citi Surprise Index for that region illustrates a near identical dynamic with the recent level making three-year highs. The soft/hard data dichotomy exists there as well, and the ECB remains the primary provider of stimulus. There are several critical elections pending in the Euro region that may pose significant challenges to their 2017 outlook. Elections in the Netherlands, France and Germany stand to offer a wave of populism that pulls even further on the fraying strings that bind the Euro project together.

An early election in Italy also remains highly likely. It is not an exaggeration to say that an outlier outcome in any of these races advances the cause for less integration, which would be particularly acute given that the union requires far more integration in order to succeed. France's election this spring probably represents the most significant threat this year, where far right, anti-Euro candidate Marine Le Pen currently leads in the polls. Pundits and betting markets still say Le Pen loses in the second round of voting (France's electoral process uses a two round runoff voting system) where opposition parties can combine to defeat the first round victor, but those same pundits and betting markets failed to anticipate Brexit, President Trump or the Italian referendum in 2016. With several months of campaigning to come, much can and will change by the actual election, but the potential for a "Frexit-like" outcome needs to be on every investor's radar in 2017. The uncertainty regarding the details of the Trump agenda, in conjunction with the upcoming regime change at the Federal Reserve and the heightened political risk in Europe are likely catalysts for much greater volatility in the not too distant future. With this volatility will come opportunity and our portfolios are positioned to capitalize accordingly.

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A **Basis Point** is equal to 0.01%.

The **Citigroup Economic Surprise Indices** are objective and quantitative measures of economic news. They are defined as weighted historical standard deviations of data surprises (actual releases versus Bloomberg survey median).

Coupon is the interest rate stated on a bond when it's issued.

Credit spreads are the difference between the yields of sector types and/or maturity ranges.

Gross Domestic Product (GDP) refers to the market value of all final goods and services produced within a country in a given period. GDP per capita is often considered an indicator of a country's standard of living.

Mortgage-backed security (MBS) is a type of asset-backed security that is secured by a mortgage or collection of mortgages.

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.

Residential Mortgage-Backed Security (RMBS) is a type of security whose cash flows come from residential debt such as mortgages, home-equity loans and subprime mortgages. This is a type of mortgage-backed security that focuses on residential instead of commercial debt.

The **Russell 2000 Index** is an index which tracks U.S. small-cap stocks and is made up of the bottom 2,000 stocks in the Russell 3000 index.

Standard & Poor's 500 Index is an unmanaged index of 500 selected common large capitalization stocks (most of which are listed on the New York Stock Exchange) that is often used as a measure of the U.S. stock market.

Yield Curve is a curve that shows the relationship between yields and maturity dates for a set of similar bonds, usually Treasuries, at any given point in time.

Investors cannot invest directly in an index.

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Past performance is not indicative of future results. An investor should consider a fund's investment objectives, risks, and charges and expenses carefully before investing or sending money. This and other important information about the RidgeWorth Funds can be found in a fund's prospectus. To obtain a prospectus, please call 1-888-784-3863 or visit www.ridgeworth.com. Please read the prospectus carefully before investing.

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