3Q 2024

QUARTERLY COMMENTARY

Penn Mutual
Asset Management

QUARTER IN REVIEW AND HIGHLIGHTS

After a brief equity market sell-off and volatility surge in early August, the stock market rally quickly regained traction as the third quarter came to a close. The S&P 500 Index notched 43 record high closes during the first nine months of the year with the recent rally broadening out beyond just the large capitalization technology names. Investor enthusiasm regarding the potential of artificial intelligence (AI) started to fade as investors worried whether the significant AI spending will pay off.

- **After much anticipation, the Federal Reserve (Fed) announced its first interest rate cut since 2020 following its September meeting. Fed policymakers delivered a preemptive 50-basis-point cut to help sustain the current economic expansion and stave off a downturn in the labor market…** The 10-year Treasury rate moved steadily lower during the third quarter closing September at 3.78%, down 62 basis points (bps) since June. The record-long Treasury yield curve inversion (as measured between the 2-year and 10-year Treasury) came to an end in early September.

- **Despite a spike in equity market volatility in early August, credit markets witnessed relative stability as strong investor demand for attractive all-in yields limited the impact on spreads…** Investment-grade credit spreads tightened by five bps during the quarter, outperforming duration-matched Treasuries by 77 bps while the high-yield market registered a total return of 5.3%. Agency residential mortgage-backed securities (RMBS) also posted solid returns, outperforming duration-matched Treasuries by 90 bps.

- **Fed policymakers continue to upgrade their outlook for gross domestic product during 2024, now projected to grow above 2%, a level suggesting the Fed is on track to achieve the historically elusive economic "soft landing"…** Labor market conditions in the U.S. are showing pockets of weakness, including an uptick in the unemployment rate, but new job creation remains solid.

Our investment capabilities incorporate a unified investment philosophy and process across the risk spectrum

Enhanced Cash	Short Duration Bond	Strategic Income	Short Duration High Yield	Core Plus Bond	High Yield Bond	Balanced Income

SHORT DURATION BOND STRATEGY

The Short Duration Bond Strategy performed in line with its benchmark, the Bloomberg U.S. Government/Credit 1-3 Year Bond Index, during the third quarter. Short-term Treasury rates moved materially lower as the Fed lowered its policy rate by 50 bps during the September meeting. Fed policymakers also lowered their forward interest rate projections, citing improving inflation trends and weakening employment data. The 2-year Treasury note yield declined by 111 bps during the quarter, closing September at 3.64%.

Equity market volatility spiked in early August as numerous leveraged investors were forced to close out positioning tied to the unwinding of the yen carry trade. Credit markets remained relatively stable throughout the quarter as strong investor demand for fixed income spread products kept any spread widening to a minimum.

Yield curve steepening and securitized credit sector outperformance contributed to the solid results during the third quarter. Strategy overweights by sector include investment-grade corporate credit, high-quality collateralized loan obligations (CLOs) and student loan asset-backed securities (ABS).

STRATEGIC INCOME STRATEGY

The Strategic Income Strategy outperformed its benchmark, ICE BofA 3-Month U.S. Treasury Bill Index, during the third quarter. Fed Chair Powell cited better news on inflation and emerging signs of weakness in the labor markets as justification for the larger rate cut.

Strategy overweights include intermediate-duration corporate bonds, student loan ABS and RMBS. We are positioning for continued yield curve steepening while remaining opportunistic with duration management.

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ABOUT US

Penn Mutual Asset Management (PMAM) is an insitutional asset management firm located just outside of Philadelphia, PA. Since 1989, the firm has been dedicated to creating value through a prudent, thoughtful and rigorous investment decision-making process. With over $38 billion in assets under management, PMAM is committed to offering fixed income investment solutions and client-focused services.

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SHORT DURATION HIGH YIELD STRATEGY

The Short Duration High Yield Strategy outperformed its benchmark, the ICE BofA 0-2 Year Duration BB-B U.S. High Yield Constrained Bond Index, during the third quarter. Performance was solid throughout the period but also benefited from a one-time event — a distressed aircraft ABS bond was retired early at par, contributing approximately 50 bps during August.

High yield credit spreads continued to tighten as the market anticipated and then the Fed delivered on the first of its interest rate cuts. Spreads ended the quarter at close to 15-year tights with the growth outlook solid and default projections for 2025 benign. The front end of the high-yield market was strong, supported by tender/call activity as issuers looked to term out maturities. New issue supply was robust and met with strong demand.

The Strategy maintained its overall risk profile, adding selectively to a few bonds with more spread duration. The Strategy ended the quarter with a portfolio duration of just under two years, approximately half of year longer than the benchmark. Average portfolio credit quality was in the BB category while the average position size was approximately 1%.

CORE PLUS BOND STRATEGY

The Core Plus Bond Strategy underperformed its benchmark, the Bloomberg U.S. Aggregate Bond Index, during the third quarter. Treasury rates moved lower across the yield curve during the period with short-term yields leading the way. Fed policymakers cut rates by 50 bps in September; however, Fed Chair Powell indicated 25-basis-point cuts are more likely moving forward.

New purchase activity during the quarter was again focused on securitized spread sectors including agency guaranteed RMBS. We continue to reduce corporate bond holdings to source more attractive relative value opportunities in the structured credit markets. Strategy overweights by sector include Treasury Inflation-Protected Securities (TIPS) and RMBS.

HIGH YIELD BOND STRATEGY

The High Yield Bond Strategy underperformed its benchmark, the Bloomberg U.S. High Yield BA/B 2% Issuer Capped Index, during the third quarter.

The high yield credit market was strong during the quarter with spreads tighter and volatility muted. Down in quality credit outperformed, and for the first time in 2024, the very distressed part of the market rallied considerably. New issue supply remained robust, largely to support refinancing activity, which further served to chip away at the high yield maturity wall.

The Strategy maintained its overall risk profile, balancing select exposure to low-quality credit that has a solid fundamental outlook and/or positive catalysts/event risk, with core BB-rated bonds. Energy exposure was reduced in response to the decline in oil prices — the latter being a function of adequate supply in the market and concerns regarding reduced Chinese demand. Floating-rate bank loan exposure was also reduced to approximately 3% due to the expectation for more interest rate cuts by the Fed.

BALANCED INCOME STRATEGY

The Balanced Income Strategy outperformed its benchmark, the Morningstar Moderately Conservative Target Risk Total Return USD Index, during the third quarter. Both stocks and bonds rallied on an absolute basis. The Strategy's equity portfolio performed well on a relative basis while a few select bond and preferred holdings helped the fixed-income portfolio perform in line with its bond benchmarks.

The first eight months of 2024 were quite challenging for many traditional value investors and the Balanced Income Strategy alike. The ultra-concentrated performance driving the major stock market indexes produced favorable results for growth stocks and a handful of mega-cap technology names in particular. However, this market dynamic changed swiftly in September. The performance across the stock market broadened out dramatically and many stock categories that previously lagged caught up to the major indexes. For the Strategy and its all-cap stock positioning, this was a greatly welcomed change as small capitalization stocks and other traditional value sectors participated with positive returns.

In terms of overall allocation (stock, bond and cash weightings) and for the majority of the quarter, allocation remained nearly the same compared to the end of the second quarter with 38% in common stock, 57% in fixed income and 6% in cash. A few days prior to quarter-end, the Strategy received a significant inflow which was held in cash and short-term Treasury bills. As a result, the allocation shifted to 27% in common stock, 36% in fixed income and 37% in cash and equivalents. Our intention is to invest this additional capital deliberately over the first few weeks of the fourth quarter in opportunities that arise during what is typically the most seasonally volatile period of the year for markets.

The Strategy's positioning should provide the potential for higher portfolio yields while its focus on great balance sheets should help to protect future downside volatility. We will continue to monitor our investable universe for any opportunity to add value. We believe this focus on individual security selection will help to decrease the portfolio's exposure to market beta while allowing for positive alpha generation.

OUTLOOK

The bond market has again become too optimistic about the pace and scale of Fed rate cuts anticipated over the next year. Strong household and corporate balance sheets are likely to remain supportive of economic growth, reducing the odds of more "super-sized" Fed rate cuts. The lack of urgency by politicians to address growing U.S. fiscal imbalances increases the potential for Treasury market volatility.

INDEX DEFINITIONS:

Bloomberg U.S. Aggregate Bond Index – An index that is a broad-based flagship benchmark that measures the investment grade, US dollar denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).

Bloomberg U.S. Government/Credit 1-3 year Bond Index- The Bloomberg U.S. Government/Credit Bond Index is a broad-based benchmark that measures the non-securitized component of the US Aggregate Index. It includes investment grade, US dollar-denominated, fixed-rate Treasuries, government-related and corporate securities.

Bloomberg U.S. High Yield Ba/B 2% Issuer Capped Index – This index measures the performance of fixed-rate dollar-denominated debt securities with rating Ba/B. The securities instruments are non-investment grade. There is a limit of 2% maximum exposure to any one issuer.

ICE BofA 0-2 Year Duration BB-B U.S. High Yield Constrained Index – This index measures the performance of ICE BofAML 0-2 years Duration BB-B U.S. High Yield Bond. It's all securities in the ICE BofAML U.S. High Yield Index rated BB1 through B3 and with a duration-to-worst less than two years, but caps issuer exposure at 2%.

ICE BofA 3-Month U.S. Treasury Bill Index – This index measures the performance of a single issue of an outstanding treasury bill which matures closest to, but not beyond, three months from the rebalancing date. The issue is purchased at the beginning of the month and held for a full month; at the end of the month that issue is sold and rolled into a newly selected issue.

Morningstar Moderately Conservative Target Risk Total Return USD Index – The Morningstar Target Risk Index family is designed to meet the needs of investors who would like to maintain a target level of equity exposure through a portfolio diversified across equities, bonds and inflation-hedged instruments. The Morningstar Moderately Conservative Target Risk Index seeks approximately 40% exposure to global equity markets.

DISCLOSURES:

The views expressed in this material are the views of PMAM through the quarter ending September 30, 2024 and are subject to change based on market and other conditions without further notice.

This material contains certain views that may be deemed forward-looking statements. The inclusion of projections or forecasts should not be regarded as an indication that PMAM considers the forecasts to be reliable predictors of future events. Any forecasts contained in this material are based on various estimates and assumptions, and there can be no assurance that such estimates or assumptions will prove accurate. Actual results may differ significantly.

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Offering a wide range of tailored investment strategies and solutions to help meet the investment goals of our clients, while focusing on our mission to provide exceptional experience and service.

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