MAY 2016 TIMELY THINKING

The timeless (and timely) case for high-yield bonds

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SUMMARY

- High-yield bonds occupy a special capital market niche: They have offered better risk-adjusted returns than equities and lower interest-rate sensitivity than the broad fixed-income market.
- High-yield bonds have been less vulnerable to the adverse effects of rising rates than other fixed-income sectors and have provided positive total returns in rising rate markets.
- Adding high-yield bonds to a broad fixed-income allocation has improved portfolio efficiency.
- Recent problems in the energy sector sparked a broad sell-off of high yield, resulting in value opportunities for investors with the expertise and diligence to select quality issuers.

Exhibit A **High-yield bonds have had equity-like returns with lower risk.**

10 years ended March 31, 2016.	Return	Standard Deviation	Sharpe Ratio
BofA/Merrill Lynch US High-Yield Master II Index	6.9%	10.6%	0.54
S&P 500 Index	7.0%	15.3%	0.28

Source: Morningstar, Inc., as of January 31, 2016. Data provided are for informational use only. Past performance is no guarantee of future results. See end of report for important additional information. Standard deviation measures historic volatility. The Sharpe Ratio uses standard deviation and excess return to determine reward per unit of risk.

Why allocate to high-yield bonds?

High-yield bonds occupy a special capital market niche. As obligations of companies with below-investment-grade credit ratings, they offer higher yields to compensate investors for accepting additional credit risk. Generally, the lower the bond rating, the higher the yield.

High-yield bonds have offered better risk-adjusted returns than equities and lower interest-rate sensitivity than the broad fixed-income market. Consider:

Better risk-adjusted returns than stocks

Over the past decade, high-yield bonds have produced essentially the same total return as stocks, with about two-thirds of the volatility, resulting in a higher Sharpe Ratio (Exhibit A).

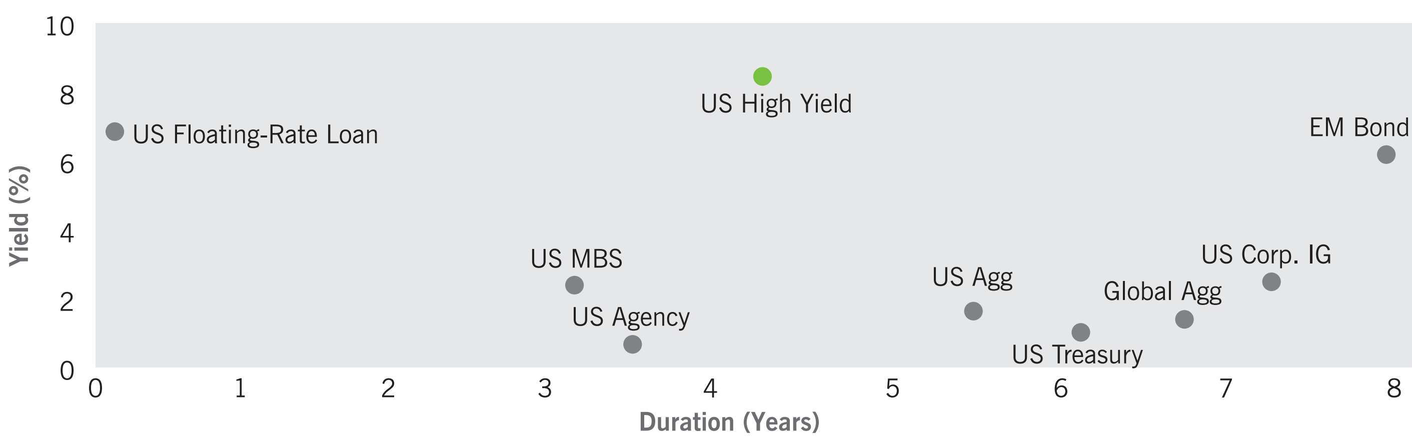
Lower interest-rate sensitivity than bonds

The high income stream from high-yield bonds helps lower their duration compared with broad investment-grade indices like the Barclays U.S. Aggregate Index and other fixed-income sectors. High-yield bonds have the highest yield per unit of duration of all sectors (except floating-rate loans, which yield less) (Exhibit B).

Positive performance in rising rate markets

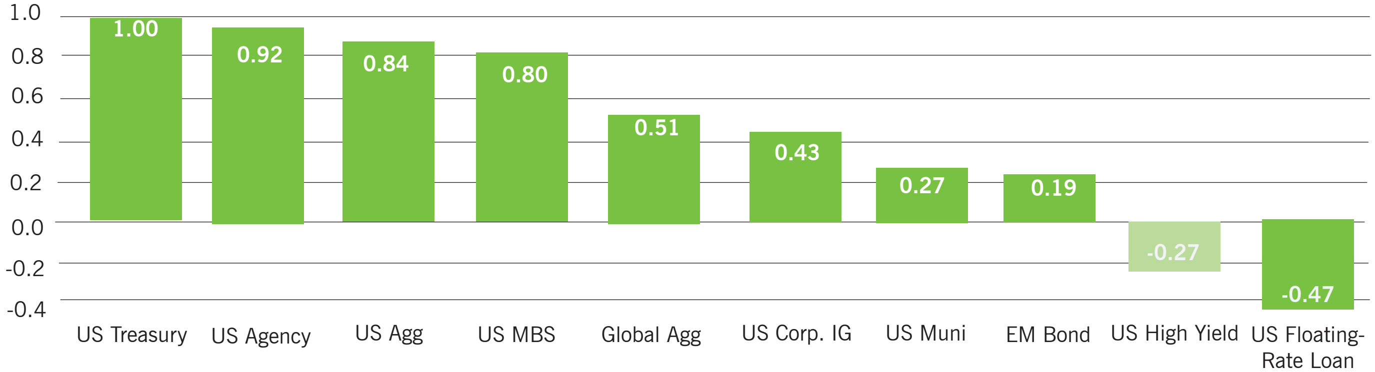
Rising rates are often an indicator of a strengthening economy. Because high-yield bonds are proxies for the credit strength of lower-rated companies, bond prices often move in tandem with equities. For example, over the 20 years ended March 31, 2016, during periods when 5-year U.S. Treasury yields gained 70 basis points (bps) or more in three months, high-yield bonds have averaged a gain of 2.5%, compared

Exhibit B **High-yield bonds offer a lot of yield per unit of duration.**



Source: Morningstar, Inc. as of March 31, 2016. Data provided are for informational use only. Past performance is no guarantee of future results. See end of report for important additional information. U.S. Agency represented by Barclays U.S. Agency Index. U.S. Treasury represented by Barclays U.S. Treasury Index. U.S. MBS represented by Barclays U.S. Mortgage Backed Securities (MBS) Index. U.S. Corp. IG represented by Barclays U.S. Corporate Investment Grade Index. U.S. Floating-Rate Loan represented by S&P/LSTA Leveraged Loan Index. EM Bond represented by JPMorgan Emerging Markets Bond Index Plus (EMBI+). U.S. High Yield represented by Barclays U.S. Corporate High-Yield Index. U.S. Agg refers to the Barclays U.S. Aggregate Bond Index. Global Agg refers to the Barclays Global Aggregate Bond Index.

Exhibit C **High-yield bonds have had low correlation with other fixed-income sectors.**
10 years ended March 31, 2016.



Source: Morningstar, Inc. as of January 31, 2016. Data provided are for informational use only. Past performance is no guarantee of future results. See end of report for important additional information. U.S. Agency represented by Barclays U.S. Agency Index. U.S. MBS represented by Barclays U.S. Mortgage Backed Securities (MBS) Index. U.S. Corp. IG represented by Barclays U.S. Corporate Investment Grade Index. Floating-Rate Loan represented by S&P/LSTA Leveraged Loan Index. EM Bond represented by JPMorgan Emerging Markets Bond Index Plus (EMBI+). U.S. High Yield represented by Barclays U.S. Corporate High-Yield Index. U.S. Agg refers to the Barclays U.S. Aggregate Bond Index. Global Agg refers to the Barclays Global Aggregate Bond Index.

with a 3.0% return for the S&P 500 and a loss of 1.4% for investment-grade bonds, according to JPMorgan.

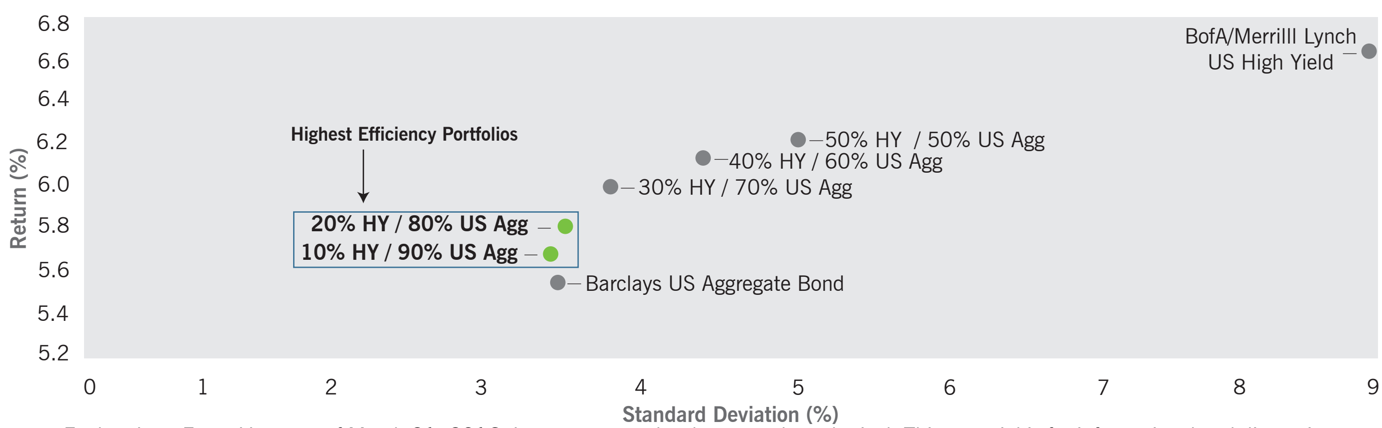
Even during the weak part of economic cycles, a diversified portfolio of high-yield bonds, like the JPMorgan Domestic High-Yield Index, has shown resilience. Over the past 35 years, the JPMorgan Index has had just five years with negative total returns, compared with seven for the S&P 500.[1]

Improving fixed-income portfolio efficiency

The unique attributes of high-yield bonds have resulted in performance with negative correlation with other fixed-income asset classes. For example, Exhibit C shows that the Barclays U.S. High-Yield Index has had a -0.27 correlation with U.S. Treasurys; only the lower-yielding floating-rate loan sector had lower correlation.

Exhibit D shows how over the past five years, adding 10% or 20% high yield to a U.S. Agg portfolio would have increased efficiency with improved performance and reduced volatility.

Exhibit D **Combining high yield with the Global Agg would have improved portfolio efficiency.**
10 years ended March 31, 2016.



Sources: Zephyr, Inc., Eaton Vance as of March 31, 2016. Investment results shown are hypothetical. This material is for informational and discussion purposes only. Information is meant to be generic in nature and does not reflect the actual or implied experience of any Eaton Vance-managed product. Certain of the assumptions have been made for modeling purposes and are unlikely to be realized. Actual performance results will differ, and may differ substantially, from the hypothetical performance presented above. See index definitions at end of report for information on the BofA/Merrill Lynch U.S. High-Yield Master II Index and the Barclays U.S. Aggregate Bond Index. Past performance is no guarantee of future results. It is not possible to invest directly in an index. Data are provided for informational purposes only.

[1]Past performance is no guarantee of future results. See end of report for important additional information, including index definitions.

Opportunities in today's market

Concerns over sluggish global growth and depressed prices in the energy sector sparked a sell-off in the high-yield sector in 2015 that has carried over into early 2016. As is often the case when broad market sentiment reaches a negative extreme, even bond prices of issuers with strong fundamentals have been driven below what we consider to be fair value, with a corresponding widening of spreads relative to U.S. Treasurys. As of March 31, 2016, the spread on the Barclays U.S. High-Yield Index was 656 bps – 112 bps above its 10-year median. The yield to maturity was 8.2%.

Exhibit E shows that among major fixed-income sectors high-yield valuation on March 31, 2016 was the "cheapest," based on median spread levels, relative to its history and other bond sectors.

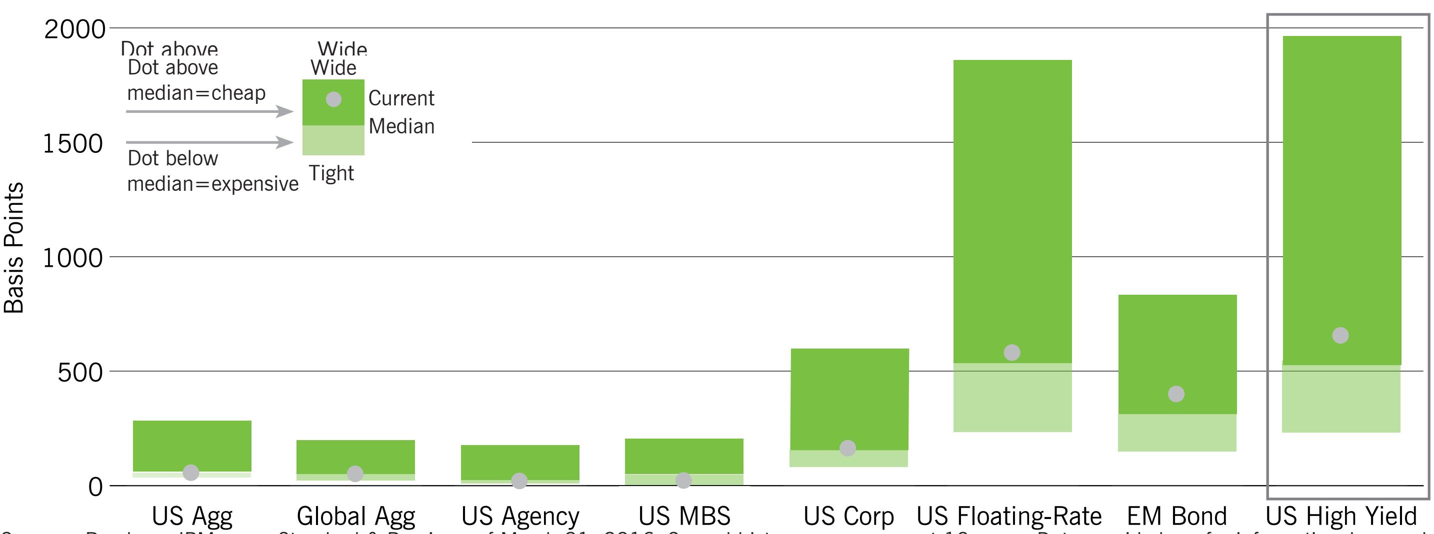
High yield has a history of strong rebounds

The history of high-yield bonds has taught us that patience is often rewarded. Exhibit F shows 31 instances since 1988 (when high-yield spreads were first tracked) through March 31, 2016 in which spreads were about as wide as they were on that date (plus or minus 50 bps)[2]. Annualized total returns for the three subsequent years ranged from 5.7% to 19.4%, with a median of 11.7%.

With high-yield defaults averaging about 2% over past 10 years and recovery rates of about 40%, exposure to credit loss would be about 120 bps per year on average. That leaves a considerable total return cushion if the default rate rises in the coming year – something we expect, given that 15% of the asset class is exposed to the energy, metals and mining sectors.

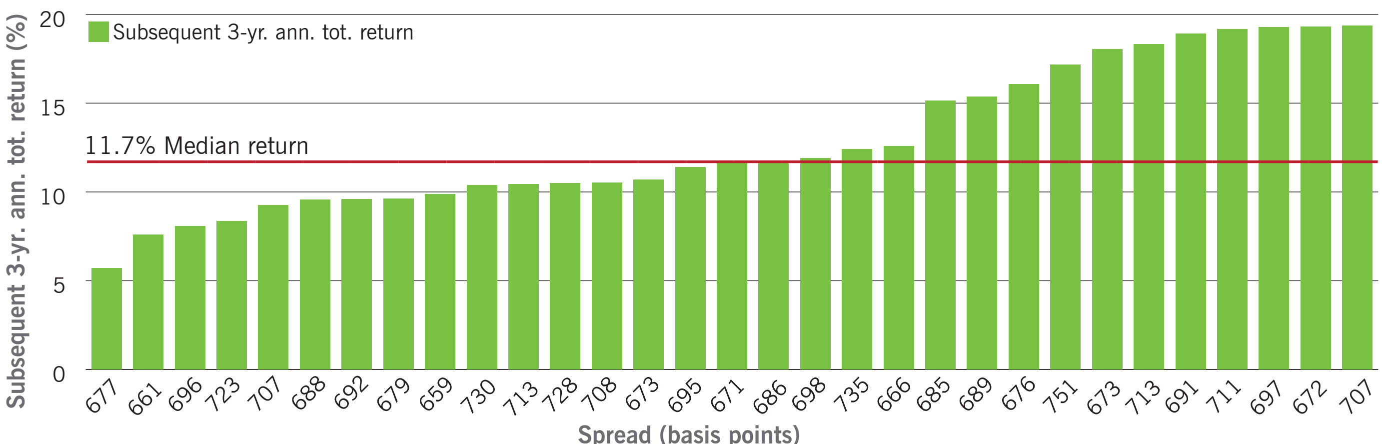
Worries about the energy sector and credit quality that have helped drive the high-yield sell-off are legitimate concerns. However, the market is already discounting default rates that are several times the current level.

Exhibit E **High yield appears cheap relative to its history and other bond sectors.**
10 years ended March 31, 2016.



Sources: Barclays, JPMorgan, Standard & Poor's as of March 31, 2016. Spread history measures past 10 years. Data provided are for informational use only. Past performance is no guarantee of future results. See end of report for important additional information. All spreads are in basis points and measure option-adjusted yield spread relative to comparable maturity US Treasurys with the exception of floating-rate loans, which is the average discounted spread over Libor. U.S. Agency represented by Barclays U.S. Agency Index. U.S. MBS represented by Barclays U.S. Mortgage Backed Securities (MBS) Index. U.S. Corp. IG represented by Barclays U.S. Corporate Investment Grade Index. U.S. Floating-Rate represented by S&P/LSTA Leveraged Loan Index. EM Bond represented by JPMorgan Emerging Markets Bond Index Plus (EMBI+). U.S. High Yield represented by Barclays US Corporate High-Yield Index. U.S. Agg refers to the Barclays U.S. Aggregate Bond Index. Global Agg refers to the Barclays Global Aggregate Bond Index.

Exhibit F **When high-yield bonds have gotten this "cheap," investors have been rewarded.**
Since 1988, there have been 31 times when the HY spread was +/– 50 bps of the 705-bps spread on March 31, 2016.



Sources: Morningstar, BofA/Merrill Lynch as of March 31, 2016, based on monthly data. Data are provided for informational use only. Returns are based on the BofA/ Merrill Lynch High-Yield Master II Index. Past performance is no guarantee of future results. See end of report for important additional information.

Eaton Vance's approach to high yield

The recent sell-off in high-yield bond underscores the need for professional expertise and due diligence across the entire credit cycle – the key to maximizing potential return in the sector, while seeking to minimize volatility.

Eaton Vance has a 32-year track record of managing high-yield investments and seeking solid risk-adjusted returns.

The Eaton Vance approach is founded on:

- Continuity and consistency as hallmarks of our leadership and investment process.
- Capitalizing on inefficiencies in the high-yield bond market through rigorous fundamental credit research and market factor analysis.
- Attention to risk-adjusted metrics and the goal of maintaining strong risk-adjusted returns throughout market cycles.

Index Definitions

Barclays U.S. Aggregate Bond Index is an unmanaged index of U.S. investment-grade bonds, including corporate, government and mortgage-backed securities.

Barclays Global Aggregate Ex-USD Index is a broad-based measure of global investment-grade fixed-rate debt investments, excluding USD-denominated debt.

Barclays U.S. Corporate High-Yield Index measures USD-denominated, noninvestment-grade corporate securities.

Barclays U.S. Corporate Investment Grade Index is an unmanaged index that measures the performance of investment-grade corporate securities within the Barclays US Aggregate Bond Index.

Barclays U.S. Mortgage Backed Securities (MBS) Index measures agency mortgage-backed pass-through securities issued by GNMA, FNMA and FHLMC.

Barclays U.S. Agency Index measures agency securities issued by U.S. government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. government.

Barclays U.S. Treasury Index measures securities issued by the U.S. government.

S&P/LSTA Leveraged Loan Index is an unmanaged index of the institutional leveraged loan market.

S&P 500 Index is an unmanaged index of large-cap stocks commonly used as a measure of U.S. stock market performance.

JPMorgan Emerging Markets Bond Index Plus (EMBI+) is a market cap-weighted index that measures USD-denominated Brady Bonds, Eurobonds and traded loans issued by sovereign entities.

JPMorgan Domestic High-Yield Index is designed to mirror the investable universe of the U.S. dollar domestic high-yield corporate debt market.

BofA/Merrill Lynch High-Yield Master II Index measures USD-denominated, noninvestment-grade corporate securities.

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Unless otherwise stated, index returns do not reflect the effect of any applicable sales charges, commissions, expenses, taxes or leverage, as applicable. It is not possible to invest directly in an index. Historical performance of the index illustrates market trends and does not represent the past or future performance.

About Risk

An imbalance in supply and demand in the income market may result in valuation uncertainties and greater volatility, less liquidity, widening credit spreads and a lack of price transparency in the market. Investments in income securities may be affected by changes in the creditworthiness of the issuer and are subject to the risk of nonpayment 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 (typically referred to as "junk") are generally 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. Derivative instruments can be used to take both long and short positions, be highly volatile, result in economic leverage (which can magnify losses), and involve risks in addition to the risks of the underlying instrument on which the derivative is based, such as counterparty, correlation and liquidity risk. If a counterparty is unable to honor its commitments, it's value may decline and/or could experience delays in the return of collateral or other assets held by the counterparty.

About Eaton Vance

Eaton Vance is a leading global asset manager whose history dates to 1924. With offices in North America, Europe, Asia and Australia, Eaton Vance and its affiliates offer individuals and institutions a broad array of investment strategies and wealth management solutions. The Company's long record of providing exemplary service, timely innovation and attractive returns through a variety of market conditions has made Eaton Vance the investment manager of choice for many of today's most discerning investors. For more information about Eaton Vance, visit **eatonvance.com**.

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Before investing, investors should consider carefully the investment objectives, risks, charges and expenses of a mutual fund. This and other important information is contained in the prospectus and summary prospectus, which can be obtained from a financial advisor. Prospective investors should read the prospectus carefully before investing.

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