# Unconstrained Fixed Income Strategy

Portfolio and Economic Commentary – 4th Quarter 2020

ALTRIUS
CAPITAL MANAGEMENT
INVEST LIKE AN AARDVARK

## UNCONSTRAINED FIXED INCOME STRATEGY COMMENTARY

Based on our macroeconomic outlook over a three to five year period and our cyclical views from quarter to quarter, we employ top-down strategies that focus on yield curve positioning, volatility, and sector rotation. We then utilize bottom-up analysis to drive our security selection process and facilitate the identification of undervalued securities with the potential for above average income. We invest in securities that operate across diversified sectors in the fixed income markets of the United States, primarily those in U.S. dollar denominated high yield and investment grade bonds, including government securities, corporate bonds, and mortgage- and asset-backed. Sources of added value:

**Credit Analysis** - We emphasize independent analysis and do not rely on credit agencies.

**Duration Risk** - We avoid long, extreme duration shifts generally operating within a moderate duration range typically between two and four years.

**High Income** - Our research attempts to identify issues paying above average income.

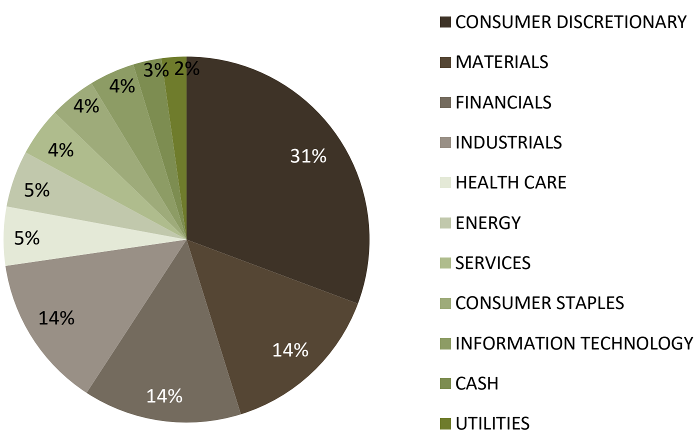
**Risk Premium Management** - We seek to attain an attractive yield/spread in relation to a five-year treasury within acceptable levels of portfolio risk.

## PERFORMANCE COMMENTARY

Despite an exceptionally volatile year all major segments in the broad based US fixed income markets closed out 2020 in positive territory. Investor demand for risk-assets which returned in force in the third quarter of the year continued unabated through year-end with the lowest rated corporate bonds (CCC & below) being the best performing fixed income market segment for the fourth quarter recording gains in excess of more than 12%, followed by aggregate high yield corporate bonds which returned in excess of 6%. Inversely, longer dated US treasuries were the worst performing fixed income market segment during the fourth quarter, as evidenced by the Morningstar US 10+ Year Treasury Bond index falling by 3.07%. However, when viewing results of 2020 in their entirety, investors clearly favored longer duration assets over shorter, as well as safer over risky, with longer dated US treasury bonds (those with maturities greater than 10+ years) returning 17.78% with longer dated investment grade corporate bonds (those with maturities greater than 10+ years) returning 13.70% for the year-end 2020. Despite resurgent investor demand for risk-assets in the latter half of the year and aggregate high yield bonds returning approximately 7.03% on the year, the lowest rated corporate bonds (CCC & below) were the worst performing fixed income market segment returning 2.86% for the year, followed by shorter dated core bonds (those with maturities between 1 – 3 years), which returned 3.28%.

The Fed left rates unchanged during the quarter, keeping the

### Sector Allocation




| Top Ten Holdings | Weight |
|---|---|
| Wendy's International Inc. 7.000% | 2.90% |
| Mercer Int'l Inc. 5.500% | 2.74% |
| Pitney Bowes Inc. 4.700% | 2.43% |
| Park-Ohio Industries Inc. 6.625% | 2.42% |
| Cleveland-Cliffs Inc. 5.750% | 2.34% |
| Suburban Propane Partners 5.500% | 2.26% |
| Coeur Mining Inc. 5.875% | 2.25% |
| Tenneco Inc. 5.375% | 2.22% |
| Allegheny Technologies Inc 7.875% | 2.21% |
| Bed Bath & Beyond 3.750% | 2.21% |

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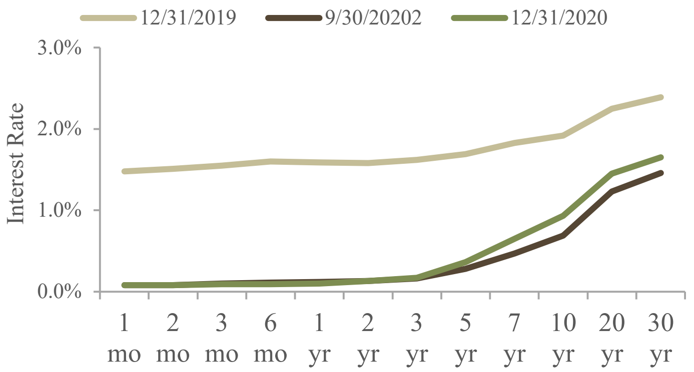
benchmark interest rate at between 0.0% - 0.25%, which will likely remain at such level over the next two to three years. In its December meeting, the Fed acknowledged that although economic activity and employment are showing signs of recovery, progress on both fronts is slow with both currently drastically below pre-pandemic levels.

The yield curve exhibited a very modest degree of steepening on the long-end during the fourth quarter, with yields on the 10yr and 30yr treasuries expanding 24bps and 19bps respectively over Q3 levels. However, with the expectation of rates remaining near zero over the long-term, yields across the curve will likely remain well below pre-pandemic levels, as the shorter-end of the curve ended the year more than 140bps below 2019 levels with the longer-end lower by between 74 bps and 100bps.

### US TREASURY YIELD CURVE




The Unconstrained Fixed Income strategy generated a return of 6.59%, gross of fees, for the fourth quarter of 2020, outpacing both the Morningstar US High Yield Bond and Morningstar US Core Bond indices by 22bps and 592bps respectively. However, the Unconstrained Fixed Income strategy recorded a loss of 0.55%, gross of fees, for the year 2020 as a whole, severely underperforming both the Morningstar US High Yield Bond and Morningstar US Core Bond indices which recorded positive returns on the year of 7.03% and 7.50% respectively.

As was the case for the strategy's underperformance in the third quarter, the selling of a number of distressed positions in the middle of the year continued to hold down the performance of the strategy on the year as a whole, despite producing exceptional results during the fourth quarter on both absolute and relative terms. Having liquidated the majority of distressed positions within the strategy throughout the middle of the year, and with the majority of remaining distressed issues experiencing strong price recoveries in both the third and fourth quarters, distressed assets currently held within the strategy only account for approximately 2.0% of total strategy assets as of 12/31/2020.

A few small changes occurred during the quarter in regard to the strategy's aggregate asset composition and credit characteristics. Consumer discretionary remained the strategy's most heavily weighted sector at approximately 31% of all invested assets, which increased by roughly 2% during the quarter as a result of continued price increases on a select number of long established positions. The strategy's exposure to the materials sector declined by 3%, as a result of a number of positions within the sector being called in full during the quarter. As of the year-end 12/31/2020 the materials, industrials, and financials sectors each account for 14% respectively of all invested assets.

The aggregate credit rating of the strategy increased marginally from 'B' to 'B+' as a result of establishing three new sizeable positions in B+ and BB rated issues. The duration of the strategy which has long since remained below 3.0 increased somewhat markedly from 2.76 to 3.01, as purchasing longer-dated issues has become necessary in this ultra low rate environment in order to capture minimum acceptable levels of yield, which we are currently holding to a minimum of 4.00% on a yield to worst basis.

Finding value anywhere in the fixed income markets became increasing difficult in the latter half of 2020. As investor confidence in high yield bonds returned in

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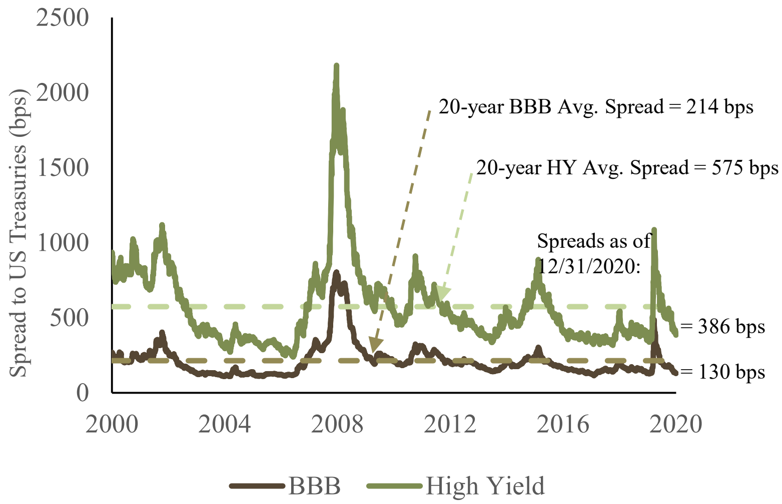
late summer, by early November aggregate yields on high yield bonds dropped by approximately 100bps and continued to compress through year-end. As can be seen in the exhibit below, 'BBB' corporate bonds, the lowest rated investment grade bonds, ended 2020 trading at spreads 84bps below their 20-year average, while the spreads on aggregate high yield bonds ended the year trading 189bps below their 20-year average. With the 5yr and 10yr treasuries ending the year trading at just 0.36% and 0.93% respectively, acceptable aggregate yields in the high yield corporate bond space will likely remain at historically low levels of between 4.0% and 5.5% going into 2021.

**BAML OAS HIGH YIELD & BBB**




As far as sector allocation is concerned, we remain largely agnostic with a preference to grow the strategy's exposure to the materials, industrial, health care, and financials sectors where opportunities arise. Most all issues in the consumer discretionary sector are currently richly priced, and we anticipate call activity within the sector to increase in the first half of 2021. Given that the energy sector was hollowed out substantially during the first half of 2020, the companies that remained solvent and a going concern did so due to the strength of their financial position in the face of unprecedented mark pressures and volatility, leaving behind a select number of potentially compelling opportunities with excellent risk to return investment profiles.

We do anticipate that the availability of appealing fixed income opportunities in the high yield corporate bond market will remain slim in the months ahead, but we also feel it is the best fixed income market segment by which to generate adequate income in an ultra low rate investment environment. Despite historically low yields across all corporate bonds, it is our opinion that the health and stability of the high yield corporate bond market is currently in a better position than at this same time last year. As always, we will continue to invest opportunistically in seeking to attain sound risk adjusted returns in this challenging environment.

## Disclosures

This report includes candid statements and observations regarding investment strategies, individual securities, and economic and market conditions; however, there is no guarantee that these statements, opinions or forecasts will prove to be correct. These comments may also include the expression of opinions that are speculative in nature and should not be relied on as statements of fact. Altrius is committed to communicating with our investment partners as candidly as possible because we believe our investors benefit from understanding our investment philosophy and approach. Our views and opinions include “forward-looking statements” which may or may not be accurate over the long term. Forward-looking statements can be identified by words like “believe,” “expect,” “anticipate,” or similar expressions. You should not place undue reliance on forward-looking statements, which are current as of the date of this report. We disclaim any obligation to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise. While we believe we have a reasonable basis for our appraisals and we have confidence in our opinions, actual results may differ materially from those we anticipate.

**Past performance does not guarantee future results. The information provided in this material should not be considered an offer nor a recommendation to buy, sell or hold any particular security.**

**Performance Reporting**
Altrius Capital Management, Inc. (Altrius) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Altrius has been independently verified for the periods January 31, 2001 – December 31, 2019 by ACA Performance Service, LLC. The verification reports are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm’s policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

The Firm is defined as Altrius Capital Management, Inc. (Altrius), a registered investment advisor with the Securities and Exchange Commission. Altrius was founded in 1997 and manages equity, fixed income and balanced portfolios for high net worth individuals and families.

**Composite Characteristics**
The Unconstrained Fixed Income Strategy is a subaccount from the Altrius Global Income Composite. A complete list and description of firm composites is available upon request. The composite and subaccount were created in December 2010 with a performance inception date of December 31, 2002. The subaccount strategy is primarily invested in U.S. dollar-denominated investment grade and high yield bonds, including government securities, corporate bonds, and mortgage and asset-backed securities diversified across sectors. The strategy seeks to attain an attractive yield/spread relative to a five year Treasury within acceptable levels of portfolio risk.

Accounts are included on the last day of the month in which the account meets the composite definition. Accounts no longer under management are withdrawn from the composite on the first day of the month in which they are no longer under management. Closed account data is included in the composite as mandated by the standards in order to eliminate a survivorship bias.

## DISCLOSURES

**Benchmark**

The benchmarks are the Morningstar US Core Bond and the Morningstar US High Yield. These benchmarks replaced the Barclays Capital Aggregate Bond Index, the Bank of America US High Yield Master II Trust, and the Morningstar US OE Nontraditional Bond Index as of 11/01/2019. Effective 01/01/2017, the Bank of America US High Yield Master Trust Index replaced the Barclays BB+ index. The change was made due to licensing fees being charged by the firms who own the indices. The volatility of the indices may be materially different from that of the performance composite. In addition, the composite's holdings may differ significantly from the securities that comprise the indices. The indices have not been selected to represent appropriate benchmarks to compare the composite's performance, but rather are disclosed to allow for comparison of the composite's performance to those of well-known and widely recognized indices.

Economic factors, market conditions, and investment strategies will affect the performance of any portfolio, and there are no assurances that it will match or outperform any particular benchmark.

### Altrius Unconstrained Fixed Income Composite Performance

*December 31, 2009 – December 31, 2019*

| Year | Gross Return % | Net Return % | Benchmark Return % | Composite 3-Yr St Dev % | Benchmark 3Yr St Dev % | # of Portfolios | Composite Dispersion % | Total Composite Assets | Percent of Firm Assets |
|---|---|---|---|---|---|---|---|---|---|
| **2009** | 36.79 | 35.01 | 5.93 | 11.24 | 4.04 | 97 | 7.43 | 16,882,344 | 15.96 |
| **2010** | 10.12 | 8.84 | 6.54 | 11.40 | 4.12 | 103 | 2.09 | 16,857,352 | 14.11 |
| **2011** | 4.68 | 3.47 | 7.86 | 7.25 | 2.82 | 101 | 1.58 | 20,032,911 | 16.10 |
| **2012** | 12.81 | 11.47 | 4.22 | 4.75 | 2.41 | 105 | 1.17 | 31,263,431 | 23.16 |
| **2013** | 8.61 | 7.40 | (2.02) | 4.60 | 2.75 | 117 | 1.02 | 36,479,754 | 20.95 |
| **2014** | (4.04) | (5.11) | 5.97 | 4.69 | 2.62 | 128 | 0.71 | 45,562,658 | 24.09 |
| **2015** | (10.55) | (11.56) | 0.55 | 6.19 | 2.90 | 114 | 1.06 | 34,421,355 | 18.75 |
| **2016** | 22.06 | 20.68 | 2.65 | 7.91 | 3.01 | 137 | 2.39 | 59,949,560 | 22.43 |
| **2017** | 5.51 | 4.35 | 3.54 | 7.29 | 2.80 | 147 | 1.11 | 60,383,355 | 17.72 |
| **2018** | (0.14) | (1.24) | 0.01 | 5.70 | 2.89 | 154 | 0.32 | 73,471,882 | 22.14 |
| **2019** | 10.39 | 9.21 | 8.65 | 3.11 | 2.86 | 152 | 0.91 | 79,944,999 | 23.14 |

## Disclosures

**Performance Calculations**

Valuations and returns are computed and stated in U.S. dollars. Results reflect the reinvestment of dividends and other earnings.

Gross of fees return is net of transaction costs and gross of management and custodian fees. Net of fees returns are calculated using actual management fees that were paid and are presented before custodial fees and but after management fees and all trading expenses. Returns can be net or gross of withholding taxes, depending on how taxes are recorded at the custodian. Some accounts pay fees outside of their accounts; thus, we enter a non-cash transaction in the performance system such that we can calculate a net of fees return. Prior to 01/01/10, cash was allocated to carve-out segments on a pro-rata basis based on beginning of period market values. Beginning 01/01/10, carve-out segments are managed separately with their own cash balance. Carve-out accounts represent 100% of composite assets for periods prior to 01/01/10.

The standard management fee for the Altrius Unconstrained Fixed Income Strategy  is 1.40% per annum on the first $500,000 USD, 1.00% per annum on the next $500,000 and 0.80% per annum thereafter. Additional information regarding Altrius Capital Management fees are included in its Part II Form ADV.

Internal dispersion is calculated using the asset-weighted standard deviation of all accounts included in the composite for the entire year; it is not presented for periods less than one year or when there were five or fewer portfolios in the composite for the entire year. The three-year annualized standard deviation measures the variability of the composite and the benchmark (Morningstar US Cord Bond) returns over the preceding 36-month period.

There are no non-fee paying accounts in our composites. When a security is purchased or sold, the principal amounts tied to the transaction are net of trading costs; therefore the calculation and market values represent amounts net of trading costs. Dispersion is calculated using asset-weighted standard deviation, gross of fees. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. A complete list and description of firm composites is available upon request.