RED CEDAR INVESTMENT MANAGEMENT

FOURTH QUARTER 2020

Strategic Income Commentary

December 31, 2020

MARKET REVIEW

Despite a global pandemic and a horrible start to the year, the capital markets managed to shrug off a deep recession caused by a shutdown of the economy to turn in an impressive performance for the year. Indeed, most every asset class apart from commodities and oil ended the year with positive returns.

Equity markets led the charge with an impressive rebound off the lows seen on March 23. At that point, the S&P 500® Index was down 30.3% year to date. Thanks to massive amounts of monetary stimulus—the Fed took interest rates to zero and re-started an aggressive quantitative easing program—and generous fiscal support, the S&P 500 rebounded to finish the year up 18.4%. The technology heavy NASDAQ led the parade, finishing the year up 45.1%. The stimulus was not just limited to the United States as many countries joined the fray by providing monetary and fiscal support. This allowed the MSCI Emerging Market Index to return 18.5% for the year, while its EAFE Index struggled to produce an 8.4% return for the year.*

Most of the major fixed income indices performed well as investment grade bonds both domestically and globally had positive returns for the year. Even the Bloomberg Barclays High Yield Bond Index finished the year up 7.1%, despite the default rate climbing significantly during the year. According to CreditSights, the trailing 12-month issuer-weighted high yield default rate moved from a rather pedestrian 3.11% as of 12/31/19 to 7.3% as of 11/30/20.

During the fourth quarter, some interesting pro-cyclical rotations were beginning to take shape in asset allocation that may be setting the stage for new leadership in 2021. Small cap stocks had an impressive 31.4% return during the final quarter of the year to lead stocks. Many of these smaller companies are levered to an economic reopening and they typically perform well in the early stages of economic recovery. Although bonds had a great year, by the fourth quarter the rally seemed to be running out of steam with the Bloomberg Barclays Aggregate Bond Index returning just 0.7% for the quarter. Even though commodities had a negative return for the year, they did return 13.0% during the fourth quarter as measured by the CRB Commodity Index. These observations of lackluster bond returns, along with stellar commodity return, could be interpreted as the market beginning to sniff out reflation and inflation caused by the massive amounts of money creation and fiscal stimulus provided by monetary authorities and governments.

PORTFOLIO REVIEW

The portfolio's allocation to preferred securities continued to be a positive contributor to relative performance during the quarter. Preferred securities benefited from the market's risk on orientation, outperforming all other fixed income sectors within the portfolio.

During the quarter, the portfolio's exposure to corporate bonds was reduced in favor of higher yielding preferred securities. While the portfolio's positions in the airline and energy sectors did well during the quarter, the overall underweight to the corporate sector was a drag on performance.

A slight drag to relative performance was our underweight to the municipal sector.

The portfolio's exposure to the securitized sector was also a drag on performance.

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PORTFOLIO MANAGEMENT TEAM

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

David L. Withrow, CFA
Director of Portfolio Management
Industry start date: 1988
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Industry start date: 2011
Joined Red Cedar: 2019

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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Throughout the period, the portfolio maintained a duration shorter than the benchmark's and underweighted the 30-year part of the yield curve. This positioning was a positive contributor to performance as interest rates increased during the quarter; the 30-year Treasury bond yield rose 19 basis points.

STRATEGY POSITION & OUTLOOK

While financial markets may experience some bumps to start the year as political discord continues and widespread distribution of COVID-19 vaccines is not as smooth as planned, we expect risk assets to ultimately continue their outperformance as reflation benefits from the efforts of monetary authorities, fiscal policy, and scientists globally.

The portfolio is overweight corporate bonds relative to the benchmark. We intend to maintain this exposure, seeking to opportunistically take advantage of market conditions by adding to exposure on market weakness and selling positions when price targets are reached.

During the quarter, we added to the portfolio's overweight position in preferred securities. We intend to maintain this exposure, seeking to opportunistically trade between $25 par securities and hybrids.

The portfolio is overweight the financial sector. We believe the companies in this sector will benefit from a steeper yield curve that results from global reflation.

We expect interest rates to increase, as such, we will maintain the duration of the portfolio shorter than the benchmark until market conditions warrant a change.

U.S. investment grade corporate bond issuance topped $1.8 trillion in 2020, breaking all records. Issuance for 2021 is expected to be around $1.4 trillion as of 12/31/20, similar to 2019 levels.

DISCLOSURES

* All end-of-year index data noted is as of 12/31/20

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Index Definitions: Bloomberg Barclays U.S. Aggregate Bond Index: Broad-based, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the U.S. S&P 500 Index: Broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. MSCI Emerging Markets Index captures large and mid-cap representation across 27 EM countries. The index covers approximately 85% of the free-float adjusted market capitalization in each country EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets outside the U.S and Canada. CRB Commodity Index is a commodity futures price index. It acts as a representative indicator of today's global commodity markets. Bloomberg Barclays High Yield Bond Index measures USD denominated, high yield, fixed rate corporate bond market. NASDAQ Composite: Market capitalization-weighted index of over 3,000 common equities listed on the NASDAQ stock exchange.

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