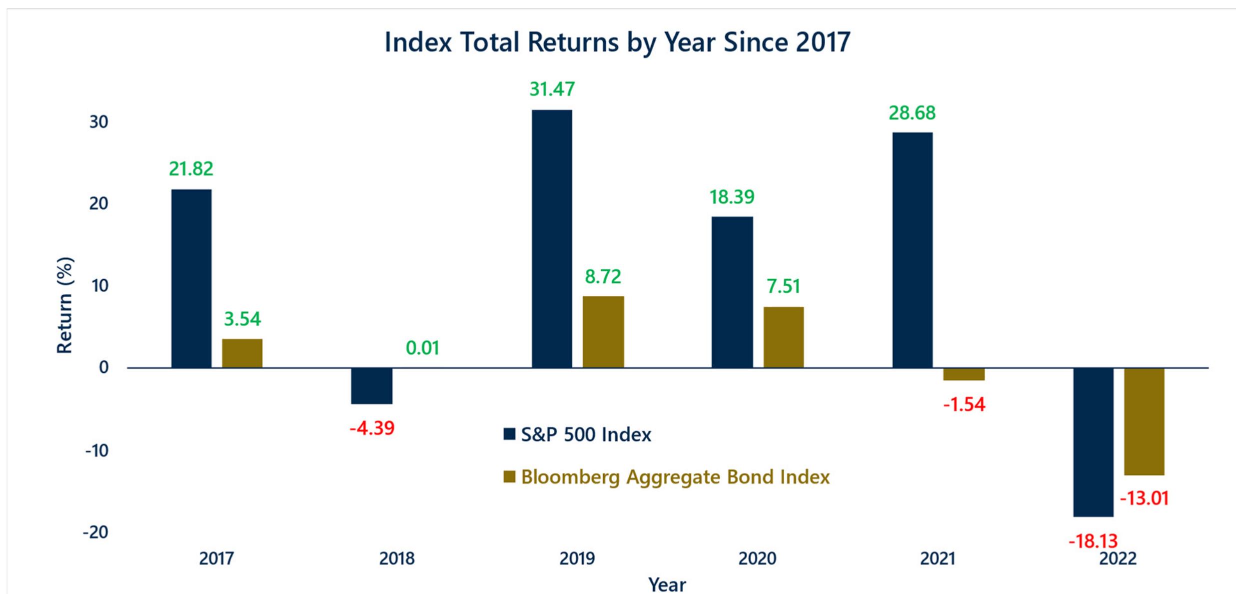
Portfolio Managers' Quarterly

2023 Outlook: Possible 2008-2009 Repeat Scenario

Dear Fellow Investor:

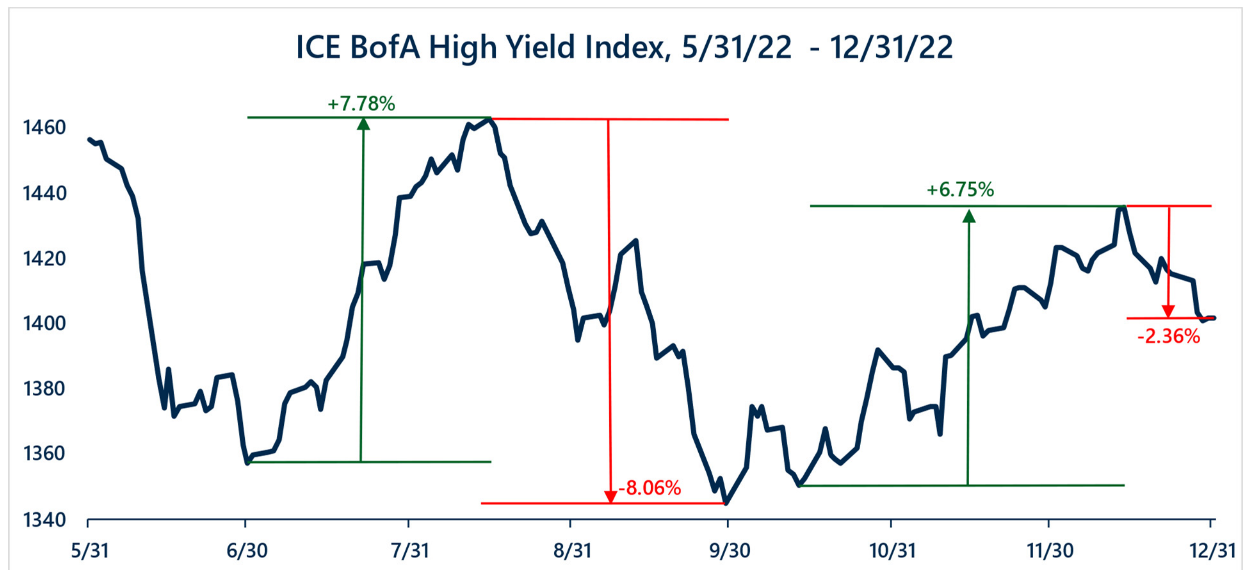
The Bond Market in 2022 once again delivered negative returns, ending the year down -13.01%, after dropping by -1.54% in 2021. As such, 2022 offered 'no place to hide, with stocks and bonds both suffering double-digit losses in the backdrop of high inflation and hawkish federal reserve policy, a paradigm which broke the trend of generally positive returns or marginal losses over the last 5 years, illustrated below. The year began with geopolitical uncertainties surrounding the war in Ukraine, which were exasperated by inflation that the Federal Reserve fell behind on containing. Inflation rates not seen since the 1970s-1980s fueled the need to hike interest rates aggressively, the fastest rate of increases seen since 1980.[1]



Source: Bloomberg. The indices shown are for informational purposes only and are not reflective of any investment. As it is not possible to invest in the indices, the data shown does not reflect or compare features of an actual investment, such as its objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return, or tax features. Past performance is no guarantee of future results.

The narrative of the rest of the year was dominated by speculation as to when the Fed would eventually make its 'dovish pivot' and move towards a less restrictive policy, albeit still needing to hold interest rates elevated for a period of time. Fed speak throughout the year by Chairman Jerome Powell introduced sporadic volatility into the markets, especially at the June FOMC meeting where his dovish tone helped fuel a 7.78% gain in the ICE BofA High Yield Index,

which was sharply followed by an 8.06% drawdown. Moreover, off only a 1-month surprise decline in the headline CPI print in October, Powell again helped propel the market by another 6.75% with his comments at the November FOMC meeting before finally retracking most of his dovish tilt in December, leading to a drawdown of 2.36% in the final weeks of the year.



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For a price driven tactical approach, these massive market swings followed by swift declines make it difficult to outperform against the broader aggregate bond market index. Our models have, however, been able to offer returns that were generally in line with the index, while modeling adjustments allowed us to participate for longer in order to accumulate yield when yields were more attractive. As our models were built with capital preservation in mind, key tactical elements have been deployed when the risk of a market crash seems probable based on initial downward trends, as in 2020.

A Look Ahead to 2023

The narrative for 2023 will likely depend on how fast and to what degree, if any, the U.S. economy contracts due to increased rate pressure from Fed policy and how quickly inflation could abate from such restrictive policy. Another big uncertainty is when the Fed will have received enough confirmation that a less restrictive policy is appropriate. The market will likely begin to discount such effects quickly, even if the time horizon for beginning the easing process is 6-12 months into the future.

During this rate cycle, the Fed has so far done the opposite as compared to 2020 by raising interest rates rapidly above 4% and communicating that they will hold rates higher for longer.

This policy, especially with the negative economic effects from inflation, may set up a similar market paradigm to the 2008-2009 period.

In the years leading up to 2008, the Fed was raising rates to similar levels seen today in an attempt to contain an overheated economy, which also came with upward price pressures. However, in the current market environment, inflation seems to be having an analogous effect on price with a relatively robust economy. In both cases, the remedy is likely higher interest rates, which may eventually be followed by a decline in rates towards a longer-run average, which could offer higher return opportunities in the high yield and stock markets.

The question, of course, is when exactly the Fed will pivot and to what extent the U.S. economy, if it does at all, will go into recession. The Fed historically has a poor track record of a 'soft-landing', which raises the probability that we will see some sort of economic decline due to their restrictive policy. No single CPI print or economic headline will bring complete clarity to the situation, however, and we believe that a price driven, tactical approach to the markets will reduce risk to capital in extreme crash periods and prolonged bear markets, while offering attractive upside potential when the Fed eventually begins its next easing cycle. Until then, we have yet to see whether the market will make a new low on the backs of recession fears or if the next bull run is one to last years into the future.

A Note on Managed Income

The current economic environment may present considerable opportunities for our Managed Income Strategy, which consists of a diversified income core along with a tactical risk management satellite. The diversified income core is further broken down into a "Risk-Off" portion, which is intended to correlate to a core bond portfolio, and a "Risk-On" portion in which we may utilize a wide variety of income-producing asset classes that are often less correlated to the aggregate bond market. This ability to explore income-producing vehicles outside the breadth of the traditionally defined aggregate bond market allows us to potentially outperform if the coming years have any resemblance to '08/'09. As an example, we highlight the following income producing ideas we consider in our modeling process that are not included in the aggregate index. We show the returns coming out of 2008 into 2011 to show potential returns. (These indices represent Emerging Market Bonds, High Yield Bonds, and Master Limited Partnerships, respectively, as compared to the Aggregate Index).

	Cumulative Return (1/1/2008 - 12/31/2011)
Bloomberg Agg Bond Index	27.26%
J.P. Morgan EMBI Global Core Index	37.63%
ICE BofA US High Yield Index	39.41%
Alerian MLP Infrastructure TR Index	72.17%

Source: Morningstar Direct. The indices shown are for informational purposes only and are not reflective of any investment. As it is not possible to invest in the indices, the data shown does not reflect or compare features of an

actual investment, such as its objectives, costs and expenses, liquidity, safety, guarantees or insurance, fluctuation of principal or return, or tax features. Past performance is no guarantee of future results.

While the potential for outperformance of these types of asset classes comes with increased risk, we attempt to balance this risk by adjusting the weights of the various components of our portfolio. One such shift would be increasing our allocation to the "Risk-Off" portion of the diversified core when our thematic analysis suggests potential turmoil in risk assets. Another risk-management lever embedded in the portfolio is our tactical risk management satellite, which will typically make up 30-40% of the portfolio. This slice of the strategy may be positioned up to 100% in treasuries or cash when our technical models indicate downward price pressures in risk assets. These features of the portfolio should allow it to look more like a core bond portfolio when bonds are in favor, and to differentiate from a core bond portfolio when risk-on opportunities arise.

A Note on Gold

With the inflation surge of the past couple of years, gold is an asset class that has risen to the top of many investors' minds and the top of many financial news outlets' headlines. With its low correlations to stocks and bonds, gold can be a great portfolio diversifier. However, when the tide turns on gold, it can turn fast and leave investors with significant losses. The table below shows returns, correlations, and drawdown statistics of gold, stocks, and bonds since the beginning of 2000, a time period representing multiple market cycles.

12/31/1999 through 12/31/2022	Annual Return	Correlation	Average Drawdown	Max Drawdown
LBMA Gold Price PM Index	8.29%	1.00	-14.73%	-44.62%
S&P 500 Index	6.28%	0.00	-16.24%	-55.25%
Bloomberg Agg Bond Index	3.97%	0.12	-3.70%	-18.41%

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While the annualized returns of gold have been excellent over that time frame, an investor looking to gold as a safe haven asset class would likely be uncomfortable with the large drawdowns experienced along the way. Thus, BTS takes a risk-managed approached to gold by tactically seeking exposure to the asset class when it is in favor and moving to the sidelines when our models indicate downward trend and momentum in gold prices.

At BTS, we remain ready to adapt to ever-changing market conditions. Thank you for the opportunity to manage your assets.

Sincerely,

Vilis Pasts

Matthew Pasts, CMT
Isaac Braley
Co-Portfolio Managers

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IMPORTANT RISK INFORMATION

Investing, including investing in mutual funds, involves risk, including possible loss of principal. There is no assurance that any strategy will achieve its investment objective. The value of fixed income securities will fluctuate with changes in interest rates. Defaults by fixed income issuers could also harm performance. Lower quality bonds known as “high yield” or “junk” bonds, present greater risk than bonds of higher quality, including an increased risk of default. An economic downturn or period of rising interest rates could adversely affect the market for these bonds and reduce the Portfolio Manager’s ability to sell its bonds. The use of leverage within a strategy will indirectly cause additional expenses and could potentially magnify the gains or losses.

[1]https://news.yahoo.com/we-have-more-work-to-do-the-complete-story-behind-the-feds-historic-shift-in-2022-114004343.html#:~:text=The%20year%202022%20will%20be,0.75%25%20at%20four%20consecutive%20meetings

The S&P 500 includes 500 leading companies in leading industries of the US economy and is a proxy for the total stock market.

Bloomberg Aggregate Bond Index - An index used by bond funds as a benchmark to measure their relative performance. The index includes government securities, mortgage-backed securities, asset-backed securities and corporate securities to simulate the universe of bonds in the market. The maturities of the bonds in the index are more than one year.

ICE BofAML US High Yield tracks the performance of US dollar-denominated below investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have a below investment grade rating (based on an average of Moody’s, S&P and Fitch), at

least 18 months to final maturity at the time of issuance, at least one-year remaining term to final maturity as of the rebalancing date, a fixed coupon schedule and a minimum amount outstanding of $100 million. Also, qualifying securities must have risk exposure to countries that are members of the FX-G10, Western Europe, or territories of the US and Western Europe. The FX-G10 includes all Euro members, the US, Japan, the UK, Canada, Australia, New Zealand, Switzerland, Norway, and Sweden.

The J.P. Morgan Emerging Markets Bond Index tracks liquid, US dollar emerging market fixed and floating-rate debt instruments issued by sovereign and quasi sovereign entities.

The Alerian MLP Infrastructure Index is a composite of energy infrastructure Master Limited Partnerships (MLPs). The capped, float-adjusted and capitalization-weighted index is disseminated real-time on a price-return basis (AMZI) and on a total-return basis (AMZIX).

LBMA is the London Bullion Market Association (LBMA), a London-based international trade association that represents the wholesale over-the-counter gold and silver market in London. The LBMA Gold Price PM is set in the London gold market at 15:00 GMT, in U.S. dollars, serving as a benchmark for pricing gold. It is widely used by producers, consumers, investors and central banks.

**Index returns are for illustrative purposes only and should not be construed as BTS model performance or performance achieved by any BTS client. More specifically, any reference to index returns during isolated or defined periods in time is for reference only and is not meant to imply index returns are indicative of actual returns achieved in client portfolios. Investors cannot invest directly in an index, and index returns do not reflect management fees, custodial fees or brokerage commissions, which vary depending upon the custodian chosen.*

Source: ***Bloomberg (for index returns)***

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PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.

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