

During the second quarter (2Q) of 2019, on net, US equity prices increased while US Treasury yields decreased across the curve on expectations of a more accommodative monetary policy stance after the Federal Open Market Committee's ("FOMC") shifted from being "patient" as it determined future adjustments to the federal funds rate to signaling a willingness to cut rates in order to prolong the economic expansion in light of muted inflation readings, depressed consumer sentiment on US trade disputes, and slow global growth. Furthermore, during the quarter the expected path of the federal funds rate embedded in future prices shifted down. As of quarter-end, the market implied probabilities reflected approximately four rate cuts during the next 12 months, three of them within the next six months before the end of 2019. Also, abroad, in other advanced foreign economies, policy expectations and sovereign yield declined notably, reflecting more accommodative monetary policy communications. The Standard & Poor's 500 Index ("S&P 500 Index") increased by 3.79% Quarter over Quarter ("QoQ") (price return) to 2,942 while the Dow Jones Industrial Average increased 2.59% QoQ to 26,600. The 10-year US Treasury yield decreased 40 bps QoQ from 2.41% to 2.01% as the rates declined on lower growth and inflation expectations. Furthermore, the 3M-10yr curve inverted during the quarter finishing the period to -9.5 as the 3-month US Treasury yield ended the month at 2.10%, yielding 9 bps more than the 10-year US Treasury. On net, US investment grade corporate bond spreads remained mostly unchanged. The Option Adjusted Spread ("OAS") for Investment Grade ("IG") U.S. corporate bonds, as represented by the USD IG All Sector OAS Index, increased 2bps from 118 to 120.

Furthermore, as stated by the FOMC in its June statement, the US labor market remains strong and economic activity is increasing at a moderate rate as growth of household spending appears to have picked up from earlier in the year but indicators of business fixed investment have been soft. Moreover, during the second quarter of 2019, the US unemployment rate declined somewhat from 3.8% to 3.7% while average hourly earnings rose at 3.1% over the 12 months ending in June, a slightly slower pace than the 3.2% reported in March 2019. Nonetheless, data pointed to a continued subdued inflation environment in the United States and abroad. In the US, both headline consumer price inflation and core consumer price inflation were below the FOMC symmetric 2% objective. Also, total consumer prices, as measured by Personal Consumption Expenditures ("PCE") price index, increased 1.5% over the twelve months ending in May (latest reported) while the Core PCE (which changes in food and energy prices) rose at a pace of 1.6%.

The FOMC kept the target range for the federal funds rate unchanged during the quarter at 2.25%-2.50%, at its May and June meetings. James Bullard voted against the action in June as he preferred to lower the target range for the federal funds rate by 25 basis points. Furthermore, in its May statement the FOMC noted that overall inflation and inflation for items other than food and energy (Core inflation) had declined and was running below 2 percent. Then, the FOMC in its June statement it acknowledged that uncertainties to the outlook had increased. And, said that in light of those uncertainties, and muted inflation pressures, the FOMC would closely monitor the implications of incoming data for the economic outlook and would act as appropriate to sustain the expansion, with a strong labor market and inflation near its symmetric 2 percent objective. Moreover, in the June press conference, the Chairman of the FOMC, Jerome Powell, noted that the FOMC was firmly committed to the symmetric 2 percent inflation objective, and that it was aware that inflation weakness that persisted, even in a healthy economy, could precipitate a difficult-to-arrest downward drift in inflation expectations. Additionally, the Chair mentioned that weaker global growth may continue to hold inflation down around the world, conceding that global inflation, in this case disinflation, is affecting US inflation. The FOMC also released its updated economic projections in June. The median inflation projections were downgraded for 2019 and 2020. And, consistently, the projected federal funds rate was downgraded. Moreover, the 2019 median projection for the federal funds rate was unchanged while the median projections for 2020 and 2021 were decreased, therefore anticipating rate cuts. In addition, the longer run median federal funds rate decreased from 2.80% to 2.50%. Nevertheless, it is important to note that while the 2019 federal funds rate median projection was unchanged the range of the projections of the members for 2019 changed from 2.40%-2.90% to 1.90%-2.60% and the central tendency changed from 2.40%-2.60% to 1.90%-2.40% showing that more participants expect the need for rate cuts while less expect the need of rate hikes.

Santander Asset Management ("SAM") believes that, given that concerns of downside risks and uncertainties surrounding the economic outlook have intensified and a leveled yield curve and muted inflation pressures have persisted, it is foreseeable that the FOMC will cut rates as much as 50 bps during the third quarter in order support the economic expansion and lift inflation expectations. Moreover, SAM remains alert to the Fed's deliberations regarding the longer-run composition of their domestic securities holdings, and its effect on the yield curve and it also remains vigilant of economic, financial and geopolitical developments. SAM will continue to monitor the investment portfolios on a daily basis in order to seize opportunities that may arise due to market inefficiencies in order and make the appropriate adjustments that are consistent with long-term objectives.

Turning to Puerto Rico capital markets, PR municipal bond prices, on average, increased 2.80% during the second quarter, as measured by the S&P Municipal Bond Puerto Rico Index. Below we summarize a list of certain price movements for the quarter ending June 30, 2019. All prices mentioned were obtained from Bloomberg Valuation (BVAL pricing).

Restructured Puerto Rico Sales Tax Financing Corp (COFINA) Taxable Bonds - Taxable COFINA bonds, as represented by PR Sales Tax Bond Series 2019 A-2 4.55% 07/01/40 (cusip 74529JPY5), increased more than 8 points from \$88.12 to \$96.46, as the Internal Revenue System (IRS) notified COFINA that the newly issued taxable sales-tax bonds could be exempt from federal taxes. Restructured COFINA Exempt Bonds- Exempt COFINA bonds, as represented by PR Sales Tax Bond Series 2019 B-1 4.55% 07/01/40 (cusip 74529JPV1), increased almost 2 points from \$98.32 to \$99.97. Government Development Bank (GDB) – GDB Debt Recovery Authority of Puerto Rico Bond 7.50% 08/20/40 (cusip 36829QAA3), increased approximately 3 points from \$75.34 to \$78.25.

The following is a brief summary of the events that shaped Puerto Rico markets during the quarter ended June 30, 2019:

During the quarter, Puerto Rico received a lot of attention from bond markets participants due to recurrent headlines relating to pending debt-restructuring deals, including the restructurings of the Puerto Rico Electric Power Authority (PREPA) and General Obligation (GO) bonds, the COFINA IRS tax-exemption ruling and exchange offer, and the decision of the Supreme Court to review the Appointment Clause Case, among other.

Early on April, the Puerto Rico Financial Oversight and Management Board (FOMB) filed a motion in the federal court that seeks to claw back some principal and interest payments made on certain GO, Puerto Rico Public Building Authority (PBA), and Puerto Rico Employee Retirement System (ERS) bonds. The motion looks to address whether some of these bonds, particularly bonds issued in 2012 and 2014, were issued in excess of the debt limits established by the Constitution. If the specific series of bonds cited in the motion are ruled invalid, the Commonwealth is expected to pursue avoidance and recovery of payments that were made in the four-year lookback period prior to the commencement of the Title III cases of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA).

On May, the Puerto Rico Fiscal Agency and Financial Advisory Authority (AAFAF) announced that it had reached an agreement with Assured Guaranty and a group of unsecured bondholders of PREPA to exchange more than \$8 billion of the public agency bonds at 67.50 cents per dollar for the Tranche A bonds and at 10 cents on the dollar for the Tranche B bonds. According to the restructuring agreement, the plan is expected to save PREPA about \$3 billion in debt service payments, and would reduce the debt of PREPA by up to 32.50%. Payments on the new bonds will be backed by a fixed “transition charge” charged to customers. The agreement appears to have the support of nearly 72% of the bondholders, 5% percent more than required to be approved. Furthermore, for the deal to be finalized the Plan Support Agreement (PSA) must be ratified by the US District Court, which is expected to review it on September 11, 2019.

Furthermore, the FOMB decided to include the 78 municipalities as covered entities. They will begin with a pilot program by requiring fiscal plans and budgets from 10 of those municipalities as well as from the Puerto Rico Municipal Revenue Collection Center (CRIM) that collects municipal property taxes. The FOMB expects to help the municipalities implement measures to reduce spending, increase a tax collection rate from 68% to 85%, hire more property appraisers and reduce the number of property exemptions, among other things. The municipalities included in the program were Aibonito, Barranquitas, Camuy, Cidra, Comerío, Isabela, Orocovis, Quebradillas, San Sebastián, and Villalba.

Then, on June 12, the FOMB reached a potential agreement with the Official Committee of Retired Employees which the board members deem would provide stability to the pension payments of the public employees. If the agreement takes place, retirees with monthly benefits below \$1,200 will not see a reduction in their pension while retirees who receive more than \$1,200 will have a maximum reduction of 8.5% in their retirement payments. A few days later, on June 16, the FOMB published a memorandum stating that it entered into a PSA with a group of investors holding nearly \$3 billion of GO and PBA securities. The agreement provides a framework for a plan that would reduce the liabilities by approximately \$23 billion from the \$35 billion worth of claims against the Commonwealth. In general, the PSA offers creditors a blended recovery of between 35 to 42 cents on the dollar if bondholders sign the PSA and cease litigation. The proposal offers a baseline recovery rate of approximately 64 cents on the dollar for the vintage GO bondholders (bonds issued prior to 2012) and approximately 73 cents on the dollar for the vintage PBA bondholders (bonds issued prior to 2012). Meanwhile, owners of GOs issued in 2012 are offered approximately 45 cents and on the dollar the holders of the GO issued in 2014 are offered approximately 35 cents on the dollar while PBA issued in 2012 are offered approximately 23 cents on the dollar. If the PSA is approved by the eligible bondholders and Judge Swain, as proposed, the FOMB foresees that the Commonwealth would have a maximum annual debt service (including COFINA) of \$1.5 billion, down from \$4.2 billion.

In addition, in mid-June, the Internal Revenues Service (IRS) notified COFINA that it would permit COFINA to offer to exchange the newly issued taxable sales-tax bonds, which include the \$3.59 billion of Series 2019 A-2 bonds and the \$45.57 million of Series 2019 B-2 bonds, for tax-exempt bonds pursuant to the Tax Exemption Implementation Agreement. Accordingly, COFINA launched an exchange offer to eligible bondholders offering them the opportunity to exchange these securities for ones that are tax-exempt with yields that are 0.25 percentage points lower than the current (restructured) bonds. In other words, investors who decide to exchange their eligible taxable bonds would receive federal tax-exempt bonds with the same principal amount, maturity and payment rank as the taxable security but will be paid a lower coupon during the remaining life of the bond. Moreover, market participants reacted positively to the announcement and the price of taxable securities increased by nearly 8 points, reducing the price gap between taxable and exempt securities.

On June 20, the U.S. Supreme Court, the nation’s highest court, said it agreed to review the U.S. Court of Appeals for the First Circuit decision related to the FOMB Board Appointment Clause. In addition, the Supreme Court will decide whether the Boards’ prior actions will be voided, which could include reverting materialized debt restructurings, including COFINA and GDB, and disrupt preliminary agreements with GO, PREPA, ERS and PBA bondholders. Back in February 2019, the U.S. Court of Appeals for the First Circuit overturned Judge Swain’s verdict concerning to the FOMB Board’s election process, specifically her judgment that the FOMB Board is inherently an entity of the commonwealth government, and therefore, its directors do not need confirmation from the U.S. Senate. Instead, the Appeals Court ruled that the provision of the federal law that allowed members of the FOMB Board to be appointed by the U.S. President without being confirmed by the Senate was unconstitutional. That said, the magistrates decided to preserve all previous decisions made by the FOMB Board. Moreover, the Supreme Court is expected to handle the case on a fast-track basis, scheduling to hear the arguments on the second week of October 2019.

Finally, at the beginning of July, after the release of a chat between the governor and several government aides that included derogatory messages and the arrest by the Federal Bureau of Investigation (FBI) of several public officials based on corruption charges, support for the resignation of the Governor of Puerto Rico, Ricardo Rosselló, intensified. On July 24, 2019, Puerto Rico Governor Ricardo Rosselló resigned effectively on August 2, 2019. According to Puerto Rico's Constitution, the Secretary of Justice, Wanda Vázquez, could be the next governor following the line of succession, as at the moment there is no Secretary of State, which would be the first in line to assume the position.

Santander Asset Management (SAM) understands that the uncertainty and lack of leadership in the government of Puerto Rico will undermine the island's debt restructuring and the economic recovery. Furthermore, it expects that price volatility will continue in those credit exposed to court rulings.

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