Are the 30 basis point rise in the yield of the 10-Year U.S. Treasury Note (Ten Year) and 1.15% loss delivered by the Bloomberg Barclays U.S. Aggregate Bond Index (the Aggregate) in January signs that the long-feared - but as-yet-to-be-realized - rising interest rate era is finally bearing down on the bond market? Robust economic growth, record low unemployment and commentary from the Federal Reserve indicating an increasing likelihood that inflation will rise toward the central bank's 2% target are all contributors to the recent increase in interest rates.

With the 10-Year yield shooting up to 2.71% by the end of January, many observers have their eye on a 3% yield threshold, which is a level the bellwether rate has spent very little time above over the last six years. Domestic economic conditions and Federal Reserve policy are naturally the focus when contemplating what may lie ahead for interest rates, but there are other important factors as well. Strong demand for U.S. Treasury bonds from foreign buyers has helped suppress rates in recent years and that may not change any time soon. Interest rates in other key global economies remain well below U.S. rates. For example, 10-year bonds in Japan still have yields near 0% and, though rates have been rising in Europe, 10-year German bonds still have sub-1% yields. Additionally, export-led economies, namely China, have found U.S. Treasury bonds to be a useful parking spot for the large U.S. dollar reserves generated by trade surpluses with the United States. Will inflation finally materialize in the U.S. economy? Will foreign demand for U.S. bonds be enough to keep a lid on rates if it does? Only time will tell.

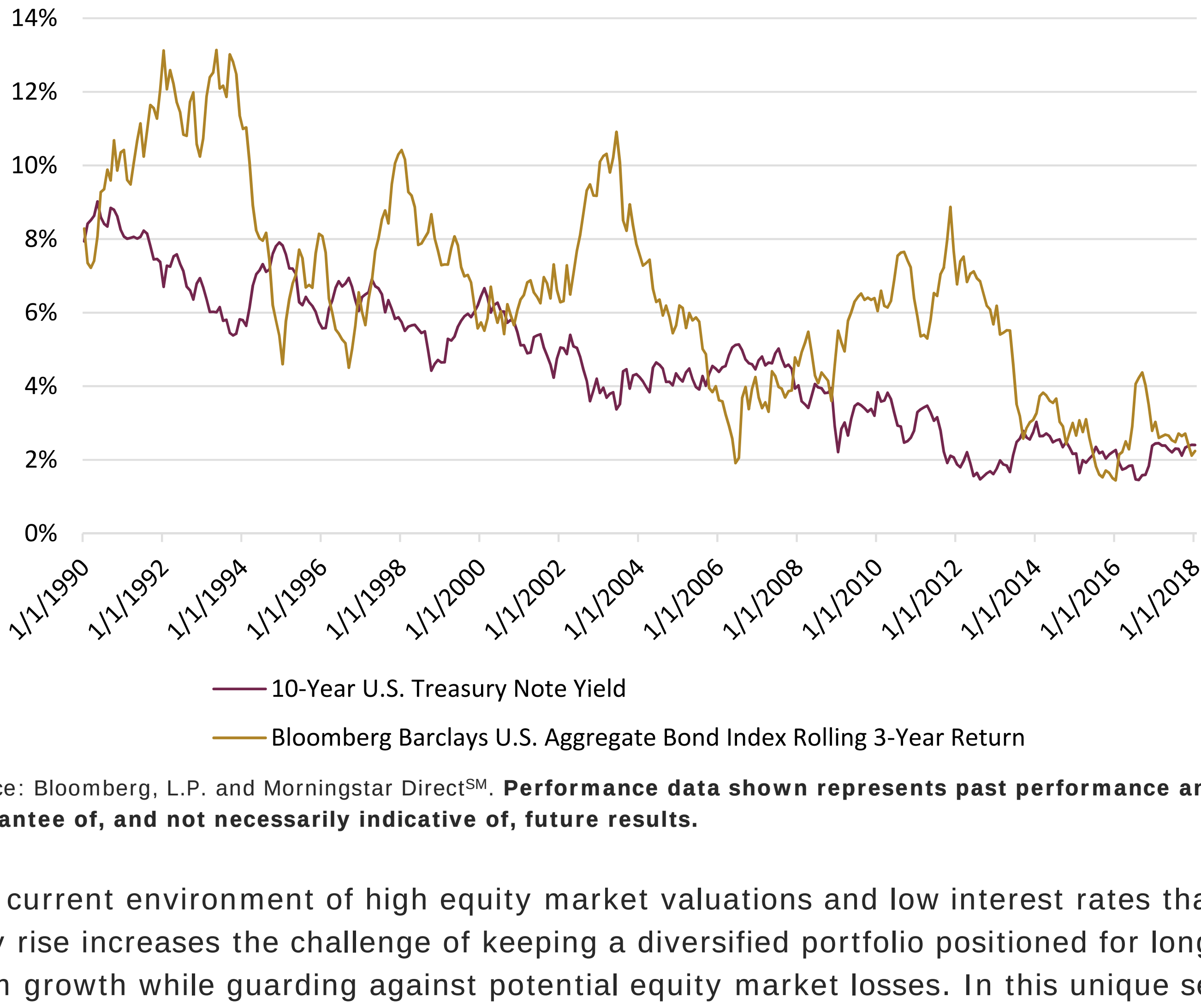
Investment grade bonds have struggled to deliver attractive longer-term returns in the interest rate environment of recent years. The impact of the interest rate holding pattern on the Aggregate is shown in the table and chart below. Brief periods of falling rates have helped generate returns for the Aggregate over certain quarters that were well above yields on the 10-Year and other investment grade bonds. Furthermore, when rates fell in consecutive quarters, calendar-year outcomes for the Aggregate were particularly attractive, as in 2014. However, looking at multi-year periods where the strong quarterly returns get muted by multiple quarters of very low or even negative returns, 3-year annualized returns for the Aggregate have trended downward along with the yield on the 10-Year for the last 30 years and, as interest rates have gotten very low, the Aggregate has not been able to sustain multi-year annualized returns that are much higher than the yield on the 10-Year. In addition, during rising interest rate periods, the annualized return on the Aggregate has dropped below the yield on the 10-Year. If the 10-Year yield breaks out of the trading range of the last several years and exhibits a more sustained upward trajectory, investors may expect returns on high quality bonds to deteriorate further.

If the uptrend in the 10-Year yield is curbed once again, potential 3-4% annualized returns on investment grade bonds may be the best that investors can expect.

Bloomberg Barclays U.S. Aggregate Bond Index Quarterly and Annual Returns 2012-2017					
	Q1	**Q2**	**Q3**	**Q4**	**Year**
2012	0.30%	2.06%	1.59%	0.21%	4.22%
2013	-0.12%	-2.33%	0.57%	-0.14%	-2.02%
2014	1.84%	2.04%	0.17%	1.79%	5.97%
2015	1.61%	-1.68%	1.23%	-0.57%	0.55%
2016	3.03%	2.21%	0.46%	-2.98%	2.65%
2017	0.82%	1.45%	0.85%	0.39%	3.54%

10-Year U.S. Treasury Note Yield vs. Bloomberg Barclays U.S. Aggregate Bond Index Returns

January 1, 1990 – January 31, 2018



Source: Bloomberg, L.P. and Morningstar Direct[SM]. **Performance data shown represents past performance and is no guarantee of, and not necessarily indicative of, future results.**

The current environment of high equity market valuations and low interest rates that may rise increases the challenge of keeping a diversified portfolio positioned for long-term growth while guarding against potential equity market losses. In this unique set of circumstances, investors may benefit from becoming less reliant on high-quality fixed income instruments for lowering the risk of their portfolios. Incorporating other risk management strategies that have relatively attractive long-term return potential is a possible solution. Low-volatility equity strategies that rely on cash flow to both mitigate equity market losses as well as participate in equity market advances, like those managed by Gateway Investment Advisers, may be a suitable alternative for investors who currently favor high quality bonds to lower the risk of their portfolios. Gateway's low-volatility equity strategies strategically and consistently seek to reduce the risk of their underlying equity exposure, creating the potential to limit losses during equity market declines and to capture a majority of the long-term return of the equity market with lower risk.