



## YEAR-END LETTER FOR 2025

*Structured Products Team: Opportunistic Income Strategy*

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Dear Client,

As we enter 2026, we want to thank you for your investment with GMO and your continued confidence in the Opportunistic Income Strategy. In this year's letter, we review strategy performance over the last twelve months and share our outlook for the new year.

The GMO Opportunistic Income Strategy delivered a 6.42% return (net of fees) for the 2025 calendar year, underperforming its benchmark, the Bloomberg U.S. Securitized Index by 207 basis points. Our strategy had much less interest rate duration than our benchmark, and in a year when interest rates rallied materially, that hurt our relative performance. Our relatively large cash position was also a negative for the year, as spread products generally delivered solid excess returns vs. risk-free parts of the market. Finally, 2025 was a year in which agency MBS finally delivered strong excess returns compared to almost any other high-quality fixed income sector, and as our benchmark consists entirely of agency MBS, that hurt the relative return performance of the Opportunistic Income Strategy.

Despite underperforming our benchmark, the strategy, for the third year in a row, significantly outpaced risk-free cash returns while still taking a conservative rate posture and emphasizing capital preservation. All the main long risk sectors within our portfolio delivered solid excess returns over cash in 2025. The strongest performer was RMBS, which generated an 8.74% total return during the year. Our RMBS sleeve had the advantage of carrying approximately 2.5 years of interest rate duration during a year, again, when it was profitable to be exposed to interest rate risk. Further, despite relatively sluggish home price growth in 2025, residential mortgage credit continued to be quite strong as favorable borrower positioning (low loan-to-value ratios, below-market coupons) made default relatively rare.

Our three other main sleeves—CMBS, student loans, and CLOs—carry no or minimal interest rate duration and therefore can be effectively compared to cash, which returned 4.35% during the year. Our largest sleeve, CMBS, didn't generate as strong a return as it did in 2024, as the sector's spread had somewhat normalized. However, we were still able to generate a reasonable return (6.08%) over the risk-free rate within CMBS through carry, avoiding any notable single-security blowup. CLOs generated a similar return to CMBS at 6.07%, mainly through carry, as our conservative positioning up the capital structure limited the ability of the portfolio to generate profit and loss (PNL) from price appreciation. Student loans generated a stronger return over cash at 7.22%, where we were able to generate some strong returns from security selection, and some of our seasoned, discount dollar price bonds rallied toward par throughout the year. The remaining smaller sleeves in our portfolio generated returns ranging from 4.46% and 4.71% (prime auto and credit card bonds) to 8.93% (small balance commercial). Our short ABS sleeves essentially serve as cash substitutes, while in small balance commercial, several seasoned and de-risked profiles saw significant price appreciation in 2025.

Our Treasury futures positions, which we use to manage the strategy's interest rate duration, generated significant positive PNL during the year. Rates rallied and the curve steepened during 2025, and we profited from 1) our overweight duration position within our stated range of 0-2.5 years, and 2) our lack of exposure to the backend of the rates curve, which underperformed significantly in 2025. Our credit shorts and credit relative-value trades drew down modestly during the year. The negative PNL mainly came from carry and rolldown as corporate credit spreads ended the year close to where they began. Despite delivering a reasonably respectable return (4.35%) in 2025, our relatively heavy cash holdings detracted from performance given that all our bond sleeves delivered returns that exceeded 4.35%.

### ***The Market in 2025***

Overall, 2025 was a year that generally delivered flat to modestly tighter spreads and lower base rates, resulting in strong total and excess returns in most structured and corporate credit sectors. The market's trajectory was mainly steady, with the notable exception of the period in April surrounding President Trump's tariff announcements. During the first two weeks of that month, spreads widened significantly, and interest rates increased as a "Sell America" narrative took hold in the markets.

The positive—and concerning—correlation between rates and spreads was explained as a reaction to 1) the expected inflationary pressures from much higher-than-expected tariff rates, and 2) a de-dollarization reaction to what seemed to be an upending of the established global trade system, causing investors to sell both risk-free (Treasury) and risky (credit, stocks) assets. The Treasury sell-off seemed to prompt the Trump administration to walk back many of the most extreme tariff measures, starting a rally that lasted throughout the remainder of 2025.

On the risk-free side, investors generally profited from being long duration, but the positive results were heavily skewed to positions on the short end of the curve. As shown in the table below, an investor positioned at the front of the curve generated significantly more PNL than one situated at the long end. The Fed’s three rate cuts and expectations for more in 2026 caused the front and, to a lesser extent, the belly to rally. However, a number of factors prevented long-end rates from participating. These included a continued stall in progress toward the Fed’s 2% inflation target, a deteriorating fiscal deficit picture, and perhaps most importantly, a growing belief in the market that the independence of the central bank was being threatened by the current presidential administration.

<i>Rate</i>	<i>Start of Year Level</i>	<i>End of Year Level</i>	<i>Change</i>
<b>2 Year</b>	4.24%	3.47%	-0.77%
<b>5 Year</b>	4.38%	3.73%	-0.65%
<b>10 Year</b>	4.56%	4.17%	-0.39%
<b>30 Year</b>	4.80%	4.84%	+0.04%

From a policy rate perspective, the market’s expectations for Fed cuts moved around throughout the year, prior to settling on the expectation that the bank would get to “neutral” for a few reasons: 1) the labor market gradually exhibited signs of at least a modest amount of weakening as the year progressed; 2) the price data, although sticky above the Fed’s 2% target, seemed to avoid the worst case expectations of tariff-driven inflation; and 3) the government shutdown introduced a risk to the U.S. economy in the fourth quarter. The Fed ended up delivering three 25-basis point rate cuts in the back half of 2025— one in September, one in October, and a final cut in December. These cuts brought the range of the fed funds rate down from 4.25%-4.50% at the start of the year to 3.50%-3.75% at year-end. Currently, the opinion of the committee is unusually divided between hawks and doves. This, combined with the ongoing legal battles between the Trump administration and the Fed, is creating an uncommon level of uncertainty as to the path of the fed funds rate going into 2026.

We continue to be constructive on interest rate duration as curve steepening has improved bonds’ carry profile, and rates are still tilted well toward the higher end of the post-GFC range. Further, we believe that the Trump administration clearly desires lower interest rates and has several tools (bank regulatory relief, issuance patterns) to facilitate that end. Risks to the government bond markets heading into 2026 include an inflation picture that is still running well above the Fed’s 2% goal (despite avoiding worst-case outcomes), a possible accelerating economic growth picture due to the pro-cyclical impacts of the Big Beautiful Bill Act, and a fiscal picture that continues to disappoint.

From the perspective of the spread markets, the on-run CDX IG started the year at 50 bps, got as tight as 46.5 bps in February, and eventually reached its widest point at 81 bps on April 8th. From there, the contract started rallying strongly throughout the remainder of April and May and eventually finished the year close to where it started at 50 bps. Meanwhile, CDX HY started 2025 at 311 bps, got as tight as 290 bps in February before widening to 475 bps on April 8th, and finished the year at 316 bps. On the cash side, corporate credit spreads (according to BAML data) ended the year 3 basis points tighter at 79 basis points for investment grade, while high yield ended the year 11 basis points tighter at 281 basis points. Both indices delivered solid total returns, with investment grade at 7.78% (+1.2% vs. comparable-duration Treasuries) and high yield at 8.50% (2.2% vs. comparable-duration Treasuries).

Within structured products, agency mortgages—finally, in the view of some—delivered a strong year of returns as current coupon zero-vol spreads tightened sharply vs. Treasuries, driven by declining volatility and a steeper curve. Agency mortgages generated an 8.3% return, 1.6% higher than comparable-duration Treasuries (according to BAML data). As a reminder, the agency MBS universe has a much longer duration and is much less negatively convex than it has been historically, providing a solid setup in a year where spreads tightened and rates rallied. Within other parts of structured

products, the returns were 5.2% and 5.7% for floating and fixed ABS (0.80% and 0.2% excess), 7.6% for CMBS (1.0% excess), and 6.5% for CLOs (1.9% excess).

### ***Our Outlook for 2026***

We continue to find the beta in most parts of credit to be unattractively valued. We think parts of structured credit (specifically CMBS and parts of ABS) still screen as relatively cheaper than corporates on a longer-run basis, but that no part of the credit markets really screens as attractive on a nominal basis. Essentially, things range from fair to rich to very rich, with more areas of structured products in the fair or rich categories vs. corporates, which appear very rich. We continue to see opportunities to generate attractive risk-adjusted returns, however, as individual profiles in many parts of the structured product market still look attractive to us, particularly those we view as having minimal fundamental risk exposure. In other words, we begin 2026 in a place where we think alpha from bond selection offers the best opportunities, especially in CMBS, RMBS, and parts of ABS, compared to broad sector calls.

Our fundamental view on structured products continues to be formed by our belief in a K-shaped economy, where prime consumers who have owned their homes for a number of years are in an especially advantageous position. Very below-market financing costs are locked in, and the seasoned homeowner has the benefit of an outsized equity position and a conservative housing balance sheet. We are more wary of subprime and younger consumers, as they generally lack the housing benefit mentioned above and are more impacted by inflation as well as one-offs like the resumption of student loan repayments. We continue to be wary of down-in-credit CLO risk due to credit weakness in the lower-rated parts of the leveraged loan market (again—haves and have nots or k-shaped). In CMBS, the recent loosening of lending standards is certainly constructive, and we continue to like the relative value advantage of high-quality CMBS versus other less risky credit products. However, CMBS delinquencies have yet to stop increasing, and investors must remain focused on avoiding individual loan blowups, which continue to pop up—especially in office and multi-family property types.

Although it certainly cost us some basis points in 2025, we think the macro setup continues to support a conservative posture: overweighting the safest profiles, maintaining a healthy exposure on the short side to the credit sectors we see as most overvalued, and retaining ample dry powder.

Thank you for your confidence in GMO and the Opportunistic Income Strategy. We look forward to working with you in 2026.

Sincerely,



Joe Auth  
*Head of Developed Fixed Income  
and Portfolio Manager*



Ben Nabet  
*Portfolio Manager*

<i>Annualized Returns as of 12/31/2025 (Net, USD)</i>	<i>Inception</i>	<i>1-Year</i>	<i>3-Year</i>	<i>5-Year</i>	<i>10-Year</i>	<i>ITD</i>
<b>Opportunistic Income Composite</b>	10/31/2011	6.42%	6.47%	3.95%	4.20%	4.62%
<b>Bloomberg U.S. Securitized+</b>		8.49%	4.97%	0.22%	1.61%	1.28%

***Performance data quoted represents past performance and is not predictive of future performance.***

Net returns are presented after the deduction of a model advisory fee and incentive fee if applicable. These returns include transaction costs, commissions and withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable. Fees paid by accounts within the composite may be higher or lower than the model fees used. GMO LLC claims compliance with the Global Investment Performance Standards (GIPS®). A Global Investment Performance Standards (GIPS®) Composite Report is available on GMO.com by clicking the GIPS® Composite Report link in the documents section of the strategy page. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Actual fees are disclosed in Part 2 of GMO's Form ADV and are also available in each strategy's Composite Report. The portfolio is actively managed, is not managed relative to a benchmark and uses an index for performance comparison purposes only and, where applicable, to compute a performance fee.

***Disclaimer***

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