FIRST QUARTER 2023

Strategic Income Commentary

March 31, 2023

STRATEGIC INCOME PORTFOLIO REVIEW

The Red Cedar Strategic Income Composite (Composite) underperformed its benchmark by 322 basis points (bps), net of fees, in what was a turbulent period of historic proportions in the bond market. The first quarter of 2023 produced both the largest three-day drop in the 2-year Treasury yield since 1987 and the failure of two of the three largest banks in United States history. These events have created extremely attractive valuations for which the strategy is well positioned to take advantage. The details follow below.

Relative underperformance was led by the portfolio's position in preferred securities. As a broad asset class, preferreds underperformed during the first quarter due to stress in the banking system brought about by the collapse of four banks: Silvergate, Silicon Valley, Signature, and Credit Suisse. Security selection was favorable as the Composite did not own any of the failed banks, however, the overweight allocation was negative as much of the asset class sold off in sympathy. The strategy enhanced returns by purchasing the securities of sound banks at steep discounts in the aftermath of the failures. Those securities partially rebounded prior to the end of the period.

Performance was also negatively impacted by the duration underweight relative to the benchmark. The strategy was positioned for the Federal Reserve (Fed) to remain active in their rate hiking campaign to tame inflation. However, the market panic caused the opposite to happen with multiple rate cuts now priced into the front end of the yield curve. Therefore, both the shift and twist effects were detractors.

Securitized products drove relative outperformance primarily through security selection. Within commercial mortgage-backed securities (CMBS), the strategy benefited from an overweight to multi-family securities while mostly avoiding office exposure and the headwinds developing in that market. In residential mortgages, a core underweight to fixed rate agency bonds helped to sidestep the spread widening brought on by fears of distressed bank sales in need of additional capital.

PERFORMANCE

ANNUAL PERFORMANCE (%)	2022	2021	2020†
Composite Gross	-7.58	6.22	14.75
Composite Net	-7.90	5.85	14.46
Index*	-13.01	-1.54	4.23

	Composite Gross (%)	Composite Net (%)	Index* (%)	Outperformance** (%)
1Q23	-0.17	-0.26	2.96	-3.22
YTD	-0.17	-0.26	2.96	-3.22
1 Year	-4.46	-4.80	-4.78	-0.02
3 Year	3.99	3.63	-2.77	6.40
ITD†	3.99	3.63	-2.77	6.40

*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

The portfolio is strategically positioned to benefit from the current market chaos and indiscriminate selling in preferred securities. As the calendar flips to Q2 2023, valuations have literally never looked better from both a carry and capital appreciation standpoint. Preferred spreads are at or near the 99th percentile based on 10 years of historical data. This is typically a carry asset class where returns are often driven by outsized interest payments. The instruments

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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

that RCIM invests in are callable, at par, at the issuer's option. This means that capital appreciation is often limited. After the recent sell-off, however, the broad asset class is trading at deep discounts to par with some dollar prices into the 70s. Therefore, rather than being negatively convex, the asset class is in the best convexity position of the last 10 years and represents meaningful upside potential. While the team is bullish regarding valuations, we are cognizant that technicals and trust in the space are currently negative given the recent defaults. From a fundamental standpoint, we believe that banks are in a much better place than just a month ago with the successful resolution of a Global Systemically Important Bank (G-SIB) in Europe (Credit Suisse) and major policy tools in place in the U.S. to address liquidity and bank runs.

RCIM acted swiftly when prices were distressed to increase exposure to preferred securities near the max of 50% from 39% prior to the first bank failure. Furthermore, the AT1 exposure was substantially increased to 13% from 6%. The funds were sourced from a rotation out of short investment grade corporates and mortgage-backed securities.

The interest rate cuts priced into the market as a result of recent events appear extreme. Risk/reward is skewed toward higher interest rates in the near term given the level of positioning and sentiment. Therefore, the duration was reduced to 3.78 years versus a benchmark duration of 6.24 years with a meaningful underweight to the front end of the yield curve. We believe that the intermediate to long-term outlook is less clear and are prepared to increase duration methodically as rates rise.

A modest equity position of 2.85% remains with a focus on oil and commodity plays as inflation hedges. Furthermore, the long volatility position remains in place as further financial stability concerns cannot be ruled out. With the S&P 500® plumbing the upper end of recent trading ranges, we expect that further stress in the system would not be so compartmentalized, resulting in a benefit to the hedged position.

A significant portion of the Composite's 28% in securitized products exposure comes from CMBS at 17%. This exposure is concentrated in multi-family securities with minimal exposure to other property types. As discussed in our Q4 2022 commentary, the strategy took steps to reduce subordinate credit exposure to single-asset properties with floating rate coupons prior to recent market turmoil.[1] The Composite continues to avoid the more troubled areas of the commercial real estate market, namely the office sector, at current valuations. The team expects reduced demand for office space due to work from home will combine with a contraction in lending as regional banks tighten standards and create further headwinds in that market. The small exposure to office was further reduced via sales earlier in 2023.

The cash position remains at the upper end of the historical range at just under 5%. This provides dry powder for opportunities that arise while current money market yields reduce the opportunity cost of holding extra liquidity.

MARKET REVIEW

It appeared the markets would continue to ask the same question during the first quarter of 2023 that it had been asking for several months: Can the Fed get inflation under control without causing the economy to fall into a deep recession? Some market participants felt the Fed could avoid any recession at all and find the perfect balance to ease inflation with minimal impact to employment and economic growth. As market yields declined during January, equity markets rallied from their December retreat and then began to favor growth stocks over value.

The debate over soft versus hard landings took a backseat in March with the collapse of Silicon Valley Bank due to a run of uninsured depositors. The contagion spread to other banks with similar characteristics and forced the government to respond with depositor guarantees and FDIC intervention. The concerns spread to Europe as Credit Suisse financials were called into question, ultimately resulting in an arranged takeover by UBS. These events had a significant impact on the banking sector's equity, fixed income, and preferred securities, negatively impacting prices. The broader markets remained surprisingly resilient with the Russell 1000® Index returning +7.45% for the quarter. Digging deeper, the Russell 1000 Growth Index returned +14.36% and the Russell 1000 Value Index +0.99%. Reflective of the turmoil in the banking industry, the Russell 1000 bank subsector returned -12.35% for the quarter.

Once the banking sector experienced some sense of stability near the close of the quarter, focus returned to inflation, the economy, and how aggressive the Fed could be in light of new banking revelations. The Fed did continue to tighten policy, ending the quarter with a total of two 25-bps increases in the Federal Funds target rate. Expectations that banks would tighten lending standards to protect balance sheets and liquidity added to concerns that the economy may be more at risk than initially thought. The 10-Year U.S. Treasury ended the quarter approximately 41 bps lower than the end of 2022 with a 3.47% yield. The rally in yields led the Bloomberg U.S. Aggregate Bond Index to return +2.96% for the first quarter. This was the second quarter in a row of positive performance for the benchmark.

The first quarter of 2023 only added to the questions surrounding inflation and the broader economy. Employment remains stronger than anticipated, frustrating economic bears and the Fed as they try to tamp down inflation. The banking system challenges could also create a headwind for lending and economic growth. While the worst may be over for banks, the outlook for growth in the near term is probably limited due to the increased likelihood of further regulation and self-imposed balance sheet building. Equities remain resilient but likely have limited significant upside as valuations are stretched and fundamentals will probably not help in the near future. The fixed income markets have repriced over the past 18 months to a point where risk has become more symmetrical, and volatility will create challenges along with opportunities.

[1] The CMBS property types sold in November 2022 were subordinate positions in both a data center and multi-family property. Office exposure was already low and not impacted.

DISCLOSURES

Red Cedar Investment Management, LLC (RCIM) is an investment adviser registered under the Investment Advisers Act of 1940, founded in 2013. Registration as an investment adviser does not imply any level of skill or training. The oral and written communications of an adviser provide you with information about which you determine to hire or retain an adviser. For more information please visit: www.adviserinfo.sec.gov and search for our firm name. Neither the information nor any opinion expressed herein should be construed as personalized investment, tax, or legal advice, or a recommendation of any particular security or strategy.

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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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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 Russell 1000 is a stock market index that tracks the highest-ranking 1,000 stocks in the Russell 3000® Index, which represent about 90% of the total market capitalization of that index.
- The Russell 1000 Growth measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.
- The Standard & Poor's 500 Index (S&P 500 Index) is a market capitalization-weighted index of the 500 largest U.S. publicly traded companies.

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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