# Fund Manager Commentary

*As of September 30, 2023*

## Fund Highlights

- Selects fixed income securities believed to be attractively priced relative to the market or to similar securities
- Conducts disciplined approach focused security selection and research
- Higher credit quality portfolio seeks to avoid higher risk strategies, such as non-dollar currencies invests primarily in investment grade debt securities
- As markets become more intricate, specialization becomes a necessity

## Market Recap

The resilience of the U.S. economy persisted during the third quarter. Unemployment remained exceptionally low, ending the quarter at 3.70%, while the net change in nonfarm payrolls averaged a very strong 266 thousand jobs per month for the quarter. The strong labor market and robust wage growth have been a boon for consumer confidence and spending, however, inflationary pressures have been a headwind. Wage growth remains above the historical average, but is declining, while certain metrics such as the Labor Market Confidence Differential indicate the labor supply/demand may be generally balanced. Consumer confidence metrics have begun to soften – particularly those tied closely to inflationary pressures – and excess savings accumulated during the pandemic is likely near depletion. Delinquency rates across auto and credit card loans have normalized, while mortgage delinquencies remain low, and the vast majority of student loans outstanding will re-enter repayment in October after the termination of the Federal student loan forbearance program. The consumer, while currently in strong financial position overall, faces numerous pressures going forward.

The U.S. Federal Reserve (Fed) executed a single rate hike of 25 basis points (bps) during July, followed by a decision to hold rates steady at the September meeting. The yield curve bear-steepened during the quarter (although still highly inverted), with markets largely accepting the Fed's hawkish rhetoric around holding rates higher for longer in order to manage inflation down to the targeted 2% level. Front-end rates were relatively stable, rising by 20bps or less, while 10 year to 30 year Treasuries rose by 75-85bps. The 10 year Treasury reached 4.60% toward the end of the quarter, pushing mortgages to new 20 year highs near 8% and stifling housing turnover.

Equity markets sold off during the third quarter, ending a multi-quarter positive streak. Credit spreads across broad fixed income ended the quarter little changed versus the prior quarter end, however spreads on short duration indices leaked wider. Corporate Credit spreads remain fair—near the midpoint of their historical range, while spreads in Securitized Products remain more attractive.

## Portfolio Review

The Touchstone Ultra Short Duration Fixed Income ETF (NAV) outperformed its primary benchmark, the ICE BofA 3-Month U.S. Treasury Bill Index and outperformed its secondary benchmark, the ICE BofA 1-Year U.S. Treasury Note Index, for the quarter ended September 30, 2023.

Front-end rates rose slightly during third by 5-20bps. This provided a slight tailwind for the Fund's floating rate exposure and a slight headwind for the Fund's fixed rate exposure—a slight net negative overall for performance during the quarter. Of the five primary sector exposures in the ETF, the strongest-performing for the quarter were CMBS, Collateralized Loan Obligations (CLO), and RMBS, while the weakest performing sectors were Corporates and Asset Backed Securities (ABS) for the quarter. Sectors with a corresponding short-duration Index performed well on a relative basis during third quarter—with CMBS, RMBS, Corporates, and ABS outperforming their indices.

During third quarter, Cash and Equivalents held in the ETF increased, as cash flow from amortizing and maturity securities was only partially reinvested—allowing for dry powder to accumulate slightly. This increase was offset by slight decreases across ABS, RMBS, CMBS and Corporates. No other material changes were made during the quarter.

The portfolio ended the quarter with an option-adjusted duration of 0.54 years. Movements in front-end rates were minimal, between 5-20bps, resulting in very little impact to performance relative to either the 3-Month or the 1-Year Treasury indices.

*(continued)*

◊ *Fort Washington is a member of Western & Southern Financial Group*

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/ultra-short-income-etf.***

## Outlook and Conclusion

While the U.S. economy has remained resilient to the Fed's rate hikes thus far, we remain cautious regarding potential downside recession risk stemming from the Fed's hawkish determination to bring inflation down to its 2% target rate. In the rising rate environment of the past year and a half, the Fund's very short duration positioning and heavy exposure to floating rate securities have helped offset the impact of sharply rising rates, but it remains challenging to protect from reinvestment risk given the strong inversion of the Treasury curve beyond 1 year. We are working to gradually add exposure to the 1-1.5 year part of the curve to lock in attractive yields for as long as possible, however, we remain highly sensitive to spread duration and credit risk. Spreads in corporate credit are generally fair, but securitized product spreads remain attractive from a historical standpoint. The Fund maintains a significant exposure to CMBS which has been under pressure with rising rates, and challenges in the retail and office segments of the market. While management is not concerned about impairment in this segment of the portfolio (most of the securities are AAA-rated with substantial credit enhancement), more commercial loans are moving into special servicing which could produce extension risk. We are maintaining our current positions but will look to reduce exposure as prices recover and bonds mature.

Our baseline expectation is that rates will remain higher for longer, and that another rate hike is possible over the coming months. However, we are also sensitive to the potential reinvestment risk associated with an adversely timed rate cut. We believe the likelihood of a severe recession is low, but we are sensitive to downside volatility risk in the event of even a mild recession and believe that volatility could remain elevated in the near-term.

That said, the Yield to Worst on the Touchstone Ultra Short Income ETF is much higher than yields generally were in the Ultra Short Duration space when the current rate cycle began (~7% today vs. ~1% in mid-2021), meaning the Fund should be better able to absorb significantly more volatility and produce attractive returns. Further, the yield on the Fund is likely to continue to increase as the floating rate securities reset to higher yielding benchmarks and as substantial monthly cash flow (maturities) are reinvested at increasingly higher rates. Subject to fluctuations in the shape of the 6 to 18 month part of the Treasury curve, we are looking to marginally begin extending duration of the portfolio by increasing exposure to the 1-1.5-year part of the curve.

Spreads on short duration securities have remained high, particularly in securitized products, creating some of the best values we have seen in the Ultra Short Duration space. However, with the risk that the Fed will be unable to engineer a soft landing and a wide gulf in potential outcomes, we are avoiding over-risking the portfolio —both in terms of interest rate risk and credit risk. Given the historical attractiveness of even high quality assets, it makes sense to lock in current attractive yields for as long as possible while also maintaining a conservative bias in terms of credit risk and downside spread volatility risk.

## Fund Facts *(As of 09/30/23)*

| Symbol | Inception Date | CUSIP | Exchange | Annual Fund Operating Expense Ratio* Total | Annual Fund Operating Expense Ratio* Net |
|---|---|---|---|---|---|
| **TUSI** | 08/04/22 | 89157W301 | Cboe BZX | 0.68% | 0.25% |
| **Total Fund Assets** | **$52.6 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 0.25%. These expense limitations will remain in effect until at least 09/29/24.*

## Total Returns *(As of 09/30/23)*

| | 3Q23 | YTD | 1 Year | Inception |
|---|---|---|---|---|
| ETF NAV | 1.58% | 4.52% | 5.37% | 4.68% |
| ETF Market Price | 1.61% | 4.56% | 5.31% | 4.74% |
| Benchmark 1 | 1.31% | 3.60% | 4.47% | 4.87% |
| Benchmark 2 | 1.21% | 2.90% | 3.68% | 3.11% |

*Benchmark 1 - The ICE BofA 3-Month U.S. Treasury Bill Index is an unmanaged index of Treasury securities maturing in 90 days that assumes reinvestment of all income.*

*Benchmark 2 - The ICE BofA 1-Year U.S. Treasury Note Index is an unmanaged index comprised of a single issue purchased at the beginning of the month and held for a full month. The issue selected at each month-end rebalancing is the outstanding two-year Treasury Note Bill that matures closest to, but, not beyond one year from the rebalancing date.*

## Yield *(As of 09/30/23)*

| | Touchstone Ultra Short Income ETF |
|---|---|
| 30-Day SEC Yield | 5.17% |
| 30-Day Unsubsidized† SEC Yield | 4.80% |

*†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.*

***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/ultra-short-income-etf.*** *From time to time, the investment adviser may waive some fees and/or reimburse expenses, which if not waived or reimbursed, will lower performance. Returns assume reinvestment of all distributions. Returns are not annualized for periods less than one year.*

*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.**

**Not FDIC Insured | No Bank Guarantee | May Lose Value**

## 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 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 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 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 Funds' 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 Collateralized Loan Obligations (CLOs) that have risks that largely depend on the type of underlying collateral and risks may include illiquidity, limited active market, the possibility that distributions from collateral securities will be insufficient to make interest or other payments, the potential for a decline in the quality of the collateral, and can bear the risk of default by the loans. 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 municipal securities which may be affected by uncertainties in the municipal market related to legislation or litigation involving the taxation of municipal securities or the rights of municipal security holders in the event of bankruptcy and may not be able to meet their obligations.**

**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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