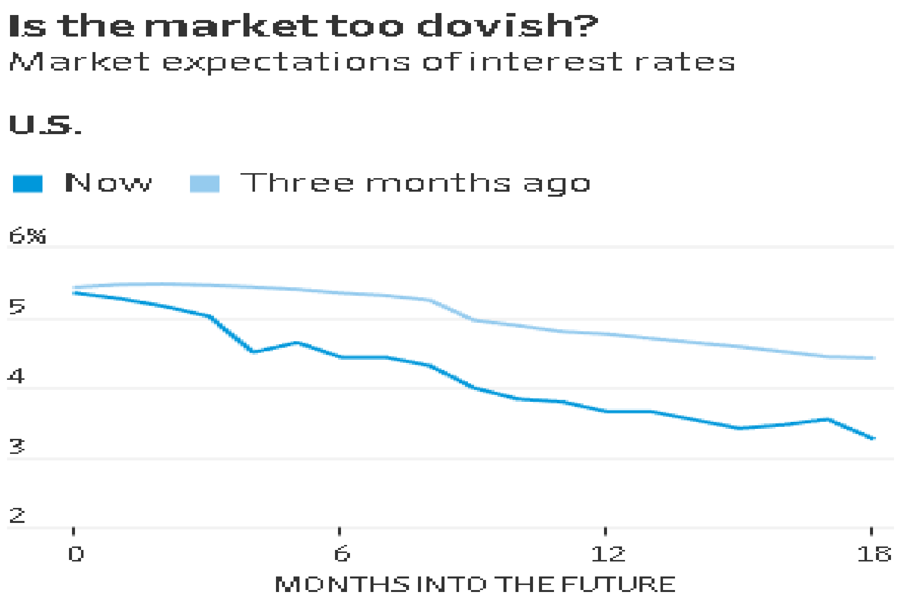
Fourth Quarter 2023 Bond Market Review and Outlook

CAM

Cincinnati Asset Management, Inc.

Investment Grade & High Yield Bond Specialists

"Monetary policy operates with long and variable lags." (Milton Freidman as quoted in *Bloomberg* 10/16/23)



Since the bond market low in mid-October 2023, a strong rally ensued. The 10-year Treasury yield fell from 4.99% to 3.79% on December 27, 2023 (source: *Bloomberg* 1/17/24). Investor's expectations of future interest rates drive the market. The chart above illustrates the decline in anticipated Fed Funds interest rate (chart from *The Wall Street Journal* attributed to Factset 1/17/24).

The trend will be bumpy as it usually is, but the consensus points toward lower yields ahead driven by perceptions of a slowing economy both here in the U.S. and abroad.

The most recent Federal Reserve Bank Senior Loan Officer Opinion Survey reports tighter lending standards and weaker demand for all loan categories (Commercial and Industrial (C&I), Commercial Real Estate (CRE), Residential Real Estate (RRE), and Home Equity Lines of Credit (HELOCs)). Also noted was tighter lending standards and weaker demand for consumer credit card, auto and other consumer loans (source: Federal Reserve October 2023 Senior Loan Officer Opinion Survey 11/6/23).

The survey also contained a special set of questions about banks' reasons for changing standards for all categories of loans. A less favorable or more uncertain economic outlook, lower risk tolerance and the deterioration in the credit quality of loans and collateral values were most frequently cited reasons.

The consumer accounts for approximately 2/3s of GDP and their spending has been trending lower, with the surprising exception of recently released data for December 2023. Retail sales in the U.S rose 0.6% in December from November. November showed a weaker 0.3% month over month increase. Some economists cite rising wages and slowing inflation as the catalysts for increased spending (source: *Wall Street Journal* 1/17/24).

The Consumer Price Index rose 3.4% in the year through December, a

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Yields* on 12/31/2023	**Yield***
CAM Broad Market (corporate core plus) Strategy (6.0 year maturity; 5.0 duration)	**5.17%**
CAM Investment Grade (100% corporate bonds) Strategy (6.4 year maturity; 5.4 duration)	**4.79%**
CAM High-Yield Strategy (only BA & B rated purchased) (5.3 year maturity; 4.0 duration)	**5.89%**
CAM Short Duration Strategy (2.9 year maturity; 2.3 duration; 50% IG & 50% HY)	**5.60%**
CAM Short Duration Investment Grade Strategy (2.4 year maturity; 2.1 duration)	**4.86%**
U.S. Treasury** (10 year maturity)	**3.88%**
U.S. Treasury** (5 year maturity)	**3.85%**
U.S. Treasury** (2 year maturity)	**4.25%**

* The lower of yield to maturity or yield to worst call date ** Source: Bloomberg

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CAM's Key Strategic Elements

- Bottom-up credit analysis determines value and risk.
- Primary objective is preservation of capital.
- Larger, more liquid issues preferred.
- Target is always intermediate maturity.
- No interest rate forecasting.
- <u>All</u> clients benefit from institutional trading platform and multi-firm competitive bids and offers.

CAM returns are after CAM's average management fee & all transaction costs but before any broker, custody or consulting fees. **The indices are unmanaged and do not take into account fees, expenses, and transaction costs.**	**Total Return (%)**	**Annualized Returns (%)**				
	4Q '23	YTD	1-YEAR	3-YEARS	5-YEARS	10-YEARS
CAM Broad Market Strategy—Net 1/3 high yield, 2/3 investment grade	7.18	8.91	8.91	-1.84	3.04	2.71
CAM High Yield "Upper Tier" Strategy—Net only purchase BB and B; no purchases of CCC & lower	7.66	11.74	11.74	0.28	4.62	2.79
Bloomberg US Corporate High Yield Index	7.16	13.44	13.44	1.98	5.37	4.60
CAM Investment Grade Strategy—Net 100% corporate bonds	6.96	7.63	7.63	-2.81	2.31	2.65
Bloomberg US Corporate Index	8.51	8.52	8.52	-3.28	2.63	2.95
CAM Short Duration Strategy—Net 1/2 investment grade, 1/2 high yield	4.26	7.29	7.29	0.44	3.20	1.90
CAM Short Duration Investment Grade Strategy—Net 100% corporate bonds	3.31	5.22	5.22	-1.00	1.74	1.79

Relative Performance Review 12/31/2023

CAM's **Investment Grade Strategy** ("**IG**") produced a gross total return of 7.02% in the quarter ended December 31, 2023, compared to 8.51% for the Bloomberg U.S. Corporate Index. CAM always positions a majority of the portfolio within intermediate maturities. CAM's positioning within the Banking industry posted the single largest positive impact to performance, generating a +25 basis point contribution to excess return. Given the sharp decline in interest rates, longer dated securities (10+ years) returned 14.73% for the period, widely outperforming the broader index. CAM's zero weighting in this duration bucket produced a -169 basis point contribution to excess return. The YTD return for the CAM IG strategy was 7.88% compared to the Index return of 8.52%. Over this period the Retailers and Airlines industry groups had the largest positive impacts to excess return with +9 and +5 basis point contributions to excess return, respectively.

The **High Yield Strategy ("HY")** delivered a gross total return of 7.74% in Q4 while the Bloomberg US Corporate High Yield Index returned 7.16%. Over this period our selection and positioning within the Technology and Electric Utility industries generated a +24 and +21 basis point contribution to excess return, respectively. The HY YTD return was 12.07% while the Index returned 13.44%. CAM does not purchase securities rated CAA and lower. The performance of lower rated credit in 2023 was relatively strong compared to higher rated credit. The impact of CAM's underweight in lower quality credit was a -46 basis point detriment to excess return for the period.

Our **Broad Market Strategy ("BM")** – a 67%/33% blend of the IG and HY strategies above – produced a gross total return of 7.25% for the quarter compared to 8.06% for the Index, a similar blend of Bloomberg IG and HY corporates. Our BM strategy is structurally underweight the 10+ year maturity bucket relative to the Index, which dramatically outperformed the Index as a whole (14.72% versus 8.06%). The result of our underweight was a -121 basis point contribution to excess return. The YTD return for the CAM Broad Market strategy was 9.20% compared to a blended Index return of 10.16%. For this period, the duration allocation effect of our structural underweight to longer-dated securities (10+ years) was a -26 basis point contribution to excess return.

The CAM **Short Duration Strategy** ("**SD**") blends equal weights of IG and HY bonds with a target duration of 3 years. The strategy's gross total return for the quarter was 4.33% while the Index, a similar blend of the intermediate components of Bloomberg IG and HY corporates, returned 5.58%. CAM's duration profile varies from that of the blended index with an overweight in the front end of the curve (0-3yrs) and underweights in the 3-to-5 and 5+ year buckets. Overall, the duration allocation effect was -104 basis points given the outperformance of longer dated securities during the period. The strategy's YTD gross total return was 7.56% compared to the blended Index return of 9.76%. For this period, CAM's positioning within the Food & Beverage and Media Entertainment industries generated the largest positive impacts to performance of +36 and +26 basis points, respectively.

The **Short Duration Investment Grade Strategy** ("**SD-IG**") delivered a gross total return of 3.37% for Q4 while the Bloomberg U.S. Corporate 1-5 Index returned 4.12%. CAM's duration profile is very similar to that of the blended index, with an overweight in the front end of the curve (0-1yrs) and underweights of the 1-to-3 and 3-to-5 year buckets. Overall, the duration allocation effect was -34 basis points given the outperformance of longer dated securities across the curve during the quarter. Over the YTD period, SD-IG underperformed the Index, by delivering 5.48% gross total return versus an Index return of 6.20%. Given the positive returns for the index during the period, CAM's average cash position of 2.70% had a -17 basis point impact on performance.

Bloomberg Bond Indices Returns vs. CAM Gross (annualized %)

Periods ended 12/31/2023	**10-yrs**	**20-yrs**
U.S. Aggregate	**1.81**	**3.17**
U.S. Corporate	**2.95**	**4.13**
CAM Investment Grade Strategy (gross)	**2.90**	**4.17**
CAM Investment Grade Strategy (net)	**2.65**	**3.93**

Better Asset Allocation Might Result from More Exacting Analysis

CAM looks to minimize the overall volatility of our High Yield strategy by focusing on the upper tier of High Yield credit (BA-B), as well as the conservative portion of a firm's capital structure. Interestingly, the chart to the right indicates that CAA-rated securities underperformed BA-rated bonds for all periods shown, as of 12/31/2023. The lowest rated cohorts (CA & D) also underperformed for all periods as of 12/31/2023, and produced negative annualized returns over the past 5-years. Not shown in the table is the pronounced volatility that has characterized the CAA-rated and lower subsectors. For example, the standard deviation of the CAA credit tier has been nearly 50% higher than the broader Bloomberg US Corporate HY Index over the 10-year period (12.28% versus 8.50%). CAA bonds returned -17.9% in calendar year 2022 when the Bloomberg US Corporate HY Index was down -11.1%. Thus, investors may not be rewarded for the additional risk of the CAA-rated and lower subsectors.

Further, BA and B rated bonds have outperformed the Bloomberg US Aggregate Index (the "Agg") for all periods shown. The Agg printed modest annualized returns for the 5-year and 10-year periods, largely a function of 2022's rising rate environment. This connotes that BA and B rated credit quality stripes have also kept better pace with inflation.

These points in aggregate suggest that better credit quality high yield bonds deserve consideration as a core holding in an investor's portfolio allocation over a complete market cycle.

Total Return of High-Yield Bonds by Credit Quality
(periods ended 12/31/2023) Source: Bloomberg US Corporate Indices
(annualized %)

High-Yield Bond Sectors	**5-years**	**10-years**	**20-years**
BA-rated bonds	**5.79**	**5.02**	**6.70**
B-rated bonds	**5.15**	**4.22**	**5.87**
CAA-rated bonds	**4.06**	**3.99**	**6.23**
CA & D-rated bonds	**3.73**	**-4.04**	**2.89**

Performance of Other Asset Classes
(periods ended 12/31/2023) Source: Bloomberg & Lipper

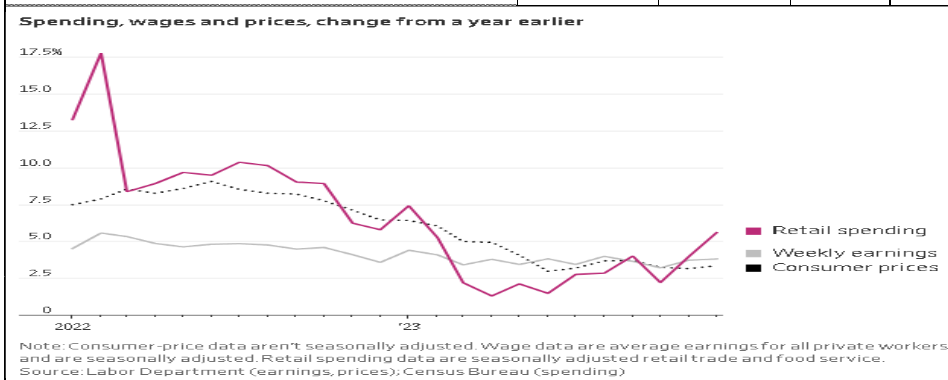
S & P 500 Stocks	**15.69**	**12.03**	**9.66**
Bloomberg U.S. Aggregate	**1.10**	**1.81**	**3.17**

Yield Spreads Over U.S. Treasuries:

The December 31 spread levels (shown at the right) enhance the value of corporate bonds versus U.S. Treasuries. As of 12/31/2023 spreads have tightened on a YTD basis, and more than half (4.55%) of the index total return for 2023 (8.52%) was attributable to tighter credit spreads. The 10-year U.S. Treasury ended Q4 2023 at 3.88%, the same as Q4 2022.

We want to be realistic with our investors about the upside potential in credits spreads. The good news is that when you are starting with a >5% yield, there is a comfortable margin of safety available for spread widening while still generating positive total returns.

Credit Rating	20-Year Average Spread	12/31/23	12/31/22	12/31/21	12/31/20	12/31/19	Tightest This Decade
A	1.26%	0.85%	1.09%	0.74%	0.73%	0.70%	0.63%
BAA	1.87%	1.21%	1.59%	1.13%	1.21%	1.20%	1.00%
BA	3.51%	2.01%	2.95%	1.94%	2.64%	1.82%	1.82%
B	4.88%	3.10%	4.89%	3.13%	3.79%	3.24%	2.94%
CAA	8.84%	8.09%	11.54%	5.96%	7.15%	9.20%	4.91%



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large slowing from the prior December's 6.5% increase (source: *Wall Street Journal* 1/17/24).

The chart above illustrates 2023's moderating spending growth and lower inflation, which many consider harbingers of an economic "soft landing". In the Federal Reserve's quest to attain this economic outcome, many anticipate rate cuts sooner rather than later in 2024.

Cooling inflation and lower wage growth in 2023 as well as record levels of consumer credit card debit and revolving credit that reflect a nearly "tapped out" consumer are significant factors influencing the Federal Reserve's interest rate policies. Consumer credit card debt topped $1 trillion in December (source: St. Louis Federal Reserve 1/12/24). Also influencing the FED is an anticipated slow down in GDP growth in 2024. A survey of economists shows GDP growth falling from 2.6% expected for 2023 to 1% in 2024 (source: *The Wall Street Journal* 1/14/24).

The charts on page four show the declining growth in wages and 2023's concentration of job growth in lower paying sectors with government, healthcare and leisure capturing the vast majority. Also, job postings at the end of 2023 declined more than 15% from a year earlier (source: *Wall Street Journal* 1/3/24).

These trends are accompanied by still healthy, but falling job growth at 2.7 million jobs added in 2023, down from 4.8 million in 2022. The Fed expects the unemployment rate to rise from 3.7% currently to 4.1% by the end of 2024 (source: *Wall Street Journal* 1/5/24).

The continuing decline in commercial real estate values is an economic drag that impacts GDP. In 2022 and 2023 many loans were extended by original loan terms, but those are now fading, forcing refinancings estimated at $2.2 trillion through 2027 (source: *Wall Street Journal* 1/16/24). Distressed sales could broaden and spiral (certainly deflationary) and impact cities tax revenues.

The administration's regulatory policies saddled many industries with higher cost. The two most obvious are the oil & gas and auto industries. Only increased output on private land has lead to a temporary increase in overall output and lower energy costs. One example of the regulatory impact is the proposed CAFE standards that would cost automakers an estimated $300 billion in penalties (source: *Wall Street Journal* 8/1/23).

The world's second largest economy, China, remains mired in a real estate collapse. *The Wall Street Journal* reported that "there are few signs of a return to robust growth– or a real bottom in the critical real-estate sec-

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Footnotes and Disclosure

Advisory services are offered through Cincinnati Asset Management, Inc., ("CAM") an investment adviser registered with the U. S. Securities and Exchange Commission. The CAM High Yield, Investment Grade, Broad Market, Short Duration, and Short Duration-Investment Grade composites consist of all discretionary portfolios under management, including all securities and cash held in the portfolios, and have been appropriately weighted for the size of the account. All accounts are included after they are substantially invested.

Returns are calculated monthly in U.S. dollars and include reinvestment of dividends and interest. Figures for periods of less than one year are cumulative returns. All other figures represent annualized returns. Past performance is no guarantee of future results.

When compared to indices' performance, CAM results are after deduction of all transaction costs and CAM advisory fees. CAM advisory fees used are the actual composite averages. Accounts managed through brokerage firm programs usually will include additional fees. "Net of fees" herein refers only to CAM's management fee. The indices and information shown for comparative purposes are based on or derived from information generally available to the public from sources believed to be reliable. No representation is made to its accuracy or completeness. The Indices are referred to for informational purposes only and the composition of the Index is different from the composition of the accounts included in the performance shown above. Index returns do not reflect the deduction of fees, trading costs or other expenses.

This material was not intended or written to be used, and it cannot be used, by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer under U.S. federal tax laws.

This information is intended solely to report on investment strategies and opportunities identified by CAM. Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. This material is not intended as an offer or solicitation to buy, hold or sell of any financial instrument. References to specific securities and their issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.

High yield bonds may not be suitable investments for all individuals. Before investing a thorough reading of all materials and consultation with an independent third party financial consultant may be appropriate. Fixed Income securities may be sensitive to changes in prevailing interest rates. When rates rise the value generally declines. For a depository institution, there is also risk that spread income will suffer because of a change in interest rates. Additional disclosures on the material risks and potential benefits of investing in corporate bonds are available on our website: https://www.cambonds.com/disclosure-statements/

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tor" (1/17/24). Real-estate accounts for about a quarter of China's GDP. Excluding the pandemic years, China's GDP growth of 5.2% in 2023 was the slowest since 1990. Direct foreign investment in China was negative in the third quarter of 2023 for the first time in 25 years (source: *Wall Street Journal* 11/6/23). Youth unemployment, which China quit reporting in November, recently climbed above 20%, while the population started to decline in 2022 (source: *Wall Street Journal* 1/17/24). The persistent economic slowdown in China could drive down many global commodity prices and thereby inflation.

The global picture is firmly set for low growth when we consider the final piece of the global economy, the eurozone. Goldman Sachs forecasts 2024 GDP growth of just 0.9% with core inflation falling to 2.7% year over year by mid 2024 (source: *Euro Area Outlook 2024* by Goldman Sachs 11/9/23).

Another consideration that has unpredictable consequences are the two major conflicts, Israel's battle against the Iranian backed Hamas terrorists and Russia's war against Ukraine. The Iranians have widened the battle to the shipping lanes of the Red Sea disrupting a significant amount of global shipping. Iran is fearful of the destruction of Hamas and may increase hostilities in the region to force a premature Israeli ceasefire.

Ukraine is now tied to our southern border dilemma. Both are major economic and geopolitical concerns. The cost of a Russian victory is incalculable and might lead to further aggression.

The cost of the migrant crises holds many problems and unknowns, but we already see that the economic cost is severe. Direct costs alone are estimated at $451 billion per year as detailed in a November report completed by the House GOP (source: *New York Post* 11/13/23).

The outlook is bullish for bonds with the global economy softening and inflation moderating. Bonds also offer a lower risk asset allocation than stocks to protect downside that may result from these foreign altercations.

Sharpe Ratios (risk & reward relative value) Inception-Q4 2023

CAM Investment Grade Strategy 0.34
Bloomberg U.S. Corp Bonds 0.31

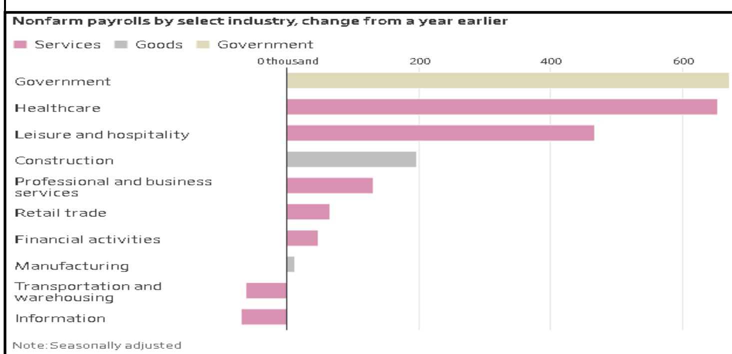
CAM High Yield Strategy 0.47
Bloomberg High Yield Corp Bonds 0.47

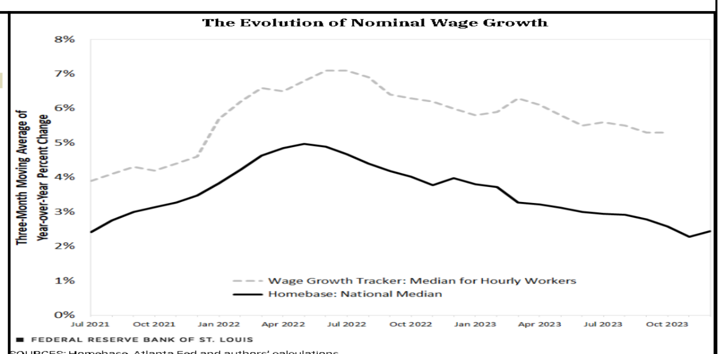
CAM Short Duration 0.43
Bloomberg Weighted Benchmark
(1/2 Interm. HY & 1/2 U.S. Corporate 1-5) 0.52

CAM Short Duration IG Strategy 0.77
Bloomberg U.S. Corporate 1-5 Yr 0.78

CAM Broad Market Strategy 0.55
Bloomberg Weighted Benchmark
(2/3 Corporate and 1/3 High Yield) 0.57

An important objective for all Cincinnati Asset Management investment strategies is to deliver superior risk-weighted returns. A quantitative indication of our success is the Sharpe Ratio that calculates total return per unit of risk. The data on the left indicates we have largely been successful. The Sharpe Ratio of the Investment Grade Strategy exceeded its respective benchmark by approximately 10%. The High Yield, Short Duration Investment Grade, and Broad Market strategies approximated their benchmarks. The Short Duration Strategy's Sharpe Ratio trailed the benchmark primarily due to total return underperformance in the 5-year and older periods.





Rating	BA	B	CAA
Avg Spread	358	516	950
Std. Dev.	165	220	413
09/30/2023	**201**	**310**	**808**
Lowest Spread	151	228	378

Spreads to Treasuries by Credit Rating show significantly lower risk of BA and B rated bonds. Source: Bloomberg, Barclays Research (12/31/99 to 12/31/2023)