Taxable Fixed Income Commentary

2Q 2026

Economic Overview

Investors once again faced a wide set of tail risks in the second quarter, yet the macro backdrop continued to demonstrate notable resilience. Brent crude pricing soared towards $120 per barrel in April when the Strait of Hormuz was effectively closed, yet the market largely looked through geopolitical concerns surrounding the Iran conflict and instead focused on durable strength in the corporate sector and on underlying economic fundamentals. With oil prices back to their pre-conflict levels by quarter end, despite ongoing disruptions in the region, fears of a sustained energy-driven inflation spike faded considerably. More importantly, economic indicators continue to point toward steady growth. The ISM Manufacturing Index extended its streak of expansionary prints to six consecutive months, the longest such streak since 2022, while the service side of the economy continued its steady pace of expansion. Importantly, the new orders component within both ISM indexes remained in expansionary territory, suggesting broadening economic growth.

Meanwhile, the labor market steadily added jobs in the second quarter, averaging 111,000 new jobs per month, representing a modest acceleration from the 1Q26 average monthly pace of 73,000. The unemployment rate ticked lower in the quarter to 4.2% from 4.3%, reflecting both new jobs added and a shrinking labor force. Crucially though, initial jobless claims remained low and stable, indicating steady labor demand and ongoing support for healthy household fundamentals. U.S. household balance sheets remained in very strong shape, supported by wealth gains via the equity market, a robust cash reserve position, and a long-term deleveraging trend. This fundamental position supported ongoing personal consumption despite the energy price spike early in the quarter.

In this context, the Federal Reserve (Fed) took a notably different tone under new Fed Chairman Warsh. Following the June meeting, the shift was evident via a dramatically shorter statement, the removal of forward guidance, reduced emphasis on the summary of economic projections and dot plots, and the introduction of five task forces to examine various facets of monetary policy. The Fed left its key policy rate unchanged, but there was a notable hawkish shift amongst committee members. While Fed Chairman Warsh did not submit a forecast, the other participants were more hawkish than in the prior iteration of the dot plot. Half of participants expected hikes in 2026, while the other half expected to leave rates unchanged. There was one dove that still called for a cut. The Committee's message that it "will provide price stability," as noted in the statement, resonated with market participants, who now expect at least one Fed rate hike by year end.

Quarterly Change in U.S. Treasury Yields

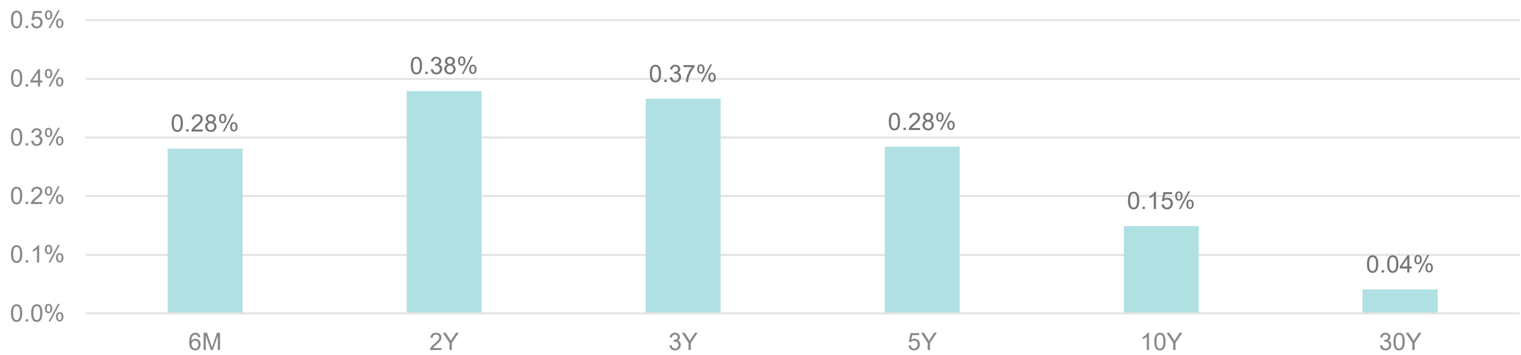

Chart sources: Bureau of Labor Statistics (BLS); Sterling Capital Management Analytics. All data referenced herein is as of 06.30.2026 unless otherwise noted. Yields are subject to market conditions and are therefore expected to fluctuate. Textual data source: Bloomberg L.P. ISM = Institute for Supply Management; AI = artificial intelligence; Fed = Federal Reserve. This information must be read in conjunction with the important disclosures and definitions on the last page.

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Outlook

The U.S. economy once again showed it can shake off tail risks and continue its steady rate of expansion. We believe the economy is likely to expand by 2-2.5% this year, supported by a sturdy labor market, a resilient consumer, and robust capital expenditures. Inflation is expected to remain in focus throughout the year as headline inflation will likely decline purely due to falling gas prices, but core inflation, which was over 3% earlier in the year prior to the war with Iran, will remain problematic for the Fed. Chairman Warsh will clearly approach monetary policy differently than his predecessor, with a strong focus on credibility. We expect the decision for the FOMC this year will be between a rate hold and a rate hike, as 3% core inflation, 4.2% unemployment, and nominal GDP growth of nearly 6% simply do not call for rate cuts. While it remains to be seen whether AI will deliver disinflationary productivity gains over the longer run, in the near term, AI capex for the datacenter buildout has a strong inflationary impulse. Should the Fed move to remove accommodation at some point later this year into next year, we expect it will simply undo the insurance cuts from 2025.

Despite the relatively upbeat outlook, the forward path for markets and the economy is not without risks. Geopolitics will likely maintain the pole position for markets this year. While tensions had eased by quarter end, there is always the risk of renewed conflict with Iran and knock on effects for commodities. Secondly, the remarkable performance of the equity market has supported spending via the wealth channel, and an equity market correction would risk eroding this support for consumption. Finally, while we do not expect an inflation surge, core inflation is likely to remain more stubborn, making affordability rather than inflation the primary challenge facing some households.

Corporate Credit

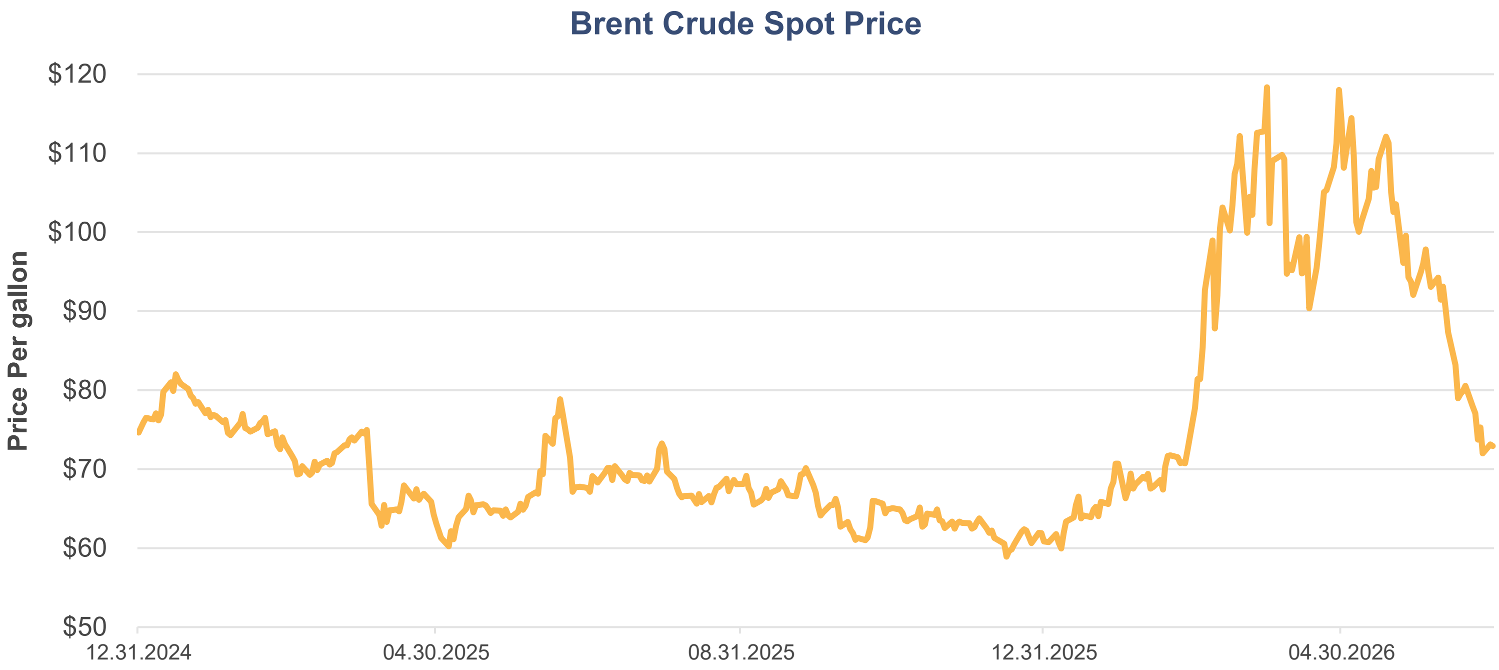
While the leadership transition at the Fed and the conflict with Iran dominated financial headlines, the strong Q1 earnings reports, periodic but well-absorbed heavy issuance, and higher all-in yields served as bigger drivers of performance in the corporate bond market. Investment grade corporates continued to see very strong demand, helping the sector recover from a weaker first quarter. The option-adjusted spread on the Bloomberg U.S. Corporate index to tighten from 89 bps (basis points) to a low of 72 bps before widening modestly to close at 74 bps, generating an excess return of 1.17%. For the Bloomberg U.S. Corporate High Yield index, spreads tightened by 47 bps to 270 bps, driving excess return of 2.21%. Spread tightening is noteworthy in what was a tumultuous quarter geopolitically, with the onset of the Iran conflict in March, precipitating an oil price shock early in the quarter. As the conflict de-escalated, front-month Brent oil futures declined sharply, ending the quarter at $72.92 per barrel, down from $118.35 per barrel at the end of March.

According to Bank of America, median Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) growth for investment grade issuers hit a five-year high of 8.1% year-over-year during the most recent earnings season. Revenue growth and margins also hit multi-year highs as companies continued to benefit from the strong macroeconomic backdrop. While elevated oil and gasoline prices put upward pressure on Treasury yields and weighed on consumer sentiment, the corresponding rise in corporate bond yields pushed the yield to worst on the investment grade index to 5.3%

Chart source: Bloomberg L.P. All data referenced herein is as of 06.30.2026 unless otherwise noted. Yields are subject to market conditions and are therefore expected to fluctuate. Textual data source: Bloomberg L.P. GDP = gross domestic product; FOMC = Federal Open Market Committee. This information must be read in conjunction with the important disclosures and definitions on the last page.

on May 15th, its highest level in more than a year. This drove strong demand from insurance companies and other institutional investors, particularly in longer maturity bonds, which helped to overcome Q2 issuance of $560B, the highest on record aside from the post-COVID surge of 2020. Investment grade issuance for the first half of the year exceeded last year's pace by 29%.

Underpinning the strong earnings season and the heavy supply was the boom in AI-driven capital expenditures. This theme explains much of the sub-sector performance across the industrial universe this quarter, as the heavy AI-spenders in the communications and technology sectors underperformed while companies that supply the materials and goods that are inputs in datacenter construction, including basic industries, capital goods and transportation, outperformed. Meanwhile, worries about private credit across the financial sectors faded as the strong economy continued to underpin fundamentals for smaller businesses propelling finance companies and the insurance sector to the strongest excess returns in the investment grade index.



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High yield credit fundamentals deteriorated modestly in the first quarter of 2026. Leverage and interest coverage ended the period at 4.6x and 3.96x, with leverage increasing by 0.1x and coverage decreasing by 0.05x, respectively. These are the weakest levels since 2021 and weaker than long-term averages, though still well below recession levels. Slowly eroding credit fundamentals and the move higher in Treasury yields (five-year yield 28 bps higher in the quarter) contributed to investors' preference for higher-quality credit, as B-rated and BB-rated spreads tightened by 68 bps and 42 bps, respectively, while CCC-rated spreads widened by 45 bps. Commentary from many companies for the second quarter has mostly been positive, however, which should support credit metrics when second quarter numbers are reported, notwithstanding higher capital spending driven by tax policy and spending on artificial intelligence.

At the end of June, DISH/DBS defaulted, impacting $9.75B of high yield bonds. As a result, the par-weighted default rate including distressed exchanges climbed to 2.67% from 2.08% at the end of March according to JP Morgan. This remains below the 25-year average of 3.2% but is above the post-financial crisis average of 2.3%. By industry, defaults remain mostly clustered in industries suffering from secular challenges including Cable & Satellite and Paper & Packaging, and do not in our opinion reflect general economic weakness.

Outlook

The recent rally in spreads left valuations near multi-year tights in both the investment grade and high yield markets. While we believe that near-term upside is limited, we also believe that yields have become nearly as important as spreads to the broader corporate bond buyer base. Investment grade corporate bond yields above 5% have typically underpinned very strong demand, and we believe this will continue given the very supportive macroeconomic tailwinds. Company fundamentals look quite healthy and with little risk of recession, we expect valuations to remain elevated in the near term. The main risk to our view is continued heavy issuance that overwhelms demand, but we generally view these episodes as buying opportunities and would use wider spreads to add exposure. Sustained inflation pressures that prompt the Fed to go beyond current expectations for rate hikes could also hamper risk appetite.

From a sector perspective, we favor areas that will continue to benefit from the datacenter buildout, including datacenter bonds themselves, select capital goods issuers, and technology suppliers. While life insurance companies have outperformed recently, we continue to see good risk/reward in the sector. High yield datacenters also offer an attractive opportunity in our view, as they feature secured structures, shorter duration, and defined near-term catalysts. In other high yield sectors, we are constructive in the near term based on underlying strength in the economy, but we are mindful of deteriorating fundamentals at a time when credit spreads are at multi-year lows.

Securitized Products

Securitized products comfortably outperformed duration-matched Treasuries during the second quarter, with agency MBS, CMBS, consumer ABS, and CLOs all posting solid excess returns. Agency MBS got off to a strong start in April, as the market moved past peak geopolitical and interest rate volatility given the deescalation in the Iranian conflict following a short-term ceasefire announced on April 8th. While interest rates continued to move higher, interest rate volatility as measured by the ICE BofA MOVE Index dropped significantly from its late March peak, reducing inherent optionality and supporting valuations of agency MBS. Additionally, the higher absolute level of rates kept prepayment risk for middle and higher coupons contained, which allowed for relative outperformance of the top half of the coupon stack, where spreads to Treasuries remain the highest. For the quarter, the Bloomberg MBS index outperformed Treasuries by 0.30%, improving the year-to-date outperformance to 0.45%.

ABS spreads tightened gradually over the course of Q2, offsetting the spread widening that followed the start of the Iran conflict and returning spreads to levels prevailing in early 2026. OAS on the index tightened 9 bps to finish the quarter at 45 bps, allowing the sector to outperform duration-matched Treasuries by 0.36% during the period. Senior bonds from esoteric sectors outperformed on-the-run senior bonds. Meanwhile, subordinated bonds outperformed overall during the quarter as the market repriced credit and liquidity risks tighter. Current levels of ABS spreads are a bit rich versus short-run relative value measures, with spreads in most sectors below their long-run medians. Tiering among issuers and across sectors has compressed meaningfully. Despite a record supply of $212B for the first half of the year, roughly 20% above last year's total, demand was strong enough to absorb the issuance and then some, requiring dealers to be large net sellers. This reflects substantial cash available to invest in the front end of the yield curve. It also comes against the backdrop of solid collateral credit performance and robust structural protections supporting ABS. Deal flow was distributed evenly across the quarter. Much of the rise in primary market activity was from esoteric segments of the market such as datacenters and fiber deals, each accounting for 4% of issuance, though autos and equipment still dominated the market in the first half at 54% of issuance.

On the CMBS front, demand remained firm and the sector outperformed duration-matched Treasuries by 55 bps during the quarter, despite new-issue supply running 60% higher than during the same period last year. Treasury yields rose during the quarter, with the 10-year yield moving above 4.5% at one point. Although higher rates could have pressured commercial real estate values, the actual impact was limited. According to the latest RCA Commercial Property Price Index, national commercial real estate prices increased 1.1% during the three months ending in May and 1.6% over the prior 12 months. This was the strongest annual increase since October 2022. CMBS credit performance also improved. The Trepp CMBS delinquency rate declined to 7.35% at the end of June, from 7.55% at the end of the previous quarter. Overall, commercial real estate fundamentals remained more resilient than expected despite higher rates. We believe this partly reflects the market's prior adjustment to an elevated-rate environment, along with expectations that rates are unlikely to rise significantly from current levels.

Triple-A rated CLOs outperformed duration-matched Treasuries by 0.45% during the quarter. As developments in the Iranian conflict turned more constructive and concerns about oil driven demand destruction eased, AAA spreads fully retraced the prior quarter's sell-off, ultimately finishing 22 bps tighter. In contrast, AI angst remained ever-present. Dollar prices of software loans remained in the low-90s during the period, pressuring subordinate tranches of the CLO capital stack with greater exposure. According to

Bloomberg, new issuance totaled $33.3B in the second quarter across the broadly syndicated and private credit markets, tracking about 18% lower relative to 2025 on a year-to-date basis. On the regulatory front, the National Association of Insurance Commissioners (NAIC) approved a new risk-based capital (RBC) framework for CLOs that punishes the triple-B and more subordinate tranches for the insurance buyer base, marginally weakening demand for these bonds.

Outlook

MBS valuations remain in a narrow trading range with index option-adjusted spreads hovering in the low-to-mid 20s, leaving the sector looking relatively rich, particularly compared to other non-agency securitized sectors. As such, we view the market as a source of funds for more attractive sectors and have generally been reinvesting MBS paydowns elsewhere, which has resulted in moderately lower MBS weights quarter-over-quarter for most strategies. Within the sector, we still prefer coupons whose dollar prices are straddled around par as those provide the best combination of spread, stable prepayments, and moderate convexity risk, while avoiding the highest coupons due to prepayment concerns and the lowest coupons due to stretched valuations.

ABS spreads and excess returns in the second quarter performed well despite the cross currents of macroeconomic and geopolitical factors. ABS credit performance so far remains well-behaved, reflecting the underlying strength of the economy for the consumer and businesses. Nevertheless, we are tracking changes in the direction of the economy and are paying particular attention to whether the recent increase in food and gasoline prices acts as a material drag on household finances and their ability to service debt. As spreads have tightened and tiering has narrowed, being selective on names and sectors has been the way to maximize relative value. Nevertheless, we continue to favor subsectors that offer additional spread without veering into the most esoteric sectors or taking undue credit risk. These include fleet lease, rental fleet, timeshares, and private student loans. Datacenters and other non-traditional ABS sectors, which are not part of the Bloomberg Barclays index, have driven most of the growth in the ABS market over the past few years, and are likely to do so again this year. We are adding selectively to the technology/datacenter space. However, we believe it is important to consider the totality of related risk exposures in a portfolio given that ABS, CMBS, unsecured debt, and newer corporate debt arrangements are all being used to fund rapid expansion.

In CMBS, we increased our overweight exposure during the quarter with the addition of selected datacenter CMBS bonds. Datacenters are still a relatively new property type within CMBS, and these bonds were priced attractively compared with CMBS backed by more traditional property types. We believe they offer compelling relative value, supported by strong expected demand for datacenter capacity over the foreseeable future. At the same time, datacenters carry risks that differ from those of traditional commercial real estate. We are managing these risks through position sizing and diversification across geographic regions and operators. We may selectively add to our datacenter CMBS exposure if valuations remain attractive and the underlying credit fundamentals continue to support the thesis.

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For CLOs, the inaugural Fed Chairman Warsh press conference somewhat counterintuitively struck the right balance for high-quality floating rate spread product: a moderately more hawkish Fed in an environment with resilient above-trend growth serves to increase 3-month Secured Overnight Financing Rate (SOFR) expectations, the benchmark rate for the CLO market, thus increasing coupon payments and modeled yields but without raising the specter of recession. We expect CLO exposure to remain a useful diversifier with attractive risk-adjusted carry going into the second half of the year. In addition, we consider the greater credit support in triple-A and double-A tranches as sufficiently protecting investors from AI risks, particularly in collateral pools with below average software exposure. Across the CLO capital stack, we continue to see the best relative value in shorter or higher coupon profiles that would likely outperform in a spread widening scenario, given spreads at or close to historically tights.

Taxable Municipals

Taxable municipal securities outperformed duration-matched Treasuries by 1.13% during the quarter, as spreads tightened 6 bps and investors continued to reach for yield. Issuance was again muted, with total taxable issuance coming in at $11.5B, which was in line with 2Q25 issuance. Municipal credit fundamentals remained broadly firm during the second quarter. Moody's reported that upgrades outpaced downgrades for the second consecutive quarter in 1Q26, citing employment strength, stable tax bases, and conservative fiscal management as key credit strengths across the sector. National Association of State Budget Officers (NASBO) affirmed the stable fiscal landscape in their Spring Fiscal Survey of States. The report showed that state tax collections remained on a positive trajectory, increasing 4.9% in fiscal 2025, with 29 states reporting revenues above forecasts. The positive environment fueled expansion of state reserves with rainy day funds reaching a record $191B in fiscal 2025. As a result, state and local governments credit quality benefited with high profile credits such as the states of Hawaii and Kansas, and the city of Atlanta, Georgia, receiving positive rating actions during the quarter. At the same time, idiosyncratic credit challenges continued to emerge, with the City of New Orleans and the State of Washington experiencing downgrades and negative outlook revisions tied to structural budget imbalances, declining reserves, and governance concerns.

Outlook

Taxable municipal bonds continue to be a fundamentally solid asset class, offering diversification to portfolios. However, in light of current valuations, we have gradually reduced our exposure to pursue more compelling opportunities elsewhere. While we do not expect substantial upside at these levels, we continue to view them as a strategic component, particularly for accounts with limited access to alternatives such as corporates or securitized credit.

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Technical Terms: the technical terms below are sourced from Corporate Finance Institute, the Bureau of Economic Analysis (BEA), and MSCI.

The **coupon rate** is the amount of annual interest income paid to a bondholder, based on the face value of the bond.

The **fed funds rate** refers to the interest rate that depository institutions (such as banks and credit unions) charge other depository institutions for overnight lending of capital from their reserve balances on an uncollateralized basis.

Mortgage-backed security (MBS) investing means purchasing a bond-like investment that represents a share in a pool of mortgages. When you invest in an MBS, you receive regular payments of interest and principal from the homeowners' loans, providing a steady stream of income.

CMBS (Commercial Mortgage-Backed Securities) investing involves buying bonds backed by pools of loans on income-producing commercial properties, such as office buildings, hotels, and retail centers. Investors receive regular income from these bonds through the principal and interest paid by the property owners on the underlying mortgages.

Asset-Backed Security (ABS): It is a type of bond whose payments are generated by a specific pool of underlying assets, such as auto loans, credit card debt, student loans, or leases. Investors buy these securities to earn reliable income streams derived from regular debt repayments.
Collateralized Loan Obligation (CLO) in finance, it is a single security backed by a pool of debt, typically corporate loans with below-investment-grade ratings.

Option-Adjusted Spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is then adjusted to take into account an embedded option. Typically, an analyst uses Treasury yields for the risk-free rate. The spread is added to the fixed-income security price to make the risk-free bond price the same as the bond.

A local government's general fund financial reserves or "**rainy day" fund** is a safeguard against risks like recessions that blow a hole in the budget or extreme events that demand a quick and decisive public safety response.

Real **gross domestic product** (GDP) is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy in a given year, expressed in base-year prices.

The **Trepp CMBS delinquency rate** refers to the percentage of loans within a financial institution's loan portfolio whose payments are delinquent.

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Important Information & Disclosures

A Note on Indices: The volatility of an index varies greatly. All indices are unmanaged and investments cannot be made directly in an index.

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The **Bloomberg U.S. Corporate High Yield Index** is an unmanaged, U.S. dollar-denominated, nonconvertible, non-investment-grade debt index. The index consists of domestic and corporate bonds rated Ba and below with a minimum outstanding amount of $150 million.

The **Bloomberg U.S. Corporate Investment Grade Bond Index** measures the investment-grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

The **ISM Manufacturing Index**, also known as the Purchasing Managers' Index (PMI), is a key monthly economic indicator that measures the health of the U.S. manufacturing sector. It is compiled by the Institute for Supply Management (ISM) based on surveys from over 400 purchasing executives across 20 industries.

Brent Crude is the benchmark used for the light oil market in Europe, the Middle East, and Africa (EMEA). Originating primarily from North Sea oil fields, the benchmark was expanded in 2023 to include crude from the Permian Basin in Midland, TX.

The **Consumer Price Index (CPI)** is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Indexes are available for the U.S. and various geographic areas. Average price data for select utility, automotive fuel, and food items are also available.

The **core Personal Consumption Expenditure (core PCE) Index** is a measure of prices that people living in the U.S., or those buying on their behalf, pay for goods and services.

The **Bloomberg U.S. MBS Index** covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). It is formed by grouping the universe of individual fixed rate MBS pools into generic aggregates.

The **RCA Commercial Property Price Index (RCA CPPI)** is a widely used benchmark that tracks transaction-based price movements in commercial real estate. Published by MSCI, it measures changes in actual sales prices using a repeat-sales regression methodology, providing insights into the market's health and asset valuation trends.

The **ICE BofA MOVE Index** is a well-recognized measure of U.S. interest rate volatility that tracks the movement in U.S. Treasury yield volatility implied by current prices of one-month over-the-counter options on 2-year, 5-year, 10-year and 30-year Treasuries.

The **ISM Manufacturing Index** (Manufacturing PMI) indicates the level of demand for products by measuring the amount of ordering activity at the nation's factories. The **ISM Non-Manufacturing Index** (Services PMI) measures business activity for the overall economy; above 50 indicating growth, while below 50 indicating contraction.

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