SECOND QUARTER 2022

Strategic Income Commentary

June 30, 2022

STRATEGIC INCOME PORTFOLIO REVIEW

The Red Cedar Strategic Income Composite (Composite) continues to outperform its benchmark in a variety of market environments with the first half of 2022 representing the worst year-to-date start to the year for the fixed income asset class on record. Despite that, the Composite still outperformed its benchmark—the Bloomberg U.S. Aggregate Bond Index—by 108 basis points (bps) through the first two quarters of 2022. The Composite underperformed its benchmark in the second quarter of 2022 by 127 bps, making it the first quarter of net underperformance for the Composite since its inception.

Relative outperformance was led by the portfolio's underweight duration position as the U.S. Treasury curve continued to bear flatten into the face of multiple Federal Reserve Bank (Fed) rate hikes, increasingly hawkish commentary, and outright quantitative tightening. Relative underperformance was led by the Composite's long credit risk position with notable underperformance from its allocation to hybrid debt instruments in general and additional tier-one instruments in particular. Long exposure to the USD via currency futures was a positive contributor as the Composite sought to take advantage of the Fed tightening financial conditions. The Composite's 0% exposure to the agency mortgage-backed securities (MBS) market was additive as the benchmark had a negative excess return of 97 bps due to a combination of rising rates and fears of MBS asset sales.

PERFORMANCE

ANNUAL PERFORMANCE (%)	2021	2020†
Composite Gross	6.22	14.75
Composite Net	5.85	14.46
Index*	-1.54	4.23

	Composite Gross (%)	Composite Net (%)	Index* (%)	Outperformance** (%)
2Q22	-5.88	-5.96	-4.69	-1.27
YTD	-9.10	-9.27	-10.35	1.08
1 Year	-6.76	-7.08	-10.29	3.21
ITD†	4.66	4.30	-3.64	7.94

*Bloomberg U.S. Aggregate Bond Index
**Outperformance=Composite Net-Index
†Performance calculated from inception date 4/1/2020

Periods greater than 12 months are annualized
Source: Bloomberg, Clearwater Analytics

PORTFOLIO OUTLOOK & POSITIONING

To start the second quarter, the Composite was as conservatively positioned as it has ever been with allocations to hybrids, high yield corporates, REITs, and equities all at or near the bottom of our investment ranges, while allocations to cash and Treasuries were near the tops of our investment ranges. Proceeds from credit sales were reallocated to more defensive areas of the securitized market, specifically floating rate legacy nonagency mortgages. Furthermore, the Composite had a long equity volatility position and a sizeable Treasury flattener that served as hedges against rising credit spreads.

As the quarter played out, the Composite gradually layered on more risk. First, the volatility hedge and curve flattener were removed. Then exposure to credit spreads was increased primarily by moving allocations to hybrids from 30% to 40% and increasingly by changing the composition of those hybrids from very conservatively structured (high back-end, short-dated call) to less conservatively structured (deep discounts to par, medium back-ends).

While some of the risk was added back to the portfolio in 2Q22, the Composite is still conservatively positioned with significant amounts of liquidity (in the form of cash and Treasuries) as well as low allocations to equities, REITs, and high yield credit. To the extent that inflation remains stubbornly high and the Fed continues to dial up its hawkishness, the Composite will likely remain conservatively postured. However, if inflation rolls over and the Fed is allowed to tone down the rhetoric, the Composite stands ready to continue to layer risk back on.

PORTFOLIO MANAGEMENT TEAM

Brandon F. Bajema, CFA, CPA
Senior Portfolio Manager
Industry start date: 2003
Joined Red Cedar: 2021

Julia Batchenko, CFA
Senior Portfolio Manager
Industry start date: 2011
Joined Red Cedar: 2019

John L. Cassady III, CFA
Chief Investment Officer
Industry start date: 1987
Joined Red Cedar: 2018

Michael J. Martin, CFA
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Industry start date: 1994
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Jason M. Schwartz, CFA
Senior Portfolio Manager
Industry start date: 2004
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David L. Withrow, CFA
Director of Portfolio Management
Industry start date: 1988
Joined Red Cedar: 2018

INVESTMENT PHILOSOPHY

"Strategic Income seeks current income, across global markets, in any capital structure where we find relative value. The strategy provides reduced correlations to both stocks and bonds in a high quality portfolio."
—John Cassady

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MARKET REVIEW

The second quarter of 2022 was a continuation of the first quarter for the capital markets as the Fed continued to remove its extraordinarily accommodative monetary stimulus while investors shunned risky assets. After hiking just once during 1Q22, the Fed increased its Federal Funds target rate twice during 2Q22. Realizing that it might be behind the curve on fighting inflation, the Fed moved in earnest by increasing rates 50 bps at the May 4 meeting, and 75 bps at the June 15 meeting, bringing the upper band of the Fed Funds target rate to 1.75%. The Federal Open Market Committee (FOMC) also continued its hawkish rhetoric as inflation remained stubbornly high at 8.6% year-over-year as measured by the Consumer Price Index.

With inflation eroding purchasing power and funding costs rapidly increasing, most major asset classes had a negative return during the quarter. Indeed, the large cap S&P 500® Index returned -16.1% for the quarter, bringing its return to -20.0% year-to-date (YTD). With investor risk appetite waning, it was not surprising to see large cap growth stocks, as represented by the Russell 1000® Growth Index, continue its relative underperformance to the Russell 1000 Value Index. Growth stocks returned -20.9% for the quarter, while value stocks returned -12.2%. With inflation running hot and the Fed playing catch-up, the Bloomberg U.S. Aggregate Bond Index turned in an abysmal -4.7% return for the quarter. This broad investment grade bond index has now returned -10.3% YTD. The riskier Bloomberg U.S. Corporate High Yield Bond Index returned -9.8% for the quarter as high yield credit spreads increased by nearly 250 bps. With Russia's President Putin still waging war in Ukraine and western sanctions still in place against Russia, energy commodities continued their good performance with a 6.2% return for 2Q22 and 46.5% return YTD as represented by the S&P GSCI Energy Index.

As we enter the second half of the year, the markets still face uncertainty as it relates to inflation, the Fed's reaction function, and a slowing economy. Paul Volcker was the last FOMC chairman to fight inflation of this magnitude. He ultimately had to send the U.S. economy into recession to get inflation under control. The FOMC chairman during the Nixon, Ford, and partial Carter administrations was Arthur Burns. He believed inflation was transitory and caused by things outside the Fed's control. Under his watch, the Fed was not aggressive enough in fighting inflation, causing a stagflationary environment for many years. The jury is still out on current chairman, Jerome Powell, and the markets must decide if it has another Burns or Volcker at the helm. The Fed could get lucky and stick the soft landing, but for now it is best to remain defensively positioned while the economy and markets sort themselves out.

DISCLOSURES

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The securities discussed do not represent the Composite's entire portfolio. Actual holdings will vary depending on the size of the account, cash flows, and restrictions. It should not be assumed that any of the securities transactions or holdings discussed will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

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All information and performance are reported in U.S. dollars.

The "Net" returns presented are net of fees. Investing involves the risk of loss and investors should be prepared to bear potential losses. Past performance is not indicative of future results.

The "Gross" returns presented are gross of fees. The results do not reflect the deduction of investment management fees. The client's return will be reduced by the management fees and any other expenses incurred in the management of the account. For example, a U.S. $100 million account, paying a 0.50% annual fee, with a given rate of 10% compounded over a 10-year period would result in a net of fee return of 9.5%. Management fees are described in Part 2A of RCIM's Form ADV Part 2A. Investing involves the risk of loss and investors should be prepared to bear potential losses. Past performance is not indicative of future results.

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RCIM Strategic Income Composite (the "Composite") includes a broad distribution pooled fund (North Square Strategic Income Fund) that invests in Treasury and agency bonds, investment grade and non-investment grade corporate bonds, municipal bonds, asset-backed securities, agency, and non-agency mortgage-backed securities, collateralized mortgage obligations, preferred securities, equity REITS and equity securities. The strategy may use derivatives, including forward contracts, futures contracts, swap contracts and options in implementing its strategy. The use of derivative instruments allows the strategy to achieve its investment objectives, reduce risks, or manage the strategy more efficiently. The strategy also invests in international securities, foreign exchange, and non-U.S. dollar denominated securities. The Strategic Income Composite was created on April 1, 2020. The inception date of the Composite was April 1, 2020.

The benchmark is the Bloomberg U.S. Aggregate Bond Index. The index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, mortgage backed securities, asset-backed securities and commercial mortgage-backed securities.

Benchmark Definitions:

- The Russell 1000 Growth measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.
- The Russell 1000 Value measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.
- The S&P 500 is widely regarded as the best single gauge of the U.S. equities market. The index includes a representative sample of 500 leading companies in industries of the U.S. economy.
- The Bloomberg U.S. Aggregate Bond represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.
- The Bloomberg U.S. Corporate High Yield Bond measures the USD-denominated, high yield, fixed-rate corporate bond market.
- The S&P GSCI Energy Index, a sub-index of the S&P GSCI, provides investors with a reliable and publicly available benchmark for investment performance in the energy commodity market.

An index is an unmanaged portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Investors cannot invest directly in an index. An index does not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown.

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