

# Short Duration Securitized Bond Strategy

DIAMOND HILL  
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## Market review and outlook

The Bloomberg 1-3 Year Government/Credit Index returned 0.28% in Q1, its lowest quarterly return since Q4 2024 (-0.02%). Through the first two months of the year, the index returned 0.75% 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 1-3 Year Bond Index, posted its weakest quarterly return (+0.30%) since Q4 2024 (+0.19%). Short-end investment-grade corporate spread levels reached their lowest point since November 2024 in late January (43.7 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 short-end investment-grade spreads, reaching as high as 65.6 bps mid-March before finishing the quarter at 60.5 bps, as investors moved away from risk assets.

### *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 performance from non-benchmark allocations in both non-agency residential mortgage-backed securities (RMBS) and non-agency commercial mortgage-backed securities (CMBS), led by residential transition loans and office CMBS, respectively, outpacing the overall benchmark.
- Within asset-backed securities, auto loans and consumer unsecured continued to deliver strong performance as the noise from the Tricolor bankruptcy continues to fade and the consumer remains resilient.
- Agency RMBS generated strong performance relative to both the corporate and Treasury allocations within the benchmark.

### Key detractors

- Despite outperforming the benchmark allocation, the portfolio's underweight to Treasuries detracted from relative performance.
- While security selection was strong in the minimal allocation to the corporate market, the benchmark's significant overweight detracted from relative performance.
- The laboratory allocation within non-agency CMBS, though small, detracted from relative performance as this sector was negative during the quarter.

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

Period and Annualized Total Returns (%)	Since Inception (31 Jul 2016)	5Y	3Y	1Y	YTD	1Q26
Gross of Fees	4.74	5.13	8.43	5.81	0.96	0.96
Net of Fees	4.27	4.66	7.94	5.33	0.84	0.84
Bloomberg 1-3 Yr. US Gov./Credit Index	2.02	2.04	4.35	3.96	0.28	0.28

Calendar Year Returns (%)	31 Jul 2016 - 31 Dec 2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Gross of Fees	0.87	4.89	3.77	5.34	3.65	3.27	-2.88	9.48	9.90	7.15
Net of Fees	0.68	4.42	3.31	4.87	3.18	2.80	-3.31	8.98	9.40	6.67
Bloomberg 1-3 Yr. US Gov./Credit Index	-0.38	0.84	1.60	4.03	3.33	-0.47	-3.69	4.61	4.36	5.35

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