Government/Credit Managed Account

Quarterly Review

- After initially moving lower in April, the overall bond market recovered over the subsequent two months to close the second quarter with a total return. Investor sentiment was muted coming into the quarter, as a series of hotter-than-expected inflation reports in Q1 dampened expectations for the number of interest-rate cuts the US Federal Reserve (Fed) was likely to enact before year-end. Whereas at the start of the year the futures markets were indicating as many as six quarter-point reductions in 2024, by April speculation had mounted that the Fed may in fact need to delay its first cut until 2025. These concerns waned during May and June, however, as inflation pressures showed signs of abating and a series of weaker-than-expected data releases indicated that the economy may be cooling. Although the timing and extent of rate cuts remained in question, we believe these developments helped boost confidence that the Fed would loosen policy in the second half of the year. Bonds rebounded in response, allowing the major fixed-income indexes to finish the quarter in positive territory.
- The US Treasury market registered a slight gain in the second quarter, with the contribution from income outweighing the impact of a slight increase in yields. The two-year note moved from 4.59% to 4.71% over the course of the three-month period, while the 10-year climbed from 4.22% to 4.36%. Still, both finished well off of their late April highs of 5.04% and 4.70%, respectively. Treasurys remained in negative territory on a year-to-date basis through the end of June, with positive returns on the short end of the yield curve offsetting weakness in longer-term issues.
- The strategy remained overweight corporate bonds on a market value basis. Allocation effect was flat during the period but issue selection was positive.
- Duration continued to be managed in line with the benchmark but duration differences along the yield curve resulted in a marginal positive performance contribution during the period.

Outlook

- The Federal Reserve continued to hold the Fed Funds rate steady at 5.5% (upper) throughout the second quarter, and maintained a hawkish tone, referencing slower progress towards their inflation target of 2% and solid economic expansion. The May Summary of Economic Projections (SEP) reflected a forward shift in the cutting cycle by a full quarter when compared with the March SEP, going from 3 to 2 cuts in 2024 and from 3 to 4 cuts in 2025. We believe Supportive supply-side dynamics and higher immigration helped to keep the GDP and unemployment projections steady despite the surprising lower real GDP print for the first quarter. Current market pricing remains consistent with the "soft landing" narrative, and the appetite for credit risk remained robust, with spreads holding in during the quarter. The yield curve remained inverted (2's-10's have now been inverted for the longest period since the late 1970s), with higher yields on shorter maturity Treasurys relative to longer-dated notes and bonds. Yields on 10-Year Treasurys hit 4.70% before ending the quarter at 4.33%. We believe that growth and inflation are likely to slow in the coming months and the unemployment rate may edge up slightly in the future.

- We continue to hold the view that we are in the late expansion phase of the credit cycle. Corporate balance sheets have overall deteriorated, but from a very strong starting point. Profit margins are likely to continue to be pressured amid higher input costs including labor, tighter credit conditions, and a slowdown in top line growth in revenue. We believe a relatively healthy middle class consumer and resilient labor market should prevent the economy from entering into a more pronounced downturn in this cycle, but we do anticipate a slowdown from current levels rather than an acceleration in growth and inflation.

- We are concerned about the lagged effects of the significant monetary tightening, globally. We also remain concerned about potential exogenous shocks to growth, possibly emanating out of the ongoing conflict in the Middle East, as well as the potential disruption and volatility around US and global elections. We do not believe that current spreads - IG OAS proxied by the Bloomberg US Aggregate Corporate Index) at 94 bps and HY OAS (proxied by the Bloomberg US Corporate High Yield Index) at 314 bps (as of 6/30/24) – provide significant market compensation for the myriad of risks facing the economy and markets.

- Our government-only strategies primarily focus on US Treasury securities and seek to maintain a duration equivalent to the benchmark.

Important Disclosure

***Key Risks:** Credit Risk, Issuer Risk, Interest Rate Risk, Liquidity Risk, Prepayment Risk and Extension Risk.*

Past performance is no guarantee of future results.

There is no guarantee that the investment objective will be realized or that the strategy will generate positive or excess return.

Commodity, interest, and derivative trading involves substantial risk of loss.
Diversification does not ensure a profit or guarantee against a loss.
Any investment that has the possibility for profits also has the possibility of losses, including the loss of principal.

Market conditions are extremely fluid and change frequently.

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