

Economic and Fixed Income Outlook

Paul Matlack, CFA

Senior Vice President, Senior Portfolio Manager, US Credit Strategist

September 2014

Views expressed here are current as of the date shown, and are those of the portfolio manager and research analysts, and are subject to change.

Delaware Investments, a member of Macquarie Group, refers to Delaware Management Holdings, Inc. and its subsidiaries. Macquarie Group refers to Macquarie Group Limited and its subsidiaries and affiliates worldwide.

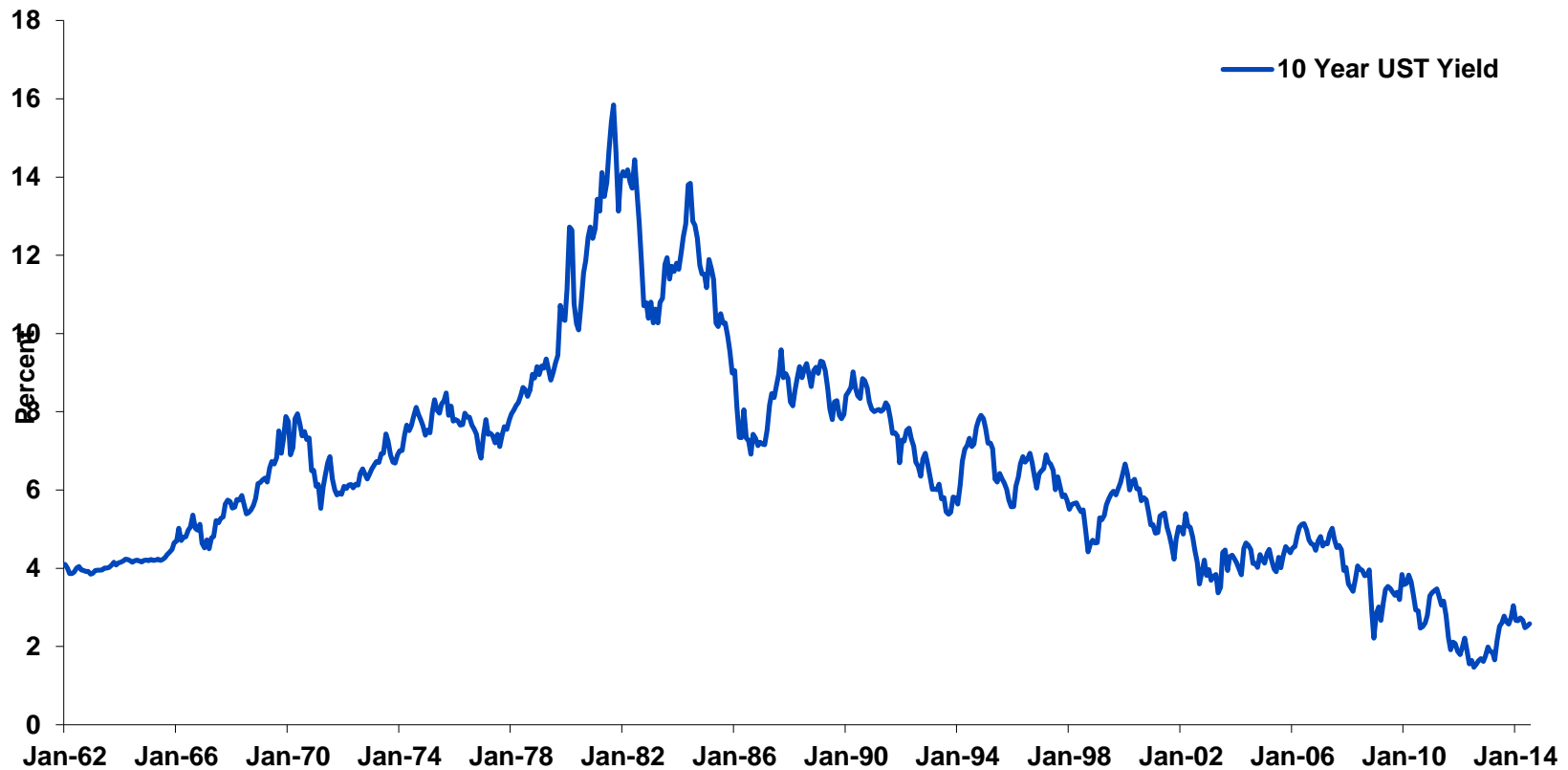
Delaware Investments is not an authorized deposit-taking institution for the purposes of the Banking Act 1959 (Commonwealth of Australia) and Delaware Investments obligations do not represent deposits or other liabilities of Macquarie Bank Limited ABN 46 008 583 542 (MBL). MBL does not guarantee or otherwise provide assurance in respect of the obligations of Delaware Investments.

© 2013 Delaware Management Holdings, Inc.

Tyranny of bond math

Two major drivers of bond returns in recent years:

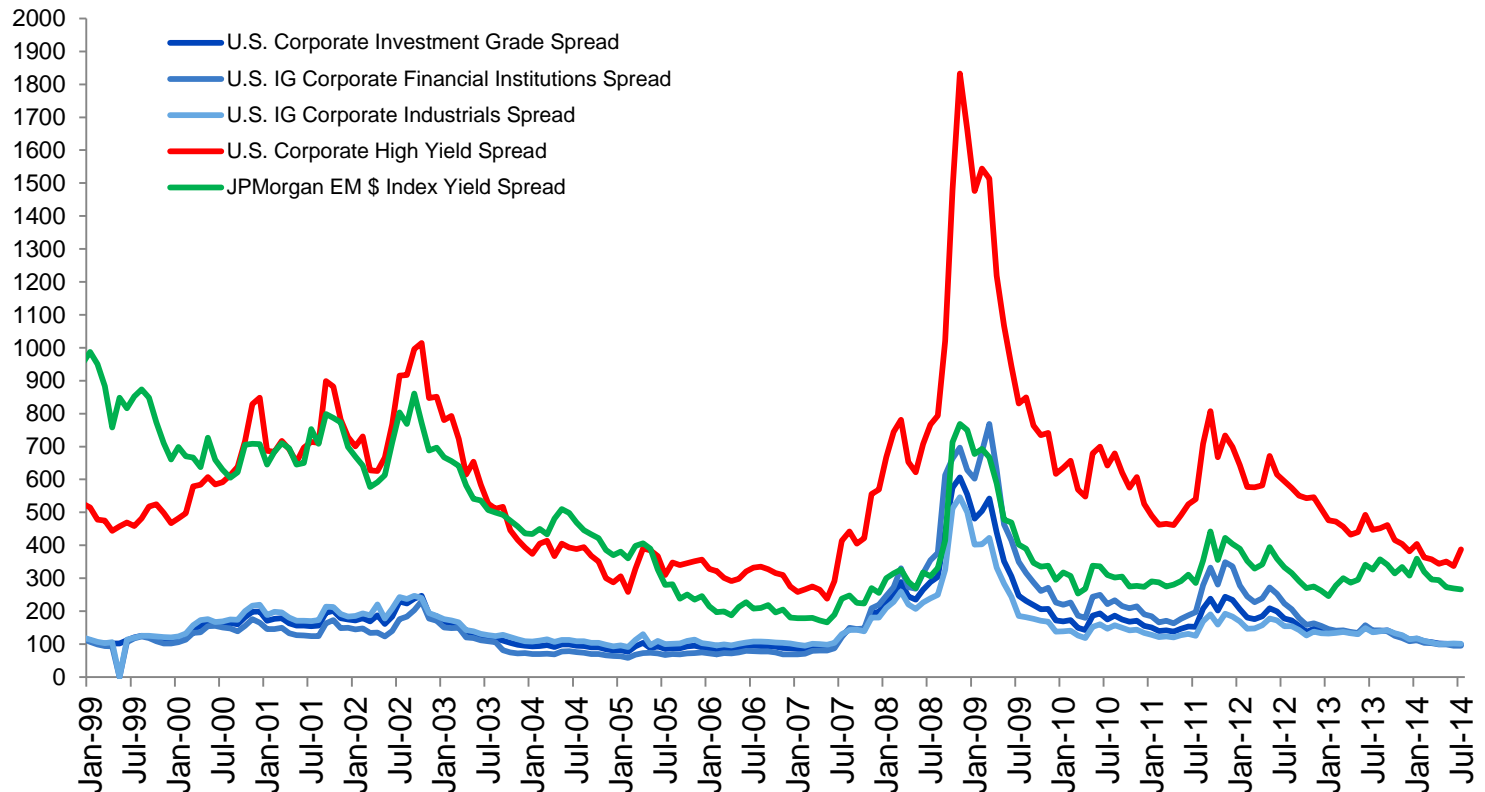
1. Secular 30 year decline in rates



Data source: Bloomberg as of 7/31/2014

Tyranny of bond math

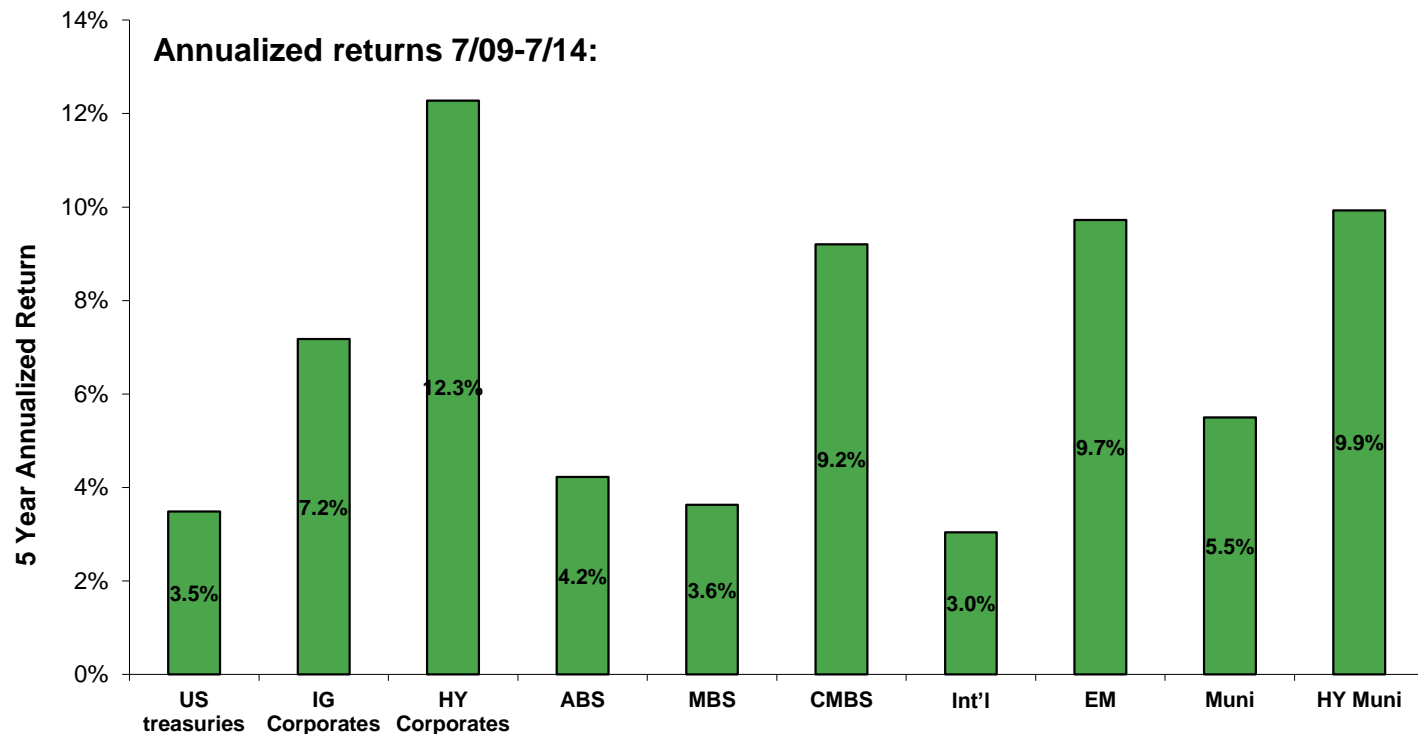
2. Cyclical recompression of bond spreads since 2008



Source: JPMorgan, Barclays, Bloomberg as of 7/31/2014

Tyranny of bond math

- Rates have been range bound, credit spreads are well inside long-term averages.
- Equity-like returns of the past five years are not repeatable

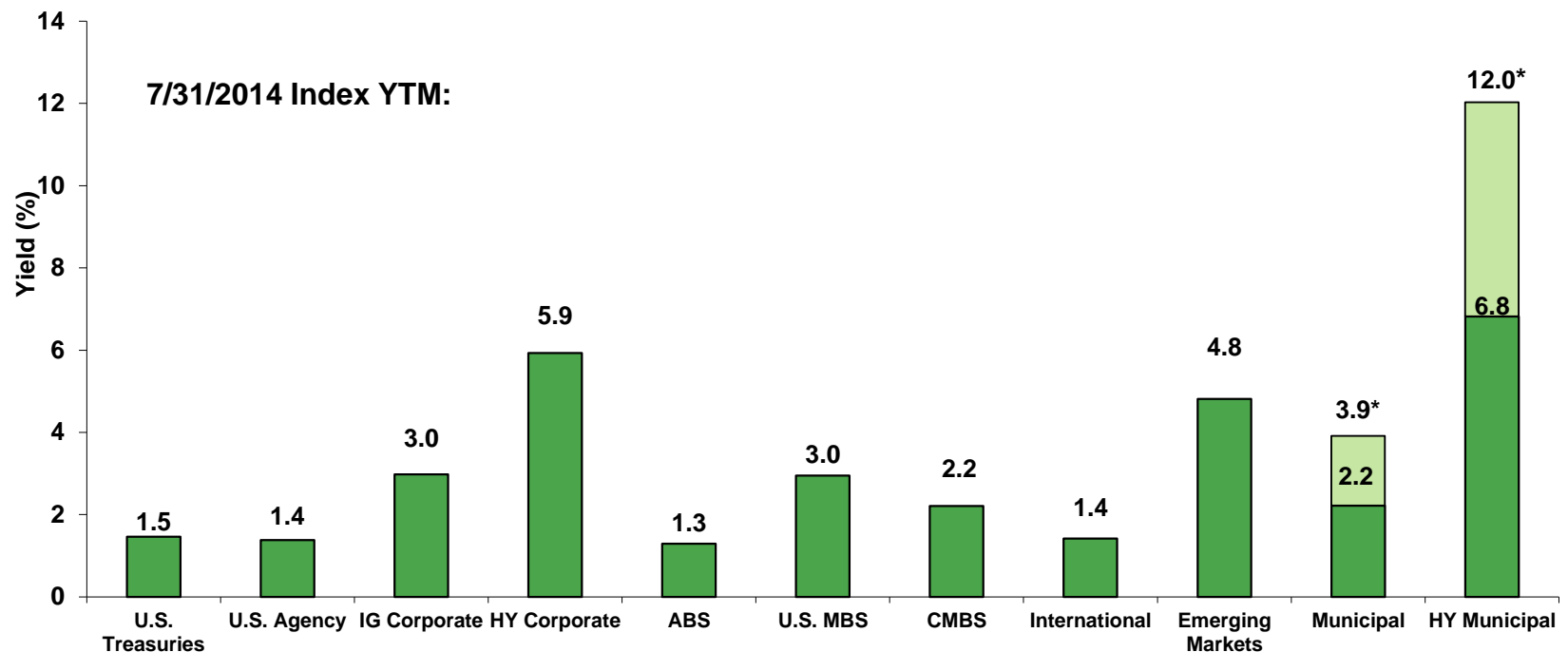


Indices shown are the Barclays U.S. Treasury Bond Index, the Barclays U.S. Corporate Investment Grade Index, the Barclays U.S. Corporate High Yield Bond Index, the Barclays Asset-Backed Securities Index, the Barclays Mortgage-Backed Securities Index, the Barclays CMBS ERISA-Eligible Index, the Citigroup® Non-U.S World Government Bond Index, JPMorgan Emerging Markets Bond Index Global Diversified, the Barclays Municipal Bond Index, and the Barclays Municipal High Yield Index.

The performance quoted represents past performance and does not guarantee future results. Indices are unmanaged and one cannot invest in an index. Indices shown are for comparison purposes only.

Tyranny of bond math

- Capital appreciation largely exhausted
- Expected return= Y-T-M barring rate increase



Indices shown are the Barclays U.S. Treasury Bond Index, the Barclays U.S. Agency Index, the Barclays U.S. Corporate Investment Grade Index, the Barclays U.S. Corporate High Yield Bond Index, the Barclays Asset-Backed Securities Index, the Barclays Mortgage-Backed Securities Index, the Barclays CMBS ERISA-Eligible Index, the Citigroup® Non-U.S. World Government Bond Index, JPMorgan Emerging Markets Bond Index Global Diversified, the Barclays Municipal Bond Index, and the Barclays Municipal High Yield Index.

The performance quoted represents past performance and does not guarantee future results. Indices are unmanaged and one cannot invest in an index. Indices shown are for comparison purposes only. *Taxable equivalent yield. 2013 top tax rate is 43.3% (39.6% + 3.8% Medicare rate).

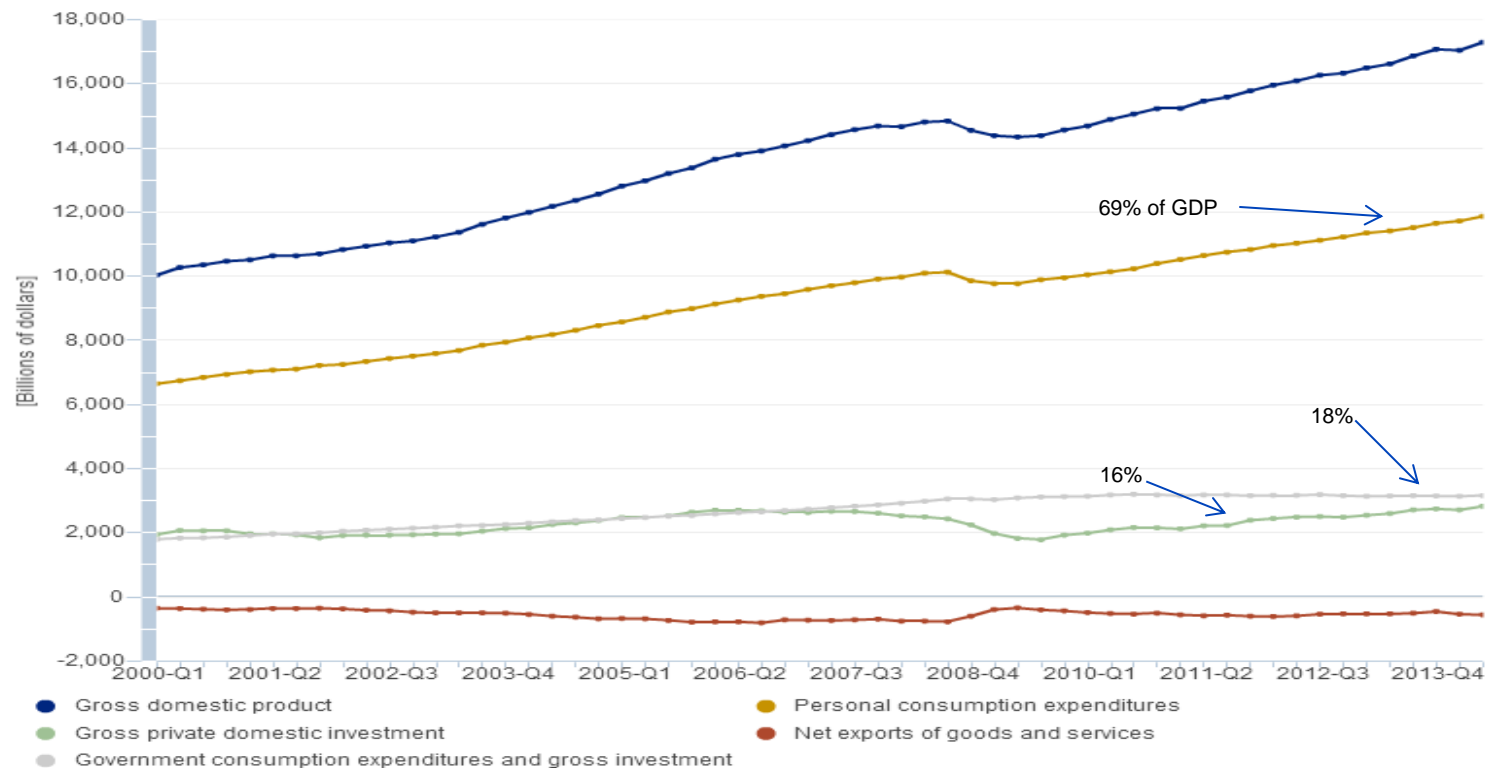
September 24, 2014 | 5

What could lift rates?

Focus on the consumer

Table 1.1.5. Gross Domestic Product

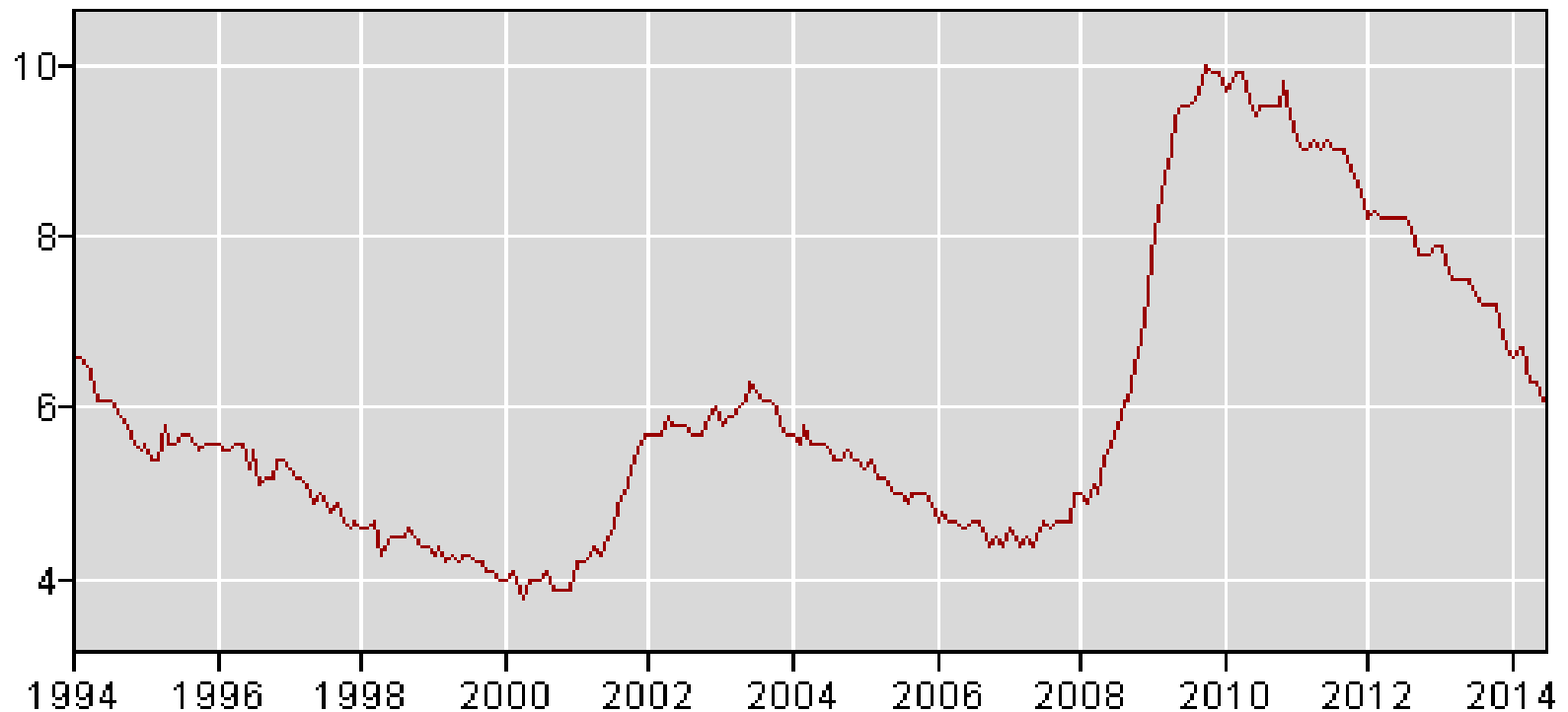
Last Revised on: July 30, 2014 - Next Release Date August 28, 2014



Source: U.S. Bureau of Economic Analysis

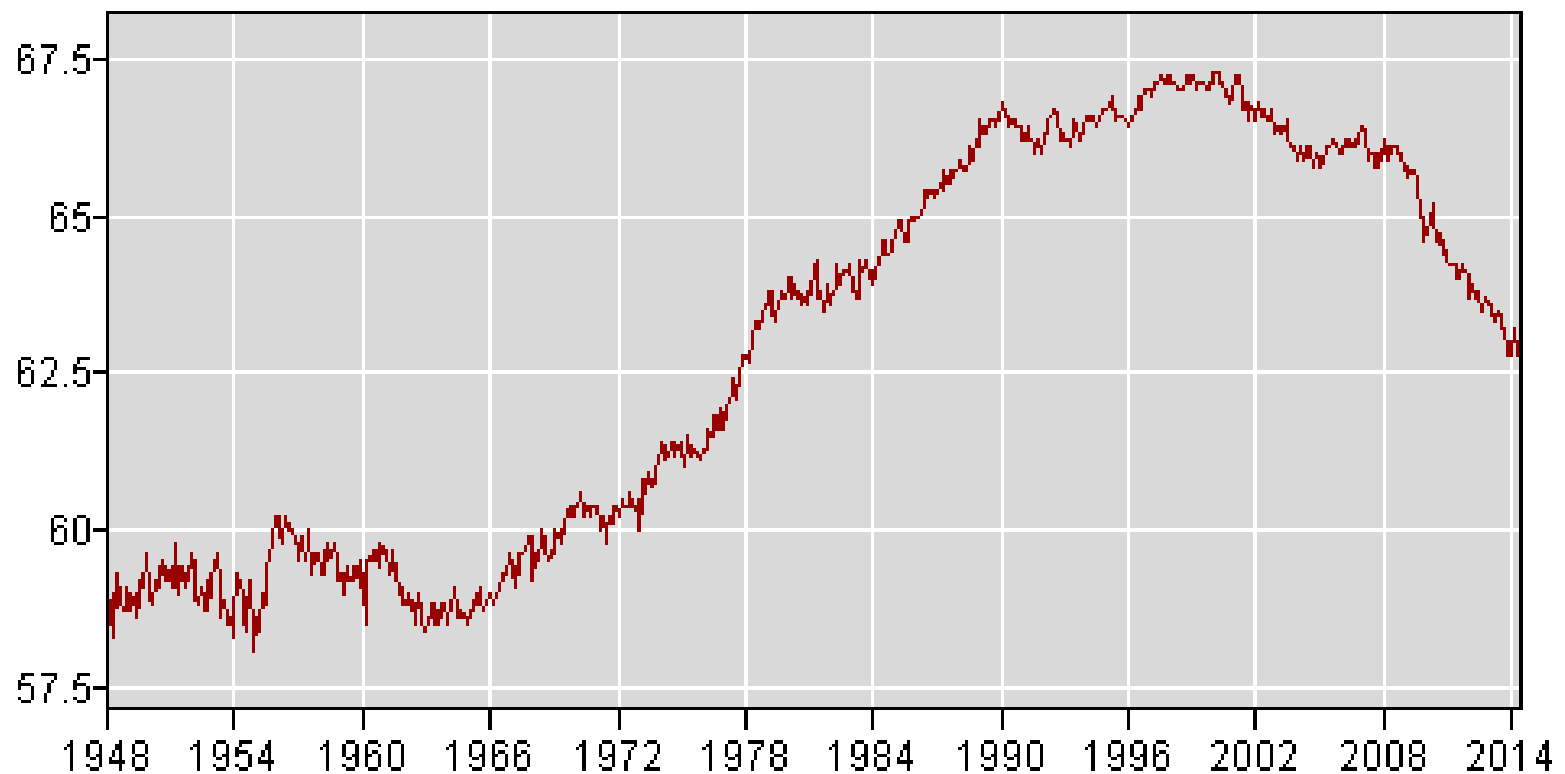
Robust consumer spending dependent on job growth

US civilian unemployment rate has trended down, but...



Source: U.S. Department of Labor as of 7/31/2014

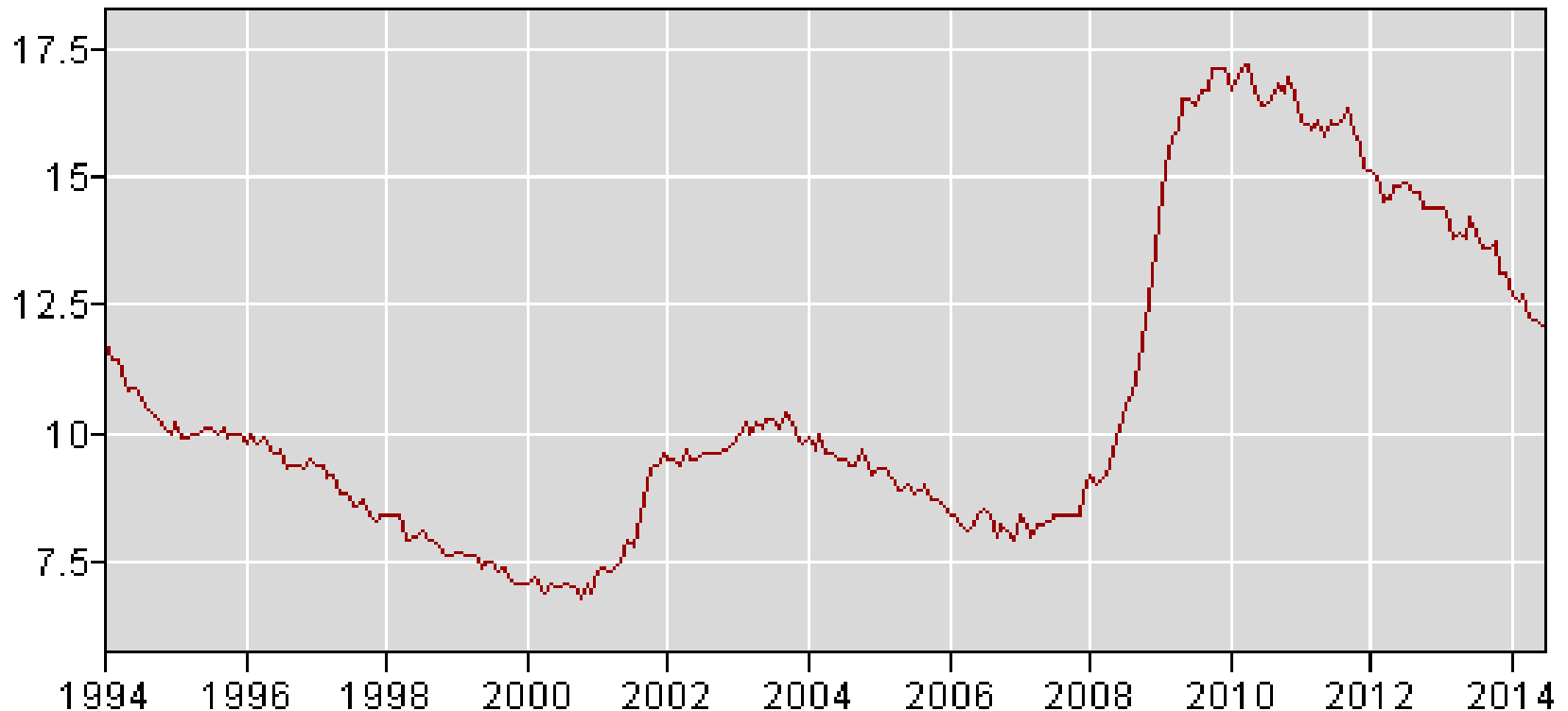
Much of the gain due to declines in the civilian labor force participation rate



Source: U.S. Department of Labor as of 7/31/2014

Broader measures of unemployment stubbornly high

Structural or cyclical?



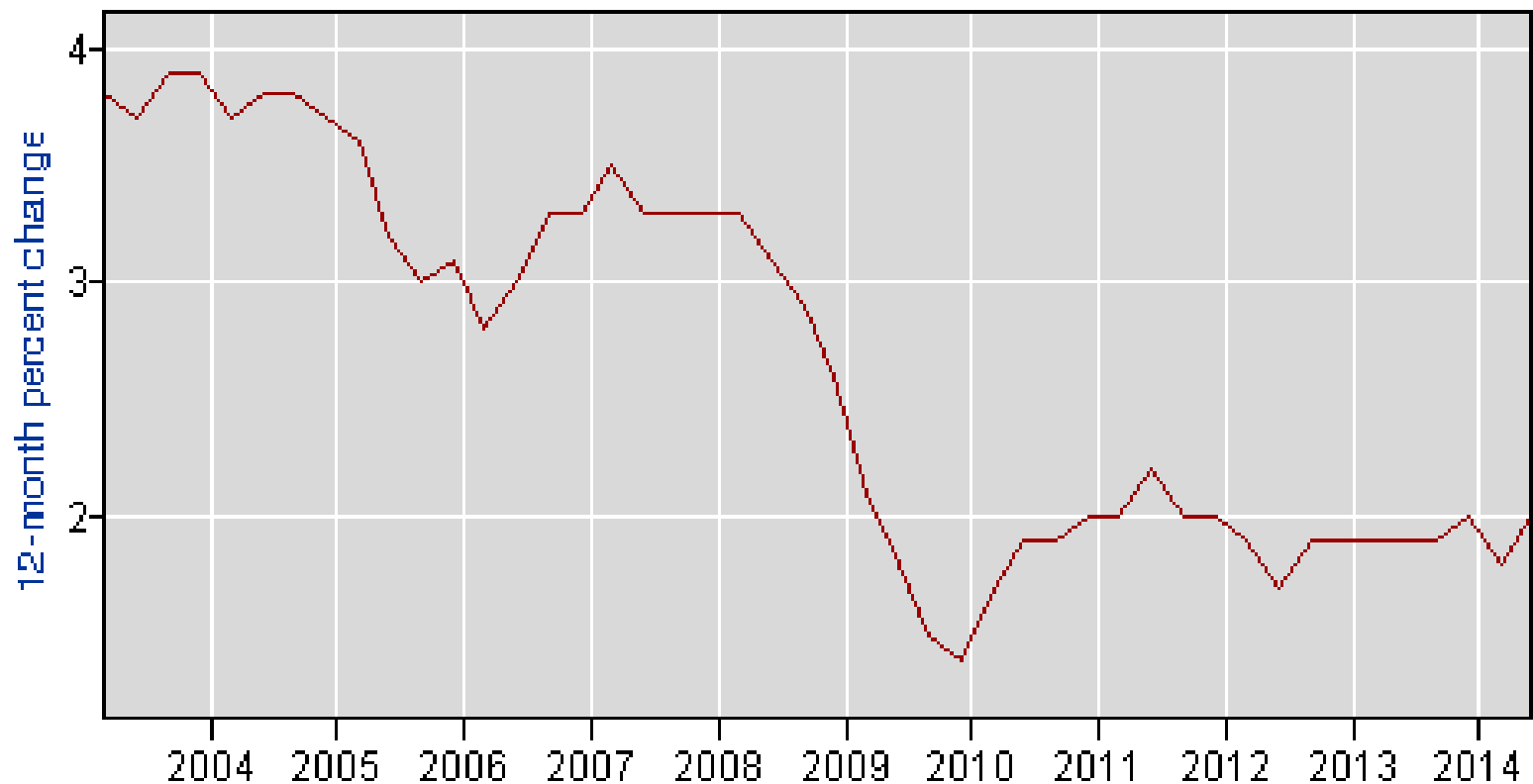
U-6 Unemployment: unemployed + p/t workers seeking F/T jobs + discouraged workers

Source: U.S. Department of Labor as of 7/31/2014

Employment slack results in muted wage pressure

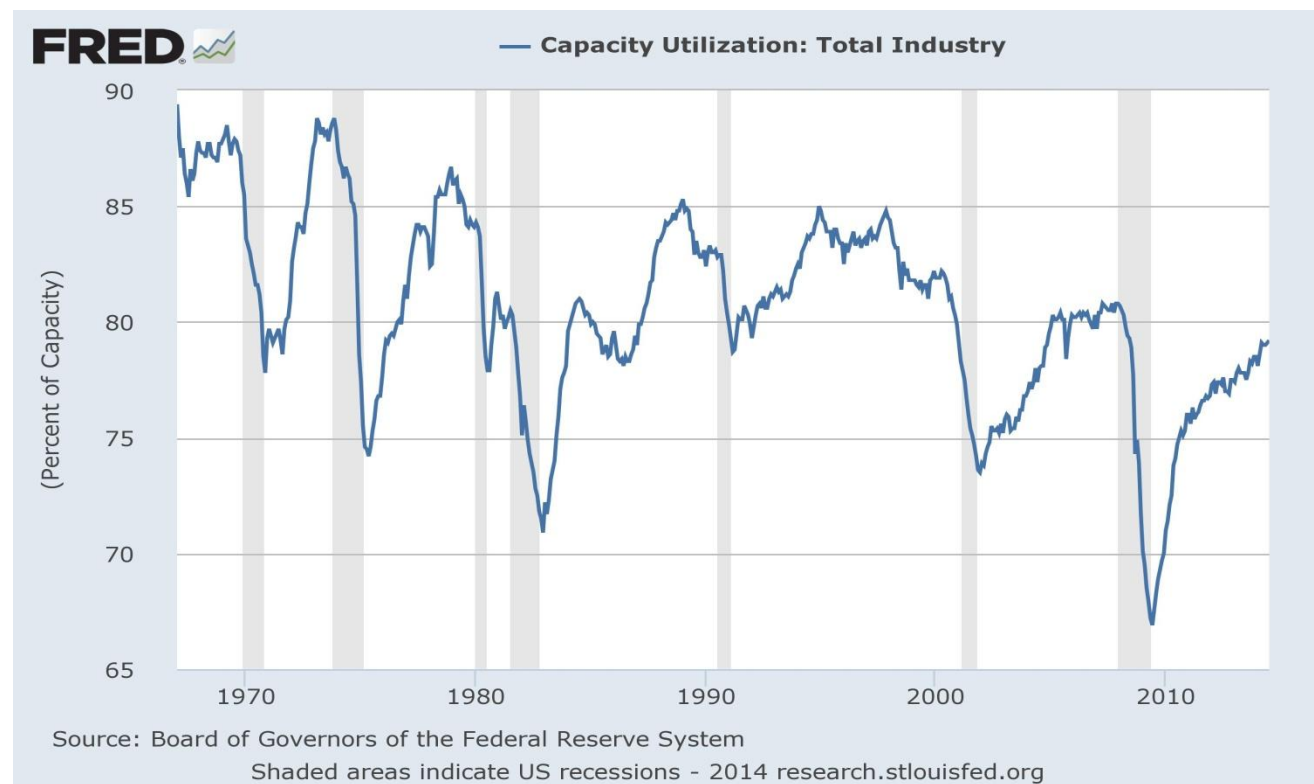
pressure

Employment cost index- all civilian



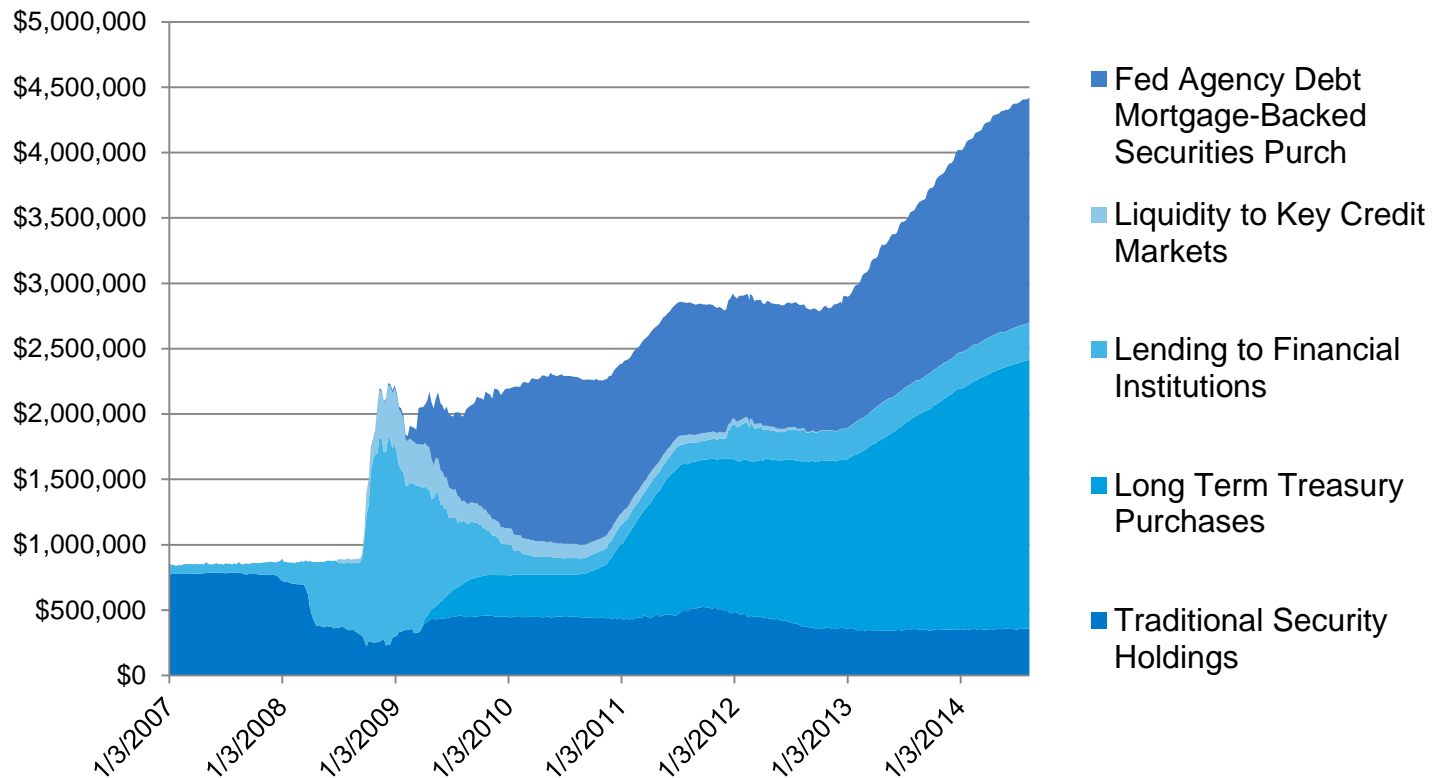
Source: U.S. Department of Labor as of 7/31/2014

Low capacity utilization limits pass-thru of manufacturing cost increases



Source: Federal Reserve Bank of St. Louis as of 7/31/2014

Monetary stimulus has been unprecedented, but...



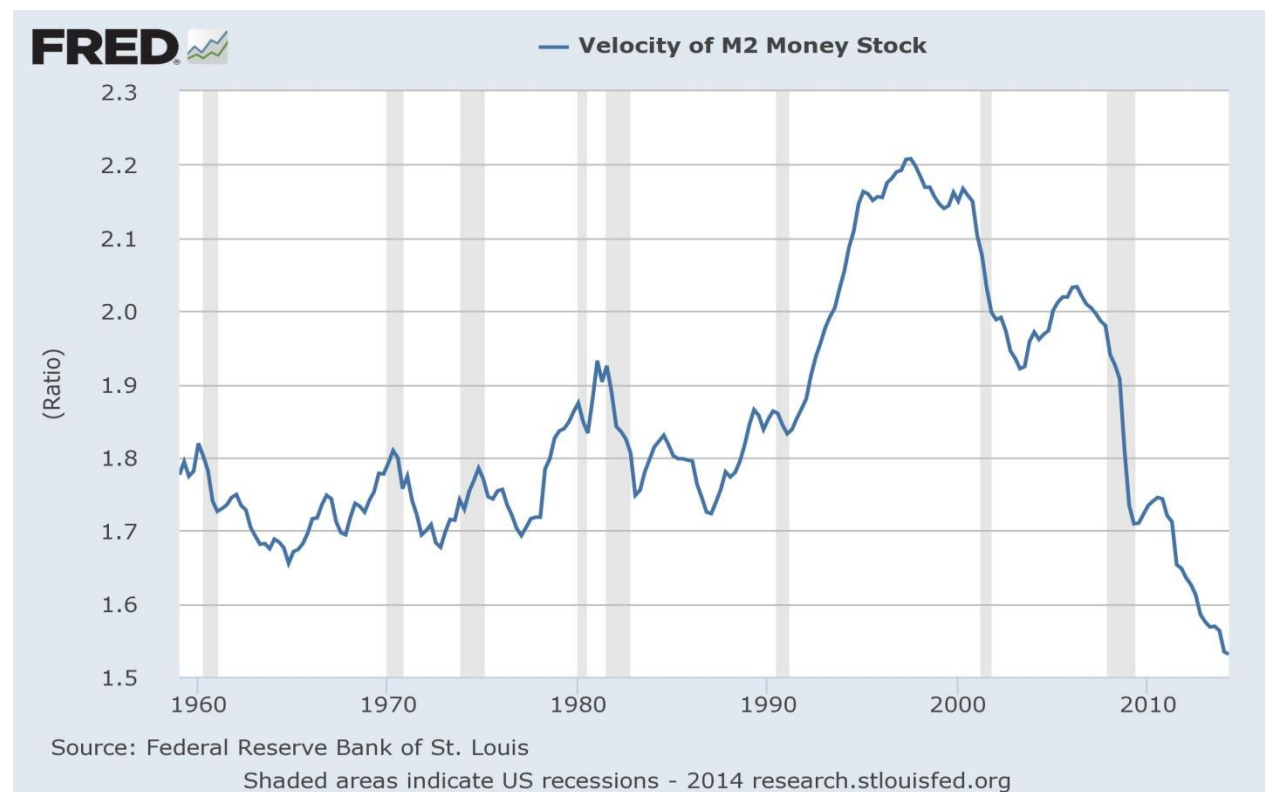
Source: Federal Reserve Bank of Cleveland, as of 7/31/2014

QE \$ remain largely dormant as excess bank reserves...



Source: Federal Reserve Bank of St. Louis as of 7/31/2014

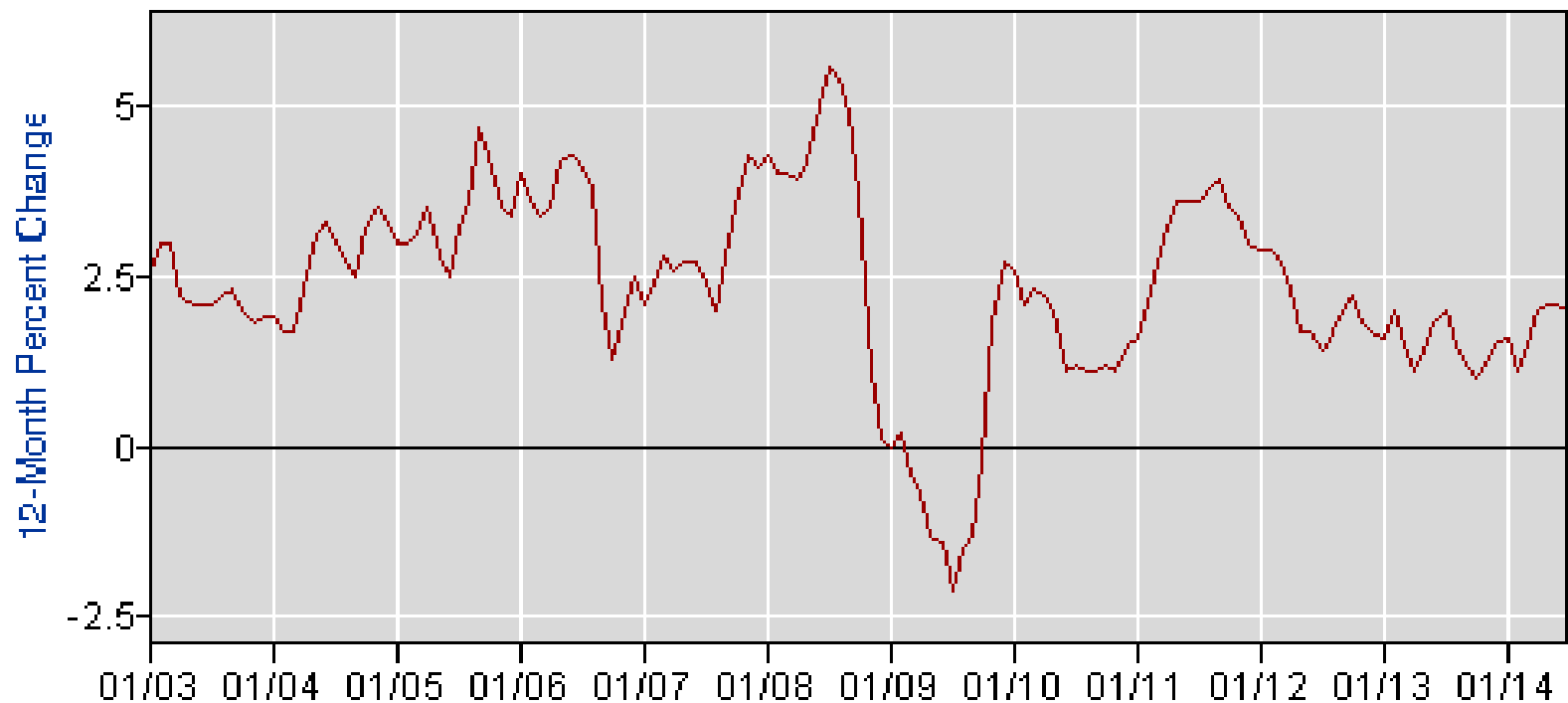
Resulting in low and falling velocity of money...



Source: Federal Reserve Bank of St. Louis as of 7/31/2014

Excess labor, excess capacity, excess reserves= subdued inflation

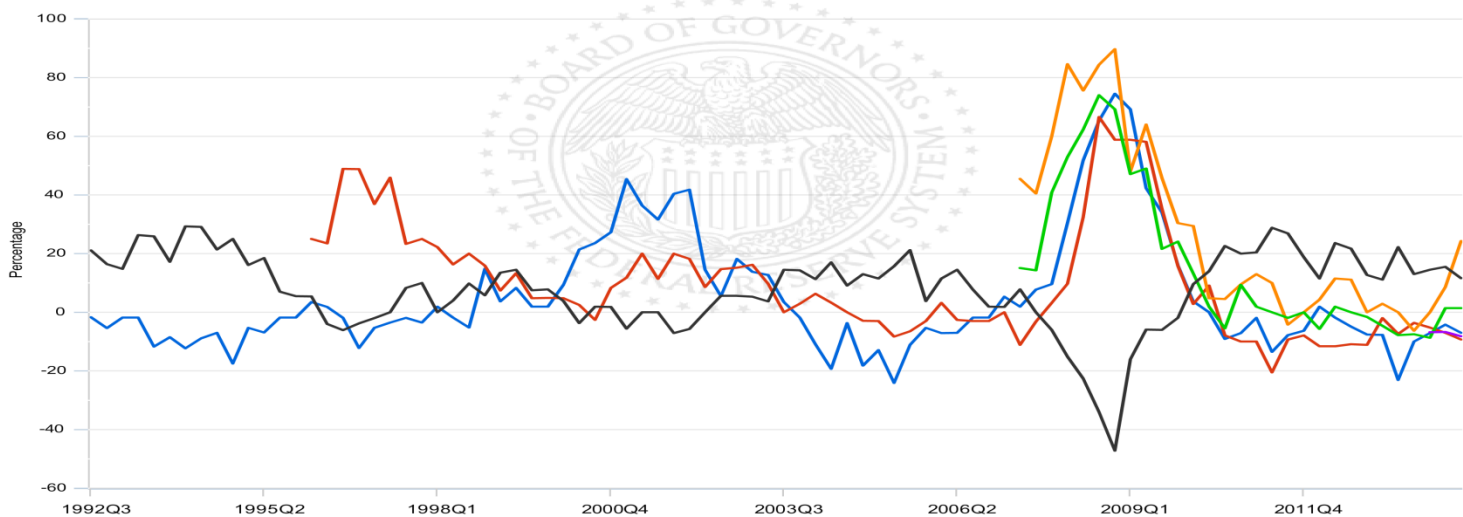
CPI- all urban consumers



Source: U.S. Department of Labor as of 7/31/2014

The good news: banks are (at the margin) loosening lending standards across almost all loan categories...

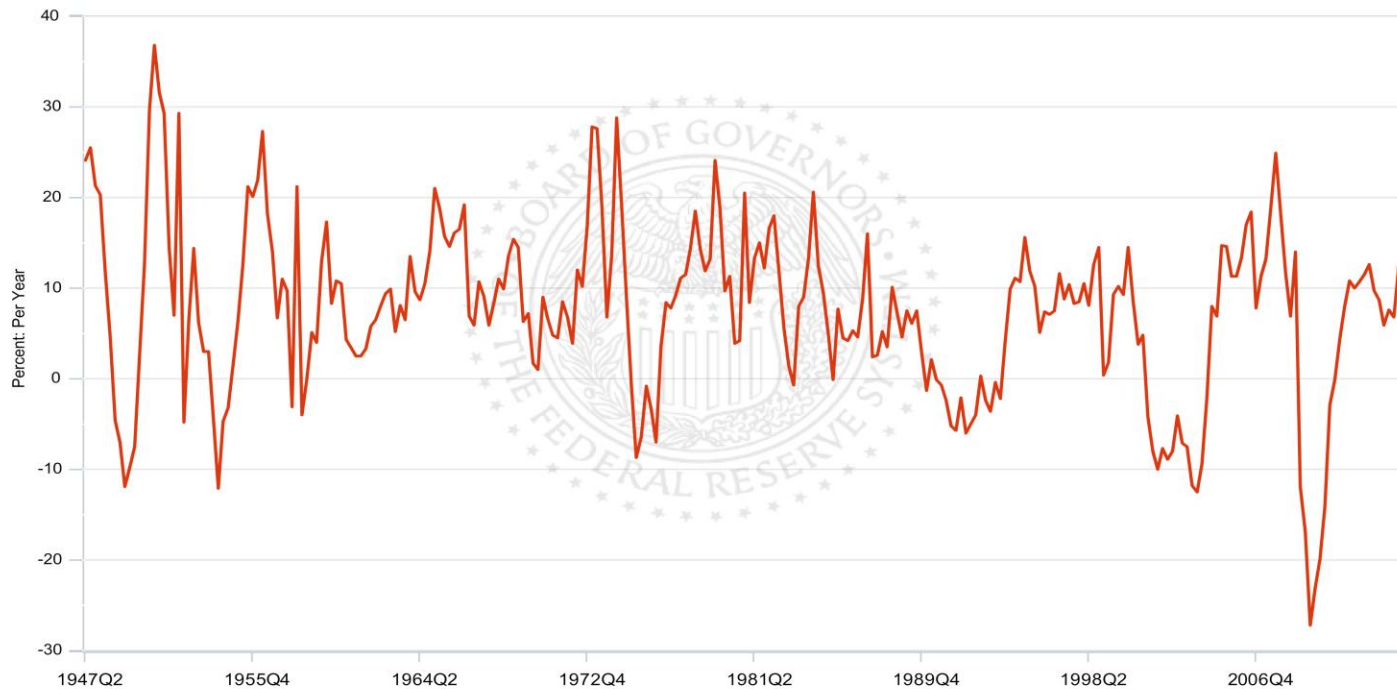
- ▲ Net percentage of domestic banks tightening standards for C&I loans to small firms
- ▲ Net percentage of domestic banks tightening standards for credit card loans
- ▲ Net percentage of domestic banks tightening standards for non-traditional mortgage loans
- ▲ Net percentage of domestic banks tightening standards for prime mortgage loans
- ▲ Net percentage of domestic banks tightening standards for commercial real estate loans secured by nonfarm nonresidential structures
- ▲ Net percentage of domestic banks reporting increased willingness to make consumer installment loans



Source: Federal Reserve Board 2014

But loan growth remains muted relative to past recoveries

◀ Commercial and industrial loans, all commercial banks, seasonally adjusted, annual growth rate (break adjusted)

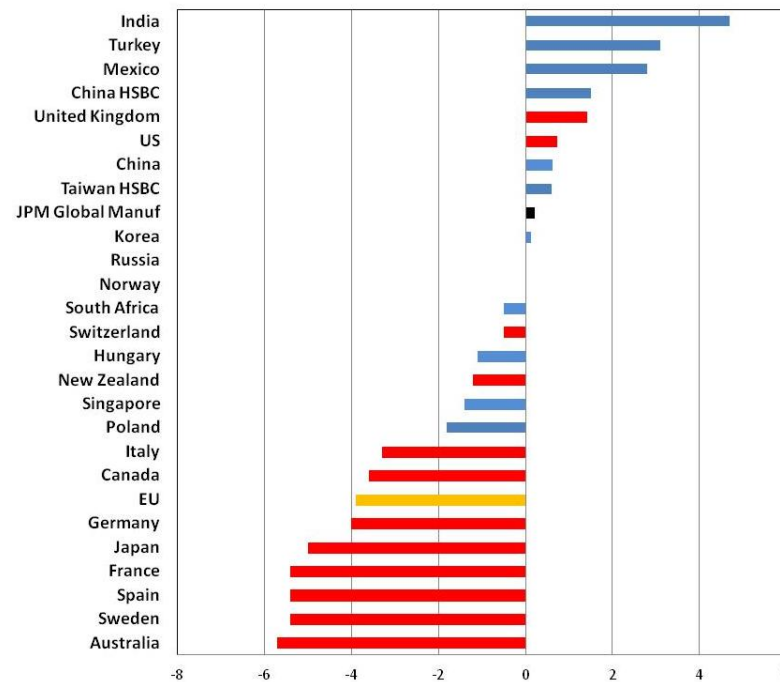


Source: Federal Reserve Board 2014

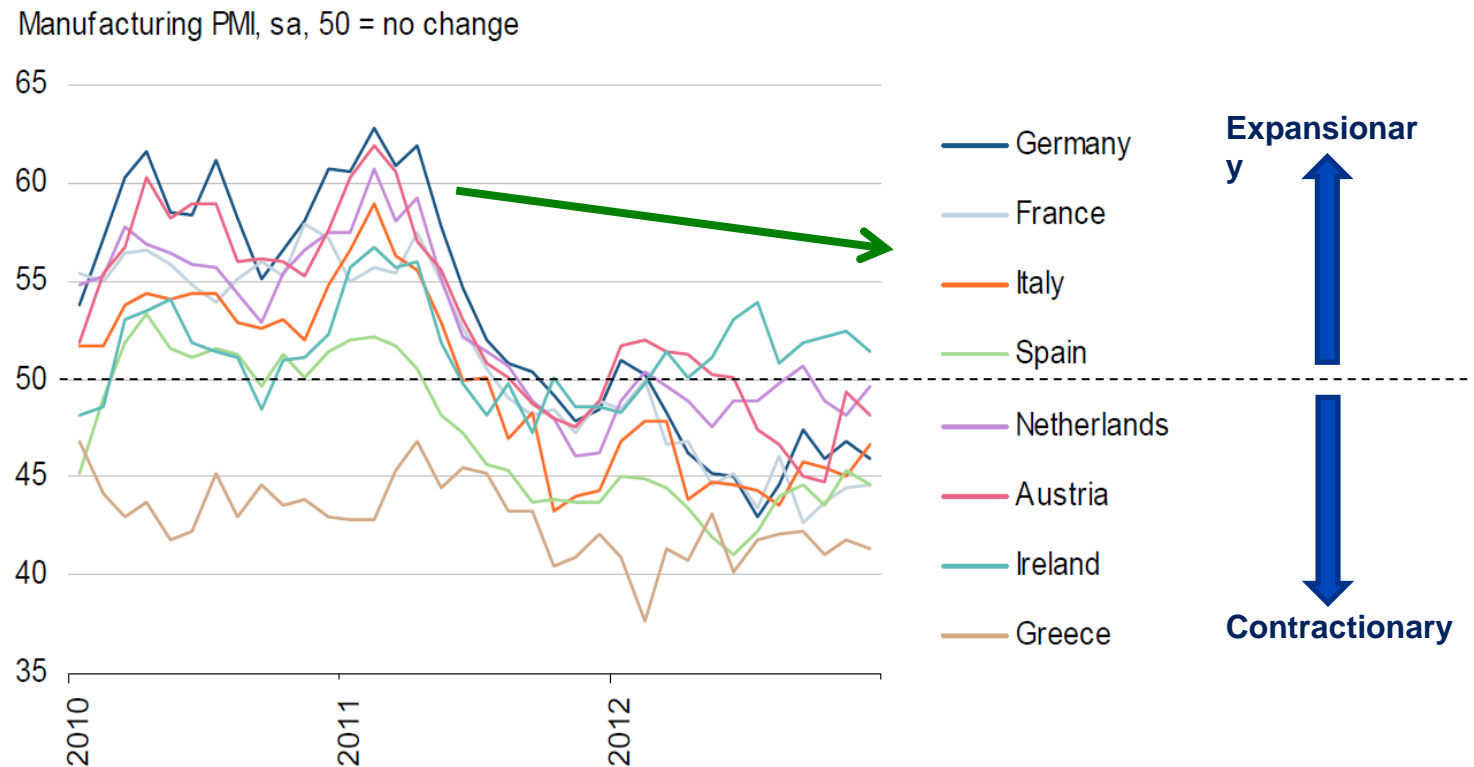
Source: Federal Reserve Board 6/30/2014

Meanwhile, the overseas picture decidedly mixed...With Europe in recession, China is the wild card

Global Manufacturing PMI (vs 50)

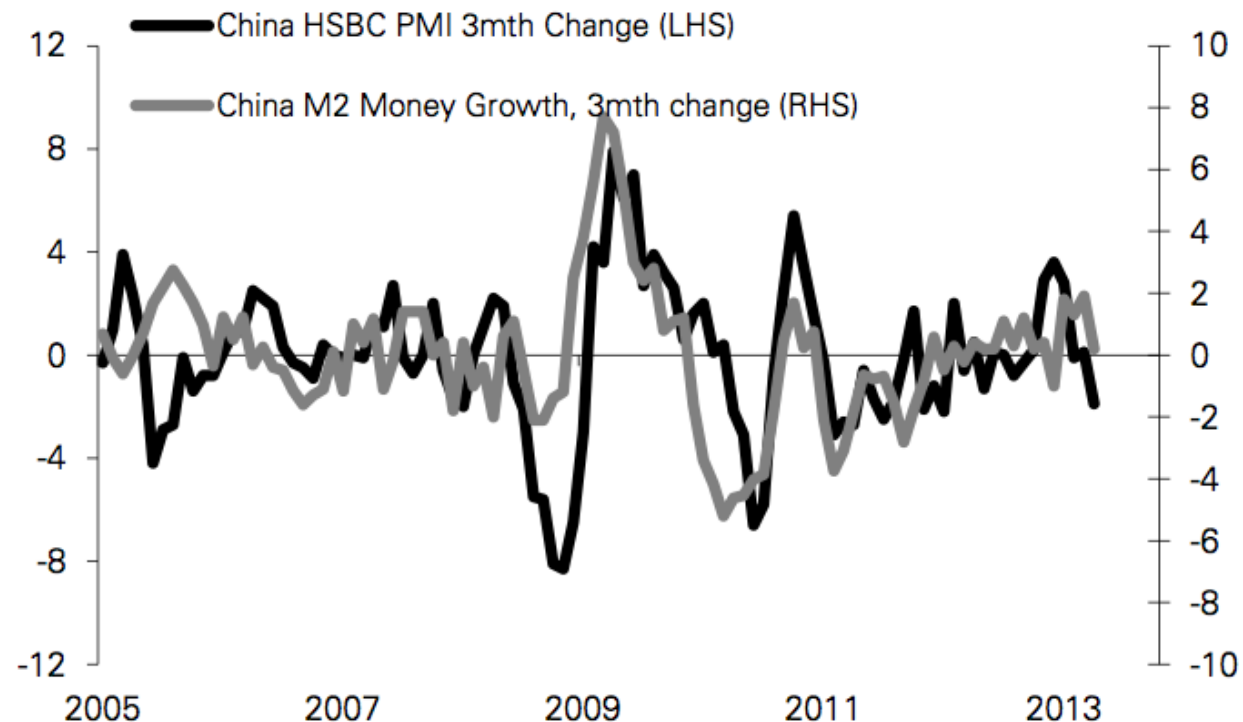


Europe contracting, structural headwinds formidable

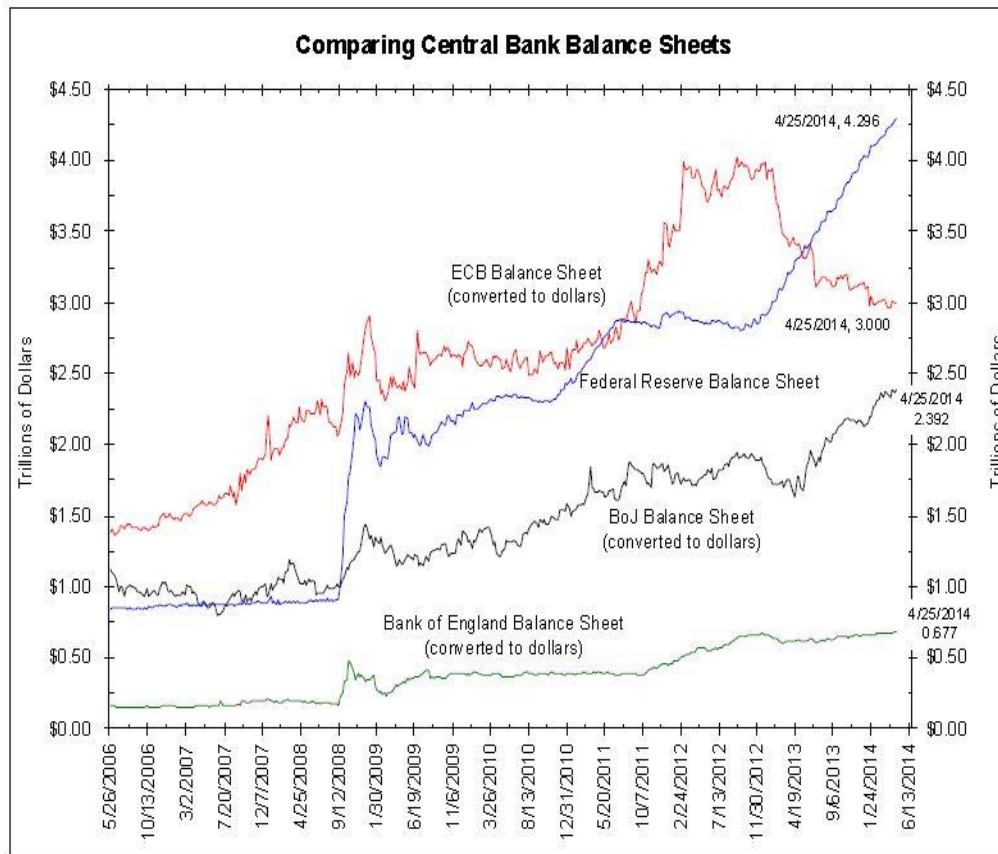


China's growth is softening and its track remains uncertain

Coupled with Europe, a Chinese slowdown would significantly impact global growth



With fiscal stimulus constrained by high debt levels, monetary stimulus appears to be the only option



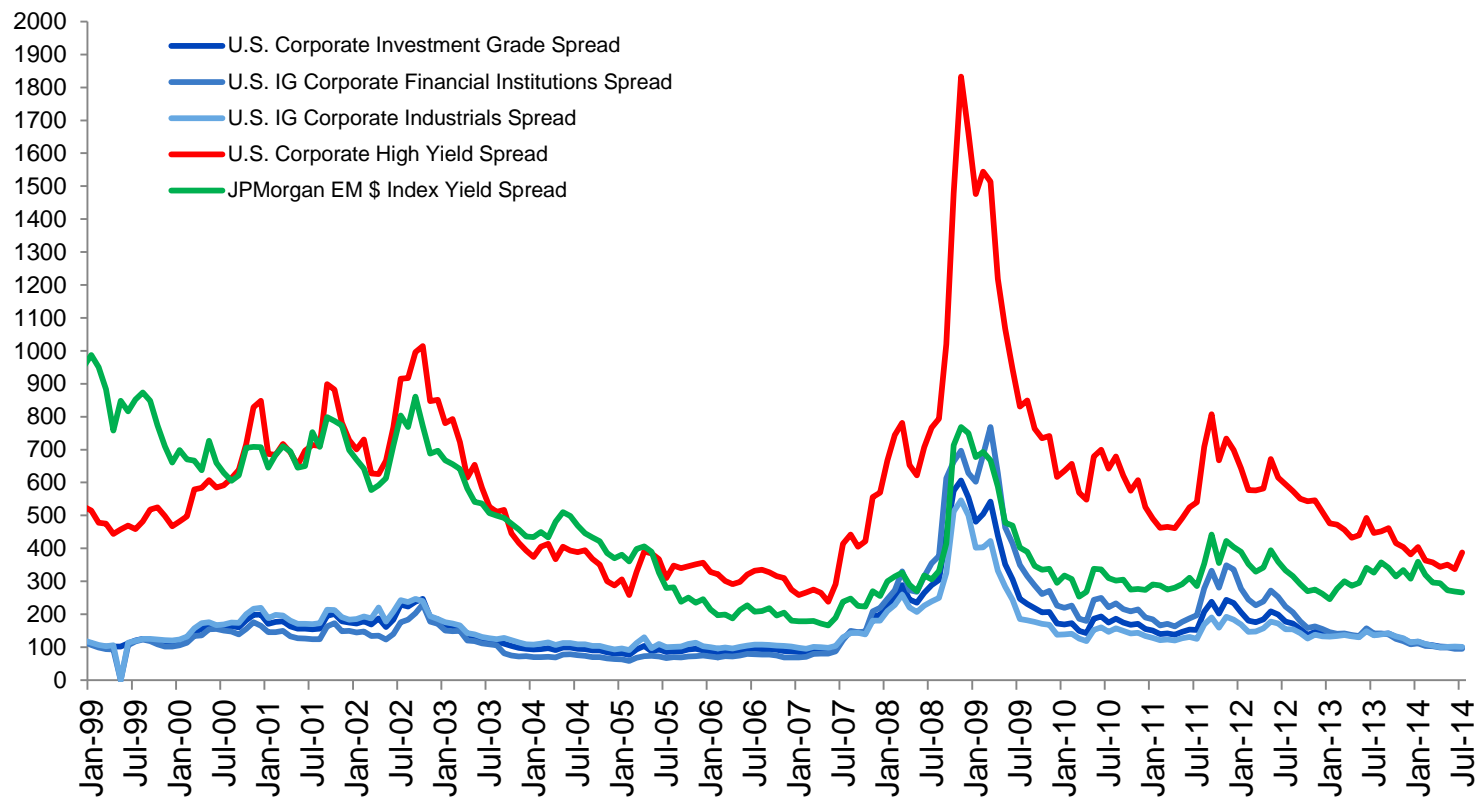
Central banks have implemented unusual measures to support growth

These measures have added trillions to their balance sheets

While these measures have supported growth to some extent, there does not seem to be a plan to unwind these positions

Narrow credit spreads are likely a fact of life

Is there value to be found in fixed income?



Source: JP Morgan, Barclays, Bloomberg as of 7/31/2014

Rates low, economy growing → Focus on stock-like bonds

Correlations

----- vs. S&P500 ----- ----- vs. Barclays Agg-----

	3 yr	5 yr	10 yr		3 yr	5 yr	10 yr
US Tr	-0.56	-0.51	-0.30		0.87	0.91	0.85
US IG Corps	0.16	0.07	0.35		0.82	0.84	0.82
Munis	-0.13	-0.11	0.04		0.86	0.75	0.63
Global ex-US	0.27	0.31	0.24		0.57	0.53	0.58
HY Bonds	0.81	0.71	0.74		0.16	0.12	0.28
Bank Loans	0.65	0.61	0.59		-0.09	-0.12	0.01
Convert s	0.87	0.90	0.86		-0.12	-0.22	0.11

Source: Morningstar Direct, as of 7/31/2014

Performance during rising rates

- Adding credit risk can improve performance

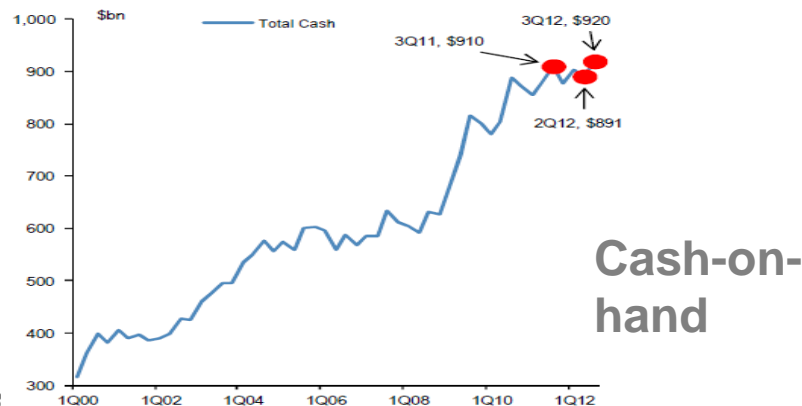
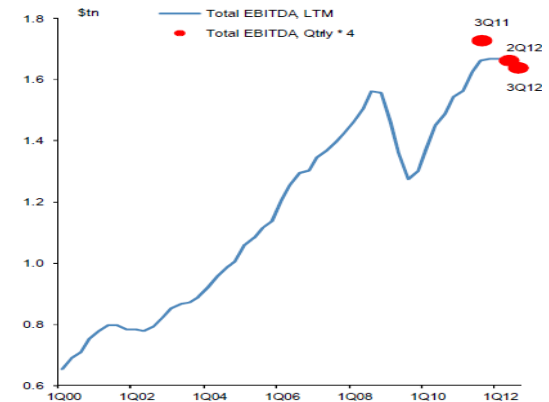
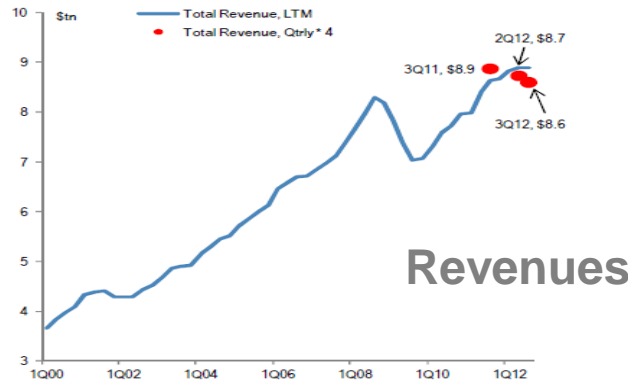
16 spikes of 75bp or more in US 10yr treasury yield since 1988 (25 yrs)

Asset Class	Number of negative returns
Barclays US Treasury	15/16
Barclays IG Corporate	13/16
Barclays Muni	11/16
Barclays Global ex-US	10/16
Barclays HY Corp	2/16
BofAML Convertible Bond	2/16
S&P/LSTA Leveraged Loan	0/16

Source: Morningstar Direct, Bloomberg, Barclays

When valuations are full, focus on the fundamentals

U.S. credit metrics are currently stronger than the rest world

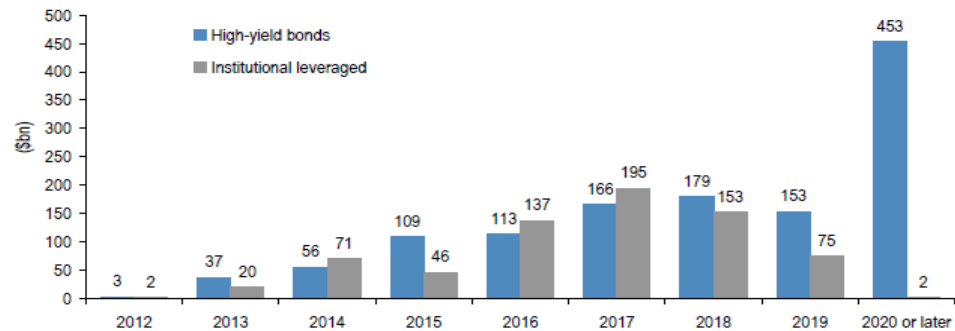


LTM: Last twelve months as of 5/31/2013
Data based on U.S. Corporations
Source: Thompson Financial, J.P. Morgan and Capital IQ

Balance sheet flexibility

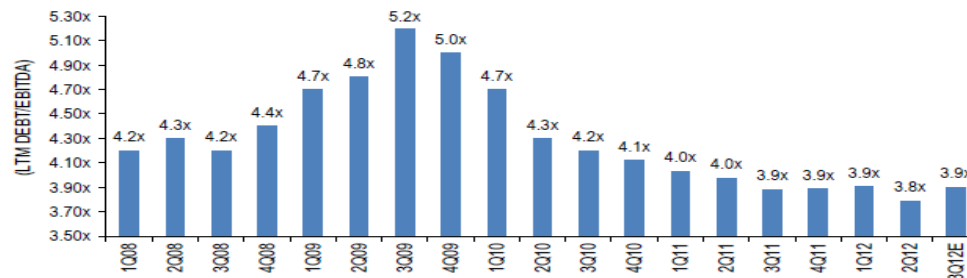
Refinancing wave has extended maturities, while record low interest costs have driven HY leverage to near record lows

High-yield bond and institutional loan maturities



Note: As of Oct 12th, 2012.
Sources: J.P. Morgan; Markit.

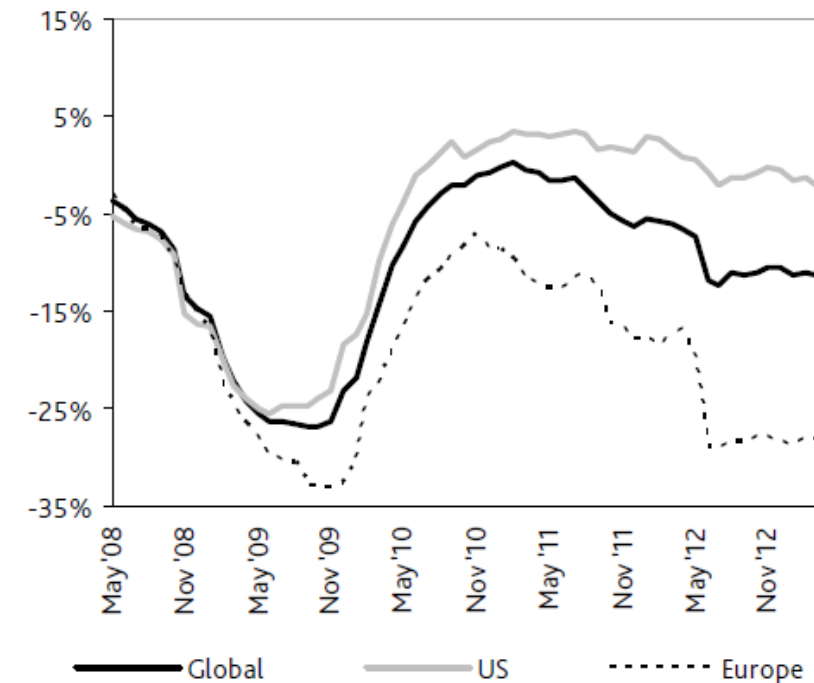
Despite weak GDP growth, leverage remains near its trough



Sources: J.P. Morgan; Capital IQ.

Liquid balance sheets, record profit margins, no near term maturities drives significant ratings improvement since 2008

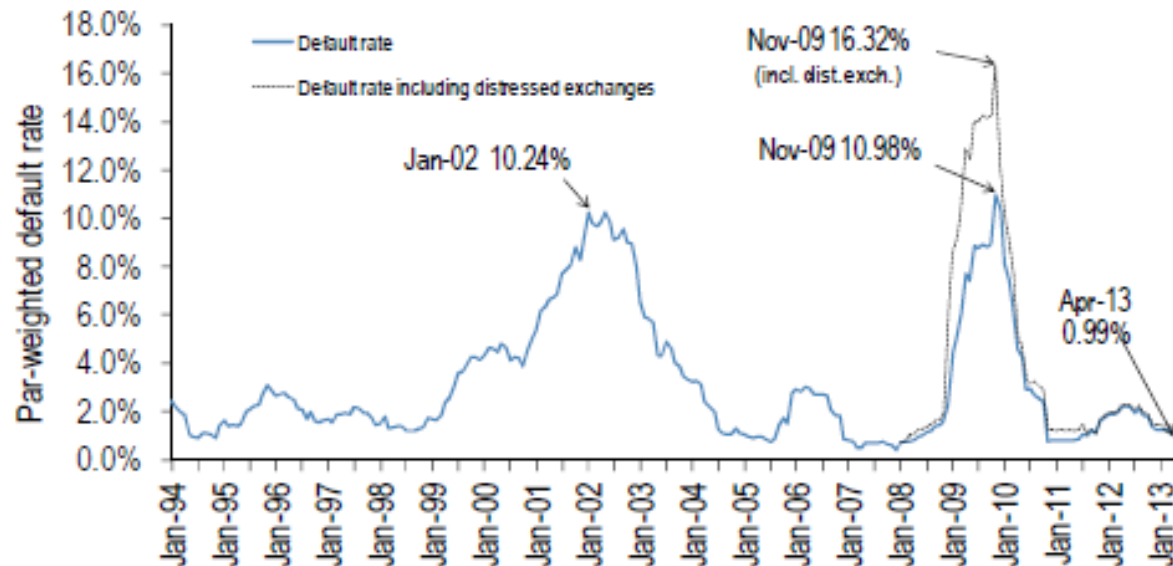
Exhibit 42: Trailing Twelve Month Rating Drift*



* Rating drift = (issuer upgrades - issuer downgrades) / rated issuers

Default rate at near record low and trending sideways

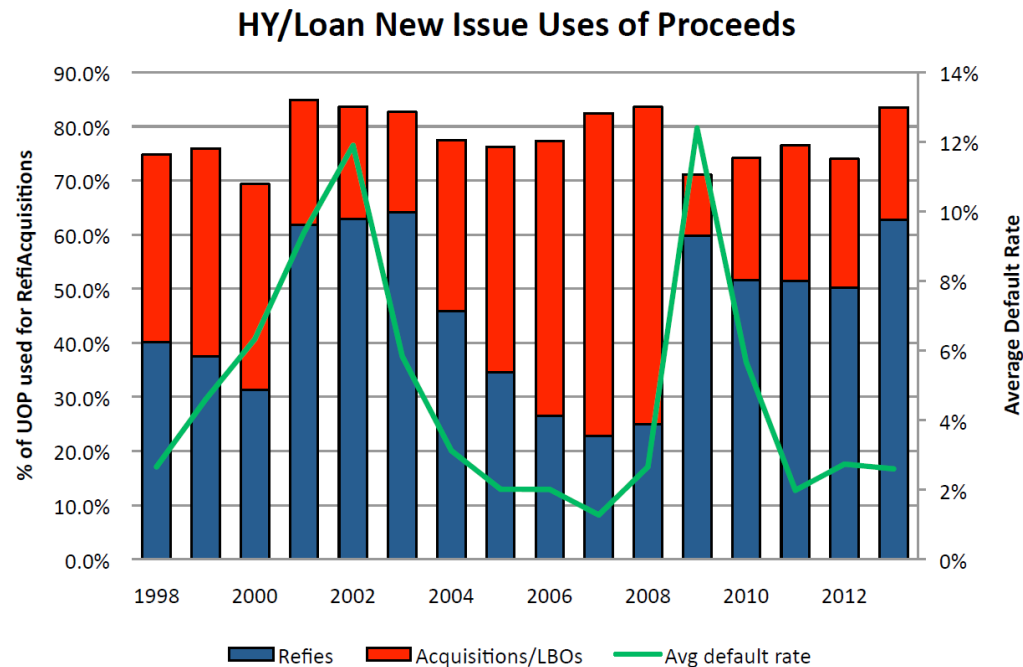
LTM default rate
based on par amount



Source: JP Morgan as of 4/30/2013

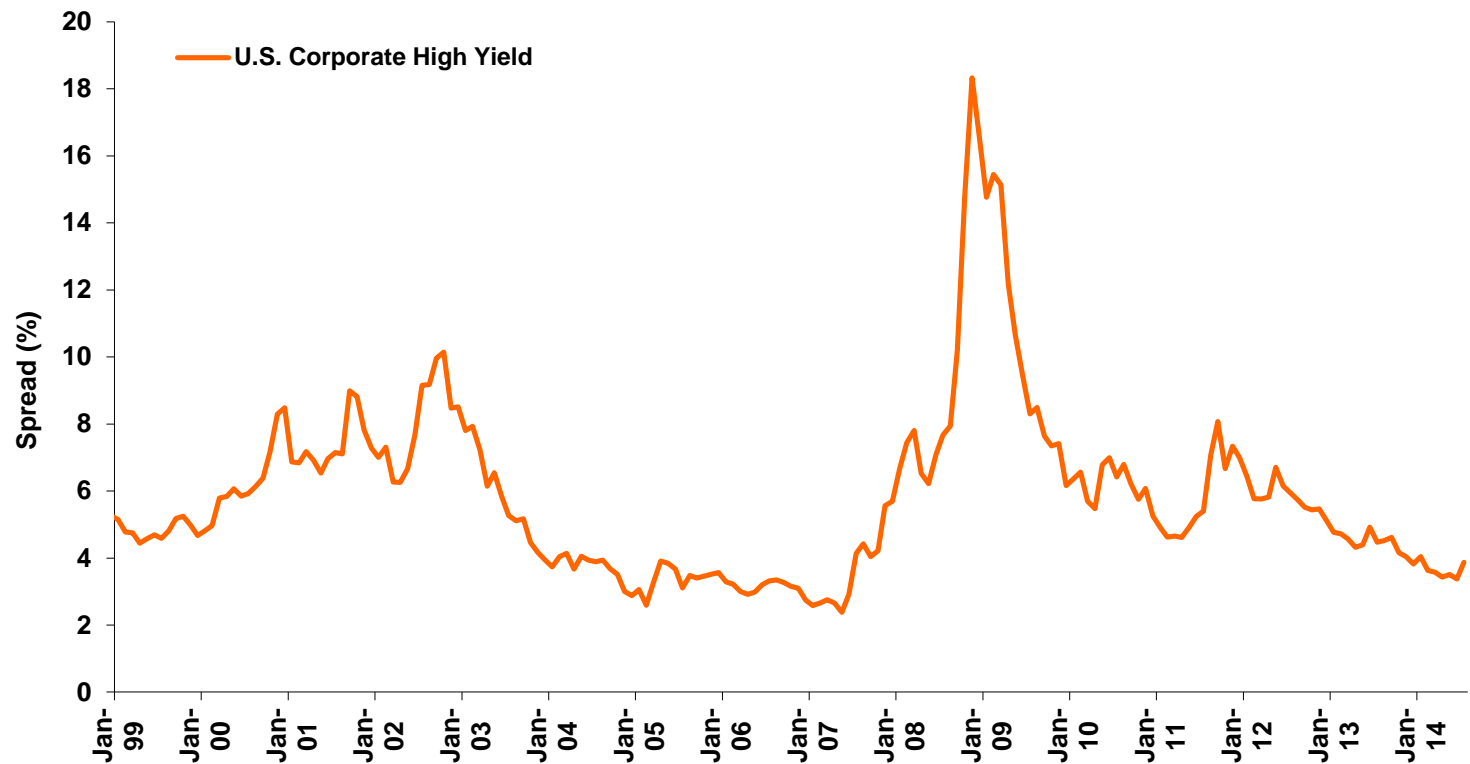
Majority of new issuance devoted to refinancing existing issues

No sign of significant LBO activity that typically presages a rise in future debt



Source: BofA Merrill as of 12/31/2013, most recent data available.

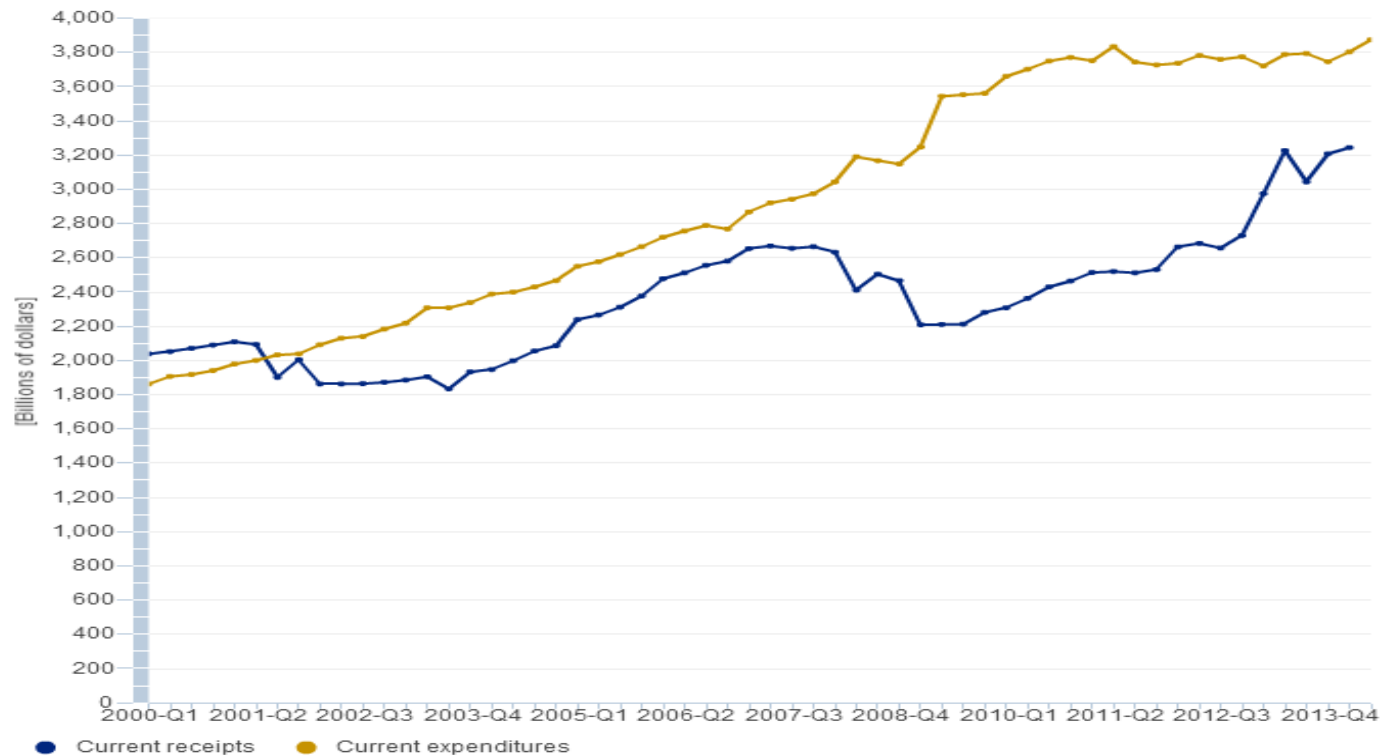
High Yield: 9th inning for capital appreciation, still the 5th inning for the credit cycle



Deficit spending is unsustainable

Table 3.2. Federal Government Current Receipts and Expenditures

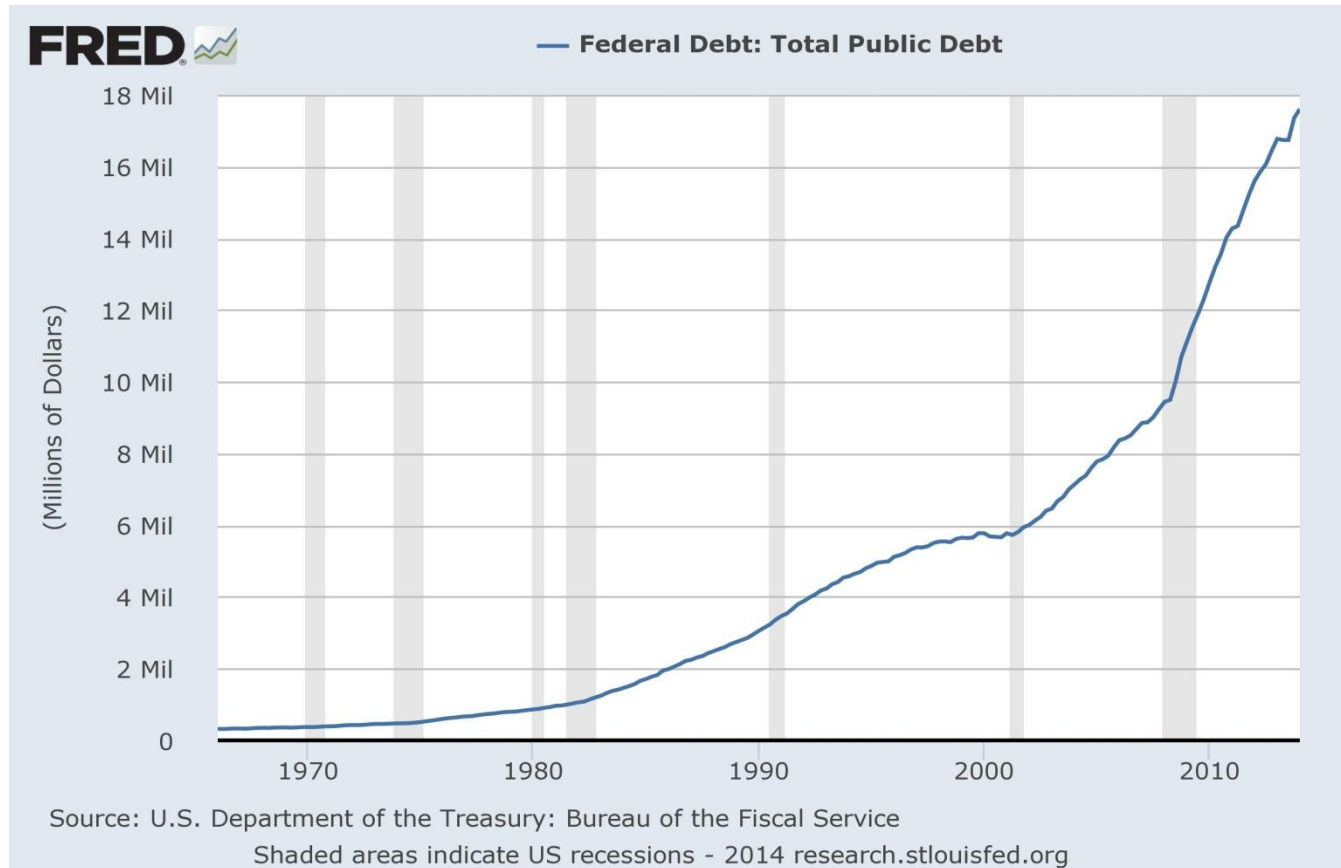
Last Revised on: July 30, 2014 - Next Release Date August 28, 2014



Source: U.S. Bureau of Economic Analysis

Source: U.S. Bureau of Economic Analysis as of 6/30/2014

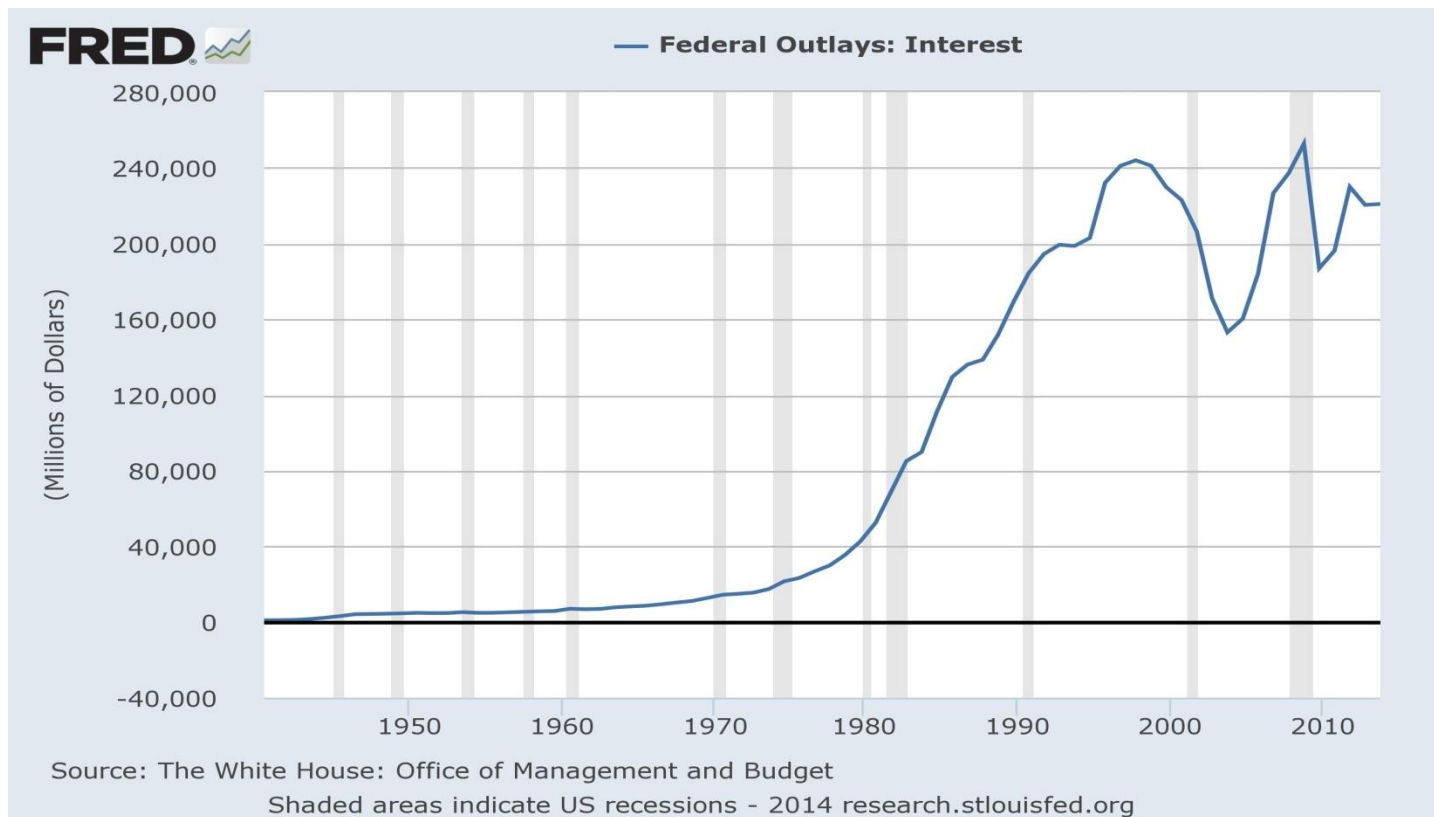
Debt is climbing exponentially...



Source: Federal Reserve Bank of St. Louis as of 7/31/2014

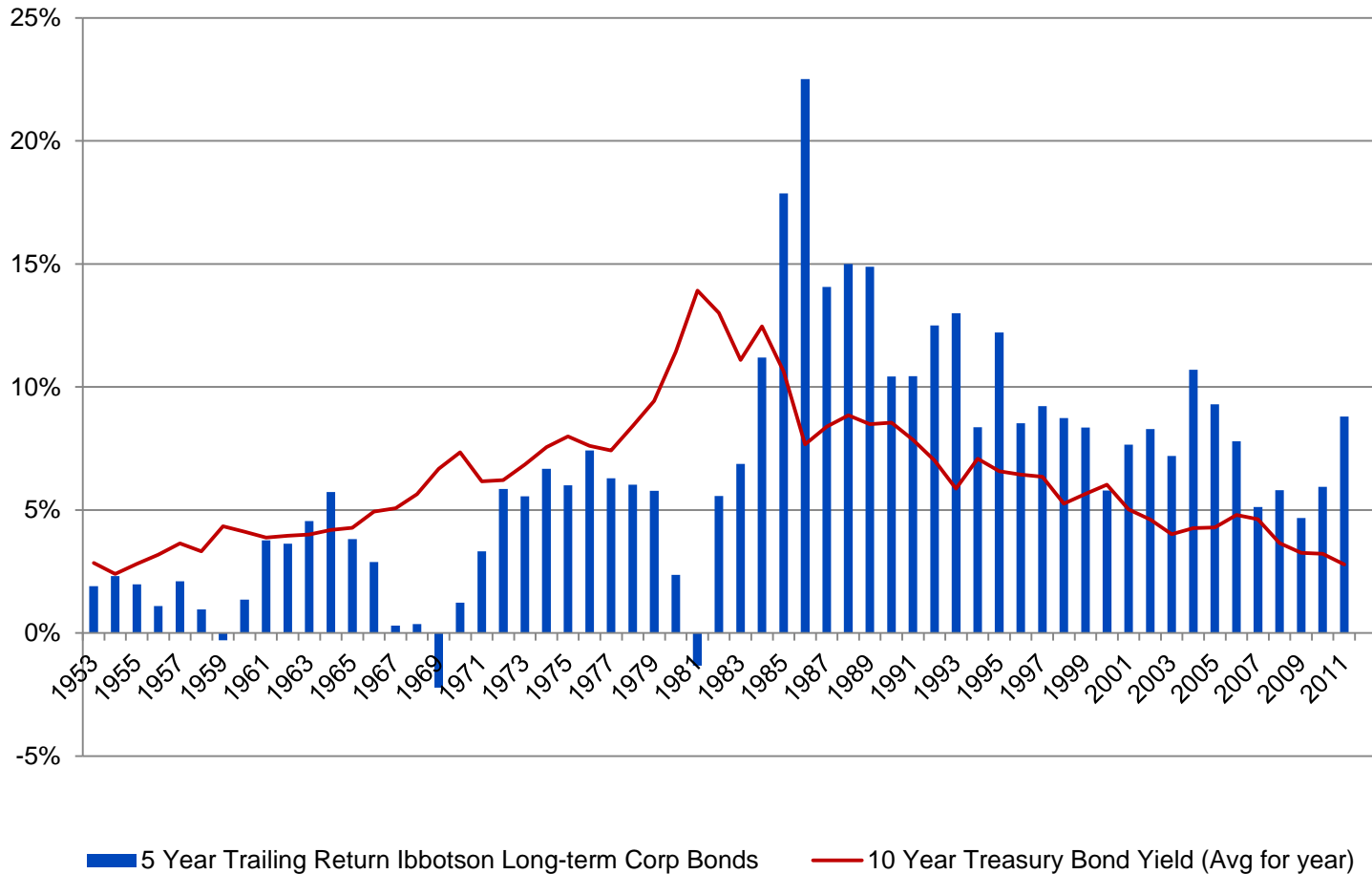
Debt manageable at average rate of 2.2%

What happens as debt increases, rates rise, and fed stops buying?



Source: Federal Reserve Bank of St. Louis as of 7/31/2014

Back to the future?



Benchmark Definitions



Barclays ABS TR USD	The Barclays Asset-Backed Securities (ABS) Index measures the performance of asset-backed securities including pass-through, bullet, and controlled amortization structures, and includes only the senior class of each ABS issue and the ERISA-eligible B and C tranche. The index has three subsectors: credit and charge cards; autos; and utility.
Barclays Gbl Agg Ex USD TR USD	The Barclays Capital Global Aggregate ex-USD Index provides a broad-based measure of global investment grade fixed-rate debt markets, excluding U.S. dollar-denominated securities.
Barclays Long US Corp TR USD	The Barclays Capital Long U.S. Corporate Index is composed of U.S. dollar-denominated, investment grade, SEC-registered corporate bonds issued by industrial, utility, and financial companies. All bonds in the index have at least 10 years to maturity.
Barclays Municipal TR USD	The Barclays Capital Municipal Bond Index measures the total return performance of the long-term, investment grade tax-exempt bond market.
Barclays Treasury TR USD	The Barclays Capital U.S. Treasury Index measures the performance of U.S. Treasury bonds and notes that have at least one year to maturity.
Barclays US Agg Bond TR USD	The Barclays Capital U.S. Aggregate Index is a broad composite of more than 8,000 securities that tracks the investment grade domestic bond market.
Barclays US Corp IG TR USD	The Barclays Capital U.S. Corporate Investment Grade Index is composed of U.S. dollar-denominated, investment grade, SEC-registered corporate bonds issued by industrial, utility, and financial companies. All bonds in the index have at least one year to maturity.
Barclays US Govt/Credit 1-3 Yr TR USD	The Barclays Capital 1–3 Year U.S. Government/Credit Index is a market value-weighted index of government fixed-rate debt securities and investment grade U.S. and foreign fixed-rate debt securities with average maturities of one to three years.
Barclays US MBS TR USD	The Barclays U.S. Mortgage-Backed Securities (MBS) Index measures the performance of agency mortgage-backed pass-through securities (both fixed-rate and hybrid adjustable-rate mortgage) issued by the Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Association (Freddie Mac), and Government National Mortgage Association (Ginnie Mae).
Barclays US Treasury US TIPS TR USD	The Barclays Capital U.S. TIPS Index measures the total return performance of the market for inflation-protected securities issued by the U.S. Treasury.
BofAML US HY Master II Constnd TR USD	The BofA Merrill Lynch U.S. High Yield Constrained Index, formerly the Merrill Lynch U.S. High Yield Master II Constrained Index, tracks the performance of U.S. dollar-denominated high yield corporate debt publicly issued in the U.S. domestic market, but caps individual issuer exposure at 2% of the benchmark.
BofAML USD LIBOR 3 Mon CM	The BofA Merrill Lynch U.S. Dollar 3-Month LIBOR Constant Maturity Index represents the London interbank offered rate (LIBOR) with a constant 3-month average maturity. LIBOR, published by the British Bankers' Association, is a composite of the rates of interest at which banks borrow from one another in the London market, and it is a widely used benchmark for short-term interest rates.
Citi WGBI NonUSD USD	The Citigroup Non-U.S. World Government Bond Index is a market capitalization-weighted benchmark that tracks the performance of 22 world government bond markets.
JPM EMBI Global Diversified TR USD	The J.P. Morgan EMBI Global Diversified Index tracks total returns for U.S. dollar-denominated debt instruments issued by emerging market sovereign entities including Brady bonds, Eurobonds, and quasi-sovereign entities, while limiting exposure to any one country.
S&P 500 Index	The S&P 500 is a market-cap weighted index that includes 500 large-cap stocks, which together represent about 75% of the total U.S. equities market. To be eligible for addition to the S&P 500, companies must have a market capitalization of at least US\$ 4 billion.

IMPORTANT RISK CONSIDERATIONS

Investing involves risk, including the possible loss of principal. Fixed income securities and bond funds can lose value, and investors can lose principal, as interest rates rise. They also may be affected by economic conditions that hinder an issuer's ability to make interest and principal payments on its debt. A Fund may also be subject to prepayment risk, the risk that the principal of a fixed income security that is held by the Fund may be prepaid prior to maturity, potentially forcing the Fund to reinvest that money at a lower interest rate. High yielding, noninvestment grade bonds (junk bonds) involve higher risk than investment grade bonds. The high yield secondary market is particularly susceptible to liquidity problems when institutional investors, such as mutual funds and certain other financial institutions, temporarily stop buying bonds for regulatory, financial, or other reasons. In addition, a less liquid secondary market makes it more difficult for a Fund to obtain precise valuations of the high yield securities in its portfolio. International investments entail risks not ordinarily associated with U.S. investments including fluctuation in currency values, differences in accounting principles, or economic or political instability in other nations. Investing in emerging markets can be riskier than investing in established foreign markets due to increased volatility and lower trading volume. Diversification may not protect against market risk.

Charts shown throughout are for comparison purposes only. Source data are the most recent available data.

Carefully consider the Fund's investment objectives, risk factors, charges, and expenses before investing. This and other information can be found in the Fund's prospectus and, if available, its summary prospectus, which may be obtained by visiting delawareinvestments.com or calling (877)693-3546. Investors should read the prospectus and, if available, the summary prospectus carefully before investing.

Credit Ratings Definitions:

Standard & Poor's: AAA - Highest rating; extremely strong capacity to pay principal and interest. AA - High quality; very strong capacity to pay principal and interest. A - Strong capacity to pay principal and interest; somewhat more susceptible to the adverse effects of changing circumstances and economic conditions. BBB - Adequate capacity to pay principal and interest; normally exhibit adequate protection parameters, but adverse economic conditions or changing circumstances more likely to lead to weakened capacity to pay principal and interest than for higher-rated bonds. BB, B, CCC, CC - Predominantly speculative with respect to the issuer's capacity to meet required interest and principal payments. BB - lowest degree of speculation; CC - the highest degree of speculation. Quality and protective characteristics outweighed by large uncertainties or major risk exposure to adverse conditions. D - In default.

The views expressed represent the manager's assessment of the market environment as of the date of this presentation, and should not be considered a recommendation to buy, hold or sell any security, and should not be relied on as research or investment advice.

Delaware Investments, a member of Macquarie Group, refers to Delaware Management Holdings, Inc. and its subsidiaries. Macquarie Group refers to Macquarie Group Limited and its subsidiaries and affiliates worldwide.

Delaware Investments is not an authorized deposit taking institution for the purposes of the Banking Act 1959 (Commonwealth of Australia) and Delaware Investments' obligations do not represent deposits or other liabilities of Macquarie Bank Limited ABN 46 008 583 542 (MBL). MBL does not guarantee or otherwise provide assurance in respect of the obligations of Delaware Investments.