

Waterfront Balanced Composite 3Q 2022 Commentary

The third quarter of 2022 was marked by volatility as a promising July rally fizzled with August and September declines driving a negative return for the quarter. The headwinds are familiar and increasingly reflected in asset markets as high inflation readings, hawkish commentary from Federal Reserve Board members, ongoing geopolitical tensions and pandemic impacts conspire to sour investor risk appetites. Inflation measures have been elevated for over a year with hopes of a reprieve proving unfounded. In response, the Federal Reserve raised short-term interest rates by a cumulative 150 basis points (bps) during the quarter. In addition, the committee's commentary in speeches and meeting minutes signal further interest rate hikes are likely with the pace faster than markets had previously thought. China continues to enforce a 'Zero-COVID' policy which resulted in intermittent lockdowns during the quarter snarling supply chains already under duress. The Russian invasion of Ukraine has become a military occupation of parts of the country with little hope for near-term resolution. As the quarter came to a close, liquidity issues in U.K. credit markets forced a reversal in monetary policy with the Bank of England pivoting to quantitative easing to calm markets. At the time of writing this commentary, U.K. credit markets continue to experience unusual levels of volatility and illiquidity. Looking forward, the U.S. mid-term elections could reshape Congress and have a meaningful impact on the legislative agenda for the next two years. In the face of all these headwinds and concerns, equity markets declined with the S&P 500 falling 4.9% during the third quarter. Fixed Income markets moved in lockstep with equities as interest rates rose and credit spreads widened. The Bloomberg U.S. Aggregate Government / Credit Index declined 4.6% during the quarter.

	Q3 Total Return
Waterfront Balanced Composite	<3.3%>
S&P 500 Index	<4.9%>
Bloomberg U.S. Agg Gov't/Credit Index	<4.6%>
60% S&P 500 / 40% BBG U.S. Agg Gov't/Credit (blended benchmark)	<4.7%>
Morningstar Moderate Allocation category (median return)	<4.4%>

The Waterfront Balanced strategy declined 3.3% in the third quarter, outperforming the funds benchmark (blended benchmark consisting of 60% S&P 500 & 40% Bloomberg U.S. Aggregate Govt/Credit) as well as peers in the Morningstar Moderate Allocation category. Relative to the benchmark, performance benefited from outperformance in both the equity and fixed income sleeves of the portfolio.

On August 11, the allocation of the Balanced strategy was adjusted after a strong rally in July to reflect the growing

Contact your advisor for a copy of the 'WB allocation update' which has more detail on our thinking at the time of the adjustment.

evidence supporting a significant deceleration in global economic growth. The equity weight was reduced from ~69% to ~61% with the proceeds invested in intermediate duration Treasury bonds. For more detail on the rationale for this move, please reach out to your advisor. At quarter end, the strategy's allocation to equity was 59% with

approximately 40% in fixed income and the balance in cash.

The equity sleeve declined 3.7% during the quarter, outperforming the benchmark as our quality bias and valuation discipline benefited relative performance. In addition, strong stock selection in the Technology, Financials and Communication Services sectors and an elevated cash position were meaningful contributors to relative performance.

The fixed income sleeve declined 4.3% during the quarter, modestly outperforming the benchmark as our short duration position and conservative credit exposure softened the impact of rising interest rates and widening credit spreads. The fixed income sleeve has over two-thirds of its exposure to Treasury's with the balance in Investment Grade rated bonds. During the quarter, Investment Grade credit spreads widened to 167 bps, above the 25yr average of ~150bps.

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The quarter's top contributors to performance were eclectic with several simply rebounding from dramatic declines in previous periods. Autodesk, Microchip Technology and Morgan Stanley rebounded from punishing declines in the first half of 2022. In each case, the fundamental outlook is difficult but adequately reflected in the equity valuation supporting my continued conviction. PayPal is a recent addition to the strategy which rallied after a 'better-than-feared'

TOP CONTRIBUTORS	AVG. WEIGHT	RETURN	CONTRIBUTION
Autodesk Inc. (ADSK)	2.35%	8.6%	0.33%
PayPal Holdings (PYPL)	1.16%	23.2%	0.24%
Motorola Solutions (MSI)	1.55%	7.2%	0.19%
Microchip Technology (MCHP)	1.53%	5.5%	0.17%
Morgan Stanley (MS)	1.99%	4.9%	0.13%

earnings report in July during which management committed to a renewed focus on profitability. In addition, during the quarter an activist investor publicly disclosed a stake in the company. Motorola Solutions is a beneficiary of reinvigorated investment by police,

fire and emergency services departments which is proving more resilient than market expectations driving a rebound in the stock.

Positions in Apple, Jazz Pharmaceuticals, VF Corp., Canadian Natural Resources and Elanco Animal Health (no longer a holding) were notable detractors during the quarter. Apple is a significant underweight for the equity sleeve (S&P 500 Index weight of ~6.9%) and it posted strong performance in the quarter as new product launches in September were received favorably by consumers. However, the equity's valuation fully reflects the strength of the franchise and benefit from an iPhone upgrade cycle in my view which underpins the underweight. VF Corp and Canadian Natural Resources declined in value as concerns

over economic growth proliferated. In each case, while growth will inevitably slow, their business is likely to prove durable in my view, rewarding patient investors. Elanco Animal Health was a disappointing investment which struggled with sub-optimal returns on R&D investment and poor execution of its sales and marketing strategies. After another quarter during which it underperformed peers in the animal health industry, I exited the position.

TOP DETRACTORS	AVG. WEIGHT	RETURN	CONTRIBUTION
Apple Inc. (AAPL)	1.5%	1.2%	<0.32%>
Jazz Pharmaceuticals PLC (JAZZ)	2.6%	<14.6%>	<0.24%>
VF Corp (VFC)	0.7%	<31.5%>	<0.23%>
Canadian Natural Resources (CNQ)	1.4%	<10.5%>	<0.18%>
Elanco Animal Health (ELAN)	0.5%	<24.6%>	<0.16%>

As I look forward, the backdrop for risk assets has deteriorated meaningfully over the last nine months. The inflation dynamic is troubling and a meaningful risk to the outlook for asset values. The war in Ukraine is, first and foremost, a human tragedy, but also an unhelpful catalyst for higher prices as the region is rich in energy, agriculture, metals and industrial goods. While I am encouraged by the consensus view that inflation rates will cool in the months ahead, the pace of interest rate increases (both completed and contemplated) by global central banks has become extreme. The impacts from tighter monetary policy occur with a lag and will likely drive a meaningful reset in consumer and corporate spending and investment in the months ahead.

While the outlook has deteriorated, my focus is unchanged. Across economic cycles and irrespective of market moods, I seek to maintain an emphasis on finding high quality, growing companies whose securities are trading at a reasonable valuation with visible catalysts to drive relative performance over the next twelve months. This approach has served investors well over time, and my confidence in it has not waned.

Matt Hekman
Portfolio Manager

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Returns presented are time-weighted returns. Valuations are computed and performance is reported in U.S. dollars.

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