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Market review and outlook

The Bloomberg US Aggregate Bond Index declined 0.05% during Q1 2026, driven lower in March by volatility associated with the Iran war after a strong start to the year. Through the first two months of the year, the index returned 1.75% as economic data remained broadly resilient despite concerns around the February sell-off in software stocks, a key tariff decision by the Supreme Court and the growing drumbeat of war in the Middle East. The US and Israel launched combat operations against Iran on February 28, and the markets spent most of March reeling from the ongoing conflict, resulting in Brent crude oil experiencing its biggest quarterly increase since the Gulf War in 1990. While one normally thinks of a flight-to-quality trade as a rally in Treasury yields as investors move away from risk assets to safer alternatives, this was not the case in March as rates pushed higher across the curve. The Fed held rates steady at the March 18 meeting and avoided any kind of hints about the future path of rates. Despite concerns around the impact of higher energy prices on inflation due to the conflict, no participants viewed a 2026 hike as appropriate at this time. At his press conference, Chairman Jerome Powell alleviated some concern around the leadership of the Federal Reserve, stating that he would remain as chair pro tempore until his replacement is confirmed.

Updates by sector

Treasury

The entire Treasury yield curve pushed higher in Q1, with most of the shift taking place in March after combat operations began in the Middle East. The 2-year Treasury yield climbed 41.8 basis points (bps) in March, marking its biggest monthly move since October 2024 when ongoing strength in economic news had investors reconsidering rate cut expectations. The dramatic shift in March was more than enough to offset some of the compression in yield during the first two months of the year, resulting in an increase of 32 bps during Q1. But the trend higher impacted the entire curve, with the 10-year Treasury yield increasing by 15 bps and the 30-year by 7 bps during Q1, resulting in the worst quarterly performance in the Treasury sector (-0.04%) since Q4 2024 (-3.14%). Market expectations for action from the Federal Reserve ranged from roughly 62.5 bps of easing by year-end 2026 in late February to 12.5 bps of tightening by year end in late March, before settling at the end of Q1 with a slight chance of a rate cut by year end.

Corporate

The investment-grade corporate market, as tracked by the Bloomberg US Corporate Bond Index, started off the year in the red, down 0.54%, the worst level since the final quarter of 2024 (-3.04%). Investment-grade corporate spread levels reached their lowest point in recent memory in late January (70.9 bps) before reversing course and pushing higher through the final two months of the quarter. As concerns surrounding a potential conflict in the Middle East ramped up, so did investment-grade spreads, reaching as high as 90.5 bps before finishing the quarter at 88.6 bps, as investors moved away from risk assets. The high yield corporate market followed a similar trajectory, down 0.50% during Q1, the worst quarterly return since Q3 2022 (-0.65%). Spread movement followed a similar trajectory as the investment-grade market, reaching a low point of 250 bps in late January before pushing higher throughout the remaining quarter and peaking at 335 bps before ending the quarter at 317 bps.

Securitized

The securitized sector delivered positive returns in Q1, bucking the trend of the other major sectors and rising 0.40%. The sector followed a similar pattern to the rest of the market, with decent performance during the first two months of the year (+2.05%) followed by a downturn of -1.61% in March. The Trump administration's pronouncement ordering government-sponsored entities (GSEs) to begin purchasing \$200 billion in mortgages in early January pushed spread levels tighter in early January and February, but the curve's shift higher in March negated most of this impact. The Bloomberg US Mortgage-Backed Securities (MBS) Index's duration, or sensitivity to interest rate movements, experienced a bit of a roller-coaster ride, starting the year at 5.56, bottoming out at 5.08 at the end of February before climbing higher in March and finishing the month at 5.44, the largest monthly increase (+7.20%) since 2022.

Q1 performance review

Key contributors

- Strong relative performance from the high yield allocation, which outpaced the Bloomberg US Corporate High Yield Index and was closely in line with the overall Bloomberg US Aggregate Bond Index.
- Security selection within non-agency commercial mortgage-backed securities (CMBS) led to outperformance, driven by office and hospitality, as non-benchmark eligible segments of this market delivered strong relative returns.
- Within the non-agency residential mortgage-backed securities (RMBS) allocation, reverse mortgages and residential transition loans (institutional fix and flip) contributed most to relative performance.

Key detractors

- The Treasury allocation in the portfolio, while ahead of the comparable benchmark allocation, trailed the overall portfolio performance during the quarter.
- The corporate allocation, while stronger relative to the benchmark allocation thanks to security selection in both high yield and investment grade, trailed the overall portfolio performance.
- Agency RMBS detracted from relative performance during the quarter as the portfolio's significant weight in collateralized mortgage obligations (CMOs) trailed benchmark plain vanilla pass-through mortgages, though the portfolio's small allocation to pass-throughs outpaced the benchmark's allocation.

Bonds rated AAA, AA, A and BBB are considered investment grade.

Period and Annualized Total Returns (%)	Since Inception (31 Dec 2024)	1Y	YTD	1Q26
Gross of Fees	7.13	5.68	0.23	0.23
Net of Fees	6.70	5.26	0.13	0.13
Bloomberg US Aggregate Bond Index	5.76	4.35	-0.05	-0.05

Calendar Year Returns (%)

	2025
Gross of Fees	8.74
Net of Fees	8.30
Bloomberg US Aggregate Bond Index	7.30

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