

Short Government Managed Account

MARKETING COMMUNICATION

Quarterly Review

- Bonds produced a modest gain in the second quarter, with income accounting for the bulk of the total return. Expectations that the lingering effects of the conflict in Iran would cause inflation to reaccelerate prompted investors to price in tighter central bank policy. While in the autumn of 2025 the markets were anticipating that the US Federal Reserve (Fed) would enact as many as five quarter-point interest rate cuts over the coming year, by the end of June expectations had shifted toward the possibility of at least one rate hike in the second half of 2026.
- Kevin Warsh replaced Jerome Powell as Fed Chairman in May. While investors speculated that Warsh would have a bias toward lower rates when his name was first floated as a potential Powell replacement in 2025, the new chair's initial comments pointed to a more hawkish tone. Most notably, Warsh indicated a desire to reinstate the Fed's 2% inflation target – a level not reached since before the COVID-19 supply shock in early 2021.
- The yield on the two-year Treasury note climbed from 3.79% to 4.14% (as its price fell). Still, the two-year finished with a positive total return for the quarter due to the contribution from income.
- The strategy is focused on US Treasury securities and does not hold benchmark eligible US Agency securities which may contribute to additional return. Yield curve effects were positive while allocation and selection effects were muted over the period.

Outlook

- The Loomis Sayles macroeconomic framework points to a resilient late-cycle expansion as the base case, supported by healthy corporate profits, strong company balance sheets, and continued investment in areas such as artificial intelligence (AI). Inflation has moderated but remains above the Federal Reserve's (Fed) long term target, which is likely to keep interest rates elevated for longer. While geopolitical developments, particularly in energy markets, remain the key risk; the overall backdrop continues to support fixed income investing. Given the later stage of the economic cycle, we remain selective in our risk-taking and maintain a lower allocation to risk where appropriate, especially in areas sensitive to political, regulatory, or financial uncertainty. Our focus remains on companies that we believe can perform well across a variety of market environments while offering attractive risk-adjusted carry.
- As expected, the Fed held rates steady at its April and June meetings, maintaining the federal funds rate at 3.75%. We believe the Fed is on hold in 2026, which aligns with our "Expansion Resilient" scenario. The expectations for rate cuts are high and have been pushed into 2027, limiting the potential for significantly lower bond yields unless economic conditions weaken substantially. We continue to remain duration-neutral while monitoring opportunities that may arise if longer-term bond yields become more attractive.



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There is no guarantee that the investment objective will be realized or that the strategy will generate positive or excess return. Diversification does not ensure a profit or guarantee against a loss. Commodity, interest and derivative trading involves substantial risk of loss.

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