Q2 2023 Market Commentary

Market Review: The best word to describe US and Global markets during Q2 is resilient, as risk assets marched higher against a wall of worry built by the cumulative impact of the Fed's 500bp of rate hikes as well as their continued hawkishness. Entering Q2, on the heels of two of the three largest banking failures in US history, Fed Funds futures indicated the market expected just one additional rate hike and for the Fed to pivot in the second half of 2023 by delivering upwards of four rate cuts by January 2024 in response to a much-anticipated recession. These rate cut expectations were a clear contradiction to Powell's repeated assertions about the amount of work needed to bring down inflation to the Fed's long-term target of 2% and that rate cuts were not going to be on the Fed's radar any time soon. However, a combination of sticky inflationary data, robust employment reports, and unrelenting consumer spending managed to push short term rates significantly higher, seemingly validating the Fed members' projections. At the end of Q2, Fed Funds futures implied two additional rate hikes at the next two meetings followed by rate cuts starting by late Q1 2024. The resiliency of the US economy was demonstrated by 2% annualized quarter-over-quarter real GDP growth in Q1, the bulk of which came from consumer spending that increased 4.2%. Consumer confidence was bolstered by an extremely robust labor market with the unemployment rate reaching 3.4%, the lowest rate since 1969. The number of available jobs was 9.8 million, which translates into 1.7 jobs for every unemployed person, an indication of a very tight labor market. This tight labor market has produced very healthy wage gains, particularly for low skilled workers in leisure and hospitality industries, with average wages rising 4.3% year-over-year.

However, May labor and inflationary data showed a deceleration in employment and wage growth with the unemployment rate rising to 3.7%, wages increasing by just 0.3%, and the average work week falling in three of the last four months. While US consumers continue to benefit from excess savings accumulated from the pandemic stimulus, the recent more gradual increases in the US savings rate and the 17% quarterly increase in credit card balances in Q1 point to dwindling excess savings balances and deteriorating consumer fundamentals.

The repricing of the Fed's rate hike probabilities pushed the 2-year up by 87bp to 4.90% by the end of the quarter and resulted in an additional 50bp of curve inversion. The 2-10 year spread finished at -105bp, almost matching the lowest level seen in early March prior to a string of bank failures. Against this rate backdrop, there has been significant dispersion of performance across risk assets, particularly within the equity markets. Fueled by robust earnings, Artificial Intelligence (AI) mania, expectations of future rate cuts, and a reversal of short positioning, the Nasdaq 100 posted a 15% return during the quarter, bringing its first half return to 39%. Not including the performance of the largest 28 stocks, the S&P 500's YTD return would be negative. These kinds of top-heavy patterns are observed among flagship European equity indices as well. On the credit side, all fixed income sectors outside of CMBS outperformed Treasuries in Q2. The Bloomberg Aggregate Index posted +0.59% excess return for the quarter despite having a negative absolute return of -0.84%. Agency MBS underperformed Corporates with +0.76% return versus +1.31% for Corporates.

Agency MBS continued to be negatively impacted by supply fears following the forced selling of MBS securities from SVB and First Republic failures. At the same time, IG Corporate spreads saw 15bp of spread tightening in Q2 with spreads ending the quarter at 153bp, similar to the 10-year average. YTD Corporate net supply has been $278bn while IG Bond net inflows totaled $22bn YTD, a reversal from negative flows seen last year as a 5.5% all-in yield proved to be an attractive draw for retail investors. Corporate High Yield had +2.79% excess return in Q2 with spreads tightening by 80bp to 404bp. High Yield bonds managed to put up a positive total return of 1.75% despite higher interest rates as declining fears of a deep recession drove demand for high yield Corporate securities yielding 8.5%+ against a paltry amount of new issuance supply. Net new supply totaled just $31bn in 1H, down 45% year-over-year.

RMBS: Residential real estate resumed its upward trend during the quarter while Commercial Real Estate (CRE) continued to be impacted by recession fears and vacancies. After posting a few month-to-month declines in the second half of 2022, home prices have seemingly reached a trough and have resumed their upward trajectory. The Core Logic Home Price Index posted its fourth consecutive positive HPA in May with a +0.9% increase as nationwide home prices are now 0.7% higher than the 2022 peak. Existing home sale inventory has increased by 120k relative to the December 2022 low of 960k units, but remains close to all-time lows as a rise in the conventional mortgage rate to above 7% caused a 50% increase in mortgage payments for borrowers with a 3.5% mortgage rate. Buying a home is cheaper than renting in only 2% of MSAs which provides a steady support to rent levels. After posting four consecutive negative prints, the Zillow month-over-month Rent index had four consecutive positive increases from February to May, with May rents showing a healthy 0.64% month-over-month (7.7% annualized) increase. We are also witnessing several strategists revise their home price projections for 2023 from negative to flat, as fears of an imminent recession have failed to materialize and inventory of existing supply remains depressed.

Spreads across RMBS credit products tightened in Q2 as favorable technicals, combined with robust fundamentals, encouraged money managers, insurance companies and hedge funds to add RMBS to their portfolios. In particular, the new issue market saw very strong participation from a number of end accounts with senior tranches from many RMBS deals being oversubscribed by at least 3x. Unlike the second half of 2022 which saw $180bn of outflows from fixed income funds, the first half of 2023 saw $23bn of inflows, as investors are getting more comfortable with higher interest rates. Against the backdrop of normalizing asset flows was a significant reduction in primary issuance across RMBS credit sectors. 1H 2023 saw just $36bn in new issuance, a 65% drop from 1H 2022. Amongst RMBS sectors, CRT spreads tightened across the board with BBB-rated M1 spreads tightening by 12bp, BB-rated M2 spreads coming in by 65bp while B-rated B1s tightened by 80bps and non-rated B2s tightened by 100bp. It was a classic example of "credit curve flattening" where lower rated tranches tightened more than those with less credit risk. While we believe this is a bit premature, given the economic uncertainty that persists, it caused CRT B1s and B2s to have some of the best returns across structured credit during 1H 2023 at over 6% YTD. The Non-QM market continued to lead private label RMBS in issuance amounts at $15bn YTD, comprising 43% of Non-Agency new issuance. Non-QM AAA-rated pro-rata Senior tranches backed by new issue collateral with WAC greater than 8% had a strong finish to Q2, ending at spreads of 155bp. Deep discount 2021 vintages backed by collateral with WAC less than 5.55 trade wider than new issue because of fear of extension risk, but tightened 30-40bp relative to Q1 levels at 160bp. While seasoned Non-QM vintages can benefit from cash-out refinances, it is more likely that borrowers can tap the HELOC market to monetize HPA. BBB-rated M1 tranches and BB-rated B1 tranches have settled at 365bp and 515bp spreads as of the end of Q2. The RPL market saw limited issuance in 1H 2023 at $6bn. AAA rated Senior RPL tranches traded at spreads from 130bp for short duration seasoned deals to 190bp for newly issued deals that mature in around 5 years. AA through BBB subordinate RPL tranches ended the quarter at spreads ranging from 220bp through 310bp. In the less liquid private label reverse RMBS sector, Ocwen issued its inaugural deal backed by active and inactive HECM loans (25%/75% split). The deal garnered a ton of attention with AAA tranche oversubscribed by more than 4x, settling at 265bp level with AAs and As coming at 390bp and 550bp. Legacy RMBS returns trailed those of other RMBS sectors as the sector has been mired in relative illiquidity compared to the new issue on-the-run RMBS.

For 1H, Legacy RMBS returns have been around 3-3.5% with spreads tighter by 10-15bp in Q2. Legacy RMBS prepayment speeds have been in mid-single digits while liquidation severities declined to 35% for Alt-A collateral.

CMBS: CRE and CMBS continued to be the outcasts of the structured credit market with challenging cyclical and structural fundamentals and a paucity of liquidity being central themes. Capital markets appear frozen to CRE issuers in 1H with just $17bn of private label issuance done YTD compared to $73bn in 2022. Higher interest rates, higher cap rates, the impact of a potential economic slowdown/recession, and longer-term secular headwinds in the retail mall and office markets have negatively impacted CRE fundamentals in 2023. Higher interest rates have triggered significant declines in property values with CoStar's repeat sales index reporting the ninth-straight month-over-month decline in CRE property prices as of April 2023. On a value-weighted basis, prices are now 11.7% below their July 2022 peak, having declined much more than residential real estate. Greenstreet's Commercial Property Price Index reported a 15% decline from the 2022 peak, with office valuations down 27% and multifamily prices down 21%. According to Barclays research, with conduit loans set to mature in Q2 2023, around 13% are delinquent, 22% that had term maturities in Q1 2023 received extensions, and 19% are still outstanding but performing. While conduit delinquencies gradually improved from the Covid-related spike throughout 2021 and 1H 2022, Q2 2023 saw an uptick in CMBS conduit 30+ day delinquencies with office collateral replacing the retail mall as the most problematic property type for CMBS investors.

CMBS performance in Q2 varied by sector. Conduit AAA-rated Last Cash Flow (LCF) are wider by 18bp year to date, but the AAA LCFs from the latest new issue conduit deal, BBCMS 2023-C20, traded at a 148bp spread, which was tighter by 35bp relative to Q1 2023. Despite tightening in Q2, CMBS AAA-rated LCFs are still trading close to historical wides relative to Investment Grade Corporates, illustrating the relative value of CMBS versus Corporates. BBBs in the last BBCMS new issue deal were not sold to the public. On-the-run BBB CMBS saw spreads reaching over 1000bp in Q1 amidst liquidity air pockets. During Q2, BBBs saw interest from hedge funds in the low 900 area for the most liquid issues. Money managers are staying away from the vast majority of seasoned subordinate CMBS tranches out of fear that they are likely to be downgraded soon by rating agencies. According to JPM, since the beginning of 2023, 747 CMBS tranches had rating changes with 84% of these rating changes being downgrades. The continuation of rating downgrades will put additional selling pressure on more seasoned subordinate CMBS tranches. Within the SASB subsector, AAA floating rate tranches backed by office and retail ended the quarter at mid-200s spreads which represent some of the highest available spreads for floating rate AAA assets. Q2 saw one new issue Small Balance Commercial (SBC) deal from Velocity, with AAAs pricing at 260bp, 10bp wider than the previous deal issued in Q1. However, the AAAs tightened by the end of Q2 to finish at 245bp while the AAs, As and BBBs ended up at 350bp, 450bp and 550bp respectively. SBC continues to lack sponsorship with spreads wider than RMBS and more aligned with Conduit and SASB CMBS deals despite having more credit support and better structural features such as excess spread. CRE CLO spreads were about unchanged from Q1 amidst low trading volumes.

ABS: Unlike the RMBS and CMBS markets, ABS issuance continued at robust pace as higher interest rates did not deter programmatic issuers in autos, credit cards, equipment, and student loans from bringing new deals to the market. Through 1H 2023, ABS issuance totaled $127bn, just below the $137bn issued through 1H 2022. Auto ABS led the way with $71bn as 2023 auto production and sales were solidly above 2022 and 2021 numbers. Credit card and equipment ABS rounded out the top three ABS issuance segments. ABS deals have attracted a healthy amount of demand from asset managers, insurance companies, hedge funds and banks, with most deals ending up printing inside the initial guidance talk due to oversubscription. ABS spreads ended Q2 at the tightest levels of the year after retracing March widening. Subprime Auto AAAs finished Q2 at 110bp after widening to 170bp in early March. There was quite bit of variation across subprime auto shelves, with subordinate tranches from US Auto and American Car Center, lenders that closed their operations during the quarter, dropping to sub-20-dollar prices as greater than expected losses wiped out credit support, At the same time, subprime auto sponsors in ACAR, EART and PART shelves injected capital and forewent servicing fees to increase excess spread in their deals which supported the price level for their securities during the quarter. According to KBRA, credit performance was mixed in Q2. Annualized losses declined on subprime auto collateral to 5.8% in May compared to 8.5% earlier in the year but were still higher than 2022 loss levels. Liquidation severities in subprime auto deals declined to 50% in May relative to 60% severity earlier in the year but prepayments also dropped. Annualized net losses for Market Place Lending (MPL) Tier1 and Tier 2 collateral declined by 3-4% in May but are still higher by 2.52% and 4.51%, year over year.

CLOs: CLO spreads retraced the wide levels from early March and finished Q2 close to the tights of the year. Demand was driven by high overall yields available on solid investment grade assets. For instance, AAA CLO yields are currently approaching 6.5% which is quite attractive for investors needing the highest rating category. AAA CLO spreads ended the quarter at 162dm, 24bp tighter from 2022 year-end. Leveraged loans benefited from stronger than expected economic growth in 1H. The leveraged loan TTM default rate ticked up to a 2-year high of 2.8%, approaching the long-term average of 3.1%. Leveraged loan recovery rates are running below long-term averages at 44% driven primarily by lower recovery rates on Loan Only Issuers (34%). Nonetheless, Leveraged Loan Index price increased to 94.4 at the end of Q2 almost reaching the highest level of 2023 from February. AA-rated CLO spreads tightened to 220 dm, A-rated CLO spreads plunged to 12 months low of 290 dm. BBBs retraced March widening to finish Q2 at 480 dm while BB bonds ended the quarter at 967 dm.

Portfolio Attribution and Activity: The Structured Credit Value composite returned 1.84% gross of fees (1.47% net of fees) for the quarter, while the Bloomberg Aggregate Index returned -0.84%. Q2 outperformance is primarily attributed to lower duration of the portfolio relative to Bloomberg Aggregate (2.1 yrs vs 6.3 yrs) and its higher carry (8.4% yield vs 4.8% yield).

Q2 2023 Portfolio Attribution and Net Return

SECTOR	ALLOCATION	NET RETURN*	ATTRIBUTION
RMBS	40.4%	2.00%	0.85%
CMBS	23.0%	0.50%	0.11%
ABS	5.7%	–1.65%	–0.10%
CLO/CDO	4.2%	2.71%	0.16%
CORP	12.9%	3.66%	0.48%
GOVT	9.0%	–1.13%	–0.07%
Cash	4.7%	0.89%	0.05%
Total	100.0%		1.47%

Source: Ultimus Fund Solutions, Orange Investment Advisors

*Net performance shown is the Orange Investment Advisers ("the Firm") Structured Credit composite in USD. Past performance is not indicative of future results. Changes in exchange rates may have adverse effects. Net performance results reflect the application of the highest incremental rate of the standard investment advisory fee schedule to gross performance results. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. Investment management fees are available upon request. The Firm claims compliance with the GIPS® standards; this information is supplemental to the GIPS® report included in this material. Returns greater than one year are annualized.

Sector-wise, the main contributor was RMBS which comprised 40% of the portfolio and contributed 1% to portfolio return. Corporate Structured notes finally saw some positive price action despite a bear curve flattener and the return to the most inverted yield curve in 40 years. This pricing action is indicative of a bottoming pricing-wise for our corporate CMS floaters as, in spite of their 0% coupons, they now yield in excess of 5% in many cases due to accretion to par. ABS was the main detractor despite comprising only 6% of the portfolio, due to a servicing transfer event that impacted a particular subprime auto ABS issuer.

There was a significant amount of trading activity in the portfolio in Q2 with continued focus on security selection. Most of the sales were shorter duration Prime and Alt-A RMBS securities trading close to par at yields below 7%, while purchases were concentrated in RMBS, Small Balance Commercial and CMBS conduit securities at yields above 8.5%. The CMBS market has experienced a buyers' strike over the last six months with limited liquidity for seasoned subordinate tranches and senior bonds backed by office and retail collateral. One thing giving buyers pause is their expectation of rating agencies downgrades which can force accounts to shed risk at inopportune times.

Along with SASB and Conduit bonds, Small Balance Commercial (SBC) subordinate tranches also failed to attract much sponsorship with yields rising above 9% as the proverbial "baby being thrown out with the bath water" has reached every sector that has commercial in its name. This has presented opportunities for the portfolio in the form of both seasoned Legacy SBC subordinate floaters (pre-2008 issuance) and fixed-rate subordinate tranches off more recent deals. We also added a Freddie K subordinate floater at a loss-adjusted yield above 10% as there is also lack of demand for non-investment grade floaters off agency multifamily collateral. Finally, we added an A-rated senior tranche from a new issue Subprime Auto ABS deal at 8% yield despite the deal having 53% of credit enhancement. .

Outlook: Coming into 2023, our view was that the Fed funds rate would reach 5.00% by the middle of 2023 and it looks like it may go a little higher as the Fed is expected to hike rates to 5.25% at its July 25-26 meeting. We do expect a long-awaited mild recession to arrive at the end of 2023 or early 2024 as consumers get tapped out of excess savings and resume student loan payments, and the economy finally feels the cumulative lagged effect of 500bp of interest rate increases. The Fed has been clear about not making a quick decision to cut rates after ending its tightening cycle so we think the earliest period for the first Fed rate cuts will now be Q2 2024. While inflation is expected to decelerate into the 3 – 4% by the end of 2023, it will be difficult for the Fed to bring it back to 2% without a more severe economic decline due to the sticky nature of services and wage-related components. We maintain our projection that the 10-year Treasury will remain rangebound within 3.25%-4% in 2H 2023 given that weaker economic growth will be counterbalanced by sticky inflation and continuing QT that will put pressure on the long-end. We also expect the 2-year to re-enter our projected range of 3.75% and 4.50% during 2H23 as the eventual rate cuts begin to be priced in. While the curve may not re-steepen in 2023, we do expect it to end the year much less inverted.

While credit spreads have tightened across sectors, there has been limited spread tightening in Legacy RMBS and an actual spread widening in CMBS and Small Balance Commercial sectors where we increased our exposure during Q2. The Legacy RMBS space is suffering from poor sponsorship given its small outstanding amount (less than $550bn) but loss-adjusted yields above 8.5% are hard to pass up on seasoned assets backed by residential real estate with a massive amount of built-up equity. In the CMBS space we have mostly focused on the top of the capital structure (senior tranches and investment-grade subordinate bonds with plenty of credit support). The pricing on these senior and IG subordinate bonds is quite punitive and accounts for deep recessionary scenarios with significant amounts of extension. We are currently looking at all seasoned conduit and SASB tranches at very punitive extension and modification scenarios and see loss-adjusted yields above 10% in our base case runs. We believe CMBS conduits and select SASB bonds offer a tremendous amount of convexity at current valuations and expect the market to re-value these bonds higher eventually once there is more clarity regarding the future economic conditions. In addition to our core 70% position in RMBS, CMBS and ABS we are maintaining a 13% allocation to liquid investments in cash and Treasuries. We expect increased spread volatility in the near term, though, and we are looking to capitalize on that by adding RMBS, CLOs and ABS upon any meaningful credit spread widening.

6/30/2023					
Sector	**Allocation**	**Price**	**Yield**	**Eff Dur**	**Sprd Dur**
RMBS	40.4%	$79.56	8.8%	2.2	3.9
CMBS	23.0%	$83.64	11.1%	1.8	3.1
ABS	5.7%	$91.30	11.0%	1.2	2.4
CLO/CDO	4.2%	$75.33	9.6%	0.1	3.3
CORP	12.9%	$66.67	5.1%	3.1	7.0
GOVT	9.0%	$98.59	4.4%	3.2	0.0
Cash	4.7%	$98.61	4.6%	0.0	0.0
Total	**100%**	**$81.11**	**8.4%**	**2.1**	**3.4**
Blbg Agg		**$89.79**	**4.8%**	**6.3**	**6.3**

Source: Ultimus Fund Solutions, Orange Investment Advisors
Sector information shown represents the quarterly average allocations and price, of the entire portfolio and should not be considered a recommendation to purchase or sell a particular security. All other information is as of 6/30/2023. There is no assurance that, as of the date of publication, the securities remain in the portfolio; such information is subject to change at any time and may differ, sometimes significantly, from individual client portfolios.

GIPS® Report

Orange Investment Advisors Structured Credit Value Strategy Composite

Composite Inception Date: September 1, 2018

Composite Creation Date: July 2018

Year End	Composite Performance				Annualized 3-Year Standard Deviation			Total Assets		
	Gross	Actual Net	Model Net	Benchmark	Composite	Benchmark	Internal Dispersion	Firm	Composite	Number of Accounts
2022	3.87%	3.10%	3.53%	2.09%	2.81%	6.17%	N/A	547.26	342.26	1
2021	-4.85%	-6.27%	-5.47%	-13.01%	5.88%	5.85%	N/A	526.47	327.74	1
2020	6.36%	4.79%	5.67%	-1.54%	5.37%	3.40%	N/A	422.64	294.19	1
2019	15.74%	14.05%	15.00%	7.51%	N/A	N/A	N/A	277.48	193.05	1
2018	8.92%	7.31%	8.21%	8.72%	N/A	N/A	N/A	39.74	39.74	1

Firm Definition

Orange Investment Advisors is a Fixed income investment manager that invests primarily in U.S.-based Structured Credit securities. Orange Investment Advisors is defined as an independent investment management firm that is not affiliated with any parent organization. Policies for valuing investments, calculating performance, and preparing GIPS reports are available upon request.

Firm Verification Statement

Orange Investment Advisors claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Orange Investment Advisors has been independently verified for the periods August 1, 2018 through December 31, 2021. The verification report is available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firmwide basis. Verification does not provide assurance on the accuracy of any specific performance report. This composite was created in July 2021, and the inception date is September 1, 2018. A list of composite descriptions and a list of limited distribution pooled funds are available upon request.

Composite Description

The Structured Credit Value Strategy Composite includes all fee paying SMAs and Funds that invest in Structured Credit based on Orange's Active Value Security Selection approach which is a bottom-up, value-based investment strategy. The strategy seeks to provide a high level of income and total return with low sensitivity to interest rates and credit spreads by taking advantage of opportunities in the inefficient and non-indexed structured credit market. Derivatives, including options, futures, and swaps, and short positions may be used, primarily for hedging or managing certain risks, including interest or credit spread risk. The account minimum for the composite is $1 million.

Benchmark Description

The benchmark for the composite is the Barclays Bloomberg U.S. Aggregate Bond Total Return Index. Index returns reflect the reinvestment of income, but do not include any expenses, such as transaction costs and management fees.

Performance Calculation

Valuations are computed and performance is reported in U.S. dollars.

Returns include the reinvestment of income and are presented gross and net of fees. Gross returns are net of transaction costs. Actual net returns are net of actual transaction costs, management fees, as well as other fund operating fees and expenses. Model net returns are supplemental to actual net returns and are calculated by reducing the monthly composite gross return by a model fee of 0.05417%, which equates to an annual model fee of 0.65%, the highest fee charged to any SMA client. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. Past performance does not guarantee future results.

Investment Management Fee Schedule

The standard annual fee schedule is: 0.65% on the first $100 million, 0.55% on the next $150 million, and 0.45% on all assets above $250 million under management.

Composite Dispersion

Internal dispersion is calculated using the equal-weighted standard deviation of annual gross returns of those portfolios that were included in the composite for the entire year. It is not presented ("N/A") when there are five or fewer portfolios in the composite for the entire year.

Standard Deviation

The three-year annualized standard deviation measures the variability of the composite gross returns and the benchmark returns over the preceding 36-month period.

Trademark

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