Eagle **Quarterly Commentary**

EAGLE | Asset Management

Strategic Income **Portfolio**

Fourth Quarter | 2022

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Market Overview

Following a difficult first three quarters, the market as defined by the S&P 500 Index rebounded nicely during the fourth quarter, trading 7.6% higher. The equity market returned -18.1% for the full year. Over the past 40-plus years, only 2002 and 2008 were worse than 2022. Perhaps the biggest driver of this decline came from rising interest rates, as both the federal funds rate and Treasury yields rose sharply, providing the primary catalyst for falling multiples. West Texas Intermediate crude oil prices also were volatile during the year, rising from $75.20 per barrel to a peak of $123.70 before ending the year at $80.30. All in, S&P 500 earnings estimates for 2022 started the year at $223.50 and finished at $220.50, a decline of only about -1.3%.

The bond market, as measured by the Bloomberg U.S. Aggregate Bond Index, gained 1.87% in the fourth quarter and finished the year down -13.01%. The positive return for the quarter can be largely attributed to November's strong performance as the index gained 3.86% due to a combination of a sharp pullback in interest rates and a tightening of corporate credit spreads. November's exceptional return was marginally offset by negative returns in October and December. The yield on the benchmark 10-year U.S. Treasury note rose from 3.83% on Sept. 30 to 3.87%, but this quarter-over-quarter comparison does not capture the whipsaw dynamic felt along the U.S. Treasury curve throughout the fourth quarter. The 10-year yield initially spiked in October to an intra-day high of 4.33% before falling to 3.40% in early December and then rapidly rising to 3.88% to close out the quarter. The volatility within the yield curve was a direct result of investors digesting economic data and front-running how the U.S. Federal Reserve (Fed) may alter its monetary policy schedule.

Investment-grade corporate bonds, as measured by the Bloomberg U.S. Corporate Bond Index, gained 3.63% during the quarter, which was the best quarterly return since June 2020, and ended the year down -15.76%. Again, the positive quarterly performance was primarily driven by a stellar November that captured the fall in interest rates and the tightening of corporate credit spreads. Corporate bonds outperformed all other major fixed-income sectors on a total return basis and outperformed relative to U.S. Treasuries on a duration-adjusted basis. Both government-related securities and securitized products (asset-backed securities and mortgage-backed securities) posted a positive total return during the quarter and outperformed relative to Treasuries.

It was a challenging year for all investment markets, including the municipal bond market. The Bloomberg Municipal Bond Index was down -8.53% at the year's end, with the fourth quarter up 4.1%, offsetting some of the negative performance. Municipals outperformed the Bloomberg U.S. Treasury Index by 3.93 percentage points, with Treasuries down -12.46% at year-end. Inflation concerns, heightened interest rate volatility, and the Fed raising interest rates resulted in longer-duration municipal bonds experiencing the most pain as investors found safety in short-duration securities.

Given the volatility in the market last year, investors continued to withdraw money from municipal mutual funds. In the fourth quarter, net outflows totaled $29.2 billion, bringing total net outflows to $120.4 billion in 2022. Total new issuance in 2022 was down 21% from the prior year, totaling $384 billion at the end of the year, well below the $400 billion to $500 billion forecast by most firms. December issuance was no exception, totaling a minuscule $17.2 billion, down 58% year over year. And with the rise in

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Asset Allocation Changes

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	Old	New*	Change
Equity	45%	45%	0%
Fixed income	52.5%	45%	-7.5%
Cash and cash equivalents	2.5%	10%**	+7.5%

* As of Dec. 31, 2022.
** 2.5% cash, 7.5% cash equivalents

rates, refunding deals declined by 58% year over year, from $111.7 billion in 2021 to $46.5 billion in 2022.

Portfolio Allocation Review[1,2]

Our team made one asset allocation shift during the fourth quarter. We decided to shorten the duration of the non-equity portion of the portfolio by selling bonds from 52.5% down to 45%, putting the proceeds into attractive yielding cash equivalents. Our models were significantly bearish on bonds relative to cash, and the large rally in bonds in response to favorable Consumer Price Index (CPI) data provided a tactical opportunity to reduce some risk in the portfolio at the margins and to pull our target allocations closer to model readings without sacrificing yield. It also provided us the chance to keep dry powder entering the new year so that we could be nimble should we see opportunities in either asset class.

Equity Performance Review[1,2,3]

Continuing a trend from the first half of 2022, dividend paying stocks outperformed non-dividend paying stocks by a wide margin (a difference of more than 17.5 percentage points) in the fourth quarter. Despite dividend paying stocks giving back some ground in the previous quarter, investors once again favored these higher-quality companies in the face of uncertainty. Given these stylistic tailwinds for our dividend paying strategy, the stock sleeve of the Strategic Income Portfolio was a strong contributor to portfolio performance. We continue to remain optimistic about the prospects of dividend paying stocks given their generally higher-quality attributes and strong visibility into cash flow. We believe companies with those characteristics will be rewarded in this challenging market.

As we have discussed in previous commentary, we continue to favor defensive companies that are less dependent on outside macroeconomic factors. We also favor companies that have shown the ability in previous cycles to grow their dividend in challenging macroeconomic environments. As of Dec. 31, 2022, all 38 stocks in the Strategic Income Portfolio had declared an increase to dividend policy in 2022. In an inflationary environment where maintaining purchasing power is a challenge, we will continue to focus on companies with strong dividend growth potential.

Taxable Fixed Income Performance Review[1,2,3]

The taxable bond sleeve was a slight detractor to relative returns in the fourth quarter. Bond selection, along with an underweight to duration, within our corporate bond holdings caused us to lag the index. Our allocation to securitized products, specifically mortgage-backed securities, contributed to positive absolute returns, but were not enough to offset.

With macroeconomic data moderating at the same time the Federal Reserve is embarking on the most aggressive tightening policy since the 1980s, we believe the odds of a miscalculation remain elevated. Our current positioning, an underweight to corporate bonds and an increased weight to U.S. Treasuries, reflects our more cautious outlook.

Municipal Market Performance Review[1,2,3]

The municipal bond sleeve of the Strategic Income Portfolio was a positive contributor to relative returns during the fourth quarter and for the year. Our bond selection was the biggest positive contributor to results, while our yield curve positioning also added to returns for the quarter.

Our municipal program continues to implement a barbell strategy, avoiding the inversion of the belly of the curve. In October of the fourth quarter, we began extending duration and investing at higher income levels as our view was the market had reached oversold conditions. Over the final two months of the quarter, the market rallied due to Treasury yields collapsing but more specifically, the lack of supply in the municipal market drove performance compared to other fixed income asset classes. Our extension trade at the beginning of the quarter was accretive to performance and elevated portfolio yields. The portfolios maintain a high-quality bias as we believe will continue to outperform lower quality due to the deterioration in the macroeconomic environment.

Outlook

Our near-term macroeconomic outlook remains cautious as the setup heading into 2023 has plenty of challenges still in place – mainly the Fed tightening into an economic slowdown with past-peak inflation and the impact that will have on corporate earnings.

Core economic activity has slowed for five consecutive quarters, and the simple math of base effects (or "comps") suggests this trend will continue until the third quarter of 2023. Consumers remain stressed, with a lot of the damage from persistent, decades-high inflation having already been done, evidenced by the falling savings rate and record increases in credit card balances. The strain on consumers also is evident across multiple consumer sentiment surveys.

It's also true that the economy has been resilient, mainly because of healthy employment. However, it's a tough proposition to hold out hope for a "soft landing" based on such a historic lagging indicator when several other economic and market gauges are flashing yellow and red. It would essentially require a case to be made that "this time is different." But if ever such a case could be made, now seems somewhat plausible with the labor market having undergone seismic swings as a result of the pandemic and the federal response (i.e., fiscal stimulus). Some evidence suggests that companies are willing to hoard employees due to the difficulty of acquiring and keeping workers over the past two years while some industries remain in a tight labor regime.

For the purposes of our outlook, however, we'll stick with the highest-probability outcome that eventually the labor market will succumb to the economic reality of corporations facing a higher cost of capital and the double whammy of slowing, but still elevated inflation. We believe that means decelerating inflation will crimp revenue and earnings growth since much of that growth has recently been driven by pricing. That said, inflation is not likely to slow fast enough to provide relief for consumers and the Fed, putting further pressure on economic activity.

Adding to the complexity are markets caught up in a game of bad news is good news, hoping for more economic data to confirm the U.S. economy is losing steam faster to give leeway for the Fed to ease back on its rate-hike campaign. However, this sort of game carries significant risks for investors willing to engage because at some point the consensus will realize that recession risk outweighs yesteryear's focus on peak inflation, and bad news will simply be that: bad news.

Historic mark-to-market losses on individual bonds should slowly recover as upward pressure on long-term rates slows and reinvestment begins to capture higher yield levels. More importantly, with yields on bonds at decade highs, and dividend style factors outperforming, the "income" component of the income-investing landscape is markedly improved. Our positioning remains defensive and is ready to take advantage of opportunities as they arise.

As a side note, this time of year typically brings forecasts for the upcoming year. We generally refrain from such endeavors as making 12-month best-guess estimates for year-end "levels" is a dicey proposition in the best of times, and yet speaks nothing to the path that respective markets and securities may take to get to those levels. We would, however, like to highlight some general points about the year we just wrapped up and about what may lay ahead. Pandemics, like famine and war, drive structural aftereffects that flow through society, the economy, and markets long after their immediate impacts abate. Inflation, a byproduct of turbo-charged fiscal and monetary policy responses and public health initiatives aimed at slowing the spread of the virus, is the market death knell of post-financial crisis boundless liquidity. The economic and market transition underway is difficult as all transitions tend to be. However, the reset of the bond and equity markets sets the stage for capital allocations based on fundamentals, not speculation. The destruction of trillions in capital in things like crypto exchanges and non-fungible tokens (NFTs) marks an important inflection point in a capital allocation process based on easy money. We are moving from a liquidity-driven stock and bond market to a fundamentally driven market of stocks and bonds. The economy and capital markets may recede for a period, but the resiliency and "reordering" of the economy sets the foundation for a more productive economy and balanced capital markets.

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There are risks associated with dividend investing, including that dividend-issuing companies may choose not to pay a dividend, may not have the ability to pay, or the dividend may be less than what is anticipated. Dividend-issuing companies are subject to interest-rate risk and high dividends can sometimes signal that a company is in distress. Dividends are not guaranteed, and a company's future ability to pay dividends may be limited.

3. Source: Bloomberg, InvestorTools Perform

The product described is a separately managed account with fixed-income components and is subject to interest-rate risk, inflation-rate risk and may experience a loss of principal. Other products may be more appropriate, depending on your investment needs. As with all investing, there is the risk that an unexpected change in the market or within the company itself may have an adverse effect. As with all investments, there is the risk of the loss of capital.

High-yield securities may be subject to greater risk than pure fixed-income instruments.

Equity Income investing is based upon the identification of companies that possess both moderate growth rates as well as higher-than-average and consistent dividend distributions. There are risks associated with dividend investing, including that dividend-issuing companies may choose not to pay a dividend, may not have the ability to pay, or the dividend may be less than what is anticipated. Dividend-issuing companies are subject to interest rate risk and high dividends can sometimes signal that a company is in distress. Historically, dividend yields have been relatively constant and therefore have created a cushion for investors when stock prices have declined. However, there is the risk that a company will not achieve its expected earnings results, or that an unexpected change in the market or within the company will occur, both of which may adversely affect investment results. The biggest risk of equity investing is that returns can fluctuate and investors can lose money. Investment-grade refers to fixed-income securities rated BBB or better by Standard & Poor's or Baa or better by Moody's.

Securitized products, such as asset-backed securities (ABS), mortgage-backed securities (MBS), and commercial mortgage-backed securities (CMBS) are created by pooling loans from a variety of sources and issuing bonds that are backed by these loans. Creditworthiness stems from the credit quality of the underlying loans, as opposed to corporate bonds in which creditworthiness is derived from the earning power of the issuing company. The primary risk of these securities is interest-rate risk. Rising interest rates might cause loan principal prepayments to slow, resulting in less available principal to invest at prevailing higher rates. Conversely, rate decreases might accelerate prepayments, leaving more dollars to invest at lower rates. Mortgage- and Asset-Backed Securities are subject to prepayment risk and the risk of default on the underlying mortgages or other assets.

Investment grade refers to fixed-income securities rated BBB or better by Standard & Poor's or Baa or better by Moody's.

Definitions

The federal funds rate, known as the fed funds rate, is the target interest rate set by the Federal Open Market Committee of the U.S. Federal Reserve. The target is the Fed's suggested rate for commercial banks to borrow and lend their excess reserves to each other overnight.

A multiple, sometimes referred as the price multiple or earnings multiple, is a measure of a company's value based on the ratio of its current share price to its earnings per share. This ratio is known as the price-to-earnings ratio, or P/E.

A yield curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity. Investors and market analysts watch certain yield curves for signs of inversion, when yields for longer-term debt instruments fall below yields on short-term debt with the same credit quality. Inversions are watched as potential signs of a weakening economy and in certain cases, a harbinger of recessions.

A credit spread is the difference in yield between a U.S. Treasury bond and another debt security with the same maturity but different credit quality. Also referred to as "bond spreads" or "default spreads," credit spreads are measured in basis points, with a 1% difference in yield equaling a spread of 100 basis points. Credit spreads reflect the risk of the debt security being compared with the Treasury bond, which is considered to be risk-free. Higher quality securities have a lower chance of the issuer defaulting. Lower quality securities have a higher chance of the issuer defaulting.

Front-running is trading any financial asset based on knowledge of a future transaction or development that will substantially affect the price of the asset.

Total return, when measuring performance, is the actual rate of return of an investment or a pool of investments over a given period of time. Total return includes interest, capital gains, dividends, and distributions realized over the specified period. Total return accounts for two categories of return: income including interest paid by fixed-income investments, distributions, or dividends and capital appreciation, representing the change in the market price of an asset.

Duration incorporates a bond's yield, coupon, final maturity and call features into one number, expressed in years, that indicates how price-sensitive a bond or portfolio is to changes in interest rates. Bonds with higher durations carry more risk and have higher price volatility than bonds with lower durations.

Fund flow is the net of all cash inflows and outflows into and out of a particular financial asset. It typically is measured on a quarterly or monthly basis. Investors and others look at the direction of fund flows for indications about the health of specific securities and sectors or the overall market.

Defensive securities provide consistent dividends and stable earnings regardless whether the overall stock market is rising or falling. Companies with securities considered to be defensive tend to have a constant demand for their products or services and thus their operations are more stable during different phases of the business cycle.

The U.S. Consumer Price Index (CPI) measures the change in prices paid by consumers for goods and services. The U.S. Bureau of Labor Statistics bases the index on prices of food, clothing, shelter, fuels, transportation, doctors' and dentists' services, drugs, and other goods and services that people buy for day-to-day living. Prices are collected each month in 75 urban areas across the country from about 6,000 households and 22,000 retailers.

A barbell investment strategy in fixed income typical entails investing half the portfolio in long-term bonds (generally those with maturities of 10 years or more) and the other half in short-term bonds (generally those with maturities of five years or less), with little or nothing in between. Barbell strategies can allow investors to benefit from current interest rates by investing in short-term bonds and also benefit from the higher yields of holding long-term bonds. The risks associated with using a barbell strategy include interest rate risk and inflation risk.

Oversold is a term used to describe a security believed to be trading at a level below its intrinsic or fair value.

A consensus estimate is a forecast of a public company's projected earnings or the expected findings of a macroeconomic report based on the combined estimates of analysts and other market observers that track the stock or data in question.

Mark to market is a method of measuring the fair value of assets, liabilities, or other accounts that can fluctuate over time. Mark to market strives to provide a realistic appraisal of a company or institution's current financial circumstances based on current market conditions. During volatile markets, however, mark-to-market measurements may not accurately represent an asset's true value in an otherwise orderly market.

An NFT, which is short for non-fungible token, is a unique cryptographic asset, including images, other works of art, or property rights, on a blockchain with unique identification codes and metadata that distinguishes it from any other asset and ensures that it cannot be replicated.

Indices

The S&P 500 Index measures change in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 75% of the investable U.S. equity market.

The Bloomberg U.S. Aggregate Bond Index is composed of the total U.S. investment-grade bond market. The market-weighted index includes Treasuries, agencies, commercial mortgage-backed securities (CMBS), asset-backed securities (ABS), and investment-grade corporates. The inception date of the index is Jan. 1, 1976.

The Bloomberg U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market.

The Bloomberg Municipal Bond Index is a rules-based, market-value-weighted index engineered for the long-term tax-exempt bond market.

The Bloomberg U.S. Treasury Index measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. Treasury bills are excluded by the maturity constraint, but are part of a separate Short Treasury Index.

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