Intermediate Duration Fixed Income Managed Account

Quarterly Review

- The global fixed-income market staged a modest recovery in the fourth quarter, recapturing some of the losses incurred over the previous nine months. Signs of cooling inflation, together with slightly more dovish commentary from US Federal Reserve (Fed) officials, increased optimism that the Fed may be nearing the end of its long series of interest rate hikes. Still, current policy remained restrictive: the Fed hiked rates by three-quarters of a percentage point in November and another half point in December, bringing the benchmark fed funds rate to a range of 4.25% - 4.50%.
- Optimism that the end of the hiking cycle is near contributed to a rally across the financial markets in October and November. However, risk appetites waned somewhat in December as it appeared investors began to anticipate a pronounced slowdown in economic growth in the year ahead.
- The strategy remained overweight corporate bonds on a market value basis which positively impacted performance as spreads compressed. However, negative issue selection offset most of the allocation benefit.
- Duration continues to be managed in line with the benchmark but duration differences along the yield curve resulted in a small negative performance contribution during the period.
- Sector allocation within Treasurys was a large contributor to outperformance. US Treasurys posted a modest gain in the quarter, with the benefit of income offsetting a small decline in prices. Short-term bonds underperformed, increasing the extent of the yield curve's inversion. (An inverted yield curve occurs when yields on short-term bonds are higher than those on longer-term debt.) The yield on the two-year note rose from 4.22% to 4.41% as its price fell, while the yield on the 10-year issue climbed from 3.83% to 3.88%. The market continued to experience high volatility, with sell-offs in early October and late December offset by a mid-quarter rally. Despite its positive showing in the fourth quarter, the Treasury market finished with its second consecutive year of negative returns – the first time this has happened since 1958-59.

Outlook

- The Federal Reserve continues to tighten monetary policy as inflation remains above the Fed's preferred range and the unemployment rate has not materially increased over the past three quarters. Market expectations for the terminal Fed Funds rate are hovering near 5% and our yield curve team is in line with this consensus. However, we believe the range of outcomes can be as low as 4.75% or as high as 5.5% depending on how the economy and inflation respond over the coming quarters. The shape of the yield curve remains inverted with higher yields on shorter maturities relative to longer-dated bonds. We anticipate the Fed could loosen monetary policy as early as the third quarter of 2023 to help restimulate economic activity.
- We believe we are in the late phase of the credit cycle. Government, corporate and consumer balance sheets entered this part of the cycle in a strong position, but have been showing strains from higher inflation, tightening credit conditions and greater economic uncertainty. We currently expect the economy to enter a brief and shallow recession in the near future. Demand destruction is expected as well as profit degradation and rising

unemployment. However, our view is the recession will be shallow and somewhat brief due largely to the strong starting position in corporate health. Risk premiums for corporate bonds have increased substantially over the past year in recognition of the potential for the increases in downgrades and defaults that accompany recessions.

- We continue to see the primary market risk as an over-tightening of monetary policy by the Fed which depresses aggregate economic demand. However, the market could be sensitive to any data which may suggest inflation will remain elevated and which could keep the Fed in a hawkish policy stance. Covid concerns have been elevated with the onset of winter and the recent outbreak in China which has impacted Chinese economic activity. Lastly, the Russia-Ukraine conflict continues to be a source of concern and has been contributing to market volatility and uncertainty.

- The strategy's corporate bond risk is currently at the low end of our risk budget, which we believe can provide room to increase risk as valuations and bid-ask spreads likely improve.

- For strategies that use securitized assets, we continue to favor non-agency spread products including commercial mortgage-backed securities and asset-backed securities.

- For strategies that use high yield, we continue to have exposure to the asset class with room to add in the event valuations materially improve.

Important Disclosure

Key Risks: Credit Risk, Issuer Risk, Interest Rate Risk, Liquidity Risk, Prepayment Risk and Extension Risk. Investing involves risk including possible loss of principal.

There is no guarantee that the investment objective will be realized or that the strategy will generate positive or excess return. Actual accounts have the potential for loss as well as profit.

Past performance is no guarantee of future results.

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.

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