

Comprehensive Research, **Broad** **Diversification**

Justin Kass, CFA
Portfolio Manager

David Oberto
Portfolio Manager

Ethan Turner, CFA
Portfolio Manager

Strategy overview

Total return approach, investing in below investment grade corporate securities.

Key takeaways

- High-yield (HY) bonds advanced in the fourth quarter.
- For the quarter, the Class I shares of the Fund outperformed the benchmark on a net asset value (NAV) basis.
- 2026 U.S. economic growth could surpass that of 2025, with potential tailwinds including stimulus from the One Big Beautiful Bill Act (OBBBA) (tax cuts and refunds as well as capital spending acceleration), foreign direct investment from overseas, continued monetary policy easing (including the recently announced asset purchase program), and steady consumption.

Portfolio review

HY bonds advanced in the fourth quarter. Third-quarter earnings results beat expectations on strong artificial intelligence (AI) spending, though management commentary highlighted cost pressures and uneven demand trends. Economic data was mixed and visibility was impacted by the government shutdown; labor market indicators softened, while consumer spending and inflation metrics were stable. The U.S. Federal Reserve cut rates by 25 basis points (bp) in both October and December, and signaled further accommodation with markets pricing additional cuts into 2026. Against this backdrop, the 10-year U.S. Treasury yield finished modestly higher at 4.17% despite significant intra-quarter volatility.

The ICE BofA US High Yield Index returned 1.35% for the quarter, bringing full-year performance to 8.50%. BB, B, and CCC rated bonds returned 1.57%, 1.55%, and -0.52%, respectively. Spreads modestly widened to 281 bp from 280 bp, the average bond price fell to 98.06, and the market's yield rose to 7.08%. Industries were mostly positive for the period. Gaming, metals, and healthcare outperformed whereas packaging and paper, chemicals, and cable underperformed. Trailing 12-month default rates finished the period at 1.88% (par) and

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1.40% (issues). The upgrade and downgrade ratio increased to 1.3. Quarterly new issuance saw 75 issues priced, raising \$65.4 billion in proceeds, bringing the full-year total to \$332.0 billion. Mutual fund flows were estimated at \$1.9 billion.

For the quarter, the Class I shares of the Fund outperformed the benchmark on a (NAV) basis. The portfolio's underweight to CCC rated bonds, which underperformed BB and B rated bonds, was a relative performance tailwind. Industries helping relative performance in the period included financial services, cable and satellite TV, and building materials. Security selection was the main source of strength in financial services, with an industry overweight providing a modest additional benefit. Overweight exposure to several outperforming issues from media companies drove performance in the cable and satellite TV industry. Within building materials, relative strength was attributable to positioning in issues in concrete products, exterior materials, and metal fabrication, offsetting a minor negative impact from an industry overweight. Industries detracting the most from relative performance in the period were healthcare, support-services, and gaming. The primary source of weakness in healthcare was exposure to an underperforming pharmaceutical issue, with some additional detraction stemming from an industry underweight. Security selection weighed on performance in support-services, primarily due to overweight positioning in an equipment rental issue. Within gaming, security selection across several casino operators had the largest negative impact.

Current strategy and outlook

2026 U.S. economic growth could surpass that of 2025.

Potential tailwinds include stimulus from the OBBBA (tax cuts and refunds as well as capital spending acceleration), foreign direct investment from overseas, continued monetary policy easing (including the recently announced asset purchase program), and steady consumption. Reshoring activity, less regulation, expanding credit, and a rebound in consumer and business confidence are also potential drivers. Improvements in the housing or manufacturing sectors could aid growth as well. Key economic risks include heightened geopolitical tensions and elevated fiscal deficits globally. Additionally, if unemployment or inflation rise sharply, the odds of an economic slowdown increase.

In an environment where changes in the labor market and prices are more muted, the Fed can continue to target a neutral policy position. Currently, market odds suggest additional interest rate cuts to a range of 3.00–3.25%—a level that is consistent with the Fed's median, longer run projection of 3%.

The U.S. HY market, yielding more than 7%¹, offers equity-like returns but with less volatility. The asset class is expected to deliver another year of coupon-like returns in 2026. The market's attractive total return potential is a function of its discount to face value and higher coupon, which also serves to cushion downside volatility. Credit fundamental factors are stable, near-term refinancing obligations remain low, and management teams continue to exercise balance sheet discipline. Additionally, the market's credit quality composition has improved. In this environment, new issuance is expected to remain steady, spreads can stay tight, and the default rate should continue to reside below the historical average.

Longer-duration issues are the most likely to be impacted by high and volatile rates, but the overall HY market should have a dampened response due to its larger coupon relative to other fixed income alternatives. As a result, U.S. HY bonds contribute from both a diversification and a relative-performance perspective, offering a very compelling yield opportunity.

¹Source: ICE Data Services; data as of December 2025

The **Bloomberg U.S. High Yield 2% Issuer Capped Index** is an unmanaged index comprised of fixed rate, non-investment grade debt securities that are dollar denominated and non-convertible. The index limits the maximum exposure to any one issuer to 2%. Index returns do not reflect fees, brokerage commissions, taxes or other expenses of investing. **Investors cannot invest directly in an index.** Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). Bloomberg or Bloomberg's licensors own all proprietary rights in the Bloomberg Indices. Bloomberg does not approve or endorse this material, nor guarantee the accuracy or completeness of any information herein, nor make any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, shall not have any liability or responsibility for injury or damages arising in connection therewith.

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