

IA Clarington Core Plus Bond Fund

Manager commentary – Q2 2024

The economy remained resilient in the second quarter of 2024, largely as a result of continued strength in the jobs market, which provided support for consumer spending. Official prints of first-quarter gross domestic product in Canada and the U.S. were 1.7% and 1.4%, respectively. Inflation has fallen since peaking in mid-2022 but remains “sticky” with the target rate of 2% still out of reach.

Short-term interest rates remain higher than longer-term rates, with inverted yield curves found in Canada and the U.S. The Federal Open Market Committee is continuing the battle against inflation, with the Fed Funds Target Rate at 5.5%, while 10-year U.S. Treasuries yield just 4.4%. The Bank of Canada cut the Overnight Lending Rate by 25 basis points (bps) to 4.75% on June 5, while 10-year Government of Canada bonds finished the second quarter at a yield of just 3.5%.

Interest-rate futures are pricing in two rate cuts in the second half of the year for the U.S. and Canada that would reduce short term rates by 50 bps, if proven correct. Economic data will continue to determine the path of interest rates.

Credit spreads across investment-grade and non-investment-grade markets remain tight in light of the resilient economy. Default rates in the non-investment-grade universe are contained and near-term maturities have been termed out. Investment-grade corporate bond spreads in Canada and the U.S. ended the quarter at 122 and 96 bps, respectively. Loan spreads, as measured by the 3-year discount margin, ended the quarter at 507 bps, having steadily declined for almost two years. High-yield bond spreads ended the quarter at 309 bps, approaching the five-year low of 262 bps achieved in the second quarter of 2021. Credit investors are still benefitting from attractive yields despite valuations appearing close to full value.

The Fund’s private credit allocation was the largest detractor from performance as smaller issues struggled with higher borrowing costs and pressure on margins from rising input costs. A number of these holdings were written down to fair value during the quarter. Private credit exposure is down to a 3.8% weight in the Fund. Canadian investment-grade corporate bonds, the largest exposure in the portfolio, and collateralized loan obligations generated higher returns than the FTSE Canada Short Term Corporate Bond Index, thus contributing to the Fund’s relative performance during the quarter. Loan holdings also outperformed the Credit Suisse Leveraged Loan Index.

Recent economic data released after the second quarter point to the possibility of a slowing economy. June unemployment rates in the U.S. and Canada increased to 4.1% and 6.4%, respectively, both at the highest levels since 2021. The U.S. ISM Services Purchasing Managers’ Index numbers fell into contraction territory in June, with business activity, new orders and employment components contracting, while prices remain elevated. We believe that consumers will be more cautious with spending the second half of the year, especially as excess savings are depleting.

The Fund’s investment-grade holdings remain focused on Canadian corporate bonds where spreads appear more attractive than in the U.S. On an absolute basis, Canadian corporate spreads are 26 bps

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higher than in the U.S. at the broad index level, and have not retraced to the lows at the same level. We also believe that interest-rate risk is lower in Canada as our economy appears less robust than that of the U.S. The overall portfolio is centred around the short end of the yield curve, which offers significantly higher yields without the volatility associated with longer-dated securities.

Our base case calls for a slowing but stable economy and modestly rising loan default rates. The risk of a recession remains but timing has been pushed out and, if one occurs, it is likely to be shallow. Recession and default risk is mitigated by focusing on investment-grade corporate credit, increasing diversification across holdings and not stretching for yield. In our view the high level of interest income earned by the Fund compensates unitholders for the risk taken.

	1 year	3 year	5 year	10 year
Fund and benchmark performance as at June 30, 2024				
IA Clarington Core Plus Bond Fund – Series A	4.4%	-0.7%	0.8%	1.5%
75% FTSE Canada Short Term Corporate Bond Index, 15% Credit Suisse Leveraged Loan Index USD, 10% ICE BofA U.S. High Yield Constrained Index (CAD Hedged)	8.1%	2.0%	2.8%	2.8%

Non-traditional fixed income asset classes may carry higher risk, but generally provide higher yield than traditional fixed income asset classes. A mutual fund's "yield" refers to income generated by securities held in the fund's portfolio and does not represent the return of or level of income paid out by the fund.

For definitions of technical terms in this piece, visit iaclarington.com/glossary or speak with your investment advisor.

The performance data comparison presented is intended to illustrate the Fund's historical performance as compared with historical performance of widely quoted market indices. There are various important differences that may exist between the Fund and the stated indices that may affect the performance of each. The benchmark is a blend of FTSE Canada Short Term Corporate Bond Index (75%), Credit Suisse Leveraged Loan Index USD (15%) and the ICE BofA U.S. High Yield Constrained Index (CAD Hedged) (10%). The blended benchmark presented is intended to provide a more realistic representation of the general asset classes in which the Fund invests. The FTSE Canada Short Term Corporate Bond Index is comprised of Canadian investment grade corporate bonds and has significantly different portfolio duration characteristics. FTSE Canada Short Term Corporate Bond Index consists of a broadly diversified selection of investment-grade corporate bonds, with maturities between 1 and 5 years, issued domestically in Canada. The Credit Suisse Leveraged Loan Index is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. The ICE BofA U.S. High Yield Constrained

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Index (CAD Hedged) tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market. The Fund's geographic, sector and credit quality exposure may differ from that of the benchmark. The Fund aims to fully hedge the portfolio's foreign currency exposure at all times to remove any currency fluctuation risk. As a result, the U.S. indices referenced within are quoted in their native currencies of U.S. dollars to reflect the performance of the holdings as opposed to currency performance. The Fund may hold cash while the benchmark does not. It is not possible to invest directly in market indices. The performance comparison is for illustrative purposes only and does not imply future performance.

Indicated mutual fund rates of return include changes in share or unit value and reinvestment of all dividends or distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Returns are historical annual compounded total returns.

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