

Riverwater BLUE Quarterly Review

By Connor Doak, CFA

The third quarter of 2022 continued the story from the first few months of the year: rapidly increasing interest rates and high levels of stock market volatility. The stock market this quarter was especially volatile with the S&P 500 rallying 12% to start the quarter on the hopes the Fed would pivot from its higher for longer interest rate policy. Stocks quickly reversed in the final 6 weeks to give up all those gains (and then some) to close the quarter near the 2022 lows. Alas, the Fed pivot the market was expecting did not come to fruition following the affirmation that the Fed is unlikely to change its interest rate policy. This reverberated through the bond market as well with the 10 Year US Treasury rising over 1% during the final 6 weeks of the quarter, causing bond prices to fall further.

Amongst this difficult backdrop and heightened volatility, the Riverwater BLUE portfolios had mixed results over the quarter and trailing year. The BLUE Sustainable Income and BLUE Sustainable Income & Growth portfolios, while falling in value, held up better than their respective benchmarks due to the lower sensitivity these portfolios have to rising interest rates. Duration, as the measure is called, describes a bond's price performance relative to changes in interest rates. As interest rates rise, bond prices fall, so having a lower duration is beneficial in environments with rising interest rates. In addition to the lower duration, the underlying bond managers performed well relative to their respective peer groups and indices. All four bond managers ranked in the top one-third of their category during the quarter. This strong relative performance from the bond managers has also carried the portfolio to excess returns over the trailing one-year, three-year, and since inception periods.

The higher risk BLUE portfolio models with larger stock allocations underperformed during the quarter and trailing year. The main culprit for the underperformance were the struggles of the underlying stock mutual funds. A few of the larger positions; Parnassus Core Equity, Parnassus Endeavor, and Calvert Equity funds all underperformed their respective peer groups during the quarter, thus dragging down the returns for these models. Despite the underperformance during the quarter, we remain confident in the long-term outlook for these funds. All the funds maintain seasoned portfolio management teams, in-depth research processes, and strong long-term performance track records.

During the quarter, we also took an opportunity to restructure our models into our highest conviction mutual fund managers. Given the more difficult economic environment ahead, we reduced the already small exposure to passively managed mutual funds. We decided to redeploy those assets to active managers who are continually looking at company

fundamentals to find and identify stocks and bonds they believe offer the best risk-adjusted returns. We believe this switch will serve the BLUE portfolios well. As markets continue into the next 12 months of elevated levels of uncertainty, we are comforted having analyst eyes on corporate financial statements, looking at economic outlooks, and undertaking deep due diligence. In addition to reducing the number of passive funds, we also added the CCM Alternative Income Fund to the Sustainable Income & Growth, Sustainable Growth & Income, and Sustainable Growth models. This fund is designed to have low volatility, low correlation to stocks and bonds, and to act as a diversifier from both stocks and bonds. During the third quarter, the CCM Alternative Income Fund did just that. This new position was the top performing mutual fund in both the Sustainable Growth & Income, and Sustainable Growth models during the quarter.

As we move into a period of heightened economic uncertainty, we believe the BLUE portfolios are well positioned for a variety of economic environments. We retain our conviction in the underlying managers' ability to select stocks and bonds to drive excess returns over a full market cycle.

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

Disclosures:

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