RED CEDAR
INVESTMENT MANAGEMENT

SECOND QUARTER 2022

Core Plus Fixed Income Commentary

June 30, 2022

MARKET REVIEW

The second quarter of 2022 was a continuation of the first quarter for the capital markets as the Federal Reserve Bank (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 2Q. Realizing that it might be behind the curve on fighting inflation, the Fed moved in earnest by increasing rates 50 basis points (bps) at the May 4 meeting and 75 basis points at the June 15 meeting, bringing the upper band of the federal 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 Vladimir 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 2Q 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.

CORE PLUS PORTFOLIO REVIEW

The Core Plus Composite returned -5.11%, net of fees, for the quarter ending June 30, 2022, underperforming the composite's benchmark, the Bloomberg U.S. Aggregate Bond Index, which returned -4.69%.

Many of the dynamics that impacted second quarter's performance were similar to those seen in the first quarter of the year, meaning higher interest rates and wider credit spreads. The yield on the 10-year U.S. Treasury Note increased 67 bps during the quarter. The strategy benefited from being underweight duration throughout the period and was the primary contributor to performance.

Offsetting the positive dynamic of the strategy's duration position was the impact of credit spreads. Investment grade and high yield credit spreads widened +42 and +244 bps, respectively, during the period, which resulted in the strategy's spread product in general, and corporate bonds and preferred securities specifically, being detractors from performance.

The relative underperformance of the strategy was due to corporate credit's negative contribution to return being only partially offset by duration's positive contribution.

CORE PLUS POSITIONING & OUTLOOK

Federal Reserve Chairman Powell is trying to "thread the needle" by bringing inflation down while not sending the economy into a recession. Second quarter GDP expectations are now negative, and the hoped-for soft landing was dealt a blow as the period ended with some unexpectedly weak economic data. It is widely expected now that the Fed will follow its June federal funds rate increase of 75 bps, with another 75 bps in July. Looking forward to the September meeting, the market has not fully settled on whether the Fed will become less aggressive. At this point, Chairman Powell has made it clear that fighting inflation is the priority, and if a recession is necessary to achieve that goal, so be it. Given this stance and the possibility of higher interest rates, the strategy's duration will be maintained shorter than the benchmark.

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STRATEGY INFORMATION

Benchmark	Bloomberg U.S. Aggregate Index
Business Minimum	$15M
Number of Holdings	211
Assets	$90.36M

PORTFOLIO MANAGEMENT TEAM

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

Jason M. Schwartz, CFA
Senior Portfolio Manager
Industry start date: 2004
Joined Red Cedar: 2018

David L. Withrow, CFA
Director of Portfolio Management
Industry start date: 1988
Joined Red Cedar: 2018

Michael J. Martin, CFA
Senior Portfolio Manager
Industry start date: 1994
Joined Red Cedar: 2018

INVESTMENT PHILOSOPHY

"We seek income producing opportunities in the capital structure, in a variety of risk profiles where we find relative value in an effort to reduce correlation to traditional bonds."
—David Withrow

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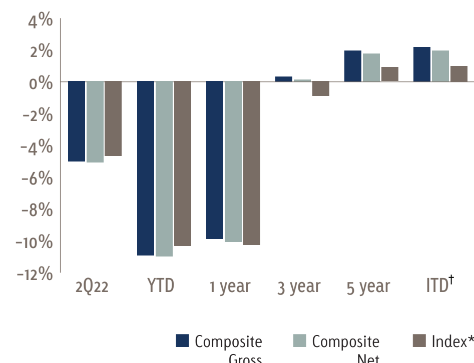
Investment grade corporate bond spreads increased during the quarter. The sector entered the quarter with strong tightening momentum as spreads continued their narrowing trend during the first part of May. However, as markets became more convinced that inflation was much higher than expected, risky assets sold off. Credit spreads ended the quarter at +164, 42 bps wider than where they started the period. At current levels, credit spreads are nearing a level that could represent good value. What is not clear is what happens to spreads should the economy dip into a recession and the corresponding impact on company earnings. For now, the corporate credit exposure in the portfolio is defensively positioned, and this stance will be maintained until market conditions are better defined. Commodity prices should be supportive of the energy sector, although this sector underperformed in the second quarter. The outperformers for the second quarter were banking (an overweight in the portfolio) and economically defensive sectors such as healthcare and utilities. For now, the emphasis will continue to be on high quality companies with strong balance sheets.

High yield credit spreads widened +244 bps during the quarter, ending the period at +587 bps, a level not seen since 2016. The strategy's exposure to high yield securities is currently at the lower end of the range, given the defensive positioning. The exposure to high yield securities will be increased when attractive risk-adjusted opportunities are identified.

Preferred securities have been under pressure throughout the year, down -7.7% for the quarter and -13.9% for the year, as measured by the ICE BofA Fixed Rate Preferred Securities Index. The strategy's exposure to the sector was increased modestly during the quarter. While not at a full allocation to the sector, there are pockets of opportunities developing in preferred securities, and the strategy started to cautiously take advantage of them. The strategy maintains a bias toward $1,000 hybrid securities, which are slightly less sensitive to increasing interest rates compared to more retail-oriented $25 preferred stock.

The strategy's exposure to agency-guaranteed commercial mortgage-backed securities was increased during the quarter due to their superior liquidity profile with a focus on securities having prepayment upside. The asset-backed securities (ABS) weighting was reduced. Specifically, consumer loan ABS was sold as the team expects lower-income consumers to experience hardship in the current environment due to higher food and energy prices. The strategy's underweight position in agency mortgage-backed securities (MBS) was maintained over concerns the Fed will begin reducing the size of its balance sheet, which could weigh on MBS prices.

PERFORMANCE



	Composite Gross	Composite Net	Index*
2Q22	-5.06%	-5.11%	-4.69%
YTD	-10.94%	-11.03%	-10.35%
1 year	-9.91%	-10.12%	-10.29%
3 year	0.31%	0.12%	-0.93%
5 year	1.94%	1.74%	0.88%
ITD†	2.15%	1.94%	0.95%

†Inception Date 5/1/2016
Periods greater than 12 months are annualized
*Bloomberg U.S. Aggregate Index
Source: Bloomberg, Clearwater Analytics

DISCLOSURES

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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.

The information herein was obtained from various sources. RCIM does not guarantee the accuracy or completeness of information provided by third parties. The information in this report is given as of the date indicated and believed to be reliable. RCIM assumes no obligation to update this information, or to advise on further developments relating to it.

RCIM's Core Plus Composite includes all fully discretionary institutional portfolios that invest 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 and preferred 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 Composite also invests in international securities, foreign exchange, and non-U.S. dollar denominated securities. The Composite was created January 1, 2019. The inception date of the Composite was May 1, 2016.

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. ICE BofA Fixed Rate Preferred Securities Index: Tracks the performance of fixed-rate U.S. dollar-denominated preferred securities issued in the U.S. domestic market. Qualifying securities must be rated investment-grade (based on an average of Moody's, S&P and Fitch) and must have an investment-grade-rated country risk (based on an average of Moody's, S&P and Fitch foreign currency long-term sovereign debt ratings.)

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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