Government/Credit Managed Account

MARKETING COMMUNICATION

Quarterly Review

- The bond market delivered a solid total return with low volatility in the fourth quarter, closing out a generally positive year for the asset class. Fixed-income assets remained supported by a backdrop of slow but positive economic growth, an annualized inflation rate that largely held below 3%, and accommodative US Federal Reserve (Fed) policy. The Fed enacted two-quarter point interest rate cuts and announced the end of its multi-year effort to reduce the size of its balance sheet. Additionally, investors appeared to anticipate that the Fed was likely to continue easing in 2026. These developments, in combination, fueled positive returns across all major segments of the market.
- US Treasurys registered positive returns in the quarter, adding to their gain for the full calendar year. Government debt benefited from the environment of low inflation, accommodative US Federal Reserve policy, and expectations for further interest rate cuts in 2026. Yields on Treasury issues with maturities of five years and below declined, while longer-term yields rose. The yield curve steepened over the course of the quarter as a result. Two-year Treasurys were the quarter's top performing market segment in terms of total return, while 30-year bonds posted a small loss.
- The strategy remained overweight corporate bonds on a market value basis. Allocation effect was negative as spreads increased but issue selection was positive and overshadowed the negative allocation effect.
- Duration continued to be managed in line with the benchmark, Bloomberg US Government/Credit Index, but there was a small but negative 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.

- While the strategy's corporate bond exposure remains overweight on a market value basis, corporate risk relative to benchmark is currently underweight largely due to a higher quality bias and shorter maturities than the benchmark. We believe this allows the strategy room to increase risk if valuations improve and transaction costs are low.

- For strategies that utilize agency mortgages, the exposure to the asset class is currently underweight but within range of neutral.

Important Disclosure

Investing involves risk, including possible loss of principal. Fixed-income securities *may be susceptible to general movements in the bond market and are subject to credit and interest rate risks.* ***Credit risk*** *arises from an issuer's ability to make interest and principal payments when due, as well as the prices of bonds declining when an issuer's credit quality is expected to deteriorate.* ***Interest rate risk*** *occurs when interest rates rise causing bond prices to fall. The issuer of a debt security may be able to repay principal prior to the security's maturity, known as* ***prepayment (call) risk,*** *because of an improvement in its credit quality or falling interest rates. In this event, this principal may have to be reinvested in securities with lower interest rates than the original securities, reducing the potential for income.*

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. Diversification does not ensure a profit or guarantee against a loss. Commodity, interest and derivative trading involves substantial risk of loss.

Market conditions are extremely fluid and change frequently.

The Bloomberg U.S. Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries (i.e., public obligations of the U.S. Treasury that have remaining maturities of more than one year) and agencies (i.e., publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government). The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements. Indices are unmanaged and do not incur fees. It is not possible to invest directly in an index.

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