



March 8, 2020 | Scott Carmack (Portfolio Manager)

CORONAVIRUS – MARKET FEAR & OPPORTUNITIES ABOUND

THE TAPE IS NASTY BUT VALUATIONS ARE GETTING MORE ATTRACTIVE

The Coronavirus, and the associated fear of a global pandemic, has disrupted the global economy and markets. I am not an epidemiologist or a virologist, so I cannot add anything of substance in that respect. Ultimately, I do not know how bad it gets and how long the disruption lasts. Historically, pandemic fears have typically shaved 10-20% off of equity markets, but there is always tail-risk and human reaction and fear can certainly have a cascading domino effect when it comes to asset prices. That is the bad news. The good news is that there is a global initiative currently underway that will provide fiscal and monetary stimulus to a problem that could be temporary.

The Federal Reserve lowered short-term rates 50 basis points in February with an emergency cut and will likely lower it another 50 bps at their March meeting. With the ten-year and thirty-year Treasury yield now at all-time lows of 0.76% and 1.29% respectively, one has to wonder if this is a meaningful overreaction by market participants, or are we on the precipice of another Global Financial Crisis. I am firmly in the former camp. Fundamentally, I believe that bank balance sheets, especially in the United States, are much stronger than they were back in 2008 and that will curtail any systemic effects to the economy. Meanwhile, the job market is still robust, average hourly earnings are still growing at a 3% YoY clip, and the recent fall in interest rates will spur refinancing to historical levels and be a boon to the real estate market. Combine this with a consumer that has deleveraged from the Great Financial Crisis of 2008, fiscal and monetary stimulus as tailwinds, and the plummeting price of oil and gas, and I think the stage is set for a robust rally in risk-assets once the fear subsides.

It can be difficult to assess how much fear has already been priced into the markets. But a couple of charts illustrate that complacency is certainly gone.

Fear & Greed Index

What emotion is driving the market now?



Fear & Greed Over Time



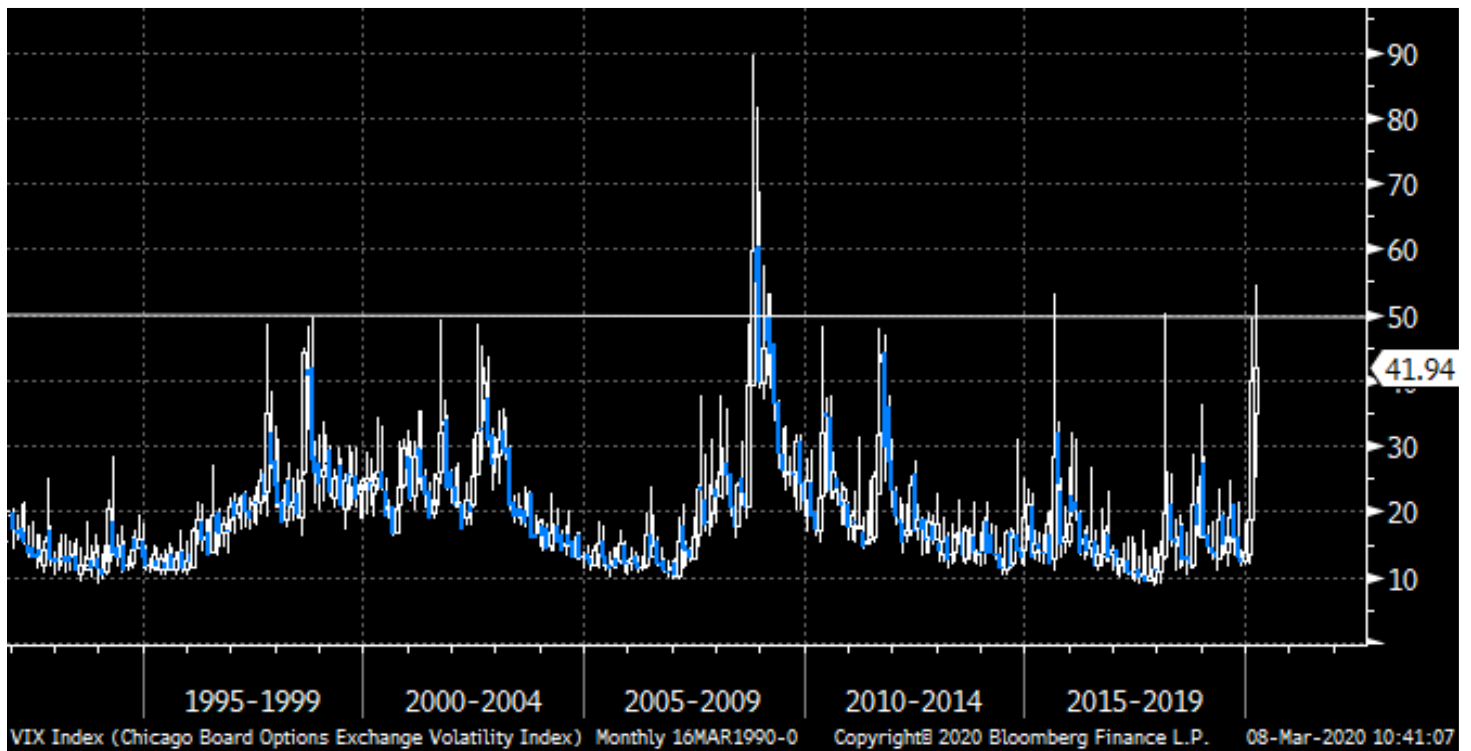
Difference in 20-day stock and bond returns



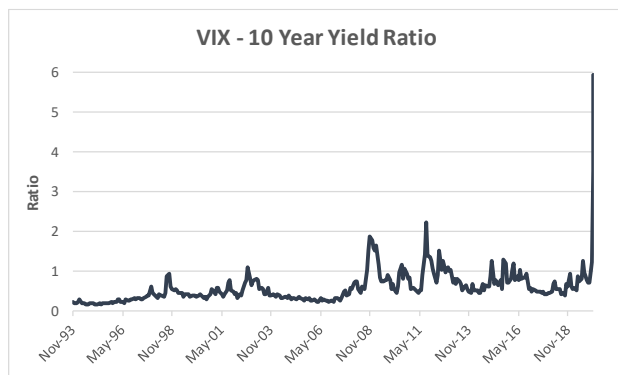
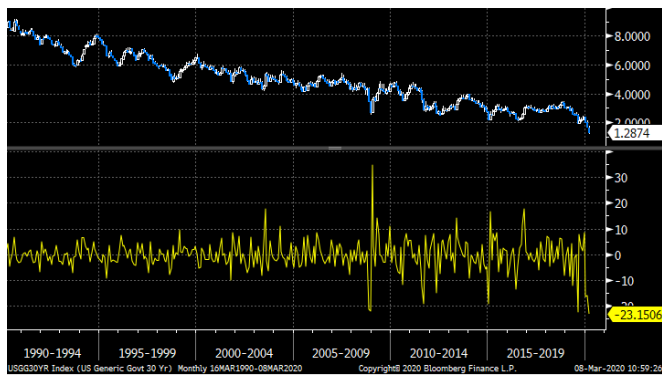
The CNN Fear & Greed Index, an indicator that incorporates a handful of market data series, is currently the lowest since December 2018, when markets were still projecting three 2019 rate hikes, and the Fed was shrinking its balance sheet. The 10 Year yield was nearly 200 bps higher than it is today. Meanwhile the outperformance of bond returns versus equity returns on a 20 Day look-back is now almost 18%.

Source: www.money.cnn.com/data/fear-and-greed 3.8.2020

Market volatility, as measured by the VIX Index has eclipsed 50 for the first time since March 2018. This is a rare event, and as demonstrated by the following chart, has only occurred four times in the last thirty years (2008, 2015, 2018 and today). Historically, the first three, were opportune times to buy risk-assets. Will this time be similar? I expect so.



Source: Bloomberg 3.8.2020; VIX Index

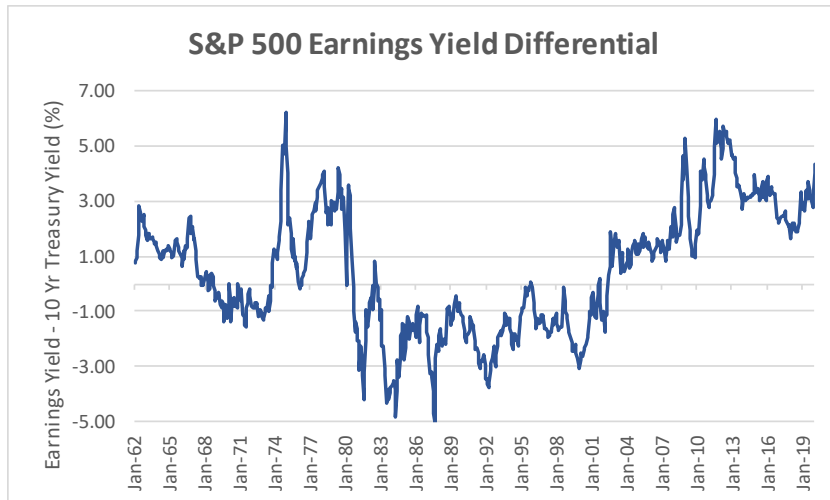


Source: Bloomberg 3.8.2020; 30 Year Treasury Yield and 1 Month Rate of change (left chart); VIX - 10-year yield ratio (right chart)

It's not only the elevated VIX that is indicating a preponderance of fear in this market, it is also the momentum by which longer-term yields have fallen. The chart above shows the thirty-year treasury yield, and below is the one-month rate-of-change. It has fallen faster in one month than at anytime over the last thirty years. And finally, the chart to the right is the VIX-to-ten-year-yield ratio. To me, this data series is a good fear indicator because it incorporates investor flight-to-quality (Treasury) and the demand to protect portfolios through the purchase of options (VIX). As you can see, this fear gauge is currently a historical outlier.

The bearish drumbeat on equity valuations is resounding through the market echo chamber. By many measures, they are high. But this is nothing new. Schiller CAPE Ratios, Forward Price-to-Earnings Ratios, and Market Cap-to-GDP Ratios have been elevated throughout the last decade of expansion. And investors would be kicking themselves for missing out on one of the most dynamic

bull markets had they heeded these nosebleed valuation metrics. The one valuation metric that has kept investors on the right side of this bull market is Earnings Yield Differentials, or the difference between the S&P 500's earnings yield and the ten-year treasury yield. I like this metric because it takes into account the relative attractiveness of equities over bonds. And if we have learned anything over the past ten years, its that rates and the Fed balance sheet matter for valuations. Low rates incentivize corporations to borrow and buyback stock. If AAPL can retire equity that has a dividend of over 1% (and likely to grow) with liabilities that are cheaper, why wouldn't they?



As you can see from the chart to the left, the Earnings yield pick-up over the ten-year treasury yield is at its highest since 2013 – currently at 4.38%. If you think companies can grow their earnings over the next five years, and that the Coronavirus slowdown will be temporary, equities look attractive. Ultimately, I believe the “bond-induced” demand for earnings will end badly. But that environment will likely be one where market concerns are inflation, rising rates, low real returns, cost-of-living increases etc. We are nowhere close to this sort of environment, although fiscal and monetary stimulus in the face of a temporary growth set-back may be sowing the seeds for such an environment in the

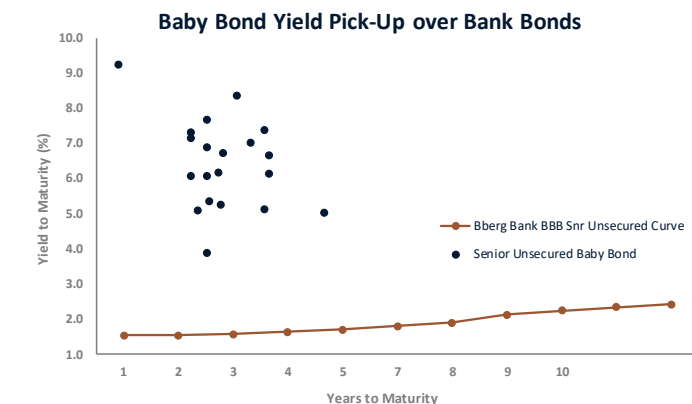
future.

Source: Bloomberg 3.8.2020

BDC BABY BONDS – SPREADS EXTREMELY ATTRACTIVE

Where am I looking for yield in this market, and where am I adding exposure? Over the last week, I have sold all of our TIPS positions because real yields are negative (on some cases very negative) across the board. Even if we have an inflation pick-up (which is unlikely in the near-term) they are no longer attractive on a risk/reward basis. Meanwhile, I will be deploying cash into Senior Unsecured Baby Bonds issued by Business Development Companies (BDC's). Currently, I am concentrating on issues that mature in the next 2-4 years. Most of these issues are either rated BBB by major rating agencies, or they are not-rated. But they all have the same covenants, and are mandated to maintain asset-coverage ratios above 150%. Many have asset-coverage ratios that

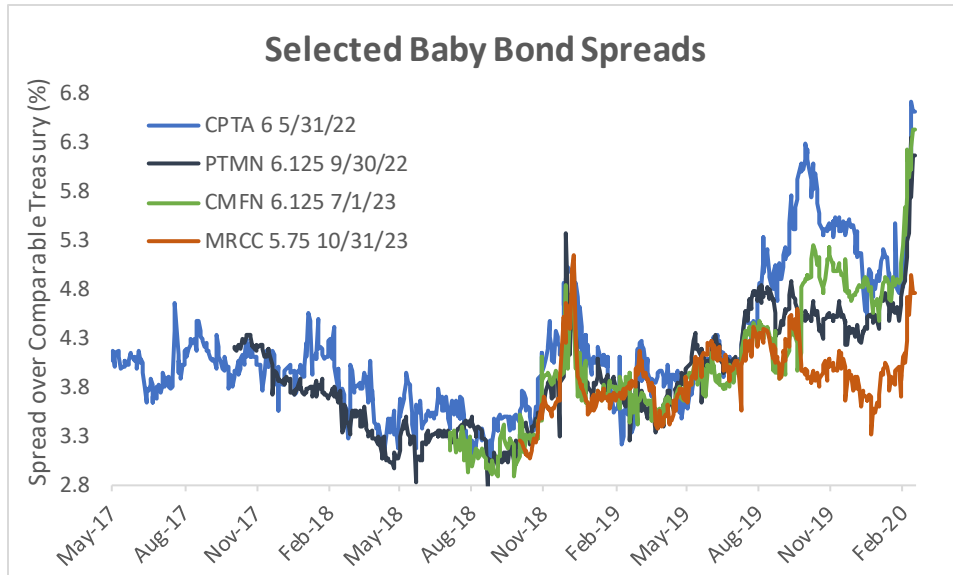
are higher. The point is that these Business Development Companies (that lend to the Middle Market) would have to experience losses in their portfolio between forty and seventy percent before bond-holders are forced to take a haircut. As far as we know, no BDC defaulted on its obligations during the Great Financial Crisis of 2008. And default rates, although they were elevated, never reached 15%. As such, we are comfortable taking volatility risk because we are confident that we will be repaid our principal upon maturity.



to the BBB Senior Unsecured Bank curve. There is a significant yield pick-up.

The scatter chart to the left shows the yields that we are getting in the Baby Bond portion of our portfolio and how they compare

Source: Bloomberg 3.08.2020; Past Performance is not indicative of future results; Investors cannot invest directly in an index. NOTE: Data points are an assortment of Baby Bonds, both senior unsecured and preferred; Chart does not reflect yield-to-call, which could be higher or lower than the yield-to-maturity reflected in the chart



Short-dated BDC Baby Bonds are becoming even more attractive in this environment. The chart below shows the spread over comparable treasuries during the last few years for four issues that I have been adding to lately.

As the chart indicates, the yield pick-up over treasuries has recently hovered between 3 and 5%, which I consider attractive given their volatility and covenant protection. Currently, we are getting between 5 and 7% more than comparable treasuries. The pick-up in yield is even more attractive than it was in December of 2018 (the last time we experienced a similar drawdown in equity markets). I added to our positions then, and I am adding to them now. Ultimately, when the smoke clears, and the fear subsides, we believe there will be a chase for yield, and these issues stand to benefit.

Source: Bloomberg 3.8.2020; Past Performance is not indicative of future results; Chart does not reflect yield-to-call, which could be higher or lower than the yield-to-maturity reflected in the chart; Spread is measured over the following treasury securities: T 1.875 5/31/22 for CPTA, T 2 10/31/22 for PTMN, T 2.75 7/31/23 for CMFN, and T 2.875 10/31/23

Currently, baby bonds account for approximately 40% of the portfolio. We will be adding into any weakness.

STILL BULLISH ON CORPORATE STEEPENERS

We continue to maintain a 12% allocation to corporate steepener bonds. These are structured notes issued by companies like Morgan Stanley, Natixis, Jefferies, Goldman Sachs, and Citigroup. Each individual bond is different, but in general, their coupons adjust based on the steepness of the yield curve. This is a mean reversion play on the yield curve and it is driven by two main tenets: 1) The Federal Reserve will opt to keep short-term rates low, especially in the face of an exogenous event such as the Coronavirus.

And 2) the long-end of the yield curve is underestimating potential future inflation, and potential supply.



The chart below illustrates the extreme steepening that occurred between the 5-year and 30-year treasury during the first four days of last week. On Friday, the curve almost entirely reversed this move as the 30-year Treasury Bond rallied almost 7 points and the yield plummeted over 25 basis points. I expect the curve to continue to steepen over the coming months and Friday's price action *could* be a blow-off top in the long bond – potentially driven by a hedge fund blow-up who was heavily short. That is just conjecture, but it is

entirely plausible. At the close on Friday, if all coupons were to adjust (they adjust quarterly), our steepener positions would yield 4.03%, over a 200-basis point pick-up over fixed-rate debt of the same issuers. The average maturity of this segment of the portfolio is 11.7 years as of Friday.

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Source: Bloomberg 3.08.2020; Past Performance is not indicative of future results; Investors cannot invest directly in an index. Chart shows the 30-year treasury yield minus the 5-year treasury yield

HIGH YIELD ENERGY – IF VALUATIONS ARE THE “GOOD”, AND MARKET ACTION IS “BAD”, ENERGY IS THE “UGLY”

Part of managing money is admitting you are wrong and taking action to prevent future losses and learning from one’s mistakes. Coming into the year, despite the high levels of debt on Exploration and Production (E&P) balance sheets, I was expecting a rotation into the energy sector. The second half of 2019 marked what I thought to be an inflection point in terms of capital discipline and a focus on free cash flow and liability management rather than just outright production. I thought that this change in industry approach would make debt loads more manageable, and investor sentiment would improve. I had conviction in this thesis, and the plan was to add to short-dated energy debt into weakness. In late January, we took our High Yield Energy position to 4.5%. I thought that companies with untapped revolvers would be able to refinance upcoming debt over the next 1-2 years. I did not foresee the extreme demand destruction resulting from the Coronavirus and the plunge in travel. Moreover, I thought that OPEC+ would act to curtail supply in an uncertain demand environment. It appears that the opposite has occurred. The OPEC+ meeting on Friday concluded without a production cut, and on Saturday Saudi Arabia drastically reduced the price of their oil in what seems like a punitive attempt to undercut Russia. There is always the potential that the two producers come back to the table, but as it seems right now, there will be an all-out price war in the months to come, at the worst possible time when demand is plunging. Below is the price of a Whiting Petroleum bond due in about one year. The chances of this being refinanced is certainly less today than it was a week ago, or even on Friday. They could still come with some sort of exchange rather than filing for bankruptcy. In any case, I



certainly regret purchasing it, and I am now in management mode with the 3.5% of the portfolio that is currently invested in high yield energy. Besides Whiting, most of our exposure is in natural gas, which despite its low price, has more viability in the long-run. As I have stated recently, I will not be adding to oil & gas positions, but due to the extreme price declines, they are also not “capitulatory sales” at these

levels. I am making an active choice to hold these positions. And full transparency-- almost our entire drawdown recently is due to these names: Whiting Petroleum, Antero Resources, Gulfport Energy, and Montage Resources. Yes, I made a mistake, and I will learn from it, manage these positions and move on.

Source: Bloomberg 3.08.2020; Past Performance is not indicative of future results; Chart shows the price of WLL 5.75 3/15/21 bond over the last 5 years

RECENT DRAWDOWN IN HISTORICAL CONTEXT

We at Holbrook hate drawdowns, but we also recognize they are a natural part of investing and our experience is that at times of heightened volatility the best opportunities present themselves. As such, we will continue to deploy capital into a fear-based market. We have had a number of drawdowns since our inception on July 6, 2016 – most have been between 50 and 100 basis points. The current drawdown is more than that. Below is a chart showing our larger drawdowns and the subsequent 1-year return.

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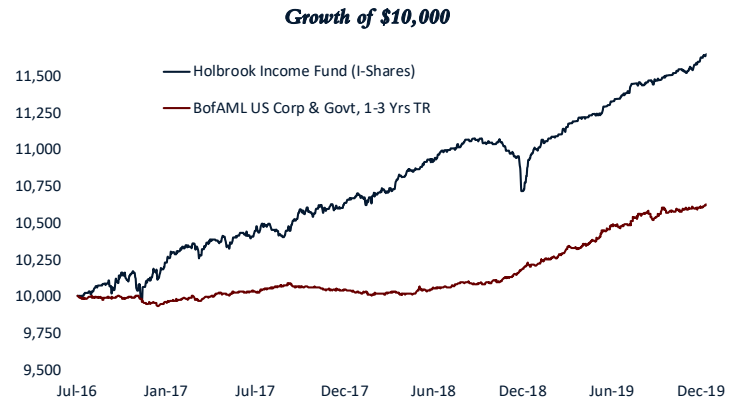
In both of our previous larger drawdowns, we built out the yield on the portfolio in the issues where we saw beneficial risk/reward. Both drawdowns were recovered relatively quickly and the subsequent year produced robust returns. This is our process. We use volatility to our advantage and as an opportunity to increase the yield in the portfolio in the names we like. In 2016, we added to our preferred and high yield positions before and after the election. In late 2018, we added exposure to our BDC Baby Bond positions. And today, we are continuing to add exposure to our short-dated BDC Baby Bond positions, which we think are particularly attractive.

HOBIX Drawdowns

Drawdown Date	Drawdown (%)	Subsequent 1 Year Return (%)
10/27/16 - 11/11/16	1.72%	6.24%
9/19/18 - 12/24/18	3.14%	8.58%
1/14/20 - 3/6/20	1.47%	TBD

Total Return (I-Shares) as of 12/31/2019

	1 Year	3 Year	Since Inception
Holbrook Income Fund	7.68%	4.43%	4.47%
BofAML US Corp & Govt, 1-3 Yrs TR	4.07%	2.18%	1.75%



Source: Bloomberg 3.08.2020; Past Performance is not indicative of future results

Fund Inception is 7.6.2016 and performance is annualized.

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.

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 1.67%. Total annual operating expenses after fee waiver for Class I 1.31%. The Fund's adviser has contractually agreed to reduce fees and absorb expenses of the Fund until at least September 1, 2020. Without these waivers the Total Annual Fund Operating Expense are 1.67% 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.

CONCLUSION

There are many fear indicators that suggest the worst of the equity market drawdown has been realized. The Coronavirus headlines will likely continue to be accompanied by heightened volatility, but I expect the smoke to clear eventually. And when it does, we believe investors will realize that the slowdown was temporary, there will be a recovery, and it will happen against the backdrop of overly easy monetary policy, fiscal stimulus, and a sturdy consumer fresh off of refinancing and more money in its pocket due to the energy slump.

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.

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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