RIVERWATER BLUE PORTFOLIOS

Performance: A Surprising Turn of Events

As we entered the year, the prevailing consensus among economists and market pundits, myself included, was a looming recession. Contrary to predictions for the S&P 500 which ranged widely from -4% to +16%, not a single pundit foresaw the actual 26% return. Despite significant volatility and fluctuating interest rate expectations, the yield curve remained remarkably stable, contributing to a 5.5% positive return for the Bloomberg US Aggregate Bond Index, and breaking its three-year streak of negative returns.

The year proved an exceptional one for investors. Heading into the fourth quarter, it seemed as if investing in anything other than the S&P 500 Index would have been a misstep. Through September, the “Magnificent 7” had driven over 85% of the return of the S&P 500 Index. However, by Q4, broader market segments rallied. The Russell 2000 Index, representing small-cap stocks, posted a 14% return, bringing its year-to-date total to nearly 17%. The bond market also saw historic gains, finishing the quarter with a positive 6.8% return and pulling it out of negative territory for the year.

Several factors fueled this broad market rally. First, inflation decreased faster than anticipated, raising the likelihood of rate cuts in 2024 and making additional rate hikes seem unlikely. This encouraged investors to re-enter areas of the stock market more sensitive to interest rates. Second, a series of slowing yet positive economic data points convinced the market that the Federal Reserve may achieve the elusive "soft landing." While there is evidence the economy is slowing from its rapid Q3 pace, it has exhibited resilience. However, as prudent investors, caution prevails, and we remain vigilant against unnecessary risk-taking.

Risk Management

Our commitment to risk management is a fundamental principle guiding how we construct the BLUE models and select investment managers. This commitment steers us towards managers with strong risk management practices who tend to be less exposed to speculative or overvalued market segments.

With the market broadening in the 4th quarter, our models performed in line or slightly outperformed their benchmarks, with the exception of the BLUE Sustainable Income portfolio. Ironically, this portfolio stood out as the best relative performer throughout the year due to its lower sensitivity to interest rates than its benchmark.

The Riverwater BLUE models are meticulously crafted as long-term buy-and-hold portfolios with minimal turnover between funds. However, when adjustments are made to the underlying funds, it is often driven by a commitment to enhancing risk management strategies. Through this lens, we identified two specific areas where improvements could be made to the risk and return metrics of these portfolios.

Early in the quarter, a strategic decision was made to replace the Parnassus Mid Cap Fund with the Boston Trust Walden MidCap Fund across all our portfolios. This change was prompted by the newly available Boston Trust option on the platform, coupled with our confidence in their ability to deliver highly competitive risk-adjusted returns against both their benchmark and peer group.

In addition, we introduced the Brown Advisory Sustainable Large Growth Fund to the higher equity models (Sustainable Growth and Sustainable Aggressive Growth). This strategic addition aimed to complement our existing exposure to the large growth sector of the market. Until this adjustment, our exclusive exposure to large growth equities was through the Calvert Equity Fund. While the Calvert fund boasts an impressive track record in stock selection, it tends to avoid what we term the "aggressive growth" segment of the market. During periods of favorable performance in this sub-style, there is an elevated risk of underperformance relative to the benchmark due to its lack of exposure.

Brown Advisory has a broader definition of “growth” which allows them to venture into more aggressive market segments, albeit within a robust risk management framework. Following thorough discussions with their team, we developed confidence in their ability to navigate this historically volatile market segment, leading us to include them in our two most aggressive models. Our anticipation is that this strategic inclusion will enable us to gain exposure to market areas where we have traditionally been underweight, all while maintaining a controlled and prudent approach.

Social and Environmental Impact: CCM Community Impact Bond Fund

To underscore our commitment to creating a better world through sustainable investing, we spotlight an instance of positive impact achieved by one of our fund managers through their sustainable investments.

The CCM Community Impact Bond Fund is a consistent presence in our BLUE models due to its remarkable ability to fund projects that not only make a genuine impact in local communities but also deliver robust risk-adjusted returns. For this quarter, we highlight their investment in Agency CMBS securities (large commercial real estate loans that are backed by a government entity), with one such investment having exposure to the Hawthorne Eco Village Apartments in Minneapolis, MN. The 75 units at Hawthorne Eco Village are dedicated to providing safe and affordable housing for households earning less than 60% of the area median income. This investment is poised to rejuvenate the neighborhood and act as a catalyst for further housing development in the area.

Beyond housing, the Hawthorne Eco Village offers invaluable no-cost employment readiness services for residents and members of the broader community.

Such investments serve as powerful examples, showcasing that investors can achieve competitive returns while simultaneously making a tangible and positive impact on their communities.

As always, we appreciate your trust and confidence.

Connor

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See next page for important disclosures.

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The performance presented is hypothetical and back-tested with the benefit of hindsight using similar holdings and portfolio asset allocation weights. This performance was generated using similar holdings and asset allocations but the hypothetical performance presented above assumes semi-annual rebalances whereas live BLUE models are rebalanced based off of fluctuation away from target weights. Actual accounts may be rebalanced more or less than semi-annually. The performance does not represent performance of a live account; it is provided for illustrative purposes only and not meant to be a representation of either future or historical returns.

Hypothetical performance information is subject to limitations and historical data may contain errors or be affected by omissions. Past hypothetical performance is not indicative of future results. Therefore, no current or prospective client should assume that future performance will be profitable, will equal the performance results reflected, or will equal any corresponding historical benchmark index. The performance presented herein reflects the reinvestment of dividends and other income. However, the performance returns do not reflect the impact that material economic and market factors could have had on the portfolio manager's decision-making process. For example, factors such as: 1) timing of purchases and sales of securities, 2) length of time positions are held, 3) market and/or sector trends, 4) client restrictions, and/or 5) other unforeseen factors that could have had a material influence on the performance results of a client's account if actual trading had taken place.

The Net Return was calculated using the highest fee of 60 bps annualized, applied on a daily pro rata basis. Live BLUE model fees are applied monthly at a rate of 60 bps annualized.

The historical performance results for all indices are provided exclusively for comparison purposes only with the intent to provide general comparative information to assist an individual client or prospective client in determining whether Riverwater Partners' performance meets, or continues to meet, his/her investment objective(s). Comparative indices may be more or less volatile than Riverwater portfolios. It should not be assumed that Riverwater Partners' account holdings will correspond directly to any such comparative benchmark index. For reasons including variances in the investment management fee, differing client investment objectives and/or risk tolerance, market fluctuation, the date on which a client engaged Riverwater Partners' investment management services, and any account contributions or withdrawals, the performance of a specific client's account may have varied substantially from the indicated portfolio performance results.

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