ALTERNATIVE OPTIMISM

QUARTERLY COMMENTARY – 4Q 2020

Introduction:

Unprecedented fiscal support and adaptive business operations helped push the economy towards a faster than expected recovery during second half of 2020. Unfortunately, economic output measures coming into 2021 will reflect some version of a holiday hangover given the re-introduction of quarantine measures following the increasing Covid-19 caseloads during the winter season. With that said, the 4th quarter of 2020 laid to rest many of the market's greatest uncertainties- namely the conclusion of the US presidential elections, and of course, a potential end to the pandemic with several effective vaccine releases. So, while 2020 has concluded, the story is not yet over. The economic response to the virus will remain the biggest threat to risk assets. Depending on the outcomes of the Georgia Senate race, a Democratic sweep and control of the Senate could potentially lead to more fiscal push over the next few years to further boost economic growth. This in turn could lead to a larger than expected steepening of the yield curve-a significant risk for fixed income investors. In the near term, the economy faces the potential of another short-term contraction while Covid-19 caseloads remain elevated and march higher as we aim for herd immunity.

Equity Outlook:

Indices	4Q 2020 (%)	YTD 2020 (%)
S&P 500 TR USD	12.15	18.40
S&P 100 Equal Weighted TR USD	15.29	13.96
BBgBarc US Agg Bond TR USD	0.67	7.51
NASDAQ 100 TR USD	13.09	48.88
Russell 2000 TR USD	31.37	19.96

Source: Morningstar as of December 31, 2020

The 2020 recovery in equity prices was incredibly bifurcated. While trends of digitization have helped boost technology and communication services stocks, there are plenty of high cash flow generating businesses that have yet to re-price. At the index level, the more well-known FAANG names (an acronym referring to the stocks of the five most popular and best-performing American technology companies: Facebook, Amazon, Apple, Netflix and Alphabet (formerly known as Google)) dominated the headlines providing most of the positive performance attribution - and with strong cash flow generation, their price multiples may be justified. Meanwhile, there are many growth stocks tied to technology enabled platform business models, which have been propped up by unsubstantiated disruption narratives. Unfortunately, this reminds us too much of the tech bubble. Investors have increasingly developed tunnel vision, becoming revenue obsessed with little concern for the bottom line (e.g. profit!). Pair this with an environment of low borrowing costs, and you have an audience that has completely tossed out any semblance of common-sense and regard for long term solvency. Just to put things in perspective, as of 2020, there were 299 US stocks with market capitalizations greater than $1.0bn that delivered negative earnings in 2019. We use 2019 earnings given the anomalous nature of earnings in 2020.

- This group's median 2020 return was 67% which is more than triple that of the SP500
- This group's average 2020 return was a 124%

Will all 299 of these really become the next Amazon or Apple? Investors are sure buying them like they will. Some of these businesses do present strong moats, transformational properties, and robust earnings potential. But many are operating unprofitable businesses that will unlikely deliver the earnings scenarios that are currently priced into their valuations. Most of these business models are in a race to the bottom regarding pricing. Many must engage in massive cost cutting tactics against both traditional and newer peers. Furthermore, they have tremendous cash outlays towards customer acquisition and retention. In addition, 2020 saw more than 200 Special-purpose acquisition companies (SPAC) come to market, raising roughly $74 billion- more than quintuple the amount raised in 2019 (a special purpose acquisition company is a "blank check" shell corporation designed to take companies public without going through the traditional IPO process.) If you just added up the market capitalization of all electric vehicle and self-driving car SPACS (these included names like Nikola, Luminar, Lordstown, Fisker, Chargepoint etc.), they combined for nearly a $36 billion market cap as of December 2020, with just roughly $36 million in total sales. Trading at nearly 1000x sales, they had an average YTD return of nearly 265%. By the way, this does not include TSLA which now is in the S&500 and trades at nearly 25X sales. This type of dream chasing will likely turn into a nightmare fast. Let us be clear this does not mean we lack exposure to growth equities. Our long-standing growth equity themes in E-Sports and videogaming, blockchain technology, and exponential technologies (healthcare, IT, and industrials) had standout years that meaningfully outperformed growth indices by over +20%.

We maintain our value aware approach to equity investing that plays both growth and value themes and see a scenario for a more balanced recovery in 2021. Today, we see optimistic long-term return potential from our multi-strategy alternative managers, our active long short equity managers and favor our cyclical themes like emerging markets, and small cap equities. These positions were strong beneficiaries of the vaccine news, and we believe that these will continue to perform well as normalization takes place. The transition from a market fueled largely by emergency liquidity and stimulus to one driven increasingly by a global economic recovery may present the biggest challenge to investor portfolios that are too focused with growth chasing. We look to 2021 with a renewed conviction that the economic recovery will be robust, and as the year progresses, we expect growth to broaden out and "left behind" sectors like travel and leisure to show new signs of life.

Fixed Income and Credit Outlook:

Traditional fixed income remains a difficult asset class to hold with much conviction. Duration and yield profiles of the broader investment grade bond market remain at unfavorable levels. Within Treasury markets, investors appear to be looking out towards the 2H 2021 when the vaccine will be readily available. The last two times that hospitalization rates increased towards the 60,000 mark, there was a flight to safety. The current third wave of hospitalizations past 100,000 was not met with the same fall in yields, but rather a steady rise in yields. This implies that the Treasury market is slowly pricing in 2021's normalization.

Investment grade corporate credit spreads have tightened nearly back to pre-COVID levels and offer little upside from here. High yield spreads at roughly +400bps also do not look attractive after you consider the likely scenario of increasing default rates. Consensus views call for inflation expectations to remain subdued throughout 2021, but in our view, there's little desire to hold broad fixed income index like exposure. We would rather source yield and total return opportunities within more idiosyncratic markets of fixed income while sourcing downside protection from alternative strategies that offer a short book or are long volatility.

Alternatives Outlook:

We feel that alternatives can be a source of both strong absolute returns and relative returns vs. that of traditional markets in the year ahead, particularly against fixed income assets for the reasons highlighted above. Coming into 2021, we are very optimistic for a variety of alternative investment strategies. We believe much of the directional beta moves that was driven by central bank liquidity will be more muted this upcoming year. That means looking for more idiosyncratic opportunities. Corporate balance sheet activity will remain a key focus for many managers. Event driven managers should be able to focus on restructuring opportunities, mergers and acquisitions, and specialty financing situations to deliver more differentiated returns. Within long-short credit, we maintain a view that managers may be able generate alpha on the short side as the market shifts from financing rescue deals to being more selective about go-forward business models. Extreme uncertainty in structured credit markets may provide skilled managers to meaningfully outperform generic forms of corporate credit. During the second half of 2020, we added a convertible arbitrage strategy to our lineup of managers given the recent record levels of new issuance which has helped to significantly diversify and grow the market even as the universe participants in this market has shrunk over the last decade. We find this dynamic to remain a favorable tailwind for such exposures. We would rather take idiosyncratic risks on the fixed income and credit side vs. long only generic corporate credit and duration exposures.

On the equity side, dispersion in various sectors, and factor volatilities are likely to remain elevated as the economy transitions towards a more normal version of itself. It is our view that more valuation aware and fundamentally driven approaches to investing will be rewarded throughout 2021 as earnings growth expands outside of just the Covid-19 lockdown winners. The long-term sustainability of both pandemic friendly and more traditional business models will be put to the test – all of which should provide another great season for stock pickers.

AlphaCore 2021 Investment Outlook:

I want to thank our clients for their continued support and trust in our team. As your advisor, we look to not only deliver exceptional service across the board, but central to our commitment to you, is a focus on compounding your capital in the most consistent manner possible. We believe 2020 was a testament to our balanced approach, whereby portfolios inclusive of alternative investments can "Win More by Losing Less." The following bullet points help summarize our investment views and outlook for 2021.

- The approval and rollout of the Covid-19 vaccines provide a much brighter light at the end of the tunnel. With that said, corporate balance sheets remain on shaky footing, unemployment numbers remain elevated, and there is a real risk that this most recent fiscal package does not bridge us through the first quarter of 2021 from a consumer spending standpoint.

- Equities are richly valued. Index concentration remains elevated, while investors on average continue to heavily reward companies producing negative earnings yields.

    - Acknowledge the recovery that is to come and play breadth over passive index exposure. Look for outperformance in more cyclical sectors, and small caps.

    - Look for equity exposure in non-US markets. Longer term economic output growth favors emerging market equities, China, and Southeast Asian markets.

- Fixed Income: Yields have backed up modestly since the news of the vaccine, however, we maintain our preference for underweights to duration.
    - Favor out of index positions for core bond like exposure.

- Credit: Investment grade corporate credit spreads are back to pre-Covid tights. High yield spreads offer investors roughly 60bps more than pre-Covid levels. With tight spreads and uncertainty still looming surrounding Covid-19, look for credit opportunities in private credit, and hedged strategies like convertible arbitrage, and long short credit.

- Alternatives: We have a very favorable outlook for alternative investments coming into 2021. We continue to allocate to a host of liquid and illiquid alternative assets and strategies given the amount dispersion, and volatility in various markets.

Should you have any questions or concerns, please reach out to me or your advisor. We hope everyone remains safe and healthy out there.

Best,

Johann Lee

Director of Research

Market Indices:

- S&P 500 Index: The S&P 500 Index, or simply the S&P, is a stock market index that measures the stock performance of 500 large companies listed on stock exchanges in the United States.

- Bloomberg Barclays US Aggregate Bond Index: Bloomberg Barclays US Aggregate Bond Index is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States.

- Nasdaq 100 Index: The NASDAQ-100 is a stock market index made up of 102 equity securities issued by 100 of the largest non-financial companies listed on the Nasdaq stock market.

- Russell 2000 Index: The Russell 2000 Index is a small-cap stock market index of the smallest 2,000 stocks in the Russell 3000 Index.

- S&P 100 Equal Weighted Index: The S&P 100® Equal Weight Index (EWI) is the equal-weight version of the S&P 100. The index has the same constituents as the capitalization weighted S&P 100, but each company in the S&P 100 EWI is allocated a fixed weight.

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