SECOND QUARTER 2023

Short Term Bond Commentary

June 30, 2023

2Q MARKET REVIEW

As the second quarter of 2023 wrapped up, investors found themselves on an uncertain but not entirely unfamiliar terrain. The S&P 500® returned a robust 8.7%, lending a sense of relative stability to a quarter tinged with volatility. Yet, this outcome stands in sharp contrast to the less cheerful performances of the Bloomberg U.S. Aggregate Bond Index, the Goldman Sachs Commodity Index, and the KBW Bank Index, which recorded declines of -0.8%, -5.8%, and -1.2%, respectively. This uneven picture is reminiscent of a complex mosaic—each element crucial, yet the overarching theme not easily discernible.

The equity markets and fixed income markets seemed to shrug off the prior quarter's troubles in the banking sector as stocks continued their upward trajectory while bond yields increased to levels seen prior to the bank failures. This would indicate that the markets are comfortable with the notion that the bank problems are behind us, and the U.S. economy will continue growing despite higher interest rates and a hawkish Federal Reserve (Fed). For its part, the Fed did not increase rates at its June 14 meeting, instead opting for a hawkish "skip." While all measures of inflation remain uncomfortably high, the headline Consumer Price Index reading for May came in at +4% year over year (YoY) non-seasonally adjusted—a level not seen since the middle of 2021. Other measures of inflation such as the Core Personal Consumption Expenditure Index (+4.6% YoY, seasonally adjusted, in May) seem to indicate a stickiness to services inflation that the Fed will continue to fight against.

Heading into the second half of 2023, we believe the Fed is close to the end of its rate hike cycle. The question remains whether it can engineer a soft landing of the economy or not. Given the Fed's poor track record in that regard, we remain cautious on equities. Additionally, the asset class looks rich from a valuation perspective, ending the quarter at a 20x P/E multiple for the S&P 500. Equity analysts are also forecasting a third consecutive quarter of negative earnings growth for that index. Finally, the most recent stock market rally has been driven by just seven stocks: Amazon, Apple, Alphabet, Meta, Microsoft, Nvidia, and Tesla. In the fixed income markets, we will look to put cash to work in order to lock in longer-term attractive yields. As valuations or economic conditions change, we will look to purchase equities at more attractive levels.

SHORT TERM BOND PORTFOLIO REVIEW

The Red Cedar Short Term Bond Composite (Composite) outperformed its benchmark, the Bloomberg 1-3 Year U.S. Government/Credit Index, by 45 basis points (bps) for the quarter on a gross-of-fee basis (37 bps, net of fees).

Relative outperformance was primarily driven by the Composite's allocation to commercial mortgage-backed securities (CMBS). Within the CMBS sector, agency-backed bonds stood out, as their discount pricing continued to benefit from prepayments. The Composite's exposure to high-quality non-agency CMBS also contributed positively to the overall relative return for the quarter.

Additionally, the Composite's overweight position in bank credit played a role in driving outperformance. The banking sector turmoil that dominated earlier in the year stabilized in the second quarter, and the sector demonstrated positive returns. The Composite benefited from an overweight to the sector, as well as from the team's strategic security selection.

Asset-backed securities (ABS) also contributed positively to overall relative performance for the quarter as fundamentals remained strong. The Composite held high-quality positions in prime auto ABS and equipment ABS, which experienced modest spread tightening throughout the quarter.

Relative underperformance was due to exposure to single-asset, single-borrower (SASB) CMBS. The sector experienced spread widening due to concerns within the office space. The Composite maintains minimal exposure to office SASB, however, it does hold a single bond that extended at maturity, which detracted from performance.

Cash was also a contributor to underperformance. Spreads tightened across the benchmark and any cash position held during the quarter was a drag on performance.

STRATEGY INFORMATION

Benchmark	Bloomberg 1-3 Yr U.S. Gov/Credit
Business Minimum	$10M
Number of Holdings	83
Assets	$67.6M

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

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SHORT TERM BOND POSITIONING & OUTLOOK

Economic data maintained a positive tone throughout the quarter, and the Fed paused its rate hiking cycle. Going into the second half of the year, the market is pricing in two additional rate hikes from the Fed. Treasury yields grinded higher across the curve, though the curve remains extremely inverted. In the securitized space, the team expects continued relative value opportunities in the agency CMBS and high-quality ABS sectors.

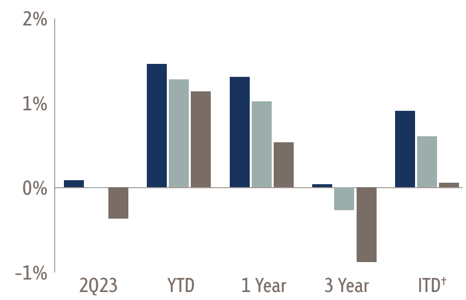
During the period, Composite exposure to non-agency CMBS was reduced, specifically holdings of the last cash flow tranche. Office space is a weak point in the sector as vacancies increase and borrowers struggle to refinance at maturity due to higher interest rates. This uncertainty surrounding conduit borrowers' ability to refinance in a timely manner prompted the team to reduce exposure in the conduit space where extensions are more likely. However, the team believes there are relative value opportunities higher in the capital stack in other tranches within this sector.

Exposure to agency CMBS was increased during the period. The team believes that there continues to be good relative value in this space as discount-priced bonds continue to prepay and receive principal back at par. The multi-family market remains resilient in the current economic environment and the team expects this trend to continue.

The Composite added a long position in 2-year Treasury inflation-protected securities (TIPS) when inflation break-evens dropped down to 2%. The investment team maintains the view that inflation will remain elevated over the next two years and the break-even level should go higher.

As uncertainty lingers regarding the Fed's actions in the second half of the year, the Composite currently maintains a neutral duration. However, the team anticipates increasing the duration to an overweight position as short rates begin to reach their peak.

PERFORMANCE



	Composite Gross	Composite Net	Index*
2Q23	0.08%	-0.01%	-0.37%
YTD	1.45%	1.27%	1.13%
1 year	1.30%	1.01%	0.53%
3 year	0.03%	-0.27%	-0.88%
ITD†	0.90%	0.60%	0.05%

†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.

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

Index Definitions: The Bloomberg U.S. Aggregate Bond 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. The Goldman Sachs Commodity Index serves as a benchmark for investment in the commodity markets and as a measure of commodity performance over time. The KBW Bank Index is a modified cap-weighted index consisting of 24 exchange-listed National Market System stocks, representing national money center banks and leading regional institutions. 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.

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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