"TRUST THE PROCESS"

QUARTERLY COMMENTARY – 3Q 2020

The restart to economic activity has been encouraging. Industrial production and manufacturing have shown strong snapbacks, and likely have some room to run as businesses press forward to match the recent uptick in goods demand. However, services likely will not participate in the same type of rebound seen in manufacturing until a vaccine comes to market. During the quarter, a second wave of infections took hold of several European countries, which prompted authorities to reintroduce restrictions on activity. Domestically, we experienced our "second" wave during the summer months, and luckily have not seen a similar surge in infections. With that said, the downward trend has slowed, with outbreaks across various colleges being the source of recent upticks in infections forming what may become a large third wave. The economic pain of these second and third wave infections have largely remained localized to COVID sensitive pockets of the economy (travel, tourism, live events, hospitality and energy). The economy has adapted, where the shift in the makeup of economic activity has been every bit as profound as the change in the level of GDP. Look no further than the massive multiples seen in tech and communication services stocks vs. the rest of the market. Virus dynamics will continue to dictate both the permanence of these adjustments, and the pace at which we move forward.

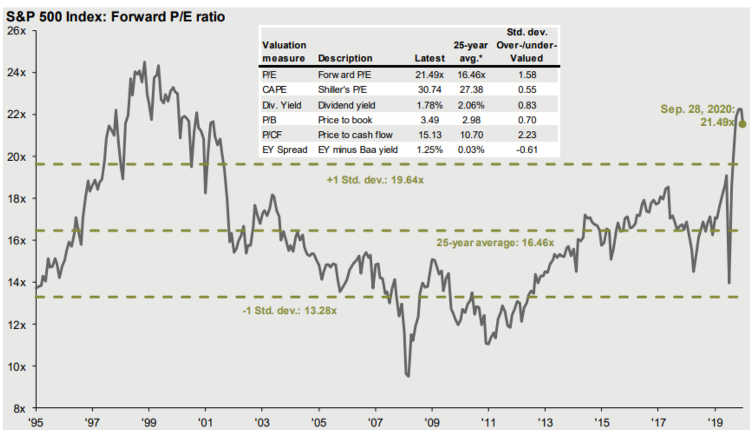
Perhaps the most important question today centers around the consumption/demand side of things. After all, 2/3 of the US economy is comprised of consumer-oriented sectors. Household spending continued its rebound during the quarter but is now slowing down. This is not a good sign because this indicates that 1) joblessness is increasing, and 2) the checks from Uncle Sam have expired. Similar to how the Fed's swift actions provided liquidity and propped up asset prices, the fiscal checks acted as the lifeline for the services and consumer sectors of the economy. The elevated level of unemployment and ongoing COVID-19 cases are likely to weigh on confidence and income growth.

Looking forward, we believe the market will be focused on the following key risks:

- Next wave of infections
- Passage of additional fiscal stimulus
- Vaccine
- Presidential Election
- Continuing protests

A key downside risk is that recurring waves of coronavirus infections during this winter flu season prompts more economy-damaging lockdowns. While we are unlikely to see the draconian measures that were implemented earlier this year, any limit on capacity obviously hurts the pace of the recovery. Risks of policy fatigue are rising on the fiscal side. With the legislative window closing, negotiations are in progress on a pre-election fiscal package even as the political parties are far apart. The consumer spending rate will fall meaningfully if Congress does not provide additional support. We are already wrestling with high levels of unemployment- a policy error here could be disastrous. Lastly, and perhaps most obvious is that a vaccine is necessary for us to see an economy resembling anything like what we had seen prior to 2020. Commercial real estate, live entertainment, tourism, and restaurants sectors are in a world of hurt, and need a vaccine immediately. The repurposing of properties and adjustments to existing business models is already taking place, but existing cost structures across many of these industries make it incredibly challenging to stay solvent without a vaccine.

Exhibit 1: S&P 500 Index Valuation Metrics:



Source: JP Morgan

Equities:

Equity valuations marched higher during the third quarter. Since the March 23rd bottom, it feels like investors have largely shaken off any concerns regarding the global pandemic, with many US indices staging +50% retracements. The S&P 500 Index posted a third quarter return of +8.93%, while the tech heavy NASDAQ 100 Index returned +12.62% for the period. Year to date (YTD), equities as measured by the S&P 500 Index, have returned +5.57%. As Exhibit 1 shows, the index now trades at a near 22X forward earnings, sitting at one of the most elevated levels in history. This valuation measure puts the index roughly at +1.60 standard deviations towards expensive. To put this in perspective, the 25-year average forward earnings multiple of the index is 16.5X. Said differently, over this same period, equities have been cheaper 99% of the time. Our last commentary extensively covered the large divergence observed across sectors and factors underneath the hood of the broad market index so I will spare our readers the pain of another round of in-depth analysis. Spreads across various factors and sectors have only become more stretched. Growth stocks have become more expensive, while value stocks remain relatively cheap. That same Q2 commentary also highlighted how the subsequent 1 and 5 year forward-looking returns for equities from today's elevated multiples have historically been followed by near zero returns- little has changed here. Another noteworthy observation is the increasing concentration risk of the broad market indices. Larger cap names have driven most of the returns this year indicating a lack of breadth. As a result, market-cap concentrations are hovering at all-time highs within the S&P Index, with the top 5 names now accounting for over 20% of the overall index weighting. In short, conditions have worsened across the board.

Exhibit 2: Bloomberg Barclays US Agg. Index: Yield and Duration:

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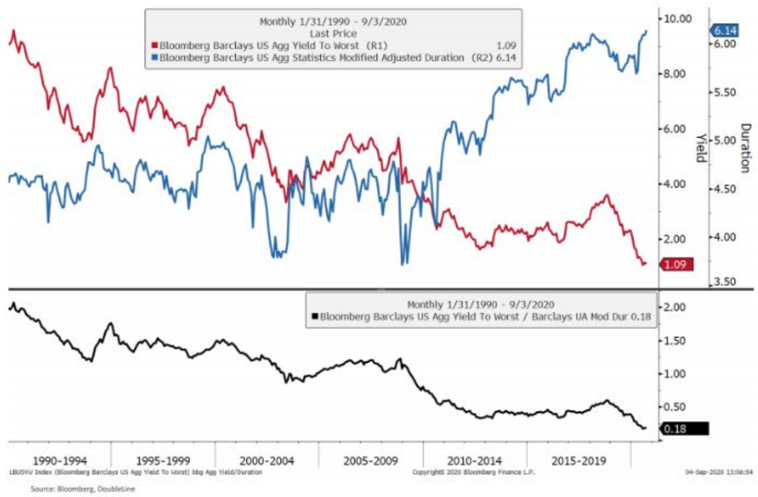


Source: DoubleLine, Bloomberg

Fixed Income and Credit:

The Bloomberg Barclays US Aggregate Bond Index posted a +0.62% return for the third quarter, bringing its YTD return to +6.79% through 9/30/2020. Yields remain at historically low levels, with the 10-year Treasury bond yield hovering around +0.70%. Our Investment Committee maintains its modest underweight to the asset class. Exhibit 2 shows the yield earned per unit of duration (interest rate risk) an investor bears by owning a passive allocation to fixed income assets via the Bloomberg Barclays Aggregate Bond Index. It has long been our view that investors simply are not being compensated for the interest rate risk they are taking today. One can argue that the current yield to duration ratio implies it could possibly be the worst time in history to take on passive fixed income risk today. Investment grade corporate credit sectors are also displaying worsening fundamentals, while pricing has dramatically improved given extraordinary policy support from the Fed. Despite decreasing credit quality within the sector, yield starved investors are anxiously lending at record low yields.

Credit quality within investment grade coporate credit has meaningfully deteriorated over the last decade. Look no further than the change in leverage profiles over the last decade. US investment grade corporate bonds were roughly 2x levered in 2009. Fast forward to today, and leverage ratios are around 3.5x. US high yield markets which are sub-investment grade bonds, are inherently riskier and more levered. In 2009, the high yield segment carried a leverage ratio of around 3.5X, and today that ratio is roughly 5.2x. Leverage ratios across corporate credit broadly have increased nearly 50%, while additional spread compensation has remained low, an unusual observation considering our current recessionary backdrop. Baa/BBB rated, the lowest rating a bond issue can receive that is not considered "junk" bonds, now makes up nearly 50% of this "high grade" universe. These types of distortions are everywhere across risk assets. Given these asymmetric risk reward profiles, we continue advocating for both alternative strategies and asset classes across our client portfolios.

Exhibit 3: Equity Drawdown in Q4 2018: Returns for Gold, Treasury Bonds, and Equities:

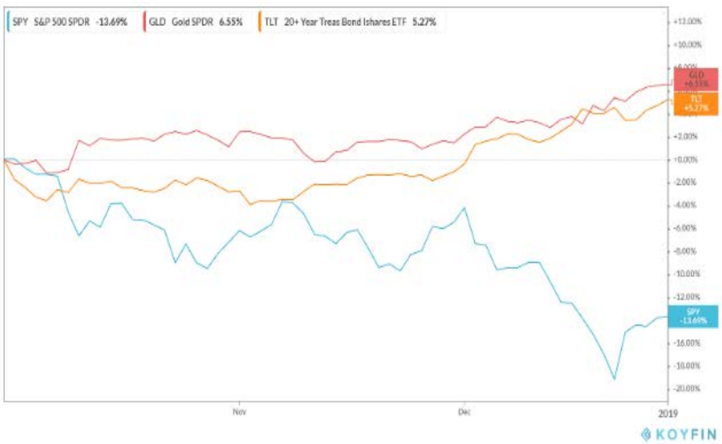
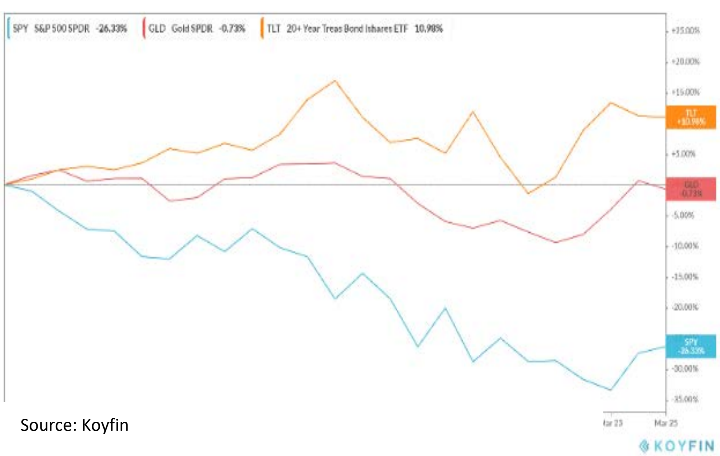


Exhibit 4: Equity Drawdown in Q1 2020: Returns for Gold, Treasury Bonds, and Equities:



Source: Koyfin

Alternatives:

During the quarter, cross asset class diversification properties seemed to deteriorate. Bringing your attention to equities, gold, and Treasury bonds- we believe that historical diversification properties will not hold in the near term and that the benefits previously experienced by investors will be diminished. Exhibit 3 and 4 show two meaningful drawdown periods in Q4 2018 and Q1 2020. In both episodes, gold and Treasury bonds displayed their usual defensive properties. However, September's -9% equity drawdown (9/2-9/23) revealed less defensiveness from both gold and Treasury bonds. Treasuries were roughly flat, while gold was down roughly -4%. On the Treasury side, there is no income after you adjust for inflation. While gold has historically shown low correlations to both equities and fixed income, its recent speculative run up is too hot for our liking. Unlike financial assets, there are also no cash flows coming off gold making a valuation framework useless. In short, there are few places to hide in our opinion when it comes to traditional assets. Today, we prefer to give larger weighting to alternative allocations.

So where to go in this low yield world? We are looking at direct lending opportunities when it comes to income replacement. We believe investors should look to yield asset classes outside that of just generic corporate credit.

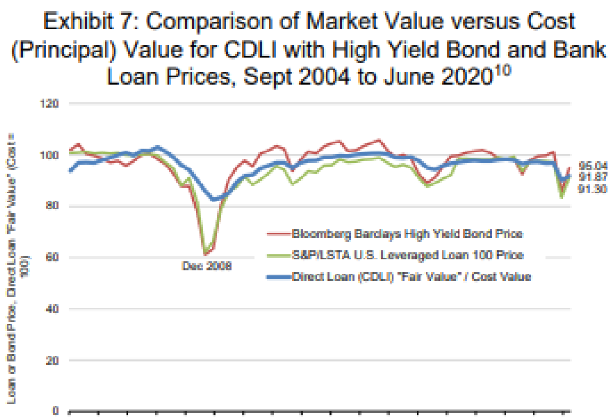
Direct Lending for our purposes means investing in loans made to US middle market companies. These loans are non-traded and made with private capital within a fund structure. We prefer managers that target the upper middle market segment, which generally seek corporate borrowers with annual EBITDA[1] ranging between $50-100 million. The overall middle market corporate segment represents nearly a 1/3 of private sector GDP, employing 48 million people. One could consider these types of companies to be of similar size to those in the Russell 2000 Index (an index of small market capitalization stocks). While you are stepping into a riskier segment of the corporate landscape, we believe the historical loss rates, income, and total return profile of the asset class makes it a compelling exposure to have in place of some traditional corporate credit. Bank loans and high yield bonds are the closest public market equivalents to US middle market corporate direct loans from an investment perspective- all three sectors

[1] Earnings before interest, depreciation, taxes, and amortization.

expose investors to meaningful credit risk and compensate them for this risk in the form of additional spread.

Looking at cumulative average credit losses across these three sectors from 2005-2017, US middle market loans averaged roughly 1.03%, which is very comparable to the broadly syndicated bank loan market which averaged 0.94%. High yield bonds averaged the highest number, with credit loss rates coming in at 1.40%. Given those loss rates, investors have been able to pick up approximately ~2% additional yield relative to bank loans by owning US middle market loans.[2] In addition, we believe that the non-syndicated nature of such deals work in favor of investors, where private lenders are in many ways issuing loans with tighter underwriting standards compared to public market equivalent syndicated loans.

Exhibit 6: Cliffwater Direct Lending Index – Loan Prices :



Source: Cliffwater

Direct lending came to a halt early on during the pandemic. As private equity deal transactions have picked back up, lending opportunities have begun to re-emerge. While this is a challenging environment for all businesses, we view today as an opportune time to deploy fresh capital into a portfolio of new originations given some COVID-19 uncertainties have been alleviated. Lenders today can earn additional spread on borrowing rates in this economic environment. We believe an allocation to private credit offers investors a chance to capture very attractive yields with relatively better credit profiles than those found in public credit markets.

We are also looking at various structured credit sectors through active management to help both income and total return opportunities. A variety of RMBS (residential mortgage backed securities, a pool of home loans) and CMBS (mortgage-backed security backed by commercial and multifamily mortgages) sectors remain dislocated relative to their corporate counterparts. Securitized credit has lagged corporate bonds which have received Fed support through various purchase facilities. Given the increasing leverage ratios we've seen in the public corporate market, we like diversifying our credit risk into a sector with larger price dislocation and yield, and more complexity given the pooled nature of the securities.

Final Thoughts and Conclusions:

We realize that there is an incredible amount of uncertainty ahead of us. Policymakers have a few more tools left in their arsenal to help bolster this recovery, but more than anything, a vaccine is necessary to get demand and growth back in line to the levels seen prior to 2020. Volatility episodes earlier in the year provided us with some significant opportunistic additions across equity and corporate credit. However, as most markets have meaningfully recovered near or beyond pre-COVID levels, we are now

[2] Stephen L. Nesbitt, "Private Debt: Opportunities in Corporate Direct Lending", 2019, pg.35

looking to areas of the market that have lagged for additional sources of return. We are also looking to alternative asset classes and strategies for reasons covered above.

We feel very good about our portfolios today and believe that they are positioned to fare well for a variety of outcomes. Within equities, we continue to hold a modest tilt to value styles with the view that improving economic fundamentals and additional stimulus will help fuel a rally across some of the more cyclical areas of the market. We also maintain our thematic growth focused exposures in video gaming/e-sports related sectors and blockchain technology - areas of the equity market that we believe have much more runway. Within fixed income, we maintain our underweight to duration through active bond managers that are hedging duration risk or actively investing outside of the usual investment grade sectors found in the benchmark index. Within credit, we maintain an underweight to corporate credit and prefer to source returns from other strategies like private credit, mortgage credit, and event driven.

As we step into election season, we've had numerous conversations with clients concerned with how election outcomes may impact markets- many of the discussions at some point suggested that we go to cash heading into the election. Right around the start of summer, we had clients feeling the FOMO fever, and suggest to us that we increase allocations to long only equities, specifically sizing into growth oriented segments of the market. We have advised against both of these dramatic moves as nothing in the market had told us to shift away from our strategic asset allocation. We assure you that long term, maintaining a strategic allocation across a diverse set of asset classes and strategies is the best way to weather a variety of uncertain outcomes. In our case, we incorporate alternatives into that strategic allocation alongside equities and bonds. Equities serve as an important source of return, while fixed income provides income and diversification away from equities. Alternatives too may provide defense, non-correlation, and returns. Like equities and bonds, alternative strategies and asset classes possess a unique risk, return, liquidity, and correlation characteristics that make them attractive exposures to own alongside your traditional assets. We want to thank you as always for your confidence in us and trusting our process. We wish you and your family safety and health. Please feel free to reach out if you have any questions or concerns.

Best,

Johann Lee, CFA

Director of Research

Appendix:

Barclays Capital US Aggregate Bond Index: The index consists of approximately 17,000 bonds. The index represents a wide range of securities, from investment grade and public to fixed income.

ICE BoAML HY Index: The index is a commonly used benchmark index for high-yield corporate bonds. It tracks the performance of US dollar denominated below investment grade rated corporate debt publically issued in the US domestic market.

Russell 3000 Index: The Russell 3000 Index is a market-capitalization-weighted equity index maintained by the FTSE Russell that provides exposure to the entire U.S. stock market. The index tracks the performance of the 3,000 largest U.S.-traded stocks which represent about 98% of all U.S incorporated equity securities.

MSCI ACWI (All Country World) Index: The MSCI ACWI is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. The MSCI ACWI Index is comprised of stocks from both developed and emerging markets.

S&P 500 Index: S&P 500 index is a float-adjusted market-cap weighted index, largely reflecting the large-cap US equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

Purchasing Managers' Index (PMI): PMI Index is an indicator of economic health for manufacturing and service sectors. The purpose of the PMI is to provide information about current business conditions to company decision makers, analysts and purchasing managers.

ISM Manufacturing Index: The ISM Manufacturing Index is a widely-watched indicator of recent U.S. economic activity. The index is often referred to as the Purchasing Manager's Index (PMI).

CBOE Volatility Index (VIX Index): The VIX Index is a real-time market index used to measure the market's expectation of future volatility. Being a forward-looking index, it is constructed using the implied volatilities on S&P 500 index options (SPX) and represents the market's expectation of 30-day future volatility of the S&P 500 index which is considered the leading indicator of the broad U.S. stock market.

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