

## ZEO QUARTERLY LETTER: 2Q2018

Dear Clients:

Here at Zeo, we don't view ourselves as just offering returns or potential outperformance, though we take pride in our track record. We place more emphasis on our objectives to deliver strong risk metrics, such as low volatility, a high absolute ratio<sup>1</sup> and absolute returns over reasonable timeframes. Even so, these quantitative measures aren't ends in and of themselves. They are the parameters of a deeply fundamental investment process designed to help investors build confidence in achieving their goals based on their own analysis of their own portfolio objectives. This stands in contrast to those who seek to appeal to investors trying to mirror whatever the "smart money" is doing. But the "smart money" doesn't know our clients, what you are trying to achieve or why you hire managers like us. For you, we are unwavering in our effort to deliver something much more valuable to go along with our performance: peace of mind and consistency.

### Are ETFs Dumbing Down the Bond Market?

For the entirety of our careers, it's been a well-worn adage that the bond market is a leading indicator for the stock market. Conventional market wisdom is that bonds tend to reflect short- and medium-term investor expectations of the economy. Furthermore, because bond payouts are asymmetric to the downside (i.e. you can lose more than you can make), bond traders tend to be less likely to engage in the levels of speculation typically found in other markets – the potential upside just isn't large enough without access to a sophisticated infrastructure not often available to most investors.<sup>2</sup> The result of this, the argument goes, is that the bond market is a more pure predictor of what will happen in the economy: the "smart money."

Except the ETF revolution may be changing all of this. Over the last few years, we have seen several reports of behaviors which may be indicating a breakdown in the factors which have historically dominated the bond markets. For example, Bloomberg News reported in 2017 that the largest public holding by Harvard University's endowment was a high-yield bond ETF. According to Deutsche Bank, institutional investors in general represented approximately 59% of all ETF assets at the end of 2016, and hedge fund holdings in ETFs grew 77% that year. Registered investment advisers held nearly 33% of all ETF assets, compared to just under 42% owned

<sup>1</sup> Absolute ratio is the ratio of an investment's total returns to its standard deviation. This calculation is similar to the Sharpe ratio except the Sharpe ratio uses excess returns over a "risk-free" benchmark such as treasury bonds or LIBOR as a numerator (total returns – "risk-free" rate). In either case, a higher ratio indicates stronger risk-adjusted returns.

<sup>2</sup> It's with mixed emotions that we caveat this statement to acknowledge the recent "innovations" that have given investors easier access to the structured products, derivatives and leverage which led to the demise of so many "sophisticated" hedge funds during the financial crisis on 2008. However, we are happy to note that most investors still limit their fixed income exposures to actual bond risks (e.g. credit and duration), which limits the attraction of speculating on bonds.

by retail investors. With virtually all ETFs representing passive indexed strategies<sup>3</sup>, these statistics alone point to a sea change in the way we would expect markets to behave in a correction.

What is notable about these observations isn't just that they point to capital flowing into ETFs, but that the investors include large institutions and hedge funds, not just self-directed investors. Institutions and hedge funds have historically tended toward actively managed portfolios of individual bonds in an effort to outperform their benchmarks or deliver uncorrelated returns. Many reports argue that one reason this is changing is because the corporate debt markets are becoming increasingly illiquid, leading these investors to more liquid options for accessing exposure to an asset class. At first, this seems like a wise and reasonable decision of sophisticated investors who must have evaluated a variety of risk factors before choosing this route.

But, on second thought, isn't this just passing the buck? After all, the bonds these investors are not buying will ultimately be bought by the ETFs. Furthermore, when the institutions and hedge funds exit, the remaining shareholders are left with heightened downside risk as the ETF managers make sales to raise cash without the benefit of the liquidity these same investors previously provided. The result could be a compounding effect that would exacerbate volatility and put smaller investors at risk of being trampled by an even bigger herd.

If this sounds familiar to some readers, you shouldn't be surprised. The last two paragraphs were pulled nearly verbatim from our investor commentary for February 2015, citing reports and statistics from the first quarter of that year.<sup>4</sup> We were not surprised to see our volatility expectations play out since then, nor are we surprised by the more recent data we cited earlier which seems to support the same expectations now. What has been unexpected is our feeling that the call to action hasn't felt as strong this time around.

We suspect this is because any hope that investors might realize the risks they are taking has been tempered by an intentional and willing blind eye to those risks – any potential repercussions can no longer be blamed on unintended consequences. For example, the United States is facing a potential trade war that could substantially gum up the economy, and the markets don't seem to care. We have speculated internally as to why, and we see investors explaining away their apparent complacency with unnerving ease. "It's already priced in." "It won't get that far." "Strong-arm negotiating tactics may very well prevail."

But plausible explanations don't erase risk; they simply give reason to analyze and change the probabilities of the various potential outcomes. And the way the market is behaving, it would seem those probabilities are being heavily, if not entirely, weighted toward "everything is awesome."<sup>5</sup> When considering this imbalance, it was a recent report in Bloomberg News which reignited the urgency in our concern from 2015: *"Leverage Angst Worse Than '08 Grips Stocks, Ignored by Bonds."* Wait. What? Aren't the bond markets the ones that tell us when to be worried? Aren't credit investors the ones most attuned to leverage? Don't equity investors usually harbor the unbridled optimism of a bull market environment until it's too late? What happened?

ETFs happened. A culture of easily trading "bonds" through instruments that look like stocks happened. An obsession with index funds as examples not just of liquid ways to take risk but of *low-cost* ways to take risk deemed fungible with actively managed strategies happened. Misleading research indiscriminately vilifying all

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<sup>3</sup> Morningstar reports that only 1.25% of all ETF assets were actively managed as of June 30, 2018.

<sup>4</sup> Interested readers can find this report in the archives of our fund portfolio reports on our web site (<https://www.zeo.com>). In that commentary, the "many reports" we cite refer to a host of articles from the Wall Street Journal and Bloomberg News from February and March 2015, though this could just as well apply to more recent stories from the same outlets. We concluded then with a suggestion to investors to shy away from strategies which tend to always run with or even against the herd and instead seek those who aim to be where the herd isn't. It won't come as a surprise that we believe our own strategy to fit the latter description, and we take pride in pointing to our performance to back up that view.

<sup>5</sup> Our apologies to anyone for whom a certain song is now stuck in their heads. For everyone else, you're welcome: <https://youtu.be/StTqXEQ2I-Y>.

active management as an overpriced means to the same (or worse) ends without regard for risk-adjusted returns happened. And institutional investors and advisers, responding to their own constituents' preferences, moving toward using ETFs rather than taking the other side of their trades happened.

In other words, the forces which collectively expressed well-researched viewpoints in the bond markets have been displaced by an industry-wide ideology that passive index investing with low-cost ETFs is definitively the right solution for all investors. Institutional managers have traded their old jobs attempting to assemble and manage portfolio risks through security selection for new ones in which they fret about market risks materially more difficult to analyze and impossible to predict. Benchmarking has gone from a way to measure a manager's relative success to a way to invest in and of itself, with any deviation viewed through a skeptical lens simply because it requires an active decision. All of this, in turn, has given traditionally rigorous bond investors permission, or perhaps even the mandate, to stop thinking for themselves and forsake their role as the counterbalance to correlation in a market disruption. In doing so, bond markets have relinquished their dependability as leading indicators for the economy.

We do not necessarily accept that equity markets have taken their place – speculation, even if contrarian in the long tail of a bull market, usually reeks more of opportunism than discipline. Until we see this discipline revived in the fixed income side of portfolios, it's tough to believe investors are deliberately responding to the same risks in their equity portfolios. But as long as bond investors continue the trend of defining success relative to the performance of their lowest-cost peers and the unmanaged risk they represent, they will give in to their low self-esteem and chase today's "in" crowd, the indexed ETF herds, rather than embrace their self-worth as measured by their own more appropriate success metrics.

Which leaves us wondering: is there anyone left in the "smart money" club?

### The Most Important Success Metrics You Aren't Using

We have spilled a lot of ink in these commentaries espousing the value of risk-adjusted return metrics. We have spent hours on various stages at industry conferences and in private settings doing the same. Time and time again, we have consulted with our clients on their overall fixed income portfolios, applying various risk-reward filters to help identify the portfolio of managers which we believe will help them best achieve their goals. Once we've determined the best risk-reward measures to apply, we typically have one more important filter before the investor applies qualitative due diligence and her own good judgment and expertise to narrow the field to a final portfolio (see Figure 1). That middle step is the consistency test. It is usually the step we find missing from most due diligence processes, but it is indispensable. If we make one recommendation to investors doing their own due diligence, it is this: come up with your own quantitative measure of consistency and incorporate it into your process.

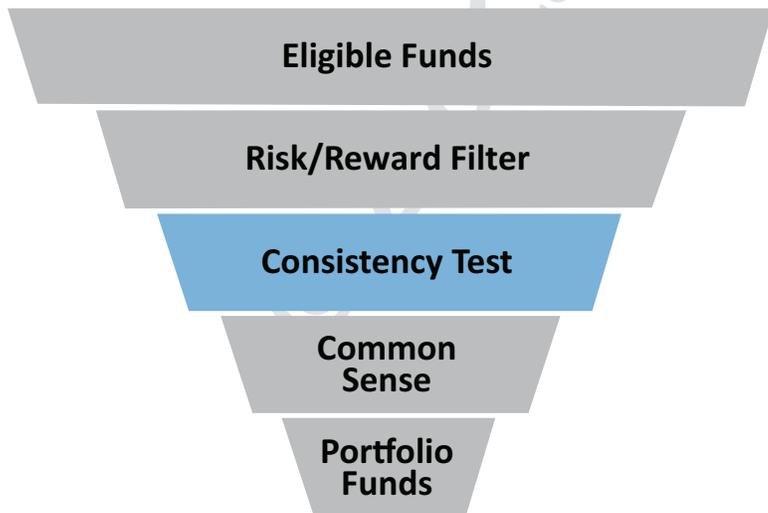


Figure 1: A High-Level Framework for Building a Risk-Minded Portfolio

To illustrate how important it is to have a consistency metric, we analyzed all taxable fixed income mutual funds available in the Morningstar database. As of 5/31/2018, there were 1201 distinct funds in this group. We then calculated the 3-year absolute ratio for all 1201 funds. In a small application of human judgment, we eliminated the 40 funds with a negative absolute ratio, which meant the fund was down after 3 years. In our opinion, this was a reasonable initial filter for exclusion from a fixed income portfolio. This left a universe of 1161 eligible funds, of which 407 funds had an above-average 3-year absolute ratio. Put another way, 33.9% of the original 1201 funds had a mere above-average risk-reward profile as measured by the absolute ratio.<sup>6</sup> In our first step, we eliminated nearly two-thirds of the universe.

However, we then applied a very simple consistency test. We encourage readers trying this at home to come up with consistency measures which mean the most to their process, and we want to make clear that we believe very strongly that there is an important role for qualitative due diligence in understanding a manager's investment process, without which one cannot fully evaluate consistency. But for the purposes of this example to illustrate the power of even having just a quantitative filter, we only included funds that were above average in every individual year of the three years in the evaluation period. This took our fund count from 407 to 106. We eliminated nearly 3/4 of the funds who were above average over the full three years simply by insisting that they also be above average in each of those three years. That list of 106 funds is only 8.8% of the original 1201. If we extend the evaluation period to five years, it drops to 6.6%. In other words, a consistency test may be the most effective way to separate the wheat from the chaff of any step in a risk-minded due diligence process.<sup>7</sup>

To make sense of these numbers, we should see what these filters do for the resulting risk profiles of the funds being considered. To do this, we calculated the alpha and beta coefficients of each fund using monthly returns relative to the Bloomberg Barclays US Aggregate Bond index, the most common broad market fixed income benchmark. While we calculate these numbers using the same methodologies as other market participants, we interpret the results differently.

The most common understanding of alpha is captured by Morningstar's definition of the statistic: "A measure of the difference between a fund's actual returns and its expected performance, given its level of risk as measured by beta." Alpha in the conventional wisdom is an *outperformance* measure above an expected return based on beta, defined as "[a] measure of a fund's sensitivity to market movements." There is a meaningful difference between beta and correlation. Correlation only expresses a measure of whether two instruments moved in the same direction, whereas beta expresses an expectation of the magnitude of the move when correlated. Also important to know is that alpha is typically reported as an excess return. So, for example, if a fund's alpha is 0.30%, that means historically, that fund outperformed its beta expectation (beta x benchmark performance) by an additional 0.30% return.<sup>8</sup>

So why are we bringing this up? For a portfolio seeking absolute returns, such as ours, managers are actively aiming to reduce beta and correlation to the broad market benchmarks. We are actively aiming to generate as much of our return from alpha, but by traditional definitions of these terms, a high alpha portfolio is underestimated if it has a low beta since the overall performance may be in line with the benchmarks. In other words, to target low volatility, one must not aim for a high alpha on top of beta; one must instead aim to replace

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<sup>6</sup> We chose to use the absolute ratio for this example, but any number of risk-reward metrics could have been used instead or in addition to narrow the field in this way.

<sup>7</sup> As part of the "common sense" step, one way to further narrow the list would be to acknowledge that returns do matter and only select the consistent funds who outperformed the Bloomberg Barclays US Aggregate Bond index over the evaluation periods. This takes our list down to 51 funds (4.2% of the total universe) for the three-year period and only 14 funds for the five-year period (a miniscule 1.4% of the total universe). If readers are looking for a way to find the needles in the haystack worth looking at closer, this makes for an easy starting point.

<sup>8</sup> These numbers are calculated by fitting a line ( $y=mx+b$ ) to  $(x,y)$  points represented by the monthly returns of a fund ( $y$ ) and a benchmark ( $x$ ). The slope of the line ( $m$ ) is beta and the intercept ( $b$ ) is alpha. Excel has handy formulas to help with this.

beta with alpha. It is actually the goal of managers like Zeo to deliver portfolios which generate high enough alpha and low enough beta that performance is consistent regardless of market movements. If we do our job right, we would expect to meet or exceed benchmark performance over reasonable timeframes even with little to no beta and with materially lower volatility.

But to properly measure this effort, we cannot just look at alpha as an excess return. We should instead look at alpha as a percentage of the overall return (which we will call “alpha%”<sup>9</sup>). Funds generating most of their return as alpha are the ones we believe can be expected to perform consistently since less of their return is driven by the beta of the market. This, unfortunately, is a metric you must calculate yourself, but it’s well worth it. What we found in our analysis above is that measuring for risk-reward does part of the job of identifying high alpha% and low beta funds. But filtering for consistency does the bulk of the work (see Table 1).

	Average 3y Alpha%	Average 3y Beta	% of Total Funds
All Funds*	24.4%	0.66	
Above Average 3yr Absolute Ratio	80.5%	0.33	33.9%
Below Average 3yr Absolute Ratio	-5.9%	0.83	66.1%
Consistent Funds	90.7%	0.12	8.8%

\* excludes funds with 3yr negative absolute ratios

Table 1 (Source: Morningstar Direct, data as of 5/31/2018)

We find two items striking in the data presented. First, we can see that those funds with below-average absolute ratios over the three-year period (nearly 2/3 of the total) had very high betas and negative alpha. This supports two conventional wisdoms: that most active managers do not earn their keep and that most index funds exhibit some negative tracking error due to fees and transaction costs. Second, we see that the consistent funds have the highest alpha% and the lowest beta. This is what we would expect, but the level to which these funds have delivered materially better risk-reward metrics came as a surprise even to us.

We should conclude this analysis with a caveat. Risk-minded portfolio construction is not for everyone. Reasonable people may prefer beta-focused portfolios. But for those investors who aim to build resilient fixed income portfolios by seeking to reduce volatility without compromising return objectives, we strongly urge you to take a closer look at your due diligence process. Making sure you apply some measure of consistency to your underlying managers and prioritize those with high alpha and low beta measures may help mitigate your portfolio’s exposure to unexpected markets.

<sup>9</sup> For clarification, alpha% = alpha / annualized total return for a specific timeframe. The aggregate data that follows are averages of individual alpha% and beta values calculated for each fund in the groups referenced.

## A New Alphabet for the Fed-Watching Set

Remember back when A was for “apple” and B was for “ball”? Such simple times seem so long ago, don’t they? C and D were for “cat” and “dog” if memory serves, though a quick internet search reveals many variations of this oldie but goodie from preschool. Nowadays, for investors, A is for “alpha”, B is for “beta”, and a search for CD now brings up FDIC-insured options to earn 2%+ interest. How times have changed.

So first, we will tackle the most obvious question that we have. How is a bank able to pay such high rates? The answer lies in how the business of banking works in the first place. As we have discussed in the past, banking is essentially the art of borrowing at lower interest rates to lend at higher interest rates, thus profiting from the difference. That difference has a name: net interest margin. If you look at the net interest margin levels reported by different financial institutions, you can learn a lot about the types of loans they make. As an illustration, we can compare and contrast Bank of America, Capital One Financial and Synchrony Financial (spun out from GE Capital several years ago).<sup>10</sup>

The net interest margin reported by Bank of America for 2017 was 2.37%. This is the average rate earned on their loan portfolio (e.g. home loans, credit cards, commercial lending) minus the rates they paid to borrow the money used to make those loans (e.g. checking accounts, savings accounts, CDs, corporate debt). Because so much of their earned interest lending (roughly 2/3) is from lower-risk debt securities and mortgages, this number is understandably low, especially given the wave of debt issuance and mortgage refinancing that took place over the last several years to take advantage of low interest rates.

Capital One Financial has a different mix of loans – roughly 2/3 through credit cards and 1/3 from consumer and commercial lending, broad categories which include auto, home and business loans. As a result of the higher mix of credit card lending, Capital One reported a net interest margin for 2017 of 6.97%. This higher number reflects the much higher interest rates consumers pay to carry credit card balances – 15.21% on average for Capital One credit card customers in 2017. Capital One’s net interest margin is diluted lower also by the over 20% of interest-earning assets that are held as cash and investments (treasuries and mortgage-backed securities, the majority of which are deemed marketable) earning approximately 2.42%.

Synchrony Financial, on the other hand, is almost entirely a credit card lender. The company reported a net interest margin of 16.25% in 2017, substantially higher than the other two banks we have discussed. This number is boosted significantly by the 21.90% rate charged to their credit card borrowers, likely higher than the other two banks (Bank of America charged credit card customers an average of 9.65%) due to the substantially higher credit risk of their credit card holders. Synchrony reported a charge-off rate of 5.37%, which means they wrote off 5.37% of their outstanding loans in 2017, versus Capital One’s 2.67% and Bank of America’s 0.54%.

But we have only discussed the earned interest side of the equation thus far. Still, readers will understand now why the CD rates differ from bank to bank (see Table 2).

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<sup>10</sup> Note that, for the following discussion, all data has been taken from each company’s publicly filed 10-K report for calendar year 2017 or its web site.

### Certificate of Deposit Rates as of 7/10/2018

<i>Tenor</i>	<i>Synchrony Financial</i>	<i>Capital One Financial</i>	<i>Bank of America</i>	<i>vs.</i>	<i>US Treasury Bills/Notes</i>
3m	0.75%	n/a	0.03%		1.97%
6m	1.00%	0.60%	0.03%		2.13%
9m	1.25%	0.75%	0.03%		2.24%
12m	2.40%	2.30%	0.05%		2.33%
18m	2.40%	1.75%	0.07%		2.45%
2y	2.50%	2.50%	0.10%		2.58%
3y	2.55%	2.55%	0.55%		2.68%

Table 2 (Source: Company websites, Bloomberg Finance LP)

The most obvious reason is that the more one charges for loans, the more one can pay to borrow the money to make those loans. Of course, based on the rates shown, it would seem that Bank of America (and its “too-big-to-fail” peers) could stand to increase their rates. But other forces are at work as well.

We find particularly interesting the jump in Synchrony’s CD rates at the one-year point (and the very flat rate curve from 1 year to 3 years). Just as peculiar is the outsized rate for Capital One’s one-year CD relative to their 9-month and 18-month rates. Both observations point to an intentional effort to incentivize people to deposit their money for a one-year term. There are a variety of reasons why this would be the case; suffice it to say here that it’s probably not out the kindness of the bank’s heart. More likely, there are specific benefits worth paying up to get people to commit to the 12-month timeframe, no more and no less – no more because credit card receivables are short-term in nature, so the offsetting funding should be as well; no less because liabilities of one year and longer result in better regulatory funding ratios. At the end of the day, it’s all just an elaborate game of cat and mouse, isn’t it?

None of this discussion is meant to frighten investors away from CDs in general or from any bank in particular. The FDIC insurance is just as valid for deposits with a bank who operates as a credit card lender as it is for deposits with anyone else. However, we also know that a yield-starved environment tends to weaken the discipline with which investors listen to their inner skeptics and ask fundamental questions. When we are asked about this topic, we often hear comparisons of our trailing returns to forward looking CD rates, as if the two were fungible. It is the rare investor who asks us how the banks can pay these rates in the first place.

Wherever you come out on the discussion above, we believe it’s important to have the resulting conversations, whether they are governance-related (“Are you ok with profiting from people who cannot pay off their credit card balances?”), risk-related (“Are you comfortable with the timing risk of recovering deposits from the FDIC if we have another savings and loan crisis?”) or liquidity-related (“Are you ok with a penalty to get access to your money during a CD’s term?”). We aren’t proposing that there are right and wrong answers to these questions; but, as we discussed last quarter, investment decisions should always be intentional.

So where does this leave short-duration credit strategies such as ours? The answer may lie at the literal start of the alphabet – alpha and beta. A common misconception of a strategy which aims to deliver high alpha and low beta is that the resulting low volatility makes it a direct substitute for products categorized as cash equivalents, such as money market funds and CDs. After all, in a market focused on outperformance of some benchmark, the natural tendency is to view these strategies as outperforming *something*. And for the last several years, they have been handily outperforming savings alternatives no matter the timeframe due to a near zero-interest rate environment. This bias has led to the question we hear most often now: With some CD rates exceeding 2%, do these strategies still have a place in savings portfolios? There are several ways to answer this question, so bear with us as we summarize each.

First, it is important to remind ourselves that it is not appropriate to compare trailing investment performance to current CD rates. It would make more sense to compare what one could have gotten by buying a CD one year ago to the performance of whatever strategy is being considered. Interest rates this time last year were over 1% lower than they are now, and 12-month CD interest rates were no exception.<sup>11</sup> For any portfolio an investor may consider, it is worth researching if that strategy has consistently delivered a premium to the CD alternative when viewed this way.

Second, it is worth understanding the differences between structures and the associated risks. CDs are FDIC-insured up to \$250,000. Investment portfolios (whether held as individual securities or through a mutual fund) are SIPC-insured up to \$500,000 (with a \$250,000 limit on cash to match the FDIC levels). These safety nets protect investors against the failure of their custodial institutions (the bank in the case of the FDIC and the brokerage firm in the case of the SIPC).<sup>12</sup>

As important structurally, an investment portfolio is readily accessible even if one doesn't expect to need it for, say, a one-year term. The risks in an investment portfolio is a market decline, though a well-managed short-duration portfolio should be expected to be non-negative (i.e. low volatility absolute returns) when viewed over an entire year. The risk of monetizing a loss in the interim is only a risk if one needs to take advantage of liquidity not available with a CD without an early termination fee (usually 3-6 months of interest). To that extent, liquidity favors the investment portfolio.

Finally, higher interest rate environments provide opportunities for investment strategies, especially those like ours that specialize in carefully-selected fundamental credit, to capitalize on higher yields and to increase the expected income in the portfolio. The entire portfolio may have a higher yield due to higher interest rates, but only the newly purchased bonds will pass those higher yields through as income right away. This is because interest income is defined by the IRS based on the cost basis of a bond. To the extent a previously-owned bond is now yielding higher than it was at purchase due to higher interest rates, the difference will show up in a strategy's total return through the life of the bond even if it is not distributed right away.

To put this in actionable terms, to the extent one has visibility into the underlying portfolio, a quick calculation of expected net total return (current underlying portfolio yield – forward looking expenses) is a more accurate value to compare to current CD rates on a forward-looking basis than even current distributed income (e.g. dividend yield from a mutual fund). Managers should be willing to help investors get to the bottom of this to enable an apples-to-apples comparison. We can't promise that this will always compare favorably for the

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<sup>11</sup> We use Bloomberg and bank websites for interest rate and CD rate data, but the observations would be the same using any sources reporting these datapoints.

<sup>12</sup> It is important for investors to understand there are differences between the FDIC and the SIPC. For example, the SIPC does not insure against investment losses but rather insures that account holders don't lose assets due to a custodial liquidation; the FDIC insures bank instruments (which don't have fluctuating market values) and protects an investor's principal amount plus accrued interest (if any) at the time of a bank failure. In both cases, account values are protected, but in different ways, and neither insulates investors from the consequences of poor choices.

investment strategy, but supporting an informed conclusion regardless of the outcome is the obligation of every manager.

As a practical matter, we have always believed that high alpha short-duration income strategies such as ours, if used in savings portfolios, are best placed in a risk ladder *alongside* CDs and other well-accepted cash substitutes. We would never imply that our portfolio is an appropriate replacement for short-term cash, but it would be equally questionable to replace the higher rungs of the ladder with longer-term CDs based solely on an apples-to-oranges comparison of trailing returns to current interest rates. A savings portfolio should prioritize liquidity, and to replace a more liquid portfolio for a less liquid one with similar (or potentially even lower) expected returns seems shortsighted.

But that this comparison is being made at all demonstrates something else. We have always made the case for thinking outside of style boxes. In the style box paradigm, short-duration strategies have two uses: to manage savings as part of a laddered portfolio as discussed above and to tactically hide from potential interest rate increases. Why? Because such strategies are only viewed in terms of their beta, i.e. how they compare to some benchmark. They are expected to always outperform savings, and they would be expected to outperform broad market fixed income benchmarks (like the Bloomberg Barclays US Aggregate Bond index) if rates rise. But what do we make of those short-duration strategies which may outperform both across market environments?

If we view these strategies not by their style-box labels but by their demonstrated risk metrics, we can move beyond a limited and incomplete understanding of where they can add value to portfolios. By thinking of consistency, high alpha and low beta as measures to gain peace of mind and confidence in potential outcomes rather than as flaws which cause deviation from an index in short timeframes, we believe investors can build more stable long-term fixed income portfolios which are easier to understand and explain.

We recognize that there will always be an “of-the-moment” investment trend to which our approach will be compared, and we always welcome questions. But we caution our readers to be patient until the natural cycles of new market trends have matured. Whether our portfolio is used for savings or core fixed income, if we haven’t communicated to our clients the confidence to believe in our approach over the long-term and through different market environments, we have not done our job.

That said, we aren’t saying indexed ETFs and high yield CDs are fads. Like with our own strategy, each has a place in reasonable portfolios – that much is already evident. But we are confident in what we do for our clients, and we can articulate where we believe our portfolio stands apart from these and other alternatives. Most importantly, we don’t make our case for investors seeking to be tactical and opportunistic but rather to reinforce our dedication to serving those seeking the peace of mind and consistency we unapologetically aim to deliver.

As always, we are available for your questions, comments or feedback. We thank you for your continued support and confidence in our management

Sincerely,



Venkatesh Reddy  
Chief Investment Officer



Bradford Cook  
Portfolio Manager

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