# Fund Manager Commentary

*As of September 30, 2024*

## Fund Highlights

- Primarily invests in income producing securities including corporate debt securities, mortgage related securities, asset-backed securities, government securities (both U.S. government securities and foreign sovereign debt), and preferred stocks
- Expanded opportunity set provides the flexibility to react to market dislocations
- Broadly diversified by sector, resulting in multiple sources of return potential and low correlation to traditional asset classes
- Duration management is used as a risk mitigation tool; seeks to avoid taking large duration positions due to the difficulty in predicting interest rates
- Active management and security selection are focused on building a high conviction portfolio

## Market Recap

The economy has continued to grow at a robust pace and the base case for investors remains a soft landing, especially now that the U.S. Federal Reserve (Fed) has begun normalizing interest rates. A balanced labor market along with wage gains and large increases in net worth have supported consumer spending. However, employment has cooled, and markets are worried the economy is not creating as many new jobs. Consequently, the Fed has shifted focus to this part of the economic environment, which was a contributor to their decision to cut Fed Funds by 50 basis points in September.

In addition, continued disinflation and greater confidence that it will return to the 2% target provided the Fed further data needed to begin cutting. The main area investors will be monitoring is the service side of inflation, which has remained elevated, largely because of shelter. Nevertheless, with inflation seemingly under control the emphasis is being placed on the labor market as Fed Chairman Jerome Powell has mentioned that the Federal Open-Market Committee (FOMC) does not want to see further weakening in employment. While non-farm payrolls show continued job growth, it has trended lower over the last couple quarters, and reports over the past year (ending March 2024) were revised down significantly.

For these reasons, the FOMC believes the downside risk for the labor market now outweighs inflation surprises. The unemployment rate has increased 0.7%, to 4.1% since the lows in 2023 as people have lost their jobs and others have re-entered the labor market. However, the number of people losing their jobs has remained relatively low and continued Fed cuts should strengthen more rate sensitive sectors of the economy. Separately, upward revisions to the Bureau of Economic Analysis' national accounts, including personal income and Gross Domestic Income, show that the average consumer is better off than previously expected.

This economic backdrop combined with the Fed's willingness to act more aggressively than previously anticipated increases the odds that the U.S. will avert a recession and has been a catalyst for rising asset prices. Lower inflation forecasts and expectations of rate cuts were a driver of meaningfully lower rates over the quarter, thus easing financial conditions. Treasury yields declined with the 10-year moving lower by 60 basis points over the quarter, ending around 3.8%. Additionally, the Treasury yield curve reversed the inversion it has exhibited for much of the last two years. In aggregate these rate moves resulted in a very strong quarter for the Bloomberg U.S. Aggregate Bond Index, which returned 5.2%.

## Portfolio Review

The Touchstone Strategic Income Opportunities ETF (NAV) outperformed its benchmark, the Bloomberg U.S. Aggregate Bond Index, for the quarter ended September 30, 2024.

The Fund's sector allocation was the largest contributor to outperformance over the quarter. The allocation to high yield corporates and non-credit sectors were the primary drivers as risk assets performed well over the quarter, supported by improving growth expectations and easing inflation.

Interest rate positioning also added to relative performance despite the Fund averaging 1.5 years shorter duration than the benchmark during the quarter as rates declined meaningfully. The main driver of relative performance was the Fund's positioning for a steeper curve which benefitted the portfolio as short and intermediate rates declined more significantly than longer rates. Additionally, the

*(continued)*

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Performance data quoted represents past performance, which is no guarantee of future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than performance data given. ***For performance information current to the most recent month-end, visit https://www.westernsouthern.com/touchstone/etfs/strategic-income-opportunities-etf.***

negative impact of being short duration compared to the benchmark was reduced as the Fund tactically adjusted duration between 4.0 years to 5.5 years as rates experienced volatility over the quarter. While the Fund began and ended the quarter with no Treasury inflation-protection securities exposure, the Fund did opportunistically utilize them as investor inflation expectations shifted, which was also a positive contributor to relative performance.

Security selection was a slight detractor to relative performance due primarily to underperformance within Securitized. The overweight allocation to non-agency residential mortgage backed securities (RMBS) detracted from performance as this sector lagged RMBS agency securities over the quarter.

The Fund did not materially adjust sector allocations over the quarter as spreads remained range bound near their historical tights. Exposure to investment grade corporates was increased marginally over the quarter with a focus on issuers with compelling bottom-up narratives, including some more esoteric front-end bonds at attractive yields.

Interest rate positioning was adjusted throughout the quarter as rates experienced volatility and declined materially. The Fund's average duration over the quarter was about 4.7 years but ended the quarter at 4.3 years, targeting a duration between 4.0 and 4.5 years. Additionally, the Fund reduced the steepening bias following the large decline in yields at the short end of the curve over the third quarter.

## Outlook and Conclusion

Regarding the Fund's risk budget, we are targeting a modest overweight to risk representing 30% of the risk budget.

Economic activity has been robust over the last year despite expectations for slowing growth. Inflation remains above the Fed's 2% target but continues to decline. As a result of disinflation and a cooling labor market, the Fed cut interest rates by 50 basis points in September. Although this decision eased financial conditions and improved the odds of a soft landing, the fed funds rate is still expected to remain in restrictive territory for some time. As a result, U.S. economic resilience could be tested if headwinds currently affecting lower income households broaden.

Valuations generally reflect a high probability of a soft/no landing with limited margin of safety. Despite our improved economic outlook, elevated asset prices result in only a modest overweight risk posture within the Fund's strategy.

The Fund's sector positioning reflects generally expensive valuations, relative value, and opportunities within each sector. Allocations were adjusted marginally in the quarter and primary risk exposures include:

Exposure to Investment Grade Credit was increased marginally over the quarter. The sector continues to favor positions lower in the capital structure within high quality financials and is selectively adding to bottom-up opportunities on attractive relative value, including targeting investments in more esoteric front-end bonds to enhance yield.

The Fund's allocation to Securitized Products was unchanged over the quarter. The team continues to favor non-agency exposure and is overweight asset backed securities, commercial mortgage backed securities and collateralized loan obligations.

The Fund maintained its exposure to Emerging Markets Debt which is toward the lower end of the Fund's historical range. The sector is primarily invested in compelling bottom-up narratives within the below-investment grade segment. Latin America remains the largest exposure within the sector.

High Yield exposure remained largely unchanged during the quarter. High Yield exposure is at the lower end of its historical range as risk/reward is skewed to the downside. The high yield allocation is broadly diversified by sector, favoring higher quality BBs, as the Fund waits for an opportunity to add risk at more attractive spreads.

The Fund's duration was reduced during the quarter from 5.0 to 4.3 years and averaged around a 4.7 year duration over the quarter. We are positioning portfolios within the current range of 4.0 to 4.5 years and favor the intermediate part of the curve. The yield curve steepened meaningfully during the third quarter as investors began pricing in quicker rate cuts. As a result, the Fund's steepening bias was reduced. We believe longer rates are now more fairly valued but expect to see volatility over the coming quarters.

The Fund is positioned to perform well in a stable to improving environment for risk assets. We believe a modest overweight to credit sectors is prudent as valuations are tight of historical medians, limiting potential upside. However, the current economic environment should support tighter spreads and if they persist, the Fund is positioned to benefit from additional yield relative to the benchmark. However, if economic growth slows materially, the Fund is also in a position to add exposure opportunistically as risk assets would likely experience weakness. Additionally, we believe positive security selection can benefit the Fund in many different market environments and tactical duration management allows the Fund to take advantage of elevated rate volatility.

## Fund Facts

| Symbol | Inception Date | CUSIP | Exchange | Annual Fund Operating Expense Ratio Total | Net |
|---|---|---|---|---|---|
| SIO | 07/21/22 | 89157W202 | NYSE Arca | 0.87% | 0.49% |
| Total Fund Assets | $143.4 Million | | | | |

*Expense ratio is annualized. Data as of the current prospectus. Touchstone Advisors has contractually agreed to waive a portion of its fees and/or reimburse certain Fund expenses in order to limit certain annual fund operating expenses (excluding Acquired Fund Fees and Expenses "AFFE," and other expenses, if any) to 0.49%. These expense limitations will remain in effect until at least 10/31/25.*

## Total Returns

| | 3Q24 | YTD | 1 Year | Inception |
|---|---|---|---|---|
| ETF NAV | 5.62% | 8.29% | 15.53% | 7.44% |
| ETF Market Price | 5.85% | 8.42% | 15.66% | 7.63% |
| Benchmark | 5.20% | 4.45% | 11.57% | 2.64% |

*Benchmark - Bloomberg U.S. Aggregate Bond Index*

## Yield

| | Touchstone Strategic Income ETF |
|---|---|
| 30-Day SEC Yield | 4.54% |
| 30-Day Unsubsidized SEC Yield | 4.32% |

*Unsubsidized is calculated without expense waivers.* ***The 30-Day SEC Yield*** *is calculated by dividing the net investment income per share (as defined by industry regulations) earned by a fund over a 30-day period by the maximum public offering price. This number is then annualized.* ***The 30-Day SEC Yield*** *reflects the rate at which a fund is earning income on its current portfolio of securities and does not necessarily reflect income actually earned and distributed by a fund and, therefore, may not be correlated with a fund's past distributions actually paid to shareholders.*

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*Investing involves risk, principal loss is possible. Unlike mutual funds, ETFs may trade at a premium or discount to their net asset value. Touchstone ETFs are new and have limited operating history to judge. Shares are bought and sold at market price not net asset value (NAV). Market price returns are based upon the consolidated market price and do not represent the returns you would receive if you traded shares at other times.*

*The indexes mentioned are unmanaged statistical composites of stock market or bond market performance. Investing in an index is not possible. Unmanaged index returns do not reflect any fees, expenses or sales charges.*

**Please consider the investment objectives, risks, charges and expenses of the ETF carefully before investing. The prospectus and the summary prospectus contain this and other information about the Fund. To obtain a prospectus or a summary prospectus, contact your financial professional or download and/or request one at TouchstoneInvestments.com/resources or call Touchstone at 833.368.7383. Please read the prospectus and/or summary prospectus carefully before investing.**

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## A Word About Risk

The Fund invests in fixed-income securities which can experience reduced liquidity during certain market events, lose their value as interest rates rise and are subject to credit risk which is the risk of deterioration in the financial condition of an issuer and/or general economic conditions that can cause the issuer to not make timely payments of principal and interest also causing the securities to decline in value and an investor can lose principal. When interest rates rise, the price of debt securities generally falls. Longer term securities are generally more volatile. The Fund invests in non-investment grade debt securities which are considered speculative with respect to the issuers' ability to make timely payments of interest and principal, may lack liquidity and has had more frequent and larger price changes than other debt securities. The Fund invests in mortgage-backed securities and asset-backed securities which are subject to the risks of prepayment, defaults, changing interest rates and at times, the financial condition of the issuer. The Fund invests in investment grade debt securities which may be downgraded by a Nationally Recognized Statistical Rating Organization (NRSRO) to below investment grade status. The Fund invests in U.S. government securities which are neither issued nor guaranteed by the U.S. Treasury and are not guaranteed against price movements due to changing interest rates.

Touchstone exchange-traded funds (ETFs) are actively managed and do not seek to replicate a specific index. ETFs are bought and sold through an exchange at the then current market price, not net asset value (NAV), and are not individually redeemed from the fund. Shares may trade at a premium or discount to their NAV when traded on an exchange. Brokerage commissions will reduce returns. There can be no guarantee that an active market for ETFs will develop or be maintained, or that the ETF's listing will continue or remain unchanged.

The Adviser engages a sub-adviser to make investment decisions for the Fund's portfolio; it may be unable to identify and retain a sub-adviser who achieves superior investment returns relative to other similar sub-advisers. Events in the U.S. and global financial markets, including actions taken to stimulate or stabilize economic growth may at times result in unusually high market volatility, which could negatively impact Fund performance and cause it to experience illiquidity, shareholder redemptions, or other potentially adverse effects. Financial institutions could suffer losses if interest rates rise or economic conditions deteriorate. The Fund's service providers are susceptible to cyber security risks that could result in losses to a Fund and its shareholders. Cyber security incidents could affect issuers in which a Fund invests, thereby causing the Fund's investments to lose value. The Fund invests in equities which are subject to market volatility and loss. The Fund invests in preferred stocks which are relegated below bonds for payment should the issuer be liquidated. If interest rates rise, the fixed dividend on preferred stocks may be less attractive, causing their price to decline. The Fund invests in foreign securities which carry the associated risks of economic and political instability, market liquidity, currency volatility and accounting standards that differ from those of U.S. markets and may offer less protection to investors. The Fund invests in emerging markets securities which are more likely to experience turmoil or rapid changes in market or economic conditions than developed countries. The Fund invests in sovereign debt securities which are issued by foreign governments whose respective economies could have an important effect on their ability or willingness to service their debt which could affect the value of the securities. The Fund invests in derivatives such as futures contracts. Derivatives can be highly volatile, illiquid and difficult to value, subject to counterparty and leverage risks and there is risk that changes in the value of a derivative held by the Fund will not correlate with the Fund's other investments. Gains or losses from speculative positions in a derivative may be much greater than the original cost and potential losses may be substantial. The Fund invests in mortgage dollar rolls which involve increased risk and volatility, as the securities the Fund is required to repurchase may be worth less than the securities that the Fund originally held. The Fund may experience higher portfolio turnover which may lead to increased fund expenses, lower investment returns and higher short-term capital gains taxable to shareholders. The Fund invests in repurchase agreements which are considered loans by the Fund and may suffer a loss of principal and interest in the event of counterparty defaults. Current and future portfolio holdings are subject to change.

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