IA Clarington Floating Rate Income Fund

Manager commentary – Q4 2025

The loan market saw modest performance for the quarter, with a quarterly return of 1.22% marking the second-weakest performance of 2025. Pressure from declining secondary prices, coupon compression, and lower base-rates contributed to a reduction in interest income that negatively impacted overall returns. BB-rated loans slightly outperformed B-rated loans, and both significantly outperformed CCC-rated loans, showing a break from the typical trend where lower-rated loans outperform their higher-rated cohorts. 2025 marks the first year since 2022 in which double-B loans outperformed both single-B and CCC-rated loans, as the incremental interest income that lower-rated loans typically offer was insufficient to offset steeper declines in market value.

58% of the loan market was priced above par at quarter end, up from 37% at the start of the quarter, as sentiment improved across the credit quality spectrum. 71% of loans rated B+ or higher were priced at or above par at quarter end, up from 20% in mid-October. On the other end of the spectrum, the share of loans priced below 90 reached its highest level since April at 10%, indicating a trend of increased bifurcation in the loan market. The share of loans priced below 80 reached 4.5% at the end of Q4, up from 3% at the beginning of the year.

The size of the Morningstar LSTA US Leveraged Loan Index grew during the period and now stands at a new record high $1.54T, beating the record last quarter. New issuance decreased to $155B in Q4, compared to a record $400B in Q3, as some deals were pulled amid secondary market weakness. However, a sharp decline in repayments resulting from slowed refinancing activity offset the decrease in new issuance and translated into net expansion of the asset class.

The default rate by issuer declined to 1.18% in December, compared to 1.47% in Q3. The default rate adjusted to include distressed exchanges fell from 4.4% in Q3 to 3.35% in Q4, the lowest since October 2023.

Retail loan funds flows were negative for the quarter, with outflows occurring in 16 of the last 23 weeks of 2025, and redemptions intensifying in the last weeks of December. Retail outflows in Q4 totaled ~$3.97B, up from ~$0.77B in Q3. Moderating retail demand resulting from increased outflows was slightly offset by elevated CLO issuance, which reached $55.34B this quarter compared to $53B in the previous quarter.

Within the portfolio’s leveraged loan allocation, B-rated loans helped drive performance in the fourth quarter. A B-rated consumer cyclical services loan was the largest contributor. An automative loan that had defaulted earlier in the year was the biggest detractor.

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Outside of the leveraged loan allocation, an ETF holding was the main contributor to the fund's performance. The account began holding the ETF this quarter in order to maintain adequate liquidity while providing a better return in times where the secondary market is particularly rich.

Most segments of the global fixed income market generated positive returns during the fourth quarter, further contributing to an already strong year. At the start of the quarter, the US federal government began the longest shutdown in US history, lasting 43 days until a resolution in mid-November. The prolonged shutdown created market volatility, economic data collection issues and brought more uncertainty to the ensuing Federal Reserve (Fed) policy decision. Despite lingering inflation concerns, the Fed followed its September rate cut with 25 basis point cuts in October and December, an approach aimed to stabilize growth as labor market data weakened. The Treasury curve steepened during the quarter as the front end of the curve declined on the back of Fed cuts while long-term yields were slightly higher, likely the result of inflation concerns, tariff uncertainty and a growing US debt burden. In 2025, the 10-year US Treasury fell 40 bps, from 4.57% to 4.17%, while demand for investment grade and high yield corporates remained strong, with spreads marginally tighter. Risk assets were supported throughout the year by the 75 basis points of Fed rate cuts, continued strong earnings growth by corporates and a surge in artificial intelligence (AI) investments.

Looking ahead in 2026, we believe the US economy will remain in the 'Expansion to Late Cycle' phase of the credit cycle, supported by easing Fed monetary policy, fiscal stimulus from the One Big Beautiful Bill Act (OBBBA) and stable corporate fundamentals. We expect growth in the US to remain resilient in 2026 and we are not anticipating a recession at this time, rather, our base case calls for trend-like growth. Positive wealth effects and solid aggregate consumer consumption, especially among mid-to-upper-tier households, have been supporting demand. While employment data has cooled, we don't anticipate widespread layoffs as long as earnings and profitability remain strong. Productivity gains from artificial intelligence (AI) implementation could lead to layoffs, but we do not see that as a near-term risk. Many companies have invested significant capital expenditures in AI and data centers, and we expect this spending to contribute to productivity gains and overall economic momentum globally. Outside the US, The US administration's willingness to negotiate trade deals with its largest trading partners is a welcome development. In Europe, the lack of US security assurances has pushed Eurozone leaders, particularly in Germany, to recommit to more expansionary fiscal policy and massive borrowing for security infrastructure, thus reviving European output including manufacturing. In China, economic data still shows a continued slowdown across all core metrics, driven by a confluence of weak consumer confidence, real estate drag, and lackluster investment. We expect Chinese growth to muddle along at current levels, however, we still have questions about the quality and sustainability of growth moving forward. The tariff reprieve has been welcomed, but a more durable long-term resolution may be more challenging.

IA Clarington Floating Rate Income Fund

Our view on interest rates is predicated on the basis that US inflation will remain sticky, continuing to print above the Fed's 2% target, and structural factors are weighing on the US fiscal deficit. Inflation is increasingly entrenched in behavior supported by structural factors such as budget deficits, geopolitical fragmentation, increased defense spending and the reconfiguration of supply chains. On a cyclical basis, despite recent inflation readings that show lagged effects of shelter inflation easing, we caution that the combination of stimulus from OBBBA, mortgaged-backed securities (MBS) purchases and other factors could lead to an uptick in inflation later in the year. From a labor market perspective, although recent labor market data has cooled, we are not expecting a massive wave in layoffs and view corporate health as the lynchpin behind the labor market. In this context, the Fed may be comfortable with inflation hovering above their 2% target, while easing monetary policy to help mitigate the labor market from softening further.

With regards to the US fiscal deficit, large nondiscretionary spending – mostly related to entitlements and defense – has led to a deficit that is structural rather than counter-cyclical. Debt servicing costs have also risen significantly, as interest rates have increased and the overall debt burden has expanded. Currently, the fiscal deficit is unsustainable and has the potential to stimulate inflation, which in turn could raise borrowing costs across the economy, in our view. Unless there is significantly higher growth (which we believe is unlikely), expenditures are reduced or another large source of revenue materializes (tariffs), we do not see a stabilization or contraction in the deficit occurring in the near term. As a result, we believe there is a risk to a move higher in long-term interest rates. We believe Treasury supply will continue to be a topic of heavy discussion, which could increase interest rate volatility and put a floor under long-term Treasury yields. We believe long-term fair value for the 10-year US Treasury is approximately 4.00-4.50%, based on a 1.75-2.00% real rate and 2.25-2.50% breakeven rate; however, Trump's policies could push the fair value target slightly higher.

Our investment process lends itself to constantly reassessing value through our risk premium framework. Our Credit Health Index (CHIN) suggest defaults/losses will be below historical averages for this part of the cycle. Bottom-up fundamentals have stayed robust despite slight weakening in leverage and interest coverage, while profit margins have continued to strengthen and the outlook for earnings growth remains positive. A combination of solid credit fundamentals and supportive technical backdrop have helped push spreads and risk premiums to tight levels, however, it is difficult to see any real signs of credit deterioration. In our opinion, corporate balance sheets can weather potential volatility in the macroeconomic backdrop.

We are mindful of the risks going forward, such as sticky inflation and a growing US deficit, either of which could force the market to reprice Fed expectations and potentially push rates back up. In addition, we continue to monitor the risk that AI investments do not deliver on optimistic revenue projections or large-scale productivity gains, the potential for further escalation in geopolitical risk and security concerns, as well as the impact of long-term structural trends such as deglobalization, decarbonization and aging demographics. Each of these risks could further elevate market volatility and create additional buying opportunities in credit, interest rates and currencies, for which we would consider redeploying reserves faster.

We believe that long-term value has returned to fixed income markets with a combination of discount-to-par (positive convexity) and favorable yields. As investors sit on record levels of cash, we expect strong demand will likely support bond markets. Given our expectation for a relatively benign loss environment, we believe investors should consider moderately leaning into credit risk for any potential extra carry pick-up. Compressed credit spreads have led us to remain diversified in our credit exposure across the fixed income markets. In today's environment, we believe bond investors should maintain flexibility with regards to interest rate and credit risk, considering the risk/reward of the intermediate part of the curve against the long-term risks associated with long-end curve exposures while being selective in potential opportunities in investment grade credit, high yield credit, bank loans and securitized credit, in our opinion. Convergence between public and private credit markets is accelerating, creating opportunities for multi-sector investors. In addition, we believe diversifying portfolios across non-US-dollar exposure is a worthwhile strategy as the current macroeconomic backdrop suggests a flight-to-safety bid is unlikely to buoy the US dollar, in our view, and investors can seek higher yields and potential for currency appreciation outside the US.

Fund and benchmark performance as at December 31, 2025	1 year	3 year	5 year	10 year
IA Clarington Floating Rate Income Fund – Series A	-0.9%	2.4%	0.9%	1.9%
Morningstar LSTA US Leveraged Loan Index (CAD Hedged)	4.1%	8.2%	5.7%	5.1%

Non-traditional fixed income asset classes may carry higher risk, but generally provide higher yield than traditional fixed income asset classes. A mutual fund's "yield" refers to income generated by securities held in the fund's portfolio and does not represent the return of or level of income paid out by the fund.

For definitions of technical terms in this piece, visit iaclarington.com/glossary or speak with your investment advisor.

The performance data comparison presented is intended to illustrate the Fund's historical performance as compared with historical performance of widely quoted market indices. There are various important differences that may exist between the Fund and the stated indices that may affect the performance of each. The benchmark is the S&P UBS Leveraged Loan Index USD which is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. The Fund's geographic, sector and credit quality exposure may differ from that of the benchmark. The Fund can invest in high yield corporate bonds and government bonds, which are not included in the benchmark. The Fund aims to fully hedge the portfolio’s foreign currency exposure at all times to remove any currency fluctuation risk. As a result, the U.S. indices referenced within are quoted in their native currencies of U.S. dollars to reflect the performance of the holdings as opposed to currency performance. The Fund may hold cash while the benchmark does not. It is not possible to invest directly in market indices. The performance comparison is for illustrative purposes only and does not imply future performance.

Indicated mutual fund rates of return include changes in share or unit value and reinvestment of all dividends or distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Returns are historical annual compounded total returns.

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