

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 positive as spreads tightened, but adverse security selection drove an overall detractor from excess return.
- The strategy utilized a no-fee fund to provide exposure to agency mortgages, agency-backed securities (ABS), and commercial mortgage-backed securities (CMBS). As a sector, agency mortgages contributed to performance during the quarter by way of positive issue selection and allocation effects. Exposure to ABS and CMBS also had a positive effect on performance over the period.
- Duration continued to be managed in line with the benchmark (the Bloomberg US Aggregate Bond Index) and there was a flat duration effect during the period.

Outlook

- Fixed income markets delivered positive total returns for the second quarter as rates reversed from the mid-May peak, despite a backdrop of a strong US economy and record quarterly equity market returns. US corporate earnings continued to impress (driven in large part by continued robust AI spend) and jobs growth exceeded expectations. Under this stronger economic backdrop, a sharp drop in Middle East tensions helped moderate rates and fueled risk markets. By end of quarter, global oil prices had fallen back to pre-war levels, as the US and Iran implemented a 60-day cease-fire. Credit spreads also narrowed and remain near historic tight, with demand for new issues remaining robust. As anticipated, the Federal Reserve (Fed) stayed on hold in Kevin Warsh's first meeting as new Fed Chair, but with a more hawkish press conference post FOMC (Federal Open Market Committee) and Statement of Economic Projections. The lack of forward guidance was also in focus, fulfilling one of Warsh's pre-nomination promises. Treasury yields initially rose across the board immediately following the Fed statement, before moderating in the following weeks as markets digested the Fed's new more hawkish stance. Fed Fund Futures markets are currently pricing in around 35 bps of rate hikes by year-end, a reversal of what was priced just three months prior, when investors had anticipated as many as one or more cuts by year-end 2026.
- Corporate fundamentals remain at a healthy level by historical standards, buoyed by the boom in AI-related capex. However, corporations may eventually seek to pass through higher input prices or shed labor to preserve margins. Consumer demand in aggregate has remained resilient, despite higher inflation, supported by stable job markets and wealth effects. The "K"-shaped economy continues to be the narrative, with higher income earners maintaining strong spending, but lower income earners feeling the pinch from higher food, energy and housing/rental costs.
- We continue to believe that we are in the late expansion phase of the credit cycle, and anticipate an eventual return to more trend-like growth and importantly, moderating inflation, as the effects of tariffs and disruptions to the supply of oil dissipate. Aggregate demand could continue to be resilient with recession risks remaining low, but remain a concern, especially in light of current risk market valuations. Key risks include a stock market correction and diminished wealth effect, a resumption in the conflict in Iran, continued tight oil supplies through summer and the fall, an increase to the fiscal burden, and potentially overly reactive monetary policy.



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

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