QUARTERLY COMMENTARY

Third Quarter 2020

Penn Mutual Asset Management

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ABOUT PMAM

Penn Mutual Asset Management (PMAM) is an institutional asset management firm located just outside of Philadelphia, PA. Since 1989, the firm has been dedicated to creating value through a prudent, thoughtful and rigorous investment decision-making process. With over $30 billion in assets under management, PMAM is committed to offering fixed income investment solutions and client-focused services.

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THIRD QUARTER IN REVIEW AND HIGHLIGHTS

The recovery in financial markets continued into the third quarter. The gradual reopening of the U.S. economy coupled with optimism regarding coronavirus vaccine trials and continued fiscal and monetary support helped to drive risk markets higher during the quarter. The underlying economy is showing pockets of strength; however, some sectors are still struggling as tentative companies and consumers gauge the effects of the pandemic through the coming fall and winter months.

- **U.S. equities generated strong results during the third quarter with large cap technology names continuing to lead the way higher…** Financial market volatility picked up during September as uncertainty around the November election weighed on sentiment. Global stocks also delivered strong returns with emerging markets up nearly 10%.
- **At the September Federal Open Market Committee meeting, the Federal Reserve (Fed) signaled zero interest rates will last through 2023 in order to sustain accommodative financial conditions through the economic recovery…** During his August Jackson Hole speech, Jerome Powell announced a significant shift in Fed policy which will allow inflation to run above its 2% target following periods of low inflation.
- **After extreme volatility during February and March, Treasury yields across the curve have traded in a tight range with the Fed's policy response bringing calm to the market…** Real yields for Treasury Inflation Protected Securities moved deeper into negative territory as investors buy protection against the risk of excessive money printing and deficit spending leading to higher inflation.
- **Credit markets continued to heal during the quarter in response to unprecedented measures of Fed stimulus with both investment-grade and high-yield bond spreads tightening versus Treasuries…** Corporate bond issuance is on pace to exceed $2 trillion during 2020 as the credit pipes have fully reopened following the short-lived shutdown in March. The economic recovery in the U.S. continues to gain traction despite ongoing challenges for numerous sectors of the economy hit hardest by the pandemic.

Our investment capabilities incorporate a unified investment philosophy and process across the fixed income risk spectrum.

LIBOR Plus	Short Duration Bond	Core Plus Bond	Strategic Income	High Yield Bond	Balanced Income

LIBOR PLUS STRATEGY

The LIBOR Plus Strategy outperformed its benchmark, 3-Month LIBOR, during the third quarter as spreads continued to grind tighter. Leveraged loan prices rallied steadily every month of the third quarter. The Strategy remains positioned up in credit quality, with 94% of the portfolio holdings rated AAA and AA.

New issue deals offer better credit enhancement than most deals seen in the secondary market, where credit deterioration post-pandemic remains a headwind. The collateralized loan obligation (CLO) primary market witnessed an increase in issuance as CLO managers sought to take advantage of tight spreads.

Improved investor sentiment in the sector led to the CLO issuance with a first 5-year reinvestment period since the onset of the pandemic. The third quarter witnessed a decline in 3-Month LIBOR from 30 to 23 basis points (bps).

We have recently found value in short, de-levering deals and continue to take advantage of market dislocations as they appear, favoring the senior part of the capital stack amidst current market volatility. We also remain focused on credit surveillance of underlying CLO credit metrics and seek to stay ahead of any rating agency activity and potential pricing pressures.

SHORT DURATION BOND STRATEGY

The Short Duration Bond Strategy outperformed its benchmark, the Bloomberg Barclays Capital U.S. Government/Credit 1-3 Year Bond Index, during the third quarter. Interest rates across the yield curve have traded in a very narrow range since March, with the Fed prepared to step up bond purchases to prevent rates from rising.

The recovery in fixed-income spread sector performance continued during the quarter but spreads widened modestly in September. Short maturity (1-3 year) investment-grade corporate credit outperformed duration-matched Treasuries by 70 bps. During the quarter, Strategy contributors to excess performance included securitized aircraft asset-backed securities and floating-rate bank hybrid securities.

We are maintaining our overweight positioning in short duration spread sectors with an up-in-quality bias in light of continuing economic and political uncertainty in the U.S. Our relative value, opportunistic approach will remain focused on identifying the most attractive short duration alternatives during the extended low interest rate environment.

CORE PLUS BOND STRATEGY

The Core Plus Bond Strategy generated positive performance relative to its benchmark, the Bloomberg Barclays Capital U.S. Aggregate Bond Index, during the third quarter. Strategy returns moved ahead of the benchmark on a year-to-date basis. Credit markets continue to recover with the promise of extended accommodation by the Fed and positive economic data helping to push spreads tighter. Despite a weak close in September, investment-grade corporate debt outperformed duration-matched Treasuries by 140 bps during the quarter. Corporate issuers took full advantage of Fed support with record new issuance volume ready to cross the $2 trillion mark this year.

Treasury yields settled into a narrow range across the curve following the extreme interest rate volatility witnessed in February and March. 10-year Treasury yields ended the quarter at 0.68% which is almost exactly where they started and approximately half the record low level before the pandemic.

Strategy performance benefitted from the recovery in valuations among corporate and securitized bond holdings. New issue spread concessions have narrowed significantly since March, but we remain opportunistic with purchase activity for both primary and secondary market corporate credit. The recovery in structured credit performance is gradually catching up to the corporate bond market. We are positioning the Strategy for yield curve steepening with inflation pressures surfacing and increased Treasury bond supply to fund fiscal stimulus increasing risks at the long end of the yield curve.

STRATEGIC INCOME STRATEGY

The Strategic Income Strategy outperformed its benchmark, 3-Month LIBOR, for the second consecutive quarter bringing year-to-date returns into positive territory. Positive contributors to Strategy performance included floating-rate bank hybrid securities and securitized sector holdings such as Freddie Mac commercial mortgage-backed securities and collateralized loan obligations.

Corporations are taking full advantage of the credit pipes reopening since March with new supply ready to cross the $2 trillion mark this year. Treasury yields across the curve settled into a relatively narrow range since April following the dramatic decline to record low territory in the first quarter.

We are maintaining a conservative approach to Strategy duration and credit in the current low interest rate and spread environment. The Strategy is positioned for yield curve steepening as prolonged Fed easy money policies and record Treasury bond supply expected to fund fiscal stimulus are likely to increase risks at the long end of the yield curve.

HIGH YIELD BOND STRATEGY

During the quarter, the High Yield Bond Strategy outperformed its benchmark, Bloomberg Barclays U.S. High Yield BA/B 2% Issuer Capped Index. On a year-to-date basis, the Strategy is also outperforming its benchmark. The high-yield market generated a solid return for the third quarter of 2020. September was the first negative month since March as elevated supply, election risk and volatile oil prices weighed on spreads as the quarter came to a close. Fund flows into credit remained strong and enabled corporate issuers to access the market, leading to record new issuance. Performance was led by lower-quality credit (CCCs) and cyclical sectors (transportation, energy).

The Strategy added risk tactically during the quarter as it became evident that government stimulus and the Fed's massive liquidity injection would soften the economic impact from the pandemic and help bridge the economy until a vaccine is widely distributed. The Strategy's energy exposure was increased to a market weight position, while attractively valued, lower-rated credit was added in healthcare, packaging and select auto credit.

BALANCED INCOME STRATEGY

The Balanced Income Strategy underperformed its benchmark, the equally blended Russell 3000 Value, Bloomberg Barclays U.S. Corporate Investment Grade and Bloomberg Barclays U.S. High Yield (2% Issuer Cap TR) Indices, since its inception on July 31, 2020. Due to its recent inception, the Strategy carried a higher-than-normal cash position, which was a drag on performance during the stock market rally in August. However, this conservative positioning benefitted performance when market volatility hit in September. The equity portfolio lagged the Russell 3000 Value Index while the fixed-income portfolio outperformed its blended benchmark. The fixed-income portfolio has found value in the front end of the yield curve with opportunities mainly focused in high-yield bonds and convertible securities.

This year, the S&P 500 Index experienced one of the quickest market recoveries in history. However, volatility picked up in September as uncertainty around the November election weighed on sentiment. With the economy still relying on fiscal and Fed support, any indication of a protracted election result could be viewed as a negative.

Strategy performance may benefit from any future bouts of volatility created by this uncertainty. We continue to search for attractive entry points in the equity and corporate bond market as a source of excess return. Our opportunistic, value-based approach will serve as a guide in making sound fundamental investment decisions as 2020 comes to an end.

OUTLOOK

The promise of continued easy money by the Fed and the lack of attractive alternatives in the bond market are likely to provide continued support for the equity markets. The Fed's commitment to keep short-term rates at zero through the end of 2023 is also likely to keep a lid on yields across the curve, but mounting inflation pressures and record Treasury bond issuance to fund stimulus increase risks at the long end.

Index Definitions:

Bloomberg Barclays U.S. Aggregate Bond Index – An index that is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).

Bloomberg Barclays U.S. Corporate Investment Grade (USD) TR Index Unh USD – The Bloomberg Barclays US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.

Bloomberg Barclays U.S. Government/Credit 1-3 Year Bond Index – The Bloomberg Barclays US Government/Credit Bond Index is a broad-based benchmark that measures the non-securitized component of the US Aggregate Index. It includes investment grade, US dollar-denominated, fixed-rate Treasuries, government-related and corporate securities.

Bloomberg Barclays U.S. High Yield 2% Issuer Cap Index – The Bloomberg Barclays U.S. High Yield 2% Issuer Cap Index covers the universe of fixed rate, dollar-denominated, non-investment grade debt, including both corporate (Industrial, Utility, and Finance) and non-corporate (Sovereign, Supranational, Foreign Agency, and Foreign Local Government) sectors, and limits any individual issuer to a maximum of 2% benchmark exposure.

Bloomberg Barclays U.S. High Yield 2% Issuer Cap TR Index Value Unhedged USD – An issuer-constrained version of the flagship US Corporate High Yield Index, which measures the USD-denominated, high yield, fixed-rate corporate bond market. The index follows the same rules as the uncapped version, but limits the exposure of each issuer to 2% of the total market value and redistributes any excess market value indexwide on a pro rata basis.

ICE BofA Merrill Lynch U.S. Dollar 3-Month Deposit Offered Rate Constant Maturity Index – An index that tracks the performance of a synthetic asset paying Libor to a 3-month maturity. The index is based on the assumed purchase at par of a synthetic instrument having exactly its stated maturity and with a coupon equal to that day's fixing rate.

Russell 3000 Value Index – An index that measures the performance of the broad value segment of the US equity value universe. It includes those Russell 3000® companies with lower price-to-book ratios and lower forecasted growth values.

Disclosures:

The views expressed in this material are the views of PMAM through the quarter ending September 30, 2020 and are subject to change based on market and other conditions without further notice.

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