# IA Clarington Floating Rate Income 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 as default rates are contained and near-term maturities have been termed out. 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 3.4% weight in the Fund. The Fund's loan holdings outperformed the Credit Suisse Leveraged Loan Index and contributed to performance in the second quarter. The Fund's bond holdings detracted from performance owing to the price decline in Corus Entertainment Inc. bonds. The Fund's positions in collateralized loan obligations contributed to performance. Currency hedging costs increased during the quarter given widening interest-rate differentials between Canada and the U.S.

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 holdings remain focused in the higher-rated, larger and more-liquid segments of the loan market. At quarter-end, holdings rated BB and higher represented almost 60% of the portfolio, excluding cash and equivalents, compared to 24% for the Credit Suisse Leveraged Loan Index.

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Our higher-rated Fund positioning stems from the attractive absolute and relative yield that can be earned in higher-rated, higher-quality loans. With the BB segment of the Credit Suisse Leveraged Loan Index yielding approximately 8%, there isn't a strong case to stretch for return by moving down in quality.

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 will be mitigated by staying higher in quality, increasing diversification and not stretching for yield. In our view, the high level of interest income earned by the Fund compensates unitholders for the risk taken.

| Fund and benchmark performance as at June 30, 2024 | 1 year | 3 year | 5 year | 10 year |
|---|---|---|---|---|
| IA Clarington Floating Rate Income Fund – Series A | 2.5% | 0.5% | 0.5% | 1.9% |
| Credit Suisse Leveraged Loan Index USD | 11.0% | 6.0% | 5.4% | 4.6% |

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 the Credit Suisse Leveraged Loan Index USD which is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. The Fund's geographic, sector and credit quality exposure may differ from that of the benchmark. The Fund can invest in high yield corporate bonds and government bonds, which are not included in 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.

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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.

The information provided should not be acted upon without obtaining legal, tax, and investment advice from a licensed professional. Statements by the portfolio manager or sub-advisor represent their professional opinion and do not necessarily reflect the views of iA Clarington. Specific securities discussed are for illustrative purposes only and should not be considered a recommendation to buy or sell. Mutual funds may purchase and sell securities at any time and securities held by a fund may increase or decrease in value. Past investment performance may not be repeated. Unless otherwise stated, the source for information provided is the portfolio manager. Statements that pertain to the future represent the portfolio manager's current view regarding future events. Actual future events may differ.

Commissions, trailing commissions, management fees, brokerage fees and expenses all may be associated with mutual fund investments, including investments in exchange-traded series of mutual funds. The information presented herein may not encompass all risks associated with mutual funds. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.