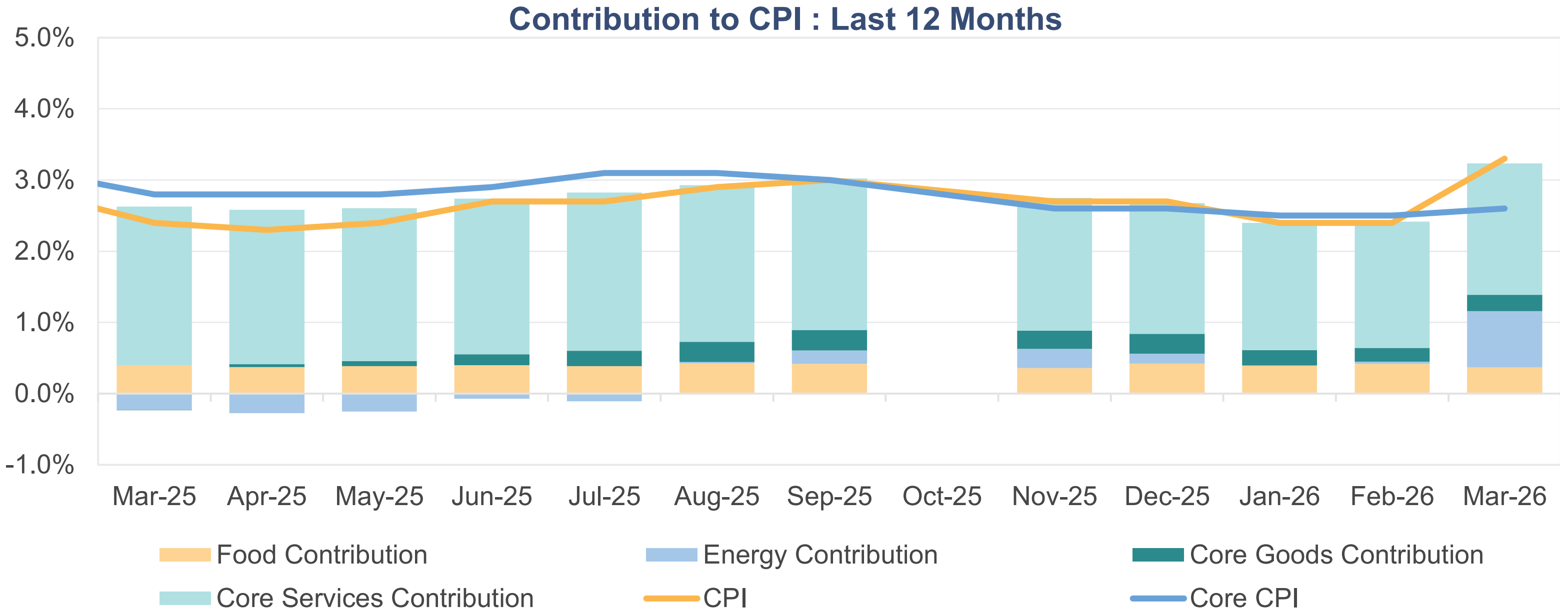
Taxable Fixed Income Commentary

1st Quarter 2026

Economic Overview

Investors entered the year with cautious optimism, as the fog of last year's government shutdown slowly cleared and themes were largely intact, specifically economic activity on the upswing, a low-turnover labor market, and a persistently above target inflation rate. After months in contractionary territory, the ISM Manufacturing Index moved back into expansion, while the ISM Service Index surged back towards multi-year highs, with solid gains in the new orders components of each index. In the labor market, headline job growth was erratic with large gains in January and March but winter weather, labor strikes, and turn of the year seasonal factors led to job losses in February. However, other labor market indicators, such as initial jobless claims, the unemployment rate, the hiring rate, and the firing rate all pointed to a stable labor market without immediate concerns on the labor demand side. Inflation data, meanwhile, painted a mixed picture during the quarter. While core CPI came in at a relatively benign 2.5% in February, the BLS structurally underreported inflation due to the government shutdown. BLS methodology assumed no change in any price level when data could not be collected; thus with no observation in October, the annual CPI data consisted of just 11 monthly observations. PCE data showed a different situation, with core prices rising 3.1% year-over-year in January, which was corroborated by sharp increases in the prices paid components of the ISM Indices, all before the price impact of the Iranian conflict.



The fog of uncertainty descended upon markets again in the second half of the quarter, first through AI disruption concerns, then through the conflict in the Middle East. Sharply accelerating updates to various large language models raised the specter of AI meaningfully reducing labor demand while also stoking fears that various industries would be wholesale replaced. Then, hostilities in Iran led to subsequent threats to close the Strait of Hormuz, and with it, prevent the flow of essential energy and goods to global markets. The market response to the evolving narrative was first lower yields from AI disruption, but then higher yields on inflationary concerns. For the quarter, the U.S. 10-year Treasury yield traded in a 49-bp range, touching as high as 4.43%.

Chart sources: Bureau of Labor Statistics (BLS); Sterling Capital Management Analytics. All data referenced herein is as of 03.31.2026 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; CPI = Consumer Price Index; core PCE = core Personal Consumption Expenditures; AI = artificial intelligence; Fed = Federal Reserve; bps = basis points. This information must be read in conjunction with the important disclosures and definitions on the last page.

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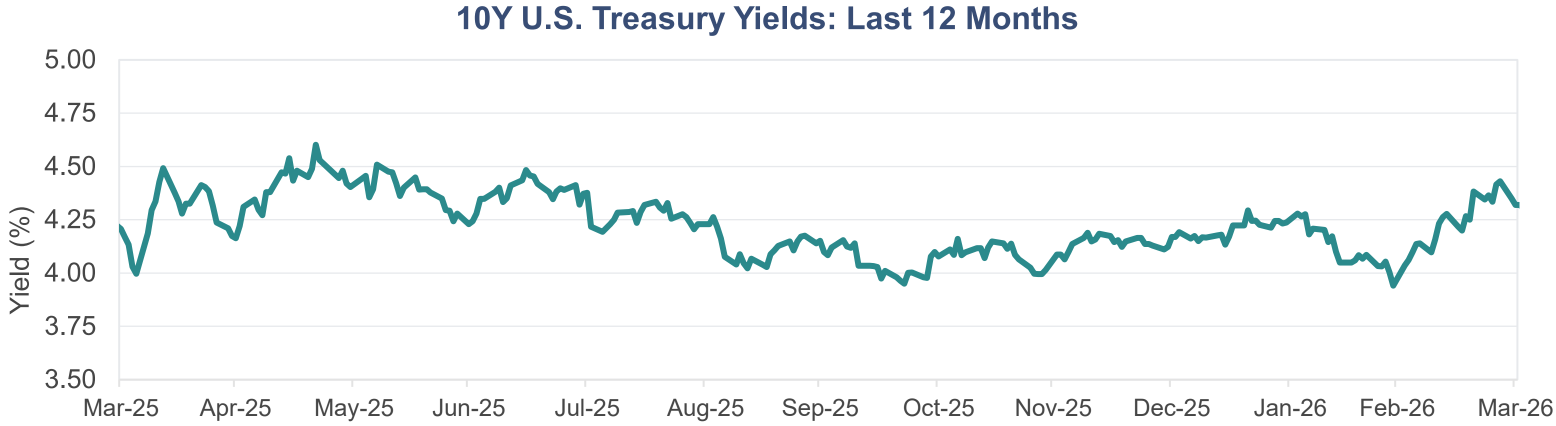

Amidst the evolving economic backdrop, the Fed spent the quarter on the sidelines. After cutting interest rates twice in 4Q25, the Fed held rates steady at both of its meetings in Q1. At its March meeting, Chair Powell reinforced that the Fed was carefully monitoring economic developments related to its dual mandate as well as conditions in the Middle East, and that the Fed can afford to be patient. The Fed viewed its policy rate setting as close to neutral and appropriate given various measures of both labor and inflation. Additionally, the Fed updated its Summary of Economic Projections, upgrading its 2026 growth outlook to 2.4% from 2.3%, increasing its core PCE forecast to 2.7% from 2.5%, while maintaining its unemployment outlook at 4.4%.

Outlook

Uncertainty once again reigns supreme in the market, as the rapidly evolving conflict in Iran and implications for the Strait of Hormuz have potentially significant impacts on domestic and global growth. Heading into 2026 we expected GDP growth of 2.5% with the balance of risks skewed to the upside. While we still believe that U.S economic fundamental strength is largely intact, specifically through solid household and corporate balance sheets, a stable labor market, and last year's Fed rate cuts, there are now greater risks to the downside the longer the Strait of Hormuz remains effectively closed. Roughly 20% of global oil products, 20% of global liquid natural gas products, and 30% of global fertilizer products traverse the Strait. A closed strait represents a significant supply chain disruption and thus higher prices. Since the start of the year, Brent crude prices have nearly doubled on supply chain fears. The situation is highly fluid, however the longer the conflict persists, the worse its effects. Higher prices can ultimately lead to demand destruction, margin compression, and potentially an equity market route that degrades the wealth effect of higher income consumers. The Fed will be on hold for the foreseeable future, as the conflict risks higher near-term inflation, while adding uncertainty to the hiring environment. As a result, portfolio durations will be managed approximately neutral versus benchmarks as we assess incoming developments in Iran and broader implications for the economy.

Chart source: Bloomberg L.P. All data referenced herein is as of 03.31.2026 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. This information must be read in conjunction with the important disclosures and definitions on the last page.

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Corporate Credit

Buffeted by a variety of crosswinds, corporate bonds traded in a relatively wide range versus the previous few quarters to start 2026. Heavy issuance, growing worries about AI disruption and knock-on effects in the private credit market, and the outbreak of war with Iran conspired to push risk premia in the sector wider, while strong technical conditions and company earnings worked in the opposite direction. The option-adjusted spread (OAS) on the Bloomberg U.S. Corporate Investment Grade Index tightened as much as 7 bps in January before selling off 18 bps to close 11 bps wider on the quarter to underperform duration-matched Treasuries by 0.49%. High yield bonds followed a similar pattern, performing well over the first few weeks of the year before weakening and finishing with spreads wider by 51 bps, generating a negative excess return of -0.73% for the Bloomberg U.S. Corporate High Yield Index.

Investment grade issuance surged to a first quarter record of $637B, an 18% increase over last year's pace. While issuance rose significantly, demand actually outpaced it early on as new deals drew huge subscription levels and largely priced inline with existing bonds. However, sentiment began to shift as the calendar turned to February. Supply remained very heavy and began to weigh on dealer balance sheets, while a series of announced advancements in artificial intelligence capabilities sparked concerns on the potential for disruption in a number of industries, particularly software. In turn, investors focused on the high levels of software exposure in the private credit market, sparking outflows from private credit funds and rising risk premia in the bonds of related sub-sectors.

In the high yield market, primary issuance came at a similar pace, printing $79.7B in the quarter representing an increase of 17.1% over the first quarter of 2025. Despite heavy supply, the market was able to absorb this with no discernable issues. Large M&A and LBO deals for Nexstar and Electronic Arts came late in the quarter and were well received by investors, clearing the decks for lighter issuance over the first few weeks of the second quarter.

March brought the U.S. and Israeli attack on Iran and the subsequent closing of the Strait of Hormuz, which triggered a spike in oil prices, inflation expectations, and Treasury yields. While equity markets sold off, corporate bonds managed to limit the damage, as spreads widened only modestly, despite a record week of $115B in investment grade supply during the first week of the month and a monthly total of over $240B. The surprisingly strong March performance appeared to be driven by the move higher in yields, which brought in strong buy interest from institutional investors. Market weakness led to some decompression between investment grade and high yield, with the OAS on the Bloomberg U.S. Corporate High Yield Index touching a year-to-date low of 250 bps in January before widening to end the quarter at 335 bps. Nevertheless, high yield spreads ended the quarter in the lower ten-year quartile, implying low single-digit default rates over the next twelve months.

The energy sector outperformed this quarter in the investment grade index, returning a positive excess return of 0.44%, with transportation the only other sector in the black. Financials, particularly finance companies, insurance companies and alternative asset managers underperformed along with the technology sector, trailing duration-matched Treasuries by 0.29 to 0.81%. The pattern was similar in high yield, energy and natural gas utilities being the only sectors with positive excess returns of 2.21% and 1.07% respectively, while financials and transportation lagged with excess returns of -1.94% and -2.66%.

All data referenced herein is as of 03.31.2026 unless otherwise noted. Yields are subject to market conditions and are therefore expected to fluctuate. Textual data source: Bloomberg L.P. OAS = option-adjusted spread; M&A = mergers and acquisitions; LBO = leveraged buyout. This information must be read in conjunction with the important disclosures and definitions on the last page.

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Outlook

We believe that many of the tailwinds supporting credit valuations entering this year remain in place despite the ongoing war with Iran, namely fiscal and monetary policy tailwinds encouraging capital expenditures and strong company earnings plus all-in yields that are attractive to long term investors. However, the longer the Strait of Hormuz remains closed and the higher oil prices climb, the threat to U.S. economic growth will rise as consumer spending gets pinched. As investors shift their concerns from rising inflation to falling growth, Treasury yields could fall, removing a key support for corporate bond demand.

Valuations have adjusted only modestly thus far, and we therefore remain somewhat cautious on credit and maintain only a small overweight. We favor sectors that should benefit from increased defense spending and investment in infrastructure like the capital goods sector and are maintaining a neutral weighting to energy while the conflict with Iran continues. We expect headlines and volatility around private credit to continue but we believe that investors are being more than fairly compensated in the securities of the largest and most experienced finance company sponsors and very large life insurance companies with private credit exposures in their investment portfolios.

Securitized Products

Securitized products generally outperformed duration-matched Treasuries to start the year, with agency MBS, CMBS, and consumer ABS posting positive excess returns, while CLOs were flat relative to Treasuries. The quarter was particularly volatile for agency MBS, which got off to a great start in January following the Trump administration's early-January directive for Fannie Mae and Freddie Mac (the GSEs) to purchase up to $200B in additional MBS in an effort to support spreads, lower mortgage rates, and improve housing affordability. The market responded quickly and the OAS for the index dropped six basis points during the month of January, with excess returns jumping out to 0.52% at month's end. February saw gradually declining interest rates, as geopolitical tensions continued to percolate, resulting in rising prepayment concerns in higher coupons along with moderately wider spreads. Sector weakness intensified in March as interest rates surged following U.S. strikes in Iran. As rates moved higher, mortgage durations extended and the bottom half of the coupon stack lagged Treasuries significantly. March saw excess returns for the MBS sector drop by 0.28%, pulling the total year-to-date figure down to 0.16%.

In a similar fashion, consumer ABS spreads widened in March, largely offsetting the spread tightening during January and February. OAS on the index tightened 5 bps to the low in February and then retraced 6 bps to finish the month at 54 bps. AAA-rated segments of the market widened 4 bps, mainly in prime auto loans and leases. Senior bonds from esoteric sectors performed reasonably well, keeping pace with on-the-run sectors. Subordinated bonds underperformed during March and subprime auto loan subordinated bonds were hit harder as the market repriced risk. Even with the near-term volatility, spread levels are back near their long-run medians in most sectors. First quarter 2026 ABS new issue volume reached $102B, well ahead of last year's record pace of $91B, and deal flow was spread evenly across the quarter. Much of the rise in primary market activity was from esoteric segments of the market such as data centers and fiber deals, which accounted for 6% and 5% of issuance, respectively. Autos and equipment still dominated the market in Q1 at 54% of issuance. ABS outperformed similar-duration Treasuries by 0.10% for the first quarter, despite the increased volatility in March from the war with Iran.

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Non-agency CMBS remained relatively stable during the quarter despite volatility in the broader market. The sector ultimately outperformed duration-matched Treasuries by 29 bps, driven primarily by its yield advantage, as spreads were largely unchanged. Supportive supply-demand technicals played an important role in the sector's resilience. While total issuance modestly outpaced the same period of last year, index-eligible conduit supply declined by roughly 20%. At the same time, secondary selling remained generally muted, as limited reinvestment opportunities within the sector discouraged investors from reducing existing exposure.

Fundamental conditions also contributed to investor confidence. According to the RCA Commercial Property Price Index, commercial real estate prices increased 0.4% over the three-month period ending in February and were up 1.3% year-over-year. Meanwhile, although the Trepp CMBS Delinquency Rate rose modestly to 7.55% in March from 7.30% three months earlier, the increase was not sufficient to materially impact investor sentiment, as delinquency rates are widely viewed as a lagging indicator. More forward-looking metrics - such as stabilizing property valuations, improved transaction activity, and better access to financing - continue to point to a gradually improving backdrop.

CLOs provided approximately flat excess returns during the quarter, equaling duration-matched treasuries at the AAA-rated level. AAA spreads rapidly widened 39 bps upon the outbreak of the Iranian conflict in late February, before recovering over the remainder of the quarter to ultimately finish at +126 bps, or 20 bps wider. While geopolitical volatility certainly battered CLO valuations as it did other credit markets, the real story of the quarter was the onset of AI disintermediation risk being broadly priced in the leveraged loan market. Software loans plunged in value during the quarter from the mid-90s dollar price to the low-90s, the impact of which was most acutely felt in tranches with more exposure to credit losses such as BBBs and BBs. These bonds widened by 77 bps and 161 bps during the quarter, respectively, with roughly half of the widening in each tranche occurring before the Middle Eastern conflict transpired, as the implications of the Claude Opus 4.5 model's release in December were digested by the market. According to Bloomberg, new issue totaled a robust $47.4B across the broadly-syndicated and private credit markets, or 0.5% higher year-over-year, while CLO ETF inflows remained a solid tailwind for AAAs, presenting a stable technical backdrop.

Outlook

We took advantage of the significant outperformance of agency MBS in January to lighten our exposure to the sector at relatively tight levels. Our focus was on reducing exposure to middle coupons, which had disproportionally benefited from increased demand following the January GSE announcement of increased MBS purchases. We maintained our exposure to higher coupon MBS, which we still view as having the best relative value within the agency MBS universe. Given underperformance of the whole sector in March, we plan to maintain current exposures for now, though we still view the sector as a source of funds as we uncover more attractive alternatives in other asset classes.

The sharp reversal of ABS spreads in the first quarter leaves the market near the midpoint of our gauges of relative value. This should provide some room for spreads to tighten going into Q2, although the timing and direction of spreads will be influenced more by macroeconomic and geopolitical factors. ABS credit performance so far remains well-behaved, in our view, although we are keeping a close eye on potential changes in the direction of the economy and the consumer. A sustained increase in oil prices will strain consumers, particularly lower income and subprime borrowers, through higher gas prices at the pump.

Further, a boost to food prices transmitted through the cost of fertilizer, and other products and services influenced by the cost of fuel, would likely provide a drag on household finances and bears watching. As spreads have widened, the attractiveness of on-the-run sectors, such as prime auto loans, has improved. 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. Robust new issue volume has the potential to strain demand from time to time.

Data centers and other non-traditional ABS sectors, which are not part of the Bloomberg Index, have driven most of the growth in the ABS market over the past few years, and are likely to do so again next year. We are adding selectively in the technology/data center 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 data center expansion.

In CMBS, we selectively added exposure on weakness, particularly later in the quarter when spreads softened in sympathy with broader credit markets. We remain constructive on the sector. While the recent rise in Treasury yields could present near-term headwinds by increasing borrowing costs and pressuring valuations, we view any spread widening as an opportunity to add. The Fed is expected to remain in an easing cycle, which should ultimately support real estate fundamentals through lower financing costs and improved liquidity, provided economic growth remains resilient.

Lastly, we view high-quality floating-rate CLO exposure as an important portfolio anchor in the context of the ongoing energy price shock, which may sustain inflation and drive interest rate uncertainty. We consider AAA-tranches to be the best relative value in the space, offering spreads at an attractive 61st percentile over a 10-year period as well as substantial structural remoteness from incremental software pressure. The uncertain outlook for software loans within collateral pools is likely to hang over lower-rated CLO debt over the medium term, as only time can reveal the actual threat to these businesses, and in the near-term, concern over their ability to refinance continues to percolate. Within AAAs, we continue to see shorter or higher coupon profiles as being attractive owing to their more resilient nature to potential further spread widening.

Taxable Municipals

Taxable municipal securities outperformed duration-matched Treasuries by 0.51% during the quarter, as spreads tightened six basis points and investors continued to reach for yield. Issuance was again muted, with total taxable issuance coming in at $5.9B and down 13.7% year-over-year, as municipalities continue to favor the tax-exempt market.

Municipal credit fundamentals remained sound during the first quarter, though rating agency activity showed a modest tilt toward negative actions. S&P reported that downgrades outpaced upgrades during the first two months of the year, driven primarily by issuer-specific factors rather than signs of systemic credit deterioration. Pressure remained concentrated within select sectors, particularly local governments and not-for-profit healthcare, where rising labor costs, ongoing capital needs, and post-pandemic revenue normalization continued to challenge operating margins.

In contrast, state-level credit quality remained a key source of stability, supported by strong reserve positions and conservative fiscal management. According to NASBO, the median rainy day fund balance as a percentage of spending is expected to increase to 14.4% in fiscal 2026. Looking ahead, most of the proposed fiscal year 2027 budgets reflected prudent growth assumptions alongside a continued emphasis on maintaining elevated reserve levels, positioning states to navigate a more uncertain macroeconomic environment.

Outlook

Taxable municipal bonds continue to be a fundamentally solid asset class, offering diversification to portfolios. That said, given current valuations, we have gradually reduced our exposure to pursue more compelling opportunities elsewhere. While we do not anticipate significant upside at these levels, we still consider them a strategic holding, particularly for accounts with limited access to other asset classes like corporates or securitized credit.

Important Information & Disclosures

Past performance is not indicative of future results. Any type of investing involves risk and there are no guarantees that these methods will be successful. Economic charts are provided for illustrative purposes only. The information provided herein is subject to market conditions and is therefore expected to fluctuate.

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

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 **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.

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.

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.

The **Real Capital Analytics' Commercial Property Price Index™** (CPPI™) measures the actual price experience of property investors, based on transaction data.

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.

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

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.

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