September 2018

Income Fund
Quarterly Review

William Blair

7663419

William Blair Income Fund Important Disclosures

Please refer to the last page of this Quarterly Review for definitions of the Indices used in this report.

Risks: The Fund's returns will vary, and you could lose money by investing in the Fund. As interest rates rise, bond prices will fall and bond funds become more volatile. The Fund is subject to credit risk. The Fund's net asset value and total return may be adversely affected by the inability of the issuers of the Fund's securities to make interest payments or payment at maturity. The Fund's investments in obligations issued or guaranteed by U.S. Government agencies or instrumentalities may not be backed by the full faith and credit of the United States and may differ in the degree of support provided by the U.S. Government. The Fund is also subject to interest rate and foreign investments risk. Foreign investments often involve additional risks, including political instability, differences in financial reporting standards and less stringent regulation of securities markets. Rule 144A securities are not registered for resale in the general securities market and may be classified as illiquid. It may not be possible to sell or otherwise dispose of illiquid securities both at the price and within a time period deemed desirable by the Fund. Investments with longer maturities, which typically provide higher yields than securities with shorter maturities, may subject the Fund to increased price changes resulting from market yield fluctuations. The Fund's investments in collateralized mortgage obligations are subject to prepayment and extension risk. Prepayment of high interest rate mortgage-backed securities during times of declining interest rates will tend to lower the return of the Fund and may even result in losses to the Fund if the prepaid securities were acquired at a premium. Slower prepayments during periods of rising interest rates may increase the duration of the Fund's mortgage-backed securities and asset-backed securities and reduce their value.

The views expressed in this report and the information about the holdings are as of the date of this material, unless otherwise noted, and are subject to change. Information about the Fund's holdings should not be considered investment advice. There is no guarantee that the Fund will continue to hold any one particular security or stay invested in any one particular sector. Holdings are subject to change at any time.

Performance cited represents past performance. Past Performance does not guarantee future results and current performance may be lower or higher than the data quoted. Investment returns and principal will fluctuate with market and economic conditions and you may have a gain or loss when you sell shares. Current performance may be lower or higher than the data quoted. Class N shares are available to the general public without a sales load. Class I shares are available only to investors who meet certain eligibility requirements.

This content is for informational and educational purposes only and is not intended as investment advice or a recommendation to buy or sell any security. Investment advice and recommendations can be provided only after careful consideration of an investor's objectives, guidelines and restrictions.

Most recent month-end performance information for the Fund is available by visiting the William Blair Funds Web site at www.williamblairfunds.com, or by calling the William Blair Funds at 1-800-742-7272.

Investing includes the risk of loss. Please carefully consider the Fund's investment objective, risks, charges, and expenses before investing. This and other information is contained in the Fund's prospectus, which you may obtain by calling 1-800-742-7272. Read it carefully before you invest or send money.

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Market Commentary & Performance

September 2018

The Bloomberg Barclays U.S. Aggregate Index returned 0.02% during the third quarter of 2018, as the combination of the market's yield levels and declining risk spreads were positive effects that offset the impact of rising interest rates. The Index returned -1.60% year-to-date ending 9/30/18 as interest rates rose across all tenors.

The Federal Open Market Committee (FOMC) increased the target range of the federal funds rate by 0.25% during the third quarter, as the Committee increased the range to 2.00% - 2.25% during its September meeting. This marked the third hike of the fed funds rate during 2018, and the fed funds futures market carried an implied probability that the FOMC will raise the target range of the federal funds rate by 25 basis points one additional time during 2018: following its December meeting.

The FOMC continued to execute its plan to gradually shrink its balance sheet during the third quarter, and effective October 1, 2018 the FOMC will permit the balance sheet to shrink at its fastest pace: $50 billion per month. At this pace, the FOMC expects to slow the pace of reinvestments of agency mortgage-backed securities (MBS) to a *de minimis* level.

The agency MBS Index generated negative total returns but outperformed Treasuries on a duration-adjusted basis during the third quarter. The MBS Index also generated negative total returns year-to-date while also underperforming comparable-duration Treasuries. Over both time periods, the weak performance has been dominated by lower-coupon 30-year pools that the FOMC has targeted in its asset purchase programs to suppress mortgage rates, such as 30-year 3.0%, 3.5%, and 4.0%. Higher-coupon segments of the market have generated positive total returns, outpaced comparable duration Treasuries, and outperformed those lower-coupon segments during the third quarter and year-to-date.

Corporate bonds experienced gains and outperformed other segments of the market during the third quarter. High yield corporate bonds continued to outperform investment-grade corporate bonds, and the most-speculative segments of the market continued to generate strong results, with CCC-rated bonds having posted a return of 5.99% year-to-date.

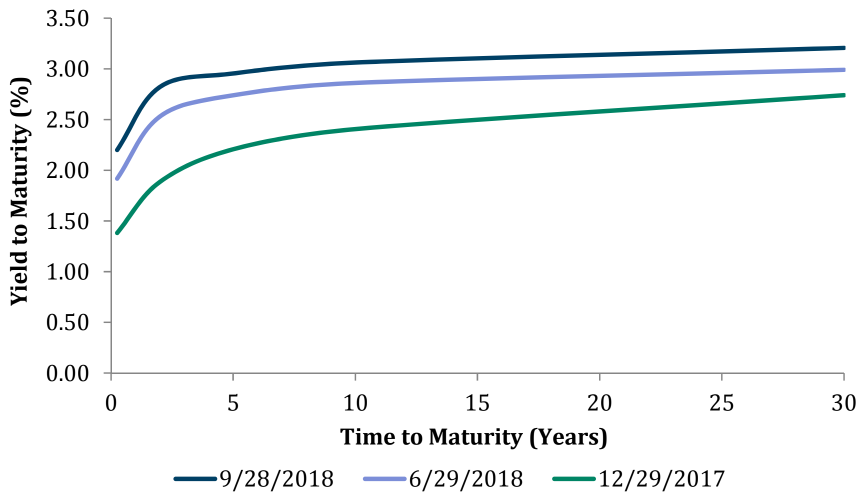
The William Blair Income Fund (Class N) outperformed the Bloomberg Barclays Intermediate Government/Credit Index during the third quarter. A couple of factors contributed to the Fund's performance relative to the Index during the quarter. Interest rate positioning impacted results favorably, as the Fund had less exposure to interest rates than its benchmark during a period of rising rates. Sector allocation contributed to results, as the Fund was underweight to fixed-rate Treasuries. Positions in corporate bonds contributed to results, particularly bonds issued by IntercontinentalExchange, ConocoPhillips, and Brookfield Asset Management. There were some factors that detracted from performance during the quarter. An underweight exposure to corporate bonds, and in particular BBB-rated corporate bonds, detracted from performance as corporate bonds generated gains during the quarter.

This information has been prepared solely for informational purposes and is not intended to provide or should not be relied upon for accounting, legal, tax or investment advice. The factual statements herein have been taken from sources we believe to be reliable, but such statements are made without any representation as to accuracy or completeness. Opinions expressed are current opinions as of the date appearing in this material only. These materials are subject to change, completion, or amendment from time to time without notice and William Blair is not under any obligation to keep you advised of such changes.

Treasury Market Overview

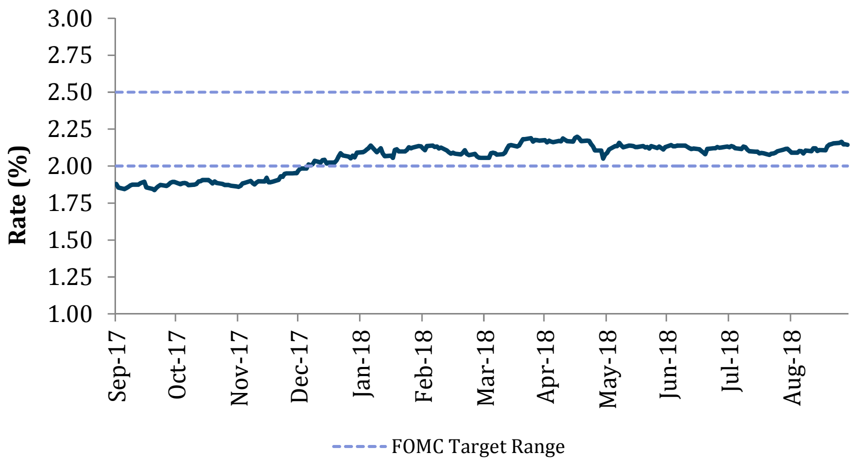
September 30, 2018

U.S. Treasury Yield Curve



	Total Returns		YTD Change in Yield		
	QTD	YTD	9/28/18	12/29/17	Difference
3 Month	0.49%	1.30%	2.20	1.38	0.82
2 Year	0.14%	0.12%	2.82	1.89	0.94
5 Year	-0.28%	-1.35%	2.95	2.21	0.75
10 Year	-1.09%	-3.73%	3.06	2.41	0.66
30 Year	-3.27%	-6.55%	3.21	2.74	0.47

10-Year Breakeven Inflation Rate



- U.S. Treasuries of all tenors experienced rising rates YTD.
- The 5-, 10-, and 30-year Treasury indexes experienced negative total returns YTD.
- TIPS outperformed nominal Treasuries YTD after adjusting for maturity; the 10-year TIPS breakeven rate increased YTD.
- The current breakeven rates on U.S. TIPS are at levels within the FOMC's stated target range for inflation of 2.0% - 2.5% per year.

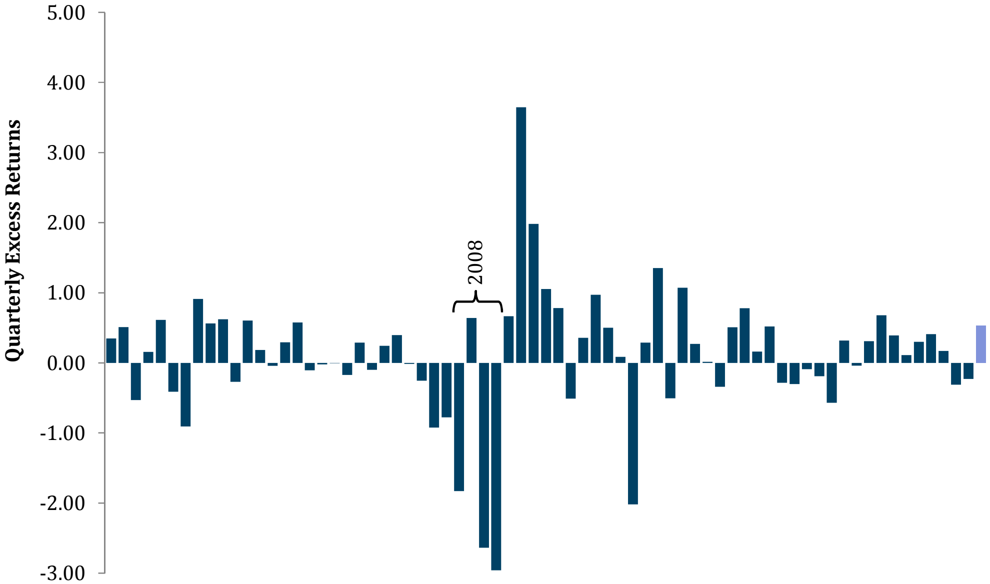
Source: Bloomberg, Barclays, Bank of America/Merrill Lynch

Past performance is not indicative of future returns. The performance shown is for illustrative purposes and is not intended to represent the performance of any account or investment strategy managed by William Blair. A direct investment in an unmanaged index is not possible.

Fixed Income Spread Sectors Overview

September 30, 2018

Bloomberg Barclays Capital Aggregate Index – Since 2001



- Mortgage-backed securities generated negative excess returns YTD.
- The credit markets generated mixed performance YTD: investment-grade corporate bonds and emerging market-related bonds generated negative excess returns, while high yield corporate bonds generated positive excess returns.
- Excess returns measure relative performance versus a duration-neutral basket of U.S. Treasuries.

Annual Excess Returns – Through 9/30/18

	Bloomberg Barclays Aggregate Index	U.S. Mortgage Backed Securities	U.S. Corporate Investment Grade	U.S. Corporate High Yield	EM USD Aggregate
2001	0.54	-0.75	2.72	-2.85	-5.41
2002	0.29	1.73	-2.45	-13.29	0.23
2003	1.55	0.11	5.80	26.42	24.65
2004	1.03	1.42	1.63	8.00	8.23
2005	-0.31	-0.37	-1.15	0.47	9.59
2006	0.85	1.22	1.26	8.43	7.02
2007	-2.06	-1.77	-5.23	-7.77	-4.57
2008	-7.10	-2.32	-19.88	-38.32	-28.42
2009	7.46	4.95	22.76	59.55	37.97
2010	1.71	2.25	2.29	9.74	5.08
2011	-1.14	-1.06	-3.67	-2.40	-5.37
2012	2.26	0.91	7.34	13.94	15.03
2013	0.93	0.98	2.86	9.23	-0.32
2014	0.10	0.40	-0.48	-1.12	-1.20
2015	-0.53	-0.05	-1.61	-5.77	0.03
2016	1.38	-0.11	4.93	15.73	8.80
2017	1.21	0.52	3.46	6.10	6.14
2018	-0.01	-0.07	-0.11	3.27	-0.59

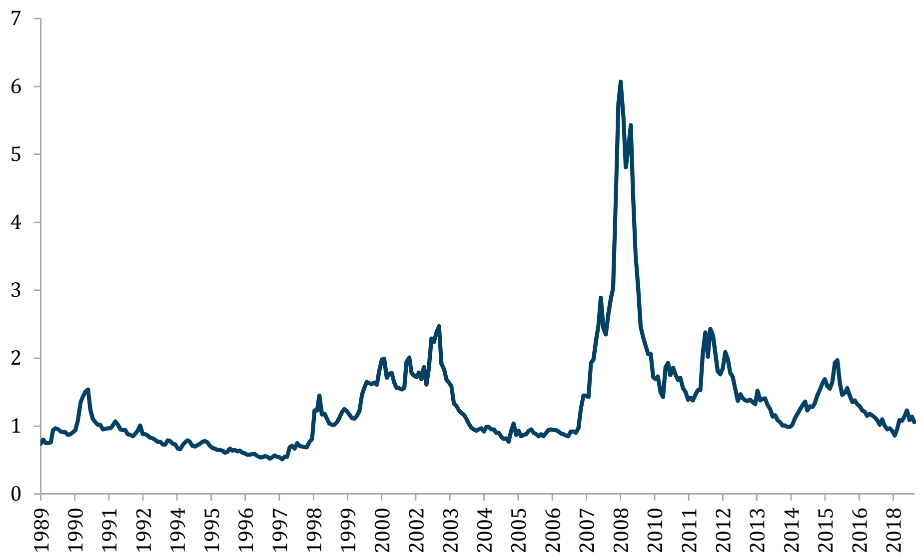
Source: Bloomberg Barclays.

Past performance is not indicative of future returns. Excess Return is a security's return minus the return from a Treasury security of the same duration. The performance shown is for illustrative purposes and is not intended to represent the performance of any account or investment strategy managed by William Blair. A direct investment in an unmanaged index is not possible.

Credit Market Overview

September 30, 2018

U.S. Corporate Investment Grade – Treasury OAS



- Investment-grade corporate bonds generated positive excess returns QTD but negative excess returns YTD.
- Longer-term corporate bonds underperformed shorter-term bonds YTD after controlling for the effects of duration.
- High yield bonds outperformed investment-grade bonds QTD and YTD, with the best performance experienced by more-speculative segments of the market ("B" and "CCC" rated bonds).
- Excess returns measure relative performance versus a duration-neutral basket of U.S. Treasuries

	Total Returns		Excess Returns	
	QTD	YTD	QTD	YTD
Bloom/Barc Corporate Index	0.97	-2.33	1.69	-0.11
Bloom/Barc U.S. High Yield Index	2.40	2.57	2.48	3.27
Bloom/Barc EM USD Aggregate Index	1.61	-2.28	2.10	-0.59
1-5 Year Credit	0.71	0.19	0.62	0.34
5-10 Year Credit	0.87	-2.02	1.34	0.14
10+ Year Credit	1.32	-5.54	3.28	-0.84
AA+	0.58	-1.58	1.14	0.11
A	0.72	-2.76	1.45	-0.54
BBB	1.29	-2.05	2.00	0.22
BB	2.32	0.51	2.48	1.46
B	2.29	3.17	2.32	3.74
CCC	2.73	5.99	2.73	6.35
Industrial	1.07	-2.36	1.90	0.07
Financial	0.93	-1.94	1.35	-0.32
Utillity	0.23	-3.94	1.44	-0.79
Non-Corporate	0.49	-1.08	0.94	0.48
EM USD Corporate: IG	1.22	-1.61	1.92	0.42
EM USD Corporate: HY	1.73	-4.22	2.10	-2.72

Source: Bloomberg Barclays.

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MBS Market Overview

September 30, 2018

U.S. Mortgage Backed Securities – Treasury OAS

- The mortgage-backed securities (MBS) Index earned negative excess returns YTD.
- 30-year pools outperformed 15-year pools QTD and YTD after controlling for duration.
- Higher-coupon, 30-year pools outperformed lower-coupon, 30-year pools QTD and YTD.
- Excess returns measure relative performance versus a duration-neutral basket of U.S. Treasuries.

	Total Returns		Excess Returns	
	QTD	YTD	QTD	YTD
MBS Fixed Rate Index	-0.12	-1.07	0.17	-0.07
Conventional 30 Year	-0.17	-1.19	0.17	-0.07
3.0 Coupon	-0.37	-1.74	0.12	-0.12
3.5 Coupon	-0.25	-1.49	0.13	-0.34
4.0 Coupon	-0.05	-0.77	0.20	0.03
4.5 Coupon	-0.06	-0.40	0.11	0.20
5.0 Coupon	0.30	0.15	0.39	0.72
5.5 Coupon	0.83	0.30	0.91	1.04
6.0 Coupon	0.25	0.03	0.35	0.72
6.5 Coupon	0.27	0.23	0.32	0.82
Conventional 15 Year	-0.04	-0.81	0.01	-0.19
2.5 Coupon	-0.07	-1.02	0.00	-0.29
3.0 Coupon	-0.12	-0.79	-0.06	-0.16
3.5 Coupon	0.08	-0.38	0.09	0.02
4.0 Coupon	0.23	0.42	0.10	0.32
4.5 Coupon	0.35	0.36	0.13	0.10

Source: Bloomberg Barclays.

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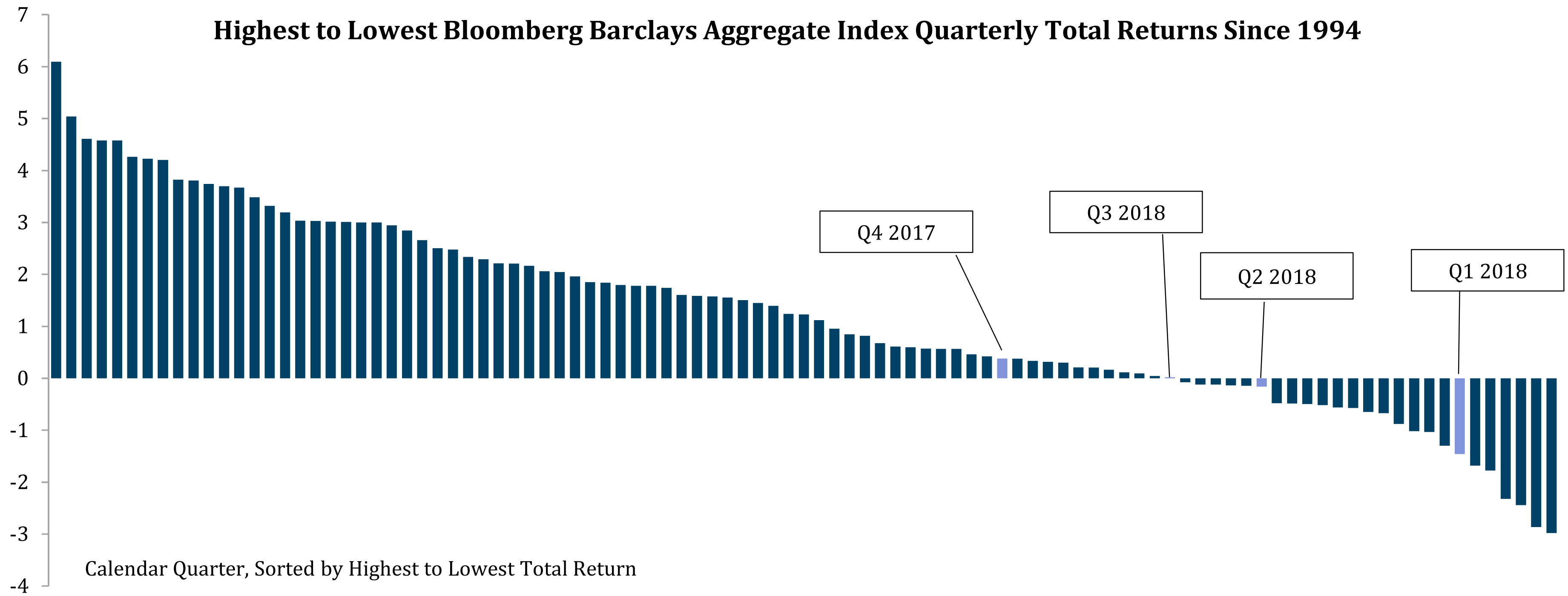
Fixed Income Market Returns

September 30, 2018



	Total Returns	
	QTD	YTD
Bloomberg Barclays Aggregate Index	0.02	-1.60
Bloomberg Barclays Treasury Index	-0.59	-1.67
Bloomberg Barclays U.S. TIPS Index	-0.82	-0.84
Bloomberg Barclays U.S. MBS Index	-0.12	-1.07
Bloomberg Barclays Corporate Index	0.97	-2.33
Bloomberg Barclays U.S. High Yield Index	2.40	2.57
Bloomberg Barclays EM USD Aggregate Index	1.61	-2.28

Source: Bloomberg Barclays.

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William Blair Income Fund Performance

September 30, 2018

Performance %	Quarter	YTD	1 Year	3 Years	5 Years	10 Years
Income Fund (BIFIX) - Class I	0.30	-0.73	-0.69	1.19	1.54	3.53
Income Fund (WBRRX) - Class N	0.26	-0.87	-0.99	0.93	1.32	3.31
Bloomberg Barclays Int. Gov/Credit Bond Index	0.21	-0.76	-0.96	0.91	1.52	3.22
Morningstar Short-Term Bond Category	0.50	0.45	0.43	1.36	1.24	2.52

Performance cited represents past performance. Past Performance does not guarantee future results and current performance may be lower or higher than the data quoted. Results shown are average annual returns, which assume reinvestment of dividends and capital gains. Investment returns and principal will fluctuate with market and economic conditions and you may have a gain or loss when you sell shares. For the most current month end performance information, please call 1-877-962-5247, or visit our Web site at www.williamblairfunds.com. Class N shares are available to the general public without a sales load. Class I Shares are available only to investors who meet certain eligibility requirements.

Income Fund Expense Ratios:

	Gross	Net
Class I Shares	0.62%	0.62%
Class N Shares	0.88%	0.85%

Expenses shown are as of the most recent prospectus. The Fund's Adviser has contractually agreed to waive fees and/or reimburse expenses to limit fund operating expenses until 4/30/19. Class I inception: 10/1/1999, Class N inception: 10/1/1990.

The Bloomberg Barclays Intermediate Government/Credit Bond Index indicates broad intermediate government/corporate bond market performance. A direct investment in an index is not possible.

The Morningstar Short-Term Bond Category represents the average annual composite performance of all mutual funds listed in the Short-Term Bond Category by Morningstar.

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William Blair Income Fund Performance Analysis

September 30, 2018

QTD Contributors

- Interest rate positioning impacted results favorably, as the portfolio had less exposure to interest rates than its benchmark during a period of rising rates.
- Sector allocation contributed to results, as the portfolio was underweight to fixed-rate Treasuries.
- Positions in corporate bonds contributed to results, particularly bonds issued by IntercontinentalExchange, ConocoPhillips, and Brookfield Asset Management.

QTD Detractors

- An underweight exposure to corporate bonds detracted from performance as corporate bonds generated gains during the quarter.

YTD Contributors

- Interest rate positioning contributed to results, as portfolios had less duration than the Index and intermediate-term rates rose.
- Positioning within mortgage-backed securities contributed, as higher-coupon segments of the market performed well.
- An allocation to TIPS was additive to performance, as the market's implied inflation expectations rose.

YTD Detractors

- Positions in bonds issued by Abbvie, BNP Paribas, and BRF SA hindered results.

Holdings are subject to change at any time. References to specific securities and their issuers are for illustrative purposes only and are not intended and should not be interpreted as recommendations to purchase or sell such securities. William Blair may or may not own the securities referenced and, if such securities are owned, no representation is being made that such securities will continue to be held. The above securities do not represent all of the securities purchased, sold or recommended for all William Blair clients.

William Blair Income Fund Attribution

Through September 30, 2018

Quarter to Date

Description	Market Value Weight			Total Return			Total Return Contribution			Active Contribution		
	Port	Bench	Active	Port	Bench	Active	Port	Bench	Active	Rates	Sector Allocation	Security Selection
Total Fund	**100.0%**	**100.0%**	**0.0%**	**48**	**21**	**27**	**48**	**21**	**27**	**15**	**8**	**3**
Treasuries	2.9%	58.7%	-55.8%	-104	-12	-91	-3	-7	4	2	20	0
Agencies	0.0%	2.5%	-2.5%	0	20	-20	0	1	-1	0	1	0
Residential Mortgages	49.9%	0.0%	49.9%	37	0	37	19	0	19	5	-3	0
ABS	2.0%	0.0%	2.0%	63	0	63	1	0	1	1	0	0
IG Corps	32.1%	37.1%	-5.0%	85	71	14	27	26	1	2	-3	3
Emerging Markets	3.1%	1.6%	1.5%	135	118	17	5	2	3	0	2	0
Cash Securities	10.1%	0.1%	10.0%	0	0	0	0	0	0	5	-8	0

Year to Date

Description	Market Value Weight			Total Return			Total Return Contribution			Active Contribution		
	Port	Bench	Active	Port	Bench	Active	Port	Bench	Active	Rates	Sector Allocation	Security Selection
Total Fund	**100.0%**	**100.0%**	**0.0%**	**-18**	**-76**	**59**	**-18**	**-76**	**59**	**42**	**11**	**5**
Treasuries	2.8%	58.0%	-55.2%	-75	-81	6	-2	-47	45	36	6	4
Agencies	0.0%	2.7%	-2.7%	0	1	-1	0	0	0	0	0	0
Residential Mortgages	50.1%	0.0%	50.1%	23	0	23	9	0	9	-12	17	0
ABS	1.8%	0.0%	1.8%	152	0	152	3	0	3	2	0	0
IG Corps	33.3%	37.5%	-4.2%	-80	-72	-8	-26	-28	2	8	-2	-3
Emerging Markets	4.3%	1.6%	2.6%	43	-78	121	-1	-1	0	-2	0	3
Cash Securities	7.7%	0.1%	7.6%	0	0	0	0	0	0	10	-11	0

Source: BlackRock Solutions.

Past performance is not indicative of future returns. The attribution analysis contained herein is calculated by BlackRock Solutions and is intended to provide an estimate as to which elements of a strategy contributed (positively or negatively) to the Fund's performance. Attribution analysis is not a precise measure and should not be relied upon for investment decisions. Holdings are subject to change at any time. Not intended as investment advice. A direct investment in an index is not possible.

William Blair Income Fund Strategy

September 30, 2018

Decision Factor	Positioning	Strategy
Interest Rates & Yield Curve	Neutral	• Strategy risk discipline to maintain benchmark-like duration and yield curve exposures
Treasuries & Agencies	Underweight	• Allocation to TIPS. We find the embedded option that benefits from unexpected inflation an appealing feature versus owning nominal Treasury notes and bonds. • Underweight agencies. We view agency MBS as a more attractive alternative
Securitized Sectors	Overweight	• Overweight agency MBS. We find valuations of higher-coupon pools comprised of low loan balances attractive as such pools offer superior spreads within the MBS sector, defensive duration posture, and manageable prepayment experiences • We avoid the lower-coupon MBS that dominate the MBS Index because we find that valuations are unappealing due to the Fed's targeting of the securities during their large-scale asset purchase programs, most recently "FedTrade." • Overweight ABS. We find certain floating-rate ABS to offer attractive yields and protection against rising interest rates • Underweight CMBS. We favor owning corporate REITs instead, as both are characterized by the same collateral but REITs are actively-managed
Credit Sectors	Neutral	• Overweight investment-grade financials. We emphasize bonds issued by financial institutions with competitive operating performance, sound balance sheet metrics, and strong management teams. • Underweight investment-grade industrials. We find valuations of high-quality, intermediate maturity corporate bonds to be unappealing • Overweight corporations domiciled in emerging markets. Within the sector, we have found value in Global Leaders—large, multinational companies with a market leadership position and strong management teams

Information subject to change without notice. Not intended as investment advice.

William Blair Income Fund Characteristics

	Income Fund												Bloomberg Barclays Gov't/Credit Intermediate Index
	Global Financial Crisis				European Debt Crisis		Taper Tantrum						
	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17	9/30/18	9/30/18
Effective Duration	3.71	3.74	3.83	3.68	3.50	3.47	3.69	3.26	3.18	3.38	3.24	3.01	3.91
Convexity	-0.04	0.05	0.04	0.02	-0.14	0.08	-0.22	0.01	-0.04	0.04	0.00	0.16	0.22
Sector Composition													
Nominal Treasuries	25.8%	17.3%	3.3%	5.2%	3.9%	0.7%	0.8%	0.9%	1.0%	0.9%	0.0%	0.0%	59.0%
TIPS	0.0%	0.0%	1.5%	3.8%	4.1%	7.5%	6.0%	5.1%	4.7%	5.4%	2.7%	2.9%	0.0%
Agency	2.9%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	2.3%
MBS	28.1%	25.0%	29.2%	26.9%	42.1%	37.2%	52.1%	49.7%	53.8%	49.9%	54.5%	48.8%	0.0%
CMBS	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ABS	12.3%	4.2%	5.9%	9.1%	5.3%	3.6%	7.0%	9.6%	8.8%	9.8%	3.3%	2.5%	0.0%
Credit	31.9%	52.5%	60.0%	53.1%	43.5%	50.0%	33.0%	33.4%	26.3%	33.7%	38.6%	35.7%	38.7%
Cash	-1.0%	1.0%	0.1%	1.9%	1.1%	1.0%	1.1%	1.3%	5.4%	0.3%	0.8%	10.1%	0.0%
	100.0%	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Rating Categories*													
TSY/AGY/AAA	55.8%	44.5%	38.6%	44.8%	44.8%	53.3%	80.9%	90.6%	91.3%	64.7%	61.4%	64.3%	65.8%
AA	6.8%	9.2%	12.9%	11.8%	11.8%	7.1%	19.1%	9.4%	8.7%	3.5%	1.9%	4.5%	6.8%
A	26.9%	35.3%	39.9%	33.9%	33.9%	30.3%	0.0%	0.0%	0.0%	22.0%	28.7%	24.1%	15.0%
BBB	9.1%	11.0%	8.3%	8.3%	8.5%	8.4%	0.0%	0.0%	0.0%	9.8%	8.0%	7.0%	12.4%
<BBB	1.4%	0.0%	0.3%	0.3%	1.0%	0.9%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	100.0%	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Credit Composition													
DM IG Industrial	16.7%	28.1%	35.1%	30.4%	30.2%	23.1%	11.1%	8.5%	10.2%	13.5%	14.2%	12.4%	17.6%
DM IG Financial	6.0%	15.2%	16.3%	15.5%	9.8%	19.0%	18.2%	16.8%	12.7%	15.4%	19.0%	19.4%	12.7%
DM IG Utilities	1.9%	4.3%	4.0%	3.1%	1.5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.5%
Emerging Markets	5.9%	4.9%	4.6%	4.1%	2.0%	7.9%	3.7%	8.1%	3.4%	4.9%	5.4%	3.8%	1.8%
DM High Yield	1.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Non-Corp	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	5.2%
	31.9%	**52.5%**	**60.0%**	**53.1%**	**43.5%**	**50.0%**	**33.0%**	**33.4%**	**26.3%**	**33.7%**	**38.6%**	**35.7%**	**38.7%**

Sources: BlackRock Solutions, Bloomberg Barclays, CMS BondEdge. Information is for illustrative purposes only and is not intended as investment advice. Subject to change without notice.
*The credit quality of securities in the Income Fund is sourced through BlackRock Solutions and derived from Fitch Ratings, Moody's Investors Service, Inc. and Standard & Poor's. In cases where the credit rating agencies have assigned different credit ratings to the same security, the higher rating is used. In cases where only one rating agency has assigned a credit rating to a security, that rating is used. The credit quality of a particular security or group of securities does not ensure the stability or safety of an overall portfolio.

Capital Markets Outlook

September 30, 2018

We believe that the Federal Open Market Committee (FOMC) will continue to raise the federal funds rate at a measured pace over the next 12 months. The U.S. economy is growing; forecasters predict a real GDP growth rate of approximately 3.0% during 2018. In addition, the U.S. labor market is adding jobs and the unemployment rate is at 3.7%. Estimates of wage inflation are roughly 3.5%, while estimates of core personal consumption expenditures (PCE) have been roughly 2.0%. Macroeconomic theory predicts that a robust labor market creates wage inflation, which in turns spurs broader inflation. We believe that the FOMC will raise rates so long as inflationary pressures do not deteriorate.

We believe that the FOMC's plans to reduce the size of the Fed's balance sheet will be executed with little disruption to the markets. We believe this is attributable, in part, to strong communication efforts, adequate advance notice, and the absence of security sales to reduce the balance sheet. However, we believe the lower-coupon MBS that was purchased by the Fed will underperform higher-coupon alternatives when the FOMC ends their campaign of purchasing agency MBS.

U.S. Treasury Inflation-Protected Securities (TIPS) have market-implied breakeven inflation rates that are at levels within the FOMC's stated target range of 2.0%–2.5%. We believe TIPS are an attractive alternative to fixed-rate Treasuries to mitigate the effects of rising rates driven by accelerating inflationary pressures.

We believe that spread sectors remain attractive relative to Treasuries over the intermediate-to-long term. Corporate risk premiums are at levels near their longer-term averages, and we believe opportunities remain after risk spreads increased year-to-date. Risk premiums of higher-coupon segments of the agency MBS market remain attractive. In addition, we believe Treasuries are likely to struggle as the FOMC tightens the federal funds rate and reduces the scale of their asset purchases.

We believe that higher-coupon segments (30-year MBS coupon rates of 5.0% and above) of the agency MBS market offer compelling value. These segments of the agency MBS market offer attractive spreads and a defensive duration profile. The key risk of these securities is that the underlying borrowers are in-the-money to refinance their loan. We believe this risk can be mitigated by focusing on pools comprised of borrowers that do not have the economic incentive to refinance their loans: low-loan balance pools.

We believe that there are opportunities in the corporate bond market as risk spreads increased to levels close to Index's longer-term average. We remain concerned about company-specific risks, including shareholder-friendly activities such as leveraged finance mergers and acquisitions, large share repurchases, and special dividends. Importantly, we do not believe the market will enter a period of excessive LBO activity.

Information subject to change without notice. Not intended as investment advice.

Index Definitions

BofA Merrill Lynch 1-Year U.S. Treasury Note Index: Comprised of a single U.S. Treasury Note issue purchased at the beginning of the month and held for a full month. Each month the index is rebalanced and the issue selected is the outstanding U.S. Treasury Note that matures closest to, but not beyond, one year from the rebalancing date.

Bloomberg Barclays Aggregate Bond Index: Composed of securities from the Barclays Aggregate Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Backed Securities Index.

Bloomberg Barclays U.S. Corporate Index: measures the investment grade, fixed-rate, taxable corporate bond market.

Bloomberg Barclays Corporate High Yield Bond Index: Composed of fixed-rate, publicly issued, non-investment grade debt.

Bloomberg Barclays U.S. Credit Index: measures the investment grade, U.S dollar-denominated, fixed rate, taxable corporate and government-related bond markets. It is composed of the U.S. Corporate Index and a non-corporate component that includes non-U.S. agencies, sovereigns, supranationals and local authorities.

Bloomberg Barclays Emerging Market Bond Index: An unmanaged index that tracks total returns for external-currency-dominated debt instruments for emerging markets.

Bloomberg Barclays Intermediate Govt./Credit Bond Index: Fixed-rate government and corporate bonds rated investment grade or higher.

Bloomberg Barclays U.S. MBS Index: Measures the performance of investment grade fixed-rate mortgage-backed pass-through securities of GNMA, FNMA, and FHLMC.

Bloomberg Barclays U.S. TIPS Index: Includes all publicly issued U.S. Treasury inflation-protected securities that have at least one year remaining to maturity, are rated investment grade, and have $250 million or more of outstanding face value.

Bloomberg Barclays U.S. Treasury Index: measures U.S. dollar-denominated fixed-rate, nominal debt issued by the U.S. Treasury.

MSCI EAFE IMI Index: a free float-adjusted market capitalization index that is designed to measure equity market performance in the developed markets outside the United States.

MSCI Emerging Markets IMI Index: a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

S&P 500 Index: A measure of domestic equity market performance published by Standard & Poor's. It consists of 400 leading industrial issues, 20 transportation issues, 40 utilities and 40 finance issues weighted on a market capitalization basis. The S&P 500 is a broad-based index composed of domestic stocks representing 80% of the market value of all stocks traded on the New York Stock Exchange.

Indices are unmanaged, do not incur fees or expenses, and cannot be invested in directly.