BROWN BROTHERS HARRIMAN

CAPITAL PARTNERS

# BBH Income Fund

## Quarterly Fund Update | 4Q 2024

**4Q Highlights**

- The Fund outperformed the Index during the quarter on the heels of favorable sector and rating emphases and credit selection results.
- We believe many credits' valuations are overbought and disconnected from their fundamentals, necessitating a cautious and careful credit selection approach.
- Strong economic data does provide a tailwind to credit, although risks are emerging with looming changes to U.S. fiscal policies.

**PERFORMANCE AS OF DECEMBER 31, 2024**

| | Total returns | | Average annual total returns | | | | |
|---|---|---|---|---|---|---|---|
| Fund/benchmark | 3 mo. | YTD | 1 yr. | 3 yr. | 5 yr. | 10 yr. | Since inception |
| BBH Income Fund - Class I | -2.38% | 3.81% | 3.81% | -0.77% | 2.06% | N/A | 3.18% |
| Bloomberg US Aggregate Index | -3.06% | 1.25% | 1.25% | -2.41% | -0.33% | N/A | 1.28% |

Class I Inception: 6/27/2018; Class I: Net/Gross Expense Ratio (%) 0.46 / 0.46
Returns of less than one year are not annualized
The Investment Adviser has contractually agreed to limit the Total Annual Fund Operating Expenses for Class I Shares to 0.50% through March 1, 2025. The Expense Limitation Agreement may only be terminated during its term with approval of the Fund's Board of Trustees (the "Board").
**Performance data quoted represents past performance. Past performance does not guarantee future results and current performance may be lower or higher than the past performance data quoted. The investment return and principal value will fluctuate, and shares, when redeemed, may be worth more or less than the original cost. For performance current to the most recent month-end please call 1-800-625-5759.**
Sources: Bloomberg and BBH

### Market environment

Treasury note yields rose last quarter despite the Federal Reserve's (the Fed) campaign of cutting interest rates. The Fed cut the federal funds rate by a total of 0.50% during the quarter and 1.00% during the 2024 calendar year. Nevertheless, note yields rose across all tenors, on the quarter and for the year, driven by lower expectations for interest rate cuts in 2025. Fed funds rate expectations for the coming year were 4.00% vs. 3.00% when the quarter began.

Most fixed income indexes experienced negative quarterly total returns due to the rise in interest rates. The Bloomberg U.S. Aggregate Index declined more than 3%. Excess returns to credit, however, were overwhelmingly positive as credit spreads in mainstream indexes narrowed further to their cyclical lows.

Short- and intermediate-duration fixed income indexes managed positive total returns for 2024 despite the rise in interest rates. Long-duration indexes posted negative total returns during the calendar year as the rise in interest rates offset any yield benefits. The Bloomberg U.S. Aggregate Index advanced just 1.3% in 2024, three points lower than its 4.5% yield at the start of the year. Excess returns to credit were positive across all major sectors in 2024.

**EXHIBIT I: FIXED INCOME INDEXES RETURNS**

| | Duration | Total return (%) | | Excess return (%) | |
|---|---|---|---|---|---|
| **Index** | **(Years)** | **QTD** | **YTD** | **QTD** | **YTD** |
| J.P. Morgan Leveraged Loan Index[1] | 0.3 | 2.41 | 9.33 | 1.23 | 4.04 |
| Palmer Square CLO Debt Index[1] | 0.3 | 2.52 | 13.22 | 1.34 | 7.93 |
| Bloomberg 2 Year U.S. Treasury Bellwether Index | 1.8 | -0.19 | 3.79 | – | – |
| Bloomberg ABS ex Stranded Cost Utilities Index | 1.9 | 0.43 | 5.42 | 0.51 | 1.25 |
| Bloomberg U.S. Corporate High Yield Index | 3.1 | 0.17 | 8.19 | 1.17 | 5.02 |
| Bloomberg Non-Agency CMBS Index | 3.7 | -0.72 | 7.03 | 1.06 | 4.73 |
| ICE BofA AA-BBB US Misc. ABS Index | 3.9 | -0.13 | 7.37 | 1.69 | 4.94 |
| Bloomberg Intermediate Corporate Index | 4.0 | -1.40 | 4.22 | 0.60 | 2.10 |
| Bloomberg U.S. TIPS Index | 4.1 | -2.88 | 1.84 | – | – |
| Bloomberg U.S. Treasury Index | 5.8 | -3.14 | 0.58 | – | – |
| Bloomberg EM USD Aggregate Index | 5.9 | -1.47 | 6.58 | 1.78 | 6.14 |
| **Bloomberg Aggregate Index** | 6.1 | -3.06 | **1.25** | **0.18** | **0.78** |
| Bloomberg MBS Index | 6.2 | -3.16 | 1.20 | -0.13 | 0.37 |
| Bloomberg U.S. Corporate Index | 6.8 | -3.04 | 2.13 | 0.82 | 2.46 |
| Bloomberg 10 Year U.S. Treasury Bellwether Index | 8.0 | -5.19 | -1.73 | – | – |
| Bloomberg Taxable Municipal Index | 9.2 | -4.39 | 0.09 | 1.11 | 2.42 |
| Bloomberg Long Corporate Index | 12.5 | -6.20 | -1.95 | 1.25 | 3.10 |

Source: Bloomberg, Morningstar LSTA, Palmer Square, ICE Bank of America, BBH
Data reported as of December 31, 2024
**Past performance does not guarantee future results.**
Unless otherwise noted Excess Returns are the returns in excess of duration matched Treasuries
[1] Excess return computed by BBH as total return less the return of the Bloomberg 3 Month T-Bill Bellwether Index, a proxy for the duration profile of floating-rate leveraged loans and CLO debt

Strong economic data does provide a tailwind to credit, although risks are emerging with looming changes to U.S. fiscal policies. Headline consumer inflation prints have been declining but remain above Fed targets. Wage growth and job openings remain higher than historic averages and could still exert upward pressure on inflation. The Chicago Fed National Activity Index remains above its recession indicator.

Corporate default rates diverged between bonds and loans, with the default rates on bonds lower and loans higher. Distressed exchanges and liability management exercises – which are undertaken by companies to avoid default but still disadvantage debtholders – are increasing. Overall, default rates for bonds and loans were steady year over year. Defaults continue to be concentrated among CCC-rated issuers, although default rates for all rating categories are below their respective long-term averages. Business loan performance appears healthy, as delinquency and charge-off rates are low and new bankruptcy filings are near pre-pandemic lows.

There are some signs of stress emerging for U.S. consumers. Loan delinquency and charge-off rates are rising to normal levels across many loan types, while the prospects of higher-for-longer interest rates and the resumption of federal student loan repayments loom as risks to straining the U.S. consumer. The increases in loss and delinquency rates remain within expected ranges and do not signal heightened risk of impairment to asset-backed securities (ABS) bondholders.

Commercial real estate headlines remain disconnected from property-level dynamics. High-quality properties have refinanced and there have been minimal losses on paydowns in commercial mortgage-backed securities (CMBS) deals. Commercial real estate woes have not had an outsized impact on banks' commercial real estate loan portfolios to date, as delinquency rates and charge-offs have been muted.

Heavy credit issuance and narrowing risk spreads were among the biggest stories of the fourth quarter and the 2024 calendar year. Headline issuance volumes were robust across credit sectors. Net issuance, though, was more moderate in most sectors, as most 2024 issuance was to refinance existing debt. Nontraditional ABS are the exception, as the outstanding market of nontraditional ABS grew 11% year over year on the heels of a 34% surge in volumes.

**Valuations**

The compression of credit spreads amid low net issuance growth and strong inflows into fixed income is suggestive of an environment where many credits' valuations are overbought and disconnected from their fundamentals. BBH's valuation framework[1] lends credence to that theory. The framework identifies few opportunities today in traditional index segments of the credit markets. The percentage of potential "buy" opportunities is screening near cyclical low levels across most sectors. It's declined to 4% from 7% for investment-grade corporate bonds, to 58% from 68% for corporate loans, and to 16% from 19% for high-yield corporate bonds. No cohort of the 15- or 30-year mortgage-backed securities (MBS) market screens as a "buy" candidate. Away from credits in mainstream indexes, bonds of collateralized loan obligations (CLOs) and a minority of nontraditional ABS sectors have narrowed to recent lows and screen unattractively for new purchases, although most non-traditional ABS and CMBS continue to screen attractively.

There remain opportunities in select subsectors of the market. Investment-grade corporate bonds in life insurance and banking, two interest rate-sensitive subsectors, continue to offer attractive opportunities. The corporate loan market continues to offer numerous opportunities that screen as "buy" candidates. In the structured credit markets, we continue to find opportunities in a variety of ABS subsectors through our bottom-up process. Opportunities are appearing in the CMBS market as supportive property and deal-level dynamics are disconnected from the negative headlines impacting the sector.

We continue to avoid emerging markets credits due to concerns over creditor rights in most countries and the impact on their durability. We continue to avoid non-agency residential mortgage-backed securities (RMBS) generally due to poor technical factors, unattractive valuations, and weak fundamentals, underpinned by poor housing affordability, low inventory of homes for sale, and stable-to-declining home prices.

**EXHIBIT II: OUTLOOK BY SECTOR**

| Sector | Outlook | Positioning |
|---|---|---|
| **Reserves** | | |
| U.S. Treasuries/futures/reserves | Hold when attractive credits unavailable | Held to balance yield curve and duration exposures |
| Government-related | Unattractive valuations; better opportunities elsewhere | No positions in portfolios |
| Municipal | Valuations of select municipals are attractive for inclusion in taxable portfolios | Holdings include transportation revenue bonds |
| **Structured credit** | | |
| U.S. MBS | No purchase opportunities in 15- or 30-year pools | No positions in portfolios |
| RMBS | Continued credit, technical, and valuation concerns | No positions in portfolios |
| CMBS | Opportunities exist among high-quality properties seeking to refinance | Hold positions in SASB CMBS deals where we have transparency into collateral dynamics |
| ABS | Opportunities remain in select sectors despite the recent narrowing of risk spreads | Hold positions across diversified set of nontraditional segments |
| **Corporate credit** | | |
| IG corporate bonds | Amount of attractively valued opportunities in benchmarks are near cyclical low levels | Holdings remain in some interest rate sensitive sectors and among certain security selection opportunities |
| Corporate loans | Roughly half the universe screens attractively | Holdings are diversified and include credits issued by healthcare, airlines, and technology companies |
| HY corporate bonds | Amount of attractively valued opportunities in benchmarks are near cyclical low levels | Opportunities tend to reside in industries with challenged business models that require strong credit work |
| **Other credit** | | |
| Emerging markets | Concerns remain about creditor rights in most emerging market countries | No positions in portfolios |

As of December 31, 2024. Portfolio holdings and characteristics are subject to change.

MBS = Mortgage-Backed Securities; RMBS = Residential Mortgage-Backed Securities; CMBS = Commercial Mortgage-Backed Securities; ABS = Asset-Backed Securities; IG = Investment Grade; HY = High Yield; SASB = Single Asset, Single Borrower; REIT = Real Estate Investment Trust
Source: BBH

[1] Our valuation framework is a purely quantitative screen for bonds that may offer excess return potential, primarily from mean reversion in spreads. When the potential excess return is above a specific hurdle rate, we label them "Buys" (others are "Holds" or "Sells"). These ratings are category names, not recommendations, as the valuation framework includes no credit research, a vital second step.

 

## Performance

The Fund outperformed its benchmark during the quarter on the heels of favorable sector and rating emphases and credit selection results.

The Fund's sector and rating emphases contributed to results despite the indiscriminate narrowing of credit spreads from already-low levels. The Fund was overweight to several strong-performing segments of the credit markets, particularly within its holdings of ABS, CMBS, and corporate issues. The Fund's avoidance of MBS also enhanced returns as MBS was the only major market sector that lagged behind similar-duration Treasuries during the quarter.

**EXHIBIT III: PERFORMANCE ATTRIBUTION**

| | Average weight (%) | | | Contribution (basis points) | | |
|---|---|---|---|---|---|---|
| | Portfolio | Benchmark | Active | Rates | Sector | Selection |
| **Total portfolio** | **100.0%** | **100.0%** | **0.0%** | **17** | **32** | **30** |
| Reserves | 16.4% | 44.7% | -28.3% | | 0 | 0 |
| Government-related | 0.0% | 3.7% | -3.7% | | 0 | 0 |
| Municipal | 0.1% | 0.0% | 0.1% | | 0 | 0 |
| U.S. MBS | 0.0% | 25.2% | -25.2% | | 3 | 0 |
| CMBS | 6.9% | 1.5% | 5.4% | | 8 | 0 |
| ABS | 22.3% | 0.5% | 21.9% | | 13 | 9 |
| IG corporate bonds | 36.5% | 24.4% | 12.1% | | 2 | 14 |
| Corporate loans | 12.3% | 0.0% | 12.3% | | 2 | 8 |
| HY corporate bonds | 5.4% | 0.0% | 5.4% | | 3 | -1 |

**Past performance is no guarantee future results**
Contribution figures are presented gross of fees
Data reported quarterly from September 30, 2024 to December 31, 2024
Basis point or "bp" is 1/100th of a percent (0.01% or 0.0001)
MBS = Agency Residential Mortgage-Backed Securities; RMBS = Non-Agency Residential; Mortgage-Backed Securities; CMBS = Commercial Mortgage-Backed Securities; ABS = Asset-Backed Securities; IG = Investment Grade; HY = High Yield
Source: BBH

Security selection contributed to results. Subsectors that impacted selection positively included loans to healthcare companies and electric utilities; investment-grade corporate bonds issued by property and casualty insurers, specialty finance companies, and life insurers; and bonds from collateralized fund obligations and data center ABS. Subsectors that detracted during the quarter included loans to cable satellite companies and high-yield corporate bonds issued by technology companies.

## Transaction summary

We continued to find durable credits[2] offering attractive value despite weak attractiveness of valuations of credits in indexes. The table below summarizes a few notable portfolio additions.

**EXHIBIT IV: TRANSACTION SUMMARY**

| Obligor | Coupon | Maturity | Yield (YTM) | Rating | Spread | Spread reference | Duration | Sector | Subsector |
|---|---|---|---|---|---|---|---|---|---|
| LCM Asset Management | 6.41 | 1/15/2038 | 6.4 | AA+ | 180 | SOFR | 0.3 | ABS | Collateralized loan obligation (CLO) |
| BAHA 2024-MAR | 7.00 | 12/10/2029 | 7.0 | AA | 270 | Treasuries | 4.1 | CMBS | Single borrower fixed CMBS |
| BX 2024-GPA2 | 6.77 | 11/15/2029 | 6.8 | AA- | 195 | SOFR | 0.1 | CMBS | Floating SASB |
| Blackstone / GSO CLOs | 5.97 | 1/17/2038 | 6.0 | AAA | 134 | SOFR | 0.3 | ABS | Collateralized loan obligation (CLO) |
| AHPT 2024-ATRM | 6.02 | 11/10/2029 | 6.0 | AA | 215 | Treasuries | 4.1 | CMBS | Single borrower fixed CMBS |
| ALP CFO | 7.45 | 10/15/2036 | 7.5 | A | 350 | Treasuries | 2.5 | ABS | Collateralized fund obligation |
| ALP CFO | 10.13 | 10/15/2036 | 10.1 | BBB | 615 | Treasuries | 3.4 | ABS | Collateralized fund obligation |
| Apollo Global Management LLC | 4.72 | 10/8/2029 | 4.7 | A+ | 110 | Treasuries | 4.4 | Corporate bond | Life insurance |
| Coastal Waste & Recycling Inc | 8.29 | 10/3/2031 | 8.3 | BB | 351 | SOFR | 0.1 | Loan | Environmental |
| FREMF 2024-K757 | 9.24 | 10/25/2061 | 9.2 | AAA | 517 | Treasuries | 6.7 | CMBS | Freddie Mac agency CMBS |

As of December 31, 2024. Portfolio holdings and characteristics are subject to change.
MBS = Mortgage-Backed Securities; CMBS = Commercial Mortgage-Backed Securities; ABS = Asset-Backed Securities
Source: BBH

[2] Obligations such as bonds, notes, loans, leases, and other forms of indebtedness, except for cash and cash equivalents, issued by obligors other than the U.S. Government and its agencies, totaled at the level of the ultimate obligor or guarantor of the Obligation. Durable means the ability to withstand a wide variety of economic conditions.

## Characteristics

At the end of the quarter, the Fund's duration was 6.0 years and continued to approximate that of its benchmark. The Fund's weight to investment-grade corporate bonds declined to 35% from 39% and its weight to reserves increased to 18% from 15%. The Fund's allocation to high-yield instruments was steady at 16%. The Fund's yield to maturity was 6.4% and remained elevated vs. bond market alternatives. The Fund's option-adjusted spread over Treasuries was 171 basis points (bps)[3]; for reference, the Bloomberg U.S. Corporate Index's was 80 bps over Treasuries at quarter end.

### EXHIBIT V: CHARACTERISTICS

**Portfolio characteristics**

| | Portfolio | Benchmark | Active |
|---|---|---|---|
| Effective duration (years) | 6.00 | 6.04 | 99% |
| Spread duration (years) | 2.56 | 3.38 | 76% |
| Yield to maturity (%) | 6.35 | 4.91 | 1.45 |
| Option-adjusted spread (bps) | 171 | 34 | 137 |

**Credit rating (%)**

| | Portfolio | Benchmark |
|---|---|---|
| AAA/TSY/cash | 27.1 | 73.0 |
| AA | 13.7 | 3.5 |
| A | 21.3 | 11.2 |
| BBB | 21.8 | 12.2 |
| BB | 9.0 | 0.0 |
| B | 5.4 | 0.0 |
| CCC & below/NR | 1.7 | 0.0 |

**Fund holdings and characteristics are subject to change.**
**Past performance does not guarantee future results.**
Benchmark is the Bloomberg US Aggregate Bond Index
Data reported as of December 31, 2024

**Sector allocation (%)**

| | Portfolio | Benchmark | Active |
|---|---|---|---|
| Reserves | 18.4 | 44.9 | -26.5 |
| Government-related | 0.0 | 3.7 | -3.7 |
| Municipal | 0.1 | 0.0 | 0.1 |
| MBS (agency) | 0.0 | 25.2 | -25.2 |
| RMBS (non-agency) | 0.0 | 0.0 | 0.0 |
| CMBS | 7.3 | 1.5 | 5.8 |
| ABS | 22.0 | 0.5 | 21.5 |
| IG corporate bonds | 34.6 | 24.3 | 10.3 |
| Corporate loans | 12.2 | 0.0 | 12.2 |
| HY corporate bonds | 5.4 | 0.0 | 5.4 |

TSY = Treausury; MBS = Mortgage-Backed Securities; RMBS = Residential Mortgage-Backed Securities; CMBS = Commercial Mortgage-Backed Securities; ABS = Asset-Backed Securities; IG = Investment Grade; HY = High Yield

Source: BBH

## Concluding remarks

Credit investors face a choice today: keep buying expensive credit and hope that historical credit risks and pricing don't return in the near term, or stick with valuation discipline, a longer-term view, and realism on the inevitability of a rise in credit spreads. We believe the valuation and credit disciplines embedded in our bottom-up process will help us balance caution and opportunity in this environment.

Sincerely,

**Andrew P. Hofer**
Fund Co-Manager

**Neil Hohmann, PhD**
Fund Co-Manager

**Paul Kunz, CFA**
Fund Co-Manager

**Thomas Brennan, CFA**
Fixed Income Product Specialist

[3] Basis point (bp) is a unit that is equal to 1/100th of 1% and is used to denote the change in price or yield of a financial instrument.

 

Totals may not sum due to rounding.

Credit Quality letter ratings are provided by Standard and Poor's, Moody's and Fitch and are presented as the higher of the three ratings. When a security is not rated by Standard & Poor's, Moody's or Fitch, the highest credit ratings from DBRS and Kroll may be used. Absent a rating from these agencies, we may display Private Credit Ratings, if permitted by the issuer, which could include ratings from Egan-Jones Ratings Co. Credit ratings reflect the credit quality of the underlying issues in the portfolio and not of the portfolio itself. Issues with credit ratings of BBB or better are considered to be investment grade, with adequate capacity to meet financial commitments. Issues with credit ratings below BBB are considered speculative in nature and are vulnerable to the possibility of issuer failure or business interruption.

Duration is a measure of the portfolio's return sensitivity to changes in interest rates.

Weighted Average Life of securities excludes US Treasury futures positions.

Yield to Maturity is the rate of return the portfolio would achieve if all purchased bonds and derivatives were held to maturity, assuming all coupon and principal payments are received as scheduled and reinvested at the same yield to maturity. This figure is subject to change and is not meant to represent the yield earned by any particular security. Yield to Maturity is before fees and expenses.

The selection effect measures the investment manager's ability to select securities within a given segment relative to a benchmark.

The sector effect measures an investment manager's ability to effectively allocate their portfolio's assets to specific sectors relative to a benchmark.

**DEFINITIONS**

Bloomberg US Aggregate Bond Index is a market value-weighted index that tracks the daily price, coupon, pay-downs, and total return performance of fixed-rate, publicly placed, dollar-denominated, and non-convertible investment grade debt issues with at least $300 million par amount outstanding and with at least one year to final maturity.

An index is not available for direct investment.

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Purchase and sale information provided should not be considered as a recommendation to purchase or sell a particular security and that there is no assurance, as of the date of publication, that the securities purchased remain in a fund's portfolio or that securities sold have not been repurchased. Nothing contained herein is intended as a recommendation to buy or sell any security, or to invest in any particular country, sector or asset class.

Traditional ABS include prime auto backed loans, credit cards and student loans (FFELP). Non-traditional ABS include ABS backed by other collateral types.

**RISKS**

Bond prices are sensitive to changes in interest rates and a rise in interest rates can cause a decline in their prices.

Asset-Backed Securities ("ABS") are subject to risks due to defaults by the borrowers; failure of the issuer or servicer to perform; the variability in cash flows due to amortization or acceleration features; changes in interest rates which may influence the prepayments of the underlying securities; misrepresentation of asset quality, value or inadequate controls over disbursements and receipts; and the security being structured in ways that give certain investors less credit risk protection than others.

SASB lacks the diversification of a transaction backed by multiple loans since performance is concentrated in one commercial property. SASBs may be less liquid in the secondary market than loans backed by multiple commercial properties.

Foreign investing involves special risks including currency risk, increased volatility, political risks, and differences in auditing and other financial standards.

The Fund also invests in derivative instruments, investments whose values depend on the performance of the underlying security, assets, interest rate, index or currency and entail potentially higher volatility and risk of loss compared to traditional stock or bond investments.

**For more complete information, visit www.bbhfunds.com for a current Fund prospectus. You should consider the fund's investment objectives, risks, charges and expenses carefully before you invest. Information about these and other important subjects is in the fund's prospectus, which you should read carefully before investing.**

Shares of the Fund are distributed by ALPS Distributors, Inc. and is located at 1290 Broadway, Suite 1000, Denver, CO 80203. Other products are offered by Brown Brothers Harriman.

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