

Performance Highlights

- Both bonds and stocks rallied from late October to the end of the year, topping off a surprisingly positive calendar year. In this environment, the Westwood Alternative Income Fund gained 3.26% in the fourth quarter, outperforming the benchmark, the FTSE 1-Month Treasury Index, which gained 1.38%.
- A series of dispiriting economic releases over the summer that had solidified the “higher for longer” interest rate trajectory, pushed equity and debt markets lower after a mid-summer rally. The fourth quarter rally was sparked by a combination of strong earnings from bellwether companies, a report that inflation continued to subside, and statements from the Federal Reserve that seemed to indicate that the rate hike regime had come to an end.
- October’s month-end FOMC meeting left the federal funds target rate unchanged for the second meeting in a row. The committee noted that job gains have moderated and tighter financial and credit conditions for both households and businesses are likely to weigh on economic activity. The committee also addressed the uncertainty around the cumulative and lagging impact of their previous decisions and the need to be cautious in the future. The tone of the comments helped send interest rates lower across the curve. The two-year U.S. Treasury declined by over 75 basis points, and the 10-year Treasury rate, which clicked over 5% intra-day in late October, declined by more than 100 basis points over the remainder of the quarter, to close the year at 3.88% — the same place they started the year.
- Risk assets took notice and were bid strongly. From November on, the S&P 500 increased 14%, the Russell 2000 Growth Index increased 22% and credit spreads declined by over 150 basis points, as measured by five-year high yield index credit default spreads. As a result of all the optimism, the VIX index finished nearly 30% lower.
- We increased our net equity exposure to approximately 7% from previous quarters of 1% to 2%, added to higher yielding credit opportunities and modestly to duration. We believe that accepting additional market risk is prudent and will add value over time. As always, the path higher for risk assets will not be linear, but in our opinion, the environment warrants additional measured and controlled volatility to achieve long-term goals.

Market Commentary

Despite mixed economic signals internationally and marginally positive economic data stateside, U.S. debt and equity investors clicked the buy button across the board with a few exceptions. U.S. consumers and the labor market remain resilient and healthy by most metrics, but there are hints of potential strain such as surging credit card debt, relatively low sentiment (which got a bump in December), and a still pricey and “stuck” housing market. The quarter certainly seemed to bring an end to the broad “higher for longer” interest rate concerns, but investors could be getting a bit ahead of themselves already pricing in six cuts for the Federal Reserve in 2024.

Reversals in both Treasury yields and the abrupt about-face in Fed speak around the timing of rate cuts fueled a nine-week rally of consecutive gains beginning in November. The rally pushed the S&P to a 26.29% return for the year with the index finishing within shouting range of its record high. The S&P 500 ended up 11.69% in the fourth quarter; November’s gain of 9.13% was the largest monthly jump since May 1985.

The strongest quarter of performance for the year was also the broadest. Both the cyclically oriented Dow Jones Index and the tech-heavy Nasdaq outperformed the S&P and small-cap stocks finally outperformed large-cap stocks. Large-

cap value continued to trail growth as the Russell 1000 Value Index gained 9.50% compared to 14.16% for the Russell 1000 Growth Index. Small-cap stocks finally rebounded with a strong quarter, as the Russell 2000 Index added 14.03%; in the small-cap world, value stocks 15.26% outgained growth names 12.75%.

Within the economy, CPI readings fell to the 3% range as the year closed, showing the slowest rate of increase since 2021 and leading to hope that the inflation monster may have finally been slain. Consumer sentiment continued to decline, though spending in the critical holiday season seemed to be elevated over previous years. Consumer debt levels remain elevated, though, and high interest rates on that consumer debt could spell trouble for this critical component of the economy.

The “Powell Pivot” sent bonds on a furious rally to close out the year. Bonds were looking to log a third consecutive year of negative returns until the end of October, when the Treasury decided to issue more short-term T-Bills, as opposed to longer-dated bonds. This, followed by Fed Chairman Powell’s statements on Nov. 1 that were interpreted as dovish — moving their stance from “higher for longer” to a more accommodative position — caused the bond market to rally to the end of the year.

After advancing to nearly a 5% yield in late October, 10-year Treasury bond yields turned sharply lower during the fourth quarter and finished 2023 in roughly the same place as they began, at 3.88%. Two-year Treasuries fell nearly as much, as they had reached a peak of 5.19% in mid-October, falling to 4.23% to end the year. For the quarter, most of the Treasury curve rallied with the 2-year yield. The substantial decline in real yields — the inflation-adjusted cost of borrowing — drove most of the steep drop in nominal yields, largely due to investor expectations for future Fed easing.

Corporate credit also advanced in the fourth quarter, as investment-grade bonds added 8.15%, while high-yield bonds gained 7.17%. The spread between corporate and Treasury yields declined in the quarter, indicating optimism about defaults and continued economic gains into the new year. Overall, the broad market Bloomberg U.S. Aggregate Index gained 6.82% for the quarter, ending the year with a positive return of 5.53%.

As the year closed, the idea of a “soft landing” or perhaps no recession at all gained momentum, with the consensus assuming a rate cut in March or May of 2024. The broad-based rally to close 2023 certainly indicated that investor sentiment had shifted to positive territory, as volatility fell and many stocks — not just the mega-cap growth Magnificent Seven — achieved new highs. With 2023 firmly in the rearview mirror, we now have S&P 500 annualized returns for the past five years at 15.69%, well in excess of historical norms.

Performance Update

As of December 31, 2023

Annualized Returns

	4Q23	YTD	1 Year	3 Year	5 Year	Since Inception
Westwood Alternative Income Fund (WMNIX)	3.26%	6.82%	6.82%	2.84%	4.84%	3.50%
FTSE 1-Month Treasury Bill	1.38%	5.13%	5.13%	2.19%	1.84%	1.39%

The performance data quoted represents past performance. Past performance is not indicative of future results. The investment return and principal value will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted. For performance data current to the most recent month end, please call 877.FUND.WHG. Expense ratio for the Fund is 0.30% (net) and 0.44% (gross). The adviser has contractually agreed to reduce fees and reimburse expenses until March 1, 2024.

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To determine if this Fund is an appropriate investment for you, carefully consider the Fund's investment objectives, risk factors, charges and expenses before investing. This and other information can be found in the Fund's summary and full prospectuses, which may be obtained by calling 877.FUND.WHG, or by visiting our website at westwoodfunds.com. Read the prospectus carefully before investing or sending money.

The FTSE 1-Month Treasury Bill Index is an unmanaged index representing monthly return equivalents of yield averages of the last 1-month Treasury Bill issue. Index performance does not reflect any management fees, transaction costs or expenses. Index returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index.

Diversification does not ensure a profit or guarantee against a loss.

Tail Risk hedge is an investment strategy that is aimed to protect the portfolio against extreme market moves.

Macro hedge is an investment technique used to eliminate the risk of a portfolio of assets. In most cases, this would mean taking a position that offsets the whole portfolio.

Gamma is the rate of change for delta with respect to the underlying asset's price. Gamma is an important measure of the convexity of a derivative's value, in relation to the underlying assets.

Delta is the ratio that compares the change in the price of an asset, usually marketable securities, to the corresponding change in the price of its derivative. A derivative is a financial security with a value that is reliant upon or derived from, an underlying asset or group of assets.

Convertible Arbitrage is the simultaneous purchase and sale of an asset to profit from an imbalance in price. It is a trade that profits by exploiting the price differences of identical or similar financial instruments on different markets or in different forms.

Short-duration yield convertible is a short-term convertible bond. A convertible bond is a fixed-income corporate debt security that yields interest payments but can be converted into a predetermined number of common stock or equity shares.

VIX Index (Chicago Board Options Exchange Volatility Index) is a popular measure of market risk and is constructed using the implied volatility of S&P 500 index options.

Earnings per Share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability.

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