MARKET REVIEW

The U.S. bond market, as measured by the Bloomberg Barclays Aggregate U.S. Bond Index, was positive for the quarter, returning 0.62%.\(^1\) The U.S. Treasury component of the Aggregate Index returned 0.18% during the quarter. Following the market bounce back in the second quarter, risk assets continued to rally in the first two months of the third quarter on the back of optimistic earnings reports for 2Q2020 and particularly strong gains in technology issues even as coronavirus cases continued to rise as several vaccine candidates entered Phase 3 trials, boosting overall sentiment. Investment grade corporate bonds\(^2\) returned approximately 1.67% and experienced significant spread tightening early in the quarter before widening amid the rebound in volatility in September. Most risk assets fell meaningfully in September as market sentiment was driven lower amid political volatility related to the Supreme Court of the U.S. (SCOTUS) vacancy, heightened COVID-19 concerns in Europe, flaring U.S.-China tensions related to national security concerns, and heightened uncertainty leading up to the U.S. Presidential election.

High yield bonds\(^3\) posted positive performance in the third quarter. High yield spreads tightened 103 basis points from June month-end levels to 542 basis points at the end of September. Within the asset class, lower quality segments of the high yield market outperformed higher quality tiers. Bank loans\(^4\) also posted positive returns for the quarter, performing in line with the high yield market.

Over the third quarter, the U.S. Federal Reserve (Fed) announced a new approach to setting monetary policy, whereby the Fed will seek inflation that averages 2% over time. Under this new policy shift, the Fed will allow inflation to moderately overshoot the 2% goal following periods of weakness. Additionally, the new approach permits labor-market gains to reach more workers. The policy shift came about following years of too-low-inflation.

PORTFOLIO REVIEW

The Fund returned 6.13%, reflecting performance at the net asset value (NAV) of Class A shares with all distributions reinvested, for the quarter ended September 30, 2020. The Fund’s benchmark, the Bloomberg Barclays U.S. 1-5 Year TIPS Index,\(^5\) returned 1.91% during the period.

The Fund’s exposure to Consumer Price Index (“CPI”) swaps contributed to performance during the quarter. Consumer prices rose during the period, driven by the gradual re-opening of the economy.

An allocation to short-term, high yield credit also contributed to performance. Most notably, the portfolio’s short-term high yield allocations within the autos, leisure, energy and technology sectors contributed.

Structured products, including asset-backed securities (ABS), collateralized loan obligations (CLO) and commercial mortgage-backed securities (CMBS) also contributed modestly to absolute returns as the economy recovered, though lagged corporate bonds.

While U.S. Treasuries produced positive returns during the period, the modest allocation to U.S. Treasuries underperformed spread products over the quarter as spreads continued to tighten.

STRATEGY POSITIONING & OUTLOOK

This strategy combines a short-term bond portfolio with an overlay of CPI swaps in order to hedge against inflation over a full market cycle.

During the weakness in September, while the risk exposure remained generally unchanged, we increased the Fund’s market weight in short-term high yield bonds with near term calls, as we found attractive relative value in specific issues within auto and telecom sectors. Within autos, we added to U.S. auto-makers as we continue to favor U.S. consumer strength and see tailwinds from the involvement from the U.S. Federal Reserve.

We decreased the Fund’s allocation to CMBS over the quarter and further improved the quality of the position. As spreads continued to repair, we trimmed the portfolio’s position as lingering concerns regarding the fundamentals of lower quality retail and hotel commercial real estate remain.

Source: Federal Reserve Bank of St. Louis as of 9/30/2020.
Expense Ratio: 0.69% * Inception date 4/29/2011

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Performance data are unadjusted for sales charges. The maximum applicable sales charge is 2.25% for initial purchases and 1% for subsequent purchases. The maximum sales charge applicable to sales of Class A shares redeemed within 60 days of purchase is equal to the maximum for initial purchases.

Bloomberg Barclays U.S. 1-5 Year TIPS Index is an unmanaged index comprised of U.S. Treasury Inflation Protected Securities with at least $1 billion in outstanding face value and a remaining term to final maturity of at least 1 year and less than 5 years.

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