Strategic Enhanced Yield Fund Commentary

Market Overview

Following a robust rally for stocks in the first half of 2023, the third quarter offered a reality check. A sell-off in global bond markets was partly to blame for the pressure on most risk assets, with the Bloomberg Global Aggregate Bond Index falling by -3.6% in the third quarter. U.S. markets were not spared any of this volatility as we saw action reminiscent of 2022, with notable negative returns for both fixed income and equity markets.

As bonds and stocks fell simultaneously, commodities were the notable outperformer, returning 4.7% over the quarter, echoing the same market dynamics of the previous year. The only sector with positive returns for the quarter was high yield, as it continued to be a strong outperformer on the year as well, mostly due to its shorter duration profile overall. The shape of the yield curve shifted significantly during the quarter as the long bond rose 84 basis points (0.84%) in a very bearish steepening fashion, which left investors with any long duration securities extremely exposed.

The short end of the yield curve, using the 2-year Treasury for representation, rose only 15 basis points (0.15%) during the quarter. The 10-year note began the quarter at 3.84% and spent the quarter marching higher in a direct but stair-step fashion, to finish at 4.57%. The U.S. dollar finished higher this quarter as it acted as a safe-haven against unstable market movements elsewhere.

Within the credit subsectors, industrials and utilities underperformed financials again this quarter as the financial sector has a much shorter duration than the other two. Longer securities in both the Treasury and corporate space suffered significantly versus shorter-dated maturities as the curve bearishly steepened all quarter long. The U.S. Treasury, government agency securities, high yield, emerging market debt (EMD) and corporate sectors outperformed the broader Bloomberg Barclays U.S. Aggregate Index's return of -3.23% on the quarter. The non-dollar and mortgage-backed securities sectors underperformed the broader index's return.

Positioning the Strategic Enhanced Yield Fund

Portfolio composition is subject to change.

As interest rates increased during the quarter, especially during September, we positioned the portfolio to a lower duration relative to the benchmark, as inflationary pressures continued to affect the economy. The U.S. investment grade corporate allocation remains stable. We are monitoring the high yield sector's overall behavior in case default rates rise to new levels, in which case a further allocation reduction will be in order. Also, a slight reduction in the EMD corporate exposure is planned for the following quarter.

Notable Changes to the Portfolio

During the third quarter, the sector allocation changed significantly, with the U.S. government sectors reducing their weight by 10% and the EMD and high yield sectors on the receiving end. Higher coupon rates from these trades raise the income generated by the portfolio.

Why should investors consider investing in this Fund?

Interest rates continue to rise but now, not only the short maturities are being affected, making yields more attractive throughout the bond universe. Even if rates continue to rise, their effect on the economy will be felt, and we believe the prospect of a longer period of high rates followed by a potential rate reduction may yield investors attractive returns for several quarters in the future.

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Investment Risks

Fixed income securities are subject to interest rate risks. The principal value of a bond falls when interest rates rise and rise when interest rates fall. During periods of rising interest rates, the value of a bond investment is at greater risk than during periods of stable or falling rates. Bond funds will tend to experience smaller fluctuations in value than stock funds. However, investors in any bond fund should anticipate fluctuations in prices, especially for longer-term issues and in environments of changing interest rates.

Short-term investment-grade bonds offer less risk and generally a lower rate of return than longer-term higher yielding bonds. High-yield bonds,"commonly referred to as junk bonds," have a higher risk of default or other adverse credit events, but have the potential to pay higher earnings over investment-grade bonds. The higher risk of default, or the inability of the creditor to repay its debt, is the primary reason for the higher interest rates on high-yield bonds. International investing involves increased risk and volatility.