Item 3

MCERA

MERCED COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

Core Fixed Income Strategy

April 28, 2016

Debbie Petruzzelli – Managing Director, Portfolio Manager

Eddie Guerra, III – Director, Client Portfolio Manager

BARROW, HANLEY, MEWHINNEY & STRAUSS, LLC

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BRIEF HISTORY OF OUR ORGANIZATION

- 37-Year-Old Firm, Founded in 1979 in Dallas, Texas, USA – $90.3 Billion AUM
- Largest Manager of Active U.S. Value Equities*
- Three-Decade History of Organizational Stability
- Institutional Focus – Boutique Culture
- 95 Employees, Including 37 Investment Professionals
- Significant Employee Equity Ownership
- Stable Partnerships, 30 Clients for More than 20 Years
- Experienced in Management of Large Portfolios, 30+ Larger than $500 Million
- Serving Clients Globally in North America, Europe, Asia, Australia, & Middle East

Emerging Markets Equity 2012
Global Value 2010
Investment Grade Credit 2009
Diversified Small Cap Value 2007
Non-U.S. Value 2006
Intermediate Credit 2004
High Yield Fixed Income 2002
Diversified Large Cap Value 2000
Dividend Focused Value
Mid Cap Value 1999
1998 Core Plus Fixed Income
1996 Vanguard Selected Value Fund
1995 Small Cap Value (closed)
1990 Long Duration Fixed Income
1985 Vanguard Windsor II Fund
1983 Core Fixed Income
1979 BHMS Founded on Large Cap Value

Assets as of March 31, 2016.
* *Pensions & Investments* May 18, 2015, based on U.S. institutional, tax-exempt assets as of December 31, 2014.

ASSETS UNDER MANAGEMENT:

- $90.3 Billion in Assets Under Management
  - ✓ $ 12.5 Billion - Fixed Income (In Various Strategies)
  - ✓ $ 77.8 Billion - Equities (U.S Multi-Cap, Non-U.S. & Global Value)

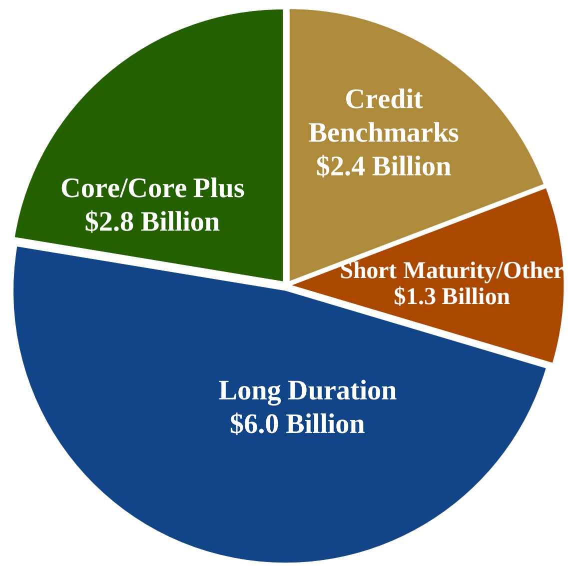
STABILITY: Organization is Financially Strong And Employees Have 24.9% Equity Interest

SYSTEM UPGRADES: Advent APX Accounting, Charles River for Compliance, and FactSet Portfolio Analysis and Attribution

TEAM:

- Experienced, Stable, and Multi-Generational
- Interviewing for a Credit and a Portfolio Analyst

$12.5 Billion Fixed Income



Research Team

	Years of Experience		*Years of Experience*		*Years of Experience*
Jim Barrow	54	Cory Martin	26	Michael Nayfa, CFA	12
Jane Gilday, CFA	48	Mark Giambrone	24	TJ Carter, CFA, CPA	12
Jim McClure, CFA	44	Mike Wetherington, CFA	23	Josh Ayers	12
David Hardin	40	David Ganucheau, CFA	20	Eric Micek, CFA	11
John Harloe, CFA	40	**Rahul Bapna, CFA**	19	Terry Pelzel, CFA	11
John Williams, CFA	40	Jeff Fahrenbruch, CFA	19	**Matt Routh, CFA**	8
Monroe Helm	40	Sherry Zhang, CFA	19	John Barber, CFA	9
Ray Nixon	39	Pranay Laharia, CFA	18	Chris Hathorn	9
Mark Luchsinger, CFA	35	**Erik Olson**	17	Coleman Hubbard	7
Lewis Ropp	35	David Hodges, CFA	16	**Shannon Hogan, CFA**	6
Tim Culler, CFA	32	Brian Quinn, CFA	15	Zane Keller, CFA	5
Debbie Petruzzelli	30	Rand Wrighton, CFA	14	Melodie Hunt	1
Scott McDonald, CFA	27	**Justin Martin, CFA**	12		

Fixed Income Team Member

Assets as of March 31, 2016.

Fixed Income Managing Directors

30 Years Average Experience / 19 Years with BHMS

John S. Williams, CFA
Portfolio Manager

40 Years Experience
33Years at BHMS

Chief Investment Officer
Risk Management
MBS, Governments

David R. Hardin
Portfolio Manager

40 Years Experience
29 Years at BHMS

Investment Grade
Credit

Mark Luchsinger, CFA
Portfolio Manager

35 Years Experience
19 Years at BHMS

Investment Grade and
High Yield Credit

Scott McDonald, CFA
Portfolio Manager

27 Years Experience
21 Years at BHMS

Investment Grade
Credit and
Long Duration

Debbie Petruzzelli
Portfolio Manager

30 Years Experience
13 Years at BHMS

Structured Products
MBS, ABS, CMBS

Erik Olson
Sr. Analyst /
Co-Portfolio Manager

17 Years Experience
15 Years at BHMS

Investment Grade and
High Yield Credit

Rahul Bapna, CFA
Sr. Analyst

19 Years Experience
4 Years at BHMS

Investment Grade and
High Yield Credit

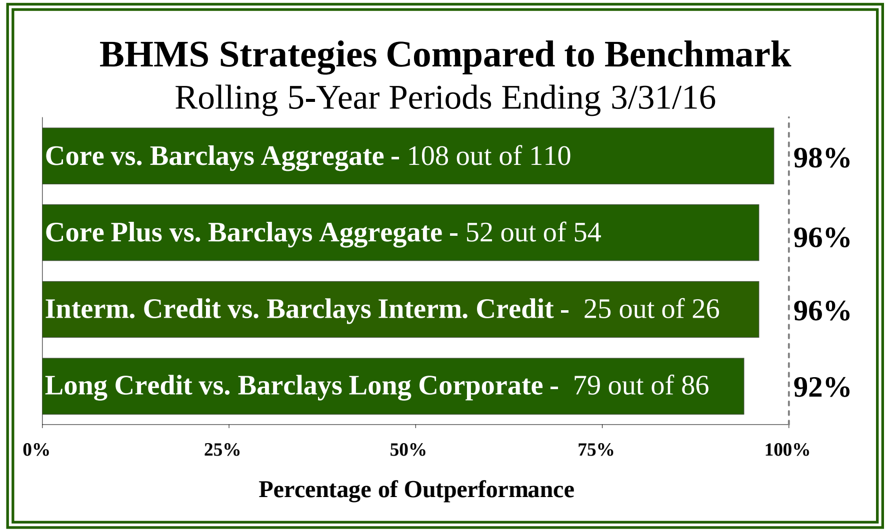
- Fixed Income Team is Experienced and Stable, Leading to Consistency of Strategy
- Fixed Income Team: 5 Portfolio Managers, 5 Analysts, 2 Client Portfolio Managers, 1 Trader, and 8 Staff Professionals

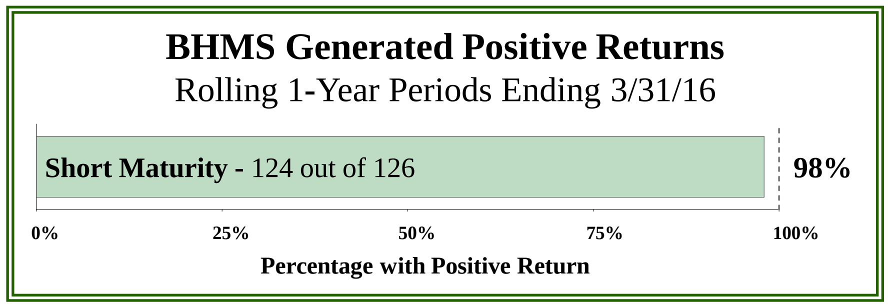
Distinguishing Factors of Our Investment Process

- Advantage of a Nimble Boutique-Size Bond Manager with Resources of a Large Firm for Research
- Direct Access to the Senior Management of Corporate America
- Opportunistic Research by Experienced and Stable Investment Team
- Able to Source Alpha from Credit and MBS Issues Across the Market Capitalization Spectrum
- Risk Management at the Security and Portfolio Levels Produces Consistency of Return

Consistent Value Philosophy Enables Repeatable Performance

- Bond Assets Should Generate Above-Market Returns with Lower Risk in a Duration Neutral Strategy to Fulfill Traditional Role in Asset Allocation
- Yield Advantage from Undervalued Bonds Produces Total Return Advantage
- Active Strategy Opportunistically Exploits Inefficiencies in Fixed Income Markets
- Disciplined Risk Controls Improve Consistency of Results



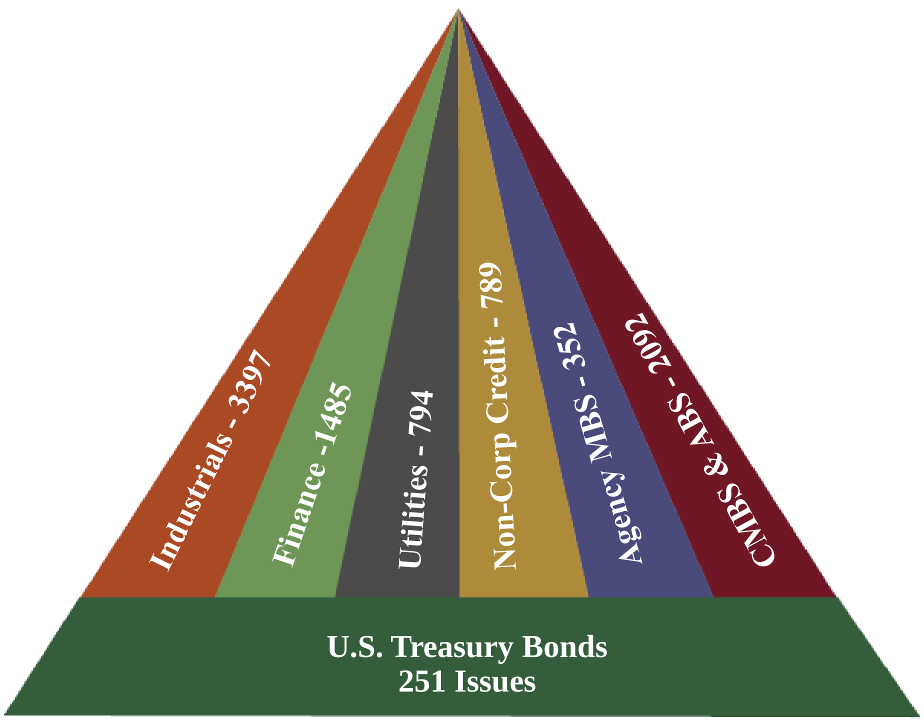


Returns are presented as supplemental information to the strategy composites shown above. GIPS® compliant presentations for these composites are available upon request.

Charts above reflect data since inception: Core and Short Maturity (1/1/84); Core Plus (1/1/98); Intermediate Credit (11/1/04) Long Credit (1/1/90)

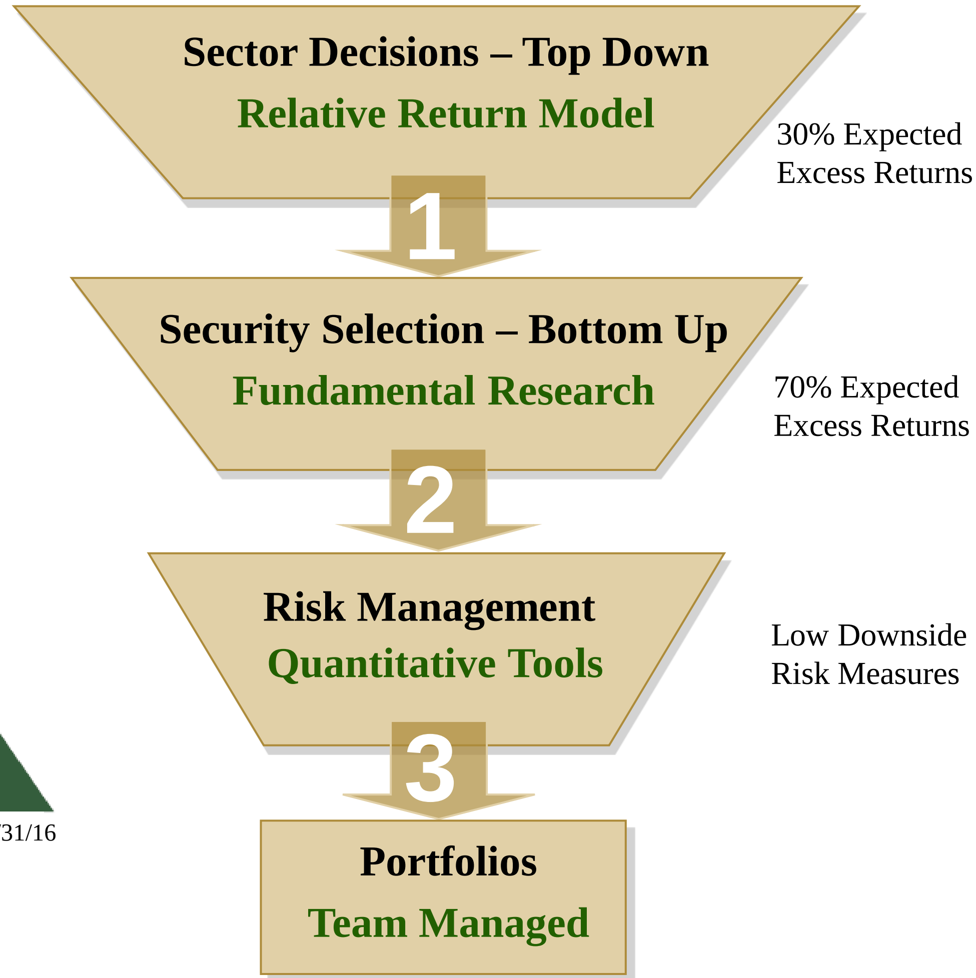
Disciplined Investment Process Since 1984

Barclays U.S. Aggregate Index
$18.8 Trillion



Source: Barclays 3/31/16

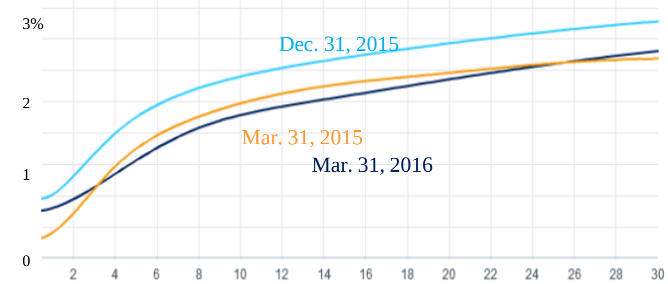
Three Step Process to Portfolios



"Is the Federal Reserve data or market dependent?"

- 1Q16 began with global risk markets in a free-fall.
  - Continued economic weakness in Europe and Japan
  - Deteriorating conditions in Emerging Markets
  - Downward slide in oil prices
  - 10-Year US Treasuries (UST) yields declined 63bps to 1.64% within the first six weeks
- The Fed had hinted of four potential rate increases, heading into 2016, but the volatility in 1Q16 spawned a dovish stance.
- U.S. economic data remained positive in 1Q16.
  - Continued strength in job growth – one year moving average of Non-Farm Payroll additions remained above 220K per month.
  - Consumer spending stronger as a result of lower oil prices.
- Inflation pressures did in fact rise as shown in the March 2.2% YoY increase in Core CPI (ex-Energy and Food).
- 63% of Japanese and 67% of German government bond markets had negative yields.
- Going forward, yields will remain range bound as a result of demand for UST.

U.S. Treasury Yield Curve



Source: Barclays Live

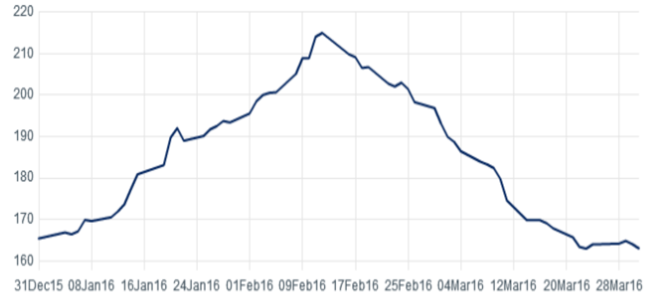
Yields & Spreads	12/31/15	3/31/16	2016 YTD High	2016 YTD Low
3 Mo. T-Bill	0.26%	0.20%	0.34%	0.17%
2 Yr. Treasury	1.05%	0.72%	1.05%	0.64%
10 Yr. Treasury	2.27%	1.77%	2.27%	1.66%
30 Yr. Treasury	3.02%	2.61%	3.02%	2.49%
Yield Curve 2-10 Yr.	122	105	122	82
Yield Curve 2-30 Yr.	197	189	199	177

Source: Barclays Live

Source: Bloomberg

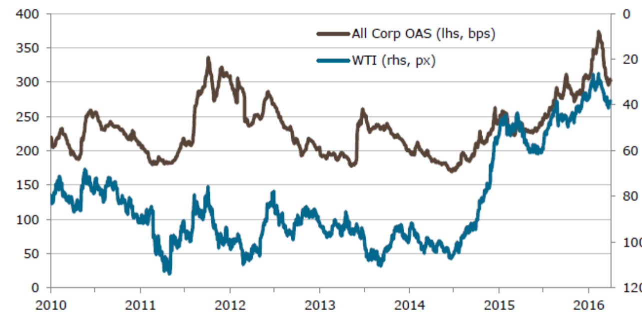
- The Investment Grade Credit (IG) market was unusually volatile during 1Q16:
  - IG Credit spreads peaked on February 10th, the largest intra-quarter widening since August 2011.
  - Spreads climbed 50bps above the YE2015 closing level of 165 bps.
  - Despite the volatility the Barclays IG Credit Index posted a 1Q16 total return of 3.92% and excess return of 0.18%.
- The ensuing spread rebound was largely driven by Industrials:
  - This pattern closely tracked the price of crude oil (WTI), which had fallen from $36.59/barrel at YE15 to a 13–year low of $26.19 on February 11.
  - WTI climbed back above $40 before settling at $36.94 on March 31.
- After an initially slow start to 2016, IG Credit new issue supply accelerated and closed 1Q16 ahead of last year's record pace.
  - New supply equaled $347B YTD in 1Q16 with Anheuser-Busch Inbev accounting for $46B of the new issue.
  - In particular, issuance weighed on performance of Financials.

IG Corporate Option Adjusted Spreads – 1Q16



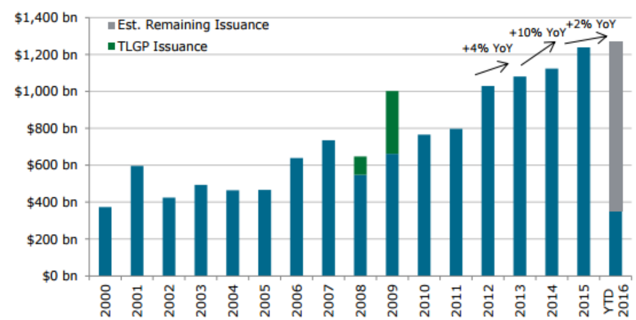
(bps); Source: BHMS; Barclays Live

Credit Spreads Highly Correlated w/Oil Since 2014



Source: Wells Fargo Securities

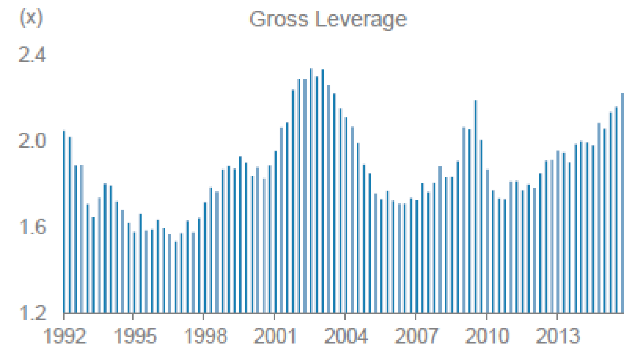
IG Issuance On-Pace to Set Another Record in 2016



Source: Wells Fargo Securities

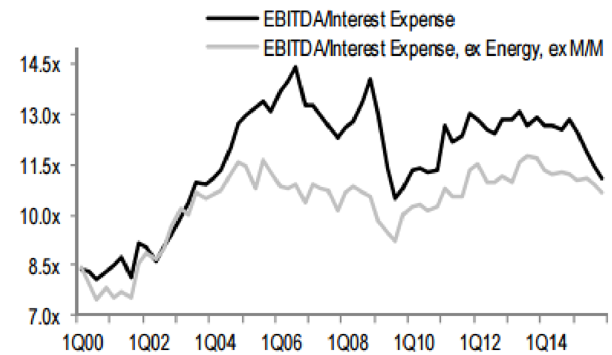
- Late Stage credit performance will be influenced by deteriorating fundamentals but offset by favorable technical factors.
  - Corporate balance sheet leverage now exceeds the level reached during the Financial Crisis peak.
  - Merger and acquisition (M&A) announcements have subsided versus 2015 levels, helping to slow the growth in leverage.
  - A decline in corporate earnings and cash flows means leverage may continue to rise.
  - Bloomberg reports S&P 500 earnings are forecast to decline 7.9% YoY, the worst since 4Q09, and 10.8%
- The technical picture, while still mixed, is mostly positive for spreads.
  - Investor demand for U.S. Credit still appears sufficient to absorb IG issuance at its 1Q16 pace.
  - Demand could also increase thanks to further easing by the BOJ and ECB which has driven Non-U.S. government yields in much of the developed world into negative territory.
  - The yield advantage offered by U.S. Credit should further boost the relative attractiveness of U.S. corporate debt to both domestic and global bond investors.

IG Corporate Leverage Now Near Crisis Peak



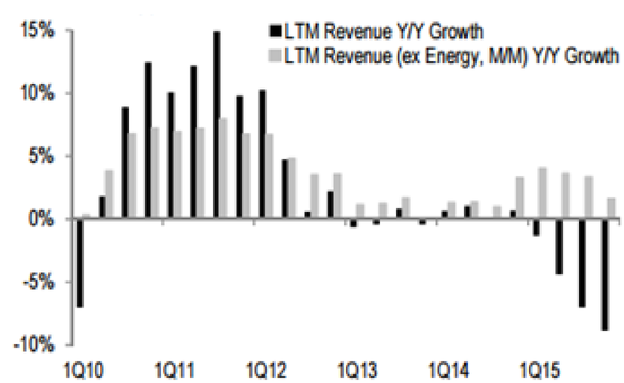
Source: Morgan Stanley Research

…and Int. Coverage Near Crisis Low, even Ex-Energy



Source: J.P. Morgan

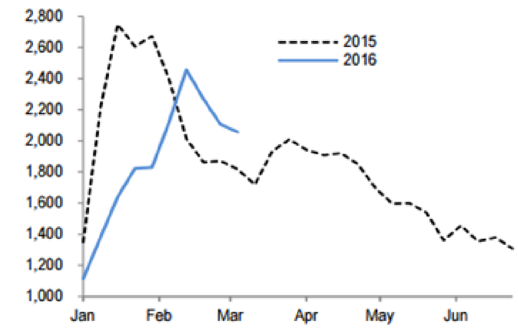
YoY Rev. Ex-Energy Actually Increased, but Slowing



Source: J.P. Morgan

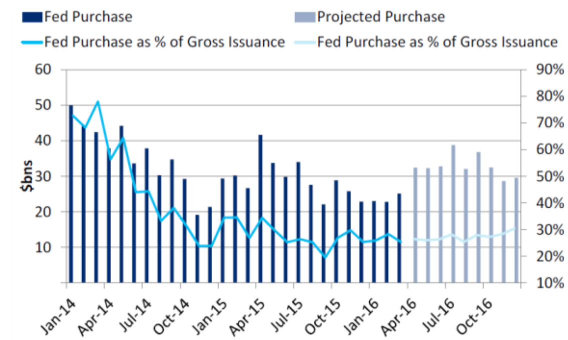
- The first quarter of 2016 appeared to be a repeat of 2016.
    - Lower UST yields led to a decline in mortgage rates resulting in a REFI wave.
- Mortgage supply during the quarter totaled +$32B on a net basis versus -$8.8B for the same period last year as mortgage rates stayed lower for a longer period of time.
- Although nominal returns for the quarter were positive (1.98%), the sector did not keep pace with UST resulting in a -0.38% excess return.
- Looking ahead, a more dovish Fed and negative Global Yields are a constructive technical for Agency MBS.
- Fed will continue reinvesting pay-downs through 2017.
    - Approximately $30-$35B per month.
- Overseas demand has seen a surge as investors with high FX costs favor MBS over UST.
- MBS continue to look attractive as a stable source of carry/income. The technical picture going forward for MBS remains mostly positive.
- Though interest rates are low, concerns about prepayment risks are not entirely priced into specified pools and valuations remain attractive due to a favorable price differential over TBAs.

MBA Refinancing Index Spiked in 1Q16



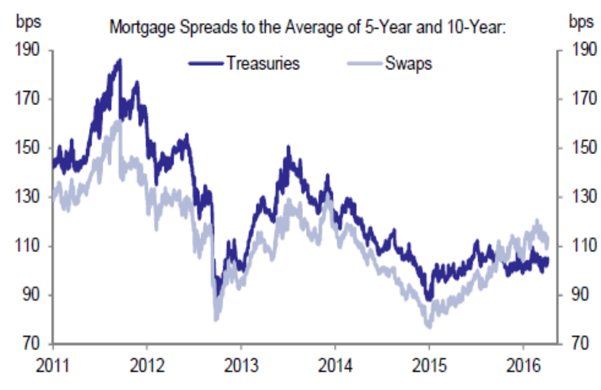
Source: J.P. Morgan

Fed Re-Investment Purchases Expected to Increase



Source: Citi Research

Mortgages Have Widened 5bps vs. UST Swaps YTD



Source: Goldman Sachs Global Investment Research.

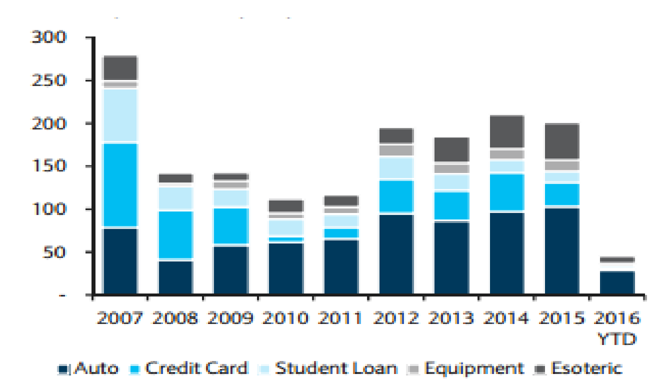
Asset Backed Securities:

- After underperforming in the first two months of 1Q16, the ABS markets recovered posting a 1.36% nominal return and 0.16% excess return.
- Issuance in the quarter was down 34% when compared to last year due to volatile markets – weakest since 2012.
- Demand for benchmark issues contributed to the positive performance as the market experienced ‘tiering’ especially between prime and subprime autos.
- A strong job market along with income growth that supports spending will be supportive of the market.

Commercial Mortgage Backed Securities:

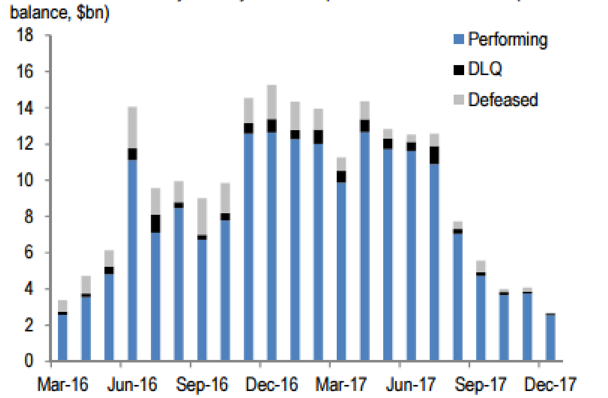
- Market volatility along with new regulations and increased capital charges has slowed issuance. Supply in 1Q16 lags 1Q15 by 46%
- Spreads in CMBS widened during the first two months of the year until the market firmed in March and reversed course.
- Although the CMBS landscape is currently changing, implementation of new rules will improve credit quality of new deals and will be a positive for investors going forward.

ABS Yearly Issuance



Source: Barclays Research

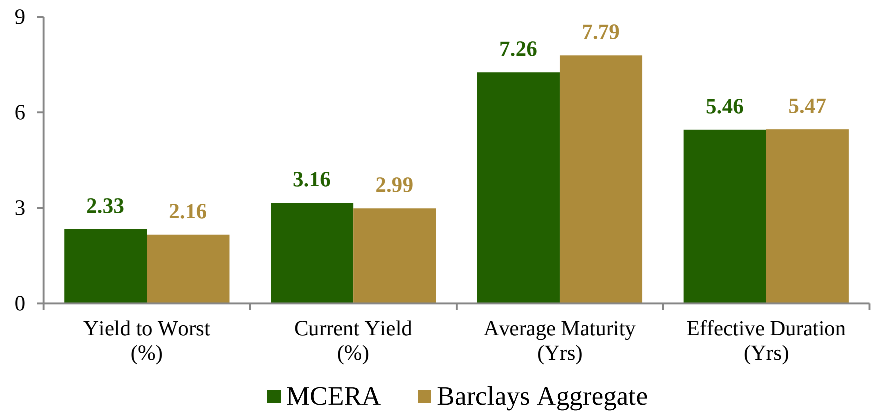
CMBS Re-Financing Wave Approaching in Late-2016



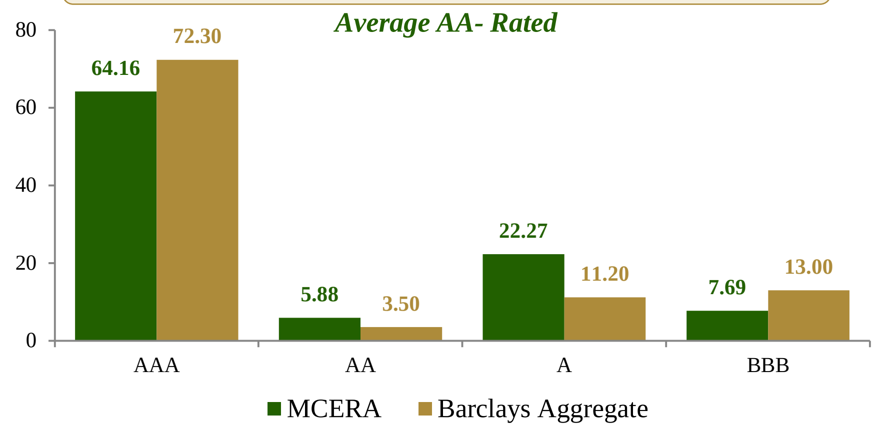
Source: J.P. Morgan

Market Value: $114,915,699

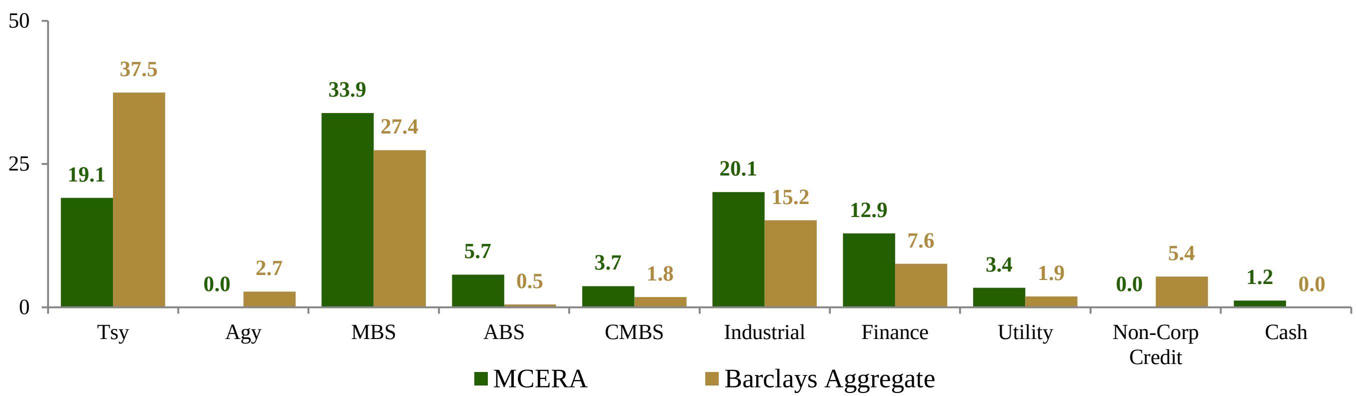
Portfolio Summary



Quality Distribution (%)



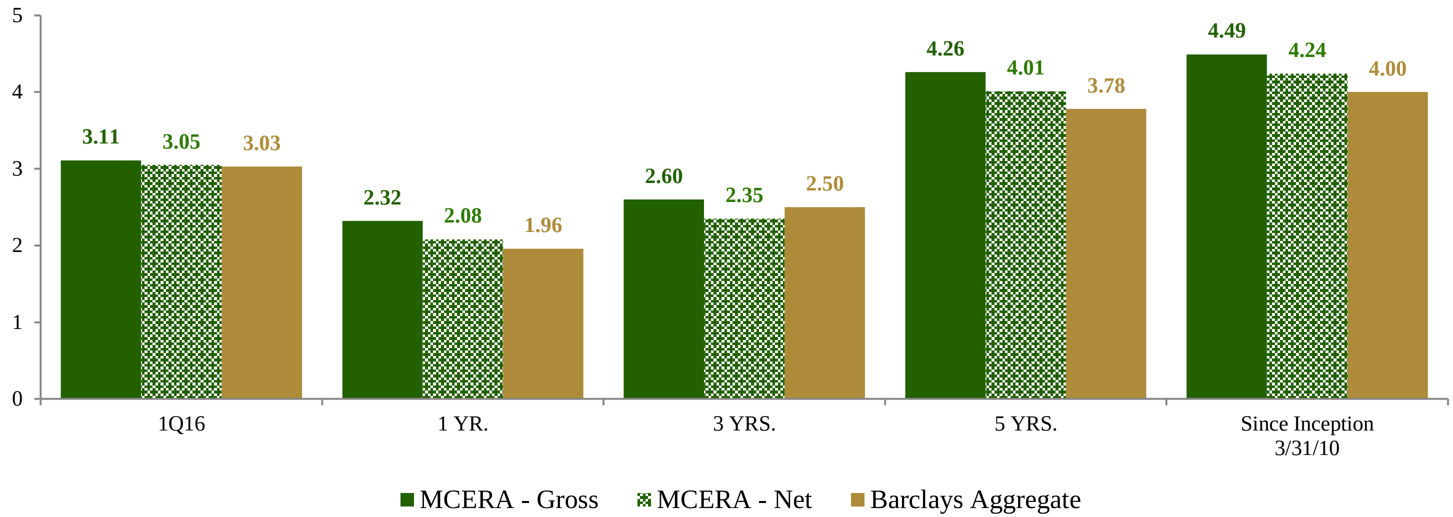
Sector Distribution (%)



Barclays Agg.	**1Q16**	**0.00**	**0.12**	**-0.38**	**0.16**	**0.58**	**0.70**	**-0.92**	**0.13**	**0.27**	**-**
Excess Returns	**12 Months**	**0.00**	**0.14**	**0.08**	**0.46**	**-0.08**	**-2.33**	**-0.74**	**-1.91**	**-1.59**	**-**

Excess return: Reflects the excess return of the Barclays Aggregate Index for 4Q and 2015, and for the Index sectors shown in table above, versus the return of the comparable duration U.S. Treasury. Average Rating reflects S&P. Sources: BondEdge and Barclays

MCERA vs. Barclays Aggregate
Trailing 1-Year Portfolio Attribution



Source: FactSet	Rate Effect	Curve Effect	Security Selection Effect	Sector Allocation Effect	Total Effect
Total	**-0.02**	**0.01**	**0.56**	**-0.19**	**0.35**

Significant Contributors to Performance:

- Security Selection in U.S. Treasuries (UST): Our 'risk-off' positioning in longer dated UST issues was beneficial during declining rate environments.
- Security selection in Basic Industry, Communications, Consumer Non-Cyclicals and Energy as our holdings outpaced their peers in the Index.
- Security Selection in Bank holdings generated better performance relative to the Barclays Aggregate Index.
- Overweight in MBS and CMBS positively impacted performance.

Primary Detractors from Performance:

- Security Selection in Mortgage Backed (MBS): Our MBS holdings lagged their benchmark peers.
- Overweight in Industrials: Our decision to overweight Basic Industry and Energy negatively impacted performance as these subsectors struggled due to lower commodity prices.
- Overweight and Security Selection in ABS: The sector in the index generated returns below the Barclays Aggregate Index.

Corporate Sector Positions of Interest

- **Banks:** Largest Overweight as New Regulation Mandates Stronger Liquidity, Less Balance Sheet Leverage, and Higher Capital Ratios.
- **Energy:** Overweight is in High Quality Integrated Issues.
- **Sovereigns:** Underweight Bifurcated Sector as High Yielding Issuers, Such as Brazil, Are Under Pressure And High Quality Issuers Have Very Low Yields.

Portfolio Well Diversified

- **Largest Five Overweights:** Portfolio 22.12% Versus 12.5% for The Index.
- **Largest Five Underweights:** With The Exception of Non-Corporate Credit, Underweights Are Less Than 1%.

Significant Over/Underweights vs. Barclays Aggregate

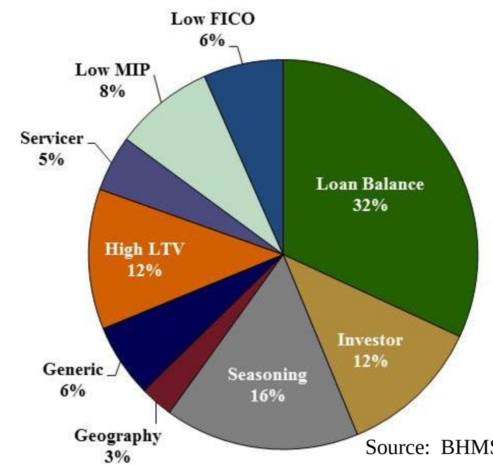
Period Ending March 31, 2016

	Portfolio	*Benchmark*	*Difference*
Overweights - Largest (%)			
Banking	**9.33**	**5.39**	**3.94**
Consumer Cyclical	**4.00**	**1.94**	**2.06**
Electric	**3.43**	**1.72**	**1.71**
Insurance	**2.16**	**1.16**	**1.00**
Energy	**3.20**	**2.29**	**0.91**
Underweights - Largest (%)			
Non-Corporate	**0.00**	**5.39**	**-5.39**
Finance Companies	**0.00**	**0.21**	**-0.21**
Other Industrial	**0.00**	**0.18**	**-0.18**
Other Utility	**0.00**	**0.16**	**-0.16**
Communications	**2.39**	**2.46**	**-0.07**

Source: BondEdge

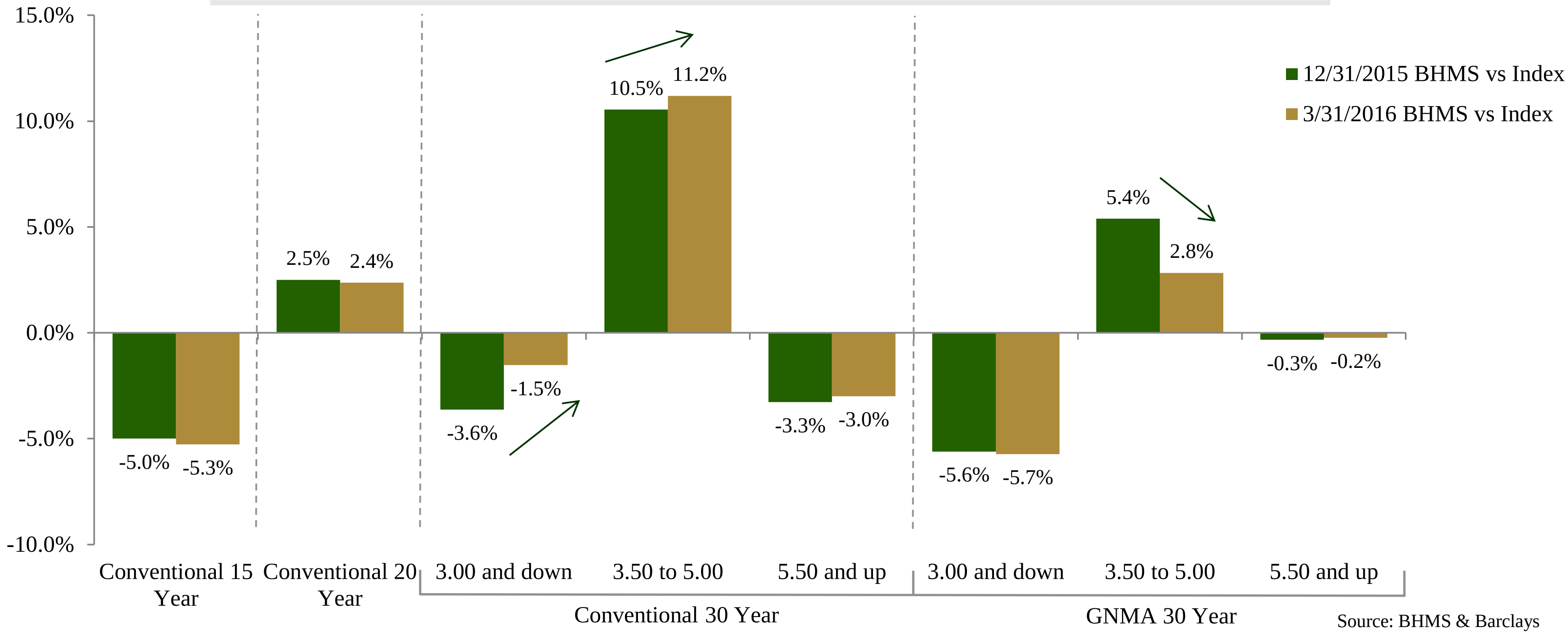
- Maintain Overweight as Carry & Liquidity Remain Strong.
- Positioning Favors 30yr Conventionals with a Focus on Lower Pay-Up Specified Pools.
- A Dovish Fed will Push Out Taper of Reinvestment of Paydowns Probably through 2017.
- Negative Yields Across the Globe are a Supportive Technical as Foreign Investors with High FX Costs Favor MBS Versus Treasuries.

BHMS MBS Pool Allocation



Source: BHMS as of 3/31/16

Over/Under Weights Relative to Barclays Aggregate Index



Source: BHMS & Barclays

Fixed Income Strategies

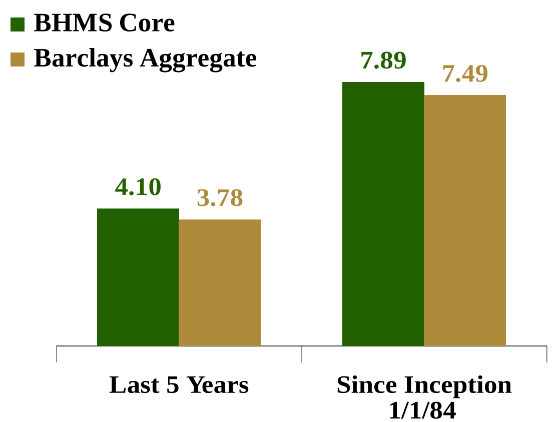
Fixed Income Performance

Periods Ended March 31, 2016

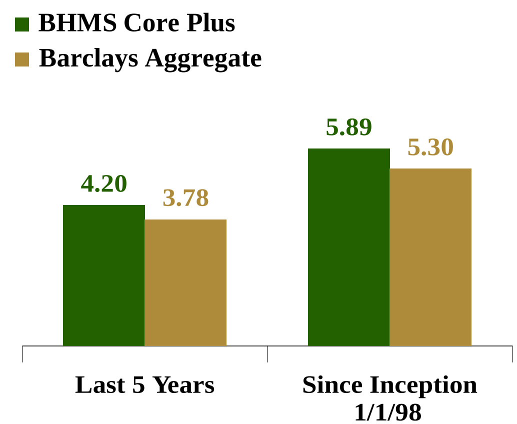
- Core and Core Plus Strategies Provide Style Diversification Compared to Large Managers. Current Market's Low-Yield Environment Has Led Us to Develop an Opportunistic Credit Strategy.

- Intermediate and Short Maturity Strategies May Gain Traction In A Rising-Rate Environment.

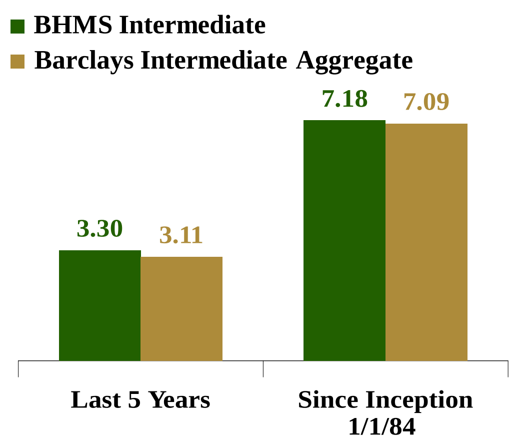
Core



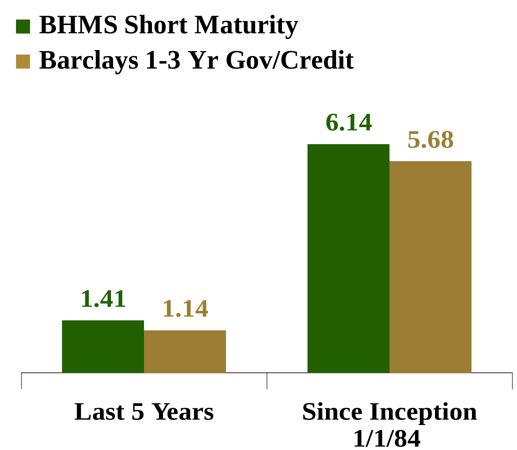
Core Plus



Intermediate



Short Maturity



Returns are annualized for periods of more than one year. BHMS' returns are shown before investment management fees and custody expenses. Index returns are shown without transaction costs, management fees, and other expenses. Performance returns are reported in U.S. currency. Returns are presented as supplemental information to the relevant BHMS fixed income composites. See appendix for GIPS® compliant presentations for these composites.

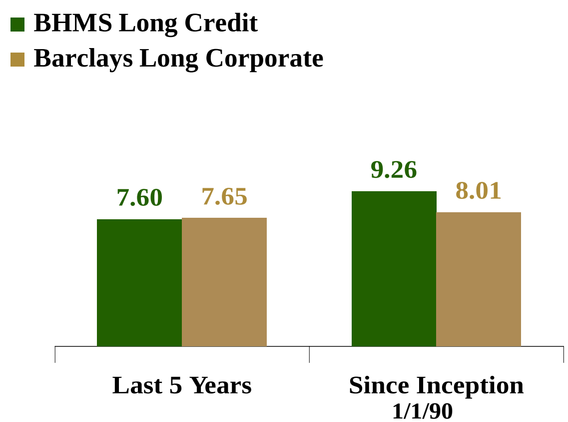
Source: PEP for Windows

Fixed Income Performance

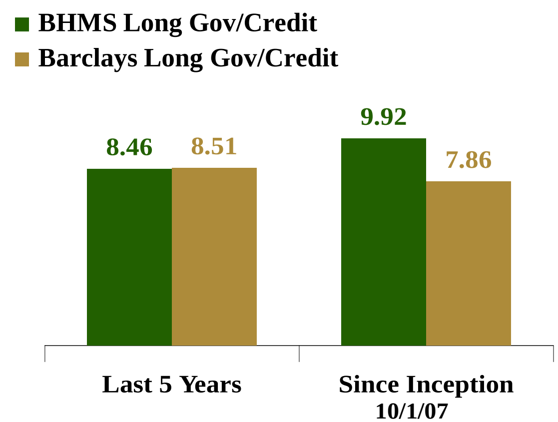
Periods Ended March 31, 2016

- Long Duration Strategies Grow as DB Plans Adopt LDI and Increase Allocation as Funded Status Improves.
- Our "Bottom-Up" Smaller Debtor Style Is Complementary to Larger Macro Managers, Making BHMS Attractive to Large Plan Sponsors With Multi-Manager Strategies.

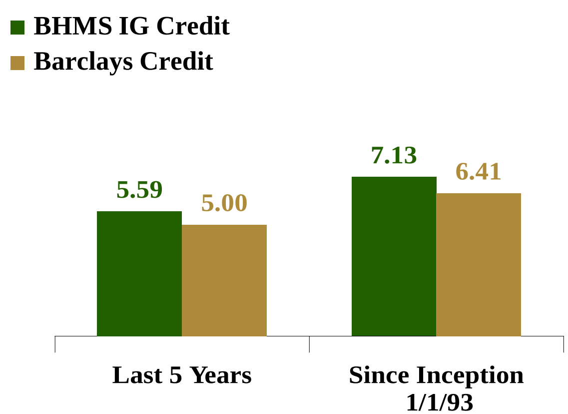
Long Credit



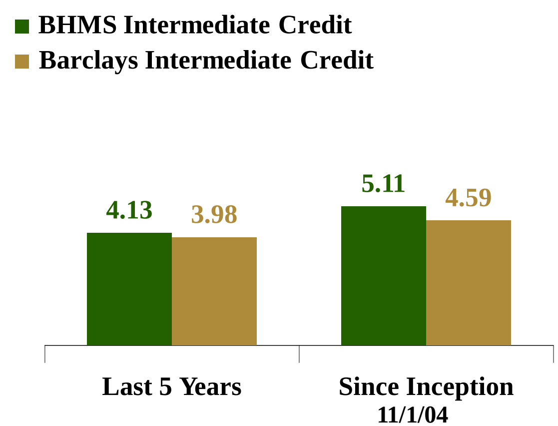
Long Government / Credit



Investment Grade Credit



Intermediate Credit



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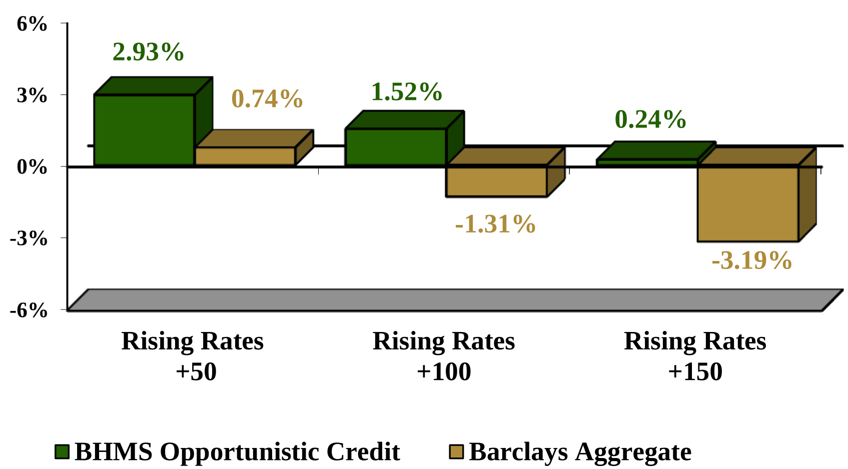
Source: PEP for Windows

Concerns About Fixed Income Environment

- Low Yields Make it Difficult to Achieve the Returns Many Clients Want from Their Asset Allocation to Traditional Core Bond Portfolios.
- The Low-Rate Environment Has Also Led to the Common Belief that Rates Must Rise When the Federal Reserve Reduces Quantitative Easing Leading to Significant Losses in Fixed Income Portfolios.
- The Barclays Aggregate Index has Extended Duration in a Low Yield Environment.
  - ✓ Treasury Bonds are the Fastest Growing Sector with the lowest average yield of only 1.0%.
  - ✓ As Rates Rise MBS Will Have More Duration Extension Risk.

Opportunistic Credit Portfolio One Year Projection as of 3/31/16



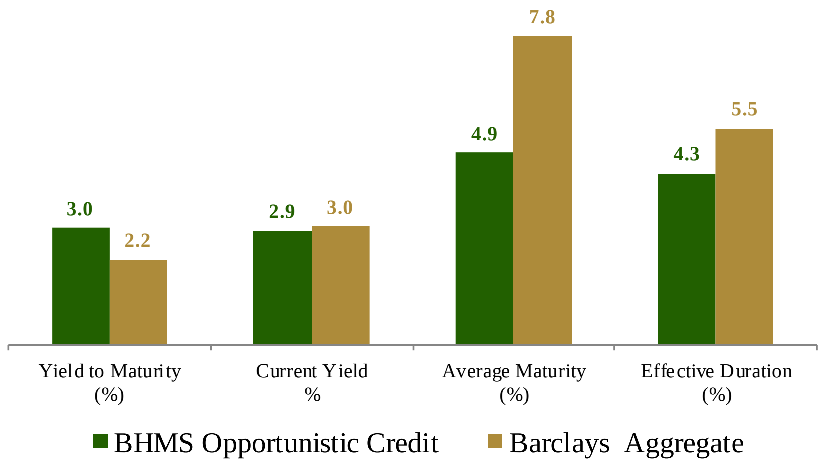
1Q16 Scenarios	#1	#2	#3		#1	#2	#3
Interest Rate Changes				Sector Spread Changes			
6 Month Treasury	50	100	150	BBB Utility	-25	-25	-25
2 Year Treasury	45	90	135	BBB Industrial	-30	-30	-30
5 Year Treasury	40	79	119	BBB Finance	-25	-25	-25
10 Year Treasury	33	67	100	BBB Non-Corp Cr	-25	-25	-25
30 Year Treasury	30	60	90	BB Corp	-30	-30	-30

Source: BHMS projections calculated in BondEdge

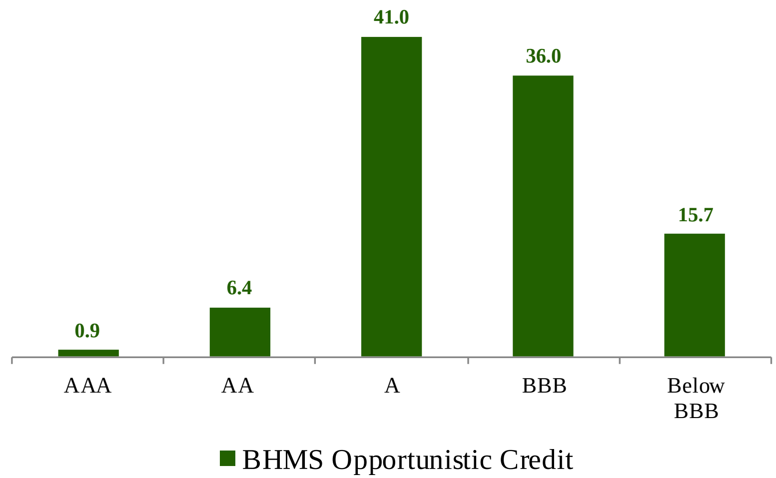
Opportunistic Credit Strategy - Higher Yield And Lower Duration Than Barclays Aggregate

- Opportunistic Credit strategy allocated to Intermediate Investment Grade Credit with Higher Quality High Yield.
- Compared to the Barclays Aggregate it generates (1) Higher Yield/Income; (2) Reduces Interest Rate Risk by 22%; and (3) Eliminates Duration Extension Risk in MBS.

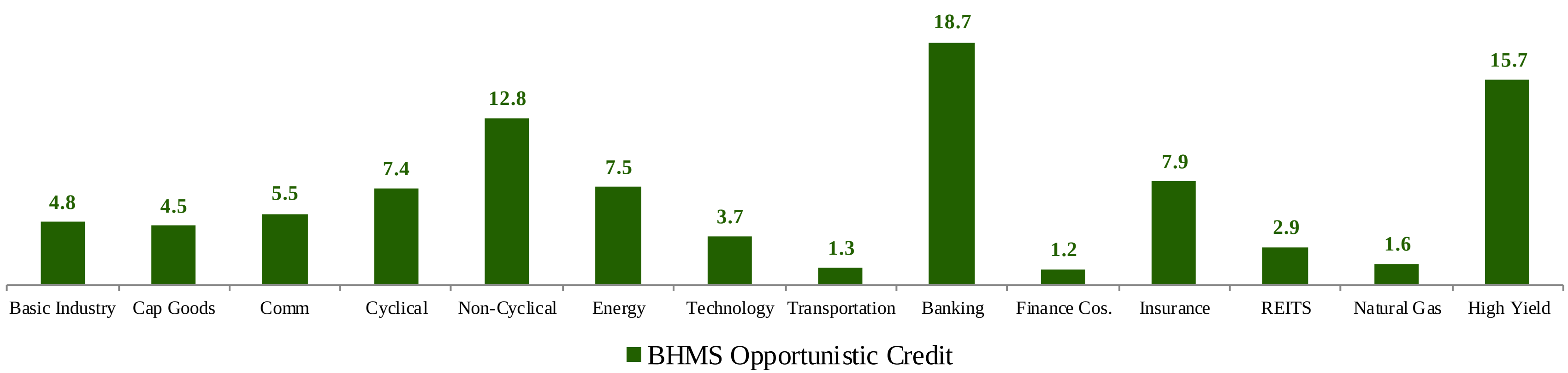
Portfolio Summary



Quality Distribution (%)



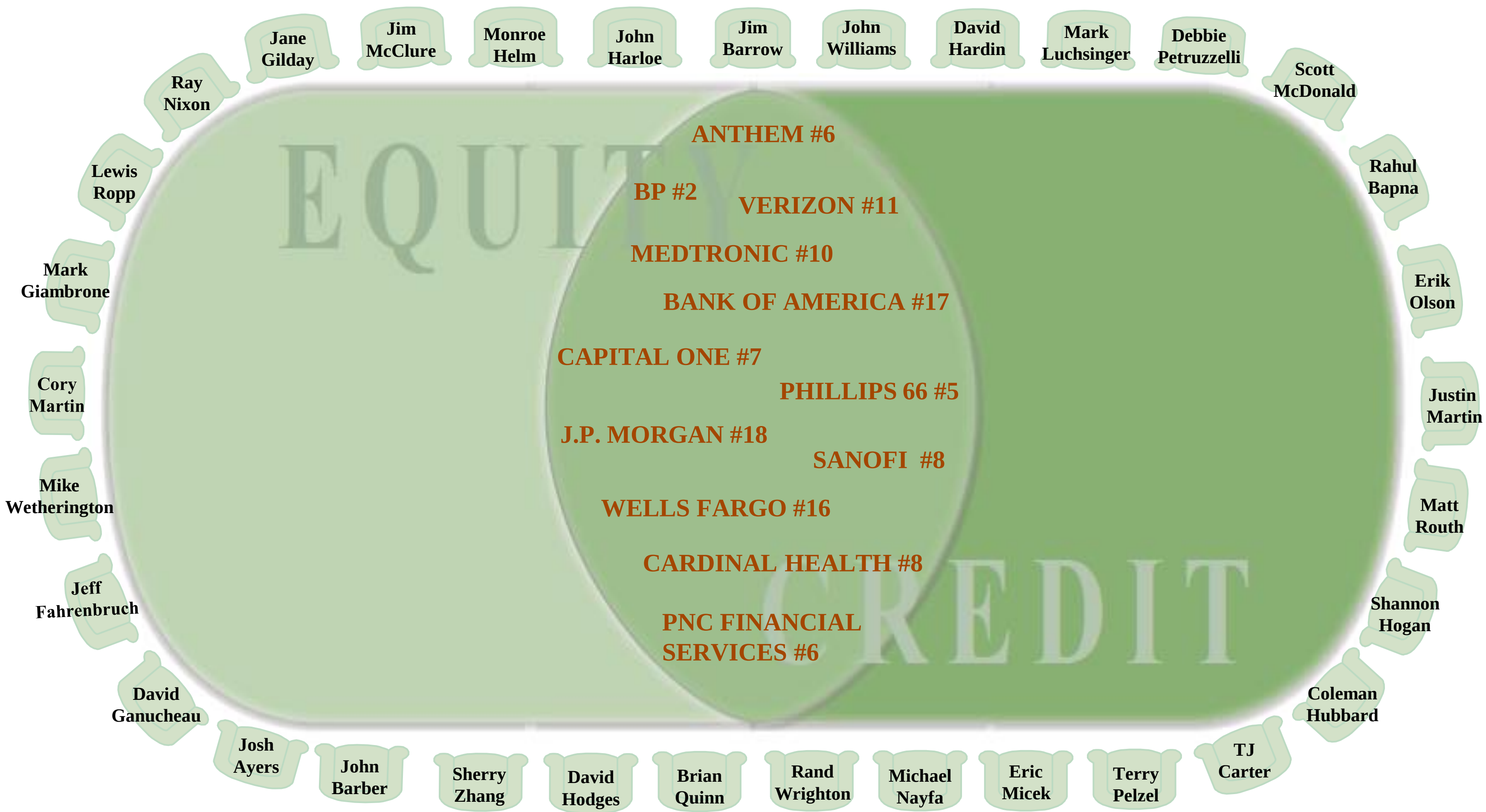
Sector/Industry Distribution (%)



APPENDIX

EXPERIENCED PROFESSIONALS LEAD TO RESEARCH SUCCESS

Integrated Research – Independent Decisions



- **Top 20 Shareholder of Over 100 Companies Provides Direct Access to Senior Management**
- **Barrow Hanley's Position Among the Largest Stockholders Benefits Bond Analysis**

# Indicates Equity Shareholder Ranking, as of March 31, 2016
BHMS also invests in the bonds of these companies in our fixed income strategies
Source: Bloomberg

Benefits of Firm-Wide Research

- **Frequent Meetings With Company Management Teams Leads to Debt-Holder Insights**
  - ✓ 280 Meetings Through December 31, 2015
  - ✓ Representative Management Meetings in 2015

Date	Firm	Date	Firm	Date	Firm
2-Apr	**CBS**	21-Sep	**Delphi**	16-Dec	**Owens Corning**
23-Apr	**JPMorgan**	29-Sep	**Caterpillar**	21-Dec	**General Dynamics**
5-May	**Starbucks**	7-Oct	**Chevron**	15-Jan	**Oracle**
8-Jun	**AT&T**	21-Oct	**Phillip Morris**	2-Feb	**AT&T**
19-Jun	**Dow Chemical**	30-Oct	**Goldman Sachs**	3-Feb	**Lockheed Martin**
14-Jul	**Oracle Corp.**	5-Nov	**Marathon Petroleum**	26-Feb	**Daimler AG**
14-Jul	**Willis Group**	10-Nov	**Sanofi**	8-Mar	**Deere & Co**
3-Aug	**Capital One**	13-Nov	**Stanley Black & Decker**	15-Mar	**Microsoft**
20-Aug	**Air Products**	20-Nov	**Target**	29-Mar	**General Electric**
20-Aug	**International Paper**	9-Dec	**Archer Daniels Midland**	31-Mar	**DreamWorks**

- **Integrated Research Allows For Direct Access to Company Management**
  - ✓ Ability to Quickly Contact Senior Management Via Conference Call or Personal Meeting
  - ✓ Assistance With Allocations on Difficult to Source New Issues

- **Firm-wide Research Approach Generates In-Depth Coverage of Companies**
  - ✓ Daily Stock Price Alert Screen: Stock Price Change +/- 4% vs. Market Triggers Credit Review
  - ✓ Equity and Bond Analysts Reports Distributed to "Research Group" and Available in Shared Digital Library

- **Third Party Resources: Bloomberg, CreditSights, FactSet and Wall Street Analysts**

***"Fear is that little darkroom where negatives are developed."* -- Michael Pritchard**

1Q16 MARKET REVIEW: Volatility was a constant throughout 1Q16, but all segments of the bond market finished with positive total returns thanks primarily to declines in U.S. Treasury (UST) yields. The 3.03% total return for the Barclays Aggregate Index in 1Q16 was the strongest quarterly performance since 2Q2010.

THE ECONOMY, INTEREST RATES & THE FED: Financial markets were held captive by investor concerns over global economic growth and a rapid decline in commodity prices during the first six weeks of 1Q16. However, those fears eventually subsided after additional monetary easing in Japan and Europe and a strong rebound in oil prices. UST yields failed to climb much above the 1Q16 low and the 10yr UST finished 50 basis points (bps) lower at a 1.77% yield.

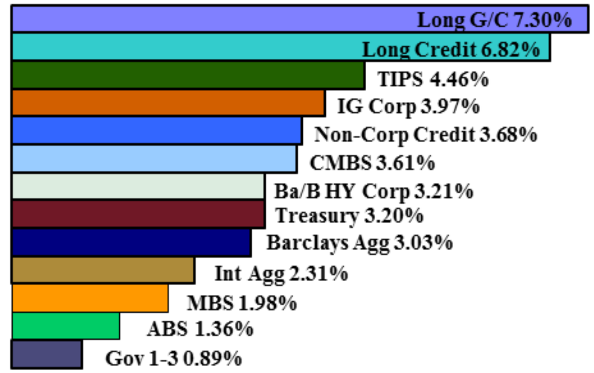
INVESTMENT GRADE CREDIT: Investment Grade (IG) Credit outperformed the Barclays Aggregate Index with positive total and excess returns. There was significant volatility in IG Credit, as the market moved quickly from risk-averse to opportunistic buying at wider spreads. Industrials and Financials were primarily responsible for the spread widening in the IG Credit Index in the first six weeks of 1Q16, but Industrials in particular, rebounded strongly thereafter to the benefit of BHMS portfolios.

HIGH YIELD: High Yield (HY) Credit enjoyed its strongest performance since 4Q2013 as the Barclays HY Ba/B Index finished 1Q16 with a total return of 3.21%. During the quarter, HY spreads reached the widest level since October 2011, driven by fears of weaker commodity prices and an economic slowdown. After commodity prices stabilized in mid-February and began an upward trend, investors migrated towards the beleaguered Energy and Metals and Mining sectors, which enjoyed strong performance. The BHMS HY Fund outperformed the HY Ba/B Index in 1Q16.

LONG CREDIT: Long Credit outperformed shorter maturities and posted positive returns in 1Q16. The Barclays Long Credit Index finished 1Q16 with a 6.82% total return and outpaced similar USTs with an excess return of 0.18%, reflecting the higher carry/yield. An overweight in Industrials boosted relative performance in the BHMS Long Credit strategy.

AGENCY MBS, ABS AND CMBS: The Mortgage Backed Security (MBS) sector lagged the overall Aggregate Index in 1Q16. As is typical during a flight-to-quality rally like 1Q16, MBS performance lags that of UST. BHMS maintained an overweight in MBS due to constructive technicals, including continued Federal Reserve (Fed) purchases and foreign institutional investor demand due to the dearth of attractive developed market sovereign yields. The performance of Commercial Mortgage Backed Securities (CMBS) and Asset Backed (ABS) diverged in 1Q16. CMBS posted the strongest nominal and excess returns of any securitized sector in the Barclays Aggregate, while ABS trailed in both regards and underperformed the benchmark. BHMS remained overweight in both ABS and CMBS.

Barclays Index Returns Q1 2016



			2016	
			YTD	YTD
Yields & Spreads	12/31/15	3/31/16	High	Low
3 Mo. T-Bill	0.26%	0.20%	0.34%	0.17%
2 Yr. Treasury	1.05%	0.72%	1.05%	0.64%
10 Yr. Treasury	2.27%	1.77%	2.27%	1.66%
30 Yr. Treasury	3.02%	2.61%	3.02%	2.49%
Yield Curve 2-10 Yr.	122	105	122	82
Yield Curve 2-30 Yr.	197	189	199	177

Barclays Sectors	Total Returns		Excess Returns*	
March 31, 2016	3-Months	One-Year	3-Months	One-Year
Financials	2.26%	1.78%	-0.92%	-0.74%
MBS	1.98%	2.43%	-0.38%	0.08%
Non-Corp. Credit	3.68%	0.93%	0.27%	-1.59%
IG Credit	3.92%	0.93%	0.18%	-1.72%
ABS	1.36%	1.71%	0.16%	0.46%
Utility	4.98%	0.91%	0.13%	-1.91%
Industrials	4.71%	0.39%	0.70%	-2.33%
High Yield Ba/B	3.21%	-2.26%	0.56%	-4.76%
CMBS	3.61%	2.80%	0.58%	-0.08%

*Barclays Indices calculates the excess return of various bond sectors by measuring the return above or below duration neutral Treasuries.

"Is the Federal Reserve data or market dependent?"

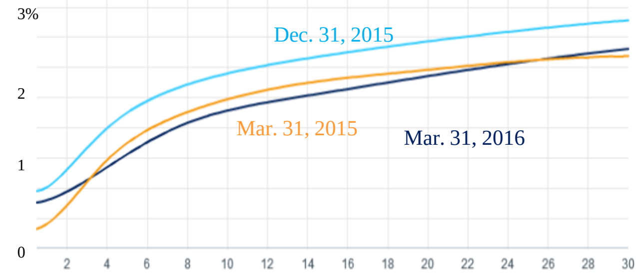
THE ECONOMY, INTEREST RATES & THE FED: Volatility was pervasive across financial markets in 1Q16. Only two weeks removed from the first Fed rate increase in ten years, 1Q16 began with global risk markets in a free-fall. The collapse was driven by fears of a sharp slowdown in global growth (particularly in China), rapidly falling oil prices, and concern over European bank capital levels. During the first six weeks of 1Q16, UST strongly outperformed in the risk-off environment, as the 10-year yield quickly declined 63bps. At the virtual depths of despair when the S&P 500 was down 11% to start 2016, oil prices staged a sharp rebound, while equity markets and credit spreads enjoyed a stunning rally after investors regained confidence that central banks will remain highly accommodative to maintain economic growth. The UST market held most of its gains through 1Q16, and the 10-year yield finished the quarter at 1.77%.

If there was a silver lining in the gathering fears of a global economic slowdown, it was the U.S. bond market's profound discounting of further rate hikes in 2016. The Fed had strongly hinted at the potential for four rate increases heading into 2016, but the volatility in 1Q16 spawned dovish language in both FOMC comments and speeches by other officials that reduced Fed Funds Futures market probabilities to only a single rate hike for the remainder of the year. However, U.S. economic data remained positive in 1Q16, and inflation pressures did in fact rise as shown in the March 2.2% YoY increase in Core CPI (ex-Energy and Food). Continued strength in job growth was also confirmed as the one year moving average of Non-Farm Payroll additions remained above 220K per month.

Despite disappointing growth that pushed yield curves in both regions further into negative territory and counter to goals of monetary officials, Japan and the Eurozone saw currency gains of 10% and 5% respective versus the U.S. Dollar (USD). By March, 63% of Japanese and 67% of German government bond markets sported negative yields. The aggregate effect of additional accommodation via asset purchases by both the Bank of Japan and European Central Bank has been offset by large selling of reserves by Emerging Market (EM) Central Banks in support of their own currencies.

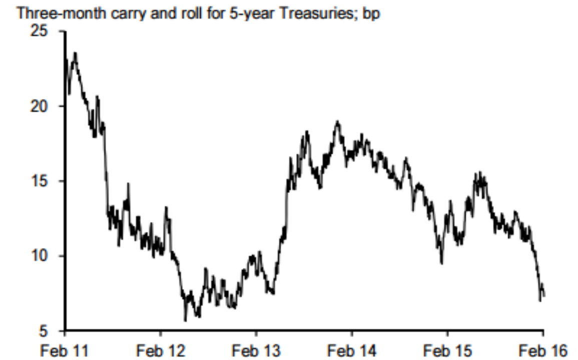
BHMS OUTLOOK: Evidence increasingly supports a belief the Fed has adopted a new and yet unofficial "third mandate" in 1Q16. Many contend global financial market stability has now become just as important to the Fed as the statutory dual mandates of stable inflation and full-employment. While this theory gained support after the depths of the correction in early 1Q16, plenty of economic and financial market risks remain. Oil prices are likely to stay low and volatile as debt-laden producers maintain production to generate cash for interest payments. While U.S. consumer spending from gasoline savings has picked up, high auto inventories and slumping Energy CapEx show some of the main drivers of post-crisis U.S. growth may be slowing. The bond market may in fact continue to be a better predictor of future rates than the Fed's own forecasts after all.

U.S. Treasury Yield Curve



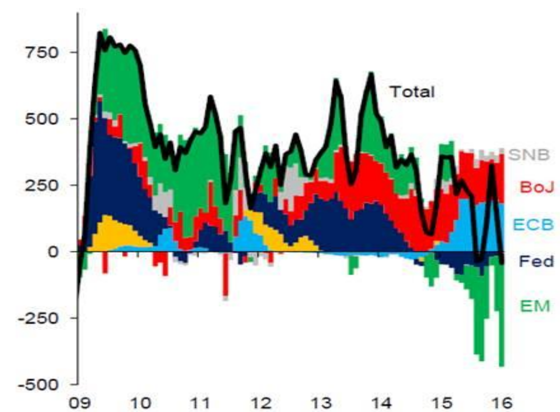
Source: Barclays Live

UST Carry and Roll Near Post-Crisis Lows



Source: Deutsche Bank Research

EM Outflows Cancel ECB/BoJ Asset Purchases



Source: Citi Research

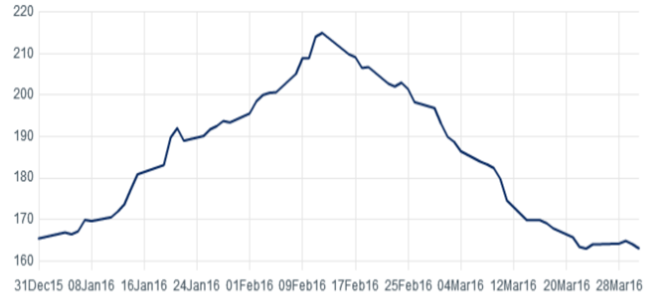
"From the worst of times, to the best of times…"

INVESTMENT GRADE CREDIT MARKET REVIEW: The IG Credit market was unusually volatile during 1Q16. At the peak on February 10, IG Credit spreads had suffered the largest intra-quarter widening since August 2011, climbing 50bps above the YE2015 closing level of 165 bps. As shown in the graph to the right, spreads subsequently enjoyed a "round trip" recovery, closing 1Q16 tighter by 1bp. Despite this volatile path, the Barclays IG Credit Index posted a 1Q16 total return of 3.92% and outpaced comparable UST results with 0.18% in excess return. The IG Corporate Index generated virtually identical 1Q16 total and excess returns of 3.97% and 0.16%, respectively.

While both Industrials and Financials were primarily responsible for the IG Credit Index spread widening in the first six weeks of 1Q16, the ensuing spread rebound was largely driven by Industrials. After beginning 2016 at an average spread of 183bps, Industrials widened to 235bps by February 11, before ending 1Q16 tighter by 15bps at 168bps. This pattern closely tracked the price of crude oil (WTI), which had fallen from $36.59/barrel at YE15 to a 13–year low of $26.19 on February 11. After various OPEC members began publicly discussing freezing production at current record levels, WTI climbed back above $40 before settling at $36.94 on March 31. The rebound in oil prices helped the Energy sector tighten 27bps in 1Q16, and a general rebound in commodity prices helped Metals and Mining (M&M) issuers top the 1Q16 corporate performance table. The M&M sector also benefited from the downward migration into HY of several large fallen angel issuers trading at spreads notably wider than the IG average. In fact, this phenomenon was present across the Industrial Corporate sector and was the source of 23% of the March spread rebound, according to Wells Fargo,

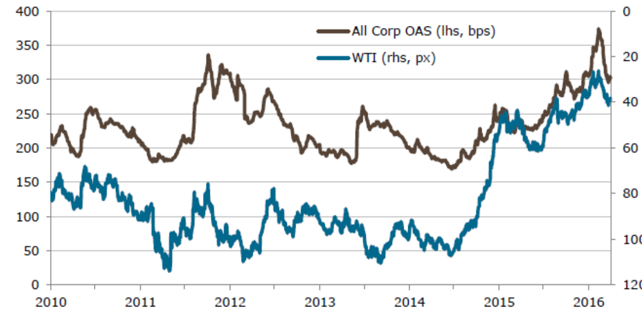
After an initially slow start to 2016, IG Credit new issue supply accelerated and closed 1Q16 ahead of last year's record pace. Although a large portion of the $347B YTD total IG supply came in a $46B Anheuser-Busch Inbev issue in January (only $3B short of Verizon's 2013 all-time record issue size), issuance exceeded the 2015 pace in several other sectors as well. In particular, issuance weighed on performance of Financials. The typically large seasonal 1Q surge in funding coincided with slumping investor sentiment focused on the impact on Financials of negative interest rates in Europe and Japan, the potential exit of the U.K. from the European Union, and slowing global growth. Unlike Industrials, Financial sector spreads did not recover and ended 1Q16 21bps wider than YE15, contributing to underperformance relative to Industrials and the overall IG Corporate Index.

IG Corporate Option Adjusted Spreads – 1Q16



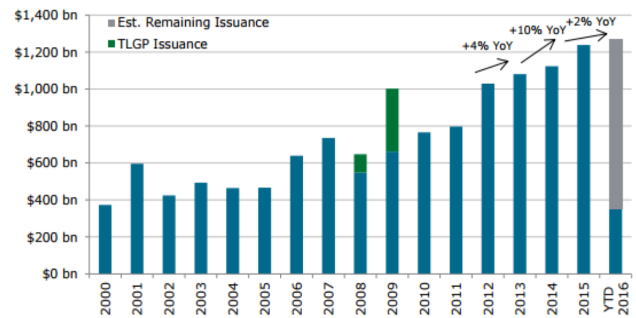
(bps); Source: BHMS; Barclays Live

Credit Spreads Highly Correlated w/Oil Since 2014



Source: Wells Fargo Securities

IG Issuance On-Pace to Set Another Record in 2016



Source: Wells Fargo Securities

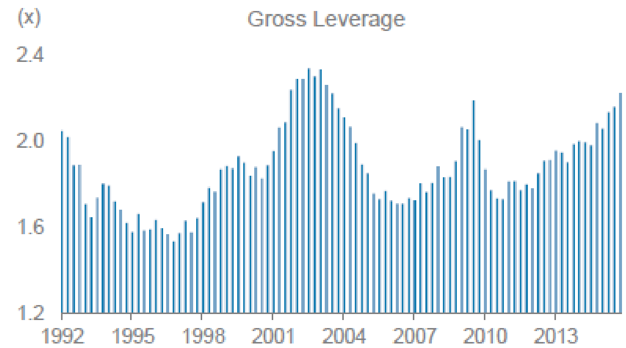
BHMS IG OUTLOOK: The volatility in the Corporate bond market during 1Q16 was not just a function of highly publicized macro fears. Investors trying to offload risk *en masse* exacerbated the increasing absence of liquidity by selling to dealers whose capacity to position inventory was already severely limited in a post-Dodd-Frank market. Virtually none of the risks that sparked the losses in the first six weeks of 2016 were resolved, yet Industrial spreads narrowed to YE15 levels. While volatility can emerge quickly, the rebound during the last six weeks of 1Q16 confirms how pockets of value are created during sharp corrections for investors with a disciplined research and investment process.

In the near-term, Credit performance will be driven by a combination of deteriorating fundamentals and a mostly constructive technical outlook. Corporate balance sheet leverage now exceeds the level reached during the Financial Crisis peak. Merger and acquisition (M&A) announcements have subsided versus 2015 levels, helping to slow the growth in leverage. However, a decline in corporate earnings and cash flows means leverage may continue to rise. Bloomberg reports S&P 500 earnings are forecast to decline 7.9% YoY, the worst since 4Q09, and 10.8% QoQ, the fourth consecutive quarterly decline. Similarly, interest coverage has also declined. U.S. corporate earnings and revenue growth (ex-Energy) which remained positive through 4Q15, are exhibiting a slowing trend that is forecast to continue in 1Q16.

Fortunately, the technical picture, while still mixed, is mostly positive for spreads. Investor demand for U.S. Credit still appears sufficient to absorb IG issuance at its 1Q16 pace. Demand could also increase thanks to further easing by the BOJ and ECB which has driven Non-U.S. government yields in much of the developed world into negative territory. Many European corporate bonds in particular now offer little additional yield following the ECB announcement in March of Euro-denominated non-financial corporate bond purchases. Consequently, the yield advantage offered by U.S. Credit should further boost the relative attractiveness of U.S. corporate debt to both domestic and global bond investors.

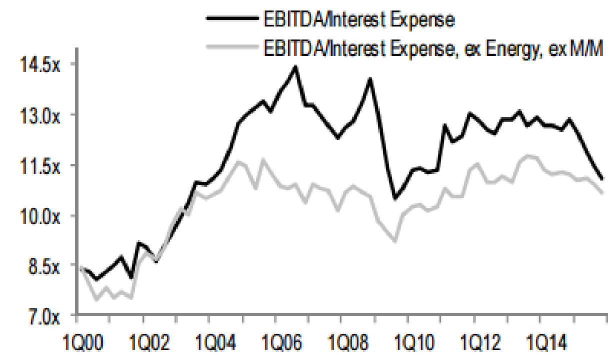
BHMS STRATEGY: ***Maintain current but increasingly selective credit exposure in light of deteriorating fundamentals.*** BHMS believes the balance between taking advantage of positive technicals and deteriorating fundamentals can be achieved by avoiding issuer-specific risks through careful fundamental analysis. This philosophy is especially true in BBB-rated issuers where the risk of downgrades out of IG has increased, but relative value opportunities remain. BHMS Energy exposure will remain focused on infrastructure, such as Midstream/MLPs (second best performing industry in 1Q16), and wary of exposure sensitive to commodity-prices which remain an unpredictable source of volatility. Financials still offer value, where many of the issuer-specific risks can be avoided. Overall, the carry advantage in the Corporate sector, not wholescale spread compression, will drive excess returns.

IG Corporate Leverage Now Near Crisis Peak



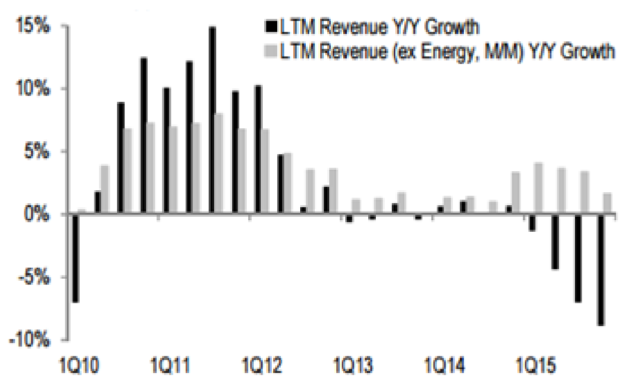
Source: Morgan Stanley Research

…and Int. Coverage Near Crisis Low, even Ex-Energy



Source: J.P. Morgan

YoY Rev. Ex-Energy Actually Increased, but Slowing



Source: J.P. Morgan

"Keep your head while all about you are losing theirs." – Rudyard Kipling

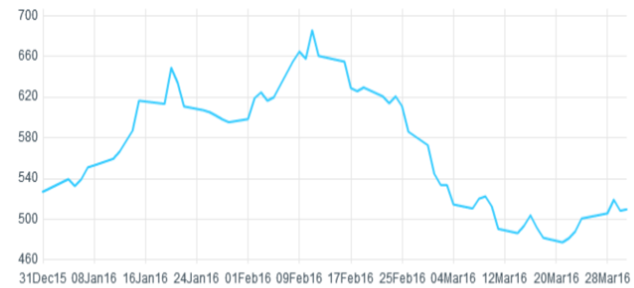
HIGH YIELD MARKET REVIEW: HY spreads exhibited a volatile pattern similar to IG Credit in 1Q16. However, HY spreads tightened 17bps below YE15 levels as option-adjusted-spreads that had gapped wider to 685bps by February 11, the widest since October 2011, narrowed sharply to end 1Q16 at 510bps. Consequently, the Barclays HY Ba/B Index posted a 1Q16 total return of 3.21% and an excess return of 0.56%. Industrials drove performance both on the downside and the subsequent rebound, and similar to IG, Energy and Metals and Mining had a large influence in both directions. The entirety of the Energy sector's positive 1Q16 return was attributable to Midstream (MLP) issuers. In addition, issuers rated BB outperformed lower tiers (B and CCC) in a continuation of the market's preference since mid-2015 for higher quality HY exposure.

New issue supply totaled $61.8B in 1Q16, a 39% decline from $101.1B one year ago. The pace of issuance accelerated during the last six weeks of 1Q16, with $28.2B in March supply doubling that of February and tripling January's issuance. In all, 68 issues were priced. Interestingly, new "Fallen Angels", many of which were former Energy or Metals and Mining IG credits, were readily received by investors, resulting in spreads tightening more than the HY average and representing 50% of total HY Index tightening in 1Q16.

BHMS OUTLOOK: The HY market remains bifurcated: the Energy and Metals and Mining sectors generally trade at distressed levels, while most other groups trade closer to fair value. Much of the YTD issuance has been high quality HY credits in sectors like Consumer Staples, where there is little uncertainty about balance sheets and cash flows. Certain subsectors within Health Care that encountered problems in reduced volumes and pricing strategies, particularly Hospitals and Pharmaceuticals, now look interesting. The market should also benefit from the continuing technical support of sustained investor search for yield coupled with light maturities ($40B) for the rest of 2016. However, if corporate M&A activity increases to take advantage of still-attractive HY financing, the new issue calendar could be more robust, causing a re-pricing of secondary bonds. The macro environment remains a wildcard: if the USD strengthens and commodity prices fall again, pressure on Emerging Markets will resume, threatening contagion in the HY market.

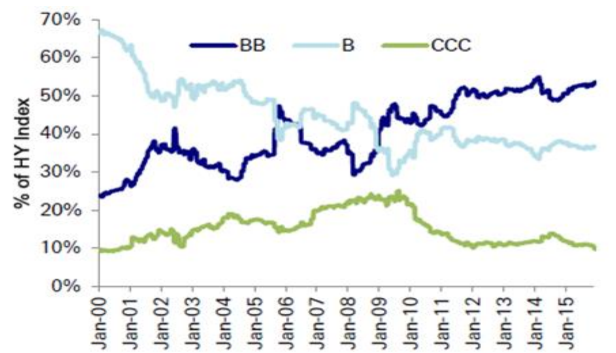
BHMS STRATEGY: ***Maintain current exposure while focusing on both fundamentals and technicals.*** We modestly increased our exposure in HY during the early-1Q sell off. Ex-Energy and Metals and Mining, much of the HY market is now close to fair value. However, pockets of opportunity remain. We continues to believe the Midstream subsector within Energy is attractive because the infrastructure assets are misunderstood and undervalued. Wireless Telecom, Cable/Broadband, and Health Care issuers are appealing for their stable cash flows.

HY Ba/B Spreads (OAS) Finished 1Q16 Tighter



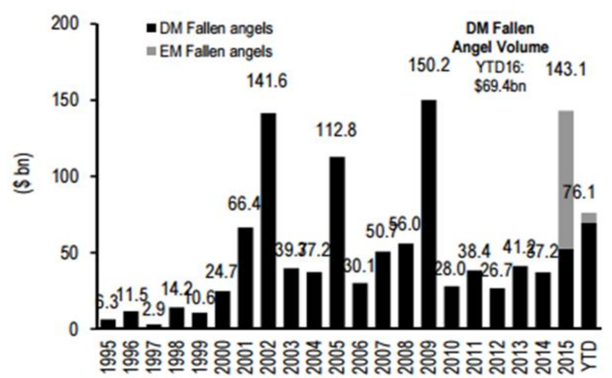
Source: BHMS; Barclays Live

HY Market Remains Higher Quality than Pre-Crisis



Source: BHMS; Barclays Live

"Fallen Angels" into HY at Post-Crisis High



Source: J.P. Morgan

"In a world where low inflation, global geopolitical headwinds, and global drag put a floor under the dollar and keep long bond yields from rising, the Fed's only policy move may be to not move at all." – STRATEGAS

LONG CREDIT MARKET REVIEW: Long Credit outperformed shorter maturity credit and posted positive returns in 1Q16. The Barclays Long Credit Index finished 1Q16 with a 6.82% total return and outpaced similar USTs with an excess return of 0.18%. The bulk of outperformance against shorter maturity Credit was the 46 bp decline in the 30yr UST yield to 2.61%, driven lower by investors seeking safe haven assets throughout much of 1Q16. The Barclays Long U.S. Corporate Index outpaced its Long Credit counterpart by a slim margin, thanks to the exclusion of Non-Corporate Credit which underperformed IG Corporates.

Industrials were the strongest performing segments in the Long Credit Index. The 7.57% total and 0.89% excess returns generated by Industrials were driven by spreads that tightened 11 bps in 1Q16. Long Financials however, underperformed the overall Long Credit Index by 293 bps, posting a total return of only 3.89% and excess return of -2.73%. A key contributor to that weakness was concern surrounding specific issuers, European Banks and select Insurers in particular, whose underperformance had a greater impact in the Long Credit Index than in the overall IG Credit market.

There were positive flows of $1.75B into the overall Long Credit market in 1Q16 according to Wells Fargo. Interestingly, increased inflows arrived despite a further decline in the funding ratio of U.S. Defined Benefit pension plans. The drop in funding ratios has been practically unabated since equity markets began to weaken in August 2015. Though equities have since rebounded, the lower discount rate due to lower UST rates has caused further deterioration in the funded status in 1Q16.

BHMS OUTLOOK & STRATEGY: ***Technical risks require careful attention in Long Credit.*** The Long Credit market has offered a cheap source of long-term funding for many corporate and sovereign borrowers over the past few years. Though the supply-demand balance has remained relatively stable, the appeal to CFOs of issuing at today's low-overall yields may eventually conflict with investor willingness to accept the amount of interest rate risk contained in today's Long Credit market. Since corporate issuers typically respond to overall yields and not spread levels, a steady supply of Long Credit issuance could continue in the face of potential late-cycle spread widening. This scenario would likely see a sharp divergence in performance among issuers. Diligent analysis of company-specific funding needs and corporate management behavior is particularly important in the late stages of a credit cycle noted for issuers continuing to source attractive funding even as investors have become more concerned about low yields.

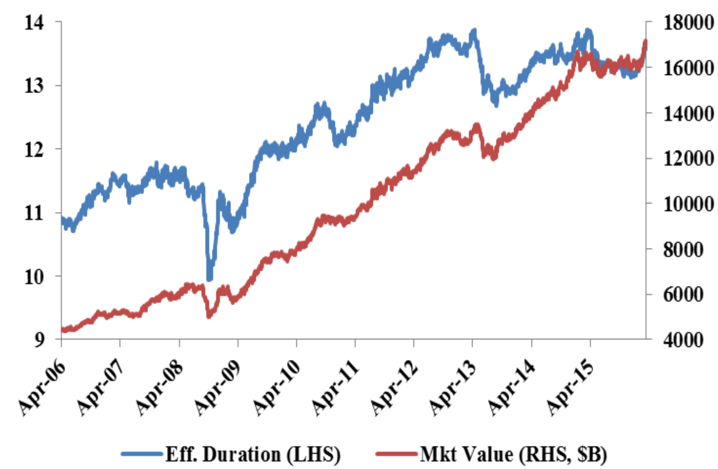
Barclays Indices Performance (%)	1Q16	One-Year
Long U.S. STRIPS 20+ Yr	11.38	1.59
Long U.S. Government	8.06	2.80
Long U.S. Gov't/Credit	7.30	0.39
Long U.S. Corporate	6.83	-1.34
Long U.S. Credit	6.82	-1.08

Source: Barclays

Barclays Sector Performance: Excess Returns (%)	1Q16	One-Year
Long Industrials	0.89	-5.15
Long Non-Corp. Credit	0.19	-0.87
Long Utilities	0.01	-3.47
Long Financials	-2.73	-3.58

Source: Barclays

Effective Dur. & Mkt. Val of Long Credit Index: Growth Over Ten Years



Source: BHMS; Barclays Live

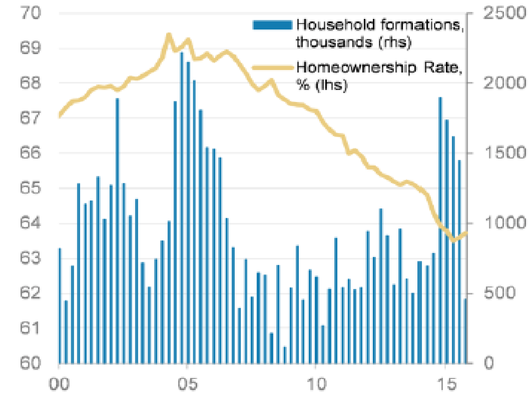
"Be fearful when others are greedy and greedy when others are fearful" – Warren Buffett

AGENCY MBS REVIEW: U.S. Mortgage Backed Securities (MBS) underperformed the Barclays Aggregate Index, IG Corporates, and USTs in 1Q16 with a total return of 1.98% and an excess return of -0.38%. Typically, a rapid flight-to-quality leads to underperformance for the MBS sector relative to USTs. Since UST yields moved sharply lower in 1Q16, investor concerns about increased refinancing prepayments in MBS sent spreads wider. The lower yields in new production MBS also scared away U.S. Banks, which had been a considerable source of demand and a driver of strong MBS performance in 2015. Conventionals (MBS issued by Fannie Mae and Freddie Mac) with longer durations outperformed Ginnie Maes. Similarly, low coupon MBS with longer durations also outperformed higher coupons. The origination picture was mixed: existing home sales declined 7% in February, but a 2% increase in new home sales and the re-fi wave that followed the 1Q16 rate decline boosted supply. Home ownership remains low by recent historical standards. Currently, the 63.8% ownership rate is the lowest since 1984 and well below the record-high of 69.3% set in 2004.

MBS OUTLOOK: The low yield environment in which most developed-world investors are currently mired is a constructive technical for U.S. MBS. Foreign institutional investors who lack the resources to conduct corporate security analysis have shown a preference for MBS over the inherent credit risk in IG Corporates. Strong 1Q16 demand from Japanese institutions likely helped offset the decline in U.S. Bank purchases. Similarly, the Fed remains a pillar of demand for the MBS market, while discussions over an eventual tapering of reinvestments by Fed officials have been all but silent since YE2015. Reinvestments will almost certainly continue through at least 2017 and remain a bulwark to the MBS market. In fact, thanks to accelerated 1Q16 prepayments that were particularly high in the portion of the coupon stack held by the Fed, reinvestments are expected to increase from $20-25B per month to $30-35B.

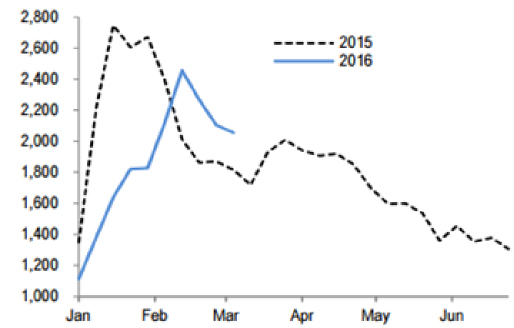
BHMS MBS STRATEGY: ***Maintain current overweight in low volatility assets that offer good access to carry.*** BHMS held an overweight in MBS throughout 1Q16 and the allocation was defensively positioned. Due to the overweight in higher coupons with shorter durations, our MBS position underperformed in the declining rate environment. MBS continue to look attractive as a stable source of carry/income advantage, while the technical picture remains mostly positive thanks to Fed and potential foreign investor demand. Portfolio MBS holdings continue to favor specified pools that offer stable cash flow yield and superior convexity relative to TBAs. Though interest rates are extremely low, concerns about prepayment risks are not entirely priced into specified pools and valuations remain attractive due to a favorable price differential over TBAs. Given BHMS' preference for carry over the low potential for spread compression, MBS will likely remain an overweight as long as current valuations and favorable technical factors persist.

Household Formations Higher, But Ownership Low



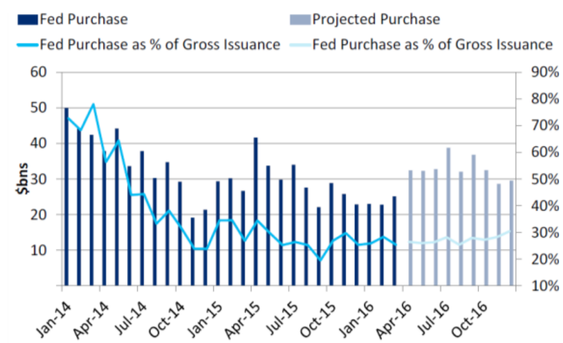
Source: Morgan Stanley Research

MBA Refinancing Index Spiked in 1Q16



Source: J.P. Morgan

Fed Re-Investment Purchases Expected to Increase

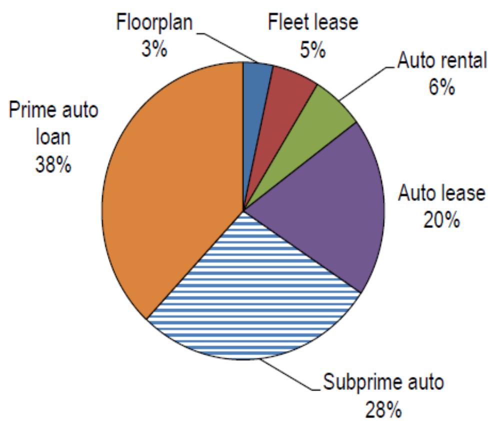


Source: Citi Research

ABS MARKET REVIEW: Asset Backed Securities (ABS) underperformed all other major sectors in the Barclays Aggregate Index with a 1.36% total return. However, much of the underperformance was due to the shorter duration of ABS relative to the Index. Despite a 2bp widening in spreads, ABS actually posted a positive 1Q16 excess return equal to IG Corporates. Credit Card ABS outperformed Auto ABS as subprime auto performance suffered from investor desire for liquidity amidst the 1Q16 volatility and increased negative media attention over credit performance. The Auto sector continued to dominate ABS issuance, increasing to nearly 60% of the 1Q16 total, compared with 51% of 2015 issuance.

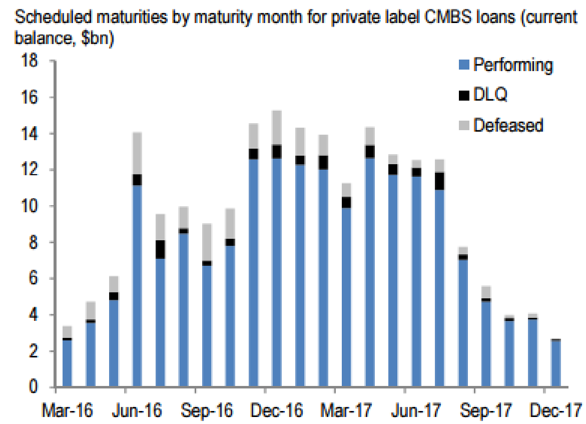
BHMS ABS STRATEGY: ***Maintain overweight given potential for spread compression.*** BHMS remains overweight ABS and continues to find opportunities within the sector, often on superior relative value versus short IG Corporates. A decline in ABS issuance, coupled with modest spread widening in 1Q16, has created conditions that could favor spread tightening, particularly among more liquid names. U.S. consumers have a much healthier credit profile than before the 2008 crisis, while job and wage gains are emerging as increasingly supportive factors. However, fundamental analysis within ABS, including due diligence of underwriters in the Auto sector, is gaining in importance.

ABS Auto Issuance YTD16 – 28% Subprime



Source: Securities Data Corp.

CMBS Re-Financing Wave Approaching in Late-2016



Source: J.P. Morgan

CMBS MARKET REVIEW: The Commercial Mortgage Backed Securities (CMBS) sector returned 3.61% in 1Q16, outperforming the Aggregate benchmark, while the excess return of 0.58% was the highest of any major sector in the Index. After initially widening, CMBS spreads ended 1Q16 12bps tighter at 109bps. Issuance declined significantly, down 35% versus the same year-ago period. Additionally, the average loan size has declined from $1.1B to $878M, largely in anticipation of pending regulatory changes and heightened underwriting scrutiny.

BHMS CMBS STRATEGY***: Overweight, but defensively positioned due to the changing sector landscape.*** The structure of the CMBS market is evolving due to new "risk retention" regulatory rules included in the Dodd-Frank legislation that will likely lead to a further slowdown in issuance and a noticeable increase in capital requirements that could sharply constrain dealer-provided liquidity. Additionally, a spike in maturities beginning in late 2016 is becoming a concern. Current estimates show $54B in CMBS loans will mature this year, mostly backed by retail and office properties. After a spell of worsening fundamentals, investors are now pushing back on inferior collateral quality. Dealer risk-retention will require that issuers hold 5% of a new deal on the balance sheet. While this development is likely to lead to an eventual improvement in collateral quality, BHMS will closely monitor the CMBS market reaction to regulatory changes and investor preferences. BHMS maintains an overweight but defensive position in CMBS.