THIRD QUARTER 2023

Short Term Bond Commentary

September 30, 2023

3Q MARKET REVIEW

During the third quarter of 2023, U.S. Treasury investors were beginning to wake up to the sobering reality that the Federal Reserve (Fed) just might hold short-term interest rates higher than previously anticipated. From a bigger picture perspective, it can no longer be ignored that the United States fiscal profligacy is unsustainable, and investors are demanding higher yields to hold U.S. Treasuries. Running 7% budget deficits in times of peace and full employment will only add to the already bloated 113% debt-to-GDP ratio. In August, Fitch Credit Ratings downgraded U.S. Government debt from AAA to AA+. It cited the lack of political will to deal with these deficits in any meaningful way along with the political dysfunction in Washington. These issues, along with a Fed still fighting inflation, were instrumental in 10-year Treasury yields rising from 3.84% to 4.57% during the quarter. The Bloomberg U.S. Aggregate Bond Index returned -3.2% for the quarter, bringing its year-to-date (YTD) return to -1.2%. Despite these less-than-ideal fundamentals and lackluster returns, fixed income has become an interesting asset class once again. As the quarter ended, real yields across the maturity spectrum—as measured by Treasury inflation-protected securities (TIPs)—are now all above 2%. These levels have not been seen across the curve since prior to the Global Financial Crisis.

The equity market turned in negative returns for the quarter as the Fed's higher-for-longer messaging was cause for concern. The S&P 500® Index returned -3.3% for 3Q but is still up YTD at 13.1%. The more interest-rate-sensitive small cap Russell 2000® Index was the laggard and returned -5.1% for the quarter and is up just 2.5% YTD. Commodities were a bright spot for investors as the S&P Goldman Sachs Commodity Index returned 12.8% for the quarter, primarily on the strength of the crude oil market.

Heading into the final quarter of the year, investors will be looking for evidence that the long-awaited corporate earnings growth will reassert itself during 4Q. Investors will also want to know if the rate of inflation will continue to moderate or whether it will be sticky as some suspect. A strong U.S. economy with moderation of inflation and a return to corporate earnings growth would go a long way to offset some of the fiscal challenges and slowing global growth picture.

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	85
Assets	$67.75M

PORTFOLIO MANAGEMENT TEAM

Jason M. Schwartz, CFA
Director of Portfolio Management
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
Co-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

Communication from the Fed during the quarter signaled its intention to maintain elevated interest rates for longer than previously priced into the market. Following a 25-bps rate hike in July, the Federal Open Market Committee (FOMC) held rates unchanged in September but conveyed a prolonged period of higher rates through a 2024 dot plot projection that exceeded previous expectations by 50 bps. This narrative of "higher for longer," along with the idea that the neutral Fed Funds rate may be higher than previously expected, led to an increase in rates over the quarter. Long rates rose by more than short rates, resulting in a steeper yield curve. In September, the core Consumer Price Index (CPI) exhibited a slowdown, while headline inflation increased during the quarter due to elevated oil prices. The U.S. economy continues to display resilience despite elevated inflation.

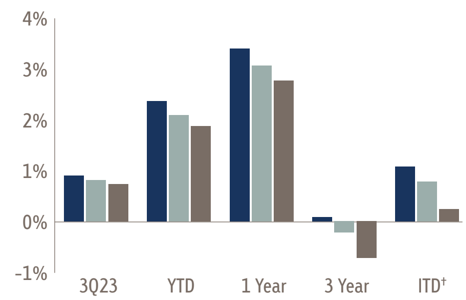
During the period, Composite exposure to non-agency CMBS was reduced, specifically holdings of the last cash flow tranche. Office space is a weak point in the sector as vacancies increase and borrowers struggle to refinance at maturity due to higher interest rates. This uncertainty surrounding conduit 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 than 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 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*
3Q23	0.90%	0.81%	0.73%
YTD	2.36%	2.09%	1.87%
1 year	3.39%	3.06%	2.77%
3 year	0.08%	-0.22%	-0.72%
ITD†	1.08%	0.78%	0.24%

†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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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 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 S&P GSCI 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 Russell 2000 (Small Cap) measures the performance of the 2,000 smallest companies in the Russell 3000 Index. It is generally representative of US Equity Small and Mid-Cap Performance. 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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RED CEDAR
INVESTMENT MANAGEMENT

333 Bridge St. NW, Suite 601, Grand Rapids, Michigan 49504
www.redcedarim.com (513) 345-4414