PENDULUM

ASSET MANAGEMENT

January 29, 2025

Q4 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	4Q 2024	YTD	Inception[1]
Income	1.75%	11.16%	11.16%
	-7.45%	2.67%	2.67%

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

Value Strategy Total Returns, net of fees	4Q 2024	YTD	Inception[1]
Value	7.64%	14.10%	14.10%
	-7.45%	5.30%	5.30%

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

Q4 2024 returns, net of fees, were 1.42% and 7.31% for the Income and Income + Value strategies, respectively. Excess returns relative to the selected benchmark, the MVIS US Mortgage REIT Index Total Return Net, were 9.20% and 15.09% for Income and Income+ Value, respectively.

This quarter's outperformance, in my opinion, can be attributed to "lesser-quality" names losing traction from their post-election rally as rates across the treasury curve sold off. The ten-year treasury, for instance, began Q4 at 3.78% and ended at 4.57%, or a change of ~79bps. Higher rates may impact valuation across all subsectors of the market, but may especially impact small caps and even further, rate-sensitive small caps like mortgage REITs. "Lesser-quality" names in my opinion are typically poorly managed and as a result have underlying credit issues that higher rates exacerbate, such as a handful of commercial mortgage REITs that have significant delinquent or non-accrual loan exposure to office, multifamily or other CRE properties. Conversely, the "higher-quality" names may have seen inflows from sellers of the "lesser-quality" names.

Why the difference in returns between Income and Income+Value? Both had good quarters, but the Value Strategy benefited from allocations in non-dividend paying small cap insurance names that had rallied significantly from either successfully reorganizing or recovering from disasters that were in practice less destructive than on paper. One name in particular, American Coastal (ACIC), returned approximately 23% in Q4 2024 depending on client portfolio. ACIC is a windstorm insurance firm located in Florida and insures garden-variety condo buildings. Hurricane Milton caused ACIC to sell off significantly intra-quarter due to the uncertainty around losses, but I viewed this as a buying opportunity as ACIC has a robust reinsurance program in place among other factors that hedged losses from Milton. ACIC also held an investor day in December in which they announced the launch of a new "MGU" (Managing General Underwriter) as well as a 0.50/sh special dividend. ACIC navigating Milton, creating a new MGU and returning capital to investors helps solidify my long-term thesis on the name. ***Clients do receive more in-depth information on names like ACIC; for more interest, please reach out.***

On the other hand, I rotated out of America's Car-Mart (CRMT) in the Income + Value Strategy into another name that I believe has higher long-term potential. CRMT is a subprime "buy now pay here" auto-retailer based in Arkansas. Quarterly return for CRMT was anywhere from -7.50% to -8.00% depending on the client, and this is the return from the beginning of Q4 24 till when I sold on behalf of clients on 11/4/24. Negative performance is from a variety of factors but primarily from credit concerns on the firm's subprime auto receivables/loan portfolio. As losses accelerated from COVID times, the firm needed to provision extra capital, leading to not only losses but the market pricing CRMT at a discount to net asset value. Part of my thesis here was that credit would normalize and that even if credit did not return to 2021 or even pre-covid times, CRMT would benefit from any moderation and that its price/net asset value would rise in conjunction. While I still believe credit will normalize and that the firm has significant operational and managerial acumen, I viewed there to be better investment opportunities for clients.

I am excited about the current state of both the Income and Income + Value Strategies and continue to be optimistic about both strategies' prospects in 2025 onward.

Fed Policy Error & Mortgage REITs

The Fed in 2024 cut rates by 100bps, with a 50bp cut in September, 25bps in November and 25bps in December. In my view the 50bp cut was partially in response to the 800k+ downward revision in jobs which signaled that maybe the job market was not as strong as initially thought. However, since the start of the rate cut cycle, the treasury curve is up anywhere between 60-90bps depending on the part of the curve you look at. As I pointed out in my last quarterly commentary ("Rate Cuts Are Not What They are Cut Out to Be"), my view on the biggest risk to the market was not some massive credit event but Fed policy error, leading to inflation rearing its ugly head again. With a Trump win, the chatter around the market has been what impact will tariffs have on inflation. My opinion is that the impact will be insignificant relative to the overstimulus from the cuts themselves, coupled with the pro-growth economic policies from a Trump administration. My fear is that we have entered a head-fake for inflation and like Arthur Burns in the 70s, cutting at that time may have seemed like the right move in light of the '75 recession but clearly set up the path for double-digit inflation later on. And at this point we are not even in a recession, so maybe that is why the bond market has been selling off as of late.

What does this mean for client holdings? My intention for how I invest is that I like to own what I think are fundamentally undervalued names regardless of rate environment. However, I believe it is naïve to assume that higher rates won't have a negative impact on holdings, at least in the short term. Which is why I communicate to both current and prospective investors that I invest on behalf of clients for the long term.

In particular, the reason why I stress investing in the long term is because I believe that the mortgage REIT trade takes time to materialize. As I tell current investors, mortgage REITs were obliterated in 2020 from COVID which turned out to be a blessing in disguise for new investors as A) much of the sector experience a mass-deleveraging event and B) from that deleveraging, some firms were able to restructure their balance sheets in a way that they are much stronger post-COVID then pre-COVID. Despite this, many of these restructured firms trade at a significant discount to net asset value, even though the firm itself has improved and has quality management. That is the core of the mortgage REIT trade and where I add value for clients is identifying what I believe are the best managed names of the sort, as even though some firms restructured into better firms and offer compelling long-term return potential, many others are struggling from credit issues that arose post-COVID.

So, my thoughts are that rates may continue to go up, and that may be a net negative for the market and for mortgage REITs in the short term. However, I view the long-term potential return potential of firm-owned mortgage REITs (as well as the rest of our holdings) to be compelling.

If you have any questions, please reach out via our website, www.penduluminvest.com.

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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.

The benchmark used for both strategies is the MVIS US Mortgage REIT Index, Total Return Net (MVMORTTR). This index tracks the performance of the largest and more liquid companies in the US Mortgage REITS Industry. The index includes price returns and dividends but withholds dividends for tax purposes. 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. MVMORTTR 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.