

NEI Global Sustainable Balanced Fund

Q4 2024 Commentary



Performance

The Fund (Series I) underperformed its benchmark over the quarter.

Over the period, fixed income investors contended with a macroeconomic environment shaped by rising yields, monetary policy shifts and resilient corporate fundamentals amidst strong economic data. Donald Trump's re-election in the US also provided an immediate boost to risk assets. Against this macroeconomic backdrop, the investment grade market underperformed high yield by 319 bps with a return of -3.06% for the quarter. The US Federal Reserve (Fed) met twice during the period and cut interest rates by 25 basis-point (bps) at each meeting. While balancing a cautiously optimistic tone in the US economy, the Fed acknowledged persistent inflation concerns. The 'dot plots', revised in mid-December, suggested that Fed officials are likely to take a more cautious approach to rate cuts in 2025, with the median dot showing only two 25-bps cuts (versus the four that were projected at the previous update in September). The December Statement of Economic Projections similarly reinforced the view that the Fed expects moderate economic growth, modest increases in the unemployment rate, and confidence it will be able to achieve its 2% inflation target through a slight decrease in its 2025 PCE Price Index forecast. At the end of the period, interest rate futures seemed to be in line with Fed guidance and similarly projected two 25-bps cuts in 2025. Interest rate volatility was heightened during the first half of the period with the ICE BofA MOVE index rising from 95 to 136, before falling to a low of 82 in December and closing out the period at 99.

Inflation, growth expectations, and uncertainty surrounding the incoming US administration's fiscal plans all put pressure on rates over the period, leading to a bear-steepening of the US treasury curve with the 2- and 10-year yields rising 60 and 79 bps, respectively. The 30-year segment of the curve also rose by 66 bps over the period. US corporate spreads continued their tightening trend and decline by 9 bps over the period to end at an option-adjusted spread of +80 bps over treasuries. The US corporate yield to worst, meanwhile, rose by 61 bps to end the period at 5.33%.

The option-adjusted spread on the benchmark fell by 6 bps over the period as all sectors apart from the government-related and agency MBS sectors experienced spread compression. Despite negative total returns across the board, excess returns were positive within the corporates, CMBS, ABS and government-related sectors. Agency MBS was the lone sector posting negative excess returns.

High yield market performance during the period was once again driven by the lowest-quality companies with the CCC and below segment of the market outperforming. The par-weighted high yield bond default rate, including distressed exchanges, continued to decrease to a multi-year low, well below the 25-year average. However, leveraged loan default rates increased over the quarter; the rate has remained well above the 25-year average for much of the past year.

Investment grade corporate issuance slowed during the period with a mere US\$237bn in gross and US\$23.8bn in net new issuance coming to market. There was US\$6bn in corporate labelled issuance over the period, bringing the year-to-date total to US\$36.1bn.

Returns

Fund	3 months	6 months	YTD	1 year	3 years	5 years	10 years	Since inception ¹
NEI Global Sustainable Balanced Fund Series I	-1.77	4.58	11.37	11.37	2.18	6.47	5.28	N/A
NEI Global Sustainable Balanced Fund Series A	-2.30	3.43	8.98	8.98	-0.01	4.21	2.95	N/A
NEI Global Sustainable Balanced Fund Series F	-2.03	4.02	10.21	10.21	1.12	5.39	4.19	N/A
Benchmark 1: 60% MSCI ACWI NR Index (C\$) and 40% Bloomberg Barclays U.S. Aggregate Index (C\$ hedged)	1.79	7.01	16.27	16.27	4.70	6.92	6.24	N/A

¹ Source: Morningstar. As of December 31, 2024. Since inception is only provided for Funds with less than 10 years of performance.

On May 1st 2020, the fund benchmark was changed. Prior to this date the fund benchmark was 30% FTSE TMX Canada Universe Bond Index, 30% S&P/TSX Composite Index, 20% MSCI World Index, 20% Bloomberg Barclays Global Aggregate Index (CAD hedged).

On May 1, 2020, the Fund's investment objectives and strategies were changed to an investment approach that includes global fixed income and equity securities with corresponding changes in the portfolio's benchmark and to the Fund's sub-advisor. The performance of this Fund for the period prior to this date may have been different had the current investment objectives and strategies been in place during that period.

Portfolio commentary

On the fixed income side, security selection among the Fund's securitised products and government-related holdings were the largest contributors to performance over the period. Positive contributions from the Fund's off-benchmark allocations to esoteric ABS, non-agency MBS and rate-recovery bonds were particularly notable. The overweight allocation to agency CMBS also bolstered returns. Security selection within government-related securities, coupled with the overweight allocation to this sector – primarily due to the meaningful overweight to supranationals – positively contributed during the period. Among corporates, security selection was positive within the capital goods, communications and consumer non-cyclical sectors. The Fund's off-benchmark allocation to high yield, coupled with strong security selection within this segment, also benefitted performance. Security selection within corporates detracted over the period, particularly within the Financial Services, Consumer Cyclical and Technology sectors. The Fund's holdings have a materially higher duration than the benchmark and underperformed as long-end rates rose. An overweight allocation to financial services also weighed on performance. Within the government-related segment, security selection was challenged among the strategy's supranational, government-sponsored and local authority bonds. Among securitised products, security selection across the strategy's esoteric ABS and rate-recovery bond holdings negatively contributed. Over the period, the Fund maintained its structural overweight to credit sectors, however, it continued to take advantage of tightening spreads to modestly reduce its allocation to corporates, most notably in the Consumer Cyclical and Technology sectors. The Fund increased allocation to the Communications, Insurance and Utility sectors, while reducing its exposure to supranationals. The allocation to securitised products increased over the period, driven in large part by the meaningful increase to non-agency MBS. The Fund also made notable individual sustainable additions through the period by initiating positions in a sustainable agriculture ABS from FARM 2024-2 Mortgage Trust, a utility green bond from California Buyer/Atlantica Sustainable Infrastructure, and a corporate bond from CVS Health. Other notable sustainable trades during the period included adding to existing positions in AGCO, Gates and an impact ABS from Foundation Finance Trust 2023-2.

On the equity side, the Fund suffered during the fourth quarter as markets reverted towards a narrower environment led by mega-cap companies. In absolute terms, the Fund's Materials exposure detracted from performance, with natural ingredient and industrial gas holdings underperforming. Industrial gas holdings suffered from a rotation towards more cyclical, higher growth stocks combined with a perception of some vulnerability to US policy changes following the US election, to which holdings have immaterial exposure to. Despite short-term weakness, these oligopolistic businesses with attractive market share characteristics and resilient through-cycle profitability provide the Fund with a valuable source of operationally defensive exposure. Industrials also detracted, as concerns of weaker non-residential construction end-markets caused underperformance from construction rental equipment exposure. Additionally, Health Care holdings underperformed in the wake of the presidential election given policy uncertainty related to the nomination of Robert F. Kennedy Jr. to lead the Department of Health and Human Services and concerns of escalating trade relations between the US and China. Despite recent headwinds, the sub-advisor believes the Fund's health care exposure offers a compelling risk-to-reward ratio, transitioning from a period of under-earning to a multi-year period of above-trend growth, setting up the potential to drive a multi-year earnings revision cycle.

Outlook

Risk assets and the high yield market, in particular, are likely to perform well in 2025 if economic growth remains stable and healthy. There is also growing confidence in a US 'soft landing' following the re-election of Donald Trump. However, inflation pressures may increase on account of the new administration's proposed policies on tariffs, tax cuts, and immigration. Concerns over the US budget deficit is likely to keep the long end of the yield curve higher for longer during 2025. The US Federal Reserve's more cautious forward stance is also likely to lead to a higher terminal rate with the 10-year US treasury remaining rangebound and a potentially steeper yield curve. A steeper yield curve should also support both ABS and MBS demand. Accordingly, the Fund prefers corporate bonds and securitised products over supranationals. Spreads are likely to remain close to their historical tightness, however, US investment grade corporate and securitised bond yields are close to their highest levels over the past decade. Even though underlying corporate credit fundamentals remain broadly favourable, the Fund prefers higher-quality credits. Within securitised products, the sub-advisor still sees value and room for further credit spread tightening across US securitised credit, including within non-agency mortgage-backed securities. The US

consumer remains in moderately good shape although there is some bifurcation by income level with lower-income consumers most at risk.

While high yield credit spreads are near their all-time tights, the sub-advisor expects this spread environment to persist given the strong underlying demand and good fundamentals. The demand for high yield has been driven by the high absolute yields and solid recent performance. Leverage is still expected to remain comfortably below long-term averages and interest coverage ratios should also remain above long-term averages. An expected healthy primary market should continue to provide further support to companies as they address their maturity walls. Accordingly, default rates are expected to remain well below the long-term average during 2025 and should centre around idiosyncratic issues.

The sustainable debt market has now surpassed US\$5 trillion, and the sub-advisor expects to take advantage of attractively priced labelled and unlabelled impact bond opportunities across asset types in the coming year.

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