

ITALIAN CREDIT MARKET UPDATE

By Frank Rybinski, CFA, Chief Macro Strategist; Garry Creed, CFA, Chief Credit Strategist; and Calvin Norris, CFA, Rates Strategist

We view the recent Italian developments as another reminder of the challenges of monetary union without fiscal union. Like most black swan events, while the effect of a new euro crisis would be quite large, the actual probability of such an event is still relatively small. Look for markets to play the role of vigilante and force the Italian government and European Central Bank (ECB) to respond (and possibly take action).

At this time, the Italian political developments have not materially changed our cautionary stance toward Italian credit. Some immediate observations:

- **Headline risk.** Until there is resolution on the government structure there is going to be constant headline risk. There is a very good chance that there are elections in September 2018 (possibly sooner) that, given the stance of the 5 Star and League parties, would likely become a de facto referendum on Italy's euro membership. The challenge with binary events like this is that they are all or nothing, and hence can become black swan-ish given the associated outcome. Thus, it will likely result in heightened headline risk over the summer months as the deluge of election polls come out (think pre-Brexit vote on steroids).
- **US economic risk.** Limited implications for the US economy at this point, we are not changing our forecasts (which are below consensus). Should a crisis develop in Europe, the financial markets would be a much more rapid transmission mechanism than economic and trade channels.
- **US rates.** Our year-end forecast for the 10-year US Treasury remains 3.10%. As yields recently tested that level, we added duration, believing that the market was exhibiting peak optimism and that a further upward move in rates would be hard to come by. Should a crisis develop, US rates would receive a flight-to-safety bid that could take rates materially lower.
- **Federal Reserve.** The recent developments would support the dove camp for slower or fewer rate hikes (which is part of our base case scenario).
- **Credit.** Through the elections we have been, and continue to be, cautious about Italian credit risk. Recent developments have only solidified our view. The combination of the political uncertainty, the weakening economic climate in southern Europe, and the continued potential for the ECB to unwind quantitative easing stimulus will likely sustain headwinds for the Italian economy. We continue to closely monitor the situation and potential effects of these pressures on companies, and remain wary of Italian credit risk except for a few instances where we see strong bottom-up fundamental support.

Disclosure

Past performance is not indicative of future results.

This material is to be used for institutional investors and not for any other purpose.

This communication is being provided for informational purposes in connection with the marketing and advertising of products and services. This material contains current opinions of the manager and such opinions are subject to change without notice. Aegon AM US is under no obligation, expressed or implied, to update the material contained herein. This material contains general information only on investment matters; it should not be considered a comprehensive statement on any matter and should not be relied upon as such. If there is any conflict between the enclosed information and Aegon AM US' ADV, the Form ADV controls. The information contained does not take into account any investor's investment objectives, particular needs, or financial situation. Nothing in this material constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to you. The value of any investment may fluctuate. Investors should consult their investment professional prior to making an investment decision. Aegon AM is not undertaking to provide impartial investment advice or give advice in a fiduciary capacity for purposes of any applicable federal or state law or regulation. By receiving this communication, you agree with the intended purpose described above.

The information presented is for illustrative purposes only. Individual accounts may vary based on restrictions, substitutions, cash flows and other factors.

Specific sectors mentioned to not represent all sectors in which Aegon AM US seeks investments. It should not be assumed that investments of securities in these sectors were or will be profitable.

References to specific securities and their issuers are not intended and should not be interpreted as recommendations to purchase, sell, or hold such securities. Aegon AM US products and strategies may or may not include the securities referenced and if such

securities are included, there is no representation that such securities will continue to be included.

Aegon AM US may trade for its own proprietary accounts or other client accounts in a manner inconsistent with this report, depending upon the short-term trading strategy, guidelines for a particular client, and other variables.

Results for certain charts and graphs are included for illustrative purposes only and should not be relied upon to assist or inform the making of any investment decisions.

This document contains "forward-looking statements" which are based on change to the firm's beliefs, as well as on a number of assumptions concerning future events based on information currently available. These statements involve certain risks, uncertainties and assumptions which are difficult to predict. Consequently, such statements cannot be guarantees of future performance and actual outcomes and returns may differ materially from statements set forth herein. In addition, this material contains information regarding market outlook, rates of return, market indicators and other statistical information that is not intended and should not be considered an indication of the results of any Aegon AM US-managed portfolio.

Aegon AM US is a US-based SEC registered investment adviser and is also registered as a Commodity Trading Advisor (CTA) with the Commodity Futures Trading Commission (CFTC) and is a member of the National Futures Association (NFA). Aegon AM US is a member company of Aegon Asset Management, the global investment management brand of the Aegon Group.

Recipient shall not distribute, publish, sell, license or otherwise create derivative works using any of the content of this report without the prior written consent of Aegon Asset Management US, 4333 Edgewood Rd NE, Cedar Rapids, IA 52499.

©2018 Aegon Asset Management US

Adtrax Code: 2134149.1
Exp Date: 5/31/19