

PRODUCT COMMENTARY

Core Aggregate Composite

MERGANSER TODAY

Merganser Capital Management is a best-in-class boutique fixed income manager with a fundamentals-based investment approach. Formed in 1985, Merganser is an SEC registered investment advisor focused on the needs of institutional clients.

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MARKET OVERVIEW


War in the Middle East sent energy prices surging higher during the first quarter, sparking concerns regarding resurgent inflation and pushing US Treasury (UST) yields higher. The 2-year, 10-year and 30-year UST yields increased by 32, 15 and 7 basis points (bps) during the quarter, respectively. Front-end yields repriced forecasts for further policy easing, while longer yields responded to higher inflation expectations. The UST yield curve flattened as measured by both the 2's vs. 10's and 10's vs. 30's curves. There was no shortage of geopolitical shocks for investors to digest. The quarter began with the US capture of Venezuelan leader Nicolás Maduro and ended with the US and Israel at war with Iran. The Iran conflict roiled global energy markets as cargo traveling through the Strait of Hormuz ground to a halt. The US Supreme Court ruled against President Trump's Liberation Day tariffs, indicating he had exceeded his authority. President Trump quickly responded with a new round of tariffs on imports, making the long-term implications of trade policy increasingly unclear. The Federal Reserve (Fed) left its target range unchanged at 3.50% - 3.75% at both its January and March meetings. Futures markets ended the quarter predicting effectively no changes to the Fed Funds target rate during 2026. Kevin Warsh is slated to become the next Fed Chair during 2Q26. The Bloomberg US Aggregate Index returned -0.05% for the quarter, bringing the trailing 12-month return as of 3/31/2026 to 4.34%. According to the Bloomberg US Aggregate index, risk sentiment among IG spread sectors was mixed during the quarter. IG corporate credit spreads widened by 11 bps and the sector underperformed USTs by 49 bps. Financials, utilities, and industrials underperformed by 67, 42 and 41 bps respectively. Heavy supply and AI disruption related concerns drove spreads wider, particularly in technology. Headlines regarding weakness in private credit spilled over to IG markets across several sectors, most notably in financials, where spreads for finance companies and insurance widened by 41

and 18 bps during the quarter, respectively. Among securitized sectors, CMBS was the top performer, outpacing like-duration USTs by 33 bps. Non-Agency and Agency CMBS outperformed by 29 and 37 bps, respectively. The Trump administration's January announcement of a \$200 billion purchase program by the Government Sponsored Enterprises (GSEs) targeting mortgage-related securities caused option adjusted spreads for Agency RMBS to tighten sharply. Spreads retraced wider in February and March, but the sector was still able to produce excess returns for the quarter, outperforming by 16 bps. ABS outperformed by 10 bps. Remittance reports for consumer receivables continued to reflect differentiation between prime and subprime borrowers.

POSITIONING CHANGES

During the first quarter, we opportunistically rotated sectors in our Core Aggregate portfolios by decreasing our allocations to Agency RMBS and US Treasuries and increasing our allocations to corporate credit and CMBS. Option adjusted spreads for Agency RMBS tightened sharply following the administration's January announcement of the \$200 billion purchase program by the GSE's. OAS on 30-year MBS tightened to levels not seen since 2021. In early January we monetized the spread tightening by swiftly reducing our allocation from 24% to 18%, a reflection of our ability to quickly rotate the portfolio. Within our allocation, we trimmed our overweights to 5's and 5.5's, moved toward neutral in 4.5's, and underweight in 4's. Since then, the MBS basis has retraced to pre-announcement levels amid geopolitical uncertainty and elevated interest-rate volatility. We opportunistically added back in February and March, raising our allocation to 20% by quarter-end. We increased our allocation to corporate credit from 20% to 23%. Weakness in private credit, heavy supply, and geopolitical tensions pushed corporate credit spreads 11 bps wider during the quarter. The widening was most pronounced in the finance companies and brokerage subsectors of financials. Banking and insurance spreads widened in sympathy, to a point where we found compelling relative value. We remain constructive on the "too big to fail" banks and expect credit spread volatility to persist, particularly in the Yankee and regional bank sectors. We believe fundamentals in both the traditional life and P&C insurance sectors are solid, with improved profitability and sound balance sheets and we selectively added exposure to our preferred issuers. In industrials, a dramatic increase in supply from M&A, Hyperscaler capex, and emerging AI disruption risks pushed spreads wider for many subsectors. The risks in the sector are better reflected in spreads, and we expect to selectively

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add exposure. Importantly, the spread duration of our corporate credit allocation is meaningfully short vs. the benchmark. We increased our allocation to CMBS by 2%. Non-Agency supply was concentrated in 5-year deals, driving an inverted credit curve given strong demand for longer duration. Over half of 2025's record issuance of \$158 billion was floating rate. We favor SASB for sponsor and collateral quality but note the spread pick vs. conduit at the top of the stack is lower. We are avoiding office while favoring other SASB sectors for targeted credit exposures, generally limited to the top of the stack. Troubled office and retail deals are likely to tarnish SASB's historically strong track record, and while losses are growing, this serves to reduce uncertainty moving forward. Spreads in generic multifamily Agency CMBS moved tighter in sympathy with Agency RMBS. Limited supply has been met with increased demand. With the widening in corporate credit, we see better opportunities in other sectors. Our allocation to ABS remained flat at 14%. Primary market spreads in traditional ABS segments offer a modest spread concession compared to secondary market opportunities. While collateral performance has shown some deterioration, deals remain well enhanced. Many esoteric ABS sub-sectors continue to appear overvalued and are likely to experience greater spread volatility in an environment with increased rate volatility and a shifting economic landscape. We plan to opportunistically add to high quality, liquid ABS subsectors.

OUTLOOK

U.S. growth remains resilient, supported by AI related investment and selective fiscal measures, even as labor data (softer job openings, rising layoff announcements) point to mounting slack. The expansion is increasingly K shaped with wealthier US consumers driving healthy spending, while lower- and middle-income Americans struggle with affordability. Policy and trade uncertainty have returned after the Supreme Court curtailed executive tariff authority. Meanwhile, the Iran war heightens concerns about already challenging debt and deficit dynamics. With oil near the low \$100s, the risk of stickier inflation raises the odds of a higher for longer rate path and a slower

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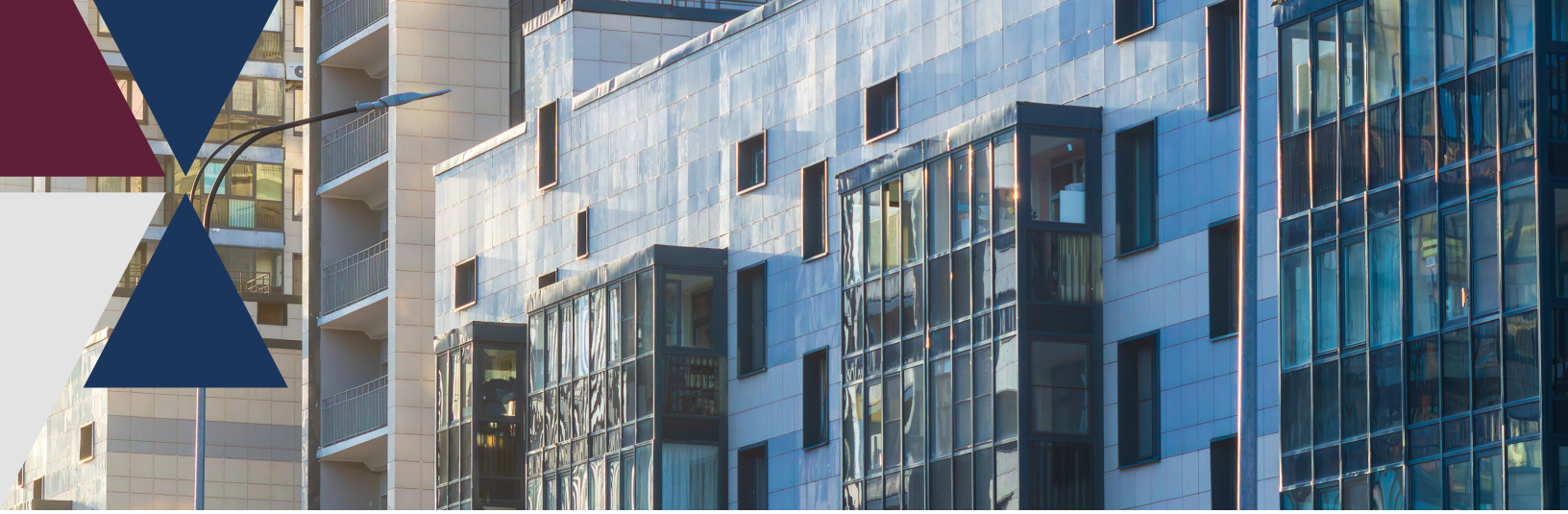
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growth trajectory. In March, the Fed kept its target rate unchanged, overall leaning hawkish. Their latest forecast pointed to slightly higher medium-term inflation and PCE forecasts were revised upward to 2.7% and 2.2% for 2026 and 2027 on the heels of the Iran war. Meanwhile, the transition to incoming Chair Kevin Warsh adds a layer of policy uncertainty: Warsh has argued the Fed has been too slow to cut and could support at least two 25 bp cuts in 2026 while advocating for a leaner, shorter duration balance sheet. The long end of the yield curve has traded within a wide range (70 bps) since the beginning of the easing cycle in September of 2024. Forward expectations of interest rate volatility (as measured by MOVE) were stable and trending lower until a sharp move higher recently due to the Iran war. The number of Fed cuts expected has decreased, and for the first time in several years, the future path of rates looks two sided; the next move could either be lower or higher. Inflation risks have tilted modestly higher in the near term, driven by a sharp spike in oil and market expectations for a Fed cut have been re-racked sharply lower. Despite these near-term pressures, intermediate-term inflation expectations remain relatively anchored, gradually moderating due to a cooling labor market. The Fed's latest projections continue to see core PCE easing toward ~2.7% in 2026.

The normalization of supply/demand within Corporate Credit has begun to take hold with a dramatic increase in supply from M&A and Hyperscaler capex putting pressure on spreads. Estimated supply for 2026 (up as much as 20% YoY) is likely to continue this trend. We continue to maintain a defensive posture but are ready to selectively add risk as spreads move wider due to AI disruption fears or heightened supply. Agency RMBS valuations are approaching an area that would be attractive, but relative value remains dynamic as other sectors have also seen spreads move wider. Technicals remain supportive for Agency RMBS, with low net supply driven by persistently weak housing affordability and mortgage rates that remain range bound. While most consumer credit strata are showing signs of weakness, the relative



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weakness varies dramatically between prime and subprime borrowers. Collateral performance in prime receivables continues to show modest deterioration. Many subprime consumer shelves have deteriorated noticeably and bear watching. We are avoiding the subprime market and focusing on the highest quality consumer and commercial related collateral. Strong CMBS issuance volumes should continue through macro volatility unless/until true labor market softness emerges or a recession precipitates a pull-back in lending. To date, global macro induced widening has been more acute in subordinate CMBS classes while senior bonds have been less impacted. With sticky AAA spreads, borrowers have not felt a large impact and lending markets are wide open. We expect that to continue as CMBS is not in the eye of the storm. In this environment we remain focused at the top of the stack in non-office SASB.



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