



FIXED INCOME | Q4 2025

Short Duration Commentary

Q4 2025

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Executive Summary

Overview

With highlights including another quarter-point cut in the federal funds policy rate at the Federal Reserve's (Fed) mid-month Federal Open Market Committee (FOMC) meeting, a general upward drift in most asset markets and global interest rates tracking higher, December closed out an event-filled year. After all the trade policy noise and drama throughout the year, in the wake of the U.S. federal government's longest ever shutdown that ended on November 12, publication of official economic data has been restored slowly, although gaps remain and inconsistencies have been observed, clouding how the economy is performing for market participants as well as Fed officials. Across fixed income sectors, spreads closed 2025 near the tights of the year and do not offer compelling opportunities, as we expect to see growing dispersion in subsector performance in credit as we move into the new year. Against a backdrop of growing fiscal policy support in 2026, we anticipate U.S. economic growth will remain solid enough, although a change in leadership at the top of the Fed, expected further challenges to its independence and pressure to lower its policy rate in the face of sustained above-target inflation could lead to renewed rate and market volatility. The extent to which the bond market's willingness to continue readily financing sovereign borrowers with challenging fiscal outlooks may also be tested in 2026, which could be another source of market volatility or underappreciated risk.

Central Banks / Monetary Policy

The Fed delivered a widely anticipated 25-basis-point (bp) cut at its December FOMC meeting, shifting guidance toward a potential pause in early 2026. Chair Powell reiterated that tariffs remain the primary reason inflation is above target, underscoring the Fed's cautious approach. Liquidity operations, specifically Treasury bill purchases framed as reserve management, began at the beginning of December and seemed to ease tightened liquidity conditions. The Bank of England also reduced rates by 25 bps on a close vote, while the European Central Bank held steady, and the Bank of Japan hiked its policy rate to 0.75%, a 30-year high, while emphasizing that real rates remain deeply negative, signaling that further rate hikes could follow. Thus, while the market expects the Fed may continue to ease monetary policy in 2026, policy divergence is emerging, as it appears other major central banks are done cutting and may be poised to lift rates in the new year. News of the Justice Department's investigation into Chair Powell's congressional testimony last summer on the Federal Reserve's Washington building renovation project(s) injects a new element of political and market uncertainty, which could impact the administration's ability to fill opening seats at the Fed, while in the short run, thwarting efforts to push interest rates lower.

The White House's decision on a nominee to succeed Chair Powell now appears likely to be announced in January. Markets are looking for signals on whether the nominee will be perceived as independence-minded or more aligned with the administration, as this could influence breakeven inflation rates, nominal yields and monetary policy in the coming years. In the event the market perceives the nominee for Fed Chair as more of a mind to carry out the administration's stated desire to push the fed funds rate well below what the market is pricing or what the economic conditions and outlook warrant, the Fed's credibility could be threatened. Under such a scenario, we believe the bond market would push long-term yields higher, contravening the administration's aim to support economic growth by bringing down interest rates to stimulate economic growth.

Economic Growth, the Consumer and Fiscal Policy

Economic activity appeared to conclude the year with decent momentum on the heels of the U.S. government's shutdown, which did not seem to ruin the holiday selling season. The most recent retail data from the government dates from October, indicative of officials playing catchup, and showed headline sales were flat due to autos and gasoline, while the control group rebounded strongly (+0.8% month over month in October's delayed release) and high-frequency indicators, such as credit and debit card transaction data, showed healthy holiday spending through mid-December, led by non-store retailers. However, headwinds are evident with higher-end consumers seen as carrying an increasing share of the load in terms of growth, helped by the wealth effect driven by another strong year for equities and even higher returns seen in commodities and other assets. Conversely, apart from that wealthier cohort, other U.S. consumers are facing more challenges mainly due to low real income growth and inflationary pressures on essential goods and services, such as in the grocery aisle, which have shown up in the slide in consumer sentiment indicators since the summer and deteriorating metrics, such as growing delinquencies. Looking ahead, additional fiscal stimulus from the One Big Beautiful Bill Act (OBBA) should provide temporary support early in 2026, though its impact may be uneven across income segments.

Business / Labor Markets

Data released in December on labor market conditions showed softening. Headline October nonfarm payrolls were -105,000 and November nonfarm payrolls were 64,000, bringing the three-month average to 22,000, well below historical norms. Recent strength has been concentrated in healthcare and education, while cyclical sectors have lagged. November's unemployment rate rose to 4.6%; however, some of this deterioration may reflect previously noted shutdown-related data issues rather than a sudden drop in underlying worker demand. Overall, the prevailing dynamics evident since mid-year of low hiring and low firing appear to remain in place, with a return to stronger economic growth in 2026 more reliant on a boost from fiscal policy and inflation turning and moving closer toward the Fed's 2% target.

Despite large companies demonstrating another quarter of solid earnings growth and pointing toward continued optimism for 2026, smaller and mid-sized companies are experiencing greater challenges from the impact of tariffs and weaker consumer income dynamics. Despite large companies' solid top-line growth and resilience, they are expected to continue to remain very cautious around hiring, with AI-driven spending and investment continuing to be key drivers of economic growth, which could represent a market vulnerability if growth plans do not come to fruition.

Inflation

November's inflation reading(s) delivered a mixed message and perhaps most clearly reflected the impact of some of the gaps in data government statisticians are working with as they publish official data. Headline CPI slowed to 2.7%, year over year, and core CPI slowed to 2.6%, surprising markets on the downside. However, these figures were likely distorted by the government shutdown, which probably understated true price pressures. Core PCE, the Fed's preferred inflation gauge, remained sticky at approximately 2.8%, signaling that the battle to bring underlying inflation to heel is far from won. Super-core services inflation (excluding housing) continues to run hot, driven by labor-intensive sectors and healthcare, reinforcing concerns about structural stickiness. Goods inflation eased modestly, but tariff-related cost pressures remain a wildcard, particularly for import-heavy categories. Market pricing reflects skepticism about a rapid disinflation path, with expectations

that the Fed will tolerate inflation above target while prioritizing growth stability. Forthcoming fiscal stimulus from the OBBBA may temporarily boost growth and inflation, raising the risk of renewed price pressures in the second half of 2026.

We remain watchful regarding the sustainability of softer inflation prints and will monitor whether tariff-related cost pressures re-emerge as fiscal stimulus lifts demand. Particular focus will remain on Owner's Equivalent Rent (OER), core goods categories and indicators such as PMI and ISM price indexes for early signs of input cost acceleration. In addition, sectors with high import exposure and discretionary goods will be monitored for renewed margin stress, as these areas are most vulnerable to shifting trade dynamics and potential second-half inflation reacceleration.

Geopolitical Environment

Heading into the new year, the geopolitical landscape is an area with many crosscurrents that could jolt markets or represent sources of tail risk, while influencing the macroeconomic landscape. U.S.-China trade tensions and tariff-related uncertainties persist, while the U.S. administration seeks to reshape long-standing economic and political relationships (such as with the EU and NATO) and broker peace to address some enduring conflicts and newer clashes such as the seemingly insoluble Russia-Ukraine war. As policymakers consider changes to trade agreements and tariff structures, market participants are paying close attention to the potential impact on global supply chains, input costs and overall risk appetite. The U.S.'s apparent efforts to force a change in Venezuela's government and some of the other hotspots impact energy markets and could influence whether low energy prices, a key element of maintaining low inflation, will continue.

Near-Term Outlook: Constructive on Interest Rates, Cautious on Spreads

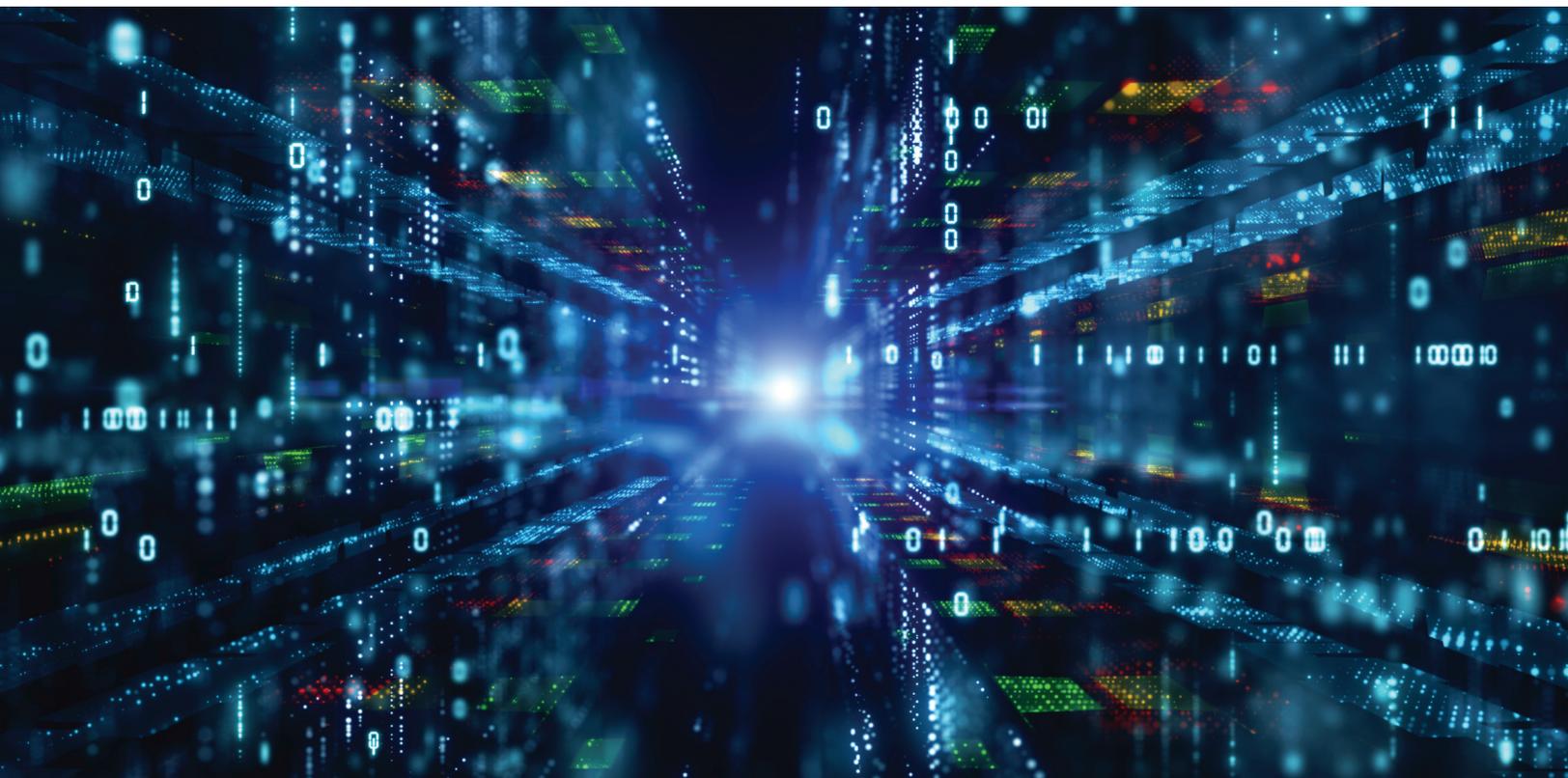
As we move into 2026, our outlook for fixed income markets is constructive but measured. The Federal Reserve's December rate cut and its hawkish pause signal have created opportunities at the front end of the yield curve. However, stress in private credit markets and uneven consumer dynamics call for careful credit selection. In this environment, generating income through carry will be a key driver of returns over the near-term, reinforcing our defensive posture and preference for higher-quality assets.

In investment grade credit, we continue to emphasize issuers with strong fundamentals and limited cyclical exposure, favoring sectors such as banking, insurance, communications, consumer staples and electric utilities and prefer senior positions in asset-backed securities (ABS) and residential mortgage-backed securities (RMBS) backed by prime collateral. Within the mortgage space, continued growth in the government sponsored enterprise's (GSE) retained portfolios should support agency MBS, though prepayment risk and policy uncertainty could weigh on valuations. We plan to selectively add exposure, focusing on pools that offer structural protections, such as seasoned loans or smaller balances, rather than more generic alternatives.

We continue to favor a "bulleted" yield curve posture and a slightly long duration bias, positioning portfolios to benefit from stable or declining interest rates, while also preserving the flexibility to respond to policy shifts or geopolitical developments. Overall, we believe that carry and disciplined credit selection will drive returns in the early part of 2026, with incremental opportunities likely to emerge as valuations normalize. We will continue to emphasize quality and liquidity across all our portfolios.

Investment Grade Credit Themes

- Corporate credit fundamentals across investment grade credit issuers remain solid at a high level. Nevertheless, a few subsectors are under strain mainly from the impact of trade tariffs and other policy-driven uncertainties, in addition to concerns over the unclear contours and timing of the massive AI buildout undertaken by large technology companies. Balance sheets are generally well positioned, stemming from management restraint in the face of shifting trade policy vagaries, potential growth headwinds and rejiggering of supply chains, although more aggressive corporate behavior and M&A have picked up of late, potentially weighing on credit ratings in the medium term.
- U.S. consumers continue to exhibit resilience; however, concerns are rising over the increased dependence on higher-income and wealthier consumers, who have benefited from the steep rise in asset prices over the past few years, to support retail spending and economic growth. Conversely, consumers further down the economic ladder are staring at a labor market generating few new jobs, tepid real wage growth, stubbornly high inflation and sharply increasing healthcare costs for some families.
- Although banking sector credit spreads tightened and outperformed other subsectors over 2025, the subsector represents a core weighting across our strategies based on a number of factors, including strong credit metrics as evidenced by robust capital levels, ample loan loss reserves and lowered impaired loans, in addition to robust profitability and returns on equity. Banks' credit fundamentals are supported by a steepening, positively sloped yield curve and improving loan demand, which will further boost profitability. Lastly, regulatory changes have reduced banks' need to issue bonds, which has offered technical support.
- Away from financials, we continue to favor up-in-quality, more defensively positioned subsectors less exposed to cyclical pressures, in addition to issuers more insulated against heightened trade policy-driven uncertainty. At current valuations within investment grade credit, which remain close to multi-decade record tight spread levels, we favor exposure in non-financials to the communications, healthcare, pharmaceuticals and electric utilities subsectors.

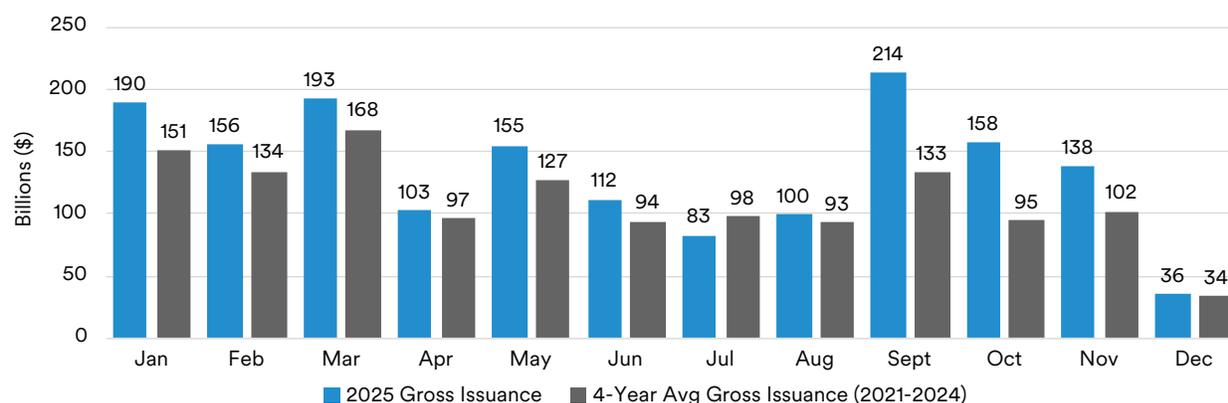


Sector Views

In terms of our view on the attractiveness of the corporate credit sector, as there have not been too many shifts in underlying credit fundamentals, valuations or the technicals / liquidity environment over the last several quarters, we maintain our stance that credit spreads sitting not far above multi-year tight levels leave us less inclined to substantially increase our sector weighting or dial up our risk profile in credit across strategies. High-grade issuer credit fundamentals, as tracked by BofA Global Research, continue to evidence stability and resilience on the part of companies in their U.S. investment grade industrial universe (e.g., financials and utilities with nearly all issuers in their universe captured) with gross and net leverage for the most recently available third quarter at 2.50x and 1.94x, respectively — a slight improvement from the prior quarter’s 2.57x and 1.95x. These metrics are more in line with their pre-COVID norms and have retreated more than half a turn since peaking during COVID as companies generally displayed balance sheet conservatism and refrained from aggressive M&A or boosting shareholder payouts meaningfully up to this point, which has preserved credit ratings. For S&P 500 Index constituents on the earnings side, we saw earnings growth of 13.2% year over year in the third quarter, as per Bloomberg — another strong double-digit showing. This came despite lingering concerns over pressure on some companies impacted by shifting tariff policy or the trajectory of the massive AI buildout.

High-Grade Bond Issuance

(as of December 31, 2025)



Source: J.P. Morgan

The fourth quarter saw steady demand on the part of corporate bond investors, demonstrated by a robust high-grade corporate new issue calendar being readily digested by the market with no discernible upward pressure on spreads. New issue volumes in October and November well surpassed recent years’ comparable levels of activity to close out the second most active year on record. With nearly \$350 billion in high-grade fund inflows in 2025, investor appetite to put money to work — at all-in yields still well above levels prevailing for much of the zero-interest rate policy period orchestrated by the Fed — continued to be evident. The tapering and cessation of new issues also provided a tailwind for the corporate bond market in December, which typically benefits from this favorable technical in terms of relative performance.

The fourth quarter was not without a few bumps, however, with several adverse developments on the lending side centered on some apparently fraud-related defaults impacting selected U.S. regional and money center banks primarily, as well as the ABS market. Those borrower defaults briefly sparked fears of broader problems developing or a “canary in the coal mine” situation signaling a negative turn of the credit cycle, but so far, those fears appear premature. In fact, these few credit blowups did not produce a large widening in credit spreads, although certain pockets of the market — business development

companies (BDCs) and the struggling chemicals subsector — have been under strain. The goings on in the technology subsector were also top of mind and a source of volatility for markets, especially hyperscalers, which have aggressively raised their capital expenditure budgets to meet the hoped-for rapid growth in and demand for AI compute expected in coming years, coupled with the consequent ramp-up in bond financing to support that growth. Even with these sources of market volatility, credit spreads remained in a fairly tight range during the quarter as investors continue to display a “buy the dip” mentality not only in equities but also in fixed income.

Portfolio Strategy

We began the fourth quarter on a somewhat cautious footing after having just trimmed our credit weightings across our longer strategies in late September, as credit spreads reapproached their tights of the year, because we viewed the risk-reward in corporates a bit more asymmetric, tilted against adding more risk at relatively tight spreads. Discipline and patience were maintained until we saw valuations improve as credit spreads tacked wider in November, concurrent with Treasury yields approaching their highs for the quarter, thus providing us an opportunity to selectively and tactically carry out swap extensions to nudge duration slightly above portfolio benchmarks in some of our favored subsectors and issuers in order to build sustained high-quality yield or carry. Thus, after a quieter start to the quarter, we picked up the pace on the spread and rate moves to conduct those tactical shifts to lock in attractive yields, mainly via the secondary market.

Looking more closely at trading activity over the quarter, we held our credit sector weighting essentially flat by adding a one-year duration money center bank issue in the Cash Plus strategy. We also held our portfolio weightings steady in our Enhanced Cash strategy by adding a utility finance company’s two-year new issue and a handful of one- to two-year-duration secondary bonds, including a U.S. telecommunications services provider, two Yankee banks, midstream pipeline, aircraft lessor and U.S. utility, while funding our purchases by selling our shortest-duration positions. In our one- to three-year strategy portfolios, we raised our credit weighting by several percentage points over the quarter. We broadly sold one-year-duration corporates and selectively added two-year-duration bonds, mainly by executing swap extensions in a number of Yankee and money center banks and through secondary purchases of a specialty finance company, aircraft lessor and sports betting issuer’s bonds. We also bought the utility finance company’s two-year new issue in our one- to three-year strategy portfolios. It was a similar story in the one- to five-year strategy portfolios where we also increased our credit weighting in the fourth quarter. We conducted swap extension trades of roughly one-year duration issues and into principally two- to three-year duration bonds in money center banks and another U.S. telecommunications services provider, as well as participating in the utility finance company’s five-year new issue.

We head into the new year with a desire to remain disciplined and continue to hold a bias in favor of concentrating our credit exposure in more up-in-quality, defensively positioned subsectors and issuers against a backdrop of mediocre economic growth constrained by a soft labor market, in addition to heightened macro and policy risks in the U.S. and abroad. Too great a share of the burden to sustainably drive forward the consumer-led U.S. economy is borne by high-end income earners who are not experiencing the challenges middle-class and lower-income consumers are facing around affordability, with inflation above the Fed’s 2% target for four years running, skyrocketing healthcare costs in certain circumstances and no hope of affording a new home at prevailing mortgage rates. However, some relief may be forthcoming from the OBBBA, which is set to begin unleashing the largest collective tax refund in history and lower taxes on corporations and individuals moving forward. That should boost economic growth, while potentially placing upward pressure on inflation in coming quarters.

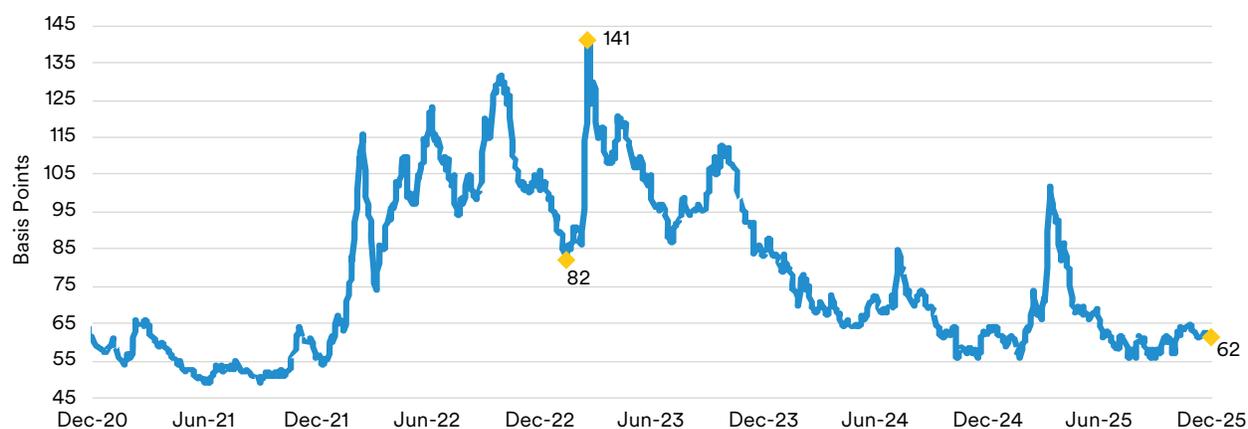
In summary, with valuations in investment grade corporates still sitting close to multi-decade record tight levels and well below five- and ten-year averages in terms of credit spreads, we prefer maintaining lower sector weightings than our historical norms, and we are biased in favor of more-defensive banking, communications, healthcare, pharmaceuticals and electric utility subsector issuers. We will also remain flexible and ready to deploy our dry powder to capitalize on tactical opportunities to reposition portfolios or add exposure in the new issue and secondary markets to build well-protected carry, while working to avoid deteriorating credit situations.

Performance

Relative to duration-matched Treasuries, our investment grade credit sector securities' fourth-quarter performance was a strongly positive contributor to excess return across all our strategies. Favorable subsector allocation and security selection helped drive positive excess returns despite the small widening in credit spreads seen over the quarter. Credit spreads remained in a fairly tight range in the fourth quarter — not too far below the range they have been in since June. As noted above, issuer credit fundamentals are solid, while a consistently healthy investor appetite for spread product, including corporate bonds and sound enough economic growth backdrop, helped prevent spread widening, notwithstanding a few bouts of volatility around AI concerns during the quarter. The ICE BofA 1-5 Year U.S. Corporate Index, our bellwether front-end credit index, widened by four basis points in option-adjusted spread (OAS) over the quarter to finish December at 62 bps vs. September's 58 bps. Quarterly total and excess returns for the credit index were 1.23% and 0.08%, respectively.

ICE BofA 1-5 Year U.S. Corporate Index OAS

(as of December 31, 2025)



Source: ICE Data Services

Taking a closer look at investment grade credit sector performance across our strategies, in the Cash Plus and Enhanced Cash strategies, our banking, automotive, energy and electric utility subsector holdings were key contributors to outperformance. It was a similar story across our Enhanced Cash portfolios where banking, automotive and electric utility subsector holdings were also notable solid contributors to excess return across the board. In our one- to three-year strategy portfolios, banking sector holdings, chiefly money center bank positions, led the way in generating excess return accompanied by some other financials and electric utility subsector holdings, offset slightly by underperformance by a technology subsector position. It was a bit of a similar but more broad-based story in our one- to five-year strategy portfolios, which saw strong excess returns in credit attributable to our money center banks, life insurance companies' secured funding agreement-backed bonds, communications, healthcare, pharmaceuticals and electric utility subsector holdings.

Treasury / Agency Themes

- If the Supreme Court were to strike down the International Emergency Economic Powers Act (IEEPA) tariffs, fiscal concerns would likely resurface, placing upward pressure on Treasury yields. That said, removing IEEPA authority would not materially change the ultimate level of tariffs, given alternative tools available to the administration. More consequential could be the Supreme Court's January 21 hearing on President Trump's attempt to remove Federal Reserve Governor Lisa Cook. A ruling that allows her dismissal could undermine confidence in the Fed's independence, lifting inflation expectations and long-end yields.
- There is a strong chance Chair Powell has already delivered the final rate cut of his tenure. Markets will closely scrutinize the Fed's reaction function amid a potential change in leadership, the Supreme Court's Cook ruling and Powell's possible departure in May. Voter rotation among regional Fed presidents could further tilt the committee in a dovish direction. While the outlook supports rate cuts toward neutral, the key question is whether the Fed redefines neutral itself, and whether that opens the door to rates below 3%. Kevin Hassett appears to be the leading candidate to be nominated to be the next Fed Chair based on recent comments from President Trump. While still one vote, the Chair's influence is substantial, from leading the central bank to congressional testimony to shaping post-FOMC meeting messaging.
- The Fed is poised to absorb a sizable share of Treasury bill issuance in 2026. It plans to reinvest all MBS paydowns into Treasury bills through secondary market purchases, with reserve management purchases expected to begin in January. We see two main avenues of Treasury bill demand. First, as part of its move toward an all-Treasury balance sheet, the Fed will redirect roughly \$15 billion per month in MBS paydowns and about \$180 billion over the year into Treasury bills. Second, under an ample-reserves framework, the Fed will need to buy Treasuries to offset the natural growth in liabilities, especially currency in circulation, which would otherwise drain reserves. These reserve management purchases are expected to include Treasury bills and potentially short-dated coupons out to the three-year maturity area.
- U.S. Agency and Sovereign, Supranational and Foreign Agency spreads appear rich at current valuations, and we remain tactically underweight. We expect European SSA spreads to have further room to widen in 2026, as funding needs increase, and a robust pipeline drives continued heavy issuance. As in prior years, several European SSA issuers have already accessed the USD market. SSA issuance has started the year strongly, led by USD deals alongside active GBP and EUR issuance. We anticipate recurring supply patterns, with January again the busiest month. While we remain underweight U.S. Agencies due to rich valuations, we are constructive on select Gulf Cooperation Council (GCC) issuers.
- Signs of relatively stable inflation and growth should bias yields lower over time, though the Supreme Court's IEEPA decision may keep rates testing the upper end of recent ranges over the near term. Front-end yields, particularly the benchmark two-year, are expected to remain range-bound between 3.45% and 3.65%. Across the curve, we will continue to define and refine interest-rate entry points, maintaining a modest long-duration bias versus benchmark indexes.

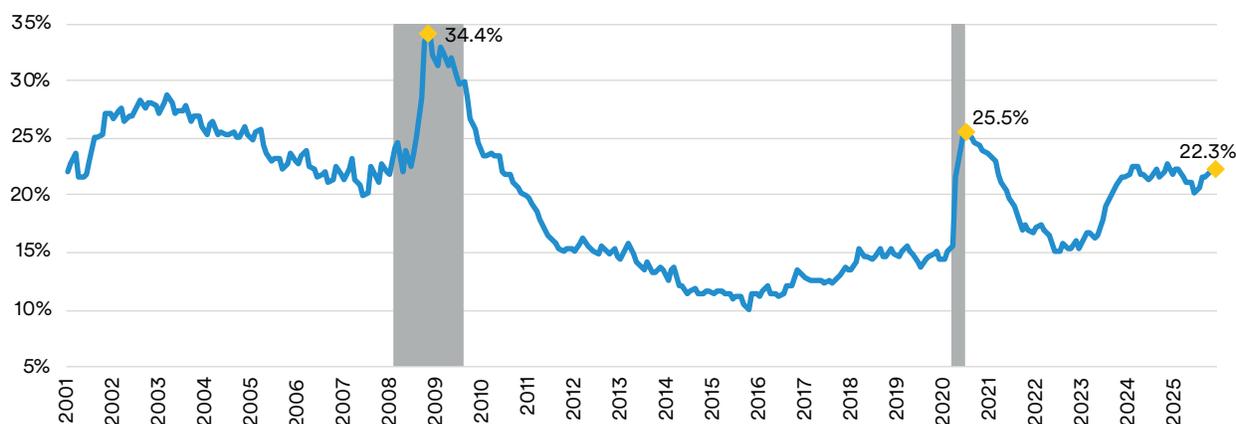
Sector Views

The U.S. enters 2026 in an unusual equilibrium with labor markets cooling while economic growth remains solid. Inflation seems to be moderating, but we see several categories still flashing red, such as shelter and food, even as fiscal policy loosens, while ongoing concerns of an acceleration of tariff pass-through to consumer prices and Treasury bond supply continue to increase. We expect the front end of the yield curve to rally as the Fed cuts rates, but longer-dated yields should stay elevated. The Fed is likely to remain on hold for now, with the December jobs report pointing

to tentative labor market stabilization. Although the unemployment rate fell to 4.4% from 4.5%, December's nonfarm payrolls showed tepid hiring, and downward revisions to past months' data revealed that momentum has been weaker than thought. We continue to expect monetary policy shifts to stay on hold in the near term, while penciling in two to three rate cuts over the balance of 2026. A dovish Fed, resilient growth and mounting supply pressures point to further curve steepening. While inflation readings are still important, a softening labor market is likely to dominate the FOMC's thinking this year, allowing the Fed to push policy into accommodative territory, potentially below 3% for the fed funds rate. Risks remain skewed as labor market weakness becomes more visible. The Treasury is likely to drop its guidance around "maintaining auction sizes" as early as the August refunding. Net Treasury bill supply should continue to rise, even after accounting for Fed purchases. It is anticipated that Treasury bill auction sizes will increase once again in January to fund early-year tax refunds. These outflows are typically reversed by strong mid-April tax receipts, creating significant seasonal volatility in funding needs. Refunds could be larger than usual due to the OBBBA, while capital gains receipts may also be elevated following strong equity performance in 2025. As a result, we expect Treasury bill supply to peak early in the year and decline in the second quarter following April tax collections. We view tighter funding conditions as a repricing of liquidity, not a shortage. Elevated bill supply is expected to persist through the year, which should keep repo rates and volatility elevated, particularly around statement dates. The Fed remains highly focused on avoiding a repeat of September 2019's pressures, and with enhanced tools, improved repo infrastructure and a low bar for preemptive action, the risk of a similar disruption is low even if modest, predictable repo volatility becomes the norm.

U.S. Treasury Bills as a Percent of the Treasury Market

(as of December 31, 2025)



Source: Bloomberg L.P

Portfolio Strategy

Over the quarter, we increased sector weights across several spread sectors as part of an effort to slightly extend portfolio duration. We executed targeted extension trades, redeploying proceeds from shorter-duration sales into longer-dated Treasuries and select spread sector securities when yields moved toward the upper end of our predefined target ranges. These actions allowed us to opportunistically increase duration slightly while maintaining discipline around valuation. We will continue to manage duration actively and with a high degree of flexibility, as the investment landscape is likely to be shaped by a range of macroeconomic policy and market-specific headwinds. In addition, shifting economic growth dynamics, geopolitical risks and evolving liquidity conditions may contribute to periods of heightened volatility. Against this backdrop, we remain constructive on Gulf Cooperation

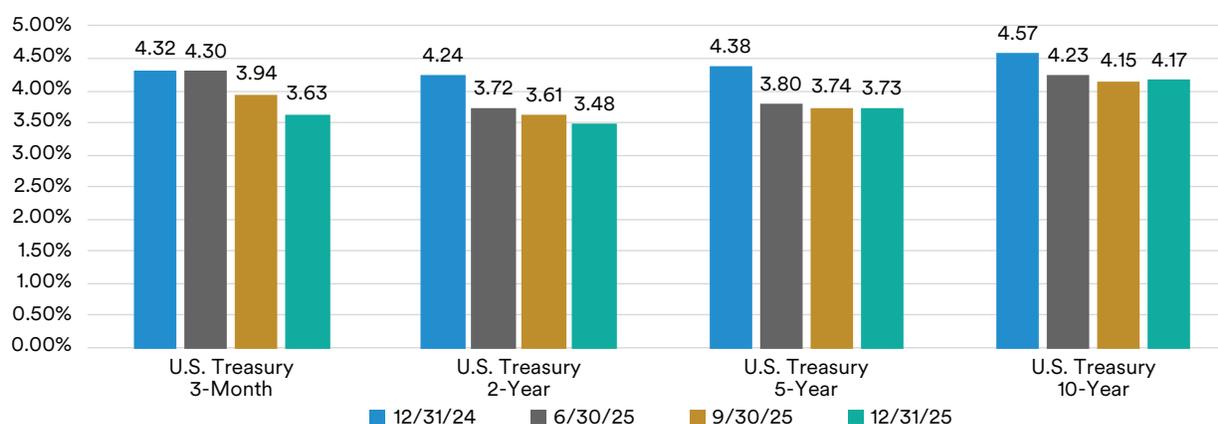
Council (GCC) issuers, where technicals remain favorable. At the portfolio level, we are maintaining a modestly long duration bias relative to benchmarks, complemented by a deliberate, bulleted curve positioning designed to benefit from a steepening of the yield curve.

Performance

Performance across our strategies was supported by our modest long-duration bias relative to benchmarks, as Treasury yields generally moved lower over the quarter. The two-year Treasury yield declined 14 bps, ending at 3.47%, and the slight two-bp decrease in the five-year yield, which finished the year at 3.73%, contributed positively to returns. Conversely, the ten-year yield rose two bps to 4.17%. From a sector perspective, agency allocations were largely neutral, contributing little to overall performance across strategies.

U.S. Treasury Yields

(as of December 31, 2025)



Source: Bloomberg

Asset-Backed Securities Themes

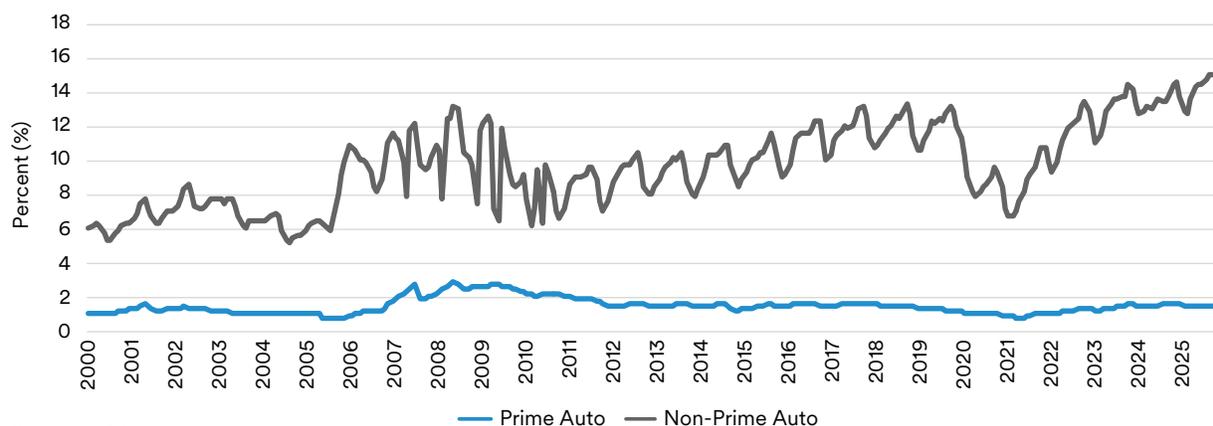
- We continue to prefer liquid, defensive ABS tranches such as AAA-rated credit cards. We also maintain a preference for prime auto and equipment commercial paper tranches, given their senior position in the payment waterfall and short-term commercial paper ratings equivalent to AAA.
- Consumer financial conditions and spending patterns remain increasingly bifurcated. Higher-income consumers, supported by rising home and equity prices, continue to spend on premium goods and discretionary experiences. In contrast, lower-income consumers, often renters with limited equity exposure, stay focused on essential purchases like housing, food and clothing. Looking ahead, we expect lower-income consumers to disproportionately feel the impact of a slowing economy and softening labor market.
- Although overall consumer balance sheets remain generally sound, credit performance indicators continue to show signs of deterioration. Prime auto 60- and 90-day delinquencies remain near historical averages, while subprime auto delinquencies continue to trend higher.
- New and used vehicle prices will remain elevated, as tariffs constrain original equipment manufacturer (OEM) production volumes and limit new vehicle sales numbers. With high price levels, buyers are likely to shift to used vehicles. Elevated vehicle prices should continue to support lease residual values and auto loan collateral recovery rates.
- We continue to avoid subprime and less liquid esoteric ABS subsectors, as we believe these segments are more vulnerable to an economic downturn and susceptible to spread widening in periods of market volatility.

Sector Views

We continue to observe signs of weakening in certain ABS collateral performance, as labor market growth moderates, and lower-income consumers face increasing financial pressure. Despite these headwinds, we remain comfortable with our top-of-the-stack, AAA, and AA-rated holdings. However, challenges persist in selected subsectors, particularly subprime auto and student loans, which continue to weigh on broader ABS performance. In subprime auto, 30+-day delinquencies continue to rise as December 30+ delinquencies now stand at 15.3%. We have also observed an increasing tendency among lower-income consumers, who often hold more limited ready cash, to prioritize certain monthly obligations over others. That said, even if credit conditions deteriorate, we do not foresee a meaningful impact on our credit card holdings, as they are backed by strong levels of credit enhancement with charge-offs and delinquencies remaining well below historical norms. Moreover, we expect securitized ABS credit card trusts, especially those backed by seasoned collateral accounts, to continue outperforming broader consumer credit portfolios. The most recent Fed Senior Loan Officer Opinion Survey, reflecting sentiment as of October, showed banks leaving lending standards for credit cards and other consumer loans generally unchanged, while loosening standards for auto loans. Banks also reported unchanged demand for credit cards and other consumer loans but weaker demand for auto loans.

Auto Loan 30+ Days Delinquencies

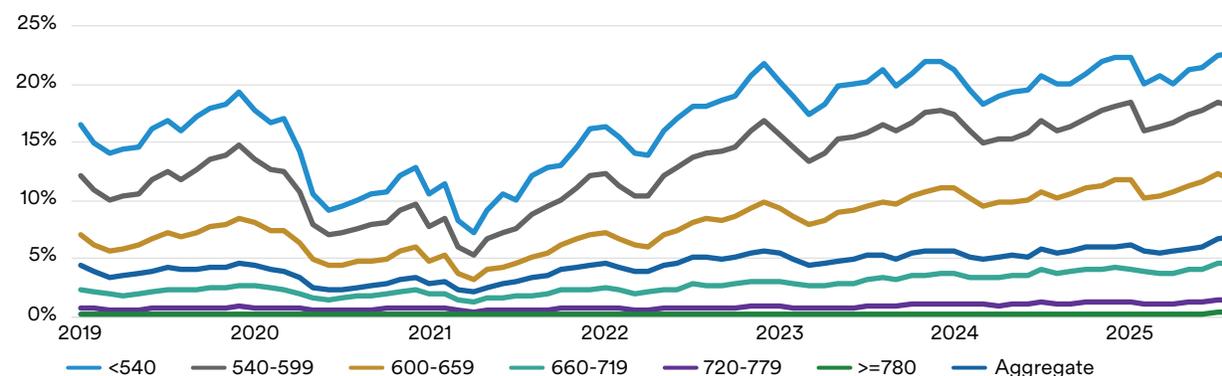
(as of December 31, 2025)



Source: J.P Morgan

Auto Loan 30+ Days Delinquencies by Credit Score

(as of December 31, 2025)

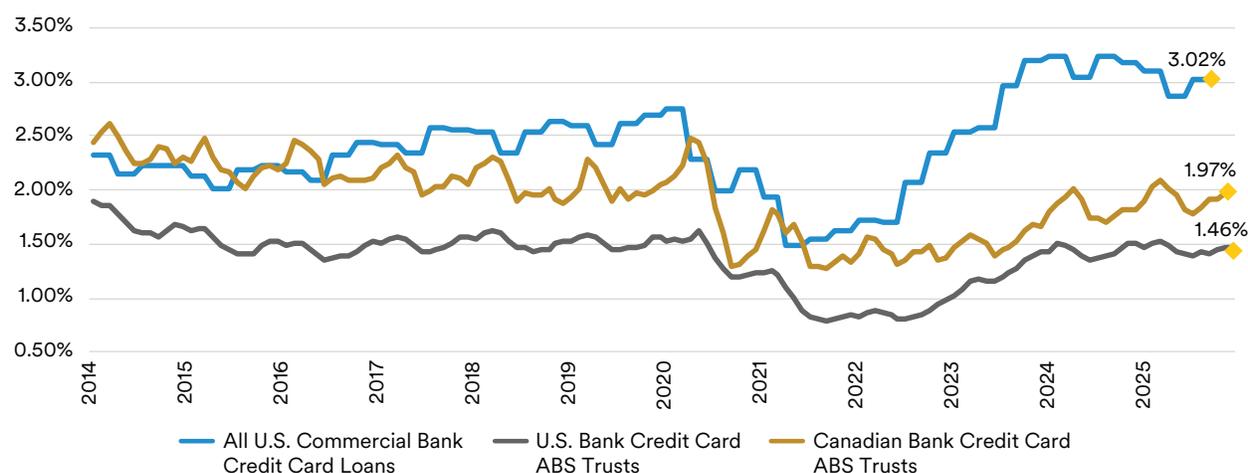


Source: J.P Morgan

Credit card trust performance metrics showed little to no change over the quarter. Data from the JP Morgan credit card performance indexes reflecting the December remittance reporting period showed charge-offs on bank credit card master trusts decreased by 10 bps to 2.23% during the quarter. The 60+-day delinquencies rose 3 bps to 1.04%. Charge-offs and delinquencies still remain well below historical norms. The Manheim Used Vehicle Value Index (MUVVI) closed out December at 205.5, marking a 0.4% increase in wholesale used-vehicle prices compared to December 2024 and a modest 0.1% gain, month over month. The year-end data reflect a market that has largely stabilized, with non-seasonally adjusted prices up 0.5%, year over year, following a slight 0.4% decline from November.

Credit Card Delinquencies

(as of December 31, 2025)



Source: Bloomberg, J.P. Morgan

There was over \$340 billion of ABS issuance in 2025, continuing the upward trend of the previous years. Autos continue to be the largest sector, accounting for over \$166 billion of total issuance. This was followed by \$80 billion of issuance in the Other ABS subsector, a “catch-all” category that includes deals collateralized by cell phone payment plans, timeshare loans, mortgage servicer advances, insurance premiums, aircraft leases, etc. Of the year’s total issuance, 63% was issued under Rule 144A and 7% was floating rate. In comparison, last year saw 62% of issuance as 144A and 8% as floating rate.

Tariff-related risks remain a key consideration, particularly for our ABS auto holdings. We expect this segment to feel the greatest impact of tariffs, as tariffs on key metals inputs are likely to increase vehicle manufacturing costs. GM and Ford appear to be the U.S. OEMs most vulnerable to tariffs, and while they are expected to absorb some of the higher costs, substantial portions will be passed along to consumers via higher vehicle prices. This creates added pressure on affordability, especially in an environment where many consumer budgets are already stretched. That said, higher new car prices may provide a tailwind for used-vehicle values, which we expect to remain relatively stable and help support used-vehicle ABS performance. Looking forward, we anticipate a decline in new-auto ABS issuance, driven by weaker sales volumes amid tariff pressures, higher sticker prices and ongoing supply chain constraints. Cox Automotive, the world’s largest automotive services and technology provider, projects new-vehicle sales in the U.S. will hit 15.8 million units in 2026, down 2.4% from 2025 levels. Most forecast metrics for the automotive market, according to Cox Automotive, are expected to be lower than in 2025, a year that exceeded most expectations. They emphasize that high-income households will benefit from wealth effects, tax relief and rate cuts,

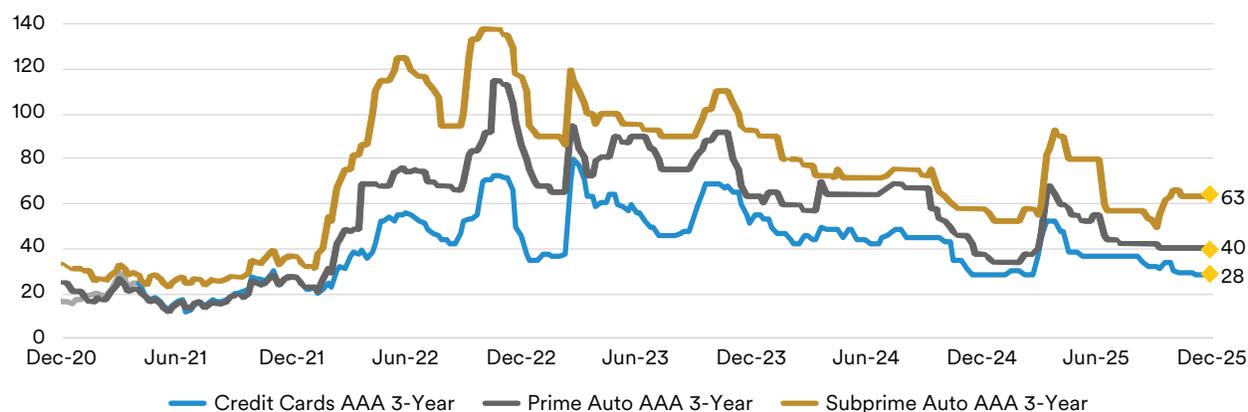
which may help support new-vehicle sales, while lower-income consumers will continue to feel the strain of prolonged inflation and high purchase costs of both new and used vehicles. This divergence will accelerate trade-down behavior, making value perception critical across the market.

Portfolio Strategy

ABS sector shifts varied across our strategies in the third quarter. We slightly increased our ABS holdings in our Enhanced Cash and one- to three-year strategies. In our other strategies, we collected our paydowns and reinvested the cash into other spread sectors. We participated in 15 primary ABS deals this quarter. Sector investments were diversified and included credit cards, device payment plans, equipment, prime and subprime auto, and auto lease and ranged from AAA to A-rated securities. We bought multiple prime auto new issue deals, with one of these being the German automaker's AAA-rated, floating-rate tranche that launched 37 bps over secured overnight financing rate (SOFR). Similarly, a U.S. regional bank's prime auto new deal, which we also participated in, launched their AAA-rated, floating-rate tranche 33 bps over SOFR.

Short Tenor AAA CMBS Spreads

(as of December 25, 2025)



Source: Bloomberg L.P, MIM

Performance

Continuing from recent quarters, ABS outperformed across all strategies after adjusting for duration and yield curve repositioning. The greatest contribution to outperformance continues to come from the Auto and Other ABS sectors. Within the Other ABS sector, device payment plan and floorplan holdings led the pack.



Commercial Mortgage-Backed Securities Themes

- Smaller loans with marginal cash flow metrics may face refinancing challenges, as regional banks burdened by troubled multifamily and office loans on their balance sheets continue to maintain a conservative stance toward commercial real estate (CRE) lending. In contrast, outstanding loans secured by trophy properties and well-performing pools of industrial and lodging assets are more likely to successfully refinance in the single asset, single borrower (SASB) market.
- Commercial real estate delinquencies are likely to trend higher as weakness in the office subsector persists, particularly among second- and third-tier properties. We anticipate signs of stabilization within the multifamily sector, supported by slowing new construction and improving absorption. In our view, delinquencies in other subsectors are not broadly thematic, but rather localized to specific geographies or individual assets.
- Agency CMBS securities are likely to continue benefiting from strong sponsorship, as banks favor them over agency RMBS alternatives, given the long-duration exposure of their existing RMBS portfolio holdings.
- We prefer trophy properties in the SASB subsector, which typically consists of prized assets in primary cities or destination vacation locations. We also favor AAA-rated conduit tranches with stable average life profiles.
- We continue to avoid agency CMBS and those conduit tranches exposed to significant extension risk, as we do not believe these represent attractive opportunities at current spreads.

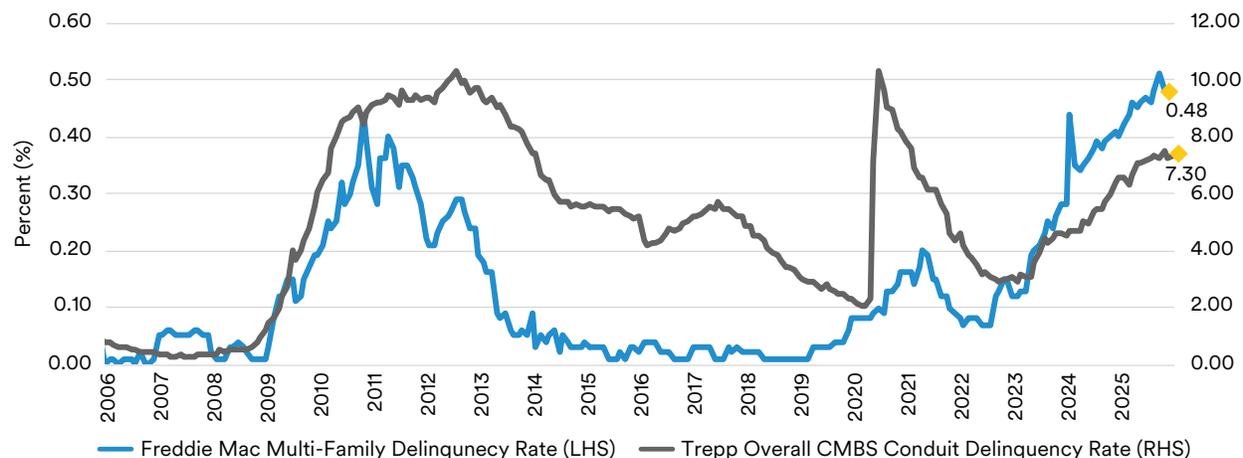
Sector Views

In line with past commentaries, we see persistent headwinds in the CMBS market with collateral performance expected to remain under pressure, particularly in the office sector. While a meaningful decline in interest rates could support refinancing activity over time, we do not anticipate a significant near-term improvement in fundamentals for the most challenged subsectors. Additionally, while tariff impacts are likely to have a more muted effect on CMBS than on consumer ABS, we remain mindful of the indirect pressures these macro developments may create. Overall, we believe the combination of a slowing economy, still-tight financial conditions and overall market volatility will continue to weigh on CMBS performance. These dynamics are likely to create additional hurdles for borrowers looking to refinance maturing debt. Given this backdrop, we maintain a cautious and defensive stance in our CMBS positioning with an emphasis on credit quality and structural protections.

The Trepp CMBS Delinquency Rate was back on the rise in December 2025, with the overall delinquency rate increasing four bps to 7.30%. Three of the five major property types saw increases in their delinquency rates. The largest rate increase once again was in lodging, which rose 44 bps to 6.61%, followed by industrial, which ticked up by a relatively large 13 bps in December to 0.80%, after adding three basis points the month prior. The retail rate increased by 18 bps to 6.92%, still 90 bps off of its recent peak in March 2025. The office rate saw the largest retreat, by 37 bps to 11.31%, marking the second consecutive decline but ending the year above the last three Decembers by margins of 30, 549 and 973 bps, respectively. The multifamily delinquency rate also continued to fall, dropping 34 bps to 6.64%.

CMBS Delinquencies

(as of December 31, 2025)

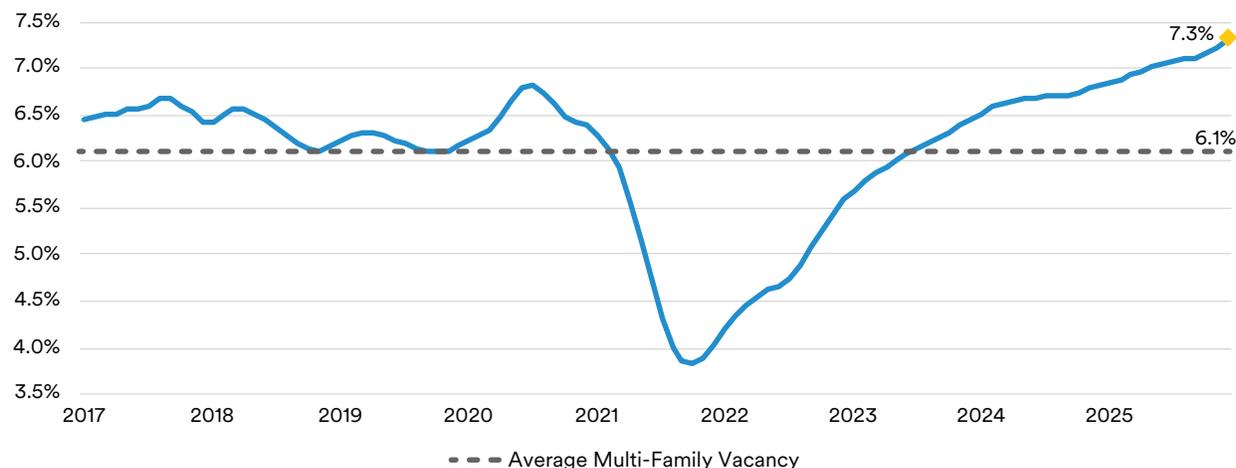


Source: Trepp, Bloomberg L.P

In the multifamily space, we are closely tracking rising delinquency rates across certain markets, which may be a harbinger of broader stress. Multifamily CRE loan spreads have remained stable, but vacancy rates have reached an all-time high for the sector. Credit spreads take into account measures of funding costs, expected loss, capital charges, market liquidity and target lender margin, meaning they effectively communicate current market sentiment and risk pricing. Unlike CMBS spreads, which are more frequently priced and generally more observed, CRE lending spreads are private, making pricing and benchmarking more difficult. Low leverage, 50-59% LTV, multifamily spreads over the 10-year Treasury were relatively stagnant in the low 140s during the fourth quarter, while the national multifamily vacancy rate climbed to a record high of 7.2%, and median rent dipped by 1.0%, month over month in November. Multifamily is considered low risk relative to other property types, but recent metrics indicate the sector is seeing supply that is increasingly outpacing current demand across the country.

Multi-Family Vacancy Index

(as of December 31, 2025)



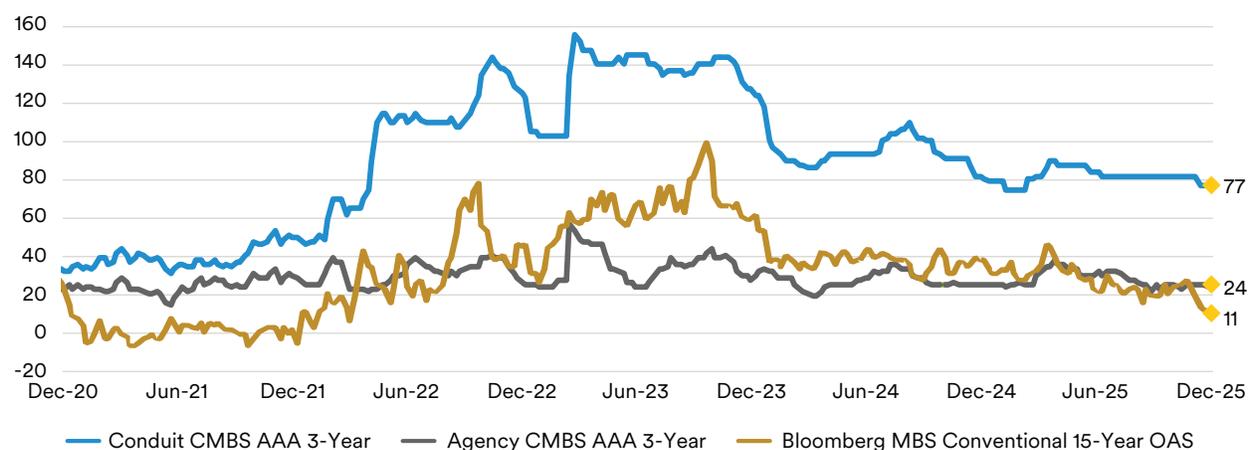
Source: Apartment List Vacancy Index

Portfolio Strategy

With the exception of our Cash Plus strategy, we generally reduced our CMBS holdings across portfolios. We used both the outright sale of agency CMBS tranches and reinvestment of CMBS paydowns into other spread product sectors to accomplish the reduction. Within the sector, we continued to favor more stable conduit ASB and select SASB tranches. In our view, spreads for securities further out the maturity spectrum remain relatively unappealing compared to other spread product alternatives. We did not participate in any primary deals this quarter. At current spread levels, we expect to maintain our present portfolio weighting and add additional exposure only when a compelling opportunity arises.

Short Tenor AAA CMBS Spreads

(as of December 25, 2025)



Source: Bloomberg L.P., MIM

Performance

After adjusting for their duration and yield curve repositioning, CMBS outperformed across all strategies. Both non-agency and agency subsectors were positive across the board, but a large part of the outperformance can be attributed to our non-agency SASB and conduit ASB positions. We continue to favor these and AAA-rated conduit tranches with stable average life profiles. Short-tenor CMBS spreads were mixed over the fourth quarter. Three-year, AAA-rated, floating-rate SASB tranches ended the quarter at a spread of 122 bps over SOFR, nine bps wider. Three-year Freddie Mac “K-bond” agency CMBS tranches ended the quarter at a spread of 24 bps over Treasuries, one bp tighter.

Residential Mortgage-Backed Securities Themes

- We favor seasoned 15-year specialized pools due to beneficial convexity characteristics as well as non-agency closed-end second liens and single-family rental tranches.
- We have been avoiding specialized pools from recent vintages exposed to prepayment risk and non-agency, non-QM tranches with high average life variability and unattractive call features.
- Most outstanding mortgages remain well out of the money, which should constrain RMBS prepayment activity. However, with rates moving lower, certain recent issue vintages could see accelerated prepayments. High single-family home prices provide broad support for the rental market and residential mortgage credit. Nonetheless, certain geographies have recently seen declining home prices, which creates challenges.
- Speculation around the potential privatization of Fannie Mae and Freddie Mac will continue to be a focus. Maintaining the ultimate government guarantee of agency RMBS securities will be necessary to effect any privatization without seriously disrupting the mortgage market. However, politics and the approaching midterm elections represent impediments to any privatization initiatives. GSEs will continue growing their MBS portfolios which should support spreads and modestly reduce mortgage rates.
- The Federal Reserve's MBS portfolio should continue to shrink as mortgage paydowns are reinvested in Treasuries. Fannie Mae and Freddie Mac will begin purchasing MBS for their own portfolios as the Trump administration seeks to push mortgage rates lower, although no concrete plan has been set in motion. The lasting effectiveness of any such purchases as a driver of primary mortgage rates is questionable.
- While President Trump called for banning large institutional investors from buying more single-family homes, these SFR companies are a relatively small portion of the highly fragmented single-family home rental market, and it is still too early to know what impact, if any, this will have on securitized holdings in this subsector.

Sector Views

We continue to find non-agency spreads attractive versus other sectors but are cautious about adding deals with significant exposure to investor properties due to early signs of worsening credit performance. Most outstanding mortgages remain well out of the money, which should keep RMBS prepayments constrained. However, with rates moving lower, certain recent issue vintages could see accelerated prepayments. High single-family home prices provide broad support for the rental market and residential mortgage credit. Nonetheless, certain geographies, such as Florida, have recently seen declining home prices — a trend we continue to monitor across broader markets.

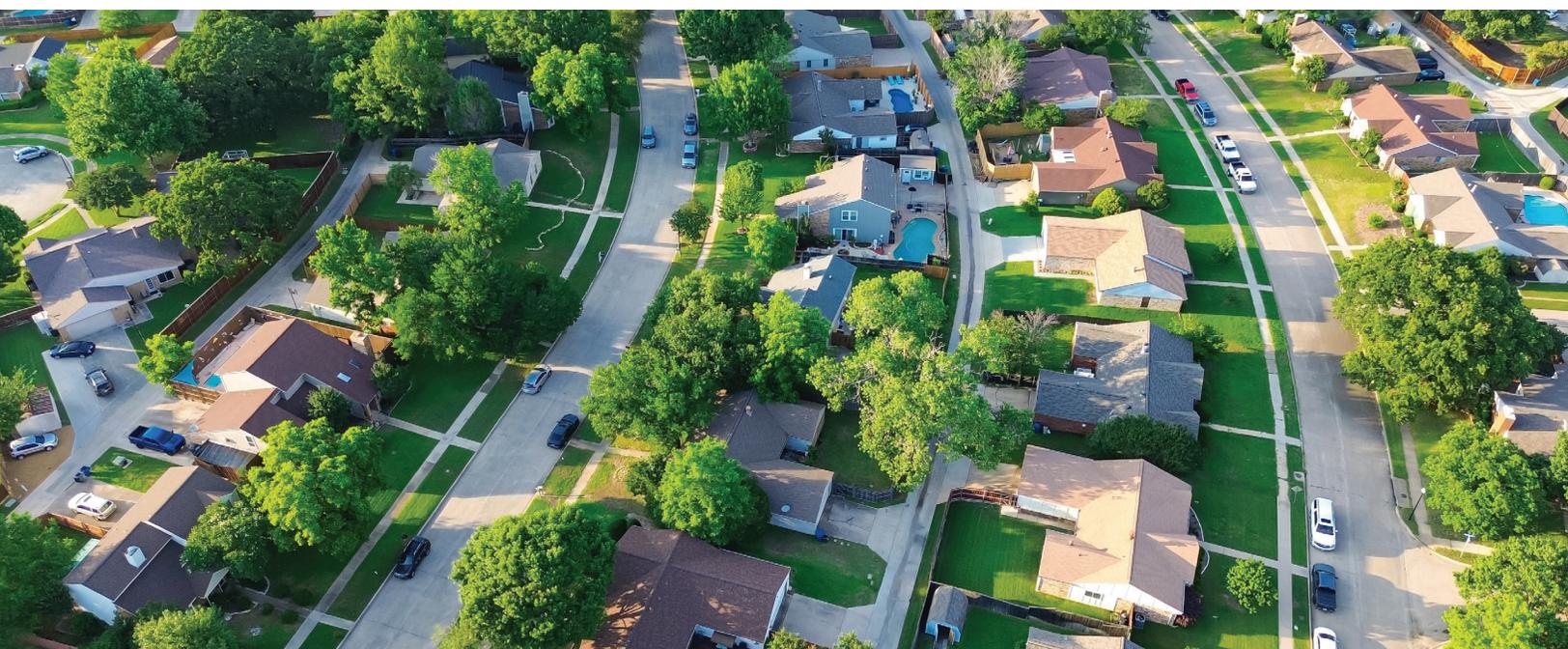
The Fed's mortgage portfolio ended the quarter at \$2.04 trillion following paydowns of \$14.6 billion in December, \$16.3 billion in November and \$16.0 billion in October. Given the composition of the Fed's portfolio, we expect Fed prepayments to remain in this range for the foreseeable future. Aggregate Fannie and Freddie 30-year prepayments increased by 4-5% in December, driven by a four-day higher day count partially offset by negative housing seasonals and a continued decline in refinancing applications since their September peaks. We expect prepayments to trend modestly higher over the next few months as recently originated collateral responds to continued Fed interest rate cuts and slightly lower interest rates.

President Trump recently communicated on Truth Social his interest in addressing housing affordability and singled out institutional investors in single-family rental (SFR) properties. The president indicated his desire to bar large institutional investors from buying more single-family homes. Currently there are too few details to accurately gauge the impact this will have on our

holdings. Our research team continues to view SFR as a sector of low leverage in the securitized products space with leverage points of typically 60-70% LTV showcasing the significant value in the transactions. SFR operators have become significant new home buyers/builders through their build-to-rent programs, and it is unclear if this type of soft acquisition would be banned since this is supporting home values as well as the builder community. In any event, large institutional SFR companies are a relatively small portion of the highly fragmented single-family home rental market with owners of over 1,000 homes comprising just 3.3% of the market. In our view, home affordability challenges are primarily tied to supply issues, so banning SFR companies from further home purchases is unlikely to materially reduce home prices.

Privatization of GSEs also continues to be a topic of market speculation. While it does not seem to be a primary focus for the Trump administration, it is a subject that has been brought up on multiple occasions, including during President Trump's first term. To recap, in response to the Global Financial Crisis, the U.S. Treasury placed Fannie Mae and Freddie Mac into conservatorship in September 2008. This action was intended to stabilize the mortgage market and restore confidence in the GSEs. There is a draft bill that calls for the U.S. Treasury Department to relinquish its senior preferred equity stake in the GSEs, exercise its warrants on the common stock, sell off that equity and release the GSEs from conservatorship within two years. Fitch currently rates GSE debt AA+, the same credit rating as the U.S. government due to the implicit government guarantee of the GSEs. Fitch noted that "ending GSE conservatorship would have a direct negative rating effect on GSEs, which in turn would have an adverse impact on a substantial number of affordable housing debt ratings that have direct linkages to Fannie Mae and Freddie Mac, based on guarantees provided by these GSEs." In our view, privatization of the GSEs continues to be unlikely in the near term, as the administration is likely to continue to prioritize other matters such as immigration reform and tariff policy.

President Trump recently directed Fannie Mae and Freddie Mac to purchase \$200 billion in mortgage bonds, a move aimed to improve affordability and bring down housing costs. Toward the end of 2025, Fannie Mae and Freddie Mac had already been increasing their holdings of MBS in their retained portfolios. Both portfolios, for now, publish their activity on a month-over-month basis, so reporting will hopefully continue to be transparent throughout this process. In 2025, Freddie and Fannie's retained portfolios had grown by approximately 20% and 17%, respectively. In the last 12 months, they have been net buyers of \$50–60 billion of mortgages in total, and this will clearly expand to support the mortgage market and the mortgage basis.

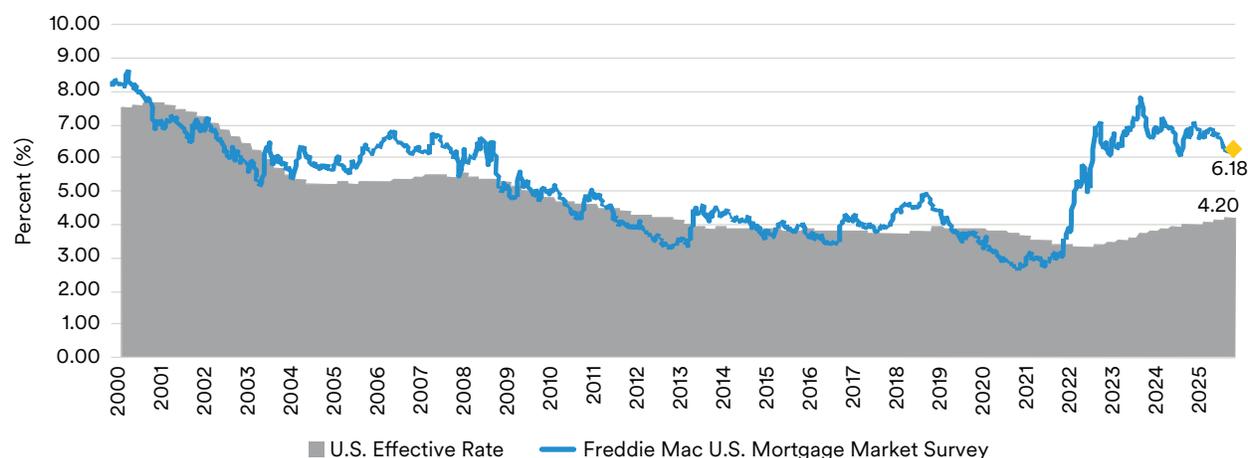


Portfolio Strategy

This quarter, we increased our RMBS exposure in our one- to three-year and one- to five-year strategies. We opportunistically added exposure in agency specified pools whose superior liquidity profile outweighs the spread advantage found in non-agencies. We believe that maximizing portfolio liquidity is paramount for the near term. In the future, we may selectively increase our exposure to non-agency second-lien deals and single-family rental (SFR) tranches. Depending on valuations, we maintain our preference for deals collateralized by full-documentation loans to high FICO borrowers at modest LTV ratios. We will continue to avoid non-agency deals with significant exposure to investor properties due to early signs of deteriorating credit performance in that subsector. We participated in two new primary deals, one of them being a AAA-rated, 2.65-year weighted-average-life, closed-end, second-lien issue that priced at 135 bps over Treasuries.

Outstanding Mortgage Average Rate vs. Current Rate

(as of December 25, 2025)



Source: Bloomberg L.P

We expect prepayments to remain relatively low for most vintages, as the vast majority of mortgage collateral remains outside of the refinancing window. While a weakening economy is a negative headwind for residential real estate performance, we believe our portfolio holdings of senior non-agency tranches are well protected and do not anticipate any meaningful credit deterioration. That said, we remain mindful of spread volatility and the potential for liquidity challenges in non-agency tranches. Going forward, we expect to maintain our current RMBS allocation across our strategies.

Performance

Our RMBS tranches contributed positive excess return performance across strategies after adjusting for their duration and yield curve positioning. Non-agency CMOs continued to be the largest outperformers, as they had another positive quarter.

Municipal Themes

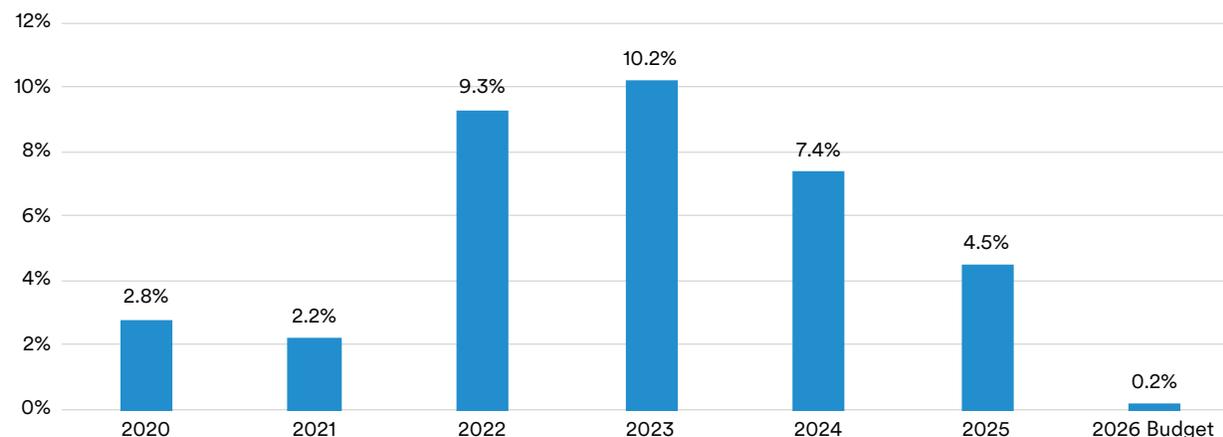
- Overall, we expect municipal credit to remain stable, supported by healthy balance sheets and moderating, continued growth in tax revenues. Some sectors, particularly smaller, rural or specialized issuers, may face idiosyncratic pressures from demographic shifts and revenue constraints. Key credit risks include uneven revenue trends, changes in federal policy, climate-related events and underfunded pension obligations.
- State governments remain broadly stable, supported by strong reserves, disciplined fiscal management and manageable fixed costs, although revenue growth is slowing toward pre-pandemic norms. Revenue and spending are expected to increase modestly, while pension funding has improved, with long-term liabilities continuing to pose fiscal challenges.
- The higher-education municipal sector displays a mixed credit picture, with large, well-capitalized institutions stabilizing, while smaller, tuition-dependent schools continue to face pressure. Enrollment growth is modest, but declines in international students and longer-term demographic trends pose risks to many institutions. Policy uncertainty and federal funding pressures continue to impact credit profiles, particularly for institutions reliant on external support. Overall, the sector offers selective relative value opportunities — as such, we favor public and highly rated institutions.
- Although spreads widened slightly over the fourth quarter, valuations remain rich, leading us to maintain a disciplined and selective approach to new purchases. We continue to favor municipal issuers and sectors with strong financial flexibility, stable revenue profiles and the capacity to navigate economic uncertainty and evolving policy dynamics.

Sector Views

State governments remain broadly stable, supported by historically strong rainy-day funds, disciplined fiscal management, and moderate fixed costs, though revenue growth is slowing toward pre-pandemic norms. According to the National Association of State Budget Officers Fall 2025 Fiscal Survey of States, on a median basis, FY2026 general fund revenue and spending are projected to increase modestly, by about 0.3% and 0.2%, respectively. These projections indicate cautious budgeting amid declining federal support, increased medical costs, housing pressures and rising demands for higher education and healthcare funding. Pension-funded ratios have improved to 82.5% in FY2025, according to the Equable Institute, reflecting strong contributions and solid investment returns, yet unfunded liabilities remain elevated at approximately \$1.2 trillion, continuing to strain state budgets and highlighting long-term fiscal risks. Additional headwinds include trade-related pressures from new tariffs, particularly in manufacturing heavy states such as MI, KY and TN, and port-reliant states including NJ, SC and GA, according to The Pew Charitable Trusts, as well as policy changes related to national disaster funding support. States with strong and diverse economies, higher income populations and lower pension burdens are expected to remain more resilient, while those more reliant on vulnerable sectors or facing larger unfunded liabilities may experience fiscal stress. Infrastructure investment, disaster response and policy-driven spending obligations will likely support bond issuance, although slower revenue growth, rising fixed costs and varying pension funding levels support being selective in evaluating investment opportunities. While the state obligation sector maintains stable credit fundamentals, anchored by strong liquidity, disciplined financial practices and robust reserve levels, it will continue to face exposure to moderate fiscal pressures and evolving economic and policy dynamics.

Median Annual Percentage Change in States' General Fund Spending

(as of December 31, 2025)



Source: National Association of State Budget Officers

Footnote: Fiscal 2025 is preliminary actual; fiscal 2026 is projected based on states' enacted budgets.

The higher-education municipal sector continues to operate within a challenging environment shaped by policy, demographic and operational pressures. Policy uncertainty has been a defining factor, driving elevated issuance in 2025 amid concerns over federal grants, nonprofit status and endowment taxation, though some risks moderated as the 8% endowment tax affects only a small number of institutions, and tax-exempt status was preserved under the OBBBA. Credit conditions remain highly bifurcated, with large, selective universities mostly maintaining or improving ratings, while downgrades are concentrated among smaller, regional and less selective institutions facing enrollment pressure, rising costs and margin compression. Enrollment trends are mixed: Fall 2025 total enrollment rose about 2%, year over year (National Student Clearinghouse), and Spring 2025 enrollment increased 3.2%, led by undergraduates; however, new international enrollment declined sharply (17%), per the Institute of International Education, concentrated in graduate programs due to visa delays and federal funding uncertainty. Longer term, the sector faces material demographic headwinds, with the enrollment cliff potentially beginning as early as 2026 due to post-Global Financial Crisis declines in birth rates, posing disproportionate risk to tuition-dependent institutions. Public universities remain structurally better positioned than private nonprofits, supported by stronger enrollment momentum and more stable funding, while private institutions continue to navigate tighter operating conditions. Overall, while relative value opportunities can be found in select credits, the sector remains vulnerable, highlighting the need for issuer-level selectivity and a focus on public and highly rated institutions, as demographic, operational and policy pressures continue into 2026.

Portfolio Strategy

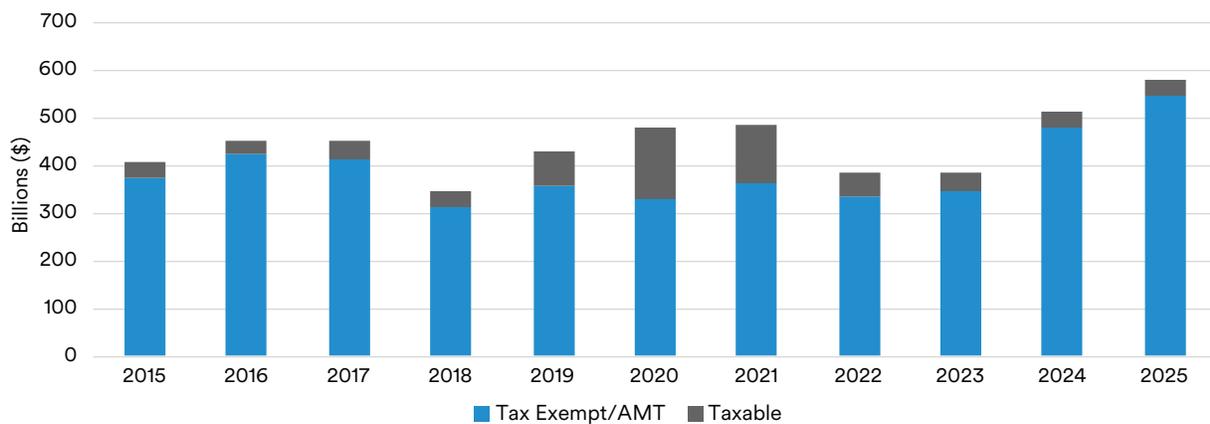
We view taxable municipals as a high-quality, defensive sector but have been selective in our purchase activity within the asset class. Over the quarter, our buy activity was focused on adding to favored names within the airport, healthcare, higher education and local obligation sectors. Our selling activity remained centered on accessing liquidity within the municipal market. This strategy involved reducing exposure to shorter-duration bonds in favor of more attractive opportunities in either longer-dated taxable municipal bonds or other spread sectors where we invest. Overall, our sector exposure was increased in our Cash Plus strategy and maintained in our Enhanced Cash, one- to three-year and one- to five-year strategies.

Performance

Despite limited new issuance in the taxable municipal market and fourth-quarter supply declining 12%, year over year, front-end credit spreads slightly widened, resulting in negative excess returns in the sector. The ICE BofA 1-5 Year U.S. Taxable Municipal Securities Index generated a total return of 1.08%, marginally underperforming the ICE BofA 1-5 Year U.S. Treasury Index, which returned 1.12%. The OAS on the taxable municipal index widened by four bps, ending the quarter at 33 bps. Within portfolios, taxable municipal holdings were neutral to performance in our shorter-duration strategies and generated positive performance in our one- to five-year strategy. On an excess return basis, Airport, Higher Education and Local Obligation holdings were the primary contributors.

Taxable Municipal Issuance

(as of December 31, 2025)



Source: Bank of America

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