UPLAND
Capital Management LLC

2023 *FIRST QUARTER* SUMMARY

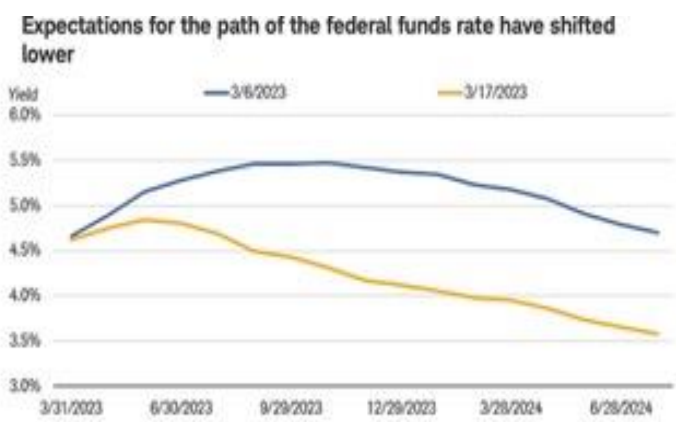
The first quarter was marked by a rollercoaster of volatility as sudden shifts in employment and inflation data, and then regional bank failures drove changing narratives for both equity and credit markets. A lower-than-expected CPI in January encouraged markets higher. This was followed by February's market consolidation, as resilient labor markets and stickier-than-anticipated inflation data led to a resurgence in Treasury yields. Short-term rates reached their highest levels since The Great Financial Crisis. March witnessed the second and third largest U.S. bank failures in history, triggering fears of a 'systemic banking crisis' and leading to a flight to quality. Treasury yields plummeted as government bond markets went from pricing in additional rate hikes to discounting sizeable rate cuts in some markets. Compounding these tensions were management and financial failures at Credit Suisse, one of the largest global banks, which led to its regulator-forced merger into another Swiss bank. Central banks continued to raise interest rates; U.S. federal funds rate reached their highest level since 2007. Despite these substantial challenges and the ensuing volatility, global equity markets proved unexpectedly resilient. The S&P 500 Index was up 7.5%, with six of the eleven major sector groups finishing the quarter with positive returns. In the U.S., the technology, communication services, and consumer discretionary sectors were top-gainers, while healthcare, financial, and energy sectors were the weakest, each finishing the quarter with mid-single digit losses. Large cap stocks widely outperformed small and mid-sized companies. International developed markets outperformed emerging markets. Bond market volatility underpinned much of the equity market's rotation during the quarter. *The MOVE Index, a measure of volatility in the Treasury markets, spiked to its highest level on record outside the global financial crisis of 2008-2009.* At quarter-end, U.S. 10-year Treasury notes were yielding 3.67%, down from 3.97% at year-end. Short-term Treasuries experienced historic swings, with 2-Year notes trading in a range from 3.08 to 5.08%, finally ending the quarter at 4.06%. Most longer maturity Treasury and investment grade bond categories posted strongest returns; lower quality bonds underperformed as credit spreads widened. The U.S. Dollar, driven by expectations of rates peaking, was weaker against most trading partners. The Bloomberg Commodity Index ended the quarter lower (-5.36%). Precious metals were strong, while energy was the weakest component.

COMMENTS:

IN SEARCH OF A NORTH STAR

U.S. consumer inflation rates continued to slow after reaching a multi-decade peak of 9.1% last year. March headline CPI showed relief across a broad group of goods and services. While the one percent decline in annual topline CPI was a welcome development, it was more the result of base effect data associated with the invasion of Ukraine one year ago, then a sudden turnaround in prices. In fact, year-over-year *Core CPI* (which excludes food and energy) was unchanged as shelter prices remained at stubbornly high levels. Although private sector data suggest coming relief in this key component, it will take time for CPI numbers to fully reflect wider disinflationary trends. With the economy appearing exceptionally resilient, any near-term softening in housing prices and labor data may not be sufficient to assure Fed policy makers, thus leaving them in the challenging position of having to raise rates in midst of a more fragile backdrop. Many now expect another .25% rate hike at the May FOMC meeting. While the Fed projects it will hold the key fed funds rate above 5 percent for the balance of this year, Treasury markets have begun pricing in multiple rate cuts in the second half. This implies financial markets are expecting a *significantly weaker economy* and potential additional stress.

Rate Assumptions Post the March 2023 Banking Crisis



Source: Bloomberg as of 3/17/2023
Market estimates of the federal funds rate using Fed Funds Futures Implied Rate

Consensus now expects the economy to weaken in the second and third quarters as the 'long and lagging impacts' of higher rates and tighter credit take hold. These forecasts expect GDP to drop to zero in the second and contract in the third, before finally re-accelerating. The Conference Board, a widely regarded economic think tank, recently offered a similar but more sobering assessment seeing a 'high probability of a recession,' with economic weakness spreading more widely over coming months. "*While US GDP growth defied expectations in late 2022 and early 2023 data has shown unexpected* *strength, we continue to forecast GDP growth to contract for three consecutive quarters starting in Q2 2023."*

As reported in the *Senior Loan Officer Survey*, bank credit standards for loans were already tightening in December 2022. January's Survey reported: "Significant net shares of banks reported tighter standards on C&I (commercial and industrial) loans to firms of all sizes and for all types of CRE (commercial real estate) loans over 2023; and also, a similar tightening of lending standards for credit card, auto and consumer loans", and among other business segments. The Survey's early January cautious comments were noted before the March banking failures. So, the additional credit tightening and higher borrowing costs resulting from these bank failures will only further dampen loan growth, especially to small and medium companies. Smaller regional banks, those most impacted by recent deposit withdrawals, have typically accounted for more commercial real estate lending than the larger banks. Not to be overlooked, leading economic indicators (LEI) have now been negative for nine consecutive months.

The Fed's latest SEP (Summary of Economic Projections) including its 'dot plot,' which maps out policy maker's expectations for where rates may be headed, suggests rates will continue to head higher but only slightly, with benchmark interest rate peaking at 5.1% this year*; no officials see rates coming down this year.* The range of opinions reflected in the dot plots was surprisingly broad with seven FOMC members expecting an even higher peak rate, and all suggesting the outlook to be 'highly uncertain.'

Financial markets often lead the economy, anticipating weakness and recovery months ahead of confirming data. While the market's recent strong performance at the Index level might suggest a brighter, if not robust economy on the near horizon, the narrow breadth of constituents driving recent performance is noteworthy. Just *ten stocks accounted for 95% of the S&P 500's first quarter return*. Each of the ten were technology-related businesses, whose share valuations are highly dependent on interest rates. At quarter-end, the S&P 500 Index was trading at more than 19X forward earnings, not inexpensive, especially as the typical late-cycle earning outlook deteriorated during the quarter.

Weakest Market Breadth in more than Twenty Years

Given the weakening economic outlook, tightening credit availability, and challenging earnings backdrop, we remain cautious on equities, anticipating volatility as we await the full impact of peak rates. We have kept the portfolios defensive tilt, weighted toward value stocks and hedged equity investments. In the meantime, cash and short-term bond proxies continue to offer both attractive returns and optionality as new opportunities unfold. We have modestly extended the duration of our bond portfolios, expecting the near-term yield curve to become more inverted as the economy weakens. This allows us to begin locking in the currently available higher yields.