Short Duration Investment Grade Strategy

As of 30 Jun 2026

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Market review and outlook

The Bloomberg 1-3 Year Government/Credit Index returned 0.48% in 2Q26, as markets recovered from the initial uncertainty and volatility brought about by the conflict in the Middle East. The index spent the past three months recovering from a challenging end to 1Q26 and a devastating month of March (down 0.46%), which was the worst single month of performance since October 2024. The largest quarterly jump in the price of Brent crude since the Gulf War in 1990 was followed by the biggest quarterly decline since the pandemic began in early 2020. Volatility in energy markets was indicative of overall volatility in financial markets, with fears of an expanding conflict ebbing and flowing with each bit of news out of the Middle East.

From an economic standpoint, upbeat news helped to dampen some of the concerns around the geopolitical situation as the third estimate of 1Q26 GDP increased by 2.1%. The labor market continued to rebound from the slow start to the year, adding an average of 155,000 jobs from March to May. With the May report reflecting 172,000 jobs added and unemployment holding at 4.3%, the outlook is looking up for the labor market. The quarter witnessed a transfer of leadership at the Federal Reserve from Jerome Powell to Kevin Warsh, and Warsh made quite the impression at his first meeting, delivering a more hawkish tone than some expected. Warsh was clear that forward guidance is going to be limited, if not outright eliminated, and hinted the Dot Plot could face a similar fate. In a symbolic gesture, the new chair did not submit a dot and referenced that all submissions were made in pencil, alluding to the fact that they could change at any time. The shift from dovish to hawkish is in full gear, with half of participants signaling a rate hike by year-end and six members targeting two rate hikes by year-end. In other Federal Reserve news, the Supreme Court prevented the administration from terminating Lisa Cook (for now), and her challenge will play out in the lower courts.

Updates by sector

Treasury

The Treasury yield curve flattened in 2Q26 as the potential end to the conflict between the US and Iran gained momentum and a more hawkish Fed shifted market expectations for the future path of interest rates. The 2-year Treasury yield climbed by 37.9 basis points with the 3-year and 5-year yields increasing by 36.5 and 28.4 basis points, respectively. The longer end of the curve moved higher but to a much lesser degree, with the 10-year climbing by 14.8 basis points and the 30-year higher by 4.1 basis points during the quarter. The Bloomberg 1-3 Year US Treasury Index returned 0.37% during the quarter, adding to the first quarter return of 0.27%. Market expectations for action from the Federal Reserve began the quarter with roughly 7.3 basis points of rate cuts expected by year-end before dramatically shifting to 37.7 basis points in rate increases by the end of the year, reflecting the potential impact of conflict-inspired inflation and a more hawkish Federal Reserve.

Corporate

The short investment grade corporate market, as tracked by the Bloomberg US 1-3 Year Corporate Bond Index, followed up a decent first quarter (0.31%) with a strong second quarter (0.85%). Short investment grade corporate spread levels peaked at the beginning of the quarter at 60.5 basis points and steadily tightened through to the end of June (42.5 basis points), finishing the first half of the year below where they began the year (49.9 basis points). Issuance in the investment grade corporate sector reached $552 billion and combined with the first quarter's issuance of $640 billion pushed past the prior record for the first six months of the year (2020) and is on pace for a calendar year record. Despite the record issuance levels, spreads in the investment grade corporate market continued to grind tighter, an indication of investors' appetite for yield.

Securitized

The securitized sector, as tracked by the Bloomberg US Securitized: MBS, ABS and CMBS Index, delivered positive returns in 2Q26, returning 0.58%. Benchmark-eligible agency passthroughs returned 0.58%, in line with the overall sector, while collateralized mortgage obligations (CMOs), as measured by the ICE BofA CMO Index, outpaced plain vanilla passthroughs (0.67%). With ongoing volatility in the rates market, interest-rate sensitive agency residential mortgage-backed securities (RMBS) trailed other segments of the securitized market including asset-backed securities (ABS) and commercial/residential non-agency mortgage-backed securities (CMBS/RMBS). Despite ABS issuance being on a record pace for 2026 and non-agency CMBS/RMBS outpacing prior years' issuance levels, new issues in the securitized market were still met with significant investor appetite as the search for yield continues.

Q2 performance review

Key contributors

- Unsecured consumer ABS, a significant weight in the portfolio, contributed to overall performance during 2Q26, outpacing the overall benchmark return as the consumer continues to show strength in the face of economic uncertainty.
- Non-agency CMBS, fueled by office and commercial real estate and collateralized loan obligation allocations, contributed to relative performance.
- Non-agency RMBS was the best performing sector within the portfolio, fueled by continued strength in the home equity conversion mortgages, or reverse mortgage, second lien and residential transition loan subsectors.

Key detractors

- While relative performance in the portfolio's corporate allocation was stronger than the benchmark, it was not enough to offset the underweight posture, resulting in a slight detraction during the quarter.
- The portfolio's significant underweight to Treasuries detracted from performance in 2Q26 despite stronger relative performance compared to the benchmark allocation, which was partially due to a shorter duration posture.
- The portfolio's allocation to subprime auto ABS detracted from performance as certain positions were adjusted to reflect market conditions.

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

Period and Annualized Total Returns (%)

	Since Inception (30 Nov 2021)	3Y	1Y	YTD	2Q26
Gross of Fees	4.30	6.98	4.46	1.58	0.89
Net of Fees	3.93	6.60	4.09	1.40	0.80
Bloomberg 1-3 Yr. US Gov./Credit Index	2.39	4.64	3.14	0.77	0.48

Calendar Year Returns (%)

	30 Nov 2021 - 31 Dec 2021	2022	2023	2024	2025
Gross of Fees	-0.09	-3.64	7.86	7.89	6.55
Net of Fees	-0.12	-3.98	7.49	7.52	6.18
Bloomberg 1-3 Yr. US Gov./Credit Index	-0.15	-3.69	4.61	4.36	5.35