



## Q3 2024: Performance Update & Commentary:

Please find below our quarterly update on our two existing strategies below, Income and Income + Value

Income Strategy Total Returns, net of fees	3Q 2024	YTD	Inception <sup>1</sup>
Income	6.15%	9.25%	9.25%
Index <sup>2</sup>	9.24%	10.93%	10.93%

1. Inception date is 3/1/2024
2. MVIS US Mortgage REIT Index, Total Return Net

Value Strategy Total Returns, net of fees	3Q 2024	YTD	Inception <sup>1</sup>
Value	4.38%	6.01%	6.01%
Index <sup>2</sup>	9.24%	13.78%	13.78%

1. Inception date is 5/1/2024
2. MVIS US Mortgage REIT Index, Total Return Net

Q3 2024 returns, net of fees, were 6.15% and 4.38% for the Income and Income + Value strategies, respectively. Performance for the quarter in both strategies was primarily driven by the broad small cap rally seen in July, in which we saw significant outperformance in the Russell 2000 (+ ~10.16%) versus the S&P 500 (~ 1.21%). However, we did underperform the index in both strategies for the quarter. We see underperformance being caused by the following:

1. Allocating ~10-15% to cash/money market instruments
2. A more dominant rally in the “lower quality” names

Regarding point #1, we have made the decision to invest the remaining cash allocation across both strategies. On point #2, we believe that while real estate, mortgage REITs, and small caps in general benefitted from the market pricing in a dovish fed and future rate cuts, we believe that the “lower quality” businesses rallied more. When we mention lower quality, we mean businesses which we have identified in our benchmark that have had historically subpar management, which may be reflected in their historical returns among other factors. They may have more leverage, or more what we view as “riskier” credit profiles that may benefit more from lower rates. We avoid these businesses, sticking to what we believe are the highest-quality names in terms of management, asset holdings and overall business quality. We believe that over the long term (at least 3-5years), identifying and investing in the higher-quality names with historically good management may translate to better risk-adjusted returns relative to the lower-quality names.

## Rate Cuts Are Not What They Are Cut Out to Be

Investors, companies and politicians alike have all been clamoring for rate cuts for the last couple of years amidst the worst inflation since the Carter era as higher rates has naturally impeded business activity and electoral possibilities. And thus, the rate cuts have come, with the Fed cutting the target rate 50bps to a range of 4.75-5.00%. However, like a monkey’s paw, what is the real cost?

The famous saying on Wall Street that tends to blow up in investors faces is “this time it’s different.”

This phrase was said to justify the tech valuations in the 2001 bubble, the real estate valuations in the 2008 bubble, and more. In general, as a rate cut cycle begins, so too does the market drawdown, likely as the impact of the rate cuts does not offset the recessionary impact of the worsening labor market, asset devaluations, etc... 2020 can be viewed as an exception given the rapid recovery from the drawdown, except that held consequences of its own.

Unfortunately, Fed/Government intervention and borrowing was significantly greater in 2020-2021 versus the prior two recessions, which led to the inflation we still see today.

However, we do not think that the biggest risk to the market is some massive credit event similar to 2008 but rather that the cut itself was unnecessary. Our view is that the risk of a bad fed policy move is stagflation, and our interpretation of what markets have done post-rate cut is that it may also be concerned about this. Case in point, US Treasury rates are broadly higher since the 9/18 Fed cut, with the 10yr selling off 37bps to 4.10% as of October 11th. Granted, the Non-Farm Payroll number of 254k for September was much higher than the expected 132.5k number helped cause rates to rise, even if we may see significant negative revisions in the forward months.

Due to the above, we find it prudent to remind investors to never remain complacent, regardless of what the broad market is currently doing. We continue to manage our positions and portfolios, focusing on company-level fundamentals and investing in what we believe to be high-quality firms that are misunderstood and undervalued. We do not invest based on what the broad market does alone. Instead, we do focus on companies that we believe can withstand broad volatility over the mid to long term.

The companies that we focus on are what we believe to be high-quality small-cap names that pay dividends/interest that we view as high-yield. Our goal is to acquire these assets at attractive valuations and earn investors good total return, both from price appreciation and income earned.

*In good times, we strive to earn good total return, and in volatile times, we intend for the income to offset some of the price volatility of our holdings.*

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## **Other Noteworthy Events:**

- **CTO Realty (CTO) originated \$273.8mm in acquisitions and structured investments YTD, exceeding 2024 guidance**
  - CTO is a holding in both our Income and Income+ Value Strategies
  - We view CTO as one of the most unique opportunities within the REIT subsector as the Company has been successfully able to rotate out of its single-tenant office properties and reallocate to “power-center” properties (retail located within areas with favorable demographic trends)
  - CTO originated the \$273.8mm at a weighted average yield of 9.1%
    - We believe that CTO is priced at a discount to peers, unjustifiably so, given that it has been able to exceed expectations on reallocating its portfolio at favorable levels
    - ***Pendulum Clients receive periodic, in-depth information on CTO. Please reach out if interested.***

## Disclaimer:

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This article contains certain forward-looking statements that indicate future possibilities. Due to known and unknown risks, other uncertainties and factors, actual results may differ materially. As such, there is no guarantee that any views and opinions expressed herein will come to pass.

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Performance data currently includes all clients invested per the strategy they have chosen. The Firm has the discretion to exclude portfolios from the performance data set if the invested assets are not within each strategy’s targeted holdings. For example, if a client wants to be in the Income Strategy, but is only in index ETFs, we would exclude that portfolio from performance data set. Certain portfolios include restrictions on investment strategy, including but not limited to limiting the treasury bill/money market allocation. As the Firm’s discretion, as long as the client’s core equity and preferred investments align with the intended strategy, they are included in the performance data.

Returns presented are time-weighted total returns that have been adjusted for cash flows and include the reinvestment of income. Composite results have been aggregated monthly and weighted based on beginning-of-month portfolio valuations.

Past performance is not a guarantee of future results.

Performance includes the reinvestment of dividends, interest and other earnings. Certain investments may not have dividend or interest reinvested. Reinvestment into securities and/or treasuries and money market instruments are up to the Firm’s discretion.

Net returns reflect the deduction of management fees. Management fees are dependent on client assets under management, or with the benefit of breakpoints.

The benchmark used for both strategies is the MVIS US Mortgage REIT Index. This index tracks the performance of the largest and more liquid companies in the US Mortgage REITS Industry. This is a modified market cap-weighted index, and only includes REITs that derive at least 50% of their revenues from Mortgage, such as REITs that are primarily engaged in the purchase or service of commercial or residential mortgage loans or mortgage related securities. MVMORT covers at least 90% of the investable universe.

The volatility of the index represented in this material may be materially different from that of client portfolios. The index has been selected as client portfolios have a significant allocation to the Mortgage REIT sector. The underlying exposures, and specifically the securities in the selected benchmark index or indices, may vary substantially from that of the strategy presented.