

Dynamic Core **Bond Strategy**

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Strategy overview

Total return approach, investing across full spectrum of the fixed income market including up to 20% in below investment grade securities.

Key takeaways

- Strong economic data continued to come through in the final quarter of 2024, which had the impact of driving spreads tighter while reversing the rate rally experienced in 3Q24.
- For the quarter, the Fund outperformed its benchmark, the Bloomberg US Aggregate Bond Index (the Index) on net asset value (NAV) basis. Sector allocation and security selection decisions contributed, while duration and yield curve positions had minimal impact.
- Overall, the macro backdrop should be favorable for credit sectors, however we continue to favor high-quality, shorter-dated assets given where valuations are.

Portfolio review

Strong economic data continued to come through in the final quarter of 2024, which had the impact of driving spreads tighter while reversing the rate rally experienced in 3Q24. The gross domestic product report for 3Q24 once again came in elevated (initially reporting at 2.8% and later revised to 3.1%) driven largely by strong consumer and government spending, which grew at 3.7% and 5.1%, respectively. Notably, consumer spending accounted for roughly 80% of the overall growth, highlighting its critical role in the economy.

Inflationary pressures remained a key concern. The Consumer Price Index (CPI) surprised to the upside in early October, and while subsequent data showed stability in both CPI and Personal Consumption Expenditures (PCE) inflation, both remained elevated. Core PCE, the U.S. Federal Reserve's preferred measure of inflation, finished the quarter at 2.8% year-over-year, slightly above where it was trending in the summer. Notably, core goods prices, which had experienced a deflationary trend for several months, began to reaccelerate.

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Labor market dynamics continued to show signs of softening without entering a state of deterioration. Job gains remained reasonable, and although the unemployment rate resumed its upward trajectory, it remained below the high watermark set earlier in the year. Meanwhile, wage growth remained strong, which helps explain both the resilience of consumer spending and the stickiness of services inflation.

While the Fed continued to deliver rate cuts at both the November and December meetings, the December cut was accompanied by more "hawkish" elements. Specifically, the Fed's Dot plot indicated only two cuts projected for 2025—down from four in the previous iteration. Additionally, officials moved their projection for both growth and inflation higher, while their projection for the unemployment rate moved lower and only slightly above the current level.

Overall, the fourth quarter of 2024 was characterized by resilient labor market dynamics, strong economic growth and sticky inflation. The impact on fixed income performance was mixed, with yields rising and credit spreads tightening, leading to modestly negative total returns for most fixed income sectors.

For the quarter, the Fund outperformed the Index on NAV basis. Sector allocation and security selection decisions contributed, while duration and yield curve positions had minimal impact. Our overweight to credit and underweight in Treasuries broadly contributed. Our overweight to asset-backed securities (ABS) was the largest individual contributor, as the sector continued to tighten in sympathy with other high quality spread sectors. Our overweight to commercial mortgage-backed securities (CMBS) was a close second, as fundamental factors improved, and the sector continued to benefit from an active primary market. Additionally, positive security selection results in CMBS were realized due to our bias towards higher yielding tranches. Security selection decisions with agency mortgage-backed securities (MBS) also contributed, due to our off-benchmark collateralized mortgage obligation (CMO) holdings which outperformed despite underperformance of Index constituents. Finally, due to our neutral duration position, the move higher in rates had limited impact on relative performance.

Current strategy and outlook

Looking forward, we continue to expect economic growth will remain resilient. The recent election outcome further strengthens this view due to election optimism and productivity gains from deregulation. Meanwhile, we expect inflation to resume its downward trend, driven by moderating service prices. In this area however, the election result lowers our conviction as an adverse policy mix of deficit spending, tariffs and stricter immigration limits would sustain higher levels of demand while

constraining supply. That said, we believe a negative market reaction would likely compel the administration to temper those policies before they derail growth.

Assuming this is the case, and inflation does not reaccelerate, we expect the Fed will tolerate inflation that is slightly above their target and deliver a few more rate cuts in an effort to preserve the current cycle.

Overall, this backdrop should be favorable for credit sectors, however we continue to favor high-quality, shorter-dated assets given where valuations are. Over the quarter we reduced our allocation to longer dated investment grade (IG) corporates and are now positioned with an underweight from a spread duration perspective. Similarly, we maintain only a modest allocation to high yield corporates, while high quality securitized makes up much of our active risk. If there is a misstep in policy implementation, we believe we are well positioned to capitalize on the short-lived market dislocation and will look to add market risk further out the curve.

Read our Fund Fact Sheet

The **Bloomberg U.S. Aggregate Bond Index** is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes treasuries, government-related and corporate securities, fixed-rate agency MBS, ABS and CMBS (agency and non-agency).

Index returns do not reflect fees, brokerage commissions, taxes or other expenses of investing. **Investors cannot invest directly in an index.**

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