Despite historic levels of global economic contraction, almost every major asset class — with the big exception of oil — has posted a positive month-to-date return through April 29. For example, after falling more than 1,000 points from February 19 through March 23, the S&P 500 has recaptured more than half of that sell-off. Markets have clearly been buoyed by the support of the US Federal Reserve, which on April 29 reiterated the commitment to “using its full range of tools to support the US economy in this challenging time.” However, many investors may feel the market has gotten ahead of itself, responding not just to the Fed, but to hopes for the relatively quick development of a COVID-19 treatment.

Investment teams across Eaton Vance’s range of affiliate managers seek to actively capitalize on opportunities presented by volatile investor sentiment, while ensuring that the portfolio risk profile remains appropriate for the specific strategy.

Eaton Vance strategies are designed to seek fundamental value that helps build client wealth over the course of many business cycles. In our view, times like these underscore the value of active management. We believe in carefully assessing the dynamics of fluctuations driven by political change or other disruptions, and in taking action that best serves the long-term interests of our clients.
CENTRAL BANK POLICY

Fed sets its sights on recovery

At the press conference following the Federal Open Market Committee (FOMC) meeting, US Federal Reserve Chair Powell conveyed a fairly neutral to medium-term dovish position to give markets confidence that the Fed is certainly committed to doing whatever it takes to keep the economy doing as well as it possibly can, despite the economic challenges created by the coronavirus pandemic.

The Fed said it is in no hurry to move rates up from the 0% to 0.25% range until the “economy has weathered recent events and is on track to achieve its maximum employment and price stability goals.”

In my view, the Fed is moving to a transition phase. From focusing almost exclusively on the core market functioning issues that it was forced to address in the middle of March, the FOMC is likely to announce more open-ended quantitative easing at its next meeting in June, which should help with the medium-term economic picture. While most of the acute market function issues have been at least somewhat resolved, the Fed announced some tweaks to the Municipal Liquidity Facility earlier this week and an expansion of the Main Street Loan Program on Thursday morning. We will likely see more changes to these and other programs if necessary going forward.

If we see the beginning of a recovery as the economy hopefully starts to begin opening up over the next few months, I think the Fed will try to ensure that it’s as strong as possible. Powell said the Fed would continue to act “forcefully, proactively and aggressively” toward achieving a robust recovery. At that point, I expect the Fed will spend more time thinking about what it must do to get inflation expectations up.

Otherwise, it was a fairly uneventful FOMC meeting, largely because the Fed has already announced an unprecedented amount of economic support. There was an expectation that it would move the interest rate on excess reserves (IOER rate) from 10 to 15 basis points for technical reasons. But that didn’t happen, as policymakers likely assumed that any negative signaling from even a technical 5 basis point hike outweighed getting the exact perfect rate from a money market microstructure perspective.

If markets sell off some more, similar to what occurred in March, I don’t believe the Fed will quit its current approach. Conversely, if markets end up being better behaved as they have been recently, and the economy remains as weak as everyone — including the Fed — is expecting, I believe the Fed is going to be very easy with monetary policy for a long time.
COVID-19 UPDATE

Antiviral therapy shows promise, vaccine could be ready in September

Health policy developments

- President Trump’s April 16 guidelines call for 14 consecutive days of declines in new cases to reopen, but no state has met them yet.
- NY governor announces “circuit breaker” that would curb social activity if hospital capacity utilization exceeds 70%.
- JetBlue is the first American airline to require all passengers to wear face masks during flights as well as check-in, boarding and deplaning; the policy will begin May 4.
- Tokyo Olympics will be cancelled (not delayed further) if SARS-Cov-2 is still a threat in 2021, says top official.

Bearish virus developments

- SARS-Cov-2 appears to linger in the air in crowded spaces: Researchers found bits of the virus’s genetic material floating in the air of hospital bathrooms, an indoor space housing large crowds, and rooms where medical staff take off protective gear, and suggested additional work to determine if the aerosolized SARS-Cov-2 is infectious.
- MIT Technology Review reports coronavirus immunity likely wanes quickly, making re-infection possible.
- Chinese scientists say SARS-Cov-2 is likely to come back year after year. Bloomberg reports “a consensus is forming among top researchers and governments worldwide that the virus is unlikely to be eliminated,” blaming asymptomatic transmission.
- Sanofi and Regeneron reported that drug therapeutic Kevzara appears to have no benefit following a randomized trial. Earlier results of a small non-randomized study had shown a potential benefit.

Bullish virus developments

- Gilead’s Remdesivir allows COVID-19 patients to recover 31% quicker, according to National Institutes of Health (NIH) trial.
- Hong Kong scientists find that new antiviral coating can protect frequently used public surfaces for 90 days. Unlike liquid antiviral sprays that evaporate, the new approach encapsulates antiviral chemicals in a coating that dissolves upon heat from a human finger; this new spray will be available for sale next month and has already been used in the homes of 1,000 low-income individuals.
- Randomized trial shows Roche’s Actemra (generic tocilizumab) significantly improves clinical outcomes of patients with moderate or severe COVID-19 pneumonia who are dealing with cytokine storms.¹
- Oxford University’s vaccine efforts remain furthest along of any western effort; a few million doses could be available as early as September.

¹The term “cytokine storm” has been adopted in the past several decades to describe the aberrant production of soluble mediators and the accompanying immunopathology that ensues following severe viral and bacterial infections (source: Springer Link).

Source: Eaton Vance research as of April 29, 2020.
COVID-19 UPDATE

**Economic and market impacts**

- Wall Street Journal reports that roughly half of US workers earn more in unemployment benefits than they did at their jobs; additional unemployment benefits related to COVID-19 will last through July 31.
- Inefficient allocation: Economists’ study finds small business bailout funds flowed to areas less hard hit, with a higher share of businesses receiving loans in “areas with better employment outcomes, fewer COVID-19 related infections and deaths, and less social distancing.”
- China’s unemployment rate appears to be 20% when idled migrant workers who remain at home following the new year holiday are counted.
- Moody’s downgrades entire education sector to negative, and Financial Times reports that 64% of university presidents say “long-term financial viability” is their number one concern.
- Bank of Japan announces new measures to purchase assets.

Source: Eaton Vance research as of April 29, 2020.
## INCOME MARKETS

**Credit analysis is the focus, following better liquidity**

- The Fed’s programs to add liquidity to a broad range of fixed-income sectors have helped stabilize the market. Spreads in general remain wider than prior to COVID-19 and value opportunities may be found in select corporate and securitized debt.
- Tracking the implementation of the multiple Fed programs will be important to assess relative value.
- Active security selection is critical. Given market repricing, we favor select opportunities across credit quality and income sectors.

### Current views

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The impact of the coronavirus on global markets could last for an extended period and could adversely affect a strategy’s performance.

**Income — About Risk:** The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the US and global markets. As interest rates rise, the value of certain income investments is likely to decline. Investments in debt instruments may be affected by changes in the creditworthiness of the issuer and are subject to the risk of non-payment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer’s ability to make principal and interest payments.
EQUITY MARKETS

Keeping the “anchor to windward” from becoming an anchor around our necks

- Humans have a deep psychological need to minimize the anxiety that comes with uncertainty about the future.
- I think the great challenge for investors right now is trying to hold two competing thoughts in their minds at the same time:
  - To make judgments, we need historical reference points — for example, the 1918 influenza, the Great Depression, the two world wars, Y2K, 9/11 or the Global Financial Crisis.
  - There may be no historical analogue that truly fits: If this is a black swan event, without precedent in its current form, then the anchor to windward¹ can become an anchor around our necks.
- One area where there can be tremendous discomfort in not knowing is 2020 earnings, but in my mind, all the emphasis on trying to nail down earnings in 2020 — or even 2021 — avoids the real question.
- What really matters is ongoing, sustainable earnings power — the somewhat abstract metric of what is permanent, not temporary — upon which stocks will ultimately be valued.
  - A potential starting point for determining earnings power is to look at 2019 and make judgments about whether industries and companies were at peak levels of profitability, even though we didn’t think so at the time.
  - If companies undertake dilutive capital raises or see structural changes to demand for their products or services, then 2019 might well turn out to have been the peak — and therefore not representative of earnings power.

Current views on valuation

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<th>Regions</th>
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- US companies are strong, but the economy is bound to take a significant hit in the second quarter.
- While valuations are attractive, the cyclical recovery is now delayed.
- Japan's underleveraged balance sheet now has appeal; should be one of the first economies to emerge from the crisis.
- First in, first out. Southeast Asia appears to be recovering, and non-Asia is a smaller part of EM these days.

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<th>Sectors: 3 Most Favored</th>
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- Banks are part of the solution this time around. Credit losses will likely be elevated, but capital markets’ activity should be an offset.
- Pharmaceutical stocks are a relatively inexpensive place to get defensive exposure in the equity market.
- Not without risk given OPEC scrum and a collapse in demand for gasoline and jet fuel, but valuations are at once-in-a-century levels.

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- Packaged food, beverage and household products are seeing a burst of demand, but that will likely prove temporary.
- An expensive, defensive sector. Balance sheets tend to carry a fair amount of debt.
- Brick-and-mortar retail was already struggling. We expect there will be bankruptcies in this sector.

¹This figure of speech means adopting precautionary or anticipatory measures in an attempt to maximize success or security.

The impact of the coronavirus on global markets could last for an extended period and could adversely affect a strategy’s performance.

Equities — About Risk: The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the US and global markets. The value of equity securities is sensitive to stock market volatility.
ESG and the corporate response to COVID-19

The COVID-19 pandemic is creating crises on many fronts, with deep and far-reaching implications. As of today, we have seen a wide range of responses across governments and corporations that have worked to either instill or diminish confidence and trust. Calvert Research and Management is studying companies carefully to evaluate their actions relative to what their corporate policies and statements have led us to expect.

In times of crisis, companies and governments have an opportunity to take major steps forward in the eyes of their key stakeholders and establish or deepen a relationship built on trust. Those that perform well right now, serving their customers, employees and communities, will benefit in the long term, winning customer support and loyalty. Those that perform poorly, on the other hand, are likely to find that customers have long memories of crisis-era actions.

In response to the pandemic, Calvert’s research team is examining corporate responses, resiliency and preparedness through the lens of companies’ employees, customers, communities and suppliers. We are developing a proprietary C-19 Preparedness and Response Factor that will allow us to rank companies based on how well they prepared for and responded to the pandemic. In some cases, companies have reacted to the virus in the same way they’ve addressed climate change risks, and this may also be an indicator of how they might deal with future crises.

The strong step up

We are generally encouraged by many of the corporate responses we have seen to COVID-19. We saw several big-box stores move quickly to raise minimum wages and create a safe physical space for employees, and a number of firms suspended dividends and buybacks. Some appear to have taken lessons from Hurricane Katrina, adjusting their priorities and corporate culture. We believe these responses are partly due to the environmental, social and governance (ESG) advocacy efforts of responsible investment firms over past five years, as well as companies’ own recognition of the materiality of ESG factors to their businesses and profitability.

In our initial analysis, Calvert found that many companies with lower scores for their financially material ESG policies and performance were ones that subsequently found it difficult to respond effectively to COVID-19. This is consistent with our expectations; companies that have not managed their material environmental risks, or built a strong human capital management approach, are not likely to suddenly change for the better in the teeth of a crisis.

However, our analysts have also seen that many companies with average ESG metrics have performed well during the crisis, and our early research shows that a company in the middle of the pack on ESG scores is just as likely to have had a constructive early response to the crisis as those with top scores. It appears that many companies have improved their ESG policies over the past five or six years, which may indicate that these companies have the governance structure to adapt to changing circumstances and respond with agility.

It appears that companies that have operationalized the identification, measurement and management of their material environmental and social risk exposures are likely to have the skill and culture to respond to other risks, including the pandemic. As we look forward to the business and economic recovery, we believe these companies will improve their competitive position, drive long-term value for investors and play a critical role in building a more resilient and just future.

Final word: We believe that how companies respond to stakeholders during COVID-19 is likely to affect their reputations and drive long-term value for years to come. Calvert is closely monitoring company responses to this crisis as a key indicator of how resilient, prepared and accountable they might be in facing future risks.
High-Quality Equities

What we are seeing: We are seeing the equity markets continue to recover, with large-capitalization stocks outperforming small caps and growth outpacing value. Now in the middle of earnings season, the top five stocks in the S&P 500 constitute nearly 20% of the index. The last time we saw this level of concentration was in 1999 during the dot.com bubble. In our view, this could be the tail end of the bounce off the bottom for stock prices. Earnings reports have been sobering, as largely expected, and management teams are reluctant to give much forward guidance. We believe it could be a long slog over the summer and that economic recovery will be slower than expected, rather than the V shape currently being priced into equity markets.

The first quarter of 2020 was obviously very volatile, with negative returns across global equity markets. In my last update, I highlighted how stocks had been sold indiscriminately, evidenced by correlations spiking. We have only recently started seeing signs of differentiation, and we believe this trend will continue, serving as a tailwind to high-quality stock performance. We define high-quality companies as those with consistent growth and stability in their earnings. Higher-quality companies also typically have strong balance sheets, significant free cash flow generation, growing revenues and meaningful competitive advantages. The opposite is true for their lower-quality counterparts. Our historical analysis suggests that high-quality equities have have tended to outperform over full market cycles.

What we are doing: We continue to actively invest for what we believe will be on the other side of the COVID-19 crisis. Activity in our strategies in the last two months has been greater than in all of 2019. We are, as I mentioned, in the middle of the first-quarter reporting season. As companies give updates on their current business environments and outlooks, we continue to actively look for opportunities to add high-quality businesses at attractive valuations, although we are seeing fewer ideas than we did a month ago. We have also been trimming positions with strong relative performance and adding to some weaker holdings that we believe have structurally sound businesses.

What we are watching: As companies report first-quarter results, we are continuing to analyze a number of short-term and long-term factors regarding a company’s growth prospects, structural soundness and ability to withstand recessions. This will allow us to evaluate our current holdings and potentially add attractively priced, high-quality companies as opportunities arise. Our analysis is nuanced, but we are favoring well-capitalized businesses with intact value propositions.

Final word: As businesses continue to report their first-quarter results and outlooks, we expect to see volatility in company share prices and will continue to add high-quality companies to our portfolios as opportunities arise. Over time, we expect quality to differentiate itself and we believe that many of our portfolio companies will actually gain market share and become stronger. We believe sticking to our quality discipline will provide the long-term benefits of equity investing if the markets move higher and may protect if markets face continued volatility or declines.
US Small Cap

What we are seeing: Since hitting its low point for the year on March 18, the Russell 2000 Index has rallied 37% through April 29, yet still trails the S&P 500 Index by almost 10% year-to-date — suggesting significant catch-up potential remains for small caps. Over this period, leadership in the Russell 2000 has come from the consumer discretionary, energy and health care sectors.

Two sectors delivering massive performance during this rebound have been consumer discretionary and energy, after both were hammered during the initial sell-off. Interestingly, the hotels, restaurants and leisure industry has rocketed 117% higher in this six-week period. While we’re obviously excited to see these sectors rise so significantly, we do remain skeptical of the current market rally.

Health care, the sector at the heart of this COVID-19 crisis, has also rebounded, driven by biotechnology. Biotech, the largest industry with close to a 10% weight in the index, has catapulted 54% higher during this period. Our portfolios typically avoid biotech, given the industry’s general lack of profitability, and that has been our largest headwind over the last month.

Over the last year, the Nasdaq has risen 11% and the S&P 500 has eked out a small gain of 2%. Indexes are posting these results despite a negative long-term outlook year-over-year. So we remain vigilant and disciplined, strictly adhering to our quality, valuation and time (QVT) discipline.

What we are doing: On a team level, we are continuing to review new ideas as first-quarter results are reported. We are concerned that the market appears to be pricing in a V-shaped recovery. It is hard to see how things will get back to normal in the next few months, and many stocks are again trading in 2019 price ranges following this rally. We are trimming and selling stocks that have overshot our 12 to 24 month expectations and rotating into stocks that are still laggards.

We spend a lot of our time trying to identify inconsistencies in how the market is valuing high-quality companies and are finding ideas in the auto and aerospace industries, select consumer businesses and cyclical industrials. We have been trimming in the areas of health care and technology. We are looking for companies with strong balance sheets and favorable competitive positions that are pricing in significantly negative outcomes over prolonged periods. We want to hold a wide range of stocks opportunistically and remain nimble during these volatile times.

What we are watching: The team remains focused on company fundamentals and is closely evaluating first-quarter company results being reported now, rather than trying to call the market direction. In these reports, we are analyzing longer-term earnings power and competitive positioning instead of backward-looking reported earnings.

We believe the economic outlook poses a severe threat for those highly levered and unprofitable stocks in the index, and we continue to emphasize quality holdings. The scale of the monetary and fiscal response to the economic contraction is a clear positive, likely to help certain industries recover in the short term and offer some support to consumers. We are focused on long-term outcomes, so we spend time assessing potential impacts and structural shifts that may take place once the public health crisis has passed. What will future air travel look like? Will the ongoing shift to e-commerce accelerate? Will office jobs move from cities to less dense areas? Understanding how industries may be impacted over time will be critical to identifying the best long-term opportunities in a changed era.

Final word: These uncertain times highlight the importance of having a compass and a disciplined process. We have a clear definition of quality, which has been further validated during this rocky environment, and will continue to scout for attractive opportunities among the wide range of companies within the Russell 2000 Index. We believe our emphasis on downside protection and disciplined application of (Q)uality, (V)aluation, and (T)ime should position us for strong relative performance in turbulent times.

US Small Cap — About Risk: The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the US and global markets. The value of equity securities is sensitive to stock market volatility. Smaller companies are generally subject to greater price fluctuations, limited liquidity, higher transaction costs and higher investment risk than larger, more established companies.
Floating-Rate Loans

**What we are seeing:** Following a month of sharply rising loan prices, the welcome rebound in the senior loan market is taking a breather at present. To recap the round-trip experience to date, the average price of the S&P/LSTA Leveraged Loan Index traded in the 96 context as recently as mid-February, plummeted to a low around 76 by the third week of the now-historic March and has since rallied to its current resting point around 86 — and here it has hovered for the last week or so. Though the market is roundly “halfway back,” prices today still rank among the lowest in the long history of the asset class.

Rarely are rebounds a straight line — in this or any asset class — and we certainly didn’t expect one here in the current environment. Things are happening quickly on the one hand: Downgrades have come fast and furious; prices have rallied sharply and quickly. Yet on the other hand, slower moving developments require waiting: When will states and businesses reopen? First-quarter earnings and the latest growth number are almost meaningless, but when will the picture clear for the back half of the year? To what extent will the Fed’s new lending programs benefit issuers?

In short, we think the market is catching its collective breath at the moment, as there’s much to take in and the “easy money” has now been made. To be sure, all rating tiers sold off indiscriminately and to similar levels at the nadir, setting up the high quality, large and liquid issuers for the earliest and largest rebounds. This has in fact played out, with BBs in the index (representing around 20% of loans outstanding) priced at 92 on average, and many of these are now back to the middle to high 90s at present. Meanwhile, the B-rated belly of the market (almost 60% of loans outstanding) is priced at 87 on average, with significant dispersion around this figure.

Market participants continue to sort these out and, as they do, there are other factors at play. New issuance has returned, not in a massive way but enough to weigh on the supply/demand balance on the margin. And according to ICI, mutual fund flows have edged from positive flows two weeks ago to now (ever so modestly) negative again. Larger cash stores in funds have been allocated at this stage, while some dry powder remains for opportunistic buying and/or redemptions.

Taken together, not a lot of net new buying... a little bit of net new supply... and myriad factors to weigh for the economy, sectors, issuers, etc. And so here loans sit at 86 while the market digests.

**What we are doing:** As always, our analysts are squarely focused on their credits. We continue to stress test our portfolio companies, assessing liquidity both in the near term and further out. We remain in touch with issuer management, and we’re keeping our credit assessments fresh as we digest first-quarter business results and probable business impacts (and again, liquidity) looking ahead. We’re paying special attention to the re-underwriting of the most direct-hit sectors in this environment: travel-related, leisure and retailers. In the meantime, our portfolio managers remain focused on value determination, and our traders are executing orders in line with our efforts to strike the right balance between offense and defense, a theme that’s the very heart of our ongoing effort to optimize risk and return in our loan strategies.

Floating-Rate Loans — About Risk: The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the US and global markets. Loans are traded in a private, unregulated inter-dealer or inter-bank resale market and are generally subject to contractual restrictions that must be satisfied before a loan can be bought or sold. These restrictions may impede the Strategy’s ability to buy or sell loans (thus affecting their liquidity) and may negatively impact the transaction price. It may take longer than seven days for transactions in loans to settle. Due to the possibility of an extended loan settlement process, the strategy may hold cash, sell investments or temporarily borrow from banks or other lenders to meet short-term liquidity needs. Loans may be structured such that they are not securities under securities law, and in the event of fraud or misrepresentation by a borrower, lenders may not have the protection of the anti-fraud provisions of the federal securities laws. Loans are also subject to risks associated with other types of income investments. Investments in debt instruments may be affected by changes in the creditworthiness of the issuer and are subject to the risk of non-payment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer’s ability to make principal and interest payments. Investments rated below investment grade (sometimes referred to as “junk”) are typically subject to greater price volatility and illiquidity than higher rated investments. As interest rates rise, the value of certain income investments is likely to decline. Investments in foreign instruments or currencies can involve greater risk and volatility than US investments because of adverse market, economic, political, regulatory, geopolitical, currency exchange rates or other conditions. Changes in the value of investments entered for hedging purposes may not match those of the position being hedged.
What we are watching: Dislocations like this indeed provide ample opportunity, but we’re proceeding with a measured approach as we always do. The first half of the rally was quick and relatively easy. We think the balance will be more of a grind. There will continue to be much to watch in the weeks ahead. At the intersection of today’s low prices are not only a wave of credit downgrades unfolding by the day, but also the Federal Reserve’s many support programs (basically, “whatever it takes”) and the growing number of governors beginning to talk cautiously but optimistically about the reopening of the economy, with May being a key month to watch these developments. Levels of distress have declined sharply in the last few weeks, and this has been good to see. The easy pickings will be harder to come by as the market rebounds, but healthy opportunity remains for now.

Final word: We believe that an emphasis on quality and diversification never goes out of style, and this remains our focus. A recent pause in the rally notwithstanding, we continue to see significant value in this asset class. Upside potential remains, but it won’t be a straight line.

Floating-Rate Loans — About Risk: The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the US and global markets. Loans are traded in a private, unregulated inter-dealer or inter-bank resale market and are generally subject to contractual restrictions that must be satisfied before a loan can be bought or sold. These restrictions may impede the Strategy’s ability to buy or sell loans (thus affecting their liquidity) and may negatively impact the transaction price. It may take longer than seven days for transactions in loans to settle. Due to the possibility of an extended loan settlement process, the strategy may hold cash, sell investments or temporarily borrow from banks or other lenders to meet short-term liquidity needs. Loans may be structured such that they are not securities under securities law, and in the event of fraud or misrepresentation by a borrower, lenders may not have the protection of the anti-fraud provisions of the federal securities laws. Loans are also subject to risks associated with other types of income investments. Investments in debt instruments may be affected by changes in the creditworthiness of the issuer and are subject to the risk of non-payment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer’s ability to make principal and interest payments. Investments rated below investment grade (sometimes referred to as “junk”) are typically subject to greater price volatility and illiquidity than higher rated investments. As interest rates rise, the value of certain income investments is likely to decline. Investments in foreign instruments or currencies can involve greater risk and volatility than US investments because of adverse market, economic, political, regulatory, geopolitical, currency exchange rates or other conditions. Changes in the value of investments entered for hedging purposes may not match those of the position being hedged.
High Yield

What we are seeing: Retail and institutional investors alike have looked to take advantage of a historically rare entry point into the high yield asset class. According to ICI, after a cumulative five-week outflow of $19.2 billion during the sell-off, investors have piled over $19 billion back into US high yield retail funds over the subsequent four-week period through April 24. The average spread in the ICE BofAML US High Yield Index has decreased from a March 23 peak of 1,082 basis points (bps) to a current spread around 800 bps as of April 28.

High yield issuers have also raced to take advantage of a receptive investor base. Over $33 billion of new issuance has priced since March 23. Just last week our market experienced the second highest weekly issuance volume on record.

Meanwhile, the commodity markets have been flashing warning signals. That the May contract for West Texas Intermediate (WTI) crude oil briefly fell to negative $37 prior to expiring may have been largely attributable to a short-term trading phenomenon. Nevertheless, there has been significant weakening in the June and July contracts, as well as Brent. Storage shortages aside, this kind of weakness clearly signals a sharp reduction in demand resulting from a pronounced contraction in global economic activity.

What we are doing: We are focusing on the fundamentals. We anticipate looking back 12 months from now on a trailing one-year return that could be attractive, from a historical perspective. However, in the near term, we expect to see some weakening, and our market may retest the lows. The rebound over the last four weeks may have been too sharp given the economic challenges that lie ahead.

What we are watching: We are watching first quarter earnings reports and re-underwriting our investments. The earnings reports we have seen to date don’t reflect the full extent of the impact in the US, given that different states shuttered their economies at different points. We believe the larger impact could be on second and third quarter earnings, so we are looking for indications of the extent of that impact on future earnings.

Defaults have been rising, and we expect that will continue. Including distressed exchanges, the default rate is creeping towards 4%. A number of energy issuers have filed for bankruptcy protection and a large, marquee wireline operator in telecom also filed. A large satellite communications company recently entered the grace period and will likely file soon. And several brand names in the retail sector have also either entered the grace period or signaled their intent to file.

Final word: Despite the recent rally, the high yield market is not out of the woods. A meaningful amount of stress lies ahead, and we are focusing on bottom-up fundamental credit analysis to help our high yield strategy avoid as much of this stress as possible.

High Yield — About Risk: The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the US and global markets. Investments in debt instruments may be affected by changes in the creditworthiness of the issuer and are subject to the risk of non-payment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer’s ability to make principal and interest payments. Investments rated below investment grade (sometimes referred to as “junk”) are typically subject to greater price volatility and illiquidity than higher rated investments. As interest rates rise, the value of certain income investments is likely to decline.
Municipal Bonds

What we are seeing: On the heels of one of the most volatile months on record in March, the municipal market has maintained a softer tone in the first month of the second quarter. According to Bloomberg, so far in April, municipal yields have ticked slightly higher, with 10-year municipal yields increasing 5 basis points (bps) through April 28. For comparison, the 10-year US Treasury yield has decreased 7 bps month-to-date. This week the Federal Reserve announced updated terms to the Municipal Liquidity Facility, effectively reducing the population requirements for cities and counties to participate in the short-term financing program.

What we are doing: The softer tone that began to emerge last week has continued this week. Fortunately the market has largely dismissed Senator McConnell’s comments about states filing for bankruptcy to restructure pension obligations as the political posturing it was. The market continues to place a premium on high quality names over lower quality names, and year-to-date benchmark returns show a clear performance disparity between higher and lower quality credits. In particular, the hospital sector persistently faces performance challenges, showing up in the headlines every day as the epicenter of the COVID-19 crisis.

We continue to monitor municipal issuers’ ability to borrow in the primary market and our focus this week has also been in the headlines nearly every day — a large municipal transit authority’s $900 million deal to refinance debt scheduled to mature on May 15. Despite the expansion of the Fed’s Municipal Liquidity Facility on April 27, this deal was postponed on April 28 to next week, reflecting to us a market that has yet to fully return to health. Now our attention has shifted to a higher quality, $1 billion state power authority deal, which will provide the next data point on market health.

What we are watching: We are closely watching the rollout of the Federal Reserve’s Special Purpose Vehicle (SPV) and how the market reacts to the unprecedented step to support municipalities. On April 27, the Fed announced updated terms to the Municipal Liquidity Facility (MLF). With regards to population, the threshold to participate was lowered from 1 million to 250,000 for cities and from 2 million to 500,000 for counties. Here are additional amendments:

- **Eligible Notes:** Include tax anticipation notes (TANs), tax and revenue anticipation notes (TRANs), bond anticipation notes (BANs) and other similar short-term notes issued by eligible issuers, either taxable or tax-exempt and callable at any time.
- **Maturity:** Increased to 36 months from the previous stipulation of 24 months.
- **Eligible Issuer:** Includes state, city, or county along with certain multistate entities. The Fed has the ability to approve additional issuers. Every case is subject to the Fed’s review and approval. Only one issuer per state, city, or county is eligible, but multiple issuances are allowed.
- **Limit per State, City, and County:** The SPV may purchase eligible notes issued by or on behalf of a state, city, or county in one or more issuances up to an aggregate amount of 20% of the general revenue from own sources and utility revenue of the applicable state, city or county government for fiscal year 2017. Multistate entities are limited to 20% of the entity’s gross revenues from fiscal year 2019.

Municipal Bonds — About Risk: The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the US and global markets. There generally is limited public information about municipal issuers. As interest rates rise, the value of certain income investments is likely to decline. Investments in debt instruments may be affected by changes in the creditworthiness of the issuer and are subject to the risk of non-payment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer’s ability to make principal and interest payments. Investments rated below investment grade (sometimes referred to as “junk”) are typically subject to greater price volatility and illiquidity than higher-rated investments.
· **Pricing**: Pricing will be at a premium to the market interest rate in normal conditions, and based on the eligible issuer’s long-term rating at the time of purchase.

· **Origination Fee**: 10 basis points of the principal amount, paid out of the proceeds from the issuance.

· **Termination Date**: The SPV will discontinue its operations on or before December 31, 2020, extended from the previous end date of September 30, 2020.

**Final word**: We have seen a somewhat weaker market over the last two weeks as the new issue calendar comes back to life. With close to $7 billion coming to market in the new issue space on a weekly basis, this has served as a good proxy for market participants’ appetite for new deals. The SPV could serve as a good backstop, if needed, and we will be keeping a keen eye on the new municipal refinancing deal that is looking to price in the next week. We expect volatility to remain manageable and trading activity to be relatively light overall, as we have seen over the last several market sessions.

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Municipal Bond Ladders

**What we are seeing:** Municipal bonds have been drifting cheaper since they hit their recent low in yields on April 16. That trend has continued this week, related to supply and demand. Demand is light, municipal mutual fund flows have been flat and support from dealers remains weak. Meanwhile, supply has continued to pick up, with new issue supply rising in addition to investor bid-wanted announcements. This adds up to more supply than demand, pushing yields higher. Further, high quality municipals are still trading at yield ratios well over 200% compared to Treasurys. And municipals have cheapened compared to investment grade taxables, offering attractive tax-adjusted yields relative to similarly rated corporate bonds.

**What we are doing:** The 1-14 year maturity range is still capturing 86% of all the yield available while providing the permanence and definition of having bonds mature, which is defensive in a rising rate environment. Though we are focusing on higher quality AA and A bonds at the moment, there will likely be some opportunities in BBBs as spreads widen. That would give us the flexibility to take advantage of those opportunities going forward by selecting BBB minimum credit quality. We also anticipate seeing promise in our total return and managed municipal strategies. Increased new issuance has allowed opportunities for institutional purchasing while still selling retail.

**What we are watching:** Senate Majority Leader Mitch McConnell threw the municipal market a curveball by endorsing state bankruptcies over direct state and local aid through a stimulus package. While local municipalities have the ability to declare bankruptcy under current US law, states do not. A change to this would require an act of Congress, which we do not believe is probable.

**Final Word:** In the investment grade space, we believe defaults are very unlikely. Downgrades, however, are possible and we’re proactively working to identify and sell issues that we deem pose potential risk. We are diligently working through all holdings by issuer, sector and individual bond to identify possible areas of concern. For some issuers that means a heightened level of surveillance, for others that means selling. In those cases, we believe selling at what may be a slight concession now — as opposed to likely a larger concession later — is the conservative, prudent thing to do.
Short Duration Government Income / Agency MBS

What we are seeing: Since its announcement of QE4 on March 15, the US Federal Reserve has now purchased more than $550 billion in agency mortgage-backed securities (MBS). The Fed quickly ramped up its asset purchases in the weeks following that announcement, working their way up to purchases of more than $35 billion per day on average. Those purchases cleared out a backlog of supply, and helped tighten spreads that had reached their widest levels since the financial crisis in 2008.

Daily MBS purchases have been gradually revised down over the past few weeks to a target of $7 billion. That number is still more than enough to cover the roughly $20 billion per week of new production, and very supportive of agency MBS spreads. In addition, following its meeting on April 29, the Fed stressed its commitment to keep purchasing agency MBS “in the amounts needed to support smooth market functioning.”

What we are doing: Our goal is to position our investments conservatively, while still offering a more attractive yield than short-term Treasurys. The team continues to perform extensive due diligence and thorough collateral analysis on each bond we purchase, focusing on loan-level characteristics such as mortgage servicer, loan size and geography. Our preference is for securities that are likely to experience slower prepayments than the broader MBS universe. In addition, with agency MBS spreads currently wider than long-term averages, we have been focusing on bonds priced at or around par, which still offer attractive yields.

What we are watching: We expect prepayment activity should slow considerably in the coming months for a number of reasons. First, social distancing and business closures will create bottlenecks in certain steps of the mortgage origination process, impacting individuals’ ability to get appraisals on homes or to clear titles. In addition, uncertainty around unemployment and home purchase activity, as well as stricter underwriting standards because of that uncertainty, may lead to lower MBS supply. Expectations for lower supply combined with the aforementioned Fed purchases should continue to serve as a tailwind for agency MBS spreads to continue tightening.

Final word: In an environment of heightened concerns on both liquidity and credit fronts, agency MBS continue to appear very attractive for their AAA-rating and highly liquid market. Investors looking for a high-quality parking place to sit out these volatile markets may want to revisit agency MBS. This sector has tended to perform well when risk markets sell off, like in 2008, when agency MBS was one of the best performing sectors during the global financial crisis.

Short Duration Government Income — About Risk: The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the US and global markets. Securities with longer durations tend to be more sensitive to interest rate changes than securities with shorter durations. As interest rates rise, the value of certain income investments is likely to decline. Mortgage- and asset-backed securities are subject to credit, interest rate, prepayment and extension risk. Investments in debt instruments may be affected by changes in the creditworthiness of the issuer and are subject to the risk of non-payment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer’s ability to make principal and interest payments. US Treasury securities generally have a lower return than other obligations because of their higher credit quality and market liquidity. While certain US government-sponsored agencies may be chartered or sponsored by acts of Congress, their securities are neither issued nor guaranteed by the US Treasury.
Global Macro

- **What we are seeing:** Global markets have settled into a more normal, high-volatility environment from the extreme volatility over the past few weeks. It’s worth noting that virtually all major global markets — excluding oil — are up month-to-date in April, from Treasurys to gold to emerging markets local currency debt to the S&P 500. What’s also notable is how few investors believe in the rally — there’s a tremendous amount of negative sentiment. Combined with ongoing massive policy support, the bearish sentiment could be a positive factor in the second half of the year. Without minimizing the world’s substantial long-term economic challenges, we could be looking at a positive delta for growth, albeit from a greatly reduced base.

That said, we do not believe markets have necessarily seen their floors, as the adverse economic ramifications will vary by country, and it’s not clear this has been fully discounted. Across countries we are seeing investors differentiate based not just on their dependence on oil, but also on varied policy responses to the virus and the potential impacts on healthcare systems, social dynamics, economies and finances.

A good example is South Africa’s new stimulus plan, amounting to 10% of GDP, which may drive their budget deficit to 16% of GDP this year! While historically considered one of the higher-quality EM countries, markets are now doubting that assessment (as we have for years), and assets are continuing to be punished even though nearly all areas of global markets have been rallying in April.

Despite the unsettled conditions, we believe a market that differentiates based on fundamentals is a good environment for us, given our focus on individual country-level policy and economic fundamentals.

- **What we are doing:** While we continue to invest with low levels of risk and high levels of liquidity and some dry powder, as noted we have begun to “nibble” at opportunities where we believe market volatility has pushed valuations substantially below what we believe are fair. As examples, our long positions (as of March 31, 2020) include local bonds in Ukraine, Serbia and Iceland; interest rates in China, and sovereign credit in Egypt and Romania. Notable short positions include several gulf country currencies, where we believe their dollar pegs are likely to be strained with the collapse in oil prices, as well as currencies and sovereign credit in both South Africa and Turkey.

- **What we are watching:** We encourage investors to turn attention away from the shocking impact of the first wave of COVID-19 infections, and consider the lasting effect that this will have on global trade patterns, consumer preferences and the economic reform momentum of countries.

We have long emphasized the fundamental advantages of countries with a higher level of economic freedom, greater rule of law, simpler business procedures and sound institutions. We think such advantages will increasingly come to the fore as we progress into the COVID-19 era.

- **Final word:** While we remain cautious, valuations do appear compelling in spots. The flexibility to be able to invest both long and short in this environment is a compelling feature of our approach, and both sides of the ledger have been bearing fruit over the past month. Given the huge leg down in core bond yields around the world, and the aggressive actions taken across the board by the Fed and other central banks, we see a clear scenario emerging on the back end of this. We believe strategies with the flexibility to opportunistically invest both long and short all around the world will be even more attractive to investors in search of differentiated, yet consistent returns.
**Index Definitions**

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<thead>
<tr>
<th>Index Name</th>
<th>Description</th>
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<tbody>
<tr>
<td>Bloomberg Barclays US Aggregate Index</td>
<td>An unmanaged index of domestic investment-grade bonds, including corporate, government and mortgage-backed securities.</td>
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<tr>
<td>Bloomberg Barclays Municipal Bond Index</td>
<td>An unmanaged index of municipal bonds traded in the US.</td>
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<tr>
<td>Bloomberg Barclays US Corporate Investment Grade Index</td>
<td>An unmanaged index that measures the performance of investment-grade corporate securities within the Bloomberg Barclays US Aggregate Index.</td>
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<tr>
<td>ICE BofAML US High Yield Index</td>
<td>An unmanaged index of below-investment-grade US corporate bonds.</td>
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<tr>
<td>S&amp;P/LSTA Leveraged Loan Index</td>
<td>An unmanaged index of the institutional leveraged loan market.</td>
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<tr>
<td>Nasdaq Composite</td>
<td>An unmanaged index of the common stocks and similar securities listed on the Nasdaq stock market.</td>
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<tr>
<td>Russell 2000 Index</td>
<td>An unmanaged index of 2,000 US small-cap stocks.</td>
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<td>Standard &amp; Poor's 500 Index</td>
<td>An unmanaged index of large-cap stocks commonly used as a measure of US stock market performance.</td>
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Source of all data: Eaton Vance as of April 30, 2020, unless otherwise specified.

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For further information, please contact:

Eaton Vance Management
Two International Place, Boston, MA 02110
800.836.2414 or 617.482.8260 | eatonvance.com

Eaton Vance Management (International) Limited
125 Old Broad Street, London, EC2N 1AR, United Kingdom
+44 (0)203.207.1900 | global.eatonvance.com