

April 25th 2022 | Scott Carmack & Ethan Lai (Portfolio Managers)

BOND MARKET HISTORYONICS

Merriam-Webster defines the word “histrionic” as overly dramatic or emotional. This is an apt description for both the Federal Reserve and the fixed income market in the first quarter of 2022, and provides a more accurate embodiment than “Taper Tantrum” since 2022 performance to date renders 2013 and 2014 as relatively benign. First, let’s frame the Federal Reserve in the context of Histrionic Personality Disorder as defined by Psychologists.

- **Attention seeking** – Bullard continues to “waterboard” the Treasury market on a weekly basis with his hawkish rhetoric, inundating the airwaves with ever-increasing allusions to faster rate hikes
- **Talks dramatically with strong opinions** – The Federal Reserve seems to think that rate policy has some affect on *supply* chain disruptions due to global economic shutdowns and war when, in reality, such policy has more influence on aggregate *demand* for credit, and ultimately goods and services.
- **Is influenced easily** – It is no coincidence that Fed policy reversed 180 degrees in a midterm election year and that politics is having a tangible affect on policy, in our opinion.
- **Thinks relationships are closer than they are** – Again, the supply chain issues that the global economy is experiencing are not driven by the Fed, and they account for much of the high inflationary prints.
- **Rapid Shifts in emotion** – Only twelve months ago the Federal Reserve opined “we are not even thinking about thinking about raising. Currently, they are insinuating a neutral rate by year-end (and they don’t even know what a neutral rate is)
- **No thinking before acting** – Considering they haven’t really *acted*, this pertains more to speaking.
- **Self-centered** – Ignoring the Fed “trading controversy” late last year and the personal liquidations in equity portfolios prior to their hawkish rhetoric, the Federal Reserve believes they control everything economic. And while they have a tangible effect, the U.S. economy is bigger than the Fed. Moreover, history has shown that they are more reactive to coincident and lagging economic indicators, than they are proactive.

But let’s put aside anymore Fed criticism because as investors we believe we are tasked with investing for “what is” rather than “what should be.” Furthermore, in our opinion, it is hapless strategy to attempt to “fight

the Fed” and much more constructive to handicap future economic outcomes and how the Fed will react within their decision-making constructs.

So, with that, let’s first delve into where we are and why the Fed is doing what they are doing in the context of their dual mandate: to achieve maximum employment with inflation stability. The chart below shows that if we are not at maximum employment in the United States, we *should* be there shortly. It plots unemployed workers minus job openings from

the JOLT’s survey. This series went slightly negative in 2018, indicating that there were more job openings than potential workers who were unemployed. Indeed, the Federal Reserve was raising rates during this time period and rightfully so – the employment portion of their mandate was being met. Recently, this series has fallen off of a cliff, and I would agree that the Federal Reserve *should* be taking steps to tighten. The common theme you will find in this newsletter is that I

Unemployed Workers - Job Openings

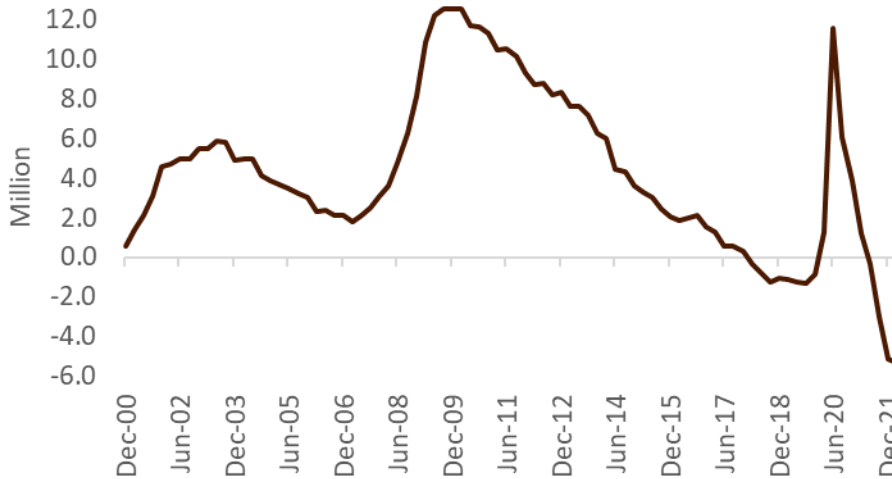


Figure 1 - Source: Bloomberg 4.25.2022; Past Performance is not indicative of future results; Investors cannot invest in an index

do not have a problem with *what* the Federal Reserve is doing – I have a problem with *how* they are doing it. It is one thing to pivot from dovish policy to hawkish policy, and admit that your transitory thesis on inflation was incorrect (which they have not done). It is an entirely different animal to transition from forecasting two rate hikes in 2022 (last year) to eleven currently. In our opinion, the latter jeopardizes investor and corporate sentiment and *could* potentially hurt the economic recovery. As I will attempt to demonstrate throughout this newsletter, I think the economy and the U.S. consumer are in a strong position to weather tighter monetary policy, but that the Federal Reserve should still be giving a nod to the transitory elements of inflation and that for many of the supply side issues, tightening policy likely *cannot* fix these.

Research suggests that children of people with Histrionic Personality Disorder may be more likely to develop it, so it comes as no surprise that the bond market is starting to develop symptoms. First consider the chart below. The market has certainly taken its cues from the Federal Reserve. The chart shows the implied amount of rate hikes by the Federal Reserve over the next 24 months. As you can see, the market was only pricing in approximately three rate hikes in October of 2021, about the time Jay Powell really pivoted in his messaging. Currently, we have approximately 11 priced-in, which doesn’t include the 25 bps they have already executed.

This newfound aggressiveness by the Federal Reserve has affected every point of the yield curve, and is glaringly obvious in the year-to-date returns for most fixed income asset classes. Here are some eye-opening

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Market Implied Pace of Rate Hikes in next 24m

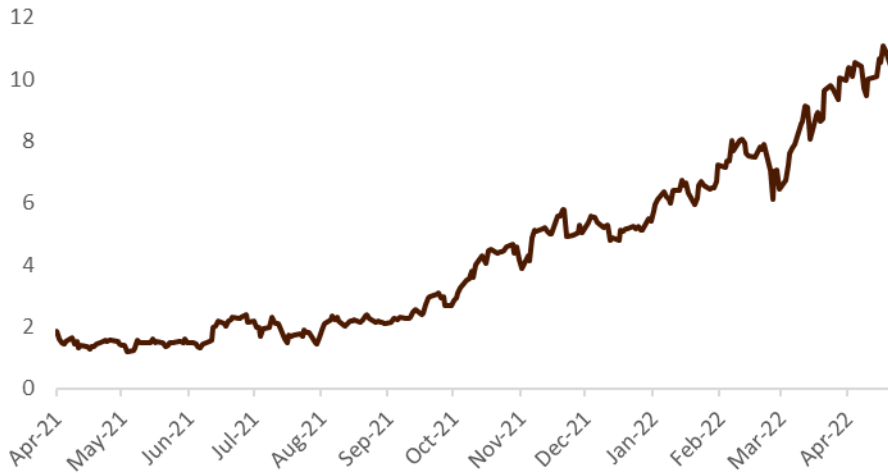


Figure 2-- Source: Morgan Stanley Global Macro Strategy 4.25.2022; Past Performance is not indicative of future results; Investors cannot invest in an index

performance of the Barclays Aggregate for each of the last 30 years.

This chart is staggering, and shows how much of an outlier 2022 has been in terms of broad fixed income performance. It has been my experience that performance like this typically mean reverts. In this case, a 6% gain in the Barclays Aggregate would *only* get the index back to performance levels of the worst years for bonds over the last 30-years. Again, this is why we have coined the term, “the Histrionic Bond Market” since “Taper Tantrum” does little to embody the return profile of bonds that the market has

witnessed. Still, we would caution investors who are ready to dynamically pare-back fixed income allocations. Telltale symptoms for Histrionic Personality Disorder are 1) subjects are influenced easily and 2) they can have rapid shifts in emotion. Given the pervasive bearishness from fixed income investors, higher year-over-year inflation comparisons, the potential for disinflationary demand destruction due to high energy prices, the potential for fiscal gridlock after the midterm elections (to name a few), we believe the Fed narrative and bond market performance could change rapidly and a significant multi-month relief rally *could* ensue.

returns as of April 22nd. The Global Aggregate is down 10.44%, Treasuries are down 10.73%, Credit is down 12.01%, U.S. Investment Grade Corporate Bonds are down 12.38%, and Agency Mortgage-Backed Securities are down 8.67%. All of these are broad-market indices published by Bloomberg and mentioned here just to provide context around how far-reaching the losses has been. A picture is worth a thousand words, so the below chart illustrates the yearly

Barclays Aggregate Performance By Year

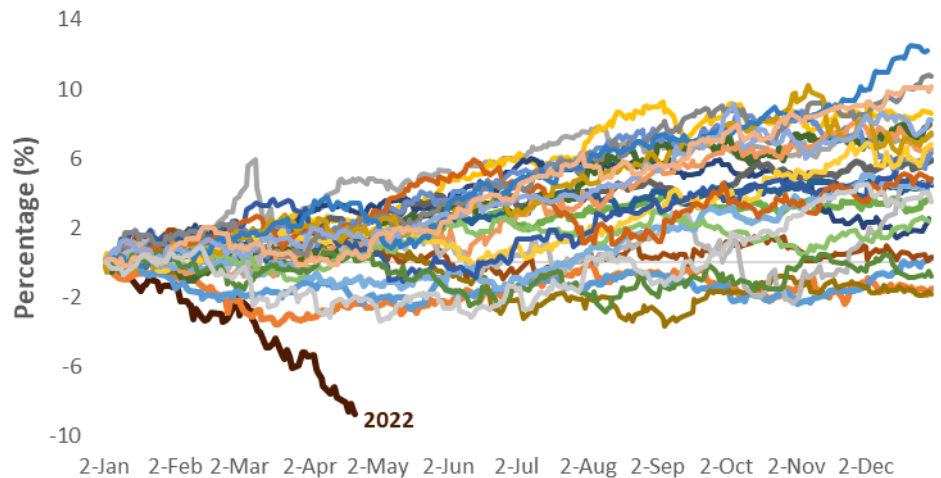


Figure 3-- Source: Bloomberg 4.25.2022; Past Performance is not indicative of future results; Investors cannot invest in an index

POISED FOR A COOL OFF IN INFLATION

Inflation is certainly running hotter than the Fed's 2% core target – significantly so. As a result, it makes sense that the Federal Reserve is normalizing rates, since most measures indicate that they are at full employment. We agree that a rate-hiking cycle should be well underway, however, their messaging over the past couple of months has strayed from deliberate and calculated to one that lacks consistency and integration – a major reason for the histrionic reaction from the bond market. We believe structurally higher inflation will remain over the longer-term, but much of the recent spike, in our opinion, has to do with transitory factors – supply chain disruption and the Russian/Ukrainian war. Even if these factors don't subside in the near-term, there is very little that the Fed can do to rectify them – short of killing aggregate demand, which we don't believe is their endgame. Moreover, the zero-Covid policy from China will likely lessen demand in the commodity markets. We believe this policy is untenable, but China accounts for approximately 17% of global GDP. Perhaps, more importantly, while we cannot forecast future inflation, we do know that year-over-year comparisons will start to become

easier. Consider the following chart. We just registered a year-over-year print of 6.5% on core-CPI. This certainly makes the Federal Reserve uncomfortable. However, the monthly increase for March was 0.32%. If we hold that stable for the rest of the year, year-over-year core inflation will be registering 4.4% by December – still elevated but enough for the Fed to be more deliberate in their action and communication, and potentially providing a reprieve for bond investors. This assumes that core price increases don't start to

decelerate due to demand destruction as well as supply chain recoveries. Furthermore, we think that as midterm elections near, the pressure on the Federal Reserve to preserve purchasing power for the electorate will become more modest. The point being made here is that even if inflation prints don't moderate (we expect they will), they will *appear* to moderate because of high yearly comparisons. We believe that such appearances will have an effect on the bond market, the political narrative, and the Federal Reserve.

Core CPI Year-over-Year



Figure 4 – Source: Bureau of Labor Statistics 4.25.2022; Data after 3.31.2022 is extrapolated by the author using the most recent MoM core-CPI print; Past Performance is not indicative of future results; Investors cannot invest in an index

CREDIT WILL REMAIN RESILIENT

We believe we are at the beginning of a rate hiking cycle, and that the Federal Reserve will attempt to decrease its balance sheet. The hiking schedule may not be as quick as the market expects, but nevertheless, we expect this trend to persist for the next couple of years. Isn't that bearish for risk assets? That depends.

Historically, the early stages of a rate hiking cycle have been advantageous for risk assets – both equities and credit. Later stages of a rate-hiking cycle are typically when warning signals emerge. It is our opinion that the media spends an inordinate amount of time discussing yield curve inversion. I typically focus on the difference between the 10-year yield and the 3-month yield as a Recession indicator. I prefer this metric because, one, it is correlated with Bank funding rates and asset returns since they typically borrow on the short-end of the curve and lend at longer durations. And two, other yield curve measurements have many more variables priced into them. The five-year for example is an amalgam of Fed expectations, inflation expectations, term

premia etc. Using my preferred tenures, the yield curve is actually quite steep, as you can see below. This should keep credit flowing, and improve Net Interest Margins for banks, who after all, are the heart of a credit-based society. This indicator is not flashing any warnings, and if the Fed fails to follow through on rate-hike expectations, it may not for quite some time. Meanwhile, high yield has a trailing 12-month default rate below 0.5%, which compares favorably to its historical average above 4%. This default rate will

3 Month Yield - 10 Year Yield

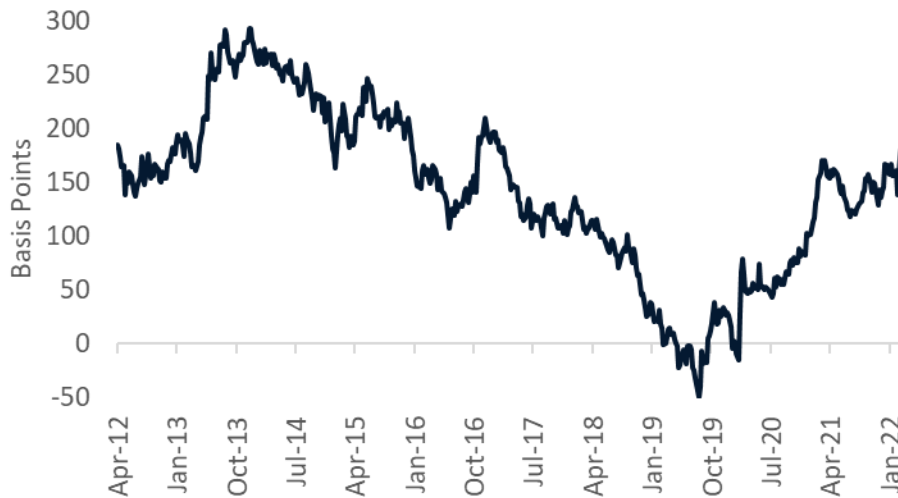


Figure 5 – Source: Bloomberg 4.25.2022; Past Performance is not indicative of future results; Investors cannot invest in an index

likely tick up over the next 12 months, however, we expect it to stay historically low and believe corporate credit in general offers value given the current level of spreads and an expected benign environment for corporate defaults. In terms of liquidity – sure, the Federal Reserve is removing some excess liquidity. However, their Reverse Repo facility is still removing almost \$1.8 Trillion worth of cash per day from the system. This is cash that the banks have nowhere to go with. The first \$1.8 Trillion that is drawn down from the Fed balance sheet will be counterbalanced by declining use of this facility, in our opinion.

And finally, I always look to the health of the consumer. The pervasive myth is that the Federal Reserve cannot raise rates without breaking an overly-leveraged society. And while U.S. sovereign debt has spiked to 126% of GDP, this has been for the benefit of the private sector as private households have largely de-levered – illustrated by the chart on the right.

Household Debt (% GDP)

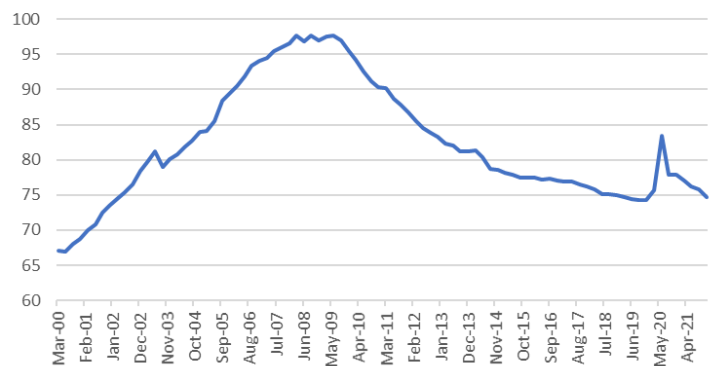


Figure 6 - Source: Bloomberg 4.25.2022

2022 Q1 – THE QUARTER IN REVIEW

At the end of last year, as we wrote in our Newsletter “Gone Fishing” we believed much of the fixed income market was fully-valued and vulnerable. We took steps attempting to mitigate both interest rate and credit risk in the portfolio. Namely, we shortened the weighted-average-life of the portfolio dramatically taking it from over 5.5 years to 3.5 years. We also opted for a two-pronged strategy by adding to floating-rate investment grade bonds and short-maturity high-coupon bonds. The latter portion was focused in commodity related industries whose fundamental metrics were improving, and could potentially benefit from a spike in energy prices. Both strategies helped the portfolio weather the worst bond market in forty years, however, nothing was entirely immune. Our standardized performance is shown below. For the first quarter, the Holbrook Income Fund as down 0.67% relative to our benchmark which was down 2.58%. Given that the 3-year treasury yield rose approximately 155 bps during the quarter, most of the subsectors within the portfolio were down, albeit, in most cases slightly. This is a testament to our industry selection, since in that environment, spreads have to tighten to absorb such a rate-spike. Spreads in our oil & gas and coal sectors all tightened relatively dramatically. Even our investment grade CLO’s, which have very little interest rate risk were down slightly over the quarter as discounted margins (DM’s) expanded. Overall, we are very pleased with Q1 performance. We outperformed our benchmark, and, our space was a dramatic outperformer relative to other subsectors with much more duration. We were one of the best performing funds in arguably the best performing fixed-income space.

Total Return (I-Shares) as of 3/31/2022

Trailing Returns

	7 Day	1 Month	Year-to-Date	1 Year	3 Year	5 Year	Since Inception
Holbrook Income Fund	-0.04%	-0.31%	-0.67%	2.19%	5.80%	4.97%	5.01%
BofAML US Corp & Govt, 1-3 Yrs TR	-0.20%	-1.42%	-2.58%	-2.95%	1.02%	1.27%	1.11%

BofAML US Corporate & Government Index, 1-3 Year Index - The index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market, including US Treasury, US agency, foreign government, supranational and corporate securities, with a remaining term to final maturity less than 3 years.

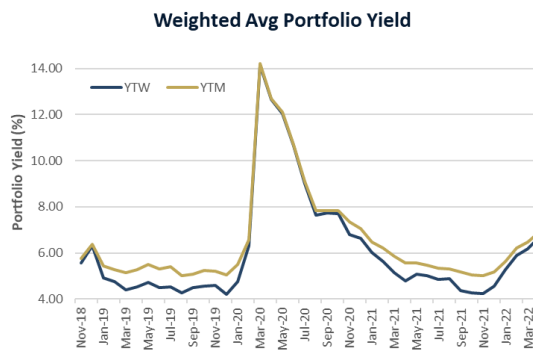
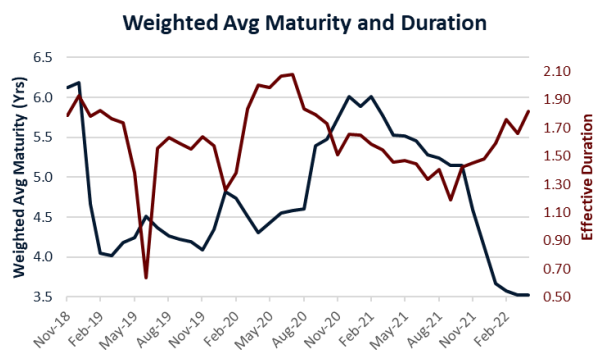
Past performance is not indicative of future results. Investors cannot directly invest in an index and unmanaged index returns do not reflect any fees, expenses or sales charges. Fund Inception is 7.6.2016 and performance is annualized. The performance data quoted here represents past performance. Current performance may be lower or higher than the performance data quoted above. Investment return and principal value will fluctuate, so that shares, when redeemed, may be worth more or less than their original cost. Past performance is no guarantee of future results. The total annual fund operating expenses for Class I are 1.06%. Total annual operating expenses after reimbursement of prior fees waived for Class I are 1.06%. The Fund's adviser has contractually agreed to reduce fees and absorb expenses of the Fund until at least September 1, 2022. Without these waivers the Total Annual Fund Operating Expense are 1.06% for Class I. Please review the Fund's prospectus for more detail on the expense waiver. Results shown reflect the waiver, without which the results could have been lower. A Fund's performance, especially for very short

periods of time, should not be the sole factor in making your investment decisions. For performance information current to the most recent month end, please call toll-free 1-877-345-8646.

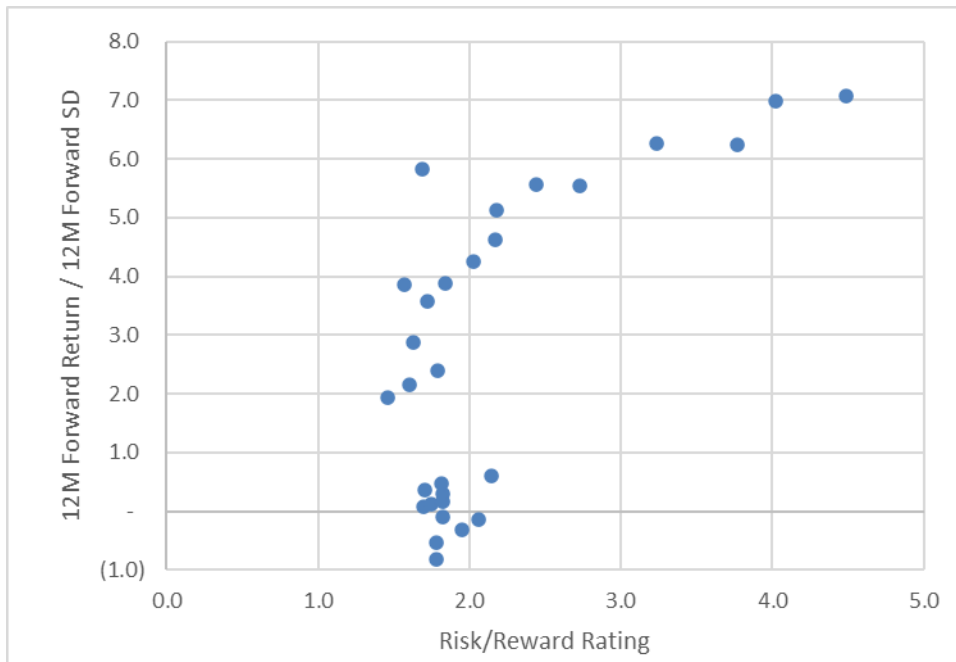
PORTFOLIO CHANGES FOR Q2

The recent spike in yields has changed the risk/reward dynamics for a number of subsectors. Given that we believe the Federal Reserve will not live up to market expectations in terms of 2022 rate hikes, we believe that the path of least resistance for rates in the near term will be lower. As such we have been purchasing fixed-rate coupon paper, investment grade, with maturities less than 4 years from now and yields well above 5%. We believe the total return prospects over the next twelve months are attractive, and all of them are trading at discounts to par – some of them well below par. Experience tells us that these will also potentially benefit when they begin trading on spread to the 3-year treasury as opposed to the 5-year treasury to which they are trading right now. Furthermore, this sort of paper, with shorter maturities, tends to get packed away in portfolios as it approaches its maturity date. As such, we are treating this the last chance to source these issues. The result of our purchases has increased the effective duration of the portfolio slightly, lowered the weighted average price of the portfolio, and increased the overall yield of the portfolio. Below are the portfolio metrics of the Holbrook Income Fund as of 4.25.2022.

Yield to Worst	Yield to Maturity	30 Day SEC Yield	Avg Eff Duration	Avg Maturity	Avg Coupon	Avg Price
6.65	6.88	4.38%	1.82	3.53	5.49	97.77



As you can see from the time-series data above, the yield on the portfolio is the highest it has been since the Pandemic recovery, and before that, it is the highest since inception. Meanwhile, the average maturity of the portfolio is the shortest it has been since inception. We use a basic model to assess the risk/reward of the portfolio. Reward is calibrated in terms of the yield-to-maturity of the portfolio. Risk is divided between two main categories: interest rate risk which is captured by effective duration and credit risk which is captured by weighted average maturity (an implicit measure of credit spread duration). This risk/reward quotient is then plotted against forward 12-month returns and forward 12-month standard deviation. This scatterplot is visible on the subsequent page and shows that when the Risk/Reward Rating is below 2, the following year outcomes are highly variable. However, historically, when the Rating is above 2.2, forward return/risk



outcomes are favorable. The current Risk/Reward rating on the portfolio is 2.57, as of April 25th. The only higher ratings registered in the five months post the Covid-19 global shutdown.

We have maintained a healthy portion of the portfolio in high quality floating rate, and as the Federal Reserve raises rates, we expect their coupons to increase. If these securities are priced to the forward curve, they add approximately an additional 40 bps to the yield of the portfolio –

which implies a yield-to-maturity on the portfolio of 7.25%

THE BIG SECULAR PICTURE

I include this section in every newsletter because it is the foundation of my secular argument for rising rates and a potential pivot in the longer-term economic cycle.

Furthermore, nothing in my longer-term thesis has changed since the inception of the Fund in 2016. The chart to the right is by far my most favorite economic chart – it encapsulates many apropos themes that are manifesting themselves in the political realm

today – income inequality, unionization, female participation, globalization, aging demographics and more. On the surface it appears to illustrate one simple point: After 1970, something changed. Productivity growth in the United States (real output per hour worked) continued unabated. However, compensation growth for workers dramatically slowed. The question is why? And through the exploration of this question, a myriad of social, economic, and political themes emerges – hence my obsession with this chart. We believe the most obvious implication of

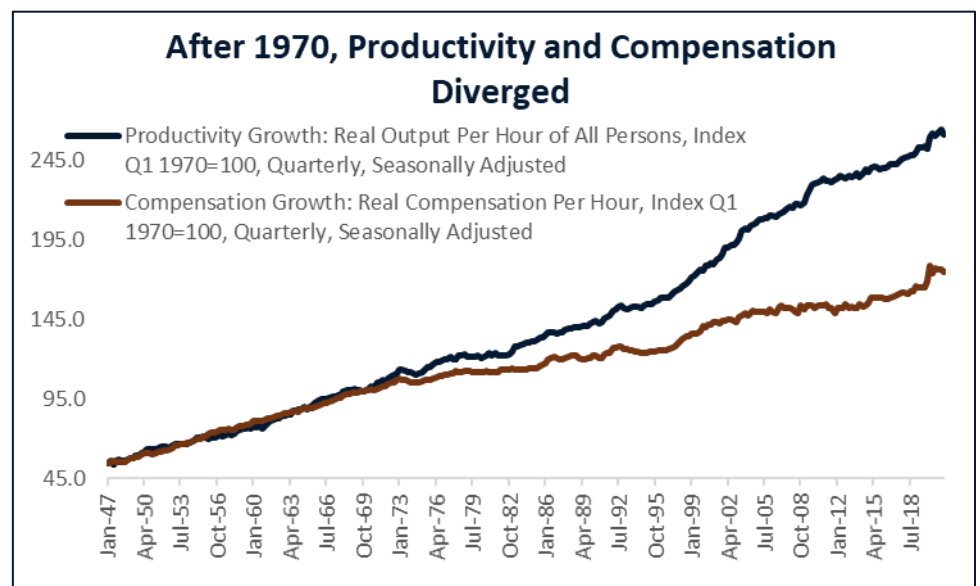


Figure 7 - Source: St. Louis Fed 12.29.2021

the chart is income and wealth inequality. Somebody is reaping the benefits of productivity growth. If not workers, who? Corporations. Owners of capital. It is my belief that the bifurcation of corporate profitability and worker compensation can mostly be explained by a labor supply glut that emerged in the early 1970's. In the U.S., baby-boomers expanded the labor-force population after 1970. Rising female participation rates exacerbated labor oversupply. And finally, when marginal supply of these two cohorts decelerated, globalization gave U.S. companies access to a massive pool of cheap labor overseas. Unionization also fell dramatically as bargaining power against corporations waned. By the time stagnant wages had become fully entrenched in the economy in the mid-80's, disinflation took root. After all, it is personal income growth that ultimately drives sustainable inflation – and like the price of everything, wages are determined at the margin.

Fast forward to 2022. It is my belief that all of these demographic forces are reversing, and the implications for the economy, interest rates, inflation, social upheaval, and politics will be enormous. The female participation rate topped out in 2000, and the overall working-age population in the United States has been falling since 2007.

Outsourcing is less profitable as the cost of labor in emerging economies catches up to that of the U.S. As the labor glut

transitions to a shortage, wages will likely breakout of their multi-generational doldrums, and disinflation (and falling yields) will be a relic of the past. Corporate margins will compress and Income and wealth inequality will lessen. Union strength will re-emerge as their bargaining power increases.

In terms of aging demographics -- On the surface it might seem that older cohorts consume less. However, from a money flow perspective, this is not always the case, especially in what I forecast to be the political environment moving forward. Older cohorts have a higher marginal propensity to consume. That is, they spend a higher percentage of their income. And while a growing percentage of their income will be sourced from transfer payments (Social Security, Medicare etc.) all of that is spent and recycled into the economy. Whether it is financed by savers via taxes (the working-age cohort) or with more sovereign debt, it doesn't matter, both are inflationary. And as the working age cohort (as a percentage of the population) falls, we will be faced with an economy that is producing fewer goods, and more money chasing those goods. This is the most basic definition of inflation.

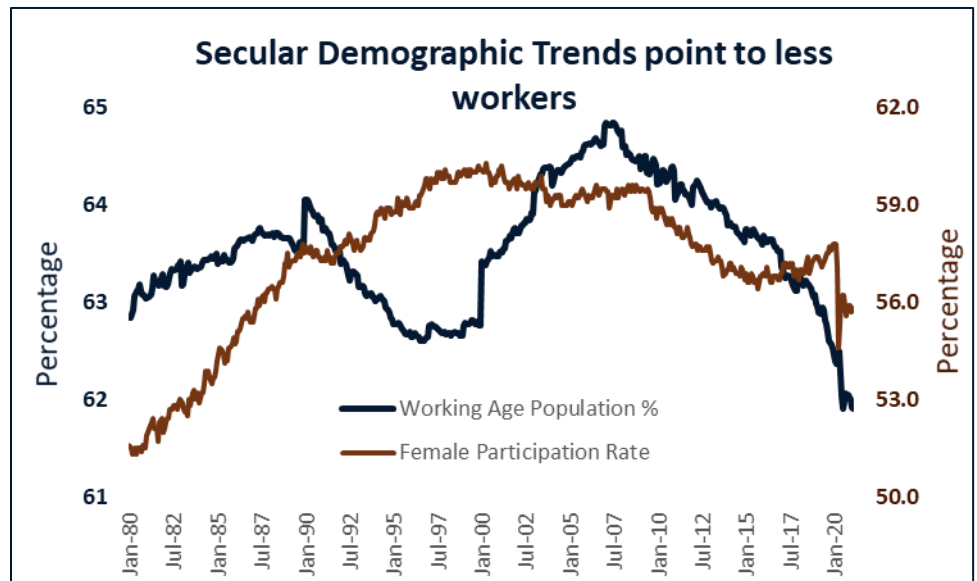
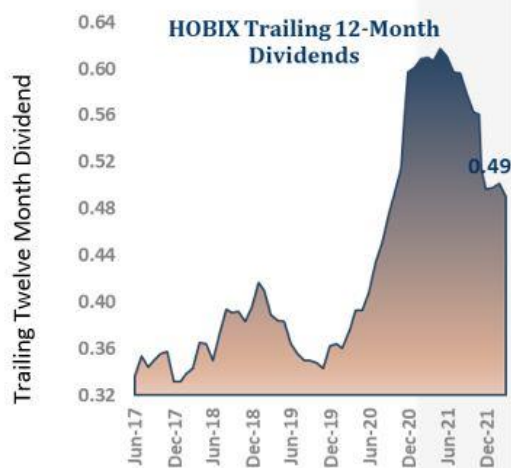


Figure 8 - Source: St. Louis Fed 12.29.2021

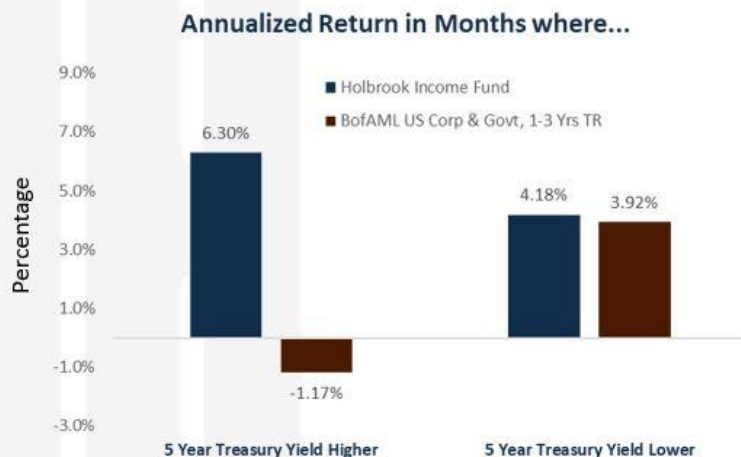
THE HOLBROOK INCOME FUND OBJECTIVES

My secular view on demographics and labor trends should shed some light on why I launched the Holbrook Income Fund in 2016 with two objectives: seeking to generate income and to preserve capital in a rising interest rate environment. Its second objective intimates that I believe fixed-income managers are going to have a difficult time during the next secular bear market in treasuries. Investor assets have been funneled into huge trough of products that are dependent on low and falling rates for outperformance – and for good reason. After all, we have experienced a forty-year bull market in bonds. I firmly believe there will always be a need for income generating assets, and I believe it is my mandate to navigate the markets when the fixed income tide recedes, and yields move higher. I will continue to measure the Holbrook Income Fund's success based on our two prospectus objectives. To those ends, the slide on the subsequent page is something I will continue to track and revisit. The first chart illustrates our trailing twelve-month dividend. The second chart shows the annualized return of the Fund and its benchmark in months when the 5-year treasury yield moves higher, and in months when the 5-year treasury yield moves lower. Given the secondary objective of the fund, I would expect outperformance in rising rate environments and potential underperformance in falling rate environments –and this is what we have seen since the inception of the fund.

Seeks to provide current income...



...with a secondary objective of capital preservation in a rising interest rate environment.



Past Performance is not indicative of future results; Investors cannot invest directly in an index. Data is taken from monthly returns and sorted by months where the five-year treasury yield increased and decreased. Monthly performance is then averaged and annualized. Performance data is reflective of all full month returns since the inception of the fund 7.6.2016 through 3.31.2021.

There is no guarantee that any investment strategy will achieve its objectives, generate profits, or avoid losses. Liquidity does not ensure profit or prevent losses.

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Investors should consider the investment objectives, risks, charges and expenses of the fund carefully before investing. The prospectus contains this and other important information about the Fund. For a current Prospectus, call 1-877-345-8646 or go to www.holbrookholdings.com
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Risks:

Investments in mutual funds involve risk including possible loss of principal. There is no guarantee that any investment strategy will achieve its objectives, generate profits, or avoid losses. The Fund invests in closed end investment companies or funds. The shares of many closed end funds, after their initial public offering, frequently trade at a price per share that is less than the net asset value per share, the difference representing the "market discount" of such shares.

The Fund may be adversely affected by new (or revised) laws or regulations that may be imposed by government regulators or self-regulatory organizations that supervise the financial markets. CLO debt securities are limited recourse obligations of their issuers and may be subject to redemption. Holders of the CLO debt being redeemed will be repaid earlier than the stated maturity of the debt. The timing of redemptions may adversely affect the returns on CLO debt. The CLO manager may not find suitable assets in which to invest during the Reinvestment Period or to replace assets that the manager has determined are no longer suitable for investment.

The value of securities issued by the U.S. Government generally fluctuates in response to inflationary concerns and may differ in their interest rates, maturities, times of issuance and other characteristics.

The risk that the Fund could lose money if the issuer or guarantor of a fixed income security is unwilling or unable to make timely payments to meet its contractual obligations. The risk that foreign currencies will decline in value relative to the U.S. dollar and adversely affect the value of the Fund's investments in foreign (non-U.S.) currencies. The derivative instruments in which the Fund may invest for hedging purposes may be more volatile than other instruments.

The Fund invests in fixed income securities or derivatives, the value of your investment in the Fund will fluctuate with changes in interest rates. These risks could affect the value of a particular investment by the Fund. Investment in or exposure to high yield (lower rated) debt instruments (also known as "junk bonds") may involve greater levels of interest rate, credit, liquidity and valuation risk than for higher rated instruments. When the Fund invests in other investment companies, including ETFs, it will bear additional expenses.

The Fund has a limited history of operation. In addition, the Adviser has not previously managed a mutual fund. The risk that investment strategies employed by the Fund's adviser in selecting investments for the Fund may not result in an increase in the value of your investment. The Adviser's use of computer trading modeling systems may perform differently than expected as a result of the factors used in the models.