

Q1 2023 Riverwater BLUE Update

Performance

The first quarter of 2023 ended on a positive note despite a quarter full of poor headlines. We saw the 2nd and 3rd largest bank failures in US history and the Federal Reserve reaffirmed its intent to continue hiking interest rates in its battle against inflation – not typically good signs for the markets. What did all the negative market news mean for returns? The S&P 500 finished the quarter up nearly 7.5% and the Bloomberg Aggregate Bond Index rallied 3%.

What happened in the first quarter was a reversal of the last twelve months. Higher growth stocks and longer dated bonds were crushed over the last year while the Fed attacked inflation by raising interest rates. As the Fed raises rates, it increases the cost of capital for companies that rely on debt financing and future growth to support their valuations. The turmoil in the banking sector and negative economic data gave investors confidence that the Fed is going to be forced to pivot and eventually cut rates instead of raising further by the end of the year. This pivot is beneficial for higher growth stocks and longer dated bonds. With that expectation in hand, market laggards can become the leaders. Exactly what happened during Q1.

Similar to what happened in the broad market, the laggards in the BLUE portfolio became some of the best performers, and some of the best performers in BLUE during 2022 ended up being some of the worst during the most recent quarter. Parnassus Value Equity was a bottom quartile performer over the trailing twelve months, but the change in market environment helped carry it to a performance in the top third of its peer group during the quarter. On the flip side, the Calvert Equity Fund performed in the top three percent over the last year, but was a bottom decile performer during Q1, trailing its index by nearly 10%. This kind of market fluctuation is why we rely on a deep understanding of the fund's philosophy and process so we can understand and try to anticipate how they will perform in different market environments. This deep due diligence gives us comfort and patience to look through volatile short-term periods to truly focus on long-term value creation.

During this volatile environment, all five of the BLUE Portfolios had positive absolute performance with returns increasing in magnitude as the stock allocation increases. Despite positive absolute performance all the models slightly trailed their respective benchmarks during the first quarter. The main culprit for the relative underperformance was the performance of the underlying funds. As a reminder, these portfolios tend to have a high quality and more conservative approach to risk taking, so when the market rallies 7.5% during the quarter it does not surprise us that many of the funds slightly trailed peers. Despite the difficult quarter on a relative basis, all five of the BLUE portfolios are ahead of their respective benchmarks over the last twelve months and since inception. Over the trailing three years, four out of five BLUE models are ahead of benchmark.

Social Impact

The Riverwater mission is to make the world a better place by growing wealth through sustainable investing. In that spirit, we like to highlight the positive impact made by one of the mutual fund managers within our Riverwater BLUE models.

Domini Impact Investments is a boutique investment firm based out of New York that has been a global leader in sustainable investing and in particular a leader in engagement. The Domini Impact International portfolio holds positions in Unilever PLC, Mondelez, and Kao Corp, all of which have exposure to the palm oil industry within their supply chain. Palm oil has become a lightning rod over the last decade due to the vast amount of dense tropical forests that have been cleared for palm oil plantations, whose output is then sold globally. Domini has engaged with all these companies to understand how they implement their commitments to protect forests and communities.

With help from Domini's engagement efforts, Kao Corp has launched a new 11-year initiative to assist small palm oil farmers to improve their yields and efficiency without further deforestation. The partnership between global corporations and small farmers producing this crop can have a significant impact by showing how global companies can work with small farmers to procure palm oil without damaging forests and harming biodiversity.

Thank you for your ongoing support of Riverwater Partners and the Riverwater BLUE portfolios.

Connor Doak, CFA

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