

# Strategic Alpha Fund

## FUND FACTS

### OBJECTIVE

Seeks to provide an attractive absolute total return, complemented by prudent investment management designed to manage risks and protect investor capital. The secondary goal of the fund is to achieve these returns with relatively low volatility

Share class	Y
Inception	12/15/2010
Ticker	LASYX
CUSIP	63872T620

## Market Conditions

- The yield on the two-year note, which stood at 2.34% on March 31, 2022, climbed as high as 3.43% on June 14. (Prices and yields move in opposite directions.) The yield on the 10-year note began the quarter at 2.34% and peaked at 3.47% in the same time span. At the close of the quarter, concerns about a potential recession began to exceed the worries about inflation. Economic activity indicators in the United States came in below expectations, measures of consumer and business confidence continued to decline, and the markets appeared to grow more concerned that the crisis in Ukraine would cause Europe's growth to fall into negative territory. Treasuries rebounded in response to this news, with the yields on the two- and 10-year notes declining to 2.95% and 3.01%, respectively. Despite this late rally, the Treasury market finished with one of its worst showings in the first half of a calendar year in history.
- High yield bonds suffered a considerable decline and were the worst performing segment of the domestic market. The yield spread between the ICE BofA US High Yield Index and equivalent Treasuries closed the quarter at 587 basis points (5.87 percentage points), well above its 310 basis points at the start of the year and its highest point since mid-2020. Lower-rated issuers tend to have less flexibility to withstand weaker economic conditions and thus are more vulnerable to recession fears. Refinancing risk, which reduces companies' ability to restructure their debt, was an additional concern.
- Investment-grade corporate bonds lagged Treasuries by a wide margin in the quarter. In addition to suffering from the uptrend in prevailing yields, corporates experienced a large increase in yield spreads relative to government bonds. Rising spreads reflected both investors' declining appetite for risk and concerns about the impact a recession could have

### CLASS Y PERFORMANCE AS OF JUNE 30, 2022 (%)

	CUMULATIVE TOTAL RETURN		AVERAGE ANNUALIZED RETURN			
	3 MONTH	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEAR
FUND	-5.32	-9.39	-9.87	0.61	1.53	2.36
BENCHMARK*	0.11	0.14	0.17	0.63	1.11	0.64

*Performance data shown represents past performance and is no guarantee of, and not necessarily indicative of, future results. Investment return and value will vary and you may have a gain or loss when shares are sold. Current performance may be lower or higher than quoted. For most recent month-end performance, visit [www.loomissayles.com](http://www.loomissayles.com).*

*Additional share classes may be available for eligible investors. Performance will vary based on the share class. Performance for periods less than one year is cumulative, not annualized. Returns reflect changes in share price and reinvestment of dividends and capital gains, if any. You may not invest directly in an index.*

*\*ICE BofA ML 3 Month US Treasury Bill Index*

*Gross expense ratio 0.72% (Class Y). Net expense ratio 0.72%. As of the most recent prospectus, the investment advisor has contractually agreed to waive fees and/or reimburse expenses (with certain exceptions) once the expense limitation of the fund has been exceeded. This arrangement is set to expire on 4/30/2023. When an expense limitation has not been exceeded, the fund may have similar expense ratios and/or yields.*

*The Class Y inception date is 12/15/2010. Class Y shares are sold to eligible investors without a sales charge; other Classes are available for purchase.*

on earnings results.

- Emerging market bonds underperformed in relation to the United States. Similar to domestic high-yield debt, the category was pressured by the combination of growth fears, global inflationary pressures, and investors' increased aversion to risk.

## Portfolio Review

- The fund underperformed its benchmark, the ICE BofAML 3 Month US Treasury Bill, primarily due to positioning within high yield corporates, investment grade corporates and emerging markets.

## Contributors

- The fund's positioning with respect to duration (and corresponding interest rate sensitivity) and non-US dollar currency exposure led positive contributions to performance for the quarter. Rising inflation concerns and increasingly hawkish Federal Reserve (Fed) policy, through rate hikes, led to higher yields for US Treasuries across the curve. The yield on the benchmark 10-year note finished the quarter up 67 basis points at 3.01%. In this environment, our short position in US Treasury interest rate futures added to performance.

## Detractors

- Exposure to high yield corporate bonds weighed most heavily on relative performance as credit spreads (the incremental yield provided by lower quality bonds) widened during the quarter. In sector terms, holdings of consumer, communications and finance companies constrained return. As stocks continued to soften amid Russia's invasion of Ukraine and ensuing sanctions placed on Russia, new issuance of high yield bonds slowed considerably compared to the peak of 2021 while the Fed continued to increase interest rates. This has led to a large sell-off, which has subsequently lowered the average price of the bonds while creating more attractive opportunities for high yield investors.
- The allocation to investment grade corporate bonds detracted as well. The 75 basis point interest rate hike in June by the Fed was the largest increase since 1994 while the rate of inflation has been at 40-year highs. Fed Chairman Jerome Powell reiterated in mid-June it would take overwhelming evidence that inflation was diminishing to the Fed's 2% target before rate increases would stop. As the Fed increases rates it will continue to hit the wallets of American businesses and consumers in the form of higher borrowing costs for credit card balances, mortgages, car loans and student loans; however, this eventually can counter rising inflation. Within the portfolio, consumer, banking and communications names were the largest detractors from performance.
- Emerging markets exposure constrained return for the period as well, largely due to the fund's position in Petroleos Mexicanos (Pemex), as the oil sector in Mexico has experienced some regulation and international pressure to revamp its operation practices. As recently as the second quarter of 2022, there have been concerns of excessive natural gas flaring, which have led to fines for the company. Mexican President Andrés Manuel López Obrador has invited Americans dealing with high gas prices to drive across the border in order to save money on fuel with the two countries displaying significant differences at gas stations. Chinese property developers such as Sunac, Kaisa and Zhenro Properties were also detractors, as the sector has remained under pressure. While in the midst of its largest

Covid wave yet, China enforced a zero-Covid strategy aimed to prevent any deaths and stop any outbreaks with the use of mass testing, quarantines, border controls and lockdowns, and by doing so it was able to limit further infections by the end of the second quarter. This development did not do much to alleviate an already weak housing sector as apartment and house sales have continued to decline.

## Outlook

- Throughout the first half of 2022, the macroeconomic environment and outlook became more challenging. Increased geopolitical risk, led by the Russian invasion of Ukraine, added a strong supply chain shock to an already concerning inflationary environment just as continued Covid-19 shutdowns in China created further uncertainty. The Fed, in an effort to get ahead of these shocks, announced the end of its quantitative easing program and delivered increasingly aggressive rate hikes of 25 basis points in March, 50 basis points in May and 75 basis points in June. As investors priced in a more hawkish Fed and growth expectations diminished, interest rates continued their move higher and risk assets came under pressure.
- In our view, the credit cycle<sup>1</sup> has shifted from the “expansion” phase to “late cycle” with a macroeconomic environment that consists of potentially slower growth and inflation that will likely moderate but remain above the Fed’s target. In our base case, growth will likely trend lower but stay resilient as a healthy consumer, positive corporate fundamentals and a strong banking system should help provide a backdrop for continued economic activity. Inflationary pressures will potentially remain sticky, with expectations for elevated commodity prices and persistent supply issues combined with a tight labor market. We believe this environment warrants an accelerated process of normalizing monetary policy, which would increase the potential for a policy mistake as the Fed, and other global central banks, embark on tighter monetary policy to combat inflation even as growth concerns have been increasing.
- We are mindful of the risks inherent to our credit cycle and macroeconomic outlook, such as ongoing global supply chain disruptions, tighter financial conditions resulting from global central bank rate hikes and quantitative tightening, slowing Chinese growth and increased geopolitical risk. All of the turmoil around the world leaves us with a wide range of potential outcomes, but the probability of a downturn in 2023 has risen. As a result, we have modestly reduced portfolio risk and increased the level of cash reserve-like, higher quality instruments that can offer flexibility. With increased uncertainty surrounding economic activity, the path of inflation and subsequent Fed policy, we expect volatility to remain elevated in the second half of 2022, which could help drive future opportunities for investors.
- Given the upward movement of yields seen so far in 2022, fixed income markets currently offer higher levels of income that can help dampen downside risk for investors and have the potential to provide attractive total returns. As a result, we believe that future pockets of short-term market volatility can offer opportunities to reduce holdings of higher quality, liquid investments in favor of adding credit exposure; however, we will be patient and selective in doing so. We continue to favor issuers with strong carry (incremental income) potential, solid corporate profits and relatively low interest rate sensitivity, and believe that increased volatility will help drive wider performance dispersion across sectors, industries and issuers. In this environment, we believe that individual issuer selection will be

key in seeking to deliver favorable performance for the remainder of 2022. We remain comfortable with corporate fundamentals, and while we expect the rate of defaults and losses to rise in the intermediate term, we believe they should stay below their long-term averages.

- With respect to interest rate risk, we expect an active Fed at each meeting for the rest of 2022 and have more modest expectations for rising nominal US Treasury rates following the significant increase seen in the first half of the year. We remain positioned shorter than broad market benchmarks from the perspective of duration and corresponding interest rate sensitivity to help minimize any negative performance impact from a further rise in interest rates. With the yield curve flattening experienced in 2022, short-dated maturity bonds currently offer favorable levels of income with potentially less volatility, without materially sacrificing yield relative to longer maturities. While we remain cautious on our outlook, we continue to focus on seeking to deliver higher levels of income and total return potential over time. As economic and central bank developments continue to unfold, we remain focused on our investing framework, philosophy and strategy to guide us.
- During periods in which the US dollar appreciates relative to foreign currencies, funds that hold non-US-dollar-denominated bonds, foreign currency or foreign currency based derivative securities (“Foreign Currency Exposures”) may realize currency losses in connection with the maturity or sale of certain Foreign Currency Exposures. These losses impact a fund’s ordinary income distributions (to the extent that losses are not offset by realized currency gains within the fund’s fiscal year). A recognized currency loss, in accordance with federal tax rules, decreases the amount of ordinary income a fund has available to distribute, even though non-US-dollar denominated bonds continue to generate coupon income.
- Fund officers have analyzed the fund’s current portfolio of investments, realized currency gains and losses, schedule of maturities, and the corresponding amounts of unrealized currency losses that may become realized during the current fiscal year. This analysis is performed regularly to determine how realized currency losses have and will impact periodic ordinary income distributions for the fund. Based on the most recent quarterly analysis (as of June 30, 2022), realized currency losses will continue to have an impact on the distributions in the 2022 fiscal year. This analysis is based on certain assumptions including, but not limited to, the amount of Foreign Currency Exposures held by the funds’, the level of foreign currency exchange rates, security prices, interest rates, the fund advisers’ ability to manage realized currency losses, and the net asset level of the fund. Changes to these assumptions could materially impact the analysis and the amounts of future fund distributions. Fund officers will continue to monitor these amounts on a regular basis and take the necessary actions required to manage the fund’s distributions to address realized currency losses while seeking to avoid a return of capital distribution.

## About Risk

**Fixed income securities** may carry one or more of the following risks: credit, interest rate (as interest rates rise bond prices usually fall), inflation and liquidity. **Below investment grade fixed income securities** may be subject to greater risks (including the risk of default) than other fixed income securities. **Currency** exchange rates between the US dollar and foreign currencies may cause the value of the fund's investments to decline. **Derivatives** involve risk of loss and may entail additional risks. Because derivatives depend on the performance of an underlying asset, they can be highly volatile and are subject to market and credit risks. **Foreign and emerging market securities** may be subject to greater political, economic, environmental, credit, currency and information risks. Foreign securities may be subject to higher volatility than US securities due to varying degrees of regulation and limited liquidity. These risks are magnified in emerging markets. **Mortgage-related and asset-backed securities** are subject to the risks of the mortgages and assets underlying the securities. Other related risks include prepayment risk, which is the risk that the securities may be prepaid, potentially resulting in the reinvestment of the prepaid amounts into securities with lower yields. **Commodity-related** investments, including derivatives, may be affected by a number of factors including commodity prices, world events, import controls and economic conditions, and therefore may involve substantial risk of loss. **Non-diversified funds** invest a greater portion of assets in fewer securities and therefore may be more vulnerable to adverse changes in the market. **Short exposures** using derivatives may present various risks. If the value of the asset, asset class or index on which the Fund holds short investment exposure increases, the Fund will incur a loss. The potential risk of loss from a short exposure is theoretically unlimited, and there can be no assurance that securities necessary to cover a short position will be available for purchase.

<sup>1</sup>*A credit cycle is a cyclical pattern that follows credit availability and corporate health.*

**ICE BoA Merrill Lynch US Dollar 3-month LIBOR Constant Maturity.** *The 3-Month US LIBOR represents the London interbank offered rate (LIBOR) with a constant 3-month average maturity. LIBOR is a composite of the rates of interest at which banks borrow from one another in the London market, and it is a widely used benchmark for short-term interest rates. Indexes are unmanaged and do not incur fees. It is not possible to invest directly in an index.*

**Standard & Poor's 500 -S&P 500® Index** *is a market capitalization-weighted Index of approximately 500 common stocks chosen for market size, liquidity, and industry group representation to measure broad US equity performance. S&P 500® is a registered service mark of McGraw-Hill Companies, Inc.*

*Outlook as presented in this material reflects subjective judgments and assumptions of the portfolio team and does not necessarily reflect the views of Loomis, Sayles & Company, L.P. There is no assurance that developments will transpire as stated. Opinions expressed will evolve as future events unfold.*

**Before investing, consider the fund's investment objectives, risks, charges, and expenses. Please visit [www.loomissayles.com](http://www.loomissayles.com) or call 800-225-5478 for a prospectus and a summary prospectus, if available, containing this and other information. Read it carefully.**

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