Thornburg Income & U.S. Government Bonds

Portfolio Manager Commentary
30 June 2024

Thornburg

Market Review

The fixed income markets finished the quarter in slightly positive territory as yields finished higher but generally rangebound. The 10-year U.S. Treasury yield rose from 4.20% to 4.40% over the quarter while the Treasury curve remained inverted between 2- and 10-year maturities. Rates drifted higher in April before experiencing a modest rally in the wake of slightly improved inflation data, a slowly weakening labor market, and more confidence that the Fed will deliver 1-2 cuts before year end. At the Fed's June meeting, the FOMC remained cautious as it expressed the need for more progress on inflation but also acknowledged the delicate balance it must strike with unemployment. Despite the uncertainty over Fed policy, spread sector volatility over the quarter remained remarkably muted, with corporate, securitized, and municipal bond spreads trading at still relatively tight levels versus their histories.

Attractive yields provide an offset to tight spreads given current macro uncertainties.

Second Quarter 2024 Performance Highlights

- In 2Q24 the Limited Term Income Portfolio (net of fees) returned 1.07%, 43 basis points ahead of the Bloomberg Intermediate U.S. Government/Credit Index. Year to date the portfolio (net of fees) returned 2.01%, 152 basis points ahead of the Index.
- The portfolio duration position which was neither a material contributor nor detractor as coupon offset the price decline from modestly higher rates. The portfolio held an average duration of 3.76 years over the period.
- Security selection within corporates was beneficial, as intermediate corporates outperformed their longer maturity counterparts over the quarter.
- Our allocation to non-agency RMBS (CMO) and asset-backed securities both contributed modestly to relative performance. Securitized credit spreads continued their broad tightening trend amidst positive investor sentiment and, specific to RMBS, continued robust housing fundamentals.
- Exposure to low-coupon MBS pass-throughs was neither a material contributor nor detractor from performance. The mortgage basis (i.e. spread between Treasuries and MBS) widened by 10 bps as investors await more commitment from the Fed on rate cuts before spurring demand.
- There were no material detractors from a sector perspective during the second quarter.

Current Positioning and Outlook

The Federal Reserve's battle to achieve their price stability goal of 2% inflation has been a slow and frustrating grind. Much of this is due to the stickiness in services inflation. In fact, the three other CPI components – goods, food, and energy – combined represent less than one-tenth of the contribution to the latest headline CPI print of 3.3%. This puts the Fed in a bind because it is services inflation they must target, which is the type of inflation most closely associated with wage growth. Some type of labor market weakness is therefore necessary to achieve the price stability goal. Labor is weakening quite slowly, but further deterioration in the absence of disinflation will create hard decisions for the central bank. The U.S. unemployment rate has risen from a cycle low of 3.4% in April 2023 to 4.1% in June 2024. While the unemployment rate is still nominally low, historically any upward momentum has been difficult to contain. In fact, over the past 75 years, each recession has been preceded by an increase in the three-month moving average of the unemployment rate by just one-third of a percentage point. The labor market is currently in this very situation, with the 3-month moving average up from 3.5% last spring to 4% today. Meanwhile, the consumer continues to slowly weaken, with credit card delinquencies higher across all age groups and in many cases at levels last seen in 2011-2012 when the labor market was much weaker.

Members of the Fed's rate setting committee (the FOMC) have been somewhat unified in stressing the need to see more good inflation data before committing to cuts. However, we find it unlikely the Fed will stay patient if unemployment continues to rise. The markets are slowly pricing in some eventual action from the Fed, with Fed Funds futures pricing in two rate cuts by December. In response, nominal and real yields have trended modestly lower and have been reflective of this 'goldilocks' scenario of marginally better inflation prints with slowly weakening employment. Against this backdrop, we have largely maintained our duration position in the portfolio and continue to prefer taking interest rate risk over credit risk on a relative value basis. As of early July, portfolio duration was 3.5 years, essentially unchanged from the prior quarter. Meanwhile, agency mortgage-backed securities (MBS) continue to demonstrate attractive relative value versus high grade credit, although valuations are somewhat neutral to non-agency RMBS. Low coupon pass-throughs, specifically 2.5% and 3.0% 30-year MBS, remain discounted and provide both attractive total return potential and diversification to credit.

In the investment-grade (IG) corporate credit sector, we have a continued focus on issuers with defensive and non-cyclical profiles. Tight IG spreads warrant keeping spread duration down. While the IG calendar has slowed from its record setting pace earlier this year, current issuance still provides select relative value opportunities. There are interesting opportunities within the securitized credit space. Within asset-backed securities, our cautious view on the consumer keeps us focused on senior bonds with short weighted-average lives. These bonds are well protected from loss, pay down principal faster than junior tranches, and have good front end yields of between 6-7%. In non-agency RMBS (CMO), fundamentals remain positive given robust underwriting and low housing LTVs, with spreads on senior bonds attractive relative to investment-grade credit. Our exposure in Income & Government Bonds has been focused on non-QM, but we see good relative value additions within reperforming loan (RPL) securities. Our view on CMBS has been relatively more cautious, and although the sector does not represent a large exposure in the portfolio, we have found opportunities in single asset single borrower ("SASB") deals backed by office properties with robust occupancy and in attractive locations within metropolitan areas.

ANNUALIZED RETURNS (AS OF 30 JUNE 2024)

THORNBURG LIMITED TERM INCOME STRATEGY (%)	QTR	YTD	1-YR	3-YR	5-YR	10-YR	ITD (1 FEB 93)
Composite (Gross)	1.15	2.18	6.46	0.70	2.33	2.68	5.19
Composite (Net)	1.07	2.01	6.12	0.38	2.01	2.35	4.50
Bloomberg Intermediate U.S. Government/Credit Index	0.64	0.49	4.19	-1.18	0.71	1.55	4.17

THORNBURG LIMITED TERM U.S. GOVERNMENT STRATEGY (%)	QTR	YTD	1-YR	3-YR	5-YR	10-YR	ITD (1 MAR 88)
Composite (Gross)	0.79	0.81	3.88	-0.67	0.60	1.34	4.86
Composite (Net)	0.70	0.62	3.50	-1.04	0.22	0.96	4.08
Bloomberg U.S. Government Intermediate Index	0.58	0.23	3.40	-1.38	0.29	1.11	4.56

THORNBURG ULTRA SHORT INCOME STRATEGY (%)	QTR	YTD	1-YR	3-YR	ITD (1 OCT 20)
Composite (Gross)	1.49	2.95	6.30	3.24	2.81
Composite (Net)	1.43	2.82	6.04	2.98	2.55
ICE BofA U.S. Treasury Bill Index	1.32	2.61	5.43	3.01	2.42

In US$ terms. **Returns may increase or decrease as a result of currency fluctuations.**
Periods less than one year are not annualized. ITD is inception to date.

Performance data for the Limited Term Income Strategy is from the Limited Term Income Composite, inception date of 1 February 1993. The Limited Term Income Composite includes all non-wrap discretionary accounts invested in the Limited Term Income Strategy. Returns reflect the reinvestment of income and capital gains.

Performance data for the Limited Term U.S. Government Strategy is from the Limited Term U.S. Government Composite, inception date of 1 March 1988. The Limited Term U.S. Government Composite includes all discretionary non-wrap accounts invested in the Limited Term U.S. Government Strategy. Returns reflect the reinvestment of income and capital gains.

Performance data for the Ultra Short Income Strategy is from the Ultra Short Income Composite, inception date of 1 October 2020. The Ultra Short Income Composite includes all non-wrap discretionary accounts invested in the Ultra Short Income Strategy. Returns reflect the reinvestment of income and capital gains.

Returns are calculated using a time-weighted and asset-weighted calculation. Periods less than one year are not annualized. Individual account performance will vary. The performance data quoted represents past performance; it does not guarantee future results. Net of fee returns are net of transaction costs and investment advisory fees. For periods prior to 2011, net returns for some accounts in the composite also reflect the deduction of administrative expenses. Thornburg Investment Management Inc.'s fee schedule is detailed in Part 2A of its ADV brochure. Gross of fee returns are net of transaction costs. Performance results of the firm's clients will be reduced by the firm's management fees. For example, an account with a compounded annual total return of 10% would have increased by 159% over ten years. Assuming an annual management fee of 0.75%, this increase would be 142%.

CALENDAR YEAR RETURNS

THORNBURG LIMITED TERM INCOME STRATEGY (%)	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Composite (Gross)	6.99	-6.53	-0.33	8.09	6.26	1.72	3.22	3.99	1.34	4.28
Composite (Net)	6.65	-6.82	-0.64	7.74	5.91	1.38	2.89	3.63	0.98	3.89
Bloomberg Intermediate U.S. Government/Credit Index	5.24	-8.23	-1.44	6.43	6.80	0.88	2.14	2.08	1.07	3.13

THORNBURG LIMITED TERM U.S. GOVERNMENT STRATEGY (%)	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Composite (Gross)	4.91	-7.21	-0.99	4.69	4.55	1.71	1.53	1.90	1.20	3.25
Composite (Net)	4.52	-7.57	-1.35	4.31	4.16	1.33	1.16	1.52	0.81	2.86
Bloomberg U.S. Government Intermediate Index	4.30	-7.73	-1.69	5.73	5.20	1.43	1.14	1.05	1.18	2.52

THORNBURG ULTRA SHORT INCOME STRATEGY (%)	2023	2022	2021
Composite (Gross)	6.10	0.52	0.62
Composite (Net)	5.83	0.27	0.37
ICE BofA U.S. Treasury Bill Index	5.09	1.34	0.05

In US$ terms. **Returns may increase or decrease as a result of currency fluctuations.**

The performance data quoted represents past performance; it does not guarantee future results. Please see the Composite standardized performance tables included herein.

Important Information

Unless otherwise noted, the source of all data, charts, tables and graphs is Thornburg Investment Management, Inc., as of 30 June 2024

Investments in the Strategy carry risks, including possible loss of principal. Carefully consider the Strategy's investment objectives, risks, and expenses before investing. There is no guarantee that the portfolio will meet its investment objectives.

The views expressed are subject to change and do not necessarily reflect the views of Thornburg Investment Management, Inc. This information should not be relied upon as a recommendation or investment advice and is not intended to predict the performance of any investment or market.

Basis Point (bp) – A unit equal to 1/100th of 1%. 1% = 100 basis points (bps).

U.S. Treasury securities, such as bills, notes and bonds, are negotiable debt obligations of the U.S. government. These debt obligations are backed by the "full faith and credit" of the government and issued at various schedules and maturities. Income from Treasury securities is exempt from state and local, but not federal, taxes.

Fed Funds Rate - The interest rate at which a depository institution lends immediately available funds (balances at the Federal Reserve) to another depository institution overnight.

Federal Open Market Committee (FOMC) - The branch of the Federal Reserve Board that determines the direction of monetary policy. The FOMC is composed of the board of governors, which has seven members, and five reserve bank presidents. The president of the Federal Reserve Bank of New York serves continuously, while the presidents of the other reserve banks rotate their service of one-year terms.

Consumer Price Index (CPI) - Index that measures prices of a fixed basket of goods bought by a typical consumer, including food, transportation, shelter, utilities, clothing, medical care, entertainment and other items. The CPI, published by the Bureau of Labor Statistics in the Department of Labor, is based at 100 in 1982 and is released monthly. It is widely used as a cost-of-living benchmark to adjust Social Security payments and other payment schedules, union contracts and tax brackets. Also known as the cost-of-living index.

A bond credit rating assesses the financial ability of a debt issuer to make timely payments of principal and interest. Ratings of AAA (the highest), AA, A, and BBB are investment-grade quality. Ratings of BB, B, CCC, CC, C and D (the lowest) are considered below investment grade, speculative grade, or junk bonds.

Credit Spread/Quality Spread - The difference between the yields of securities with different credit qualities.

Duration - A bond's sensitivity to interest rates. Bonds with longer durations experience greater price volatility than bonds with shorter durations.

Yield Curve - A line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates.

Asset-backed Security (ABS) - A security whose value and income payments are derived from and collateralized (or "backed") by a specified pool of underlying assets. The pool of assets is typically a group of small and illiquid assets that are unable to be sold individually. Pooling the assets into financial instruments allows them to be sold to general investors, a process called securitization, and allows the risk of investing in the underlying assets to be diversified because each security will represent a fraction of the total value of the diverse pool of underlying assets.

Mortgage-backed Security - A type of asset-backed security that is secured by a mortgage or collection of mortgages. These securities must be grouped in one of the top two ratings as determined by a accredited credit rating agency and usually pay periodic payments that are similar to coupon payments. The mortgage must have originated from a regulated and authorized financial institution.

Mortgage Pass-Through - A security consisting of a pool of residential mortgage loans. Payments of principal, interest and prepayments are "passed through" to investors each month.

RMBS (Residential Mortgage Backed Securities) - A type of mortgage-backed debt securities where the cash flows are derived from residential mortgages.

The Bloomberg Intermediate U.S. Government/Credit Index (BBG Int US Govt/Credit TR Value) is an unmanaged, market-weighted index generally representative of intermediate government and investment-grade corporate debt securities having maturities from one up to ten years.

The Bloomberg U.S. Government Intermediate Index (BBG US Govt Int TR Value) is an unmanaged, market-weighted index generally representative of all public obligations of the U.S. Government, its agencies and instrumentalities having maturities from one up to ten years.

ICE BofA U.S. Treasury Bill Index tracks the performance of US dollar denominated US Treasury Bills publicly issued in the US domestic market.

Portfolio construction will have significant differences from that of a benchmark index in terms of security holdings, industry weightings, asset allocations and number of positions held, all of which may contribute to performance, characteristics and volatility differences. The index shown is unmanaged, reflect total returns and assume the reinvestment of all income in U.S. dollars. It does not reflect any management fees or brokerage expenses associated with a portfolio's returns. Returns for an actual portfolio may differ from those of an index due to (among other things) differences in timing and the amount invested and fees and expenses. Investors may not make direct investments into any index.

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*Includes assets under management ($43.6B) and assets under advisement ($1.2B).

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