1290 FUNDS®

1290 Diversified Bond Fund

Fund commentary 2Q20

Market overview

A One-of-a-Kind Macro Cycle

Investment management is about handicapping uncertainty. Rarely has there been more of it. In the category of "what could go wrong?", it is pick your poison:

- Fear of the pandemic and the lockdowns triggered the biggest economic bust in 90 years during the first half of 2020. History shows pandemics play out in waves. Are we on the cusp of a fresh surge in the third and fourth quarters as countries reopen? Will people and policymakers lock down once more? What happens to employment and incomes as corporations, geared up with debt, gear up for layoffs?
- Election polls warn of an impending U.S. regime shift amid jaw-dropping images of domestic social turbulence. Co-opted by both the left and right, the domestic press is no longer the sentinel of America's constitutional democracy. Modern journalism and news vie with social media for the mouthpiece of polarization.
- The pandemic and global bust have accelerated shifts in the global order: cyber war, cold war, and threats of a hot war. If ever there was a case of not letting a crisis go to waste, it is the recent actions of the Chinese Communist Party (CCP). Emboldened by its success in the containment of the domestic epidemic and reopening of its economy, the CCP has increased its control and angrily pushed back on global condemnation for alleged delays in warning the world of the new disease. The end of democracy in Hong Kong? Border wars with India? Violations of Taiwan airspace? Is China preparing to reclaim all the lands that defined its borders before the communist revolution?
- Is this the end of the globalism that brought so much prosperity to the world economy over the last 40 years? Will supply chains relocate domestically?
- The world is spewing public debt. How much is too much? Everyone has bought into "lower for longer." However, the fact that investors have not revolted yet does not mean it is limitless. How long can governments remain solvent?

It is a lot to digest.

Amid all this great uncertainty, the Nasdaq is up on the year while the S&P 500® Index, DAX, and Nikkei are within a few percentage points of their February highs. China's stock market has broken out, and Chinese 10-year yields are back to levels that existed before the pandemic. Breakeven inflation rates, copper prices, and investment grade corporate bond prices have staged significant recoveries from their lockdown-induced swan dives. Emerging market sovereign bonds have staged impressive rallies across the board. The U.S. dollar is down but only back to where it started the year despite trillions of dollars of debt added to the Federal Reserve (Fed) balance sheet.

It is understandable why investors might feel whiplash from the rally in risk assets. It was not that long ago when reports of the virus sent markets into a nosedive. So incomprehensible is the rally in risk to many investors that financial stability and fear of a downturn in equity markets have been added to the risk ledger.

Source: Brandywine Global

Market overview (continued)

So, what is the real story?

In our view, it is a complex one-of-a-kind macro cycle. That said, it is still a macro cycle with features familiar to all macro cycles, especially at this stage.

An accepted aspect of the modern political economy is that policymakers often introduce stimulative macro measures aimed at righting the economy and employment after any kind of economic dislocation. The more severe the economic dislocation, the more extreme the policy response. Furthermore, the more extreme policy, the more expansive the subsequent economic response. This year's economic bust was of Great Depression proportions. True to form, officials around the world have responded to the dislocation with epic reflationary macro policies and with no sign of ending anytime soon.

What was different about this economic dislocation was the catalyst: fear over the lethalness of COVID-19. People started to retreat before the lockdowns as news trickled out of China, followed by Italy and the rest of Europe. Then, public health officials' models, projecting tens of millions of deaths, drove government-ordered lockdowns around the world. The collapse in activity during March and April was historic. In the U.S. alone, there have been 50 million initial claims for unemployment insurance, representing 30% of the labor force.

What is different about this countercyclical macro stimulus is the speed and scale of the measures taken. Officials realized the scale of the carnage that would follow the lockdowns and moved rapidly with size-appropriate macro measures. Historically, 2% used to represent a big fiscal impulse. This year's numbers are between 5% and 15%, or as much as 50%, depending on the country and if you include guarantees. In the U.S., gross domestic product (GDP) may have contracted by about $2 trillion while the budget deficit has expanded by $3 trillion. The range of aggressive central bank measures is well documented and clearly matches the fiscal firepower. The two macro policy levers, rarely coordinated together, have never been deployed on this scale—a controversial move.

For all intents and purposes, the global economy bottomed in April or May, depending on the region of the world. V-shape rebounds defined the early stages of recovery in almost all instances. If the U.S. employment data continue to improve as rapidly as in May and June, domestic employment will return to its beginning-of-year starting point by the end of the year.

Few investors believe that the U.S. or global economy will continue to rebound at this pace for much longer. The consensus view appears to be a fast start and then a slow, drawn-out retracement back to the high-water marks over years, not months. It is the complexity of this macro cycle that translates all the uncertainty into a diminished growth outlook. The virus threat, which has not gone away, continues to encourage fear. Clusters of new outbreaks have led to subsequent shutdowns in different cities and regions of the world. Melbourne, Australia, is one of the most recent larger population centers to reimpose stay-at-home policies. In addition, a wide range of permanent layoffs is expected later in the third quarter as fiscal support slows to a trickle. Corporations were heavily leveraged going into the crisis, and there is widespread expectation that they will use this period to restructure, creating permanent layoffs.

For all these reasons, the precise profile of the global economy is unclear other than the natural tendency will be expansion while policymakers should keep the fire hose on for a long time. As uncomfortable as this stage feels, it is the sweet spot of the macro cycle. The global economy is starting to come back, and macro policy will remain on maximum stimulus settings due to the scale of the output gap, concerns about permanent layoffs, and anxiety about how the disease will affect the profile of the recovery. Without knowing how all this works out in the long run, the current "sweet spot" seems likely to persist for the balance of the year.

As for the pandemic itself, there still is not much clarity from the epidemiologists. We remain optimistic that we will adapt and learn to live with it as scientists around the world mount an unprecedented effort on new therapies and possible cures. The further out we look, the more likely the pandemic threat diminishes.

Source: Brandywine Global

Fund overview

The 1290 Diversified Bond Fund seeks to maximize total return consisting of income and capital appreciation. Under normal circumstances, the Fund invests at least 80% of its net assets, plus borrowings for investment purposes, in a diversified portfolio of U.S. and foreign bonds or other debt securities of varying maturities and other instruments that provide investment exposure to such debt securities, including forwards or derivatives such as options, futures contracts or swap agreements.

The flexibility of the guidelines allowed the portfolio managers to nimbly position the Fund to take advantage of tactical opportunities and reallocate when risk on/risk off sentiment presented itself.

For the second quarter of 2020, the Fund outperformed the Bloomberg Barclays U.S. Aggregate Bond Index, the Fund's benchmark. While both bond and currencies were additive on a relative basis, bonds had the far larger impact.

Fund highlights

What helped performance during the quarter?

- The Fund's allocation to U.S. Investment grade corporates was the largest aid to performance by far. For the period, investment grade outperformed high yield, particularly in the U.S. due to the Fed's backstop.
- Chinese economic data continued to show signs of improvement while increased demand and the return of some manufacturing helped oil and raw materials to recover, providing a needed lift to the developing world. The resurgence in optimism emboldened investors on their search for yield, leading them to emerging market assets, which benefited some overweights held in the Fund such as Mexico and Argentina bonds.
- Select developed market bonds, such as Italian BTPs where we added long exposure via futures, were additive. The position benefited by commitments made by the ECB to keep rates low across the European Union.

What hurt performance during the quarter?

- Overall, most of the positions in the Fund worked during the period. However, a few of our currency shorts detracted, such as Australian and Canadian dollars. Improving Purchasing Manager Index data in China lifted the currencies of its trading partners, including AUD. Meanwhile, the Canadian dollar was firmer on the back of the strong rally in crude oil prices.
- Additionally, the Fund's short futures position of German bunds detracted during the quarter as the yields for the underlying bonds were flat.

Source: Brandywine Global

For more information, call **(888) 310-0416** or visit **1290funds.com.**

An investor should consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. To obtain a prospectus containing this and other information, please call 1-888-310-0416 or download the file from 1290funds.com. Read the prospectus carefully before you invest.

1290 Diversified Bond Fund seeks to maximize total return consisting of income and capital appreciation. Performance may be affected by one or more of the following risks. Fixed income investments are subject to credit risk and interest rate risk. The fund is subject to the risk that the issuer or guarantor of a fixed income security, or the counterparty to a transaction, is unable or unwilling, or is perceived as unable or unwilling, to make timely interest or principal payments, or otherwise honor its obligations, which may cause the Fund's holding to lose value. In addition, changes in interest rates may affect the yield, liquidity and value of investments in income producing or debt securities. When interest rates rise, the value of the Fund's debt securities generally decline. Conversely, when interest rates decline, the value of the Fund's debt securities generally rises. Investments in foreign securities involve risks in addition to those not associated with investments in U.S. securities. Foreign markets may be less liquid, more volatile and subject to less government supervision and regulation than U.S. markets, and it may take more time to clear and settle trades involving foreign securities, which could negatively impact the Fund's investments and cause it to lose money. Security values also may be negatively affected by changes in the exchange rates between the U.S. dollar and foreign currencies. Differences between U.S. and foreign legal, political and economic systems, regulatory regimes and market practices, as well as trade barriers and other protectionist trade policies (including those of the U.S.) governmental instability, or other political or economic actions, also may adversely impact security values. There are greater risks involved in investing in emerging market countries and/or their securities markets, and investments in these countries and/or markets are more susceptible to loss than investments in developed countries and/or markets.
Past performance is no guarantee of future performance.

Bloomberg Barclays U.S. Aggregate Bond Index covers the U.S. dollar denominated investment-grade, fixed-rate, taxable bond market of securities. The index includes bonds from the Treasury, government-related and corporate securities, agency fixed rate and hybrid adjustable mortgage pass through securities, asset-backed securities and commercial mortgage-backed securities. Individuals cannot invest directly in an index.

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