Core Fixed Income with Securitized Asset Fund Managed Account

MARKETING COMMUNICATION

Quarterly Review

- The strategy remained overweight corporate bonds on a market value basis. Allocation effects were negative as spreads widened slightly, but positive security selection drove an overall contribution to excess return.
- The strategy utilized a no-fee fund to provide exposure exposure to agency mortgages, asset-backed securities (ABS) and commerical mortgage-backed securities (CMBS). As a sector, agency mortgages contributed to performance during the quarter by way of positive issue selection. Exposure to ABS and CMBS had a negligible effect on performance over the period as negative security selection negatived positive allocation effects.
- Duration continued to be managed in line with the benchmark, the Bloomberg US Aggregate Index, and there was a flat duration effect during the period.

Outlook

- Fixed income markets delivered a solid positive total return as rates declined while the curve steepened on the back of two 25 bps Federal Reserve (Fed) cuts during the fourth quarter. Risk premiums, or credit spreads, drifted slightly higher but remained near historic tights. The Federal Reserve continues to grapple with their dual mandate as inflation remains elevated while labor market conditions have deteriorated. The lack of official data due to the extended government shutdown made policy decisions more challenging for the Federal Reserve and there was an increase in voting member dissents over the last two meetings. The Fed Funds Rate target now stands at 3.75%. Markets are currently pricing in only a 50% probability of another cut in the first quarter of 2026, although just over 2 more cuts are priced by year end, 2026. Spread sectors (primarily corporate bonds, mortgage-backed securities, asset-backed securities and commercial mortgage-backed securities) remained well supported with new supply easily absorbed.

- Corporate fundamentals remain at a healthy level by historical standards. Growth in the first quarter of 2026 may receive a boost through higher tax refunds and a reversal of the negative impacts from the shutdown. However, weak corporate pricing power and rising debt service costs suggest margin compression going forward. On the consumer front, we believe that moderating demand for labor, the continued decline in excess savings, and increasing impatience with higher prices are potential catalysts for weaker spending, which may be further exacerbated by higher prices for goods.

- We continue to believe that we are in the late expansion phase of the credit cycle, with growth slowing to below trend, while inflation - which is still above target, should moderate as the effects of tariffs dissipate. While we do not anticipate that the US will enter a recession, we continue to see elevated risk of a downturn scenario. We are concerned that slowing rates of hiring and reduced affordability may weigh more heavily on incomes and consumption. Additionally, the risk of additional Federal Government stimulus leading up to mid-term elections may also add to the growing fiscal burden. This concern has been evident in the still elevated level of term premium in the longer end of the yield curve. Market volatility may remain elevated due to ongoing geopolitical tensions and interventionism.

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