# Fund Manager Commentary

*As of March 31, 2023*

## Fund Highlights

- Seeks a high level of income consistent with reasonable risk by investing primarily in income producing securities
- Primarily invests in investment grade corporate bonds, high yield corporate bonds, preferred stocks, U.S. municipal bonds and U.S. Treasuries
- Actively manages the portfolio by rotating among asset classes and tactically hedging during various interest rate and market environments
- Seeks to identify relative value across asset classes and capture opportunities primarily within the corporate, U.S. Treasury, municipal and preferred security markets
- Analyzes and targets the portfolio's level of risk and interest rate sensitivity
- Selects individual positions based on security credit metrics and structures
- Focuses on liquid securities with transparent pricing and actively-traded capital structures

## Market Recap

The first quarter of 2023 began with broader markets rallying on the prospects that the U.S Federal Reserve Board's (Fed) campaign to fight generationally high inflation was near the end of its tightening cycle. Fourth quarter 2022 gross domestic product (GDP) in the U.S. cooled slightly to a 2.7% annual rate, slowing from the 3.2% growth rate in the third quarter 2022. Consumer spending rose 1.4% in fourth quarter 2022 and many investors began to focus on risk assets to start the year, since they declined substantially in 2022. U.S. labor markets continued to show resiliency to the over 425 basis points (bps) of consecutive interest rate hikes, as the unemployment rate hit 3.5%, a 50-year low. This continued to put upward pressure on wages, a closely watched barometer of inflation by the Fed. At the end of its two-day meeting, the Federal Open Market Committee (FOMC) announced another 25 bps increase in the federal funds rate from 4.50% to 4.75% on February 1. The economic data reported in February 2023 caused investors to reassess strategies as the Fed's preferred gauge of inflation, the U.S. Personal Consumption Expenditures Price Index (PCE), came in higher than estimates with headline and core PCE data at 5.4% and 4.7%, respectively. The report also showed the largest increase in personal-income fueled by a resilient job market and the largest upward cost-of-living adjustment for Social Security recipients.

With investors focused on economic data in advance of the March 22 FOMC meeting, the markets woke up on March 10 to the news that Silicon Valley Bank was taken over by the Federal Deposit Insurance Corporation. Silicon Valley Bank was confronted with a classic "run on the bank" in a short period, prompting the U.S. government to backstop all of their deposits. Over that subsequent weekend, news spread that New York State regulators shut down Signature Bank, a big lender in the crypto industry, to prevent or at least slow the banking crisis that was underway. Then on March 18 Credit Suisse Group AG, was thrown a $54 billion lifeline by the Swiss central bank to shore up liquidity after its stock and bonds were trading lower intensifying fears of a global banking crisis. The lifeline failed to assuage investors' fears and Swiss authorities helped orchestrate a sale to UBS Group AG for $3.25 billion to avoid further turmoil in the global banking system. The 2-year U.S. Treasury fell dramatically as the flight-to-quality mindset returned to the markets and posted an intra-quarter drop of approximately 153 bps (5.08% peak to 3.55% trough). The 10-year U.S. Treasury posted an intra-quarter drop of approximately 111 bps (4.09% peak to 3.28% trough). The 2's-10's spread, the difference between the yield of the 10-year U.S. Treasury Note and the 2-year U.S. Treasury Note, ended the first quarter at negative 58 bps after posting an intra-day low of negative 111 bps in March. Toward the end of the quarter, on March 22, shortly after the turmoil from the banking

*(continued)*

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 TouchstoneInvestments.com/mutual-funds.***

Touchstone Investments®
DISTINCTIVELY ACTIVE®

crisis subsided, the FOMC announced another 25 bps increase in federal funds rate from 4.75% to 5.00%, raising it to its highest level since 2007.

### Portfolio Review

The Touchstone Flexible Income Fund (Class A Shares Load-Waived) underperformed its benchmark, the Bloomberg U.S. Aggregate Bond Index, for the quarter ended March 31, 2023.

Our main tenets have been to focus on investment opportunities with high current income, relatively short duration (generally inside 5 years) combined with high confidence of a very low probability of default. We continue to be extremely focused on underlying fundamentals and credit quality. A significant portion of the Fund, as of the end of the quarter, was invested across Preferred Securities and Agency Commercial Mortgage-Backed Securities (CMBS) holdings. The Preferred asset class generically consists of low coupon, fixed-for-life perpetuals, which we currently find unattractive. However, we see value in our Preferred exposure, which is centered on securities with fixed coupons for 5 years at issuance and then reset at a spread off U.S. Treasuries, thus mitigating interest rate risk. Our Preferred holdings in less rate sensitive, fixed-to-reset structures screen extremely cheap in our quantitative models when compared to both fixed-for-life Preferred and corporate credit. The Agency CMBS positions are generally backed by loans on multi-family residential housing properties originated by U.S. government agencies, which are performing very well fundamentally compared to other commercial sectors such as retail, lodging or office which we are actively avoiding, as we do not like the fundamentals of those sub sectors.

After tightening during the beginning of the first quarter of 2023, credit spreads widened as news of bank failures and the prospect of global bank contagion increased volatility. Investors rotated into the safety of U.S. Treasuries as they were repricing risk. We deployed credit hedges opportunistically during the quarter to counter a portion of our high yield credit exposure. We did this with various positions in an ETF referencing the S&P 500 Index and buying protection via Credit Default Swaps referencing the 5 year High Yield Index. We also deployed rate hedges, opportunistically, during the quarter to counter a portion of the duration exposure within the portfolio via shorting long-term U.S. Treasuries. Finally, we remained wary of investments in lower credits and/or with longer durations and focused on 1) rotating into shorter, higher quality investments or 2) building our cash and cash equivalents instead.

The Fund's allocation to Preferreds remained the largest but decreased slightly over the course of the first quarter. We continue to favor these holdings, which are shorter in duration than the rest of the Preferred universe due to their high back-end resets and short call dates. Most of these holdings are now trading below par due to the re-pricing of the Preferred market, which began in 2022 due to the rising rate environment and continued into 2023 with the regional banking crisis. Given their discounted marks at the end of the first quarter, these holdings are currently offering yields-to-maturity higher than 7%, and due to their floating back-end reset features, if rates stay elevated, many of these securities may be called offering upside scenarios of double digit yields-to-call.

The Fund's Investment Grade securities allocation decreased during the quarter. We reduced exposure in both Investment Grade corporate bonds and securitized. We continue to like the positions we hold for their credit and carry. We have added several low dollar price Investment Grade bonds to our bullpen. We will continue to monitor price action and look to put capital to work if they reach our downside price targets. We will look to add to this asset class on a tactical basis. We are converting our cash and monthly distributions from our shorter duration and/or amortizing Investment Grade structured products securities into cash and short-dated U.S. Treasury Bills in order to optimize liquidity.

The Fund's Non-Investment Grade or High Yield allocation decreased over the quarter as well. As the Fed continues to signal that fighting inflation is their primary objective, we have subsequently reduced our High Yield corporate exposure. The high yield index yielding north of 9% does screen somewhat attractive, however, spreads are just fair value, especially in an economic environment where we feel earnings will reset lower along with a continued slowdown in GDP and economic activity. We see some pockets of either opportunities in High Yield starting to develop via short term tactical trades via liquid products, or longer-term opportunities up the cap structure in select secured bonds with strong credit metrics trading north of 8%. We continue to feel constructive with the risk/reward of these securities, as we stay focused predominantly on housing related transactions that have good fundamentals, which provide for a very low probability of default with relatively low duration and high current income. Although we did not add any exposure during the first quarter 2023, we will look to add to this asset class on a tactical basis.

The Fund's Municipal Bond exposure slightly decreased during the quarter. Although it's an asset class susceptible to an increase in long term rates, we see relative value opportunities in closed-end funds which trade at double digit discounts to NAV and offer approximately 5% yields. We cautiously added some incremental exposure late last year, as tax loss selling pushed many of these funds to attractive levels. Furthermore, during March we added to these positions, as U.S. Treasury rates declined and the federal funds rates futures curve became further inverted as many market participants are now anticipating the Fed to cut rates later this year. We will continue to monitor these developments closely and look for relative value opportunities.

The Fund's overall combination of cash and short-dated U.S. Treasury allocations increased during the quarter. We increased our investment in short-dated U.S. Treasuries to take advantage of higher yields versus the Fund's money

*(continued)*

Touchstone Investments®
DISTINCTIVELY ACTIVE®

market sweep fund. We continue to remain patient and look to further aggregate cash flows generated from the securities held by the Fund and may continue to reinvest any cash flows received into short-dated U.S. Treasuries and/or other short duration investments in order to prepare for any corrections and/or better entry points.

The Fund's duration at the end of the first quarter of 2023 was approximately 2.7 years vs. the Bloomberg U.S. Aggregate Bond Index of approximately 6.3 years. The Fund is positioned with a lower duration than the benchmark purposefully as we wanted to stay in shorter solid credits to protect from any spread volatility and/or large moves up in benchmark interest rates. Although this was a major reason for the Fund's underperformance versus the benchmark during the huge rally in rates caused by the banking crisis, the Fund's shorter duration has typically allowed us to experience less negative performance during periods of sell-offs in U.S. Treasuries. We believe this shorter duration positioning will still benefit the Fund in this market and outperform benchmark returns over the course of the economic cycle.

## Outlook and Conclusion

In general, the greatest headwind to the portfolio is the same thing that is protecting us from inflation, rising U.S. Treasury yields, credit deterioration, etc. - it is the fact that we are running lower duration and more cash than our peers. We would likely underperform in the short term, a modest amount, if there were a large move lower in yields without a commensurate widening of spreads. Although we have a high yielding portfolio, we are underweight risk and duration.

In our view, the Fed's 475 bps of tightening since the beginning of 2022 has still not fully impacted the U.S. consumer (i.e., caused all the demand destruction that it ultimately will). Although the recent banking failures caused a short-term rally in U.S. Treasury rates, we expect the Fed will want to digest the resulting deteriorating metrics over the next few months after reaching their terminal rate (currently anticipated to be in the low-to-mid-5% area for the federal funds rate). We anticipate fundamentals will deteriorate more than the Fed is expecting, and that U.S. Treasury short-term rates may further decline ahead of the Fed's decision to pivot back to an easing schedule (the opposite of when rates sold-off months ahead of the Fed's tightening schedule). We are constantly monitoring rates, as we are aware that our largest allocations in Preferred securities and Agency CMBS can be somewhat sensitive to longer U.S. Treasuries.

We continue to be wary and avoid highly credit sensitive asset classes (i.e., generic High Yield), although they are currently much more fairly priced on a risk-adjusted basis than they have been in a few years. In our view, we will remain tentative to rotate into such investments as they have a meaningfully higher probability of default. We will look to take advantage of investment opportunities in this space on a tactical basis. As always, we remain diligent and patient as we are focused on avoiding any positions that have the potential to suffer from extreme illiquidity, which could be caused by an unforeseen event.

The main driver of returns in the first quarter of 2023 was our high current income of the Fund in addition to total return opportunities that we capitalized on via portfolio rotation, asset allocation, opportunistic investing, etc.

We do not see any obvious fundamental issues in any of the asset classes/sectors in which we are currently invested. Many of these asset classes/sectors experienced their all-time tights during 2021. Although some spreads have widened to somewhat fair or even cheap values from their 2021 tights (all-time tights in some sectors), they did not gap out to cyclical wides during 2022 and in the first quarter 2023. Most of the higher yields achieved since the beginning of 2022 have developed through the widening of benchmark rates instead. We envision that some downside (i.e., spread widening) may still exist as fundamentals may deteriorate over the course of 2023. We feel that we are conservatively positioned for further downside with a large amount of cash and cash equivalents at the end of the first quarter of 2023. We anticipate allocating our liquidity (cash and cash equivalents) into more optimal risk-adjusted returns on a tactical basis. We believe that our active portfolio management methodologies will be important to add to returns and reduce risk.

As of March 31, 2023, Credit Suisse Group AG, Silicon Valley Bank, Signature Bank and UBS Group AG each made up 0.00% of the Touchstone Flexible Income Fund. Current and future portfolio holdings are subject to change.

## Fund Facts *(As of 03/31/23)*

| Class | Inception Date | Symbol | CUSIP | Annual Fund Operating Expense Ratio* Total | Net |
|---|---|---|---|---|---|
| A Shares | 04/01/04 | **FFSAX** | 89154Q620 | 1.18% | 1.16% |
| C Shares | 10/29/01 | **FRACX** | 89154Q612 | 1.94% | 1.91% |
| Y Shares | 09/01/98 | **MXIIX** | 89154Q596 | 0.92% | 0.91% |
| INST Shares | 09/10/12 | **TFSLX** | 89154Q588 | 0.91% | 0.81% |

**Total Fund Assets $837.8 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 1.04% for Class A Shares, 1.79% for Class C Shares, 0.79% for Class Y Shares and 0.69% for Class INST Shares. These expense limitations will remain in effect until at least 07/29/23.*

*Share class availability differs by firm.*

***Fifth Third Strategic Income Fund Class I Shares became Touchstone Flexible Income Fund Class Y Shares on 09/10/12.***

## Annualized Total Returns** *(As of 03/31/23)*

| | 1Q23 | YTD | 1 Year | 3 Year | 5 Year | 10 Year | Inception |
|---|---|---|---|---|---|---|---|
| Excluding Max Sales Charge | | | | | | | |
| A Shares | 1.60% | 1.60% | -2.39% | 3.53% | 2.13% | 2.68% | 5.70% |
| C Shares | 1.34% | 1.34% | -3.16% | 2.75% | 1.35% | 2.07% | 5.22% |
| Y Shares | 1.55% | 1.55% | -2.14% | 3.78% | 2.36% | 2.93% | 6.05% |
| INST Shares | 1.58% | 1.58% | -2.04% | 3.92% | 2.49% | 3.04% | 6.14% |
| Benchmark^ | 2.96% | 2.96% | -4.78% | -2.77% | 0.91% | 1.36% | 6.09% |
| Including Max Sales Charge | | | | | | | |
| A Shares | -1.71% | -1.71% | -5.60% | 2.82% | 0.93% | 2.07% | 5.54% |
| C Shares | 0.34% | 0.34% | -4.09% | 2.75% | 1.35% | 2.07% | 5.22% |

*Max 3.25% sales charge for Class A Shares and 1% Contingent Deferred Sales Charge for Class C Shares held less than 1 year.*

*^Benchmark - Bloomberg U.S. Aggregate Bond Index[1]*

*[1]The Bloomberg U.S. Aggregate Bond Index is an unmanaged index comprised of U.S. investment grade, fixed rate bond market securities, including government, government agency, corporate and mortgage-backed securities between one and ten years.*

*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.*

*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 TouchstoneInvestments.com/mutual-funds.*** *From time to time, the investment adviser may waive some fees and/or reimburse expenses, which if not waived or reimbursed, will lower performance. Performance by share class will differ due to differences in class expenses. Returns assume reinvestment of all distributions. Returns are not annualized for periods less than one year.*

*****Class A, Class C and Class Y shares performance was calculated using the historical performance of the Fifth Third/Maxus Income Fund Investor shares, with an inception date of March 10, 1985, for periods prior to April 1, 2004, October 29, 2001 and September 1, 1998, respectively. Institutional Class shares performance information was calculated using the historical performance of Class Y shares for the periods prior to September 10, 2012. The returns have been restated to reflect sales charges and fees applicable to Class A, Class C, Class Y and Institutional Class shares.***

## 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 agency securities which are neither issued nor guaranteed by the U.S. Treasury and are not guaranteed against price movements due to changing interest rates. 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's investments in other investment companies, including ETFs, will be subject to substantially the same risks as those associated with the direct ownership of the securities comprising the portfolios of such investment companies, and the value of the Fund's investment will fluctuate in response to the performance of such portfolios. In addition, if the Fund acquires shares of investment companies, shareholders of the Fund will bear their proportionate share of the fees and expenses of the Fund and, indirectly, the fees and expenses of the investment companies or ETFs. 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. The Fund invests in convertible securities which are subject to the risks of both debt securities and equity 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. 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. Banks and financial services companies could suffer losses if interest rates rise or economic conditions deteriorate. 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. Current and future portfolio holdings are subject to change.**

**Please consider the investment objectives, risks, charges and expenses of the Fund 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 800.638.8194. Please read the prospectus and/or summary prospectus carefully before investing.**

**Touchstone Funds are distributed by Touchstone Securities, Inc.***

*A registered broker-dealer and member FINRA and SIPC

Touchstone is a member of Western & Southern Financial Group

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

Touchstone Investments®
DISTINCTIVELY ACTIVE®

800.638.8194 • TouchstoneInvestments.com



TSF-28-FFSAX-2303