PENDULUM
ASSET MANAGEMENT

Income Strategy - Q1 2025 Commentary

April 28th, 2025

Dear Investors and Prospective Investors,

With one year wrapped up on the Income Strategy, it is time to do an in-depth dive on the performance of the strategy and what I am convinced are the reasons behind the outperformance. Granted, this is as of Q1 2025 end, and a lot has changed with the global tariff situation since then. However, my long-term view of the viability of the Income Strategy and my view on how its held securities are significantly undervalued has not changed.

Income Strategy Total Returns	1Q 2025	YTD	1 Yr	Inception[1]
Income Strategy Returns, Gross	4.92%	4.92%	14.60%	15.89%
Income Strategy Returns, Net	4.72%	4.72%	13.70%	15.05%
Index[2]	4.54%	4.54%	3.23%	6.75%

1. Inception date is 3/1/2024. Inception returns are annualized
2. MVIS US Mortgage REIT Index, Total Return Net. Index returns above a 1 Yr time period are annualized

Q1 2025 returns was 4.92% (gross of fees) and 4.72% (net of fees) for the Income Strategy, exceeding the Benchmark's return for the same time period by 0.18%.

The end of this quarter also marked the 1-yr mark for the Income Strategy, in which rolling 1-yr returns were 14.60% (gross of fees) and 13.70% (net of fees). Compared to the Benchmark's 1-yr rolling return of 3.23%, the Income Strategy's net return exceeded it by 10.47%[1].

Focusing on the Income Strategy, it also outperformed a couple of mainstream equity indices over a 1yr period, including the S&P 500 Total Return Index and Russell 2000, which returned 8.25% and -5.30%[2], respectively.

So why the broad outperformance?

Detailed below, but summarizing, the Income Strategy likely outperformed in its first year because the strategy held, what I believe to be, the highest quality names within the mREIT sector as well as broad market recognition of the quality of those names. It goes down to my core belief that in order to invest successfully, it is better to invest in firms with high-quality management even if they trade at a premium to their less well-managed peers. Management is by far the most important aspect of investing, and while business quality, asset quality and more are also important and not secondary to management, I tend to place most of my weight on managerial quality.

Given the above, my conviction is that an allocation to the Income Strategy could be beneficial, as it:

1) Provides diversification away from the broad market via exposure to mortgage REITs, preferred stock, and other small cap investments
2) Allows investors to earn what I believe is a higher-than-average dividend yield than the broad market, with the trailing twelve-month dividend yield being **7.36%[3]**

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[1] Time period for 1 Year returns assumed Q1 2025 end, or 3/28/2024-3/31/2025

[2] S&P 500 Total Return Index includes dividends reinvested. Time period for returns presented for S&P 500 Total Return Index and Russell 2000 Index are 3/28/2024 – 3/31/2025

[3] Dividend yield does not reflect the deduction of all fees and expenses that a client or investor has paid or would have paid. Please refer to the Income Strategy gross and net performance shown above to understand the overall effect of fees. Yield is calculated by dividing the income generated by all yield producing securities held over the past twelve months by the average balance maintained during the same period

a) This yield may go higher given that it is backward-looking and a few companies within the Income Strategy have raised their dividends since then

3) The fund structure is in my opinion very investor-friendly, as there are no lockups of capital, a simple fee structure of 1% annually with assets under $1mm (see disclosure brochure for more information on fees), and all clients are in separately managed accounts so that investors have full visibility and transparency into what they own

Going forward, I expect next year to be rife with volatility, not necessarily because of the ongoing tariff uncertainty but because my viewpoint is that the broad market is overvalued and that a reduction in federal spending is likely to induce some sort of slowdown. That being said, the tariff uncertainty has caused a lot of short-term volatility and small-cap dividend stocks have not been immune.

My conviction is that the long-term investment horizon for small cap dividend stocks, especially mortgage REITs, is attractive given that A) I do not believe the long-term fundamentals, both from a managerial and business/operational viewpoint has changed and B) the income generated may be viewed as an attractive hedge in light of the volatility.

To existing investors, thank you again for your trust over the last year and to prospective investors, learn more "HERE" and please reach out if you have any questions.

-Eric Kruglak

Key reasons why the Income Strategy outperformed over a 1yr period relative to its benchmark and some mainline equity indices are:

A) The Income Strategy Portfolio is comprised of approximately 50% mortgage REIT assets, whereas the index is 100%

a. The Benchmark/Index, the MVIS US Mortgage REIT Index (MVMORTTR) (see disclaimer for more detail) tracks the performance of the largest and more liquid companies in the US Mortgage REIT Industry. As I have written before, there are a handful of high-quality companies amidst a sea of junk. I intentionally structure the portfolio to include what I believe are the best names and leverage my experience in the sector to avoid what I think are the worst

B) 1.0 Versus 2.0 Investments:

a. In essence, mortgage REITs are levered investment vehicles that invest in loans and mortgage securities. Using leverage has its upsides and downsides, and unfortunately when using leverage goes wrong, it goes really wrong. During COVID, many mREITs used mark-to-market repo to finance their loans and mortgage-backed securities, and when the credit quality of said instruments came into question and marks came in much lower than expected, repo lender seized these securities and liquidated them. The net effect of that was turning unrealized losses into realized losses, greatly impacting both book value and valuation. While not the sole reason for the underperformance in the subsector, it certainly contributed to the volatility that in my opinion transformed the subsector for the better

b. While the chart below explains more, the general thesis for the mortgage REIT holdings in the Income Strategy is that many of these companies have either A) weathered the COVID deleveraging event well or B) transformed their business post-COVID or C) restructured their balance sheet to shift from repo financing (mark to market) to securitization financing (non-mark to market). Or D) all of the above. Part of what has been dragging down the sector for so long in my opinion is that the market assumes that since much of the sector is poorly managed, that that should apply to the entire subsector when in reality there can be quite a few gems.

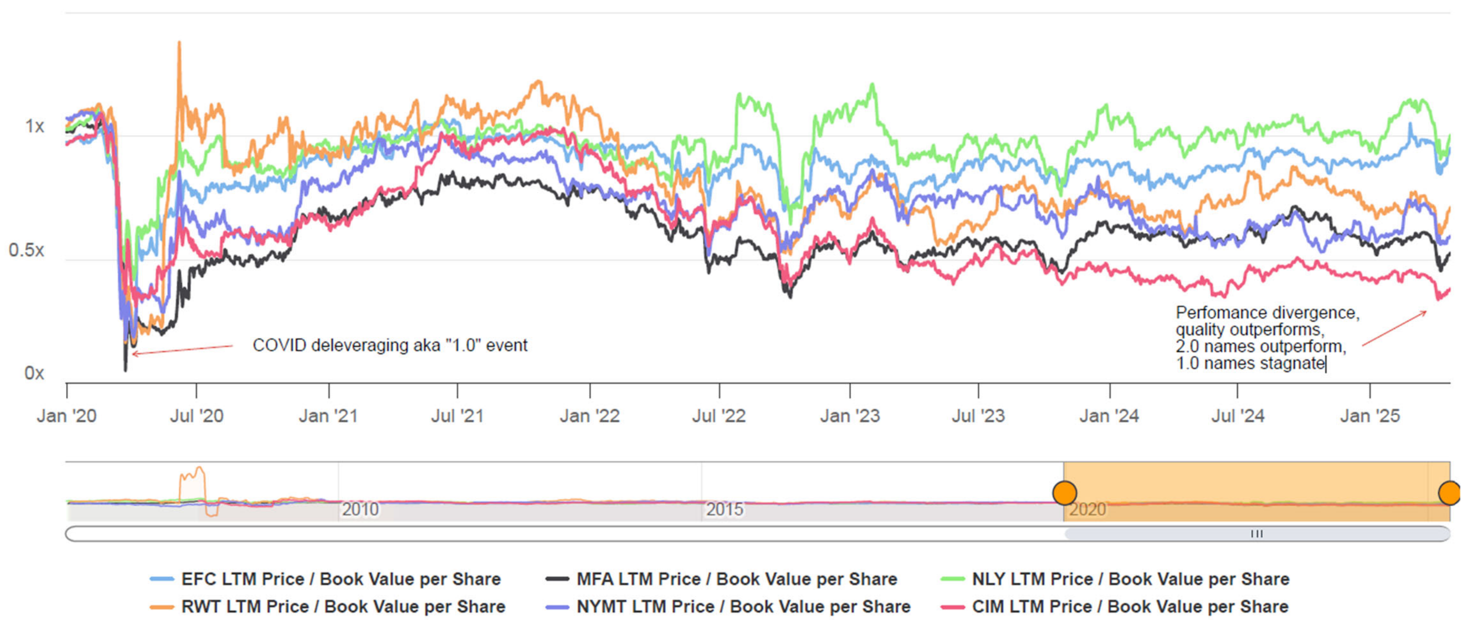
c. Within the mREIT subsector, there is a clear delineation between companies that were able survive and thrive post-COVID (2.0 investments) and those that have struggled since then (1.0 investments), and that in part can be shown by the price/book value.

d. **The thesis** is that the market will start to differentiate the quality of the 2.0 bucket versus the 1.0 "legacy" investments. Elaborating, the thesis here is that many of the 2.0 names that are still trading at a discount to net asset value will start to accrete to 1.0x net asset value or greater. On the other hand, the 1.0 legacy investments may go in the opposite direction and highlight greater discounts to net asset value)

e. If the trade takes a while to materialize, investors may earn dividends that I believe could range in yields from 6% to low double digits.

f. See below for two comparison charts between the hybrid[4] names held with the MVIS US Mortgage REIT Index as well as their 2024 economic returns[5]:

Price/Book Value Comparison Across Hybrid mREITs, 2020-Present [6]



Source: TIKR.com

Hybrid mREIT Comparison List

Ticker	Name	2024 Economic Returns	Beginning Price/Book (1/2/2020)	End Price/Book (4/25/2025)
CIM	Chimera Investment Corp	2.67%	0.96x	0.38x
EFC	Ellington Financial	9.31%	0.97x	0.95x
MFA	MFA Financial	4.29%	1.01x	0.53x
NLY	Annaly Capital Management	11.78%	1.03x	1.00x
NYMT	New York Mortgage Trust	-10.44%	1.07x	0.59x
RWT	Redwood Trust	5.67%	1.04x	0.71x
Average		**3.88%**	**1.01x**	**0.69x**

Source: TIKR.com

4 Defined as a mortgage REIT that invests in both agency and non-agency loans and securities
5 Defined as the change in book value *plus* the dividends paid
6 Information as of 4/25/25

Using metrics such as economic return and price/book do not paint the entire investment picture when deciding to invest but I have found that economic returns are an indicator of management execution and price/book is how the quality of that execution is expressed in the public market.

There is a wide discrepancy between valuations these companies had in 2020 versus today, and while 2024 economic returns are not the entire reason for the valuation difference, in my opinion they do provide some explanation. As written above, a lot of these companies suffered during COVID, but my view is that the companies with price/book values sub-0.60x were unable to recover from the damage caused by COVID. Some of the above companies may have been unable to properly their balance sheet, pivot to a different business model, or have suffered credit quality deterioration of their existing loan portfolio (or all of the above). On the other hand, the above companies with price/book values above 0.60x may have been able to do the opposite and thrive because of it.

Again, my view is that all of this is a matter of managerial quality, and that the well-managed companies (aka the 2.0 firms) are valued higher relative to their less well-managed peers (aka the 1.0 firms).

So, I believe outperformance in the Income Strategy can be attributed to selecting the best-run companies and the market recognizing the quality of the best-run companies versus their poorly-run counterparts.

Updated Thoughts on Recent Market Volatility:

Make no mistake, while being aware of global issues is important, I do not base my investment decisions off of the macroeconomic environment. The firm closes out returns on a month-to-month basis, and so while I cannot disclose formal returns yet, I can say that the entire market is down and mREITs and other small-cap income stocks are not immune. For color, the Benchmark month-to-date (as of 4/25/2025) has returned -7.1% and -2.88% year-to-date. Not good, but again recalling what I wrote above, since there are a lot of poorly-run names in the index, I believe those names have been contributing to underperformance and I intentionally try to avoid any name that has poor management. In any case, here are my quick thoughts on how trade war chaos could impact the mREIT subsector:

A) Inflationary pressure causes broad selloff with higher rates
   a. If tariffs causes inflation to go higher, that coupled with low economic growth (“stagflation”) would certainly impact any interest rate-sensitive investment, including mREITs
B) Credit risk increases
   a. If tariffs cause a broad economic slowdown, the credit quality of the mortgage market may come into play
C) Slowing down of origination activity
   a. Going with point B, if credit deteriorates, originations will also slow down, decreasing fees for the originator/servicer mREITs

When push comes to shove, I am not concerned about the macroeconomic environment as again, my investment style is to buy well-managed firms at relatively attractive prices, and to hold the equity in those firms in perpetuity unless business fundamentals and managerial quality changes for the worse.

Closing Thoughts:

Thank you for taking an interest in the firm. Despite the market volatility, I am optimistic for 2025 and onward.

If you wish to learn more about the firm, please visit www.penduluminvest.com or reach out to me directly. I am always happy to have a conversation on our Income Strategy and other offerings as they may be appropriate for investors looking to diversify away from the broad market.

To existing investors, thank you again for your trust with your hard-earned capital, and to prospective investors, I hope I can earn yours.

Thank you,

Eric Kruglak

Eric Kruglak
Founder & Managing Member, Pendulum Asset Management LLC

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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.

Strategy Returns presented are time-weighted total returns that have been adjusted for cash flows and include the reinvestment of income. Strategy/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.