



Intermediate Duration Fixed Income Managed Account

Quarterly Review

- The overall bond market produced a strong gain in the fourth quarter, moving its total return for 2023 firmly into positive territory. The final three months of the year helped to bring an easing of the fears that had weighed on the fixed-income market since early 2022, boosting investor sentiment. Inflation continued to experience a meaningful decline during the quarter, with the headline Consumer Price Index falling back to levels not seen since early 2021. This represented a major shift from the previous quarter, when bonds were largely under pressure from concerns that inflation would remain sticky and the US Federal Reserve (Fed) would be compelled to adopt a “higher for longer” approach with respect to interest rates. With inflation receding, the markets seemingly grew comfortable with the idea that the Fed was finished raising rates. In December, Fed Chairman Jerome Powell added fuel to the rally with comments suggesting that rate cuts could begin as early as the first half of 2024. The bond market took another leg higher in response, helping it recover all of the price decline that occurred in the first ten months of the year.
- The strategy remained overweight corporate bonds on a market value basis, which positively impacted performance via allocation effect as spreads contracted during the period. However, negative issue selection offset the allocation benefit.
- Duration continued to be managed in line with the benchmark but duration differences along the yield curve resulted in a negative performance contribution during the period.

Outlook

- The Federal Reserve elected to hold the fed funds rates steady at 5.25% throughout the fourth quarter, although forward guidance shifted from a hawkish to a dovish tone, as inflation surprised to the downside and softer economic data increased the odds of achieving the elusive “soft landing”. In our view, the shift in tone caused market sentiment to dramatically reverse course; yields fell sharply while spreads tightened. Yields on the 10-year Treasury peaked at just over 5% in late-October before falling over 110 bps to 3.88% by year-end. Market expectations for any additional hikes disappeared, while expectations for easing monetary policy rose and were pulled forward into early 2024. Current pricing reflects 150 bps of anticipated cuts in the next 12 months, equivalent to three additional hikes on top of what is reflected in the Fed’s Summary of Economic Projections. The yield curve steepened but remained inverted during the quarter, with higher yields on shorter maturity Treasuries relative to longer-dated notes and bonds.
- We continue to hold the view that we are in the late expansion phase of the credit cycle, with a significant probability of either a softer landing or more meaningful slowdown (i.e. downturn) sometime over the next 6-9 months. Corporate balance sheets have deteriorated, but from a very strong starting point; profit margins could continue to be pressured amid higher input costs, tighter credit conditions, and a slowdown in de-leveraging trends. We believe a relatively healthy middle class consumer and resilient labor market should prevent the economy from entering into a severe recession in this cycle.
- We remain concerned about the lagged effects of significant monetary tightening, globally. This has come through traditional monetary policy tightening, including some central bank asset sales and/or balance sheet run-off, and covers many developed and emerging economies across the globe. Notable exceptions include the



Bank of Japan, where policy remains very accommodative, and the Bank of China, where weakness in the Chinese property sector in particular remains a concern, in our view. We also remain concerned about potential exogenous shocks to growth, possibly emanating from the ongoing conflict in the Middle East.

- 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 if valuations and bid-ask spreads improve.
- For strategies that use securitized assets, we continue to favor non-agency spread products such as commercial mortgage-backed securities and asset-backed securities.
- For strategies that use high yield corporate bonds, 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.

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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