Interest Rate Strategy

Highlights

- US Treasury rates rose over the course of the quarter with the most pronounced increase coming in the 5-10 year maturity range. Most of the move came in anticipation of the Fed's tapering of quantitative easing as this maturity range would be the most affected by the reduced buying.

- The combination of these factors has pushed the slope of the yield curve to historically wide levels as indicated by the spread between 10-year and 2-year Treasury bellwethers.

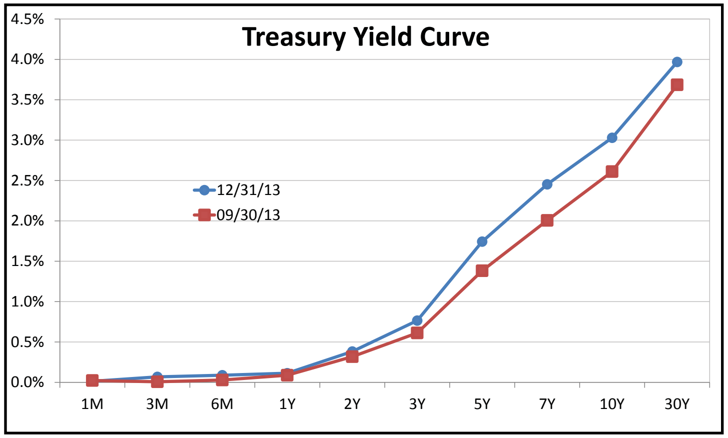
- These rate moves resulted in negative total returns for all but the very shortest maturities of US Treasury and Agency securities.

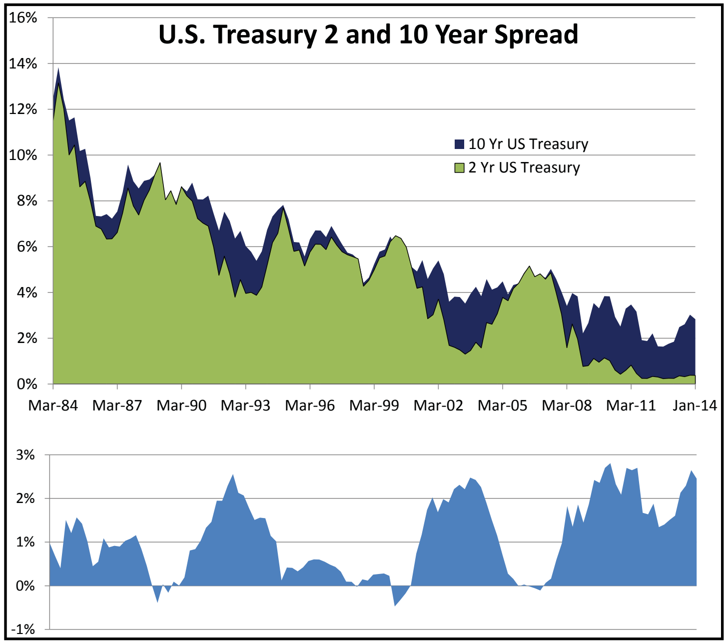
- Tight yield spreads and limited issuance of FNMA and FHLMC benchmark debenture issues have kept us away from this government-related sector over the last quarter, however, we continue to hold some core positions in both for the modest yield pick-up.

Outlook

- Short rates continue to be anchored by the Fed's zero interest rate policy which is expected to continue for the foreseeable future.

- Anticipating continued improvement in US domestic growth but with muted inflation expectations, we believe monetary policy will continue to be accommodative. This may temper rising rate expectations in the short run, but over the course of 2014 we believe there remains upward pressure on rates as the Fed reduces purchases through tapering of current buying and over time markets anticipate a return to a more normal rate policy.





Mark Kummerer, CFA
Sr. Portfolio Manager

Please see Disclosures for important information.

Corporates

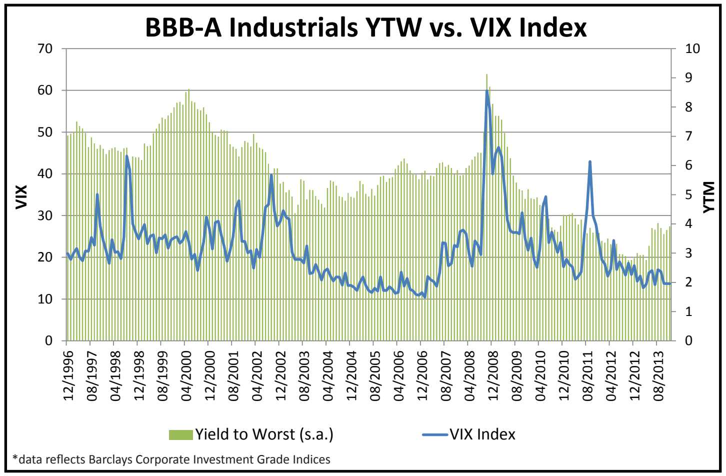
Highlights

- For the 4th quarter, Corporates exhibited total and excess return over Treasuries of 1.12% and 2.32%, respectively. The quarter's strong performance was not deterred by the two week government shutdown in October or the start of tapering by the Fed in December.

- For the full year 2013, Corporates total return of -1.53% was negatively impacted by rising rates. Despite the brief bout of volatility during the summer, however, excess returns in 2013 were the 4th best performance for Corporates in the past 25 years. Corporates excess returns were 2.86% versus the long-term median of 1.04%.

- 2013 was another record setting year as gross new issuance totaled $1.1 trillion. The past year included the two largest corporate debt offerings in history, the $49 billion Verizon debt deal and the $17 billion Apple deal.

- Corporate option-adjusted spread (OAS) tightened 28 bps to end the year at 114 bps. The index ended the year at pre-crisis levels, dating back to 2007.



Dan Kang, CFA
Sr. Research Analyst

Outlook

- We continue to favor the financial sub-sector versus the industrial sub-sector due to lower event risk, improving fundamentals and incremental spread. However, the financial/industrial basis has shrunk significantly over the course of the year; therefore, the relative outperformance of financials versus industrials should be more muted.

- Event risk continues as a major source or detractor of alpha. According to HFR, Inc. activist strategies have increased hedge fund assets under management from $36 billion in 2009 to over $90 billion in 2013. During 2013 activist hedge funds have made numerous impacts on the investment grade universe as it increases its target size. With the mixture of inflows of funds and the relative success of this type of strategy, we expect the prominence of activist investors to continue during 2014.

- We expect further mergers and acquisitions in 2014 as greater confidence in the economic outlook by management should encourage deal making. As suggested by comparing the yield-to-worst (YTW) on investment grade industrial corporate bonds with the CBOE Volatility Index (VIX), the sustained period of low volatility and historically low borrowing costs with the prospects of rising rates may provide further impetus for a transaction. The impact of M&A on investment grade credits is uncertain depending on size, price, financing, financial strategy and operational synergies/risks. However, we note Verizon's willingness to sacrifice their single-A ratings to complete their acquisition of Verizon Wireless and subsequent spread widening.

	2013	2012	2011	2010
S&P 500 Index	32.0%	16.0%	2.1%	13.9%
HFRX Global Hedge Fund Index	6.7%	3.5%	-8.9%	5.2%
HFRX Activist Index	19.3%	9.3%	-16.9%	15.0%

Source: HFR and Bloomberg

Mortgage-Backed Securities (MBS)

Highlights

- US Agency mortgage-backed securities outperformed Treasuries during the fourth quarter.

- MBS benefitted from continued net purchases of $40 billion per month by the Fed while gross and net issuance declined to $77 billion and $11 billion, respectively, in December due to slower seasonal factors and higher mortgage rates.

- Higher coupons led outperformance in the sector, as extension risk and declining sponsorship by the Fed impacted the lower production coupons.

- At their December meeting the Fed made the long-awaited decision to begin tapering their Quantitative Easing (QE) MBS purchases by $5 billion per month, with further reductions expected at a measured pace.

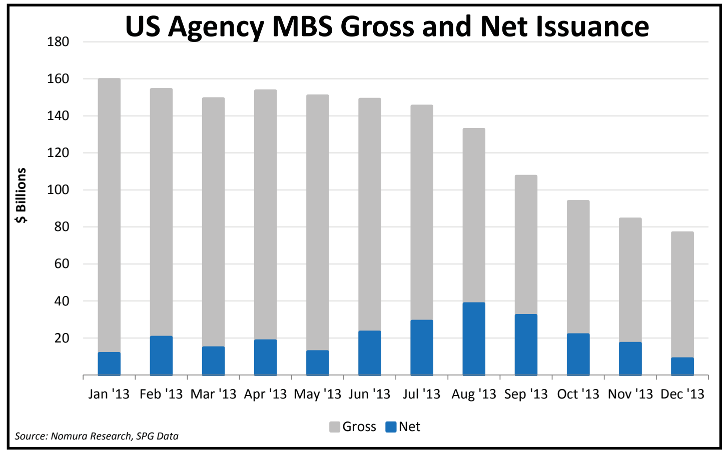
- The Mortgage Bankers Association's refinancing index declined to a five-year low by quarter-end as the average 30-year mortgage rate climbed to 4.80% and borrowers were less responsive to refinancing opportunities, reflecting burnout.

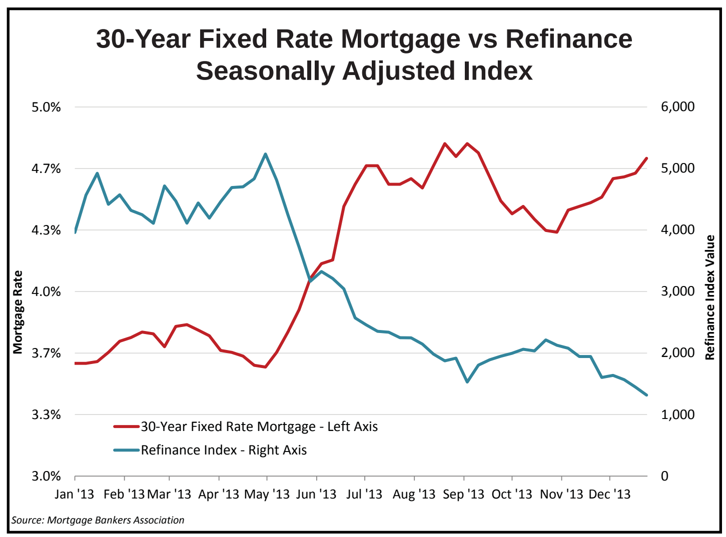
- Prepayment rates continued their decline during the quarter, with aggregate speeds falling by 30-35%.

Outlook

- Current MBS valuations appear rich, with nominal spreads to Treasuries at very low levels relative to historical averages. Valuations are strongly supported by the volume of Fed purchases tied to QE. We see very limited upside to the sector and significant downside risk as Fed support is withdrawn and spreads must recalibrate higher to attract relative value buyers back to the market.

- We expect MBS performance to remain volatile and data-dependent over the near term until the economic picture becomes clearer. While MBS spreads may remain tight over the short term given expectations for the Fed to buy an additional $200+ billion MBS before QE ends, we believe the sector is vulnerable to underperforming over the longer term and will look for trading opportunities to capitalize on this.





Perpetua Phillips
Sr. Portfolio Manager

Asset-Backed Securities (ABS)

Highlights

- The 2013 tally for gross issuance amounted to just under $180 billion, and the expectation across the market is that the 2014 supply pipeline will most likely mirror trends from this past year.

- Much like 2012, the 2013 issuance pipeline was dominated by the auto sector. Estimates for 2014 auto sales are supportive of increased auto ABS issuance.

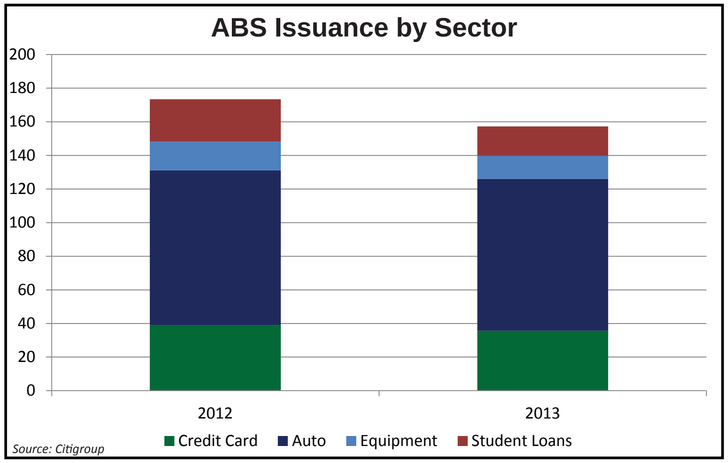
- With lease penetration rates at their highest level since 2005, and an increasing number of auto lease ABS transactions coming to market, attractive opportunities exist in this sector as an alternative to prime auto loan ABS.

- Both the Barclays ABS AAA index and the BofA Merrill Lynch Fixed Rate Consumer ABS Index registered positive excess returns as compared to Treasuries for 1 month, 3 month and YTD as of December 31, 2013.

Outlook

- We anticipate positive excess return performance for the ABS sector to continue into 2014.

- While spreads in most ABS sectors never fully recovered from this summer's spike in rate volatility, strong demand for ABS throughout the fourth quarter and light December new issue supply benefitted spread performance heading into the end of the year. With the majority of taper-related uncertainty seemingly behind us, the supportive balance between new issue supply and the market demand for ABS will likely continue to drive AAA spread movement in the short term.



Issuance by Sector 2012-2013

Sector	2012 ($ in Billions)	2013 ($ in Billions)	2013
Credit Card	39.09	35.62	19.91%
Auto	91.21	90.42	50.54%
Equipment	17.13	13.62	7.61%
Student Loans	25.28	17.57	9.82%
Total (Includes 'Other' ABS)	184.8	178.9	100.00%

Source: Citigroup

Barclays U.S. Aggregate ABS Sub-indices – Excess Returns December 31, 2013

Description	1 Mo	3 Mo	YTD
U.S. Aggregate – ABS AAA[1]	0.06%	0.33%	0.08%
SIMI[2] – U.S. ABS Auto AAA	0.04%	0.22%	0.24%
SIMI – U.S. Credit Card AAA	0.07%	0.39%	0.07%

[1] includes Utility ABS

BofA Merrill Lynch ABS Sub-indices – Excess Returns December 31, 2013

Description	1 Mo	3 Mo	YTD
ABS Other AAA Fixed Rate	0.05%	0.33%	0.36%
ABS Auto AAA Fixed Rate	0.06%	0.29%	0.47%
ABS Credit Cards AAA Fixed Rate	0.07%	0.36%	0.23%

Mark Kummerer, CFA
Sr. Portfolio Manager

Jason Delanty
Investment Data Analyst

Commercial Mortgage-Backed Securities (CMBS)

Highlights

- Private label new issue production for 2013 hit a post-crisis high of $85 billion with 70% of Non-Agency CMBS supply coming from conduits and/or fusion deals. In addition, Agency CMBS reached $66 billion in new issue supply. Market expectations for 2014 suggest new issue volume could reach over $100 billion.

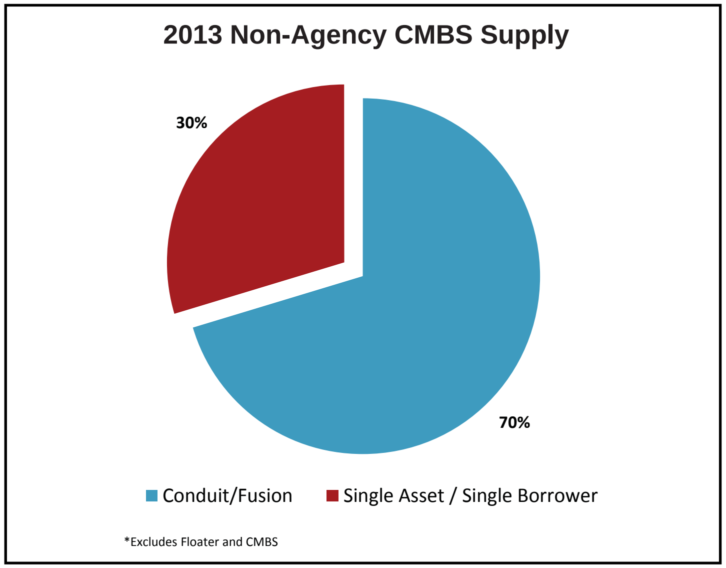
- Private label issuance for 2013 was roughly 76% higher year-over-year. Agency issuance increased 17% from 2012 volumes.

- The A1 tranche spreads of AAA CMBS conduits are currently hovering 30-35 bps off of year-to-date tights. New issue first-pay tranches continued to be our primary focus throughout the fourth quarter.

Outlook

- In line with our Q3 strategy towards vintage deals, we remain cognizant of prepayment risk from unexpected liquidations, but recognize that refinancing risk should decrease as rates continue to rise.

- With new issue senior AAA CMBS yet to fully retrace last summer's spread widening, 2014 spread performance seems as though it will depend largely on the strength of sector demand. With forecasts suggesting positive net supply for 2014, the market's appetite for new issue CMBS as an alternative to comparable duration corporates and ABS will likely impact the 2014 CMBS spread trajectory.



Excess Returns as of December 31, 2013

	1 Mo	3 Mo	YTD
SIMI – US CMBS AAA 1-6 Yr	0.12%	0.47%	0.35%

Rupa Raman, CFA
Sr. Research Analyst

Disclosures

PAST PERFORMANCE IS NOT A GUARANTEE OF FUTURE RESULTS

The material provides economic and investment commentary that represents the opinions of Morley Capital Management Inc. (MCM) and such opinions should not be considered investment advice or an evaluation, recommendation, offer, or solicitation of any particular security or strategy. The opinions provided do not take into account the investment objectives, financial situation, or needs of any particular investor and prospective investors should consider whether any security or strategy is suitable for their particular circumstances, carefully consider the risks associated with any security or strategy (including a review of applicable disclosure documents) and, if necessary, seek professional advice before investing.

The material represents information available at the time of production, no forecast based on the opinions expressed can be guaranteed, and such opinions and data may be subject to change without notice. Although the information is obtained from sources deemed to be reliable neither MCM, nor its affiliates can guarantee the accuracy of the information.

Investment management services are provided MCM, a registered investment adviser and a subsidiary of Morley Financial Services Inc., which is a wholly owned subsidiary of Principal Financial Group, Inc.

Market indices have been provided for comparison purposes only. They are unmanaged and do not reflect any fees or expenses. Individuals can not invest directly in an index.

The BofA Merrill Lynch AAA US Fixed Rate Credit Card Asset Backed Securities Index is a subset of the BofA Merrill Lynch US Fixed Rate Asset Backed Securities Index including all asset backed securities collateralized by credit card loans and rated AAA. The BofA Merrill Lynch US Fixed Rate Asset Backed Securities Index tracks the performance of US dollar denominated investment grade fixed rate asset backed securities publicly issued in the US domestic market.

The Barclays U.S. Aggregate Index is a broad-based bond index comprised of dollar-denominated publicly issued government, corporate, mortgage and asset-backed issues, rated investment grade or higher, and having at least one year to maturity.

The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements within the Barclays U.S. Aggregate Index.

The Stable Income Market Index represents a low-risk blend of asset classes from within the Barclays U.S. Aggregate Index, focusing on shorter maturities, and providing diversified exposure to debt from the government, credit and securitized sectors.

The S&P 500 Composite Stock Price Index is a capitalization-weighted index of 500 stocks intended to be a representative sample of leading companies in leading industries within the U.S. economy. Stocks in the Index are chosen for market size, liquidity, and industry group representation.

The HFRX Activist Index represents activist strategies that may obtain or attempt to obtain representation of the company's board of directors in an effort to impact the firm's policies or strategic direction and in some cases may advocate activities such as division or asset sales, partial or complete corporate divestiture, dividend or share buybacks, and changes in management. Strategies employ an investment process primarily focused on opportunities in equity and equity related instruments of companies which are currently or prospectively engaged in a corporate transaction, security issuance/repurchase, asset sales, division spin-off or other catalyst oriented situation. These involve both announced transactions as well as situations which pre-, post-date or situations in which no formal announcement is expected to occur. Activist strategies are distinguished from other Event Driven strategies in that, over a given market cycle, Activist strategies would expect to have greater than 50% of the portfolio in activist positions, as described.

The HFRX Global Hedge Fund Index is designed to be representative of the overall composition of the hedge fund universe. It is comprised of all eligible hedge fund strategies; including but not limited to convertible arbitrage, distressed securities, equity hedge, equity market neutral, event driven, macro, merger arbitrage, and relative value arbitrage. The strategies are asset weighted based on the distribution of assets in the hedge fund industry.

*Visit us online at **www.morley.com** for the most recent market updates, Insights and Perspectives from the Morley investment team.*