Short Government 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.
- Security selection detracted marginally while yield curve effects contributed over the quarter. The strategy is focused on US Treasury securities and did not hold benchmark[1] eligible US Agency securities during the period, which weighed on relative performance.

Outlook

- Our base case is that the macro environment has shifted into an "Expansion Resilient" scenario (where growth is likely to persist with a boost from fiscal programs, partially offset by tariff policy effects), with a constructive growth outlook for 2026 driven by strong corporate health and earnings, expected rate cuts, and supportive fiscal policy. The labor market looks to be cooling with supply softening and demand is showing early signs of weakening, but we do not anticipate a major wave of layoffs as long as profitability remains solid. Inflation has been more moderate than expected; while goods prices may see some temporary upward pressure from tariffs, we expected disinflation to resume once these effects pass through. The main risks to this would be stimulus via AI investment, and start-of-year price increases, both of which could be inflationary. Despite a generally strong backdrop, we have trimmed risk where appropriate, especially in areas sensitive to political, regulatory, or financial uncertainly. Our focus remains on companies that we believe can withstand a downturn while offering attractive risk-adjusted carry.
- As expected, in December the Fed cut the federal funds rate by 25 bps, lowering it from 4.00% to 3.75%, reflecting concerns about a softening labor market and slower economic momentum. We believe that the Fed will continue along a data-dependent path, balancing labor-market health, corporate conditions, and inflation dynamics. Under our "Expansion Resilient" scenario, we expect two additional cuts in 2026, June and July. Although labor and earnings data remains stable, uncertainty persists around U.S. debt demand, Fed leadership changes & independence, and tariff-driven inflation. We remain duration-neutral, and could grow constructive on longer yields should the yield curve continue to steepen.

[1]*Benchmark for the strategy is the Bloomberg U.S. Government 1-3 Year Index*

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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 1-3 Year includes securities in the Bloomberg U.S Government Index with a maturity from 1 up to (but not including) 3 years. 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). Indices are unmanaged and do not incur fees. It is not possible to invest directly in an index.

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