Quarterly Commentary

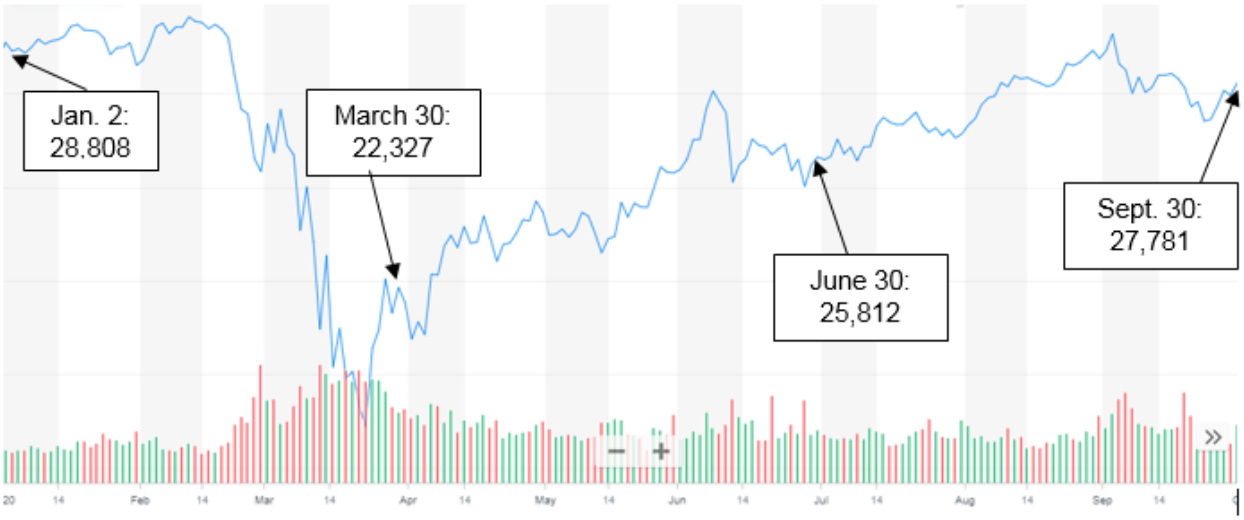
Third Quarter 2020

Market Review with Ted Halpern

An Amazing Q2 and Q3 Market Performance

Q3 2020 completed a second straight quarter of impressive gains, extending this historic stock market recovery that nobody would have predicted back near the end of March. Both the S&P 500 and Nasdaq Composite recorded a stretch of records during the past quarter. Even with a pull back towards the end of September, both the DJIA and the S&P 500 gained over 8% during the third quarter. The very healthy gains added to the historic snap back in Q2, making it the best two quarter performance since 2009!

There is no question: the first three quarters of 2020 have been a wild and historic ride for markets. Evidence to this record volatility for the markets is that even after a couple of consecutive outstanding quarters, the DJIA ended Q3 down -0.9% for the year-to-date. Amazingly, after all we have been through this year, markets are right around where they started the year.



Dow Jones Industrial Average 2020 YTD

I feel for the younger generation. They will have to spend two full semesters in history class covering just the year 2020! This year has been an ugly one in virtually all categories. If you are reading this, then you are one of the luckier ones. First, you are here and healthy and managing to successfully get through this pandemic. Second, your wealth is at a level where, although there may have been an impact from the economic lockdowns, your portfolio provides insulation. Sadly, so many around the globe suffered either from one or both scenarios.

2020 Showed the Importance of Stress-Testing

This year is an ultimate litmus test for so many parts of our lives. Of course, it permits us to see how well our portfolio can perform during a time that most software programs wouldn't even consider a reasonable possibility of occurrence. But, a time like this also drops the veil on your home life, workplace and friend

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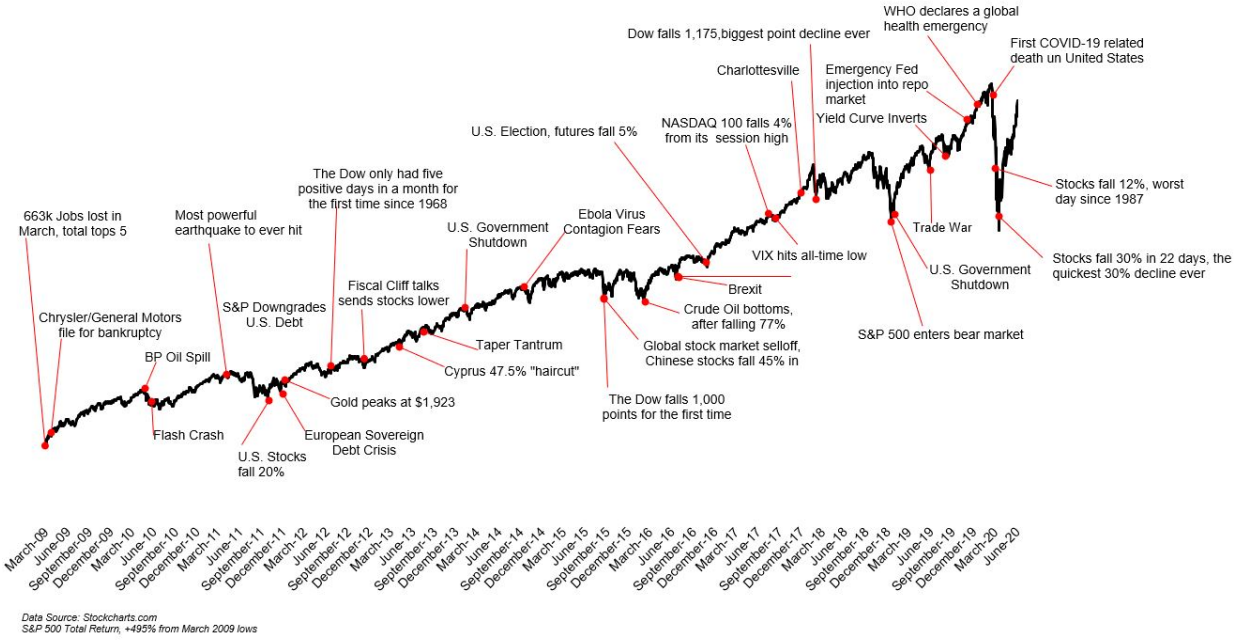
relationships. Everyone and everything is being put to a test. The risks of the virus and the economic and emotional risks associated with the lockdowns shorten patience, and cause all of us to evaluate various "stress-tests" on so many components of our lives. We perform stress and strength tests on your portfolio on a regular basis.

On top of the uncertainty businesses and markets face, the current political climate has the country in a powder keg of irreconcilable beliefs. For markets, it adds a critical additional layer of uncertainty. What will the tax code look like, how will regulations play out, and what will permitted savings and earnings levels be? So much is unknown, and as we all know, markets do not appreciate the unknown!

Our concerns focus more on economic data, corporate earnings and of course, the impact fiscal and monetary policies will have on our clients' income, business and portfolio holdings. Uncertainty increases the volatility surrounding national elections. The most important thing to remember during these election cycles regarding your long-term investment success is to not overweight the mere possibility of short-term volatility. Long-term stock market results are much more dependent on corporate earnings and economic growth than changes in political leadership. Presidents come and go, but the passion of individuals and companies to improve, invent, create and grow is infinite and markets have prospered for it!

Don't Let Short-Term Volatility Derail Long-Term Growth



(source: [The Irrelevant Investor])

The truth is we consistently live in a state of uncertainty. We can proactively plan for the 'known unknowns'. These are things like pending economic data releases, Fed interest rate announcements and even upcoming elections. There are also many 'unknown unknowns'. Two examples are events such as 9/11 or the current pandemic. Events simply happen, as risk is inherent in our lives. Risk is actually a necessary thing! Without risk there can be no sense of accomplishment, no sense of adventure in our lives and in

markets, no returns! Who could have predicted the largest-ever point decline and gain for the DJIA would occur over just a few days this past March, while the world was gripped in panic and uncertainty?

Risk is something we all encounter. They key is to plan and prepare. We can plan for the known potential risks, like buckling up in a car and not texting or driving while impaired. And, although we cannot predict the unknown events in our lives, we must prepare for their possibility. Planning and preparation are essential tools for your investment success as well. As the old saying goes, “Success is where preparation and opportunity meet”.

We make every effort to ensure our client portfolios follow a custom designed plan suited to their own specific and unique planning objectives. But rest assured, we also prepare your portfolio for the unknowns we cannot predict. The diversified nature of a portfolio is the first step to defend against these occurrences. We also make sure portfolios are optimized for tax efficient growth and that all holdings take advantage of institutional pricing to elevate your probability of improved performance. We further ensure the bonds in your portfolio are prepared for the trajectory interest rates may move and always focus on higher quality issues to avoid default risks. Equities focus on a time tested and proven approach to long-term success. We take advantage of ultra-low-cost indexing where efficient and use managed funds or ETFs where markets present the opportunity to do so.

We further focus on the current market and economic climate. For example, just this year we made significant shifts (all within your stated investment objective) to focus on the opportunities this crisis presented. These included taking advantage of technology being used to work and educate remotely, increasing exposure to companies with record demand for their products, and of course, the massive investment and reduced regulations surrounding the healthcare sector during a pandemic. These moves have helped you tremendously during this historic time. As always, we ensure all transactions were free of any commissions or trading costs.

Look Forward to Progress and Innovation

I believe risk will be rewarded in the coming year. America will soon more fully re-open, and advancements in therapeutics and an eventual approved vaccine for Covid-19 will help to power markets further. In addition, it is important to understand real bond yields (interest rate an investor receives after accounting for inflation) are effectively negative. This will naturally drive money into equity markets. Even the recent announcement from Fed Chairman Powell, that inflation will be permitted to swell above 2%, will promote equity markets in two ways – this permits rates to stay lower for longer (making equities more attractive relative to bonds), and equities act as a traditional hedge against inflation. Progress, innovation and future business developments are on their way.

2020 has been an extraordinary year…and it isn’t over yet! Hang in there, stay healthy and try to remain positive. Be prepared for anything and stay committed to your plan for the future. After all, the future will be here before we know it! I hope you and your family has a very happy and healthy and wealthy holiday season!

Investment Commentary with Kirsty Peev, CFP®
Summary:

A second straight quarter of incredible equity performance brought the S&P 500 into positive territory YTD. We don't often see the S&P 500 gain 8% in a single quarter, much less after a Q2 with over 20% in gains. In fact this was the largest two-quarter gain for equity markets since 2009!

Improving economic data supports growth. At its worst, the unemployment rate increased to 14.7%. After steady recovery, we are back down to an unemployment rate of 7.9%. While this is a long way from the historical low of 3.5% pre-pandemic, the improvement is significant. The recovery in GDP growth has also been amazingly strong – estimates for Q3 which will be released at October-end, suggest the growth in GDP may be historically positive.

A positive quarter for all bond sectors, bringing most into positive territory YTD. Bond markets continued to improve in a strong and steady manner. The bond funds within your portfolio are navigating the low interest rate environment with strength.

Equities:

Global Equities continue with incredible gains during the third quarter. The first half of the year delivered investors a terrible Q1, followed by an exceptionally strong Q2. Q3 provided continued gains across all equity asset classes. Some equity funds we use are up over 20% for the year-to-date!

Market gains in the face of pandemic travel restrictions and local business shutdowns may seem puzzling at first glance. A few key points explain recent market moves:

- **Markets are forward looking.** By the time economic data is released, markets have already absorbed it. Data like GDP reports and company earnings are based entirely on what HAS happened and not what WILL happen. As Ted Halpern mentioned in his 2nd quarter commentary, "on day 1 of the new bull market, we will still be reading about job losses, lost profits and bleak statistics." We can only know when a bull market begins in hindsight, but Ted's prediction is exactly what we are seeing now.
- **Tech led markets ahead while energy trailed markets.** Tech stocks are pulling their weight when it comes to supporting the earnings of broad indices like the S&P500 – for now, technology has some characteristics of a defensive sector! This is a direct reflection on usage – during this last 6-month period, people worked remotely, using the internet and streaming services, and invested in new technology. We all went to the gas pump far less often than normal and may have postponed or canceled big trips that burn fuel.
- **Technology and healthcare gains had an outsized impact on equity markets.** Tech makes up 28.2% of the S&P 500, healthcare 14.2%, and consumer discretionary 11.6%. Industries that have struggled in the pandemic make up a very small percentage of market indices— Energy makes up just 2.1% and real estate 2.6%—and therefore their performance has little effect on the overall direction of the market.
- **It's not only technology.** Companies like Kraft Heinz announced strong earnings based on the increase of home cooking during the pandemic. Many consumer staple companies have also done very well like Proctor and Gamble, Colgate Palmolive, Costco, and Walmart.

- **Companies became leaner and more efficient almost overnight.** These efficiencies help the bottom line for the long-term. The trend of digitization was already happening prior to the pandemic, but progress accelerated significantly.
- **Economic data is improving.** Consumer confidence is up significantly. As businesses re-open, and jobs return, initial jobless claims and continuing claims are trending downwards. According to the *Wall Street Journal*, new businesses are opening at the fastest rate in more than a decade.
- **Confidence in a vaccine and improved therapeutics.** Companies around the globe are in the race for a vaccine. Coordination among these global companies is amazing and there are a number currently in late-stage, Phase 3 vaccine testing! Ultimately, science will beat the virus!

International Equities

Globally, there have been coordinated policy responses, and central banks are embracing quantitative and credit easing and fiscal stimulus. The fiscal policy in the Eurozone, where member EU countries coordinate their economic and fiscal policies in line with common objectives and responsibilities may give them strength in terms of a stronger Euro, a more stable backdrop for European financial assets, and less risk of breakup of Eurozone. These may continue to contribute to a weaker dollar – which is inherently stimulative for the global economy.

Asian markets are getting back to 'normal' at a more accelerated pace. Areas that experienced Covid-19 earlier are naturally recovering faster. The recovery in China has a positive impact on emerging market equities since China tends to lead that area. Global equity markets responded well in August to optimism about the U.S. - China trade situation – with both countries recommitting to the Phase 1 trade deal.

Bonds:

Bond markets continued their recovery. The third quarter provided added healthy gains for all the bond funds held within your portfolio. Higher-risk bond asset classes enjoyed outsized gains, including high yield municipals and corporates, and floating rate bank loans. As we would expect, bond performance increased along the yield curve and credit curve. That means higher-risk/higher-reward assets outperformed, while more conservative assets, like short-term munis and corporate bonds, were positive to a lesser degree. The bond funds we selected for inclusion in your portfolio have gained as much as 7.31% YTD, in the high-quality bond spectrum. This is especially impactful when you consider that a 30 year Treasury bond is yielding just 1.45%!

Fed committed to low rates for the foreseeable future. The Federal Reserve also reiterated their commitment to use all necessary tools to support the economy, including extending their lending program. This extension helped allow more small and mid-sized businesses to receive support.

Focusing on high quality fund managers is more important than ever. Just like with personal finance, liquidity (the ability to convert

assets to cash) is something you may not think about until you really need it.
For example, there are 174 bond funds in the short-term category within Morningstar (a category that should in theory be fairly liquid). Within those 174 bond funds, the durations range from 0-4 years, the high yield allocation ranges from 0% - 20%, and the performance during the dip in March ranged from positive 3% to NEGATIVE 19%. This demonstrates how important it is to understand the underlying structure of your bond funds. We take great care to focus on risk, liquidity management, and the ability to adapt to changing market situations, without taking on undue risk as part of our in-depth fund selection process. We take this extremely seriously and conduct regular and reoccurring in-depth analysis.

Muni bonds providing strong returns.

- Municipalities are taking advantage of record-low rates for borrowing. This helps mitigate the impact of an economic slowdown.
- Fed further helping by announcing reduced borrowing costs for municipal issuers through its Municipal Liquidity Facility (an emergency lending program for state and local government issuers launched during this pandemic).
- Demand still far exceeds supply.
- Tax-equivalent yields available on municipal bond funds compare extremely favorably to their corporate bond counterparts.

Expectations and Perceptions for the Future:

EQUITIES

Combination of favorable monetary and fiscal policy for stock markets. The Treasury and the Federal Reserve are working towards a common goal with easy money policies, and zero rates for the foreseeable future. The Fed has stated they don't plan to increase rates until 2023 at the earliest!

Business efficiency combined with supportive fiscal policy should continue to boost equities. Consumers and businesses around the globe have adapted, and are now much better at operating even in the midst of the virus. Central banks around the world are likely to remain accommodative for some time which is extremely stimulative towards growth. At the same time, equity and bond markets are significantly less sensitive to numbers around the virus. These factors, combined with pent-up demand as economies continue to open, should provide a strong backdrop for continued recovery.

Banks are extremely well capitalized. This is a vastly different landscape than during the Great Financial Crisis in 2008 and healthy banks are critical for a healthy economy. So are households. 2020 has resulted in record levels of savings and cash reserves.

Improving economic numbers – while GDP was down around 31% in Q2, we are likely to see a huge bounce in GDP in Q3.

Be careful about predictions and numbers 'missing' estimates. Whenever this happens, the headlines are dominated by the fact that 'numbers missed estimates. However, what this means is that the estimates were wrong! It doesn't mean the number is necessarily bad, simply that the predictors of those figures were incorrect.

It is our job to analyze your financial life and to design a portfolio for you that enables you to stay invested through periods of volatility. We use fundamental and technical data, review probabilities and make use of technology all in an effort to fit what makes sense for an audience of one – you.

Remember there are many variables affecting equity and bond markets. Corporate earnings, monetary policy, fiscal policy, trade policy,

individual and corporate tax policies, regulation, virus management and many more! As your Advisor, we take care to consider all of the scenarios which could affect global equity and bond markets, and prepare portfolios designed to navigate changing environments.

BONDS

Bonds still very attractive, but finding income from bonds has never been harder! According to Lord Abbett, 88% of bonds around the globe are yielding less than 2%, and only 3% of bonds available globally yield more than 3%. By contrast, 428 of the 500 stocks in the S&P500 have a dividend yield which is more than a 10-year Treasury bond yields! The need for high quality, professional management is clear, to avoid taking on excessive risk in the hunt for yield.

Inflation policy change from the Fed. While the Federal Reserve committed to keeping rates at their current historical lows through 2023, this is in coordination with a change to their target inflation policy. Instead of always targeting an inflation level of 2%, the Fed will now target an AVERAGE 2% inflation rate – allowing for periods of higher inflation to balance out periods of persistent lower inflation over time. This provides flexibility to keep rates low for longer, even after inflation hits 2%. We do not anticipate inflation for some time, but will continue to monitor this diligently. The Fed will also continue their Treasury and MBS purchase programs to support bond markets.

Municipal bonds are still incredibly attractive. The tax-equivalent yield combined with credit quality and low default rates still play an important role within taxable accounts.

Core roles of bonds within your portfolio stand strong: income, capital preservation and diversification.

Risk management is more important than ever. Volatile bond markets in March highlighted just how important it is to make sure your bonds...behave like bonds! We continue to focus on the quality and duration of your bond funds to ensure they perform their intended roles appropriately.