Look beyond core bonds to unlock diversified sources of returns

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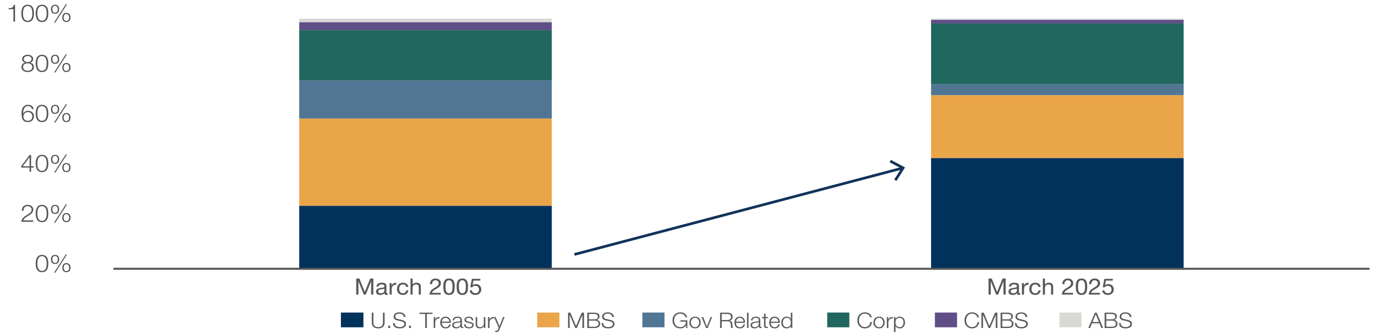
Core bonds have always been a staple in investment portfolios and will likely continue to play an important role in the future. Not only do they generate income, but they also serve as a buffer against equity volatility. Often, the term "core bonds" is synonymous with the Bloomberg Aggregate Bond Index ("Agg"), which is the most widely followed bond index.

The Evolution of the Bloomberg Aggregate Index

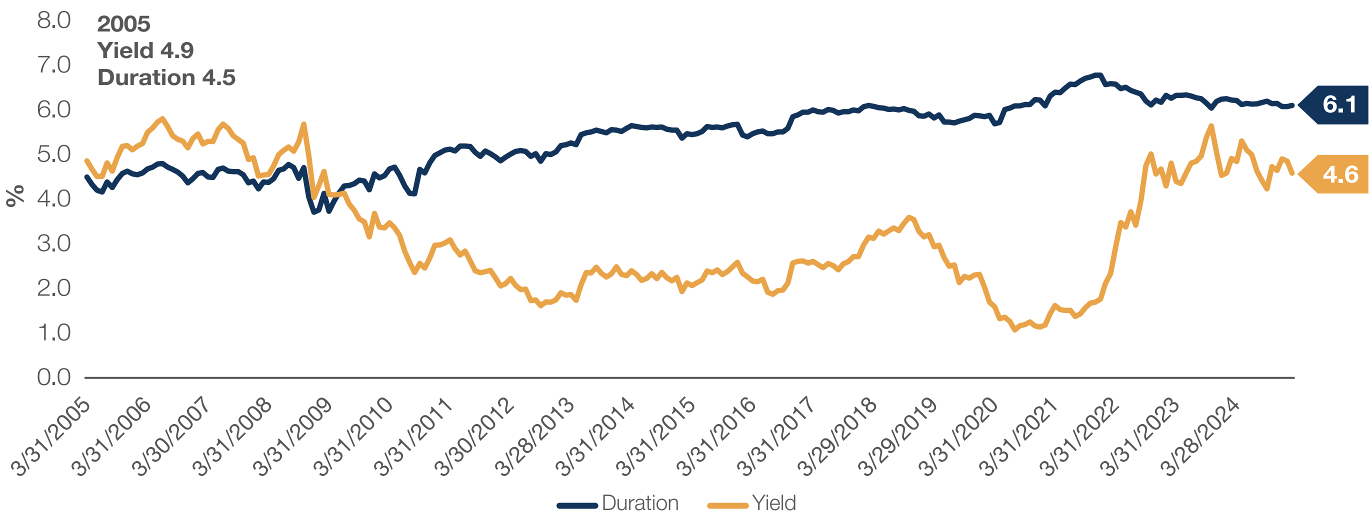
Due to the proliferation of government borrowing, U.S. Treasuries have nearly doubled from 25% of the Agg to 45% over the past 20 years. Investment-grade corporate bonds and agency mortgage-backed securities ("MBS") constitute most of the remaining Agg components with a combined weighting of approximately 50%. One byproduct of the evolution of the Agg is that it has become increasingly rate sensitive as reflected by its duration, which has lengthened from 4.5 years to 6.1 years over the past 20 years. A longer duration isn't problematic in and of itself, but it does suggest a higher volatility profile if and when rates move. For some investors, this creates a need to look beyond core bonds to manage that interest rate risk.

Chart 1: Treasuries now represent almost 50% of the Bloomberg Aggregate Bond Index



Source: Bloomberg as of 3/1/2025. ABS = Asset-Backed Securities; CMBS = Commercial Mortgage-Backed Securities; MBS = Mortgage-Backed Securities. Past performance is no guarantee of future results, which may vary. An investment cannot be made directly in an index.

Chart 2: Agg duration has lengthened while yield has declined



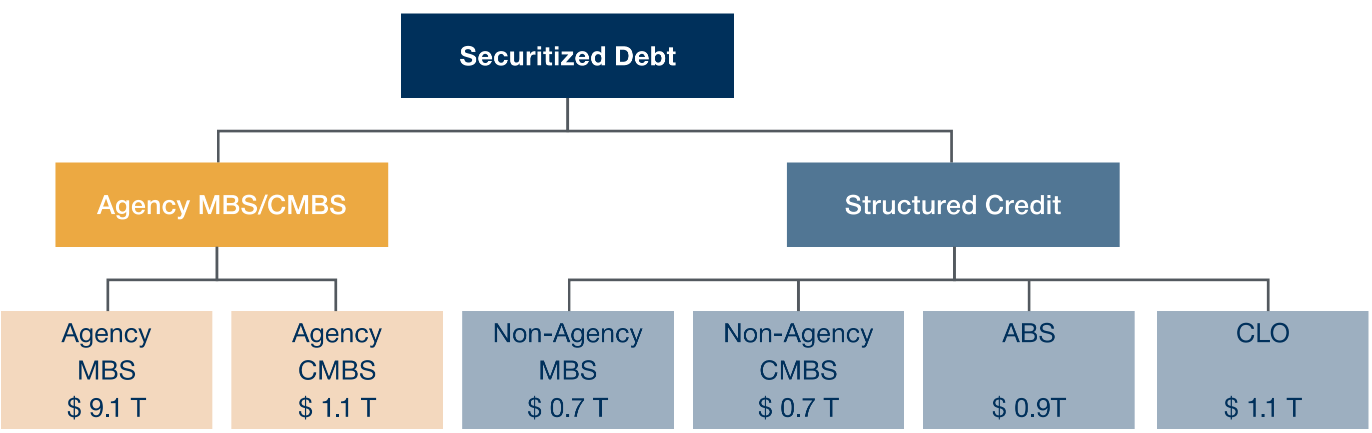
Source: FactSet 2/28/25. Yield represented by Agg Yield to Worst. Agg = Bloomberg Aggregate Bond Index. Past performance is no guarantee of future results, which may vary. An investment cannot be made directly in an index. Index definition below. Duration measures how long it takes, in years, for an investor to be repaid a bond's price through its total cash flows. Yield to worst is a measure of the lowest possible yield that can be received on a bond that fully operates within the terms of its contract without defaulting.

Looking beyond the index

From a yield perspective, Treasuries, while safer, offer limited income compared to other fixed-income sectors. Even marginal increases in credit exposure can significantly enhance yield, which can be critical for meeting long-term objectives. Index weights are based on how much debt an issuer has outstanding—that may not coincide with the desired allocations of investors. Therefore, investors may want to look beyond the Agg to generate income.

One such place is the securitized debt market, more specifically in structured credit. Securitized debt broadly consists of agency mortgages (both MBS and commercial mortgage-backed securities ("CMBS")) and structured credit. An important distinction between agency bonds and structured credit is that agency bonds have either implicit or external guarantees from the U.S. government, which means investors are not exposed to credit risk. While most agency MBS are constituents of the Agg, structured credit is a $3.5 trillion market with limited representation in the core bond index.

Chart 3: Structured credit is a small component of the Bloomberg Aggregate Index



Source: Bank of America 1/31/25.

For example, asset backed securities ("ABS") and CMBS only account for about 2% of the index. At almost one trillion dollars, there is considerable depth across ABS where auto loans, credit cards and student loans are common collateral types. Less common collateral types include fast-food franchises, movie and music royalties, loans for RVs and boats, solar panels, and cell phone towers. With a range of different collateral types, investors can diversify their economic exposure and revenue streams, which can ultimately help manage portfolio risk and potentially achieve better overall outcomes.

Within the CMBS market, there is a component called Single Asset, Single Borrower ("SASB") that is excluded from the Agg. A SASB CMBS is a loan on a specific property, or group of properties under the same loan. SASB CMBS span office, hotel, industrial, multifamily and retail sectors. This is another example of how a manager with deep credit research capabilities can use that expertise to seek attractive income and total return opportunities beyond what is available through a passive approach.

Importantly, securitized products possess substantial structural protections, and these markets have matured significantly in the past two decades. We believe investors can be well-compensated for credit exposure while still maintaining a prudent level of portfolio resilience.

Looking beyond securitized debt, some investment strategies known as "Core Plus" expand upon the core bond universe by including sectors such as high-yield bonds, leveraged loans, and emerging market debt. High-yield bonds, for example, are rated below investment grade, making them ineligible for inclusion in the Agg. Not only have high-yield bonds generated attractive total returns, but they also provide diversification benefits as they tend to be more credit sensitive, which results in lower correlations to core bond sectors. Therefore, in addition to increasing return potential, complementing core bonds with high yield may also help manage risk by reducing overall volatility.

High yield may complement core bonds due to strong performance

	Returns as of 2/28/25				
Index	**1-year**	**3-year**	**5-year**	**7-year**	**10-year**
Bloomberg U.S. Aggregate	5.96	(0.43)	(0.52)	1.66	1.50
ICE BofA U.S. High Yield	10.17	4.86	4.78	4.85	4.96

Source: FactSet 2/28/25. Past performance is no guarantee of future results, which may vary. An investment cannot be made directly in an index. Index definitions below.

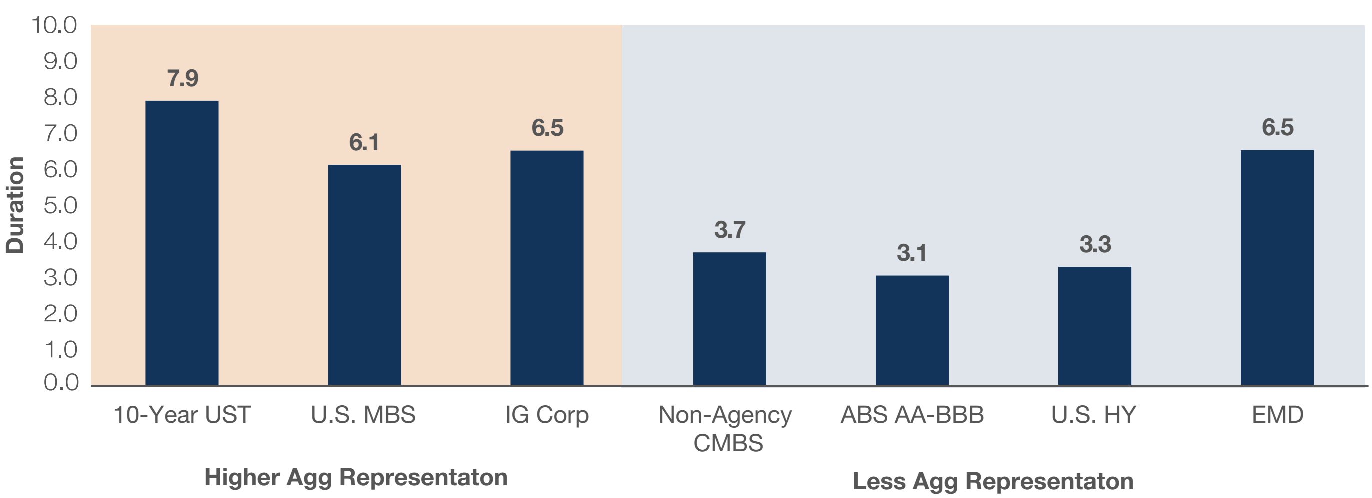
Increasing yield while decreasing rate risk

In the current environment, economic conditions support corporate and securitized credit. As history has demonstrated, credit spreads can remain tight for periods of years during consistent, modest growth environments. Yields of sectors well represented in the Agg are near their 10-year highs, reflecting the attractiveness of fixed income on an absolute basis. However, there are sectors in fixed income with little to no Agg representation that have even higher yields. Also, due to shorter maturities, floating rate structures and/or higher coupons, some of these sectors have shorter durations than those with more prominent weights in the Agg. Therefore, a flexible approach that focuses on the broader fixed-income universe may enhance yield and return potential while maintaining appropriate risk profiles.

Chart 4: Under-represented sectors have higher yield profiles

Source: FactSet as of 2/28/25. Data from 2/28/15-2/28/25. Yield shown is Yield to Worst. Past performance is no guarantee of future results, which may vary. An investment cannot be made directly in an index. UST = U.S. Treasury. U.S. MBS represented by Bloomberg U.S. MBS (30 Y) Index. IG Corps represented by ICE BofA U.S. Corporate Index. Non-Agency CMBS represented by Bloomberg Non-Agency CMBS Index. ABS AA-BBB represented by ICE BofA U.S. Asset Backed Securities (AA-BBB). U.S. HY represented by ICE BofA U.S. High Yield Index. EMD represented by J.P. Morgan EMBI Global Diversified Index. Index definitions below. Yield to worst is a measure of the lowest possible yield that can be received on a bond that fully operates within the terms of its contract without defaulting.

Chart 5: Less rate sensitivity in under-represented sectors



Source: FactSet as of 2/28/25. Past performance is no guarantee of future results, which may vary. An investment cannot be made directly in an index. UST = U.S. Treasury. U.S. MBS represented by Bloomberg U.S. MBS (30 Y) Index. IG Corps represented by ICE BofA U.S. Corporate Index. Non-Agency CMBS represented by Bloomberg Non-Agency CMBS Index. ABS AA-BBB represented by ICE BofA U.S. Asset Backed Securities (AA-BBB). U.S. HY represented by ICE BofA U.S. High Yield Index. EMD represented by J.P. Morgan EMBI Global Diversified Index. Index definitions below. Duration measures how long it takes, in years, for an investor to be repaid a bond's price through its total cash flows.

Having an allocation to core bonds remains an important component of a well-diversified portfolio. However, passive strategies that replicate the Bloomberg Aggregate Index or have limited flexibility may ultimately lead to more constrained portfolios with unintended concentrations. We believe that to build portfolio resilience, it is important to take advantage of the whole fixed-income toolkit, using diversified sources of returns in order to provide investors a flexible portfolio that can respond to changing opportunities.

Index Definitions:

The **Bloomberg U.S. Aggregate Bond Index** is a broad-based benchmark that measures the performance of the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, mortgage-backed securities (agency fixed-rate and hybrid adjustable-rate mortgage pass-throughs), asset-backed securities, and commercial mortgage-backed securities. Index results assume the reinvestment of all capital gain and dividend distributions. An investment cannot be made directly into an index.

The **Bloomberg U.S. Mortgage Backed Securities (MBS) Index** tracks fixed-rate agency mortgage backed pass-through securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

The **Bloomberg Non-Agency Investment Grade CMBS Index** measures the market of conduit and fusion CMBS deals with a minimum current deal size of $300 million that are rated investment grade or higher using the middle rating of Moody's, S&P, and Fitch after dropping the highest and lowest available ratings.

The **ICE BofA U.S. Fixed Rate Asset Backed Securities Index** provides a measure of the performance of USD-denominated investment grade fixed rate asset backed securities publicly issued in the U.S. domestic market.

The **ICE BofA U.S. High Yield Index** tracks the performance of U.S. dollar denominated below investment grade rated corporate debt publicly issued in the U.S. domestic market.

The **ICE BofA U.S. Corporate Index** tracks the performance of U.S. dollar denominated investment grade rated corporate debt publicly issued in the U.S. domestic market.

The **J.P. Morgan EMBI Global Diversified Index** tracks liquid, U.S. Dollar emerging market fixed- and floating-rate debt instruments issued by sovereign and quasi-sovereign entities.

About Risk:

Past performance is no guarantee of future results, which will vary. All investments are subject to market risk and will fluctuate in value. Index performance is for illustrative purposes only and does not represent actual performance.

Investing in below-investment-grade securities may carry a greater risk of nonpayment of interest or principal than higher-rated bonds. High-yield securities (junk bonds) have speculative characteristics and present a greater risk of loss than higher-quality debt securities. These securities can also be subject to greater price volatility.

Bonds are subject to interest-rate risk and can lose principal value when interest rates rise. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner.

Bond ratings are expressed as letters ranging from AAA, which is the highest grade, to C ("junk bonds"), which is the lowest grade. Different rating services use the same letter grades but use various combinations of upper- and lower-case letters to differentiate themselves. To illustrate the bond ratings and their meaning, we'll use the Standard & Poor's format: AAA and AA = high credit-quality investment grade; AA and BBB = medium credit-quality investment grade; BB, B, CCC, CC, C = low credit-quality (non-investment grade), or "junk bonds"; D = bonds in default for non-payment of principal and/or interest.

Treasury Securities are backed by the full faith and credit of the United States government as to payment of principal and interest if held to maturity. Interest income on these securities is exempt from state and local taxes.

Diversification cannot assure a profit or protect against loss in a declining market.

Disclosure

Opinions expressed herein are current opinions as of the date appearing in this material only. Investing involves risk, including possible loss of principal. Asset allocation and diversification may not protect against market risk, loss of principal or volatility of returns. There is no guarantee that these investment strategies will work under all market conditions or are suitable for all investors, and each investor should evaluate their ability to invest long-term, especially during periods of downturn in the market. No representation is being made that any account, product, or strategy will or is likely to achieve profits.

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