QUARTERLY COMMENTARY

First Quarter 2021

PennMutual Asset Management

PORTFOLIO MANAGEMENT TEAM

Mark Heppenstall, CFA
Chief Investment Officer

George J. Cipolloni III, CFA
Portfolio Manager

Scott Ellis, CFA
Portfolio Manager

Zhiwei Ren, CFA
Portfolio Manager

Mark J. Saylor, CFA
Portfolio Manager

Trevor Williams, CFA
Portfolio Manager

Greg Zappin, CFA
Portfolio Manager

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 $31 billion in assets under management, PMAM is committed to offering fixed income investment solutions and client-focused services.

For more information, please contact:

Chris Fanelli
Managing Director,
Business Development
Fanelli.Chris@pennmutualam.com
609-306-7034

FIRST QUARTER IN REVIEW AND HIGHLIGHTS

The Biden administration followed through on its promise to "go big" on fiscal stimulus with passage of the $1.9 trillion American Rescue Plan. The combination of expected, strong gross domestic product (GDP) growth in 2021, a massive fiscal stimulus and a dovish Federal Reserve (Fed) contributed to an 82 basis-point increase in 10-year Treasury rates and a material steepening of the yield curve. Broad equity indices were volatile throughout the quarter; however, they made new highs during each month. Corporate earnings continue to improve while the government extended support to individuals and struggling industries. The "reopen" theme gained momentum through the start of the year and those expectations may need to be realized for the market rally to continue.

- **During the March Federal Open Market Committee meeting, Chair Jerome Powell reaffirmed the Fed's commitment to use the full range of policy tools to realize its dual-mandate goals for maximum employment and 2% inflation…** Despite interest rates at the front end of the yield curve remaining anchored to the Fed's zero-interest-rate policy, Treasury rates out the curve moved substantially higher. Long-term Treasury bonds had their worst quarterly performance in over four decades.
- **The pace of the labor market recovery remains uneven, but improving vaccine news recently contributed to a March rebound in many of the hardest hit service sectors…** 10-year inflation expectations, or breakeven inflation, moved above 2.3% during March, the highest level since the 2013 Taper Tantrum.
- **Corporate credit spreads moved modestly tighter during the quarter and are approaching post-financial crisis tight levels...**Despite the recent backup in long-term Treasury yields, mortgage rates remain near record-low territory. Housing affordability continues to be challenging as limited home supply is pushing prices higher, offsetting the benefit of low mortgage rates.
- **Equity markets continued to move higher during the quarter despite higher interest rates weighing on performance for many of the large-cap technology names…** The quarter witnessed a dramatic change in leadership across the stock market as previous laggards such as banks, energy and small-cap stocks turned in strong performances.

Our investment capabilities incorporate a unified investment philosophy and process across the risk spectrum.					
Enhanced Cash	Short Duration Bond	Core Plus Bond	Strategic Income	High Yield Bond	Balanced Income

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 first quarter. Credit markets continued to benefit from extraordinary measures of monetary and fiscal policy support in addition to the reopening of the U.S. economy.

Despite a rapidly improving outlook for economic growth and inflation, the Fed expects to keep its policy rate at zero through the end of 2023. The Treasury 2-year note yield finished the first quarter at 0.16%, up four basis points (bps) since year-end.

We remain modestly underweight duration, or interest rate risk, as improving news on the economy and inflation may force the Fed to reconsider its commitment to bond purchases and prolonged zero-interest-rate policy. We are maintaining our overweight to high-quality structured securities including collateralized loan obligations, student loan asset-backed securities and securitized aircraft debt, while opportunistically reducing exposure within the more fully valued corporate sector.

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 quarter. Treasury yields moved higher as positive vaccine news in the U.S. boosts the near-term economic growth and inflation outlook. The 10-year Treasury closed the quarter at 1.74%, 82 bps higher since year-end. Investment-grade corporate credit spreads tightened modestly, approaching their tightest levels since the Great Financial Crisis.

Quarterly results benefited from duration and yield curve management in addition to continued healing across the credit markets. The largest contributors to the positive quarterly results included securitized aircraft debt and commercial mortgage-backed securities (CMBS) – both sectors benefiting from improving prospects for a full reopening of the economy. We remain positioned short duration relative to benchmark and for continued yield curve steepening. Increased Treasury bond supply to fund fiscal stimulus coupled with mounting inflation pressures are likely to keep upward pressure on interest rates. We see the securitized spread sectors as offering the best relative value but remain underweight agency residential mortgage–backed securities, where significant Fed purchase activity extends valuations.

STRATEGIC INCOME STRATEGY

The Strategic Income Strategy outperformed its benchmark, 3-Month LIBOR, during the first quarter. Credit markets maintained positive momentum as optimistic vaccine news and additional fiscal stimulus supported the economic recovery. Investment-grade corporate credit outperformed duration-matched Treasury bonds by 95 bps with spreads nearing the tightest levels since the Great Financial Crisis.

Improving prospects for growth and inflation weighed on longer-term Treasury valuations. The overall Treasury bond market posted its worst quarterly performance in over four decades. Strategy performance benefited from broad-based contributions across both corporate and securitized sector holdings. Conservative duration management and yield curve positioning also contributed to the positive quarterly results. We are maintaining a disciplined, but still opportunistic, approach to Strategy duration and credit in the current low interest rate and spread environment.

HIGH YIELD BOND STRATEGY

The High Yield Bond Strategy outperformed its benchmark, Bloomberg Barclays U.S. High Yield BA/B 2% Issuer Capped Index, during the quarter. The high-yield market was among the best returning fixed-income asset classes in the period, generating positive absolute and excess returns in the face of rising Treasury yields. Lower quality credit and cyclical sectors such as transportation and energy led the rally, with duration-sensitive BB credit underperforming CCC credit by over 350 bps. New issuance set records as issuers took advantage of low absolute yields.

The Strategy continued to add risk and shorten portfolio duration during the period, but still maintained its up-in-quality orientation. The Strategy’s energy exposure continued to be in a roughly market weight position, while down-in-quality credit was added in the healthcare, airline, retail and auto sectors.

BALANCED INCOME STRATEGY

The Balanced Income Strategy outperformed its benchmark, the Morningstar Moderately Conservative Target Risk Total Return USD Index, during the first quarter. In the equity allocation, eleven holdings posted returns over 30%. On the downside, a few small-cap equity holdings posted negative returns for the quarter. The Strategy has maintained a relatively short duration, with the fixed-income allocation being predominantly comprised of shorter dated high-yield securities and convertible bonds. The fixed-income allocation posted a positive return with significant contributions from several convertible securities, while only a few securities posted negative returns.

Strategy allocation is approximately one-third dividend-paying equities and two-thirds fixed-income securities and cash. The equity allocation is diversified across sectors and market-cap size. We believe each equity security in the portfolio presents an opportunity for significant total return upside. Additionally, we consider the dividends paid by these companies to be sustainable; that is, covered by company operating cash flow with the potential to grow in the future. In the fixed-income allocation, we have found the most value in the shorter end of the yield curve, predominately in high-yield bonds and convertible securities. We believe this segment of the market, at current, offers the best balance of yield and upside potential relative to downside risk.

OUTLOOK

Despite remaining uncertainty about the global health crisis and its impact on the economic recovery, we expect continued improvement in U.S. economic conditions and the employment picture. The biggest risk to capital markets in the second half of 2021 may be better news on economic growth and inflation forcing the Fed to reconsider its promise of prolonged bond purchase activity and zero interest rates.

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. 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.

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.

The Morningstar Target Risk Index family is designed to meet the needs of investors who would like to maintain a target level of equity exposure through a portfolio diversified across equities, bonds and inflation-hedged instruments. The Morningstar Moderately Conservative Target Risk Index seeks approximately 40% exposure to global equity markets.

Disclosures:

The views expressed in this material are the views of PMAM through the quarter ending March 31, 2021 and are subject to change based on market and other conditions without further notice.

This material contains certain views that may be deemed forward-looking statements. The inclusion of projections or forecasts should not be regarded as an indication that PMAM considers the forecasts to be reliable predictors of future events. Any forecasts contained in this material are based on various estimates and assumptions, and there can be no assurance that such estimates or assumptions will prove accurate. Actual results may differ significantly.

Past performance is not indicative of future results. The views expressed do not constitute investment advice and should not be construed as a recommendation to purchase or sell securities. All information has been obtained from sources believed to be reliable, but accuracy is not guaranteed. There is no representation or warranty as to the accuracy of the information and PMAM shall have no liability for decisions based upon such information.