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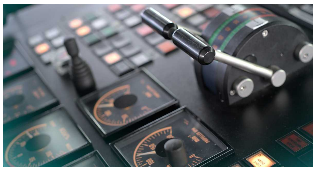

Navigating Challenging Fixed Income Markets

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Investing is never easy, but it is especially challenging this year. Inflation has reached 40-year highs with major ramifications for securities markets. U.S. equity market declines were foreshadowed by a historically severe drawdown across bond markets in the first quarter of the year. Supply chain disruptions have continued while major events, including the Russia-Ukraine war and slowing growth in China, further threaten the global economy. Meanwhile, developed market central banks are tightening aggressively into the inflationary environment even as growth slows.

If inflation and rate increases do not rise above current market expectations, however, there is a case for longer-duration instruments. While bonds have been more volatile and more correlated to equities in the first part of 2022, this relationship has not been the case historically. If inflation moderates and proves to be more of a money supply shock from the COVID response, the diversification benefits and defensive ballast that longer-duration government bonds provide could be an attractive value opportunity.

Approaching Fixed Income Markets

Given the current backdrop, it has been an especially challenging year for fixed income investors. Fixed income indices began the year with record-high duration, which led to the worst drawdown in decades, and the increased volatility has added an additional layer of complexity. What type of approach may help navigate such a difficult fixed income market environment?

Asset allocation models are well documented across the investment universe, and portfolio diversification is a widely accepted principle. Within fixed income markets specifically, the same premise can be applied to managing bond allocations. Applying an active, multi-sector approach in fixed income investing has historically led to improved risk-adjusted returns and lower drawdowns over time.

Taking Advantage of Different Cycles

Fixed income markets and segments are far from homogenous. What makes the diversification beneficial is the range of outcomes different fixed income segments may return over time. For example, yearly returns across different broad fixed income categories vary significantly, and the top-performing segment often changes from year to year (see Figure 1). While bond yields are the common denominator, other sources of alpha can drive returns, especially during different times of the economic cycle. These wide variations of outcomes and low correlations among fixed income segments allow managers to actively position portfolios over time for better return potential.

1

Annual Performance for Broad Fixed Income Categories Varies Widely

Median One-Year Gross Returns, As of 12/31/2021

	Global Aggregate Fixed Income - Median	Global Emerging Mkts Fixed Income - Corporate Debt - Median	Global Emerging Mkts Fixed Income - Local Currency - Median	Global Government Fixed Income - Median	Global High Yield Fixed Income - Median	Global Securitized Fixed Income - Median	Global Multi-Sector Fixed Income - Median
12/31/2010	6.98%	14.87%	15.32%	6.99%	14.16%	13.08%	12.51%
12/31/2011	5.05%	2.96%	-2.40%	6.16%	3.10%	2.34%	4.84%
12/31/2012	7.77%	18.65%	17.27%	5.81%	17.96%	16.54%	12.74%
12/31/2013	-1.68%	-0.24%	-8.32%	-2.56%	8.03%	6.89%	2.07%
12/31/2014	1.44%	4.27%	-4.96%	1.31%	1.41%	5.67%	4.07%
12/31/2015	-3.53%	0.21%	-14.12%	-4.14%	-2.01%	0.80%	-0.69%
12/31/2016	1.68%	11.02%	10.20%	1.10%	14.08%	4.27%	8.30%
12/31/2017	8.26%	9.86%	15.36%	7.79%	8.68%	6.52%	6.99%
12/31/2018	-1.63%	-2.29%	-6.94%	-0.82%	-2.63%	2.51%	-1.37%
12/31/2019	8.25%	13.92%	13.77%	6.34%	14.84%	5.44%	10.69%
12/31/2020	10.04%	8.40%	3.50%	10.53%	6.72%	1.25%	7.87%
12/31/2021	-4.20%	0.65%	-7.83%	-6.48%	4.20%	3.31%	1.42%

Source: eVestment, Brandywine Global

eVestment is a third-party, global provider of institutional investment data intelligence and analytic solutions. eVestment universes are based on a set of criteria which includes qualitative and quantitative factors to create and maintain a comparative peer group. eVestment collects information directly from investment management firms and other sources believed to be reliable and accurate. Only products reporting gross-of-fee performance and a base currency of USD are included in the eVestment universe calculation. Annualized performance rankings of the products versus the applicable eVestment universe as 12/31/2021.

Responding to the Macro Environment

A bond portfolio does not need to remain static. It can function both as an income generator in the best of times and as ballast to equities and other risk assets in a challenged growth environment. While the investment process remains consistent, the objective can differ depending on market conditions. The outcome of this type of dynamic solution has been compelling. Figure 2 highlights the returns, standard deviation, and risk measures of multiple fixed income segments since the recovery from the Global Financial Crisis. The returns are comprised of the median managers within each category. It is no surprise to many that the best overall return comes from the Global High Yield median manager. However, with higher returns also come higher volatility and drawdowns. Meanwhile, the median Global Multi-Sector manager successfully delivered attractive returns while sacrificing only a modest amount of return. In exchange, the Global Multi-Sector median manager produced a substantial drop in both volatility and drawdown, beating its single-mandated peers in both risk

categories.

2

Since the GFC, Metrics for Broad Fixed Income Segments Have Differed

Comparative Statistics, 12/31/2009 - 3/31/2022

	Annualized Gross Return	Standard Deviation	Return per unit of Risk	Maximum Drawdown
Global Aggregate Fixed Income - Median	2.51%	4.84%	0.52	-9.90%
Global Emerging Markets Fixed Income - Corporate Debt - Median	5.79%	7.07%	0.82	-13.84%
Global Emerging Markets Fixed Income - Local Currency - Median	1.55%	11.45%	0.14	-27.96%
Global Government Fixed Income - Median	1.98%	4.91%	0.40	-11.95%
Global High Yield Fixed Income - Median	6.63%	7.16%	0.93	-13.93%
Global Securitized Fixed Income - Median	5.33%	5.49%	0.97	-12.10%
Global Multi-Sector Fixed Income - Median	5.21%	4.63%	1.13	-8.44%

Source: eVestment

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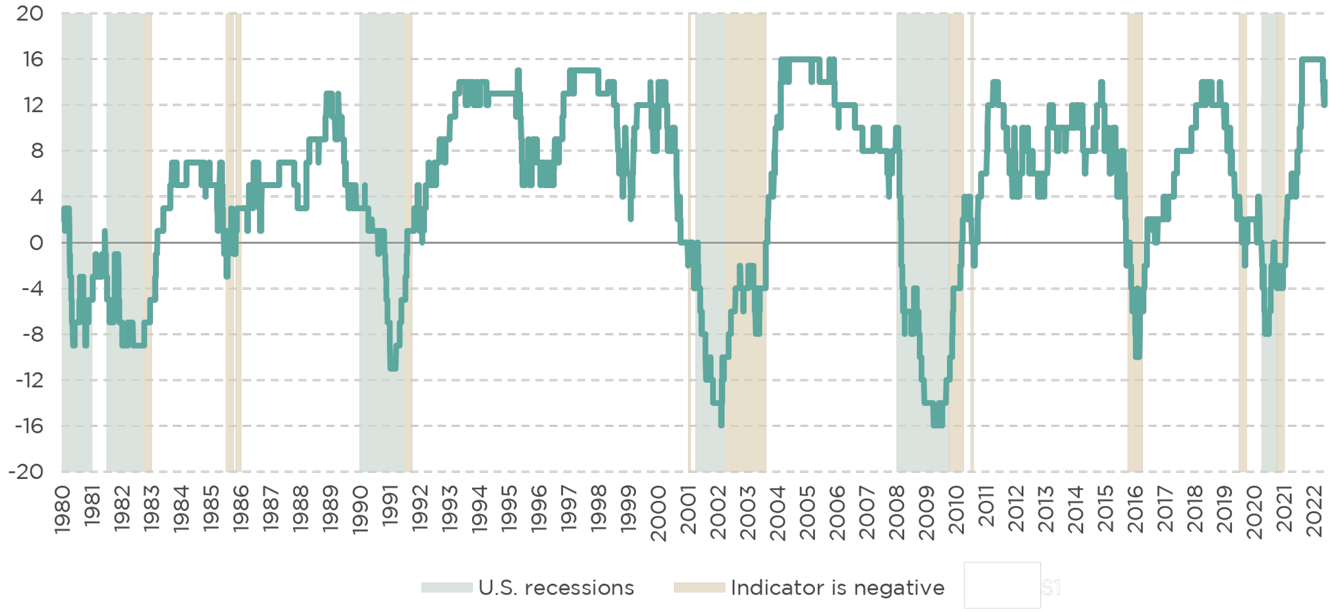
Managing Timing and Volatility

Fixed income investors are caught in a quandary. Bond yields have risen yet growing concerns over the likelihood of a recession and the path of central bank rate hikes make it difficult to gauge the next phase for yields and determine when to add duration. Similarly, recent spread widening in corporate bonds creates an attractive entry point in terms of valuations; however, growing risks to economic growth and corporate profits increase the probability of further spread widening and defaults. Lastly, shorter economic cycles in recent years add further complexity to manager decisions around timing opportunities. A multi-sector approach to fixed income may help to smooth the risk and potential impact on returns.

Our internal recession model (see Figure 3) illustrates how business cycles have compressed since the dot-com crash in the early 2000s, requiring managers to be faster and more responsive as opportunities materialize more quickly. For 2022, a buy-and-hold or passive, indexed fixed income manager would be having a very troubling year-to-date experience. We feel that the rapidly changing macro environment further argues for an active multi-sector fixed income solution that can rotate between asset classes in response to the broader macroeconomic forces driving the overall economy. Various economic indicators can be used to guide a portfolio manager in prudent strategic positioning as the economy reacts to fiscal policy, monetary policy, inflation, employment, corporate profitability, and so on. The current macroeconomic landscape requires a nimble, flexible, and focused approach to finding value across the entire fixed income landscape while not being beholden to index-like static allocations.

3 **U.S. Recession Indicator***

Model, As of 5/24/2022



*Based on 16 components, including interest rates, high yield spreads, business confidence and activity, corporate profits, equity and lumber prices.

Source: Brandywine Global, Macrobond

Top-down and Bottom-up

Historical results highlight how a multi-sector approach should lead to better risk-adjusted outcomes. In the current environment, we believe this type of dynamic approach becomes even more important, particularly relative to passive strategies or those that tie duration decisions to benchmark weightings. Ultimately, we believe the key to success when managing a multi-sector solution is a disciplined, macroeconomic-focused approach coupled with bottom-up fundamental analysis. In other words, the macro research can drive the allocation across duration, sector, and quality while bottom-up diligence can determine the selection. In combination, the end result should provide an outcome that can adapt to an increasingly challenging market environment.

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