GLOBAL ECONOMY AND POLICY
Zane Brown

- Global support for risk assets—The global environment for investments in the second quarter will be influenced by U.S. central bank policy, economic improvement in the eurozone, and policy decisions in China. With China avoiding both a hard landing and disruptive policy mistakes, the coming quarter seems poised to benefit from supportive monetary policies and persistent (if underwhelming) economic improvement in the eurozone and the United States. Economically sensitive assets also could benefit.

- The Fed targets growth—The U.S. Federal Reserve (Fed) has realigned its policies and its projections toward economic growth, a shift that seems unlikely to change quickly. Recent data from the Bureau of Labor Statistics support continued progress toward Fed-determined full U.S. employment, but at a slow enough pace to justify delaying a rate hike until at least June—and possibly later. A Fed policy supportive of growth builds confidence in economic strength and the risk assets that should perform well in that environment.

- A quantitative-easing boost for the eurozone—In the eurozone, European Central Bank (ECB) policy is likely to provide support for economic expansion in the second quarter of 2016 and beyond. Expansion of quantitative easing should boost credit markets, and the resulting lower interest rates should promote financing throughout the eurozone. While the longer-term consequences of negative interest rates, and other central bank policies, may be less constructive, ECB president Mario Draghi seems to have “done what it takes” to support the economy, and risk assets, in the second quarter and for the balance of 2016.

- China’s cautious path—Policies in China should continue to support consumption and economic growth during the second quarter, even though longer-term imbalances may continue to build. We expect the government to proceed slowly with reforms that may compromise growth, such as cutting excess capacity and forcing deleveraging, while concentrating on programs and incentives to create jobs and promote consumption. Avoidance of controversial policies, combined with some success in maintaining economic growth, should assuage investors and support interest in risk assets.

U.S. EQUITIES
Brian Foerster

- Pockets of opportunity—Our general view is that while the “easy money” has been made during the unprecedented period of quantitative easing by the Fed, there are distinct pockets of opportunity in the equity markets, requiring investors to be more selective. For instance, identifying the next group of disruptive, transformative companies (like the so-called FANG stocks of 2015) that can deliver outsized growth despite the slow-moving U.S. economy is one place to start. Innovation in secular growth industries, such as biotechnology, cloud software, and e-commerce, continues to thrive, fundamentally speaking, despite a sluggish economy and the fact that stocks in those sectors have been sold off in recent months.

- A big preference—Small- and mid-cap stocks appear underappreciated in a market where investor preferences have favored the durability of mega-cap stocks. Notably, since the end of the Fed’s quantitative easing program in mid-2014, the trailing price-to-earnings (P/E) ratio of small-cap growth stocks (as represented by the Russell 2000 Growth Index) fell 13% through February 29, 2016, despite double-digit sales growth. Meanwhile, the P/E of mega-cap stocks (as represented by the Russell Top 200 Index) rose slightly (even as sales declined), from 7% to less than 3%, during that same period. In short, investors have been willing to pay up for stability over growth.

- The U.S. consumer looms large—Despite the slow growth of gross domestic product (GDP), the U.S. consumer is demonstrating resilience, and may be strengthening. In March, we saw the sixth consecutive month of increases in the labor market-participation rate, based on data from the U.S. Bureau of Labor Statistics—a phenomenon that eluded the first six years of the current U.S. recovery. In addition, the housing market continued to exhibit strength, as did monthly nonfarm payrolls data. In particular, an improving labor market suggests that U.S. GDP—which nearly 70% is driven by consumer spending—likely will not turn negative.

- Dividends and durability remain highly prized—That said, overall U.S. economic growth likely will remain sluggish, as severe weakness in the energy sector continues to weigh on corporate earnings and decelerating global growth puts pressure on U.S. exports. These factors, along with election-year uncertainty, may dampen investor sentiment. As a result, the preference for “dividends and durability”
could continue into the fall. Since late summer 2015, for example, the disparity in performance between mega-cap stocks and small-cap stocks has deepened, as has the gap between high-dividend payers and non-payers. Dividends remain an attraction for staying invested during uncertain times, though the need for selectivity here is paramount, in our view, as the hunt for yield has created bubbles in some low-growth stocks and industries.

INTERNATIONAL EQUITIES
Harold Sharon

- **Hope for Europe, concern for Japan**—Even though global growth is still expected to remain below average, current policies of major central banks should keep the developed economies out of recession and provide the short-term support needed to weather the manufacturing slowdown that has spread globally. We see increased signs that the eurozone's economy is on the mend, with positive movement in both consumer and credit indicators. Japan continues to be the primary market that concerns us the most, as corporate confidence has waned and a potential tax hike next year could once again dampen overall economic growth.

- **Emerging from divergence**—It appears that capital markets are finally moving away from many of the popular investment strategies supported by divergent monetary policies, and growth prospects, among the U.S. and other major economies. The U.S. dollar and high-growth stocks all benefited over the past few years from the view that the Fed would increase interest rates amid a strengthening U.S. economy, while other central banks would loosen policy, thus shifting the locus of economic growth outside the United States. The rotation away from these strategies has become quite evident in 2016, and the unwinding should continue, with equity valuation becoming increasingly important to investors.

- **A test for Europe**—Looking forward, the June referendum on the United Kingdom’s continued membership in the European Union (EU) will be a major focus for European markets. In the event that U.K. voters decide to exit the EU [the so-called “Brexit”], it likely would trigger investment flows into the perceived safety of U.S. dollar-denominated assets, thus reversing some of the trends we’ve seen year to date. While we do not believe that the United Kingdom will leave the EU, the prospect that it could happen, and any attendant negative reaction cannot, and should not, be ignored—so investors should be prepared.

- **Dividends gain importance**—Given the myriad political issues facing capital markets here and abroad, and the fact that economic growth worldwide is slack, the importance of earning dividends has become paramount for one’s investment strategy, in our view. Historically, high dividend yields provide a quality source of return, while we await clarity on many of the policy issues worrying markets, such as the direction of monetary policy. In addition, a focus on identifying high-quality business models that can succeed even in tough market conditions should be rewarding.

INVESTMENT-GRADE BONDS
Timothy Paulson

- **The doves have their day**—As we have seen time and time again in the post–financial crisis era, the Fed’s dovish activity has helped boost a spectrum of asset prices and reconfirmed the sensitivity of risk assets to global monetary policy. This trend is likely to continue. The Fed’s move in March to scale back its rate-hike projections and its shift to include “global economic and financial developments” as a policy consideration have proven critical to the investment outlook, as has apparent cooperation among major central banks. Continued strength in risk assets will depend on continued cooperation among the world’s policymakers.

- **Policy remains paramount**—Central bank behavior will be the key factor within the current market environment. Risks to the bullish case for risk assets include another round of policy divergence, as the differing trajectories of global economies may put continued pressure on central bankers, driving differing policy responses. Also, if U.S. growth or U.S. inflation surprises to the upside, we could see more Fed hikes than currently expected, which could rattle markets globally.

- **Finding opportunities**—We are positive on U.S. fixed-income risk, and favor ‘BBB’ rated corporates and some ‘BBB’ rated commercial mortgage-backed securities (CMBS), both of which still have considerable room to recover from widening spreads versus higher-rated assets. We also believe that there is a turning in the real estate cycle that will negatively affect some CMBS issues, particularly those related to suburban office space and many suburban strip malls; so, we favor urban office space and prime retail.

LEVERAGED CREDIT
Brian Arsenault

- **More volatility possible**—The volatility in the credit markets that characterized the second half of 2015 continued into early 2016, as markets digested the Fed’s interest-rate increase in December 2015. We believe volatility may continue as markets assess further potential rate increases, economic data from China, and supply/demand fundamentals among key global commodities.

- **The view on high yield**—We think two sectors of the U.S. high-yield market—health care and telecom—will continue to face challenges, and may prove less attractive to investors in the second quarter. Issues relating to the pharmaceutical industry (including M&A concerns and slowing profit growth) and a loss of earnings momentum in hospitals could have a negative impact on the healthcare sector, while competitive pressures could weigh on telecom issuers. Meanwhile, another recently out-of-favor sector, energy, may hold some appeal. In particular, select exploration and production companies may represent attractive opportunities based on current valuations.

- **The view on leveraged loans**—In leveraged loans, consumer-oriented sectors, including food and drug, retail, and gaming/leisure, may be well positioned to benefit from increased consumer spending resulting from savings derived from the decline in energy prices. We note that spreads on the representative benchmark Credit Suisse Leveraged Loan Index are still above long-term averages, and the average dollar price of loans remains at a discount. Thus, we believe there remains the opportunity for both current income and some capital appreciation in the loan market in 2016.

EMERGING MARKETS
Leah Traub

- **Emerging markets rebound**—After a challenging 2015, emerging market asset classes—including currencies, sovereign and corporate bonds (denominated in hard currency and local currency), and equities—received a substantial boost in the first quarter of 2016 due to a number of supportive factors.

- **Commodity and currency support**—In the commodities market, crude oil prices stabilized, providing some relief to emerging markets that rely on the export of crude oil as a chief commodity, such as those of Colombia, Malaysia, and Russia. In the currency market, the Chinese yuan regained strength against the U.S. dollar, as the People’s Bank of China intervened in March to back the currency and to assure investors that support would be ongoing, as needed.

- **Easier times**—Continued quantitative easing by both the Bank of Japan and the European Central Bank also supported emerging
market currencies, as abundant liquidity and lower rates domestically in the eurozone and Japan encourage outward investment in the higher-yielding emerging markets. In addition, the U.S. Fed’s decision to scale back the pace of rate hikes based on “global economic and financial developments” helped further reduce U.S. and global interest rates.

**Reasons for optimism**—Reflecting these developments, the representative Barclays Global Emerging Market Strategy Index rallied sharply: as of April 4, 2016, it was up 7% from its low on January 21. We believe that there is still room for additional appreciation, and we remain cautiously optimistic, as continued stabilization in global growth, especially in China, will be supportive for emerging markets that depend largely upon exports and foreign investment for growth.

**MUNICIPAL BONDS**

Daniel Solender

**The supply/demand picture**—For the municipal bond market, the first few months of 2016 have seen moderate new issue supply complemented by strong investor demand. Year to date in 2016, the supply of new issues has trailed the pace of the year-ago period, while inflows into municipal bond funds have been positive in each week. As U.S. interest rates remain historically low, issuers will have opportunities to refund outstanding bonds, which could lead to an increase in supply. Demand from retail investors has been consistent, but needs to remain steady if supply increases.

**Puerto Rico and Chicago are not systemic issues**—The bond market will be watching headlines regarding Puerto Rico and Chicago. Congress is developing a bill in response to Puerto Rico’s troubled fiscal situation. Also, the U.S. Supreme Court is expected to render an opinion in June regarding the ability of Puerto Rico’s public utilities to restructure their obligations that could affect the commonwealth’s financial strategy. Meanwhile, the Illinois Supreme Court ruled against Chicago’s plan to reduce its pension liabilities, so the city needs a new strategy soon. Even though these issues only apply to these issuers for now, they will receive considerable attention.

**Munis versus Treasuries**—Some investors choose between taxable fixed-income investments and munis. An important relative value indicator is the ratio of yields on municipal bonds to those on U.S. Treasury securities. For long maturities, municipal yields are more than 100% those of comparable maturity of Treasuries without even calculating the tax-equivalent yield. Ten-year municipal yields are 96% of Treasury yields, before any calculation of tax-equivalent yield. Both ratios currently suggest that the muni market remains attractively valued compared with historical levels, and these conditions should continue to create demand for municipal bonds. Yet if they were to decrease, the municipal market may experience some pressure, but it would take a significant downward move to have any effect.

**Risks to Consider:** Statements concerning financial market trends are based on current market conditions, which will fluctuate. All investments involve risk, including the loss of principal invested. The value of an investment in fixed-income securities will change as interest rates fluctuate and in response to market movements. As interest rates fall, the prices of debt securities tend to rise. As rates rise, prices tend to fall. Investing in the bond market is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. Longer-term debt securities are usually more sensitive to interest-rate changes. The longer the maturity date of a security, the greater the effect a change in interest rates is likely to have on its price. High-yield, lower-rated securities involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. The municipal bond market may be impacted by unfavorable legislative or political developments and adverse changes in the financial conditions of state and municipal issuers or the federal government in case it provides financial support to the municipality. Income from the municipal bonds held could be declared taxable because of changes in tax laws. Certain sectors of the municipal bond market have special risks that can affect them more significantly than the market as a whole. Because many municipal instruments are issued to finance similar projects, conditions in these industries can significantly affect an investment. Income from municipal bonds may be subject to the alternative minimum tax. Federal, state and local taxes may apply. Investments in Puerto Rico and other U.S. territories, commonwealths, and possessions may be affected by local, state, and regional factors. These may include, for example, economic or political developments, erosion of the tax base, and the possibility of credit problems. The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy. Small-cap and mid-cap company stocks tend to be more volatile and may be less liquid than large-cap company stocks. Small-cap companies also may have more limited product lines, markets, or financial resources and typically experience a higher risk of failure than large-cap companies. Mid-cap companies typically experience a higher risk of failure than large-cap companies. Investing in international securities generally poses greater risk than investing in domestic securities, including greater price fluctuations and higher transaction costs. Special risks are inherent to international investing, including those related to currency fluctuations and foreign political, and economic events. The securities markets of emerging countries tend to be less liquid, especially subject to greater price volatility, to a smaller market capitalization, have less government regulation and may not be subject to as extensive and frequent accounting, financial and other reporting requirements as securities issued in more developed countries. Further, investing in the securities of issuers located in certain emerging countries may present a greater risk of loss resulting from problems in security registration and custody or substantial economic or political disruptions. No investing strategy can overcome all market volatility or guarantee future results.

References to specific securities and issuers are for illustrative purposes only and are not intended and should not be interpreted as recommendations to purchase or sell such securities. Due to market volatility, the market may not perform in a similar manner in the future.

**Forecasts and projections are based on current market conditions and are subject to change without notice. Projections should not be considered a guarantee.**

**Gross domestic product (GDP)** is the total value of all the goods and services produced within a country’s borders. When that figure is adjusted for inflation, it is called the real gross domestic product, and it’s generally used to measure the growth of the country’s economy.

**Price-to-earnings ratios:** Stock analysts calculate a forward price-to-earnings (PE) ratio by doubling a stock’s current price by estimated future earnings per share. Some forward PE’s are calculated based on estimated earnings for the next four quarters, while others use actual earnings from the past two quarters with estimated earnings for the next two. A forward PE may help you evaluate the current price of a stock in relation to what you can reasonably expect to happen in the near future. In contrast, a trailing PE is based exclusively on past performance.

**Dividends** are not guaranteed and may be increased, decreased, or suspended altogether at the discretion of the issuing company. **Yield** is the annual interest received from a bond and is typically expressed as a percentage of the bond’s market price. Spread is the difference in yield between two different investments.

**The Barclays Global Emerging Market Strategy (GEMS) Index** is based on investing in one-month synchronous money market deposits across 15 diversified emerging market currencies. **The Russell 2000® Growth Index** measures the performance of those companies in the Russell 2000 Index with higher price-to-book ratios and higher forecasted growth values. **The Russell Top 200® Index** measures the performance of the 200 largest companies in the Russell 1000 Index.

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