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MARKET REVIEW

- Most fixed income spread sectors generated positive total returns and outperformed duration-equivalent government bonds as spreads narrowed. Most global sovereign yields declined markedly on cooling US economic releases, receding European election risks, and expectations of more aggressive Fed policy easing.
- US economic data releases were mixed. Consumers remained positive, according to the Conference Board survey, despite high borrowing costs and elevated prices. The labor market stalled as the unemployment rate edged higher, nonfarm payrolls posted lackluster gains, and jobless claims rose steadily. Retail sales stabilized, and excluding autos posted a modest gain, while the producer price index inched higher on account of higher service costs. The trade deficit widened, led by a large drop in pharmaceutical imports; meanwhile, wholesale inventories growth missed expectations. Manufacturing PMI fell on a significant drop in new orders' demand. Durable goods orders plunged owing to a steep decline in transportation, led by commercial aircraft. New home sales declined, following a more pronounced downward revision the prior month, and construction spending missed expectations.
- Eurozone manufacturing PMI fell further into contractionary territory, and industrial production declined, led by Germany and France. Germany's industrial production plummeted, owing to supply chain challenges impacting the automotive segment. UK's manufacturing and services PMIs each expanded.

FUND PERFORMANCE AND ATTRIBUTION

- The portfolio generated positive total returns during the month of July.
- Positive total returns were driven by our Strategic sector positions, followed by Tactical and Relative Value positions. Duration drove positive total returns at the portfolio level, while credit exposure detracted amidst modest spread widening across credit sectors.
- Within our Strategic sector, exposure to Activist Governments and EM Opportunities were the largest contributors. Within emerging markets, local markets debt outperformed external debt. Spread widening detracted from external debt performance, while a decrease in US Treasury yields had a positive impact. EM currencies appreciation drove the positive performance within local markets, and EM rates movement also benefited results.
- Within our Relative value theme, exposure to Discretionary Macro Rates, Global Credit Absolute Return, and Opportunistic Currencies had a positive impact on results. The USD ended mixed versus most major currencies as the market grappled with US election uncertainty and more signs of a slowing US economy. Among the G10, the JPY rallied against the USD, following the unwinding of carry trades further compounded by the BOJ's decision to hike rates.
- Within our Tactical sector, exposure to Agency Mortgages and Duration Management contributed to performance over the period.

FUND POSITIONING AND OUTLOOK

- Over the last year, we have been positioning the portfolio for decelerating US data particularly compared to the rest of the world. This has largely not occurred because of robust fiscal spending in the US despite very high level of interest rates. However, the growth rate of government spending is slowing and consumer excess savings accumulated during Covid have been largely exhausted, leading US economic data to start weakening markedly.
- We also believe that the inflation data has now come in weak enough to justify the beginning of a Fed cutting cycle. The June core CPI print showed a month-over-month change of only 0.065%; this is the lowest monthly change since the US economy was in the throes of the pandemic. In addition, core CPI less shelter has been in deflation over the past two months, and has only grown 1.8% over the past year, which is similar to its growth rate pre-pandemic. Shelter inflation, which is the largest component of CPI, has been very high and sticky, but even this component is starting to decelerate. Shelter tends to be the most lagging part of inflation, and it makes very little sense for the Fed to wait to cut interest rates until shelter inflation returns to trend. In our opinion, the Fed already has enough data that inflation will converge to its 2% target over the medium term.
- We view the opportunity set in fixed income as one of the most attractive we have seen in our careers, and although volatile, it is an environment where our philosophy and process have served us well in the past. Despite the initiation of rate cutting cycles around the world, we believe that clients have not yet missed the opportunity to add fixed income to their portfolios. History has demonstrated that bonds outperform cash after the Federal Reserve stops hiking, making now an opportune time to move out on the risk spectrum from cash to high quality total return fixed income strategies like Opportunistic Fixed Income.

PAST PERFORMANCE DOES NOT PREDICT FUTURE RETURNS. AN INVESTMENT CAN LOSE VALUE.

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