TRAPHAGEN
CPAs & WEALTH ADVISORS

Q2 2020 Market Synopsis

Economic & Market Update:

The first half of 2020 will certainly go down in the history books for a multitude of reasons. The COVID-19 pandemic and US focused social unrest will have a lasting impact on healthcare, politics, regulation, global travel, small businesses, and virtually every individual on planet Earth. The pandemic also has had an unprecedented impact on the global financial markets. For many individuals other COVID-19 related impacts are much more pressing, but it is our job to focus 100% on the financial market and economic effects. That is of course what we will cover within this update.

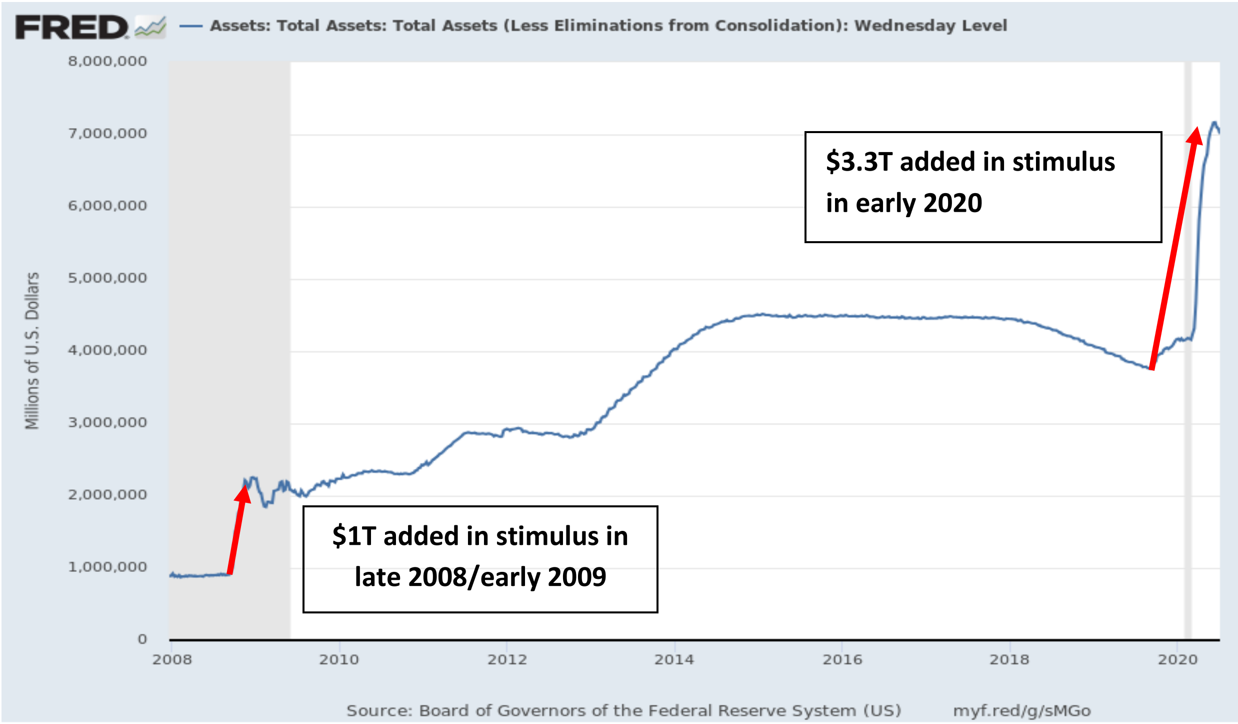
After a horrendous first three months of the year, the SP500 had the best quarter since 1998, with an eye-popping 20.4% return in Q2. Essentially, the US markets went through an entire economic cycle (all time market high, 35% bear market drawdown, recession, and subsequent ~ 40% bull market recovery) in about 3 months. This process has taken 3-4 years during the prior 2 recession cycles. The ability to act quickly to defend portfolios and take advantage of offensive opportunities has never been more valuable. This is what Traphagen has been focused on from late 2019 through today.

The 10-year Treasury yield has remained in a very tight range, oscillating between 0.6% and 0.7%. This rate has been 'controlled' to a large extent by FED policy.

Select 2020 YTD Asset Class Returns (6/30/2020)	
US Mid/Long Treasury Bonds	+ 11.2%
Investment Grade Corporate Bonds	+ 6.4%
TIPS (Treasury Inflation Bonds)	+ 6.0%
Insurance Linked Securities (XILSX)	+ 2.5%
Private Real Estate Equity (TIPWX)	+ 0.1%
Alternative Lending (LENDX)	- 1.9%
S&P 500 (US Stock Market)	- 3.7%
Private Farmland, Timberland, Infrastructure (VCRRX)	- 3.8%
High Yield Bonds	- 5.1%
MSCI Emerging Market (Emerging Stock Market)	- 10.6%
MSCI EAFE (Foreign Developed Stock Market)	- 11.3%
DJ US Real Estate (US Real Estate)	- 14.0%
Nat Gas/Oil Pipeline Companies (TPYP)	- 26.9%

** GPB Holdings II, Mosaic, BREIT, and KKR Fund Performance included within the private investment section on page 6*

Below: *2008 – 2020 Chart of the 'Fed' Balance Sheet (Monetary Stimulus; Trillions)*



The major factors which impacted markets in Q2 2020 are highlighted below:

- **Fiscal & Monetary Government Support:** As depicted above in the chart, starting in March the US government (along with most other major global governments) embarked on an unprecedented path of fiscal and monetary support. The US FED reduced short term interest rates to near 0% and through bond purchases are keeping the 10 Year Treasury rate well below 1%. The FED also has purchased billions of mortgage backed, investment grade, municipal, and high yield debt on the open market.

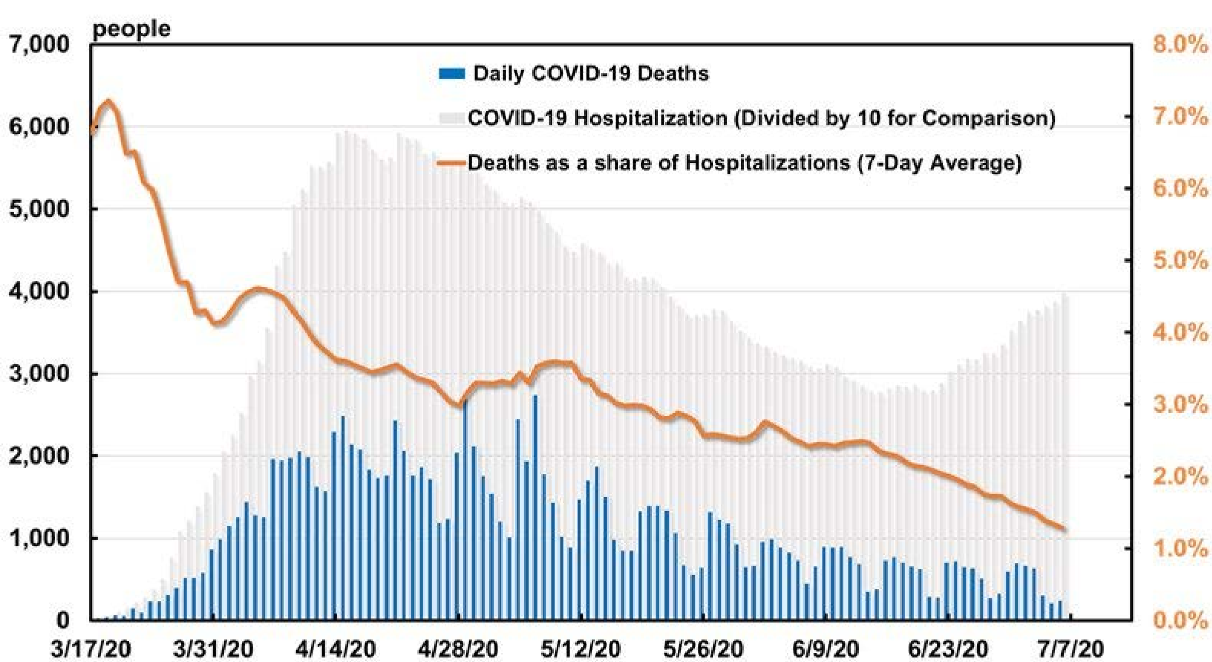
  On the fiscal side, the Trump administration and Congress passed the CARES act in late March. This is by far the largest fiscal stimulus/support package ever passed with a monetary value somewhere in the $3T to $5T range. If you add both pieces together within the course of 2-3 months the US government has pumped roughly $6T to $9T into the economy in various forms.

  This action, representing roughly a third of US yearly GDP, has driven bond yields much lower, equity valuations significantly higher, and to this point seems to have created a 'bridge' over the COVID-19 economic chasm. We will see over the next few weeks if the Trump Administration and Congress pass additional stimulus. We do expect something to pass; albeit more focused and at a smaller scale.

This is not 'free money' of course over the long term, and this will either be paid for lower future economic growth, higher personal and corporate taxes, inflation, or most likely a combination of all the above.

- **Positive & Negative COVID-19 Headlines:** From early April through early June the majority of news surrounding COVID-19 was generally positive with declining cases across the US and especially in the hardest hit areas of New England, New York, and New Jersey. On the vaccine and treatment front it seemed there was a different drug candidate or company coming out with significant progress news on a weekly basis. These trends in combination with a brisk reopening of the US economy created a brief 'euphoria' within the economically sensitive stocks. From early June through today the news has been more cautious with an increase in cases (especially in southern/western states) and some reopening plans paused or reversed.

Below: *Several COVID-19 related health statistics from 3/17 – 7/7 of 2020. Although daily cases continue to increase in the US and the 'reopening' has slowed, hospitalization and death rates continue to improve.*



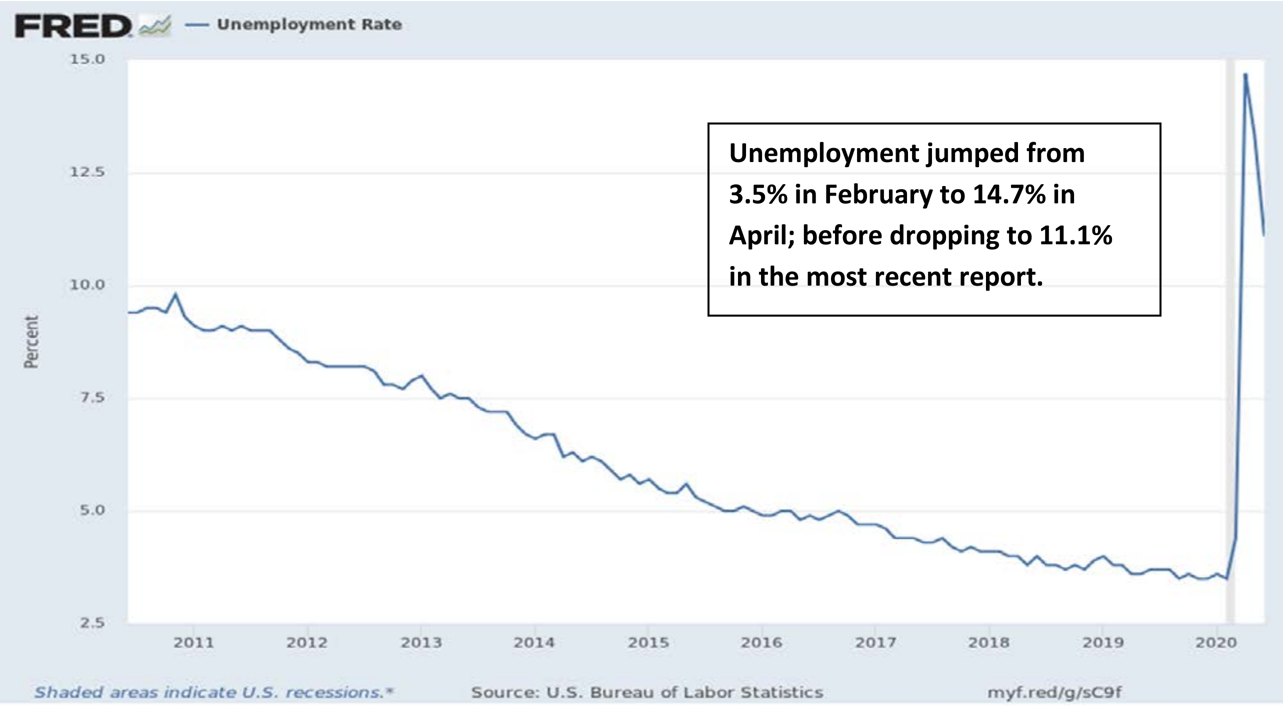
- **COVID-19 related trends within the stock market:** Highly correlated with the above information are the cross currents we are seeing in the stock market. When COVID-19 headlines look more positive; airlines, travel, restaurant, financial, and industrial stocks outperform. When we see negative headlines technology, consumer staple, and healthcare stocks tend to be the winners. There are almost two separate stock markets within the SP500 that Traphagen is monitoring. We are balancing our portfolio allocation between the more expensive/defensive technology stocks and higher risk but cheaper cyclical sectors. It is worth pointing out, the extent to which the technology trade has outperformed versus the rest of the market. As we write this update, the broad technology sector is up 20% for the year while the SP500 is flat, and more cyclical/recession sensitive stocks are down about 14%.

  As we get closer to a vaccine/better treatments, and the economy starts to normalize we expect this gap of performance to close. Technology might chop sideways; while financials, materials, energy, and industrials catch up to an extent.

- **Corporate Profit & Unemployment:** We are one week away from the beginning of the second quarter earnings season and it is expected to be ugly pretty much across the board outside of some technology, consumer, and healthcare companies. It will be interesting to see how the stock market reacts, although we believe Q2 earnings are largely already priced in. Traphagen sees US corporate earnings down about 40% from $140 in 2019 to near $85 or so in 2020. With a recovery likely beginning in the current quarter, we should see a rebound of around 40% to $120 SP500 earnings for 2021.

  Unemployment, although still extremely high in absolute terms, has been improving at a significantly quicker rate than many thought just 2 months ago. Instead of a near 20% unemployment rate that many were originally predicting for mid-summer, it is likely we will be closer to 10%. The current level stands at 11.1% down from a high of 14.7% in April.

Below: *Unemployment Rate over past 10 Years*



Traphagen 2020 Portfolio Changes & Performance Update

Through the first half of 2020 Traphagen has made the most tactical and long-term portfolio changes since 2009. Again, with the tremendous speed of changes that took place, we took action both in late 2019 and January 2020 before the pandemic began and again in March/April to take advantage of many offensive opportunities. We continue to make changes today in response to new trends we are seeing among sectors and asset classes and in anticipation of the upcoming election.

Below: *Summary of trades made from early March through July 2020*

Addition to large cap technology *Strong Balance Sheets, Strong Growth, Limited COV-19 Impact*	**IGM (2)**	**+ 33%** *to* **+ 37.0%**
Purchase of high yield debt *Market dislocations & very wide corporate to Treasury spreads*	**ANGL (2)**	**+ 20.5%** *to* **+ 22.5%**
Purchase of public real estate *Cheapest valuations since 2011, 4.5% dividend, Cell Towers/Data/Residential*	**FREL**	**+ 5.5%** *to* **+ 7.0%**
Purchase of Utility companies *Cheapest valuations since 2016, 4.0% dividend, defensive cash flows*	**FUTY**	**+ 12.5%** *to* **+ 14.0%**
Addition to natural gas/oil pipeline companies *Cheapest valuations since 2009, 8.0% dividend, defensive cash flows*	**TPYP**	**+ 10.5%** *to* **+ 13.5%**
Addition to high yield municipal bonds *Deep discount to actual value of up to 13%; 6% tax free yield*	**HYMB**	**+ 12.0%** *to* **+ 13.5%**

NOTE: Trimmed long-term Treasuries, TIPS, and some alternatives in same time period as a source of funds *(all had positive returns on the year)*

Addition to higher quality/fundamentally screened IG Bonds *Higher quality corporate bonds in time of stress, ~ 3% yield*	**GIGB**	**+ 2.0% to + 3.0%**
Allocation to Foreign Developed Growth Stocks *Reasonably priced (vs. US) growth stocks in Europe, Japan, etc.; 2% yield*	**EFG**	**- 0.5% to + 2.0%**
Allocation to Technology/Telecom Related Real Estate *Cell Tower/Data Center, higher growth & largely recession proof; 1.6% yield*	**SRVR**	**+ 4.5% to + 6.5%**
Disruptive 'Long Horizon' Technology Active ETF *Genomics, Crypto, AI, Robotics, Autonomous Transportation, etc.*	**ARKK**	**+ 3.0% to + 15.0%**
Trim of High Yield/Lower Quality/Higher Vol. Tax Free Bonds *After recent increase in allocation felt it prudent to take profits*	**HYMB**	**N/A**
Sale of shorter term/lower yielding-quality IG Bonds *Rotated from lower yielding and quality IG bonds into 'GIGB'*	**SLQD**	**N/A**

NOTE: During June rebalance many other smaller rebalancing trades were made on existing securities. In general this included trimming oil/gas pipelines, high yield bonds, and some USLC stocks after significant run-up. Also included additions to some bonds, US SC stocks, and some foreign stocks.

Private Investment Update *(for accredited investors only; $1M+ with Traphagen)*

Private Equity (GPB Fund II): 2020 has been a much better year for GPB Fund II despite the impacts of COVID-19 on some of their businesses.

The audits for all portfolio companies have been completed for years 2017 – 2019, with the fund level audit pegged to be completed within the current quarter. This would conclude the Eisner audit of all entities, which continues to be a top priority.

GPB declared a roughly 6.7% Q1 2020 dividend, which represented the profits from the sale of two portfolios companies. We expect the next sizeable dividend to be issued in Q4 2020 or Q1 2021.

In terms of 2020 operations, their technology companies were largely spared from COVID-19 impacts, while their physical therapy and auto dealership businesses experiencing significant effects during April and May. Fortunately, through June these businesses have seen a swift recovery with revenues roughly 70% to 80% that of pre-COVID-19 levels with continued improvement expected. In addition, GPB received roughly $4M - $6M in PPP funds.

Between 2018 – 2020 Prime Auto Group has accumulated roughly $85M in cash from retained profits. A large portion of this will likely be available for a dividend payment once the final audit is complete. In addition, there is roughly $100M in cash at the fund level that will be used for investment in current portfolio companies and the opportunistic purchase of other physical therapy and auto assets.

Private Equity (KKR Fund): The well diversified private equity fund with roughly 70% KKR exposure, 20% other private equity exposure, and 10% in cash has nicely outperformed the public stock market through April 31. The KKR fund returned -7% through April, while the SP500 returned -11.5%. In times like this, well positioned private equity funds look for opportunity among distressed companies and we see them making some purchases in this area.

Private Real Estate Credit (Mosaic): Traphagen was extremely pleased with Mosaic's performance during good economic times (2018-2019), but it's 2020 Q1 performance really proved the fund's worth. While the stock market was down 20% in the first quarter Mosaic returned a stable + 1.9% return. To date, there have been no construction projects stopped, delayed, or halted due to COVID-19 and although very early we do expect another positive quarter in Q2. They continue to manage their portfolio of property loans across the country with the syndication of their large Portland Ritz Carlton loan a top priority.

Private Real Estate Equity (Blackstone Fund): Although down 6.9% on the year through the end of May we are pleased with the performance of the fund versus public real estate (REITS) and their proactive allocation among real estate sectors. This fund is heavily tilted to triple net lease, residential, and industrial/warehouse properties and has very little commercial/retail exposure. This was an excellent position to have going into the pandemic as commercial and retail real estate are reeling. After a sharp markdown in March, we have seen a 2% positive return over the past 2 months.

2020 Market and Economic Outlook Update:

Volatility and uncertainty will continue to be the buzzwords for the remainder of 2020. COVID-19 headlines, the uneven path of economic reopenings across the world, and the upcoming US election promises a challenging second half of 2020. That said, Traphagen believes the worst of the recession and pandemic related market action is now behind us. We are on the winding, bumpy road to recovery and normalcy that hopefully comes to a head sometime in early to mid-2021.

Like we have done since mid/late 2019, when the first red flags appeared signaling a possible slow down or recession via our TRI (Traphagen Recession Index) we will be uniquely vigilant and active (if warranted) within portfolios to both guard against risk while also looking for opportunities to make outsized profits amidst the volatility. We are already making some defensive changes in response to recent election trends. We will be ready to adjust those positions depending on future data points.

As we stated in the last newsletter we are living through a historic period that is posing special challenges in all areas of life for many of our clients. Direct health impacts, unemployment, lifestyle changes, small business closings, and finances are all being impacted for many. Hopefully despite the pandemic you are able to enjoy the summer by rediscovering the Jersey shore, outdoor BBQs, or road trips to nearby destinations while staying healthy.

Regardless of your summer plans, rest assured we will be here safeguarding your portfolios, looking for opportunities, and making sure your long term goals are not jeopardized by the events of this historic year.

Best regards,
Your Traphagen Investment Team