TRANSAMERICA®

FIXED INCOME

Lessons from history

Income strategies in a rising rate environment

Remembering when...

U.S. Treasuries have been in a secular bull market for more than 30 years.

Some investors may not know anything different or remember the events leading up to the recent historic bond market run. However, it was a period well worth noting.

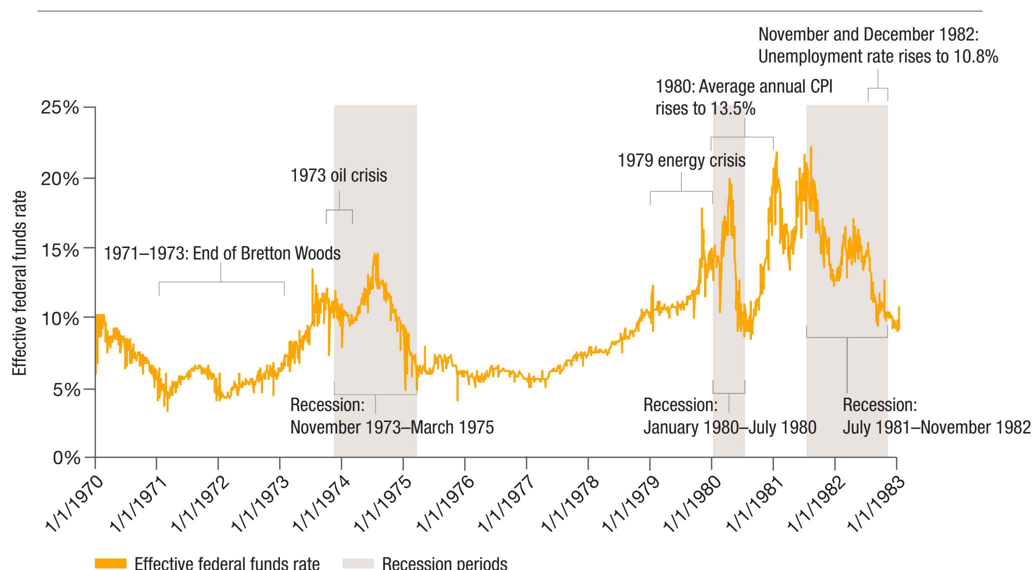
The 1970s was a turbulent time in U.S. history and for the global economy. The collapse of the Bretton Woods system marked the end of the gold standard as the U.S. dollar transitioned to that of a fiat currency. Gold prices soared, the U.S. dollar fell and equities plummeted as the Dow Jones Industrial Average (DJIA) lost approximately 40% of its value between 1973 and 1974 (calculated from data obtained from The Wall Street Journal). The Organization of the Petroleum Exporting Countries (OPEC) oil embargo and 1973 crisis added to financial market volatility and loose monetary policy pushed inflation higher. By the late 1970s, the Iranian Revolution triggered another energy crisis and financial market deregulation began to gain momentum.

Quickly after Paul Volcker was appointed Federal Reserve Board (Fed) chairman in August 1979, he limited money supply growth and embarked on an aggressive and historic monetary policy tightening campaign, which led to back-to-back recessions in the early 1980s. Inflation rose above 13.5% and the unemployment rate soared (Figure 1). The effective federal funds rate spiked, briefly rising above 20%, the 10-year Treasury yield topped 15% and the nation's economy contracted (Figures 1 and 2 illustrate movements in the effective federal funds rate and 10-year Treasury yield).

Such radical actions by the Fed broke the back of runaway prices and lowered market expectations for future inflation, thereby setting the stage for extended prosperity over the next two decades as the nation benefited from relative price and economic stability. Can history teach us anything?

The effective federal funds rate is the negotiated rate that banks charge each other. In general, the effective rate will closely track the federal funds target rate, which is set by the Federal Open Market Committee (FOMC). Through open market operations, the FOMC influences the effective rate.

Figure 1: Effective federal funds rate from 1970–1982



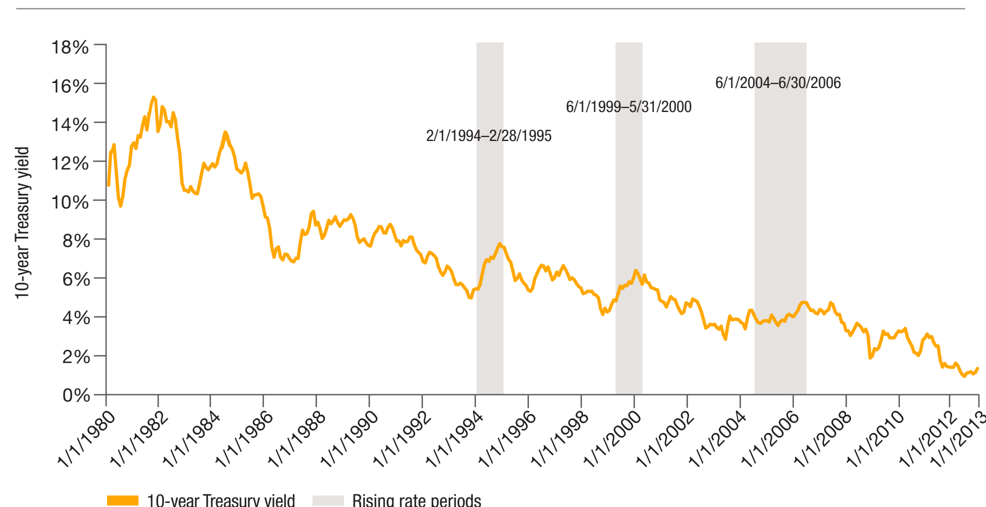
Source(s): Federal Reserve Board, National Bureau of Economic Research (NBER), International Monetary Fund (IMF) and the Bureau of Labor Statistics (BLS). Recession periods, the 1973–1974 OPEC oil embargo and crisis; and the 1978–1979 Iranian Revolution and energy crisis are as defined by the NBER. According to the IMF, key milestones marking the end of Bretton Woods include U.S. President Nixon's suspension of the dollar's convertibility to gold in August 1971 and in March 1973, when all major currencies were no longer fixed. Average annual CPI (consumer price index, all items and not seasonally adjusted) and the unemployment rate are according to the BLS. General information about risk and Terms and Definitions can be found beginning on page 14.

When what goes down must come up

Previous rising rate environments

Since the 1980–1982 recessions, the 10-year Treasury rate has generally trended lower, punctuated by brief periods of rising interest rates as illustrated in Figure 2:

Figure 2: Last three rising rate periods



Source(s): Federal Reserve Board and Transamerica. Rising rate periods are based on increases to the federal funds target rate. General information about risk, including sector and asset class benchmark information, and Terms and Definitions can be found beginning on page 14.

However, each of the last three rising rate periods was defined by a different economic backdrop:

2/1/1994–2/28/1995

In February 1994, the Fed announced for the first time in history its plans to raise the federal funds target rate. The magnitude of the cumulative increase was steep over a relatively short time period. The target rate doubled over the course of seven rate hikes spanning 13 months, increasing 300 basis points (one basis point [bps] is equal to 1/100 of 1%) from 3.0% to 6.0% (Federal Reserve). The economy was growing at a brisk pace that was faster than expected and above historical averages. Fed tightening was a preemptive bid to prevent the economy from overheating. The yield on the 10-year Treasury rose 145 bps from 5.77% to 7.22% (Federal Reserve). Investment-grade corporate spreads (the difference) over U.S. Treasuries narrowed slightly and short-term bonds performed better than their longer-term counterparts. As illustrated in Figure 3, commodities, U.S. stocks and global bonds were among the strongest performing asset classes. However, emerging market debt sustained steep losses, hindered by fallout from the Mexican peso crisis.

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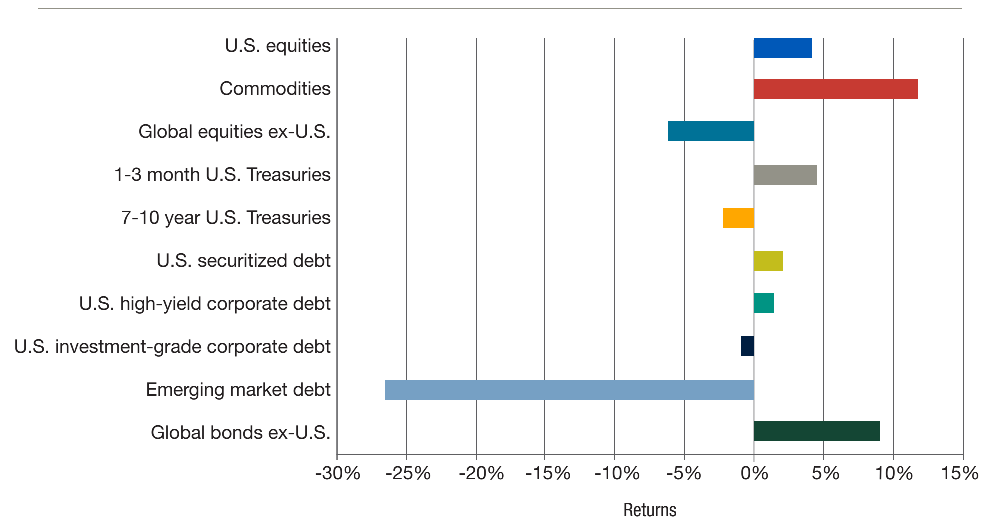
Figure 3: Asset class performance from 2/1/1994–2/28/1995



Source: Morningstar Direct. **Past performance is not a guarantee of future performance.** General information about risk, including sector and asset class benchmark information, and Terms and Definitions can be found beginning on page 14. **This chart is for illustrative purposes and is not intended to reflect the performance of any Transamerica fund**. Market indices do not include fees. One cannot invest directly in an index.

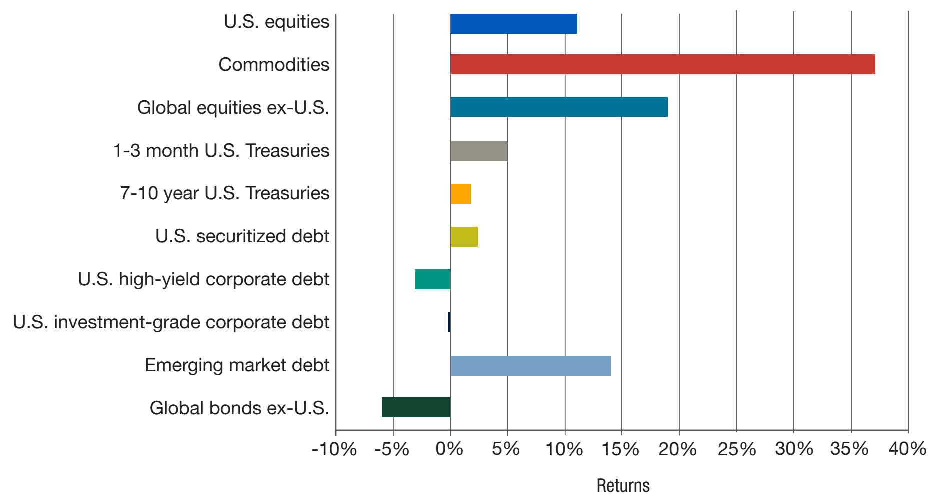
6/1/1999–5/31/2000

The Fed increased the federal funds target rate six times over 12 months (Federal Reserve). Although the time frame was shorter, the breadth of the total increase was shallow compared with the previous rising rate period as the target rate rose just 175 bps (Federal Reserve). During the period, the U.S. economy expanded at a rapid pace, the labor market was tight and productivity growth, robust. U.S. stocks rallied and equity benchmarks achieved new highs as valuations soared. By the third quarter of 1999, inflationary pressures, which had previously been contained by falling gas prices, began to build. During the period, 10-year Treasury yields rose 51 bps from 5.78% to 6.29% (Federal Reserve).

Figure 4 shows global stocks and commodities were the strongest category performers. U.S. equities and Treasuries also had positive returns, but unlike the previous rising rate period, emerging market debt performed well. However, global debt performance was generally negative, held back by European developed market bonds following the introduction of the euro. Record defaults in 1999 also dampened U.S. high-yield corporate debt returns.

U.S. equities and Treasuries also had positive returns, but unlike the previous rising rate period, emerging market debt performed well.

Figure 4: Asset class performance from 6/1/1999–5/31/2000



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6/1/2004–6/30/2006

The last rising rate period was the longest of the three, lasting just over two years. Fed tightening roughly corresponded with the rise and peak of the housing bubble. The Fed incrementally increased the federal funds target rate 17 times during the period from 1.00% to 5.25%, for a total of 425 bps (Federal Reserve). Rising food and energy prices pushed headline inflation higher while core inflation remained relatively contained. Economic growth moderated as consumer spending softened, household and government debt grew, and the labor market weakened.

Global markets were buoyed by easy liquidity made possible by accommodative central banks. While the U.S. Fed began raising the target rate in 2004, central banks in Europe and Japan did not begin tightening monetary policy until 2005 and 2006, respectively. Global equities, emerging market debt and commodities were among the top asset classes. As interest rates rose, high-yield corporate spreads fell by as much as 100 bps (Barclays) and U.S. Treasuries were among the weakest performing sectors while still posting gains.

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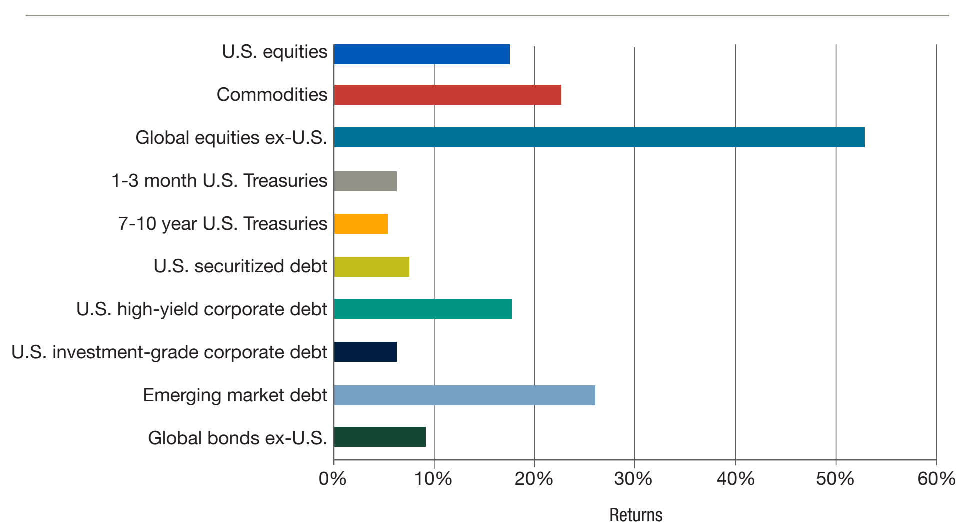
Figure 5: Asset class performance from 6/1/2004–6/30/2006



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Why fixed income?

Fixed income investments are often considered an integral part of a well-balanced and diversified portfolio.

While all investments have some risk, fixed income investments are generally associated with less risk.

In general, investors look to fixed income securities for their potential to provide a predictable income stream, stability, and capital preservation, and to offset equity market volatility.

Investors should note that diversification does not assure or guarantee better performance, nor does it eliminate the risk of investment losses and may not protect against an overall declining market. In addition, greater return potential generally corresponds to increased risk exposure and fixed income opportunities cover a wide spectrum of risk, return and credit quality characteristics.

Putting history in context

The three rising rate periods are not a perfect roadmap for fixed income and bond investors. Yes, rates can rise and while there were some similarities across all three periods, the impact was not the same in each.

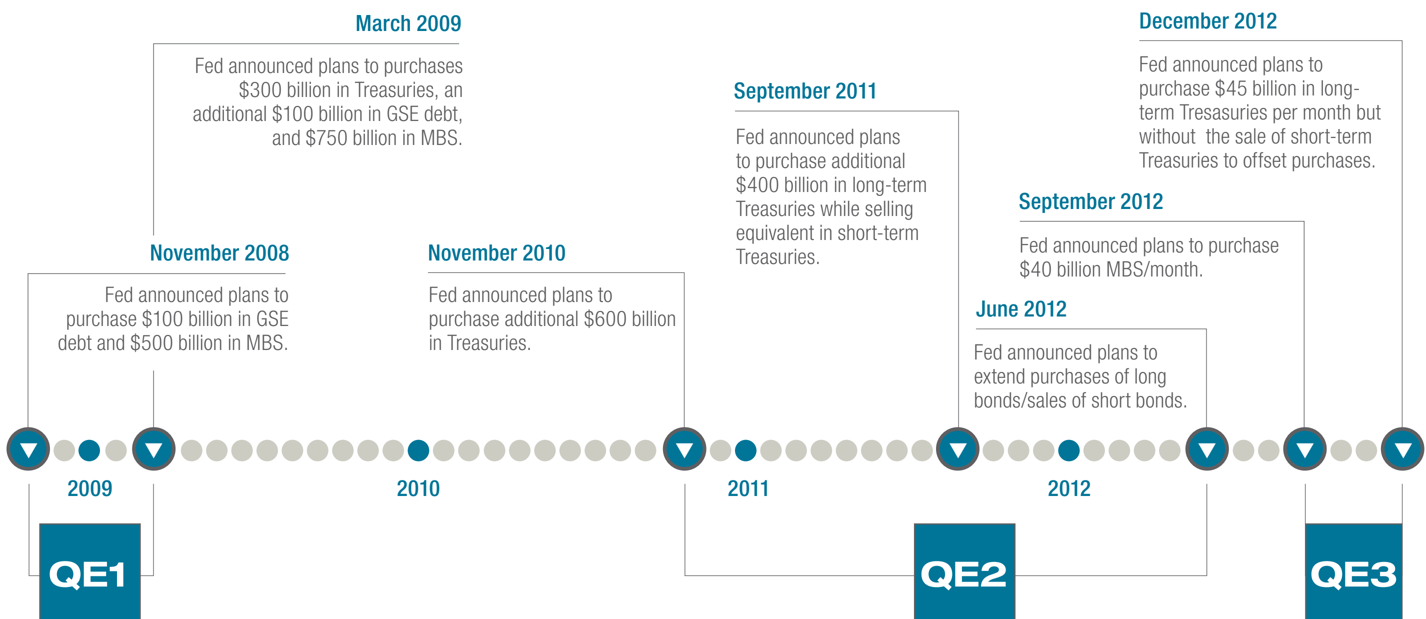
Equities and commodities were generally among the top performers in each period and some fixed income instruments lost money—but not all did. For example, during the 1994–1995 period, developed market bonds had strong returns, which lifted the entire global debt category solidly into positive territory, while emerging market bonds had significant losses. However, emerging market debt was among the strongest performing categories in both the 1999–2000 and 2004–2006 periods. It was also notable that during the 2004–2006 period, not a single fixed income category had negative performance.

A rising rate environment does not mean investors should get rid of all their bonds and fixed income holdings. Instead, we believe investors can navigate volatile fixed income markets by managing exposure to income generating sectors and strategies.

Where are we now?

The 2007–2008 global financial crisis sent the world's major economies into a tailspin. Investors flocked to the safety of U.S. Treasuries as they sought refuge from volatile financial markets. In the U.S., ultra-accommodative Fed policy helped sustain the bond market's bull run by pushing rates down. Interest rates fell to historical lows as current Fed Chairman Ben Bernanke implemented three successive rounds of quantitative easing (QE) from 2008–2012 to stimulate growth and ward off deflation:

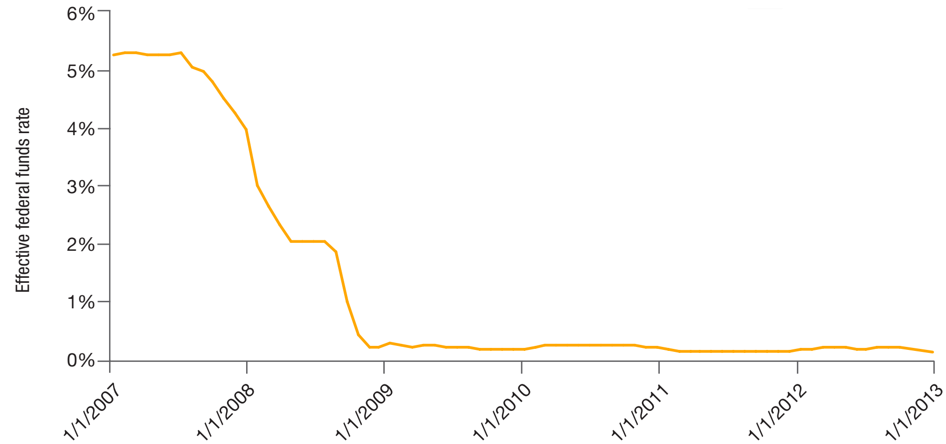
Figure 6: Quantitative easing timeline



Source: Federal Reserve Bank of St. Louis. Government-sponsored enterprises (GSE) are federal agencies or federally sponsored agencies designed to lend money to certain groups of borrowers such as homeowners, farmers and students. Debt issued by GSEs is not guaranteed by the federal government. Examples of GSEs include Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), which are privately owned corporations; and the Federal Home Loan Banks and the Federal Farm Credit Banks, which are systems of regional banks. Mortgage-backed securities (MBS) are securitized investments that are backed by pools of residential or commercial mortgages. General information about risk, including sector and asset class benchmark information, and Terms and Definitions can be found beginning on page 14.

As illustrated in Figure 7, the targeted federal funds rate fell 500 basis points and has hovered just above zero, oscillating in a tight band between 0.25% and 0.07% since November 2008.

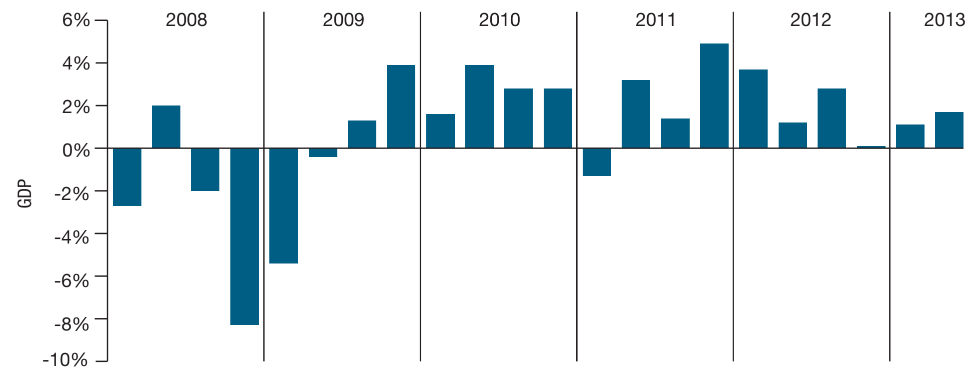
■ Figure 7: Effective federal funds rate from 2007–2012



Source: Federal Reserve Board. General information about risk and Terms and Definitions can be found beginning on page 14.

Since then, the U.S. economy has struggled to find its footing. Headwinds to a more robust recovery have included a slowing global economy, high oil prices, lack of personal income and wage growth, and weak business investment. More recently, deep cuts by state and local governments have also dampened the economy.

■ Figure 8: GDP annual growth rate (quarter/quarter)



Source: Bureau of Economic Analysis. As of August 6, 2013. Terms and Definitions can be found beginning on page 14.

While recent growth rates have been slow, the economy is expanding nonetheless, and slow growth is better than no growth at all. Thus far, the recovery has been bolstered by increased consumption, growing domestic energy production and export strength. With interest rates so low, some investors think interest rates have nowhere to go but up.

As the economy strengthens, investors believe it becomes more likely that the Fed will reduce monetary stimulus and eventually interest rates will rise.

When do rates rise?

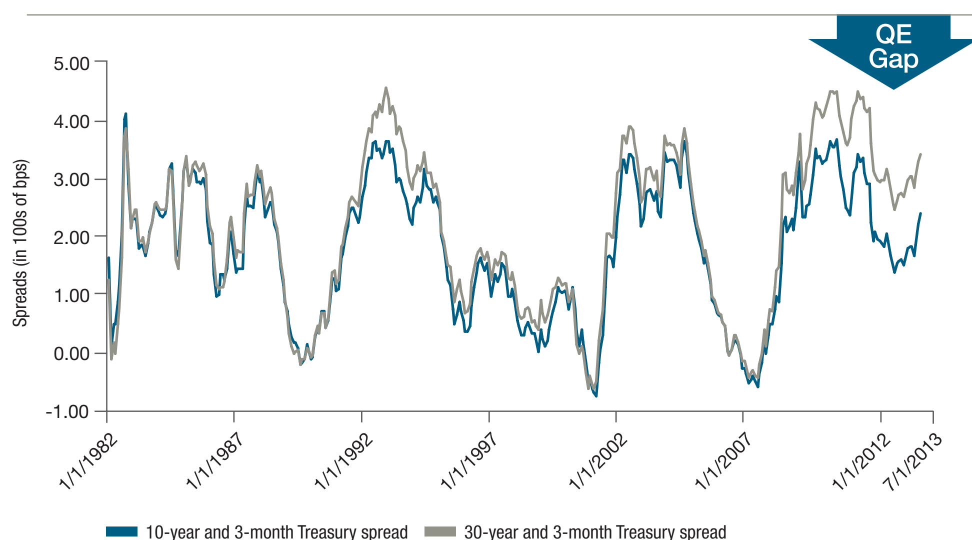
Rates generally rise in the middle stages of economic expansion as corporate earnings improve, causing investors to favor equities over bonds. As investors sell bonds, rates are pushed higher. In later stages of the economic cycle, rates may continue to rise as a healthy and expanding economy often results in higher inflation.

In general, when interest rates are low, consumers can borrow and spend more. However, as growth gains momentum, it is possible for the economy to overheat with too many dollars chasing too few goods, which can result in higher prices. When this happens, the Fed may raise rates to keep inflation in check. If and when the Fed does raise rates, the impact is largely felt on the front-end of the yield curve.

In the second quarter of 2013, the market effectively pushed interest rates higher, particularly those of longer-dated bonds, without the Fed raising either the federal funds target rate or the discount rate (sometimes called the repo rate—the rate that the Fed charges member banks to meet short-term liquidity needs through the discount window). Some investors were quick to assume higher drifting 10-year Treasury yields validated concerns for higher interest rates in the near future. However, the current environment is different than previous rising rate periods in that inflation is not a factor. Instead, recent yield increases have largely been confined to the long-end of the curve as QE was designed to push long rates down. When long rates rise, the yield curve will steepen as the markets absorb the impact of unwinding Fed policy—at least until the slope of the yield curve returns to normal. Later, if inflation begins to heat up, the Fed may begin to raise rates and short-term rates should rise.

As QE Treasury purchases pushed 10-year yields down, the gap between 10-year and 30-year yields increased as shown in Figure 9:

Figure 9: Yield curve slope



Source: Federal Reserve Board. General information about risk, including sector and asset class benchmark information, and Terms and Definitions can be found beginning on page 14.

As long-term rates have been artificially suppressed, the question isn't so much a matter of if rates will rise, but what will happen when they rise and what can investors do to prepare for a rising rate environment.

As shown in Figure 10, U.S. equities have soared since the beginning of the year. High-yield corporate debt also had positive returns as investors were rewarded for taking on more risk by extending durations and investing in lower-rated securities. Unlike previous rising rate periods, commodities had the steepest losses in the absence of inflationary pressures.

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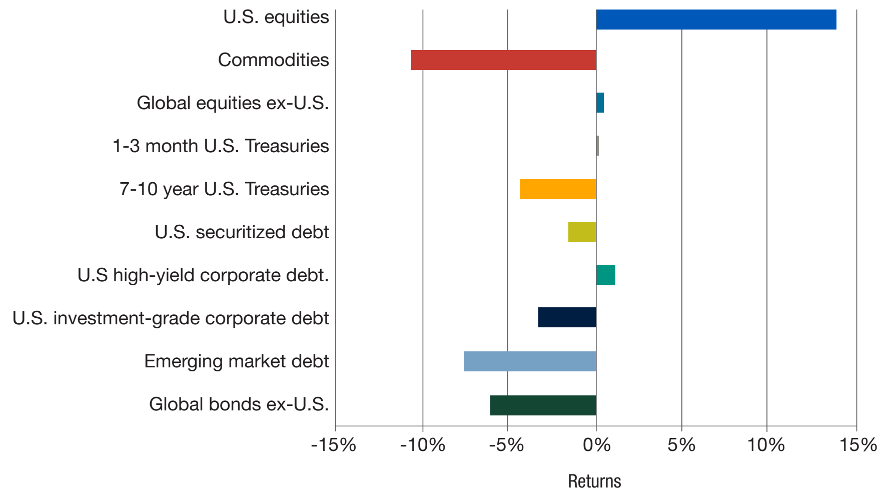
Figure 10: Asset class performance from 12/31/2012–6/30/2013



Source: Morningstar Direct. **Past performance is not a guarantee of future performance.** General information about risk, including sector and asset class benchmark information, and Terms and Definitions can be found beginning on page 14. **This chart is for illustrative purposes and is not intended to reflect the performance of any Transamerica fund**. Market indices do not include fees. One cannot invest directly in an index.

What works and how

Rising rates are a challenge for income investors in general. However, at Transamerica, we do not believe investors should have to settle for reduced yields or negative real returns. Instead, we believe it is possible for investors to effectively weather rising rate periods and possibly even benefit from them.

For many investors abandoning fixed income in general is not an option regardless of the interest rate outlook. Fixed income has been and will likely always be considered a core component of most diversified portfolios. Not only do many investors rely on the income stream, but investments that have the ability to produce income can often help lower portfolio volatility by offsetting riskier investments such as equities, while contributing to what can result in significant total return over time.

Yield basics

Understanding how yield works is essential to knowing how to prepare for a rising rate environment. Yield is the income generated from an investment in the form of interest or dividend payments.

Yield is a function of credit quality, liquidity and duration:

Credit quality measures the likelihood that an issuer will repay its debt. Credit risk is the risk that the issuer may default on its debt. Lower-rated bonds generally have higher yields as investors demand a premium for the added risk exposure.

Liquidity measures how quickly an investment can be converted into cash. When an investor sells a bond, there may not be anyone willing to buy the bond or they may have to sell the bond at a loss. Generally, bonds with longer maturities are not as liquid as shorter-term bonds. Government bonds are generally more liquid than corporate bonds.

Duration is a measure of a bond's overall sensitivity to interest rate movements that is expressed in years. It is based on a bond's present value, yield, coupon, maturity and call provisions. The longer the duration, the more sensitive a bond/bond fund is to interest rate changes.

In an uncertain environment, investors are often tempted to sit on the sidelines and wait for the volatility to pass. However, the consequences of doing nothing can be severe as today's current low yields offer fixed income investors little in terms of price protection. Bonds and income strategies will always play an important role in investor portfolios—regardless if the goal is capital preservation, a steady income stream or diversification.

Changing market conditions often highlight the fact that there is no such thing as a one-size-fits-all approach to investing. In general, bond prices fall when interest rates rise. However, not all bonds or bond funds are created equal as rising interest rates will not have the same impact on all asset classes. Security selection and risk management may mean more in a rising rate environment.

Among the best strategies for a rising rate environment are: 1) managing duration exposure and 2) diversifying sources of yield.

Investors searching for yield may find they must choose between lower credit quality and longer duration investments to get their desired income stream—effectively a tradeoff between exposure to interest rate risk and exposure to credit risk.

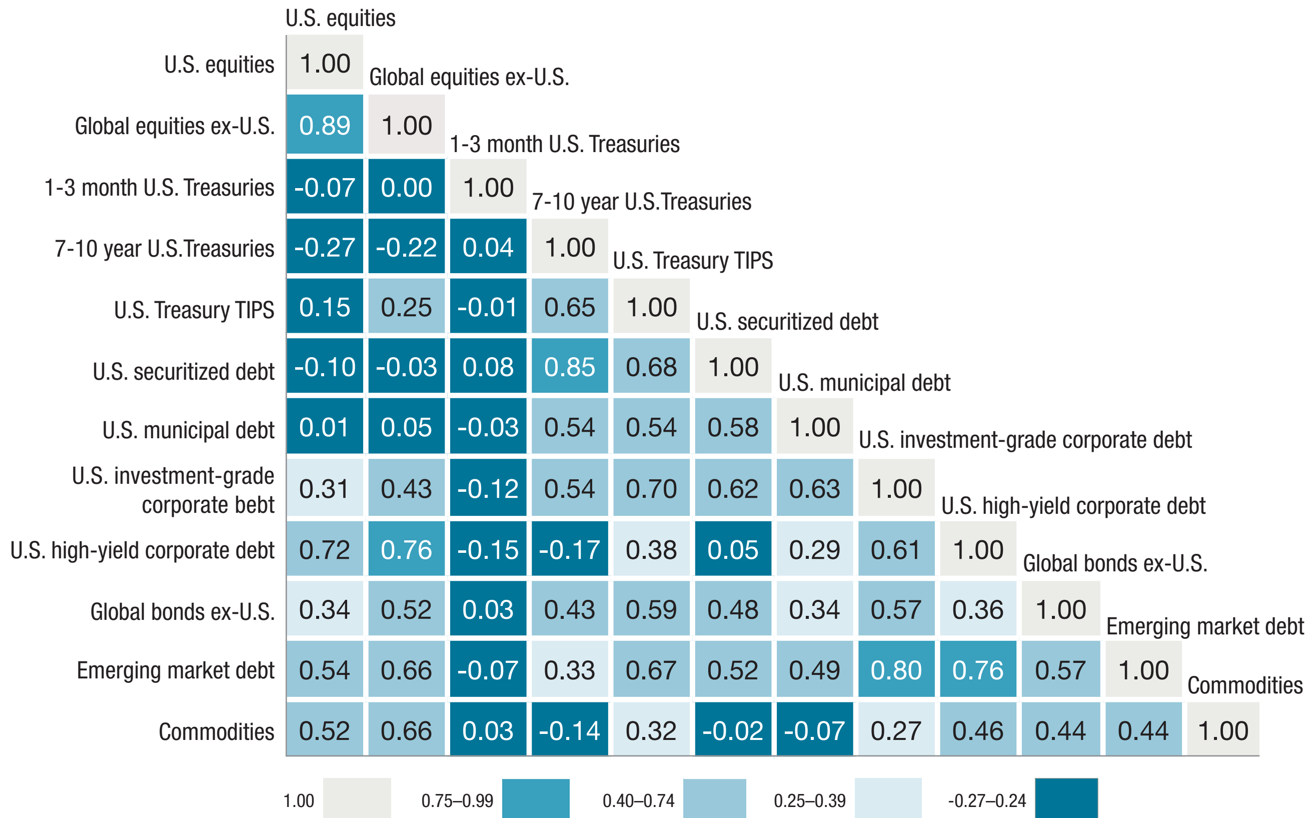
In a rising rate environment, it may not be necessary to completely abandon traditional bond holdings. Instead, investors may want to consider their fixed income assets in the context of an entire portfolio and adjust exposures as needed. For some investors, it may make sense to cast a wider net and include a more diverse set of investment opportunities.

A wider net

U.S. Treasuries and other higher-credit quality investments have historically low correlations with stocks and may not perform well in a rising rate environment.

By the same token, some bond sectors and other income generating securities may be less correlated with U.S. Treasuries, thereby offering diversification benefits:

Figure 11: Bond sector correlations



	U.S. equities	Global equities ex-U.S.	1-3 month U.S. Treasuries	7-10 year U.S.Treasuries	U.S. Treasury TIPS	U.S. securitized debt	U.S. municipal debt	U.S. investment-grade corporate debt	U.S. high-yield corporate debt	Global bonds ex-U.S.	Emerging market debt	Commodities
U.S. equities	1.00											
Global equities ex-U.S.	0.89	1.00										
1-3 month U.S. Treasuries	-0.07	0.00	1.00									
7-10 year U.S.Treasuries	-0.27	-0.22	0.04	1.00								
U.S. Treasury TIPS	0.15	0.25	-0.01	0.65	1.00							
U.S. securitized debt	-0.10	-0.03	0.08	0.85	0.68	1.00						
U.S. municipal debt	0.01	0.05	-0.03	0.54	0.54	0.58	1.00					
U.S. investment-grade corporate bebt	0.31	0.43	-0.12	0.54	0.70	0.62	0.63	1.00				
U.S. high-yield corporate debt	0.72	0.76	-0.15	-0.17	0.38	0.05	0.29	0.61	1.00			
Global bonds ex-U.S.	0.34	0.52	0.03	0.43	0.59	0.48	0.34	0.57	0.36	1.00		
Emerging market debt	0.54	0.66	-0.07	0.33	0.67	0.52	0.49	0.80	0.76	0.57	1.00	
Commodities	0.52	0.66	0.03	-0.14	0.32	-0.02	-0.07	0.27	0.46	0.44	0.44	1.00

Source: Morningstar Direct. **Past performance is not a guarantee of future performance.** General information about risk, including sector and asset class benchmark information, and Terms and Definitions can be found beginning on page 14. Correlation is for the 10 years ended June 30, 2013. Investors cannot invest directly in an index. Correlation is a statistical measure of how two variables move in relation to each other. A correlation coefficient ranges between +1 (positive) and -1 (negative). A correlation of +1 implies that as one security moves up or down, the other security will move in the same direction in unison. A correlation of -1 correlation implies that as one security moves up or down, the other security will move in the opposite direction. A correlation of 0 implies that there is no relationship in the movement between two variables.

In a rising rate environment, higher yielding opportunities may help buffer against price volatility and interest rate risk as investors are generally rewarded with higher yields for taking on more risk. High yielding investments may also provide strong total return potential, benefiting from both income and price appreciation.

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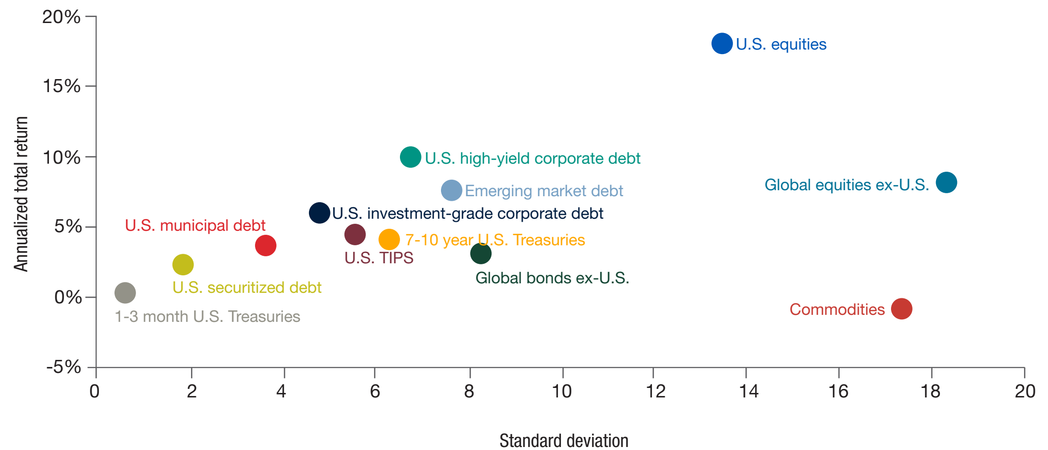
Figure 12: Return vs. risk



Annualized returns and standard deviation are for the three years ended June 30, 2013.

Source: Morningstar Direct. **Past performance is not a guarantee of future performance**. General information about risk, including sector and asset class benchmark information, and Terms and Definitions can be found beginning on page 14. Standard deviation is a measure of a security's historic volatility—the degree of a data set's dispersion from its mean. A higher standard deviation indicates greater relative risk. Investors cannot invest directly in an index.

Just as diversification makes sense on a portfolio basis, actively managing sector and duration exposure among income generating holdings by type and strategy may also make sense in a rising interest rate environment.

Figure 13: Strategies that can help in a rising rate environment

Defensive ← → Opportunistic

	Short duration: Stay quick, stay nimble	Think globally, invest internationally	Investment-grade and high-yield strategies	Real returns and low correlations	Multi-sector strategies and flexible allocations	Total return: Focus on income and growth
Why:	Short duration strategies are generally less sensitive to interest rate movements than their longer-term counterparts. Strategies may be diversified across sectors, including government, corporate, agency and asset-backed securities.	When U.S. rates rise, foreign markets may offer attractive opportunities as economic conditions and interest rate cycles can differ significantly by country.	During periods of economic expansion, investment-grade and high-yield bonds may benefit from improved balance sheets, robust liquidity, healthier credit ratios, and lower default rates.	Real return strategies generally have low correlations to equities and traditional fixed income markets. Real assets include tangible investments such as commodities and real estate. U.S. Treasury inflation-protected securities (TIPS) and floating rate loans periodically adjust to inflation or other such benchmarks.	Optimize risk/return potential with actively managed multi-sector and flexible mandate strategies. Dynamic strategies may shift allocations to sectors that are less correlated to U.S. Treasuries and with lower durations to offset the impact of rising rates.	Sometimes total return may trump low yields. Investments with performance that is more closely tied to the overall economy and creditworthiness of underlying issuers generally perform better than those that are more sensitive to interest rate movements. Examples include stocks, convertible and preferred securities, and other income generating investments.
How:	Diversified short-duration strategies can be used as a core fixed income holding.	Consider corporate, sovereign and local currency debt opportunities in both developed and emerging market economies.	Look for investments with attractive yield relative to U.S. Treasuries. When interest rates rise, bond prices generally fall. With current interest rates near zero, total returns may be negative as existing low yields can do little to offset declining bond prices.	Consider TIPS, floating rate loans and other investments that have a low correlation to the market, such as commodities, master limited partnerships (MLPs) and real estate investments.	Look for flexible strategies that can invest in all segments of the fixed income universe, including credit sectors.	Consider investments that can provide both income and growth, such as dividend paying stocks, and convertible and preferred securities. Historically, dividend stocks have provided higher returns with less risk compared with non-dividend paying stocks. Investing in common stock may carry more risk than other securities.
The funds:	Transamerica Short-Term Bond	Transamerica Emerging Markets Debt Transamerica International Bond	Transamerica High Yield Bond Transamerica Enhanced Muni Transamerica High Yield Muni	Transamerica MLP & Energy Income Transamerica Floating Rate	Transamerica Flexible Income Transamerica Tactical Income	Transamerica Income & Growth Transamerica Dividend Focused

Mutual funds are subject to market risk, including the loss of principal. Please see the next page for additional risks of the funds.

In summary

Not all bond funds behave the same. At Transamerica, we believe a diversified portfolio can help protect against rising interest rates and enhance risk-adjusted returns. In an uncertain interest rate environment that may include heightened risks, we believe it makes sense to take advantage of the expertise and capabilities of a professional money manager and an actively managed portfolio.

There is no assurance that a mutual fund will achieve its investment objective. Investments in fixed income funds are subject to certain risks including credit risk, inflation risk and interest rate risk. Credit risk is the risk that the issuer of a bond won't meet their payments. Inflation risk is the risk that inflation could outpace a bond's interest income. Interest rate risk is the risk that fluctuations in interest rates will affect the price of a bond. Long-term bonds are most exposed to interest rate risk than short-term bonds. Investments in MLPs involve risks that differ from investments in corporate issuers, including risks related to limited control, cash flow risks, dilution risks and risks related to the general partner's right to require unitholders to sell their common units at an undesirable time or price. Investments in emerging/global/international markets involve risks not associated with U.S. markets, such as currency fluctuations, adverse social and political developments, and the relatively small size and lesser liquidity of the markets. Investing in high-yield securities may be subject to greater volatility and risks as the income derived from these securities is not guaranteed and may be unpredictable and the value of these securities tends to decline when interest rates increases.

General Information About Asset Class Risk

Different types of assets have different types of risks. Some investments may have greater return and more volatility. In general, equity securities tend to be more volatile than fixed income investments. Exposure to commodities may subject a fund to greater volatility than investments in more traditional securities, such as stocks and bonds. Foreign, global and emerging market investments may include exposure to additional risks such as currency fluctuation, and political and economic instability. The value of, and income generated by, debt securities will decrease or increase based on changes in market interest rates. In general, as interest rates rise, bond prices fall. U.S. Treasuries are guaranteed as to the timely payment of principal and interest. However, there are other factors that may contribute to how securities react in various interest rate environments. Except in certain circumstances, income is generally subject to both federal and state taxes. Income is only one component of performance and an investor should consider all of the risk factors for each asset class before investing.

Terms and Definitions

1973 oil crisis: Organization of the Petroleum Exporting Countries (OPEC) declared an international oil embargo as a result of escalating Arab-Israeli tensions that prohibited any country that supported Israel from buying its oil.

1979 energy crisis: Also known as the second oil crisis. Massive protests disrupted oil exports from Iran leading up to, and in the wake of, the Iranian Revolution.

Basis point: A unit of measurement often used to calculate changes in interest rates and yield. One basis point [bps] is equal to 1/100 of 1%.

Bretton Woods: In 1944, the Bretton Woods agreement formed the International Monetary Fund (IMF) and established the U.S. dollar as the international reserve currency that was linked to gold. The Bretton Woods agreement was established in 1944 by the United Nations.

Bull market: An environment often associated with rising investor confidence and increased investment activity as the prices of a group of securities (or market) are expected to rise.

Call provisions: A clause in the debt agreement that allows the issuer the right to refund its debt at a predetermined price on or after a specified date.

Consumer Price Index (CPI): A measure of inflation based on consumer prices for a basket of goods and services as defined by the Bureau of Labor Statistics (BLS).

Core inflation: Inflation, less food and energy.

Correlation: A statistical measure of how two variables move in relation to each other. A correlation coefficient ranges between +1 (positive) and -1 (negative). A correlation of +1 implies that as one security moves up or down, the other security will move in the same direction in unison. A -1 correlation implies that as one security moves up or down, the other security will move in the opposite direction. A correlation of 0 implies that there is no relationship in the movement between two variables.

Deflation: A general decline in the prices of goods and services.

Discount rate: Sometimes also called the repo rate, the rate that the Fed charges member banks to meet short-term liquidity needs through the discount window.

Terms and Definitions (cont.)

Economic cycle: The economy's fluctuation from expansion to contraction.

Effective federal funds rate: The average rate that depository banks lend to each other. The FOMC indirectly influences the effective federal funds rate through its open market operations. The effective federal funds rate will closely track the target rate.

Federal fund target rate: A target established by the FOMC for trading in the federal funds market.

Federal Open Market Committee (FOMC): The FOMC is composed of the Fed's Board of Governors and a rotating panel of presidents from regional Federal Reserve Banks and the Federal Reserve Bank of New York. The FOMC establishes monetary policy for the Federal Reserve.

Fiat-based currency: Currency that is determined legal tender by government mandate.

Government-sponsored enterprise (GSE): Federal or federally sponsored agencies designed to lend money to certain groups of borrowers such as homeowners, farmers and students. Debt issued by GSEs is not guaranteed by the federal government. Examples of GSEs include Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), which are privately owned corporations.

Gross domestic product (GDP): The value of the goods and services produced by a country or region.

Headline inflation: Inflation, including food and energy.

Iranian Revolution: In 1979, amid social unrest, the Shah of Iran fled the country and the Ayatollah Khomeini, an Islamic cleric, came into power. Under the Ayatollah, Iranian oil production was inconsistent and lower than it was under the Shah.

Mexican peso crisis: In 1994, the Mexican peso plunged and the nation fell deep into recession as its current account deficit soared.

Mortgage-backed security (MBS): Mortgage-backed securities (MBS) are securitized investments that are backed by pools of residential or commercial mortgages.

Organization of the Petroleum Exporting Countries (OPEC): An organization of the world's major oil exporting countries which attempts to manage oil supply and prices.

Quantitative easing (QE): A form of monetary policy used by central banks to increase the money supply by buying government securities or other securities from the market for liquidity.

Recession: The NBER defines recession as a significant decline in economic activity spread across the economy, lasting more than a few months.

Secular trend: An overarching trend that extends over a long time period.

Standard deviation: Standard deviation is a measure of a security's historic volatility—the degree of a data set's dispersion from its mean.

Yield curve: Interest rates plotted on a graph over a set period of time with different maturities and the same credit quality.

Sources for data

Barclays Capital: Barclays Capital is a multinational financial services company and a leading provider of fixed income indices.

Bureau of Economic Analysis (BEA): The BEA is an agency of the U.S. Department of Commerce and is responsible for the analysis and reporting of economic data.

Bureau of Labor Statistics (BLS): The BLS is the principal Federal agency responsible for collecting and reporting on economic and labor data.

Federal Reserve Board (Fed): Also known as the Federal Reserve or more formally as the Board of Governors of the Federal Reserve System. The Fed is the main governing body of the U.S. central bank, the Federal Reserve System.

International Monetary Fund (IMF): An international organization that was established as a result of the Bretton Woods agreement to promote global monetary cooperation, secure financial stability and sustainable economic growth. The fund also helps facilitate international trade and works to reduce poverty around the world.

Morningstar Direct: A web-based institutional global investment analysis and reporting platform.

National Bureau of Economic Research (NBER): A non-profit, non-partisan research organization dedicated to promoting a greater understanding of the economy.

The Wall Street Journal Online: A member of the Wall Street Journal Digital Network, published by Dow Jones & Company, Inc., a division of News Corp.

Index descriptions

Barclays Global Aggregate ex-USD Bond Index (global bonds ex-U.S.) is an unmanaged index and is a broad measure of investment-grade government, corporate, agency, and mortgage-related bonds in global markets outside the U.S.

Barclays Municipal Bond Index (U.S. municipal debt) is an unmanaged index that covers the tax-exempt bond market including state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

Barclays U.S. 1-3 Month Treasury Bill Index (1-3 month U.S. Treasuries) is an unmanaged component of the Short Treasury Index and tracks U.S. Treasury bills with remaining maturity of less than three months and more than one month.

Barclays U.S. 7-10 Year Treasury Index (7-10-year U.S. Treasuries) is an unmanaged component of the Treasury Index and tracks U.S. Treasuries with remaining maturities of at least seven years and no more than 10 years.

Barclays U.S. Corporate High-Yield Bond Index (U.S. high-yield corporate debt) is an unmanaged index and measures U.S. non-investment grade, fixed rate, taxable corporate bonds.

Barclays U.S. Corporate Investment Grade Index (U.S. investment-grade corporate debt) is an unmanaged index and measures U.S. investment grade, fixed rate, taxable corporate bonds.

Barclays U.S. Mortgage-Backed Securities Index: (U.S. securitized debt) is an unmanaged index and measures U.S. mortgage-based securities (MBS) issued by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

Terms and Definitions (cont.)

Barclays U.S. Treasury Inflation Protected Securities (TIPS) Index (U.S. TIPS) is an unmanaged index that measures the performance of U.S. TIPS.

Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 stocks considered to be industry leaders and representative of general U.S. stock market performance.

Dow Jones-UBS Commodity Index (Commodities) is a broad-based measure of commodity performance.

JPM Emerging Market Bond Index (EMBI) Global Diversified (emerging market debt) is a broad measure of emerging market debt performance.

Morgan Stanley Capital International (MSCI) All Country World Index (ACWI) ex-U.S. (global equities ex-U.S.) is a free float-adjusted market capitalization weighted measure of developed and emerging market equity performance outside the U.S.

Morgan Stanley Capital International (MSCI) Emerging Markets (EM) Index (emerging market equities) is a free float-adjusted market capitalization weighted measure of emerging market equity performance.

Morgan Stanley Capital International (MSCI) Europe, Australasia, Far East (EAFE) Index (developed market equities) is a free float-adjusted market capitalization weighted measure of developed market performance.

Standard & Poor's 500® Index ([S&P 500®] (U.S. equities) is an unmanaged index comprised of 500 stocks and is generally considered a broad measure of U.S. equity performance.

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