



## Investment Team

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Portfolio Co-Manager

## Characteristics

Total Net Assets  
(billions): \$1.81

Number of holdings: 278

## Top 10 Holdings

FNCL 6 5/25

FNCL 5.5 5/23

U.S. Treasury N/B  
T 4 1/4 08/15/54

Treasury Bill B 05/08/25

Treasury Bill B 08/14/25

U.S. Treasury N/B  
T 4 3/8 12/31/29

U.S. Treasury N/B  
T 4 1/4 11/15/34

FNCL 5 5/24

SECRETARIA TESOURO  
(PRICES NEAR 1000)

U.S. Treasury N/B  
T 3 7/8 08/15/34

## Market Overview

### U.S. President Donald Trump unveils heavy tariffs in his first weeks.

The current administration appears willing to follow through on its campaign promises of punitive tariffs. This involved imposing and subsequently suspending tariffs, often in rapid succession, followed by additional adjustments. The opaque rationale behind these initial actions has contributed to heightened economic uncertainty. Tariffs targeting Canada, Mexico, and China were initially presented as measures to combat narcotics trafficking, address illegal immigration, and safeguard the U.S. manufacturing sector. However, their inconsistent application suggests a strategic intent that may deviate from the stated goals. Follow-on tariffs focusing on steel, aluminum, and the automotive industry, as well as those targeting China, appear more likely to persist. The outcome of these and future tariff actions remains to be seen.

### Loss of confidence due to tariff uncertainty.

Inconsistent communication, uneven tariff implementation, and concern over long-term implications have generated substantial uncertainty for the business community, which can be seen in declining University of Michigan Surveys of Consumers data. In the short term, global markets have experienced significant disruptions, leading to the unwinding of the “Trump trade.” This phenomenon drove an equity rally, elevated interest rates, and strengthened the U.S. dollar following the election and through the early weeks of the administration. However, investor confidence began eroding by February, prompting a reversal of these trends. This shorter-term uncertainty may soon have adverse effects on long-term investment decisions.

### Rapidly shifting foreign policy.

International policy decisions, particularly efforts to distance the United States from the North Atlantic Treaty Organization (NATO), have been significant for the war in Ukraine and Europe’s broader security landscape. President Trump’s advocacy for an end to the conflict in Ukraine has inadvertently weakened Russia’s international isolation. The shift has had profound effects on global commodity markets, affecting energy prices most acutely. These developments prompted a swift response from Germany, which increased its infrastructure and defense spending beyond the limits established by E.U. regulations. Consequently, German interest rates rose sharply, which may elevate the global floor for real interest rates. The policy shift also strengthened the euro; Germany’s actions may offer a pathway to economic growth after two years of contraction.

### Fed resurrects “transitory” description.

The decline in inflation has stalled, and the resurgence raises concerns about the effectiveness of efforts to bring it back to the Federal Reserve’s (Fed’s) 2% target. Rate cuts implemented in the final months of last year began to feel somewhat premature; inflation has become persistently elevated at a level that exceeds comfort. The introduction of tariffs is likely to drive up prices temporarily — the Fed has described it as “transitory,” and while the central bank has faced significant criticism for using that term in the past, it may be more appropriate in this instance. The Fed has acknowledged increased uncertain-

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## Market Overview (continued)

ty in its ability to meet employment and inflation objectives, but markets continue to price in potential rate cuts this year. Investors are looking beyond the immediate inflationary impact of tariffs and focusing on their potentially longer-term economic drag.

### Spread sectors were weaker on investor uncertainty.

Sector excess returns were negative in the first quarter; high-yield (HY) credit, investment grade (IG) credit, and asset-backed securities (ABS) all underperformed significantly. Commercial mortgage-backed securities (CMBS) and mortgage-backed securities (MBS) had modestly negative excess returns. Most of the yield curve moved sharply lower in a largely parallel shift. Front-end maturities, defined as 3 months and shorter, did not move much. The Fed did not adjust rates during the quarter, but the back end of the curve responded to a weaker economic growth outlook. The curve is now inverted out to the 3-year point, but it has normalized beyond that. Future Fed actions have become increasingly uncertain.

## Portfolio Review

Following a sharp move upward in the fourth quarter of 2024, the yield curve saw a sharp move downward in the first quarter of 2025. The move occurred in the longer end of the curve while the front end remained anchored, resulting in a relative flattening. The Fund's longer duration positively impacted performance, which was slightly offset by its curve positioning.

Sector allocation and security selection contributed to performance during the quarter, primarily driven by emerging market/foreign exchange sector allocation. The underweight to investment grade (IG) corporate credit, on a cheapest-to-deliver basis, was a positive contributor as spreads widened throughout the quarter. The small overweight in asset-backed securities (ABS) detracted from performance as spreads increased. The overweight to MBS detracted as mortgages underperformed due to rising interest rate volatility. High yield (HY) corporate credit detracted as risk positions sold off during the quarter.

Security selection in mortgage-backed securities made a positive contribution as high-coupon mortgages outperformed lower-coupon securities. Selection within ABS also contributed; the portfolio's focus on securities with attractive embedded options has continued to perform well. IG corporate selection was a more limited detractor, with utilities underperforming.

The allocation to agency residential mortgage-backed securities (RMBS) decreased, and exposure to non-agency RMBS also fell by a modest amount. Mortgage sector valuations were compelling at

the start of the quarter, and they continue to represent a meaningful overweight. Exposure to IG corporates increased to a modest overweight relative to the index as corporate credit spreads reversed their trend and widened during the quarter. All three sectors (utilities, financials and industrials) of IG corporate allocations were overweight relative to the index, albeit slightly. The Fund established an initial toe-hold position in HY corporate credit during the quarter as spreads began to widen. ABS exposure increased during the quarter. The weight in commercial mortgage-backed securities increased, but it continues to represent a low absolute exposure. The exposure to non-U.S. dollar bonds increased slightly, although the allocation to non-U.S. dollar currencies was unchanged. The allocation to U.S. Treasuries increased, although it remains notably underweight relative to the index.

Portfolio duration fell during the quarter as the yield curve flattened and rates moved sharply lower. Duration ended the quarter slightly longer relative to the benchmark, reflecting the decline in real rates. Yield curve exposure at the end of the quarter featured overweights to the 2- to 5-year, 7- to 10-year, and 20- to 30-year duration segments. This was offset by underweights to the 5- to 7-year and 10- to 20-year duration segments.

## Outlook

### More tariff uncertainty.

A presidential administration's first 100 days traditionally establishes the tone for its subsequent four years. However, the current administration has needed less than half that time. The emerging tone reflects a strategy of expansive action taken at a frenetic pace, designed to advance rapidly while keeping the opposition off balance. This administration also has a tendency to implement ideas without sufficient vetting beforehand. One notable example is in the realm of global trade, particularly tariffs. Any individual tariff may lack longevity, but the uncertainty surrounding their application is highly likely to persist. The uneven implementation of these tariffs has made their ultimate impact on global trade highly unpredictable.

### DOGE initiative likely to hit resistance.

Despite considerable attention surrounding the Department of Government Efficiency (DOGE), meaningful cost-cutting success may prove elusive. Legal challenges are expected to intensify, which could threaten the group's initial momentum. The concept of an efficient government is widely appealing, but the rapid elimination of jobs — and in some cases, entire government entities — is unlikely to proceed without significant opposition, because political

## Market Overview (continued)

careers have been built on the ability to deliver tangible benefits to constituents.

### The Fed's job is now more difficult.

The Fed implemented a cumulative rate cut of 100 basis points in the final four months of 2024, aiming to normalize monetary policy after high single-digit inflation (stemming from post-COVID economic excesses) had necessitated historic rate hikes. The U.S. election and consequential shifts in global trade since then have significantly complicated the central bank's mandate. Tariffs, a favorite tool of the new administration, exert upward pressures on prices that intensify inflationary challenges and limit the Fed's ability to justify further rate reductions. The substantial tariffs introduced thus far could slow economic growth markedly, depending on their duration and scope. This challenge heightens the Fed's imperative to consider rate cuts if the economy decelerates excessively. The

politically charged environment adds to these difficulties; the Fed may face obstacles in preserving its historic independence, further complicating the role of its chair.

### Geopolitical shift could spark some growth.

The evolving geopolitical landscape could redefine U.S. relationships with traditional allies, particularly with President Trump's emphasis on increased defense contributions from other NATO members. This stance prompted a swift response from Germany, which circumvented E.U. spending constraints to bolster investments in infrastructure and defense. The durability of this shift remains uncertain, but it carries significant implications for Germany's efforts to emerge from its recent economic stagnation. Should the broader European Union follow Germany's lead and assume greater responsibility for defensive efforts, debt levels could become elevated and exert a lasting influence on the region's growth trajectory.

### Risk Considerations:

The return of principal in a fixed income fund is not guaranteed. Fixed income funds have the same interest rate, inflation, issuer, maturity and credit risks that are associated with underlying fixed income securities owned by the fund. Mortgage- and Asset-Backed Securities are subject to prepayment risk and the risk of default on the underlying mortgages or other assets.

High-yield securities involve greater risk than investment grade securities and tend to be more sensitive to economic conditions and credit risk.

Foreign investments present additional risks due to currency fluctuations, economic and political factors, government regulations, differences in accounting standards and other factors. Investments in emerging markets involve even greater risks.

Derivatives such as options, futures contracts, currency forwards or swap agreements may involve greater risks than if the Fund invested in the referenced obligation directly. Derivatives are subject to risks such as market risk, liquidity risk, interest rate risk, credit risk, and management risk. Derivative investments could lose more than the principal amount invested. The Fund may use derivatives for hedging purposes or as part of its investment strategy. The use of leverage and derivatives investments could accelerate losses to the fund. These losses could exceed the amount originally invested.

The Fund may, at times, experience higher-than-average portfolio turnover, which may generate significant taxable gains and increased trading expenses, which, in turn, may lower the Fund's return.

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### Definitions

Basis points (bps) are measurements used in dis-

cussions of interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%.

A credit spread is the difference in yield between a U.S. Treasury bond and another debt security with the same maturity but different credit quality. Also referred to as "bond spreads" or "default spreads," credit spreads are measured in basis points, with a 1% difference in yield equaling a spread of 100 basis points. Credit spreads reflect the debt security's risk compared with that of Treasury bond — which is considered to be risk-free — and they are considered to be "tighter" when the spread is smaller or "looser" when the spread is larger.

Duration incorporates a bond's yield, coupon, final maturity and call features into one number, expressed in years, that indicates how price-sensitive a bond or portfolio is to changes in interest rates. Bonds with higher durations carry more risk and have higher price volatility than bonds with lower durations.

Cheapest-to-deliver terms, in U.S. Treasury bond futures contracts, allow any bonds to be delivered that are within certain maturity ranges and have certain coupon rates.

Headwind is a term used to describe events or market forces that hinder the prospects for performance in an individual investment or group of investments.

High-yield bonds have credit ratings below BBB- from Standard & Poor's or below Baa3 from Moody's.

Investment-grade refers to fixed-income securities rated BBB or better by Standard & Poor's or Baa or

better by Moody's.

The North Atlantic Treaty Organization (NATO) is a political and military alliance of 32 countries from Europe and North America that is organized to guarantee their security and cooperation.

Overweight describes a portfolio position in an industry sector or some other category that is greater than the corresponding weight level in a benchmark portfolio.

Spread tightening refers to the contraction of credit spreads in response to changes in economic conditions that cause a decline in credit risk.

Spread sector is a term used in fixed income investing to describe nongovernmental fixed-income securities, such as corporate bonds or mortgage bonds, whether investment grade or high yield, that provide an additional yield, or "spread," over the yield of a risk-free government bond.

A real interest rate is an interest rate that has been adjusted to remove the effects of inflation. Once adjusted, it reflects the real cost of funds to a borrower and the real yield to a lender or to an investor.

Overweight describes a portfolio position in an industry sector or some other category that is greater than the corresponding weight level in a benchmark portfolio.

Tailwind is a term used to describe events or market forces that exert a positive influence on an investment's performance. The opposite of a tailwind is a headwind, which contributes to an investment's underperformance.

The term "transitory" has been used by the U.S. Federal Reserve to describe inflation that is not expected to endure for extensive periods of time.

U.S. Treasury Inflation-Protected Securities (TIPS) provide protection against inflation. The principal of a TIPS instrument increases with inflation and decreases with deflation, as measured by the Consumer Price Index. When a TIPS matures, investors are paid the adjusted principal or original principal, whichever is greater.

Trump trade refers to the expectation that policies and actions of the Trump administration could benefit certain areas of the capital markets.

Underweight describes a portfolio position in an industry sector or some other category that is less than the corresponding weight level in a benchmark portfolio.

University of Michigan Surveys of Consumers conduct monthly telephone surveys asking consumers in the continental United States about what they think now and what their expectations are for their personal finances, business conditions, and buying conditions in the future. Their responses are used to calculate monthly measures of con-

sumer sentiment that can be compared to a base value of 100 set in 1966.

A yield curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity. Investors and market analysts watch certain yield curves for signs of inversion, when yields for longer-term debt instruments fall below yields on short-term debt with the same credit quality. Inversions are watched as potential signs of a weakening economy and in certain cases, a harbinger of recessions.

### Benchmark Index

The Bloomberg U.S. Aggregate Bond Index is composed of the total U.S. investment-grade bond market. The marketweighted index includes Treasuries, agencies, CMBS, ABS, and investment-grade corporates. It is not possible to invest in an index.

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