THIRD QUARTER 2022

Short Term Bond Commentary

September 30, 2022

MARKET REVIEW

The Federal Reserve (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 to be 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 Jerome 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.

SHORT TERM BOND PORTFOLIO REVIEW

The Red Cedar Short Term Bond Composite (Composite) successfully navigated near record levels of interest rate volatility to outperform its benchmark, the Bloomberg 1-3 Year U.S. Government/Credit Index, by 37 bps for the quarter. This brings total year-to-date outperformance to 50 bps amidst the worst bond market rout on record.

Relative outperformance was led by the portfolio's strategic allocation to commercial mortgage-backed securities (CMBS). Specifically, agency guaranteed securities backed by multi-family collateral prepaid rapidly and returned 100% of par despite deeply discounted prices given the broad interest rate sell-off.

Relative underperformance was led by the allocation to residential mortgage-backed securities. Despite the Composite's defensive posture in short weighted average life securities, even those bonds weren't immune from cashflow extension given mortgage rate increases and reduced housing turnover.

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.

The period was a tale of two halves overall. The Fed pivot narrative gained traction early in the quarter. The corporate bond overweight contributed positively to results during that time. However, as the hope of a pause in the rate hike cycle lost traction, risk assets began to underperform. At that time, the underweight allocation to U.S. Treasuries became a drag on relative performance.

STRATEGY INFORMATION

Benchmark	Bloomberg 1-3 Yr U.S. Gov/Credit
Business Minimum	$15M
Number of Holdings	73
Assets	$71M

PORTFOLIO MANAGEMENT TEAM

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

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

Patricia S. Younker
Senior Portfolio Manager
Industry start date: 1987
Joined Red Cedar: 2018

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

INVESTMENT PHILOSOPHY

"We seek income producing opportunities while preserving capital by focusing on securities that have demonstrated superior risk-adjusted returns over time."
—Jason Schwartz

continued on page 2

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SHORT TERM BOND POSITIONING AND OUTLOOK

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.

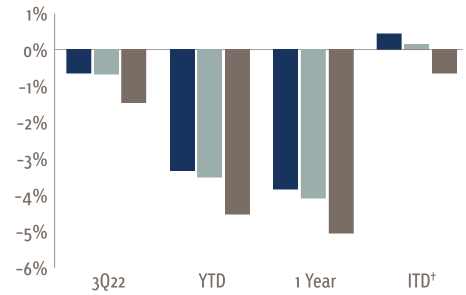
To that end, the Composite became more defensively positioned during the period. Single-asset, single-borrower CMBS exposure was reduced as the team expects soaring interest rates to weigh on the sector.

Exposure to subordinate multi-family securities issued by Freddie Mac was reduced. The investment team believes that multi-family collateral will continue to perform well, however, a better entry point in the sector lies ahead.

Proceeds from the sales were used to increase liquidity and overall credit quality. The cash position in the portfolio was increased while the U.S. Treasury allocation remains at the upper end of the historical Composite range.

Purchases in mortgage securities were concentrated in short weight, average life bonds to limit extension risk. The duration underweight was marginally reduced when the 2-year U.S. Treasury rate went below 3% and then subsequently increased when those same rates crossed the 4% threshold. The team will continue to increase duration as short rates are expected to increase further and converge on the Fed's terminal rate projection in the mid-4% area.

PERFORMANCE



	Composite Gross	Composite Net	Index*
3Q22	-0.67	-0.70	-1.48
YTD	-3.35	-3.53	-4.54
1 year	-3.86	-4.11	-5.07
ITD†	0.43	0.14	-0.67

†Inception Date 1/1/2020
Periods greater than 12 months are annualized
*Bloomberg 1-3 Yr U.S. Gov/Credit Index
Source: Bloomberg, Clearwater Analytics

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.

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.

The Short Term Bond Composite includes all fully discretionary institutional portfolios that invest in Treasury and agency bonds, U.S. dollar denominated investment grade corporate bonds, municipal bonds, asset-backed securities, agency and non-agency mortgage-backed securities and collateralized mortgage obligations. The strategy also invests in derivatives such as Treasury futures and CDX for hedging purposes. The weighted average portfolio effective duration range will be 80% - 120% of the benchmark effective duration during normal market conditions. The Composite was created January 1, 2020. The inception date of the Composite was January 1, 2020. Prior to November 1, 2021, the name of the Composite was RCIM Short Term Bond Composite.

The benchmark is the Bloomberg 1-3 Year U.S. Government/Credit Index. Bloomberg 1-3 Year U.S. Government/Credit Index measures Treasuries, government-related issues, and corporates with maturity between 1-3 years.

Benchmark Definitions: The S&P Goldman Sachs Commodity Index serves as a benchmark for investment in the commodity markets and as a measure of commodity performance over time. The Consumer Price Index (CPI) measures the monthly change in prices paid by U.S. consumers. The Bureau of Labor Statistics (BLS) calculates the CPI as a weighted average of prices for a basket of goods and services representative of aggregate U.S. consumer spending. The U.S. Dollar Index is used to measure the value of the dollar against a basket of six foreign currencies.

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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