Portfolio Commentary

Navigator® Global Tactical

Portfolio Manager

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Senior Portfolio Manager

Top Contributors as of December 31, 2022

Company Name	Avg. Weight (%)	Contribution to Return (%)
iShares Core MSCI Total International Stock ETF	14.74	2.00
Vanguard FTSE All-World ex-US Small-Cap ETF	6.53	0.72
SPDR Portfolio S&P 500 ETF	33.58	0.54

Top Detractors as of December 31, 2022

Company Name	Avg. Weight (%)	Contribution to Return (%)
iShares Core S&P Small Cap ETF	14.56	-0.13
PIMCO Enhanced Short Maturity Active ETF	3.78	-0.02
JPMorgan Ultra-Short Income ETF	3.80	0.01

Source: Factset. For illustrative purposes only. Past performance does not guarantee future results. The holdings identified do not represent all of the securities purchased, sold or recommended for advisory clients. In the chart above, "weight" is the average percentage weight of the holding during the period, and "contribution" is the contribution to overall performance during the period. To obtain the calculation methodology and a list showing every holding's contribution to the overall composite during the period, contact: PortfolioAnalytics@ccmg.com.

Dramatic Readjustment in Fixed Income Makes It Again Compelling Versus Equities

Market Review

Markets enjoyed solid gains during the fourth quarter, but the defensive tone of the recovery was hard to ignore. At the end of September, equity markets were down over 23% on the year, and both Treasuries and high yield bonds were down over 15%. Multi-year lows in investor sentiment had been reached, providing reasons for optimism.

After initially struggling and making new lows, interest rates began to decline, providing some welcome relief for stocks. However, the friendly rate environment did not last as the Fed hiked rates again in December. The stock rally cooled, but the S&P 500 was still up 7.6% on the quarter. Participation was broad as small-caps gained 9.2% and broad international equities led the way as the dollar weakened. The sector leadership profile, however, was defensive, with Energy, Industrials, Materials, Healthcare, and Staples outperforming.

Large and mega-cap sectors such as Technology trailed, and Communications Services and Consumer Discretionary actually posted further losses. On the fixed income side, the scale of the damage for all of 2022 is hard to overstate. The Bloomberg Aggregate Bond Index was down 13.0%, its worst year on record. Through October, when rates were their highest, the JPMorgan Global Government Bond Index was down over 20% — four times its prior largest decline.

Fourth Quarter Portfolio Highlights

- The portfolio entered the quarter invested 100% in cash vehicles, but our credit-based models began to improve even before rates began to decline. Credit spreads came in sharply during October, and 10-year yields peaked on October 24th. Our risk models turned positive at the end of October, and we purchased U.S. and international equity positions. Since our purchase on October 28th, U.S. equities declined slightly through year-end, but broad international equities and international small-caps produced impressive gains.
- As 2023 begins, our risk-on position in equities is tenuous, as rising interest rates and mediocre credit markets have forced our models close to turning defensive. While we believe a short-term bounce is overdue and likely, many leading economic indicators have begun to roll over. The first half of the year is likely to be a battle between the negatives (a slowing economy and earnings) versus the positives (a bullish Fed pause or slowdown).
- When positive on equities, the portfolio contains a 70-30 mix between U.S. large-cap and small-cap stocks. The portfolio also employs a 70-30 mix between U.S. and international equities, and is effectively a 10% underweight

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of international stocks. While we could at some point increase the proportion of our international exposure, we are unlikely to do so soon given our belief of a higher likelihood of recession abroad than here in the U.S.

Positioning and Outlook

2022 confronted investors with dramatic changes and losses, and the change in relative valuations among the four market segments important to the Global Tactical portfolio was eye-opening (as seen in the table below):

Market Segment and Yield	12/31/21	12/31/22
3-Month U.S. Treasury Bill Yield	0.04%	4.2%
Broad U.S. Treasury Index Yield	1.2%	4.2%
High Yield Corporate Bond Index Yield	4.2%	9.0%
S&P 500 Earnings Yield	4.2%	4.7%

Source: Ned Davis Research, Bloomberg

The Fed's 4.25% interest rate increases in 2022 delivered a huge shock to fixed income investors, but as we look into 2023, we now have an inverted yield curve and T-Bills over 4% yield with near zero interest rate risk, which strikes us as attractive, particularly if inflation has peaked – which we believe it has.

U.S. Treasury bonds also offer a 4.2% yield, which comes with the risks and opportunities that duration and interest rate sensitivity present. While we cannot deny that an inverted yield curve presents risks for Treasuries if inflation becomes resurgent, we can at least say that Treasuries offer a much more hefty yield – one that potentially will come in above inflation.

Moreover, with a much higher yield, Treasuries can resume their role as defensive vehicles when the Fed begins to cut rates if a recession occurs. At that point, we would expect the inverse correlation between Treasuries and corporate credit to kick in, as it most often does during times of stress. This could well enable Global Tactical investors to have a vehicle that could preserve and possibly grow capital during times of severe market stress.

High yield credit, while not a vehicle that the portfolio invests in, is a notable portion of our credit-based risk models. The Bloomberg Barclays High Yield Corporate Bond Index closed the year with an 8.96% yield, which means that while investors are taking on large credit risks, they are at least being paid healthily to wait. Nevertheless, we are also mindful that 2023 could well bring a recession to the U.S. – and recessions abroad are very likely. High yield bond spreads are at or below their long-term averages, and given a deteriorating macroeconomic environment, they could experience substantial spread widening sometime in 2023. Such a turn of events would likely shift our portfolio into defensive U.S. Treasuries or cash.

Overall, we can see that fixed income was sharply and painfully revalued in 2022 – but the result has been that it has become quite compelling on a relative basis. We expect to see considerable monies flow back into bonds. Stocks, while down nearly 20% on the year (with even more pain seen in growth stocks), offer an earnings yield only slightly above Treasuries. While they have the potential to grow earnings, those earnings can also decline, of course, and the macro backdrop remains quite murky.

Our projections for 2023 provide for the potential for more pain and volatility in equities, particularly in the first half of the year. While earnings expectations have declined and some economic weakness is priced into stocks, equity and credit valuations have not fully priced a recession into the picture. Even though the Global Tactical portfolio is currently risk-on and favors equities, we would not expect that to be the case throughout all of 2023. We continue to rely on our credit-based models to manage market risk, and those models are only modestly positive. We are closely watching the macroeconomic backdrop and are prepared to manage risk based on our objective, quantitative indicators.

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The Bloomberg Aggregate Bond Index or "the Agg" is a broad-based fixed-income index used by bond traders and the managers of mutual funds and exchange-traded funds (ETFs) as a benchmark to measure their relative performance.

The S&P 500 measures the performance of the 500 leading companies in leading industries of the U.S. economy, capturing 80% of U.S. equities.

A Treasury Bill (T-Bill) is a short-term U.S. government debt obligation backed by the Treasury Department with a maturity of one year or less. Treasury bills are usually sold in denominations of $1,000.

The JP Morgan Global Government Bond Index measures the performance of leading Government bond markets based on total return in US currency. By including only traded issues, the Index provides a realistic measure of market performance for international investors.

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