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## Research Highlights

# CCM Investment Team

## MARKET COMMENTARY

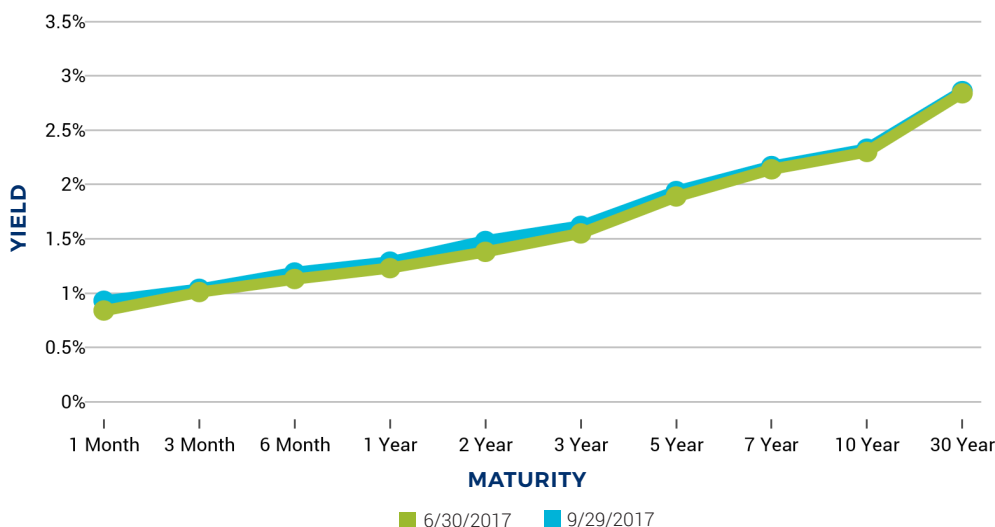
The fixed income markets broadly posted positive returns during the 3rd quarter, with the Bloomberg Barclays Aggregate Index returning 0.85%. Lower rated fixed income assets outperformed higher quality debt, as the need for yield and income continued. The Bloomberg Barclays US Corporate High Yield Index returned 1.98% for the quarter, outperforming the Bloomberg Barclays Agg which is composed of investment grade bonds. Investment grade corporate bonds, as measured by the Bloomberg Barclays US Corporate Index, returned 1.34% as corporate spreads tightened by 8 basis points; BAA rated debt in the Bloomberg Barclays Aggregate returned 1.63% versus AAA rated debt of 0.63%.<sup>1</sup>

A detractor to bond market returns was a flattening yield curve, driven mainly by the Federal Reserve's (the "Fed") remarks of another potential rate hike before year end. For the quarter, the 10-year and 30-year rates increased by 3 bps, with a greater increase in rates being seen on the shorter end of the curve (1-month to 3-year). As of quarter end, the 2-year yield was 1.47% and the 10-year yield was 2.33%.

The Fed announced it will start to reduce the size of its nearly \$4.5 trillion balance sheet by scaling back the reinvestment of principal payments from agency debt, mortgage-backed securities, and Treasury securities held in the System Open Market Account. The systematic and gradual decrease in principal reinvestments is intended to smooth potential impacts on the fixed income markets.

## Treasury Yield Curve

DATA 2Q 2017 and 3Q 2017 | SOURCE: BLOOMBERG



<sup>1</sup> Ratings are typically measured from Aaa (highest) to C (lowest).

Equity markets continued to trend higher with positive returns in all three months for the quarter, with the S&P 500 posting a 4.48% total return. The S&P 500 experienced nine new highs during third quarter, driven mainly by stronger than expected earnings numbers and a surprise in revenue forecast beats versus Wall Street consensus. Small cap stocks, as measured by the Russell 2000 Index, returned 5.68% in the quarter. Global equity markets posted positive returns with the MSCI Emerging Market Index up 8.04% and MSCI Europe index up 6.49%.

Fundamental economic data released during the quarter was mixed as the United States experienced two major hurricanes in Texas and

Florida. Damages are expected to be significant and short-term effects to economic activity, labor markets and business and consumer behavior should be strained. Consumer Price Index (CPI) continued to be below the Federal Reserve's 2% benchmark at 1.9% yearly change as of August 2017. The Unemployment rate improved to 4.3% in July and increased slightly to 4.4% in August. The Labor Department job's report surprised many in July with 209,000 jobs added, while the month of August underwhelmed adding only 156,000 jobs vs. the estimated 180,000. Durable goods new orders were up 5% year-over-year (y-o-y) compared to a 2.2% y-o-y increase last August.

3Q 2017 Commentary

## CRA Qualified Investment Fund

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### PORTFOLIO COMMENTARY

In the third quarter of 2017, the CRA Qualified Investment Fund CRA Shares (CRAIX), Institutional Shares (CRANX) and Retail Shares (CRATX) returned 0.66%, 0.68% and 0.68%, respectively, on a net of fees basis, underperforming the Bloomberg Barclays U.S. Aggregate Bond Index ("Benchmark") return of 0.85%.

The Fund's largest sector, agency commercial mortgage-backed securities (CMBS) returned 0.64%, outperforming the U.S. Government subsector return of 0.39%. The higher income profile of the Fund's agency CMBS relative to U.S. Government securities, coupled with product spread tightening, were the main contributors to the outperformance.

The Fund's second largest sector, single family agency mortgage-backed securities, returned 1.03% in the quarter, outperforming the U.S. MBS sector return of 0.96%. The sector's slower prepayments and allocation to 30-year MBS, which was the best performing sub-type during the quarter, were the two main reasons the sector outperformed on a relative basis.

The third major sector in the Fund, taxable municipal bonds, underperformed the U.S. Credit sector, returning 1.28% compared to 1.37%. The Fund's taxable municipal profile of shorter duration, higher credit quality, and lower income, were the main reason for the relative underperformance given the continued rally in riskier assets.

As of September 30, 2017, the Fund's Yield-to-Worst (YTW) is 2.84% above the Benchmark's YTW of 2.55% and it exhibited 19.5% shorter duration (interest rate risk) to the Benchmark. We feel the Fund is fundamentally well positioned given its lower duration compared to the Benchmark and its higher concentration in agency and government guaranteed securities. The portfolio management team does not anticipate any changes to its current asset allocation weightings.

3Q 2017 Commentary

## CCM Alternative Income Fund

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### PORTFOLIO COMMENTARY

The CCM Alternative Income Fund returned 1.64% in the third quarter with 1.22% of distributable income. The fund's year to date return is 3.93% with 3.62% of distributed income. Gains were fairly evenly distributed in the quarter with different parts of the strategy taking turns leading the portfolio.

The change of season so far has been in name only. An Indian summer has kept the weather nearly identical with August. The same can be largely said of financial markets. While the Federal Reserve has officially reversed gears and kicked off its "quantitative tightening", markets have not turned over a new leaf. Volatility and

yields remain low and valuations inch ever higher. The days go slow into the changing season.

Moreover, risk premia seem lowest where very large amounts of capital can find a home. In fixed income, credit spreads remain at or near historical tight, particularly for benchmark issuers or major index components. Similarly, in equities, dividend yields are plumbing all time lows, again for large components of indices or sector ETFs. Valuation and underlying company performance take a backseat, if they are even in the car. Capital seems to flow to wherever it can be absorbed in large quantities.

“ Oh, the days go slow  
into the changing season.  
Oh, bought and sold  
for all the wrong reasons.  
Oh, down they go  
for all the wrong reasons. ”

- TOM PETTY

To the extent we hear people attempt to justify these generally indefensible asset prices, a major part of the song remains same: low interest rates. Low interest rates make a five-year junk rated bond yielding 3% attractive. Low interest rates and 2.5% dividend yields seem to warrant 25x earnings multiple to century-old consumer staple companies that usually grow largely in line with GDP.

Of course, large numbers of people are not actually making these idiosyncratic decisions. Many are simply buying ETFs that have these investments as components. Seeing what goes into the sausage might be unpleasant so perhaps most choose not to look. Bought and sold for all the wrong reasons.

There is no question that headline inflation has remained low and longer duration bonds have had yield ceilings on them. As we pointed out in the last letter, however, shorter-term rates have continued steadily higher. Libor recently closed above 1.35%. September was the

worst month for the two-year treasury yield since the 2016 election and recently crossed 1.5%.

We are by no means suggesting that 1.5% is an attractive yield for a two-year investment. But that yield is up from 1.2% at the beginning of the year. If low interest rates are a primary driver for owning “bond substitutes” such as low-growth, consumer staple companies at 2.5% dividend yields, would that calculus change if the two-year yield approached 2%? Do people realize that moving a dividend yield 50 basis points higher to maintain a 100 basis point spread from the 2 year treasury requires a 17% share price drop? (\$2.50 dividend needs share price decline from \$100 to \$83 to get 3% yield) Down they go for all the wrong reasons.

We do not mean to give the impression we are overly bearish. On the contrary, for the first time in close to 10 years we see real strength in the economy. Headline GDP growth of 3% is apparent almost everywhere.

## 2-year Treasury Yield (white line) and 3-month LIBOR (orange line)

DATA FROM 9/30/16 - 9/29/17 | SOURCE: BLOOMBERG



Everything from manufacturing to services to container volumes at ports is screaming. Companies are hiring and people are spending.

We expect most of our long equity investments to show outstanding third quarter results, particularly the cyclically oriented. Many of these investments continue to trade at attractive yields with a few trading at their highest yields ever (while not small companies they are not big index components). Similarly in fixed income, credit risk behind our investments has diminished with a better economy and our portfolio remains negatively correlated to interest rates.

In closing, things seem headed back to normal, at least economically and monetarily. Normalization without the distortions of hyperactive central banks will indeed be a welcome change. There is now a whole generation of market participants who have never really experienced change though. They have never worked in a rising-interest rate

environment, where interest-rate sensitive investments can be seen as toxic. They have never experienced an economy where growth is not scarce and therefore does not trade at a premium.

Moreover, no one has experience with central banks draining massive pools of liquidity since those pools were unprecedented to start with. Similarly, no one has seen large, sustained outflows from passive funds since passive funds have grown logarithmically only in the past few years.

While the weather has been sunny to date, Indian summers, like legendary, soulful, poetic rockstars do not endure forever. The end can indeed come without warning. Forever Running Down a Dream, Tom.

## CONCLUSION

Overall we remain constructive on the U.S. and worldwide economies. The low growth torpor of the past few years seems to be lifting across industries and geographies. However, valuations and the shotgun approach to risk-taking persist as concerns. Many indexes and large swathes of asset classes are trading at or close to all time high multiples of historically high margins with low interest rates a primary justification. As yield investors always concerned about downside, paying high prices based on ultimately transitory rationale is a risky proposition. We continue to look for and find pockets of opportunity, particularly in areas that have not yet attracted passive capital.

## Disclosures

*Index returns do not reflect any fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.*

*As of 9/30/17, the average annual returns for CRAIX for 1-year, 5-year, 10-year and since inception (8/30/1999) were -0.27%; 1.08%; 3.23%; and 4.11%. The average annual returns for CRANX for 1-year, 5-year, 10-year and since CRANX inception (3/2/2007) were 0.08%; 1.51%; 3.68%; and 4.36%. The average annual returns for CRATX for the same periods were -0.18%; 1.18%; 3.33% and 4.16%. As of 9/30/17, the 30-Day SEC yield for the CRA Shares, Institutional Shares, and Retail Shares was 2.09%, 2.54%, and 2.19% respectively. As of 9/30/17, CCMNX one-year performance is 5.12% and since inception (5/31/13) is 2.70%. Performance quoted is past performance and does not guarantee future results. Current performance may be lower or higher than the performance data quoted. An investor's investment return and principal value will fluctuate so that your shares, when redeemed, may be worth more or less than your initial cost. To obtain the most recent month-end performance, call 877-272-1977. The annual operating expenses for the CRA Qualified Investment Fund's CRA Shares, Institutional Shares, and Retail Shares is 0.91%; 0.46% and 0.81% respectively. For CCMNX, performance reflects fee waivers, which if not in effect, would have decreased performance. Performance reflects fee waivers, which if not in effect, would have decreased performance. The total annual fund operating expenses is 3.10%. The net expense ratio is 2.94% which is the amount the investor would pay. The total annual fund operating expenses after fee waivers and expense reimbursements (other than acquired fund fees and expenses and dividend expense and prime broker fees on securities sold short) is 1.60%. Waivers are contractual and in effect until 9/30/18.*

*This material must be preceded or accompanied by the current Fund prospectuses. Please read them carefully before investing.*

*The Funds' are distributed by SEI Investments Distribution Co., which is not affiliated with Community Capital Management, Inc.*

*Investing involves risk, including possible loss of principal. Bonds and bond funds will decrease in value as interest rates rise. The CRA Qualified Investment Fund is not diversified. High yield bonds involve greater risks of default or downgrade and are more volatile than investment grade securities, due to the speculative nature of their investments. The CCM Alternative Income Fund uses investment techniques that are different from the risks ordinarily associated with equity investments. Such techniques and strategies include hedging risks, merger arbitrage risks, derivative risks, short sale risks, leverage risks, commodities risk, and foreign investment risks, which may increase volatility and may increase costs and lower performance. Commodities can be highly volatile and the use of leverage may accelerate the velocity of potential losses. There is no guarantee the investment objective or goals of the Funds' will be achieved.*

*LIBOR: London Interbank Offering Rate, which is the most widely-used benchmark for short-term interest rates.*