THIRD QUARTER 2022

Strategic Income Commentary

September 30, 2022

STRATEGIC INCOME PORTFOLIO REVIEW

The Red Cedar Strategic Income Composite (Composite) successfully navigated near record levels of interest rate volatility to outperform its benchmark, the Bloomberg U.S. Aggregate Bond Index, by 3.73% for the quarter. This brings the year-to-date outperformance to 4.42% amidst the worst bond market rout on record in both domestic and global markets.

Relative outperformance was led by the portfolio's core position in preferred securities that was increased on a tactical basis during the period. Specifically, excess returns were driven by currently or soon-to-be floating rate hybrid securities issued primarily by U.S. domestic financial institutions. Results were also fueled by the portfolio's underweight duration relative to the benchmark as the U.S. Treasury curve bear-flattened to a level of inversion on the 10-year/2-year spread last seen in the early 1980s. Relative underperformance was led by the portfolio's position for a steeper yield curve through a significant underweight to maturities of 10+ years where real yields remain the most deeply negative. The composite's avoidance of agency mortgage-backed-securities was additive as that market experienced the worst returns on record due to fears of quantitative tightening and rising interest rates.

The strategy effectively utilized portfolio hedges in an environment where tightening financial conditions drove negative excess returns in most sectors of the benchmark. Long exposure to the U.S. dollar via currency futures was a positive contributor as currency adjustments have been the relief valve for the domestic economy to export inflation to the rest of the world. In addition, long equity volatility exposure produced sizable gains near the end of the period as Federal Reserve (Fed) Chairman Jerome Powell and various Fed governors increased hawkish rhetoric.

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** (%)
3Q22	-0.94	-1.02	-4.75	3.73
YTD	-9.95	-10.19	-14.61	4.42
1 Year	-7.92	-8.24	-14.60	6.36
ITD†	3.79	3.43	-5.14	8.58

*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 AND POSITIONING

With interest rate volatility as measured by the MOVE Index at an extreme level that has historically been associated with disintermediation and Fed intervention, maintaining a dynamic strategy with maximum flexibility is of utmost importance. Given the high levels of inflation, the Fed does not have the freedom to rescue the market at the first sign of trouble as it has in the past.

To that end, the strategy entered the quarter with an overweight to risk on a tactical basis as breakeven spread levels became attractive and the market ran with the narrative of a Fed pivot. While the team believes that pockets of value remain in areas like floating rate hybrids and rising star credits, adjustments were made to dial the overall risk level on the portfolio back down. The strong U.S. currency creates challenges for both foreign corporations and governments. Therefore, the strategy shed risk to non-U.S. markets. Specifically, the allocation to Additional Tier 1 (AT1) securities was significantly reduced given their exposure to the European market. Non-USD-denominated bond exposure was cut to zero with sales out of all emerging market debt. Proceeds

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PORTFOLIO MANAGEMENT TEAM

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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

from the sales were used to increase exposure to U.S. Treasuries. Furthermore, the securitized products allocation was increased via purchases of agency-guaranteed multi-family securities.

The Composite enters the fourth quarter more defensively positioned for a further tightening of financial conditions while remaining fully invested. The long dollar position has been increased and diversified across developed markets. The allocation to equities was reduced to join the REIT allocation at zero. Duration was increased via purchases on the front end of the U.S. Treasury curve where breakeven rates have become attractive. The Fed is currently in the driver's seat, and it has put market participants on notice that "some pain" might be required to bring inflation down. The strategy stands ready to change course when that pain point has been reached.

MARKET REVIEW

The Fed continued with its aggressive tightening cycle by increasing the Fed Funds target rate by another 75 basis points (bps) at its September meeting. This brings the lower band of the target to 3%, after beginning the year at zero, making it the fastest pace of rate hikes since the 1980s. Additionally, the Central Bank continues to shrink its bloated balance sheet by nearly $100 billion per month. These actions were necessitated by the fact that U.S. inflation remains stubbornly sticky as measured by the unexpectedly high August year-over-year Consumer Price Index (YoY CPI) reading of 8.3%. Across the Atlantic, Germany and the United Kingdom experienced August YoY CPI readings of 10.0% and 9.9%, respectively.

Unsurprisingly, the government bond markets did not take these events lightly. 10-year U.S. Treasury yields increased by 84 bps during the quarter, ending at a 3.83% yield to maturity (YTM). 10-year German bunds, which began the year with negative yields, increased by 74 bps during the quarter to end with a 2.07% YTM. Meanwhile, as the UK made plans to cut taxes and spend approximately 5% of GDP to subsidize this winter's heating bills, 10-year Gilt yields exploded by 186 bps to the upside, ending the quarter at 4.09%. Europe's more dire circumstances relative to the U.S. provided the spark for the counter-cyclical U.S. Dollar Index (DXY) to increase an astounding 7.1% for the quarter. After trying to rally earlier in the quarter, the government funding issues and stronger U.S. dollar proved too much for equity markets to handle as the S&P 500® ultimately finished down 4.89% for the quarter. With risk-free interest rates increasing at a quickened pace, it was somewhat surprising that growth stocks outperformed value stocks on a relative basis.

As we enter the final quarter of the year, Chairman Powell and the Fed seem determined to follow the Paul Volcker model rather than the Arthur Burns model on fighting inflation. This, along with U.S. companies' earnings being negatively impacted by a strong dollar, could make for a challenging 3Q earnings season and a continued bear market for stocks.

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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.

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The Strategic Income Composite (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 S&P 500® Index 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 Index 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.

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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