HIGH YIELD COMMENTARY

The U.S. equity markets reversed course in the second quarter, despite persistent geopolitical and inflation concerns. The Federal Open Market Committee (FOMC) met twice during the quarter and maintained the Fed Funds target range at 3.50% – 3.75%. New Fed Chair Kevin Warsh signaled a tough stance on inflation, "Economic activity is expanding at a solid pace despite elevated uncertainty that owes, in part, to the conflict in the Middle East. Productivity growth and capital investment are both strong. Job gains have kept pace with the workforce, and the unemployment rate has changed little. We recognize that inflation has been running well ahead of the Fed's long-stated inflation goal of 2 percent that's been going on for more than 5 years. Persistently high prices are a burden for the American people. But the recent past need not be prologue. I am pleased to report that members of the FOMC are unambiguous and unanimous: This Committee will deliver price stability." U.S. Real Gross Domestic Product (GDP) grew in the prior quarter (Q1) at an annualized rate of +2.1%. Inflation, as measured by the U.S. Consumer Price Index (CPI), re-accelerated and rose by 4.2% for the twelve-month period ending in May, while Core CPI (ex-food and energy) rose 2.9% for the same period. The Bureau of Labor Statistics (BLS) reported that the unemployment rate ticked slightly lower to 4.2% in June, while the U6 measure, which includes the unemployed, underemployed workers, and those marginally attached to the labor force, came in at 7.9% for the same period, unchanged from the prior quarter. The Conference Board Consumer Confidence Index came in at 91.2 in June, down slightly from the end of the first quarter. Additionally, the closely followed University of Michigan Consumer Sentiment Survey reported a final June reading of 49.5, up modestly from the record low 44.8 set in May.

The S&P 500 reversed its negative trajectory from the prior quarter to post a strong second-quarter return of 15.20%, while the tech-heavy NASDAQ 100 returned a remarkable 27.73% for the quarter. The Bloomberg U.S. Aggregate Index generated a positive, albeit very modest, return of 0.67%. The 2-10 yield curve flattened by 23 bps, as the 2-year Treasury yield increased 38 bps to 4.18%, while the 10-year Treasury increased by 15 bps to finish the quarter at 4.47%. During the quarter, U.S. Treasuries returned 0.32%, while other major investment grade bond sectors provided outperformance: Investment Grade (IG) corporate bonds returned +1.40%, U.S. Agency Securities +0.37%, Mortgage-Backed Securities +0.58%, Commercial MBS +0.45% and Asset-Backed Securities +0.75%. The Bloomberg U.S. High Yield Corporate Index (Index) produced a 2.47% total return in the second quarter, rebounding nicely from the first quarter's negative return. By ratings category, BB-rated and B-rated bonds recorded returns of 2.26% and 2.84%, respectively, while the CCC-rated cohort outpaced all U.S. credit with a 2.98% second-quarter return. The Index option-adjusted spread (OAS) contracted 25 bps quarter-over-quarter to +292 bps, while the yield-to-worst (YTW) declined commensurately by 24 bps to 7.16%. BB-rated credits now trade at an OAS of +155 bps and offer a YTW of 6.03%, B-rated credits at an OAS of +308 bps and 7.26% YTW, and CCC-rated credits at an OAS of +783 bps and 12% YTW. The average dollar price of the Index improved to $97.11 in the second quarter. The mounting geopolitical risks and energy-related inflation concerns of the on-again, off-again Iran War doesn't seem to have investor's appetite for risk assets in the second quarter. The trailing 12-month par-weighted U.S. high yield bond default/distressed exchange rate increased by 60 bps to 2.67%, yet still remains well below the 25-year average default rate of 3.4%. However, the trailing 12-month issuer-weighted U.S. High Yield bond default rate including distressed exchanges declined by 35 bps QOQ to 3.28%, source: JP Morgan.

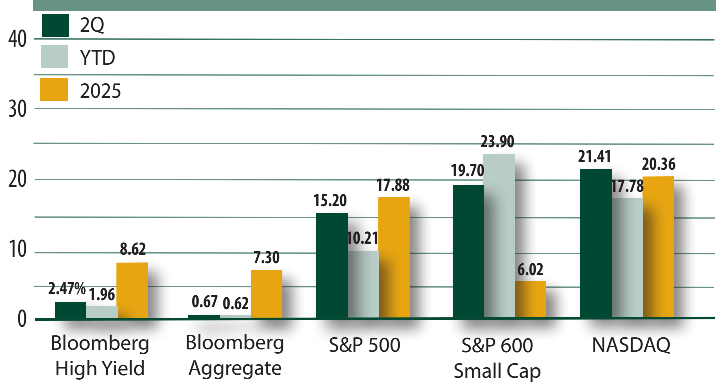
The PIA Investment Strategy Group (ISG) is responsible for portfolio construction across all PIA Fixed Income strategies, including both benchmark-centric and value-added (Plus) strategies. ISG Research is anchored by our Yield Curve Analysis and proprietary Sector Model, which provide detailed insight into our two key macro decisions: yield curve positioning and sector selection. As we enter the second half of 2026, PIA portfolio construction is uncommonly neutral relative to each strategy's benchmark index, reflecting our view that potential risks and returns are in an atypical equilibrium amid an unusually volatile election year. Historically, election years have often featured pro-growth, pro-voter policies such as tax cuts, liquidity events, cost-of-living relief, and efforts to deliver on campaign promises. However, 2026 has proven to be an anomaly because the cost of living remains elevated. While we typically focus on core inflation measures, which tend to be more structural and longer-term, current headline inflation—driven by recent energy shocks and elevated food prices—could contribute to secondary inflationary pressures over time. Looking past volatile food and energy components, we believe the bond market continues to underprice the recent buildup in structural inflation, which points to a greater risk of higher interest rates. Although U.S. tariffs have taken a backseat to multiple global wars, a $2+ trillion budget deficit, and a ballooning national debt, they remain an important component of fiscal policy.

In June, markets were introduced to Kevin Warsh, the 17th Chair of the Federal Reserve Board. Investors will need time to get to know Chair Warsh, who has indicated that he intends to be less communicative and provide less forward guidance than his predecessor, Jay Powell. Widely respected for his prior experience as a central bank governor, White House economic advisor, and Wall Street executive, Chair Warsh has stated clearly that the Fed's primary objective is to return inflation to its 2% target. That objective may require difficult policy choices in an election year, particularly if additional rate hikes prove necessary. Given that the U.S. economy was running at or above trend GDP growth and full employment before the late-2025 rate cuts, we believe current monetary policy is below the equilibrium "neutral" rate, the theoretical interest rate consistent with full employment and stable inflation. To become sufficiently restrictive and achieve the stated 2% inflation target, we believe fed funds may need to be higher. Despite the current challenges, we remain confident that Chair Warsh will prove to be a good steward of U.S. monetary policy.

The current "low hire, low fire" labor market remains relatively healthy by most conventional metrics and continues to exceed the estimated labor replacement rate, which has been notably reduced by near net-zero new immigration and minimal migration. A smaller available workforce could imply a labor supply shock and increase the risk of an inflationary wage-price spiral. However, according to ADP, 42% of new jobs are considered part-time, suggesting multiple jobs per person and effectively reducing the true rate of job creation. From the consumer's perspective, labor market sentiment remains overwhelmingly pessimistic, driven in part by widespread anxiety over Artificial Intelligence (AI)-related job destruction and displacement. We believe, however, that AI's potential to enhance productivity may ultimately prove greater than its risk of job destruction. AI appears to be a transformational technological advancement, potentially greater than the Internet or the spreadsheet. Jevons Paradox holds that as technology increases the efficiency with which a resource is used, total consumption of that resource often increases rather than decreases. In other words, efficiency lowers the relative cost of use, demand rises, and growth accelerates. As a result, we can envision AI producing both inflationary and disinflationary growth effects over the medium term. In the near term, however, we are more concerned about the debt cost fueling AI growth. We are not drawing direct parallels between AI and the Internet of the late 1990s; nevertheless, history suggests that when widespread vendor financing leads to leveraged, circular investment and purchases, systemic risks can escalate. In summary, we believe inflation represents the greatest economic risk over the next 12 months. We anticipate the Federal Reserve may need to hike rates, corresponding with a parallel shift higher or steepening of the yield curve that could push 10-year yields above 5%. Additionally, we expect credit spread volatility to increase with geopolitical tensions but ultimately return to historically tight levels.

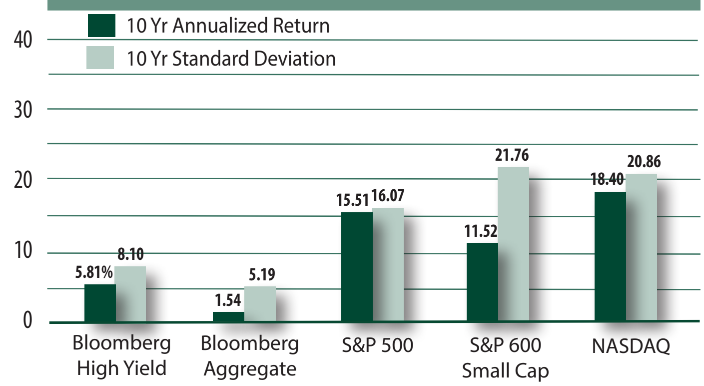
PIA Investment Strategy Group

INDEX RETURNS



Source: Bloomberg, Informais PSN
Past performance is not a guarantee of future results.

HISTORICAL PERFORMANCE



Source: Informais PSN; Annualized 10 Years
Past performance is not a guarantee of future results.

INDEX RETURNS	2Q	YTD	2025
BB	2.26%	1.98%	9.02%
B	2.84	2.18	8.44
CCC	2.98	1.69	8.27
CC - D	-11.45	-9.40	-2.89
Basic Industry	2.82	2.65	6.85
Capital Goods	2.66	0.80	7.63
Consumer Cyclical	3.03	2.21	8.20
Consumer Non-Cyclical	2.31	2.26	9.87
Energy	1.62	4.18	7.31
Technology	2.95	1.20	7.15
Transportation	2.28	-0.15	6.97
Communication	1.59	1.50	10.87
Other Industrials	1.95	1.05	9.18
Utility	2.52	2.66	7.62
Financial	2.93	1.11	9.97

Index is Bloomberg U.S. High Yield Index. Source: Bloomberg

INDEX SPREADS	6/30/26	12/31/25	12/31/24
BB	1.83	191	203
B	308	294	309
CCC	783	631	582
CC - D	3,399	2,685	1,588
Basic Industry	292	316	284
Capital Goods	245	246	276
Consumer Cyclical	258	267	272
Consumer Non-Cyclical	279	269	331
Energy	214	304	288
Technology	365	344	294
Transportation	439	390	319
Communication	449	368	481
Other Industrials	177	294	246
Utility	189	176	219
Financial	272	252	269

Index is Bloomberg U.S. High Yield Index. Source: Bloomberg

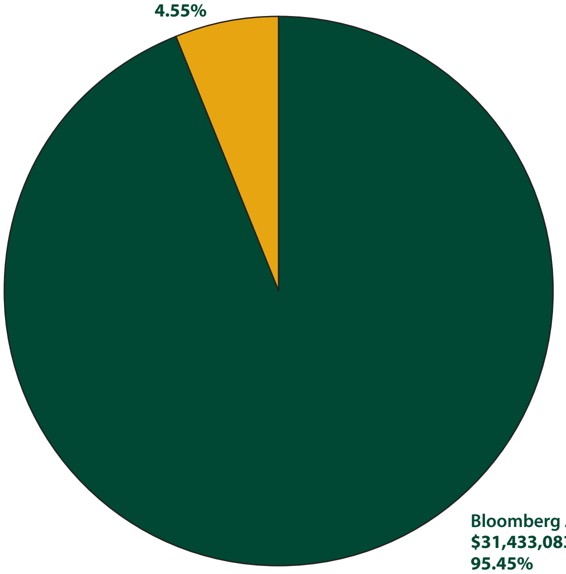
KEY CHARACTERISTICS	6/30/26	12/31/25
Duration	2.9	2.8
Yield To Maturity	7.5	7.1
Current Yield	6.9	6.7
Yield To Worst	7.2	6.5
Weighted Average Maturity	4.8	4.8
% $500mm and under	21.0	22.2
% $501mm and over	79.0	77.8

Index is Bloomberg U.S. High Yield Index. Source: Bloomberg, Yield Book

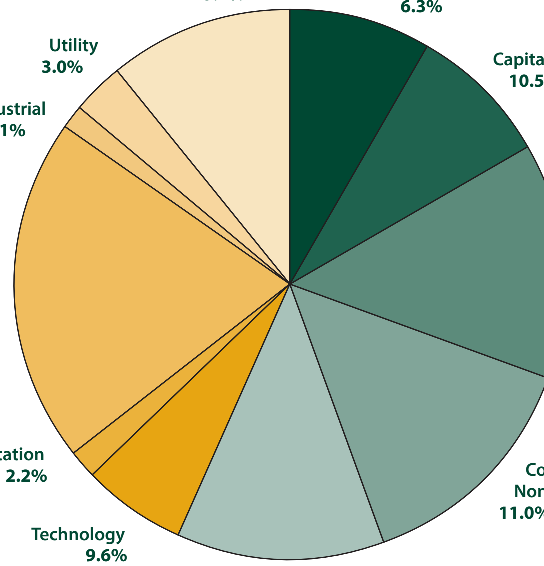
KEY CHARACTERISTICS	6/30/26	12/31/25
% BB or >	55.4	54.8
% B	34.8	33.2
% CCC	9.4	11.3
% CC and below	0.4	0.7
% Debt Maturing in < 3 Years	23.6	19.7
% Debt Maturing in 3 - 5 Years	38.5	40.1
% Debt Maturing in > 5 Years	37.9	40.2

Index is Bloomberg U.S. High Yield Index. Source: Bloomberg

US DEBT MARKET ($MM)



BLOOMBERG HIGH YIELD



Source: Bloomberg

Pacific Income Advisers is an investment management firm registered with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940. Registration does not imply a certain level of skill or training. PIA manages a variety of fixed income and equity assets for primarily United States clients.
Indexes are unmanaged, do not incur management fees, costs, and expenses, and cannot be invested in directly. Past performance is not indicative of future results. Asset allocation does not assure a profit or protect against a loss in declining financial markets. All investments carry a degree of risk, including loss of principal. It is important to note that there are risks inherent in any investment and there can be no assurance that any asset class will provide positive performance over any period of time.
The views expressed are those of Pacific Income Advisers as of the date of publication and are subject to change. Forward-looking statements, including market forecasts and expectations, are based on current assumptions and are inherently uncertain. Actual results may differ materially from those anticipated.
Bond ratings provide the probability of an issuer defaulting based on the analysis of the issuer's financial condition and profit potential. Bond rating services are provided by credit rating agencies currently registered as Nationally Recognized Statistical Rating Organizations ("NRSROs"). Bond ratings start at AAA (denoting the highest investment quality) and usually end at D (meaning payment is in default). Securities not covered by any agency will receive a non-rated (NR) rating.
This document does not constitute advice or a recommendation or offer to sell or a solicitation to deal in any security or financial product. It is provided for information purposes only and on the understanding that the recipient has sufficient knowledge and experience to be able to understand and make their own evaluation of the proposals and services described herein, any risks associated therewith and any related legal, tax, accounting or other material considerations. To the extent that the reader has any questions regarding the applicability of any specific issue discussed above to their specific portfolio or situation, prospective investors are encouraged to contact Pacific Income Advisers or consult with the professional advisor of their choosing.
Bloomberg U.S. High Yield Index covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets (e.g., Argentina, Brazil, Venezuela, etc.) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included. The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility, and Finance, which include both U.S. and non-U.S. corporations. The Yankee sector has been discontinued as of 7/1/00. The bonds in the former Yankee sector have not been removed from the index, but have been reclassified into other sectors.
Bloomberg U.S. Aggregate Bond Index is an unmanaged index that covers the investment grade fixed rate bond market with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. The issues must be rated investment grade, be publicly traded, and meet certain maturity and issue size requirements. You can not invest directly in an index.
S&P 500 Index – The S&P 500 index includes 500 leading companies in leading industries of the U.S. economy. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.
S&P SmallCap 600 covers approximately 3% of the domestic equities market. Measuring the small cap segment of the market that is typically renowned for poor trading liquidity and financial instability, the index is designed to be an efficient portfolio of companies that meet specific inclusion criteria to ensure that they are investable and financially viable.
Nasdaq Composite is a stock market index of the common stocks and similar securities (e.g. ADRs, tracking stocks, limited partnership interests) listed on the NASDAQ stock market, meaning that it has over 3,000 components. It is highly followed in the U.S. as an indicator of the performance of stocks of technology companies and growth companies. Since both U.S. and non-U.S. companies are listed on the NASDAQ stock market, the index is not exclusively a U.S. index.

P I A
Pacific Income Advisers

2321 Rosecrans Avenue Suite 1260 El Segundo California 90245

telephone 310.255.4453 facsimile 310.434. 0100

www.pacificincome.com