FOURTH QUARTER 2023

Strategic Income Commentary

December 31, 2023

MARKET REVIEW

During the fourth quarter of 2023, investors completely changed their view on the direction of U.S. interest rates, causing both stock and bond prices to rally into year end. The Federal Reserve's (Fed) decision on November 1 to leave the targeted Fed funds rate unchanged for the second consecutive meeting convinced investors that rate cuts were imminent. This was despite Federal Open Market Committee (FOMC) Chairman Jerome Powell's insistence that the Fed still had work to do on inflation and would remain vigilant. Investors would have none of it, however, as the S&P 500® Index returned +11.7% for the quarter and +26.3% for the year. Domestic investment grade bonds, which had spent much of the year flirting with their third consecutive year of negative returns, managed to return an impressive +6.8% for the quarter, bringing the total return for the year to +5.5% as represented by the Bloomberg U.S. Aggregate Bond Index.

In contrast to the first three quarters of the year, the rally in stocks was broad-based with the small cap Russell 2000® Index returning +14.0% for the quarter. This eclipsed the NASDAQ Composite Index, which returned +13.8% for the quarter. For the entire year, however, the NASDAQ beat all of the major stock indices with a +44.7% return while the broad S&P 500 Index returned +26.3%.

As interest rates fell globally, most fixed income markets showed impressive returns. The Bloomberg Global Aggregate Index (ex-USD) returned +9.2% for the quarter, while the Bloomberg U.S. Corporate High Yield Bond Index returned +7.2%. Commodities struggled during the quarter with the S&P Goldman Sachs Commodity Index returning -12.1% based on slow growth in Europe and China. At the December 13 Fed meeting, Powell and the FOMC delivered a "dovish hold," sending the 10-year Treasury yield tumbling an additional 32 basis points (bps) to end the year at 3.88%.

As 2024 unfolds, we are left to question whether the market has gotten ahead of itself in projecting nearly six interest rate cuts from the Fed. Both the market and the Fed should be concerned with inflation still running above the Fed's target. Additionally, the U.S. government continues to run unsustainable deficits and must bring $816 billion in new Treasury issuance to market during the first quarter. With no obvious recession looming on the horizon, the Fed does not need to cut rates. While some may question valuations in the equity markets, the Street consensus forecast for earnings growth in 2024 is a robust 11%. This should help buoy the equity market as the year progresses.

PORTFOLIO MANAGEMENT TEAM

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PORTFOLIO REVIEW

During the final quarter of 2023, the Red Cedar Strategic Income Composite (Composite) trailed its benchmark by 87 bps while ultimately outperforming for the full year by 14 bps, net of fees. Similar to the 10-year U.S. Treasury, which ended the year very close to where it began, this would say nothing of the path in between. The portfolio has a strategic allocation to preferred securities and therefore had a front row seat to the most consequential month for the preferred, hybrid, and additional tier 1 (AT1) asset class since at least 2008/2009, when two of the three largest bank failures in the history of the United States occurred. Three weeks later, the failure of Credit Suisse caused $16B of AT1 notes—or 6% of the ICE BofA Contingent Capital (COCO) Index—to be written down to zero. We held none of the affected banks at the time of failure, yet the narrative in the media was one of death to the entire AT1 asset class and security prices fell precipitously. We strongly disagreed with that thesis and increased exposure to preferred, hybrid, and AT1 securities to the max of 50% due to extremely attractive valuations.

Relative performance during the fourth quarter was driven by maintaining the maximum allocation to preferreds through the remainder of the year. Excess return to the portfolio from the asset class was 293 bps for the quarter with the majority of that coming from the recovery in bank AT1s and U.S. regional bank preferred securities. Of utmost importance was security selection within those asset classes as high conviction positions in deeply discounted, low

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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coupon securities continued to pay off as spreads normalized and call probabilities increased.

Relative underperformance was driven by the sharp decrease in interest rates that was jumpstarted by the U.S. Treasury's announcement on November 1 that 10- and 30-year issuance would increase by less than Wall Street estimates. When quarterly refunding announcements enter the domain of mainstream media, this is a sign that the market is clearly on edge about the national debt and deficit. The Treasury announcement came on the same day that the Fed hinted interest rate increases were likely over and caused a massive short-covering rally in bond prices. After touching a post Global Financial Crisis high of 5% on the 10-year Treasury, yields plummeted to end the quarter at 3.88%.

The equity book experienced mixed results during the period. Specifically, the strategy had sizable exposure to the energy sector, which underperformed due to the falling price of oil. Helping to offset the equity drag were materials and REITs with the latter benefiting from falling interest rates. Volatility trading also added to the Composite's performance where the multi-dimensional nature of the trade played a key role in return. Despite the VIX Index falling from a high of 23 down to 12 during the quarter, the volatility strategy of the Composite did not detract from returns and instead added 28 bps of alpha.

The performance of securitized products detracted from overall results, primarily due to the underweight in agency mortgage-backed securities. Despite the recent additions to the sector, the strategy remains underweight due to the plethora of opportunities available in the preferred market. As a result, the allocation effect was a drag with low coupons within the benchmark outperforming where the strategy was underweight.

PERFORMANCE

ANNUAL PERFORMANCE (%)	2023	2022	2021	2020†
Composite Gross	6.04	-7.58	6.22	14.75
Composite Net	5.67	-7.90	5.86	14.46
Index*	5.53	-13.01	-1.54	4.23

	4Q23	YTD	1 Year	3 Year	ITD†
Composite Gross (%)	6.04	6.04	6.04	1.35	4.85
Composite Net (%)	5.95	5.67	5.67	1.00	4.49
Index* (%)	6.82	5.53	5.53	-3.31	-1.58
Outperformance (%)**	**-0.87**	**0.14**	**0.14**	**4.31**	**6.07**

*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 market consensus has priced a rosy scenario of falling inflation, resilient growth, and Fed rate cuts. Our investment team is more than skeptical of that trifecta, but nothing is impossible, especially in a re-election year. The strategy is positioned for the yield curve to steepen, which could be in response to the Fed following through on rate cuts, or more likely, the long end of the yield curve misbehaving. This would likely be the result of some combination of inflation reaccelerating in response to easing financial conditions, heavy U.S. Treasury issuance required to finance the deficit, or the change to a more yield-sensitive buyer base of long Treasury bonds just to name a few. The portfolio duration is currently 3.58 years with long exposure heavily concentrated at the front and middle of the yield curve. The portfolio is outright short exposure to 10- and 30-year maturities.

The Composite maintains a maximum allocation of 50% to hybrid securities with a focus on AT1s and U.S. regional banks. The team continues to believe that AT1s are more likely than not to be redeemed at first call. With an average dollar price on the AT1s in the portfolio at $87, this represents material upside from already elevated base case yields. Regional banks have yet to recover their value following the March selloff and remain attractive as well.

The outlook for the equity market is for a wide trading range that struggles to make significant point-to-point progress at the index level over the year. Under the surface, however, wide dispersion is expected among individual names and sectors. Therefore, security selection within the equity market is where the money will be made. The team trimmed energy and repurposed the proceeds into two additional themes: AI beneficiaries and infrastructure plays. Covered call writing is a potentially attractive proposition as single-name volatility remains high relative to the index level and the team could dust off the old playbook for income generation. Finally, the volatility hedge was reduced going into year-end due to seasonality but will likely be scaled back up given the attractive entry point of index volatility.

The Composite established a long position in the Japanese yen versus a short in the euro. Upside in the yen is attractive for a few reasons. First, upside potential exists if the Bank of Japan were to abandon yield curve control and/or hike rates out of negative territory. Second, as one of the few central banks that did not hike, it is very unlikely to cut rates further. As other central banks lower rates, the yen could gain on the relative attractiveness of interest rate differentials. Finally, the yen would likely rally in a risk-off scenario and therefore contains some value as a portfolio hedge.

DISCLOSURES

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 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 Russell 2000 Index (Small Cap) measures the performance of the 2,000 smallest
- companies in the Russell 3000 Index. It is generally representative of U.S. Equity Small and Mid-Cap Performance
- The NASDAQ Composite Index is a market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.
- The Bloomberg Global Aggregate ex USD Index is a measure of Investment grade debt from 24 local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bond from developed and emerging markets issuers.
- The Bloomberg U.S. Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.
- The S&P Goldman Sachs Commodity Index is widely recognized as a leading measure of general price movements and inflation in the world economy. It provides investors with a reliable and publicly available benchmark for investment performance in the commodity markets.
- The ICE BofA Contingent Capital (COCO) index tracks investment grade and high yield contingent capital issued in major domestic and Eurobond markets.
- The VIX Index is a financial benchmark designed to be an up-to-the-minute market estimate of the expected volatility of the S&P 500 Index and is calculated by using the midpoint of real-time S&P 500 Index (SPX) option bid/ask quotes.

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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RCIM-2023-12