Q2 2021 Market Synopsis

Economic & Market Update:

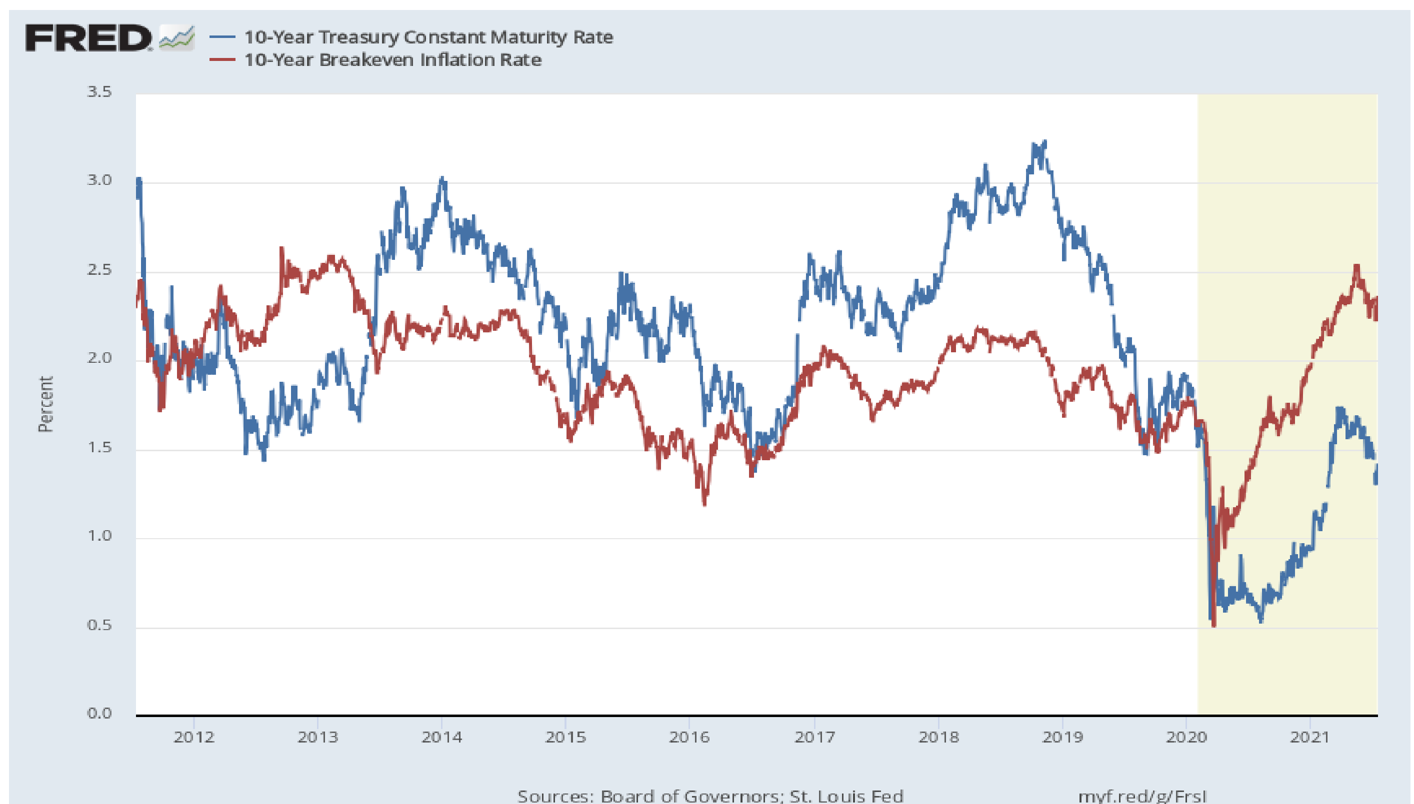
The second quarter of 2021 was a welcome and much needed change regarding lower market volatility, improving COVID statistics, and a return to a more 'normal' lifestyle for many. As more Americans receive vaccinations COVID has begun to fade gradually into the background (despite the recent appearance of the 'delta' variant), governments largely reopened economies and many consumers, for the first time in more than a year, traveled and spent money on all types of products. This behavior was both welcomed by individuals and the US companies providing these products. This splurge in spending is observable by the record growth in corporate SP500 earnings in 2021 vs. 2020.

With this robust backdrop, it should be no surprise almost all financial assets performed quite well. The ACWI (global stock index) was up 8% in the quarter, while US stocks and real estate were the standout performers, both up 14.5%. Even bonds, after a very poor 1st quarter, recovered between 2% and 4% with falling interest rates.

Select 2021 YTD Asset Class Returns (6/30/2021)	
Nat Gas/Oil Pipeline Companies (TPYP)	+ 33.3%
Alternative Lending (LENDX)	+ 24.0%
DJ US Real Estate (US Real Estate)	+ 20.2%
S&P 500 (US Stock Market)	+ 15.3%
MSCI EAFE (Foreign Developed Stock Market)	+ 9.9%
MSCI Emerging Market (Emerging Stock Market)	+ 8.7%
Private Real Estate Equity (TIPWX)	+ 6.2%
Middle Market Lending (CCLFX)	+ 5.5%
Private Farmland, Timberland, Infrastructure (VCRRX)	+ 4.0%
High Yield Bonds	+ 2.6%
TIPS (Treasury Inflation Bonds)	+ 1.5%
Insurance Linked Securities (XILSX)	+ 1.2%
Municipal (Tax Free Bonds)	+ 0.9%
Investment Grade Corporate Bonds	- 1.8%
US Mid/Long Treasury Bonds	- 3.4%

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

Below: ***Decade Chart of the 10 Year Treasury Yield (Blue) vs. 10 Year Inflation Expectations (Red)***



The chart above depicts the current 10-year Treasury yield (blue) vs. market expectations for annual inflation over the next 10 years (red). Usually, these two metrics move closely together through time, as when inflation is higher, interest rates also tend to move up to compensate savers. However, at times these metrics do diverge providing opportunity and risk. Currently, the difference between the implied inflation rate vs. the 10-year Treasury is higher than at any time over the past 20 years. While inflation is expected to be 2.3% per year over the next 10 years, the current 10-year Treasury yields only 1.3%. This means one of two things should occur; inflation expectations are too high and will come down, or rates will move higher. We will see how this plays out over the rest of the year, but the bottom line is the same as communicated in the prior newsletter, we see very little long-term value in any traditional bonds at the moment.

Despite inflation concerns, the 10-year Treasury dropped from 1.74% to 1.45% over Q2 causing most bonds to return between +2% and +4% in the period. Investment grade bonds performed best in the quarter, while municipal bonds lagged. Despite the recent rebound, most bonds still have a negative or near breakeven return on the year after a brutal 1st quarter. Since the

beginning of July rates have continued to drop with the 10-year Treasury yield currently sitting right around 1.3%.

With our thesis of traditional bonds generally being poor long-term investments, Traphagen has replaced between 65% and 100% of most portfolio bond allocations with our unique suite of alternative and private securities. Since inception (2013) and especially over the past two years we have seen this strategy pay off in terms of both risk management and net investment returns.

Below: ***List of all currently held Traphagen Private/Alternative investments, their 2020/2021 YTD Returns, and Max Drawdown of each investment through the 2020 Recession/Pandemic. Shaded investments are available to $1M+ clients.***

Symbol	Asset Class	2020	2020 Max Drawdown	YTD
SHRMX	Insurance	6.6%	-1.5%	1.4%
XILSX	Insurance	7.2%	-1.8%	1.4%
LENDX	Consumer Lending	10.3%	-4.5%	25.0%
CCLFX	Middle Market Lending	8.4%	-2.5%	5.7%
VCRRX	Infrastructure/Farmland/Timber	1.2%	-4.6%	4.1%
TIPWX	Private Real Estate Equity	1.4%	-2.7%	7.7%
MREC	Private Real Estate Credit	7.8%	0.0%	2.9%
BREIT	Private Real Estate Equity	6.9%	-8.2%	11.7%
KKR	Private Equity	10.4%	-7.0%	16.2%
GPB Fund II	Private Equity	6.7%	0.0%	0.0%
NICHX	Diversified Private Credit	5.9%	-1.7%	8.0%
PIIVX	Private Equity	24.0%	-2.1%	18.6%

Traphagen is very pleased that all of our private and alternative investments returned positive returns through the 2020 recession/pandemic and several are performing above our expectations in 2021. In addition, while stocks experienced a 35% drawdown and most bonds dropped by 10% to 20% in March of 2020, our alternative/private investments dropped at most by 8% and several did not experience any price drop. This is the combination of risk management, downside protection, and significant return benefit over bonds we are looking for from these investments.

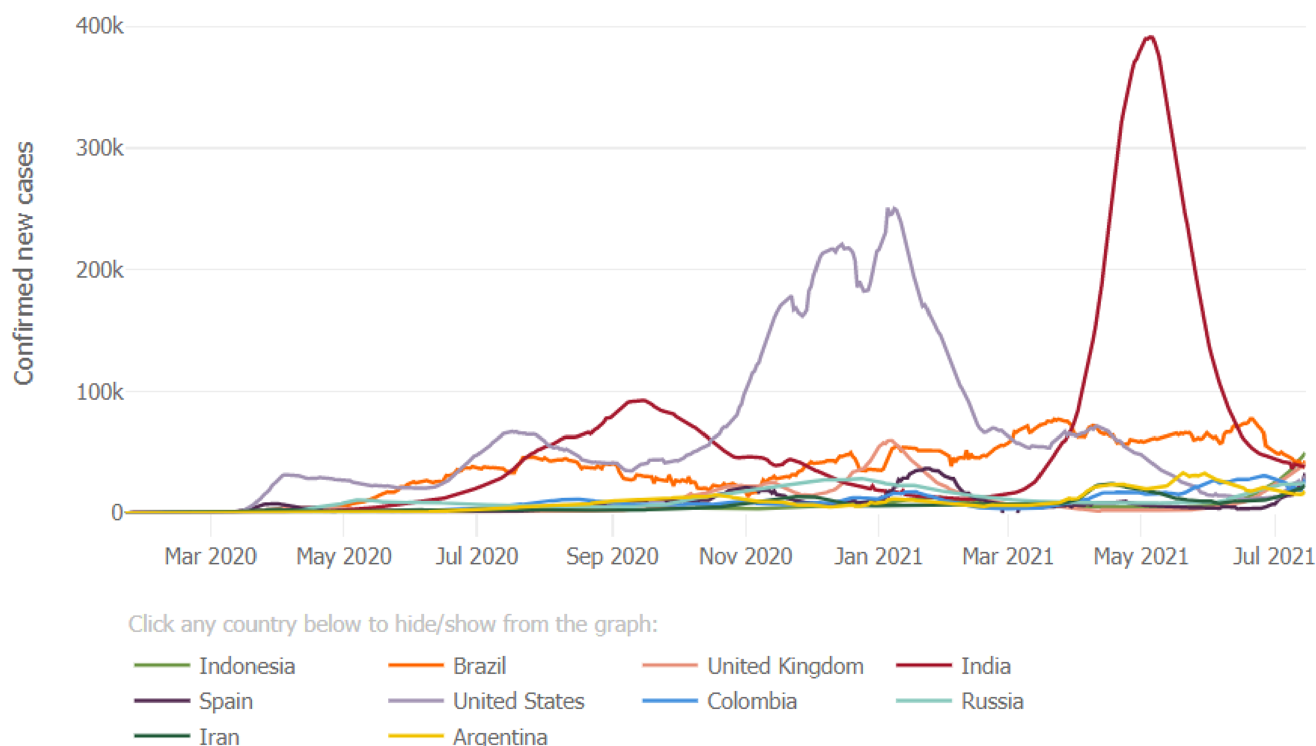
The major factors which impacted markets in Q2 2021 are highlighted below:

- **Falling Interest Rates/Rising Inflation:** As we briefly mentioned prior, although interest rates have fallen during the second quarter of 2021, inflation is on the rise. Over the past few months, the consumer price index (CPI) has been rising at the

highest pace in about 13 years, with the latest reading showing a 5.4% year over year increase. CPI, although useful, does have its shortcomings, as it excludes several important items almost everyone uses in their lives. Residential housing has spiked in value by 15% year over year according to the Case-Schiller index, gasoline is up 44% from $2.20 to $3.16 per gallon since last June on a national basis, and several other food items and commodities are also up more than 5%. The FED sees these levels of inflation as 'transitory' and for now the bond market seems to agree. Traphagen has positioned client portfolios to be very resilient to higher inflation, while at the same time not relying on it.

- **Improving COVID-19 Statistics & Economic Reopening:** Since March, natural immunity from infection and especially the rapid increase in vaccination has caused COVID-19 infection rates to plummet. The 'delta' variant is a more recent concern. According to most experts, the 'delta' variant case numbers will increase over the next several months, but it's impact should be less than prior waves due to the combination of factors mentioned above.

  Despite some possible 'delta' impacts, the US and other economies have largely reopened over the past 3-4 months. This 'normalization' paired with an enormous amount of consumer spending has caused an impressive surge in economic activity and corporate earnings growth versus 2020 levels.



Above: ***Confirmed new Daily COVID-19 cases by major countries (Mar 2020 – Current)***

- **Historic Economic and Corporate Earnings Growth:** As expected, while the US and most other global economies reopen and are attempting to return to normal, consumers spent their record savings on goods, services, entertainment, and travel. US GDP growth reached 6.4% in Q1 2021 and the latest forecasts for the full year 2021 are close to 7%. We have not seen this level of economic growth since 1984! Along with this surge in consumer spending and economic activity, comes impressive corporate earnings growth. The SP500 is forecast to increase earnings from $122 in 2020 to $188 in 2021 on an 'operating basis'. If the $188 2021 earnings estimate is accurate, this 54% earnings growth would be the largest year over year increase since 2010. The quantitative easing employed by the FED starting in early 2020 in addition to the historic amount of fiscal policy support over the past 18 months have arguably been the largest contributors to the corporate earnings recovery and current equity valuations. This recovery supports the long-term stock market investment strategy and to avoid short term fear driven 'market timing' temptations. No matter how dark the circumstances may appear, the US stock market has always shined brighter after the storm has passed.

Traphagen 2021 Portfolio Changes & Performance Update

Through the first half of 2021 client portfolios (outside of the most conservative) are up between 7% and 13% net of fees. Traphagen is very pleased with this result, as the strong returns from stocks, commodities, alternatives, and private investments have far outweighed the relatively poor performance of bonds.

The four most critical components of the positive performance within client portfolios this year are summarized below:

- **Reallocation to alternative/private investments from bonds:** Traphagen looks for a roughly 5% - 6% per year net return from our suite of alternative/private investments. This would represent roughly 2 to 3.5X the return of holding mid/long term high-quality bonds. From the beginning of 2020 through early July 2021, the bond market index is up roughly 4.5% while our alternative/private investment suite is up between 13% and 16%. In the first half of 2021 alone, the majority of clients are up between 6.5% and 9.5% on their alternative/private suite. The 2021 year to date returns are outperforming our estimates and just as importantly have added no additional volatility to portfolios vs. traditional bond holdings.

- **LENDX (Stone Ridge Consumer Lending Fund) performance:** As discussed in the prior newsletter, the combination of a well performing 'core strategy' of owning a well-diversified portfolio of consumer loans and a private equity investment (Upstart) have created an outsized gain for LENDX in 2021. The core strategy has returned about 5.7% year to date, while the sale of UPST stock in June returned an additional 19.1%, yielding a total return of just under 25%. Since the UPST stock has now been completely liquidated, LENDX will return to being a much lower volatility fund for the foreseeable future.

- **Broad positive performance in most risk/stock assets:** Whether investors were holding technology (outside of the most speculative), industrial, energy, financial stocks, commodities, real estate, or infrastructure assets, good returns were realized in the first half of 2021. In all these areas returns ranged from roughly 10% to 30% depending on the sector and specific investments. The alignment of low interest rates, accommodative fiscal policy, an economic and earnings resurgence, and the fading of the COVID pandemic amid the vaccination roll-out all contributed to these results.

- **Allocation to 'TPYP' (oil/natural gas pipeline stocks):** With much higher oil and gasoline demand along with constrained supply, pipeline stocks have soared in 2021. Traphagen thought this sector was extremely undervalued last year, and to date this has played out as we expected. Through early July, 'TPYP', our holding in this space is up roughly 33%, with a combination of a healthy dividend and significant price appreciation. Given the large valuation increase we might be trimming the position in the near future to secure profits.

In addition to the points mentioned above, over the past month we have made several portfolio changes and it is likely some additional trades will be made within the next few weeks. The most important changes are highlighted below:

- **Introduction of a new 'bond replacement' alternative fund:** The Variant Diversified Private Credit Fund (NICHX) is a recent addition for our $1M+ clients and is a replacement for cash, investment grade, and Treasury bonds. This is a fund that invests in a wide variety of hard to access credit assets such as royalty, transport, portfolio, and litigation finance. Historically it has yielded around 8% per year net of fees with very low volatility. Traphagen will be publishing a webcast on this new investment in the near future with more information on the fund's holdings and overall strategy.

- **Introduction of a new diversified private equity fund:** The Private Shares fund (PIIVX) is also a recent addition for our $1M+ clients and invests in approximately 60-70 private companies that have a good chance of going public within 2-4 years. The fund is up just under 19% year to date and has been the beneficiary of several IPOs in 2021. The largest holding in the fund currently is SpaceX and the fund does tend to focus on healthcare, technology, fintech, and consumer companies.

Over the next couple weeks most clients will see a complete elimination of Chinese and emerging market stocks. It is becoming clear that China and companies located within its borders have increasing risks. We no longer think these securities are worth holding on a risk vs. return basis. Our only holding in the space 'XSOE' (currently a 1% to 3% allocation for clients) will be sold and replaced with broad US stock exposure.

After strong returns caused by initial undervaluation and the 'reopening trade', our cyclical/value/small cap holding 'DON' will be sold for many clients (tax dependent) over the next month. Most clients are up between 25% and 40% on the position and we think it is time to take profits here. In our opinion the 'reopening trade' is largely behind us and regional banks (which make up almost 30% of the fund) continue to be under pressure from falling interest rates, fintech companies, and crypto. This fund will be replaced with more broadly diversified small/mid cap US stocks.

Lastly, as mentioned earlier, after a ~ 33% return so far in 2021, we will possibly be trimming 'TPYP' our oil/natural gas pipeline fund. We will retain some exposure here, as it still has a formidable 4.5% dividend yield and acts as a nice inflation hedge, but we do think it prudent to harvest some profits.

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

Private Equity (GPB Fund II): We have seen some important milestones reached in the second quarter of 2021 with our GPB private equity investment. GPB's auto division/Fund's audited financials (Form 10) was filed on May 14th with the SEC, and we expect GPB Fund II's Form 10 to be filed within the next month. Since Auto is the largest allocation within the GPB II fund this gave us some important information.

The major points include an operational profit in 2020 of $20.7M compared to a $9.4M profit in 2019. In addition, the auto division sold 14 dealerships within 2020, and as of the end of 2020 the fund has $135.4M in cash available, generated from operations and asset sales. Of note, is the following opinion issued by GPB's auditor, Eisner, on their financial statements covering calendar years 2019 and 2020. "***In our opinion, the consolidated financial statements present fairly,***

in all material respects, the consolidated financial position of the Partnership as of December 31, 2020 and 2019, and the consolidated results of their operations and their cash flows for each of the years then ended, in conformity with accounting principles generally accepted in the United States of America.”

Once the GPB II Form 10 is issued, Traphagen will communicate information on the financials and operations, in addition to GPB issuing updates as appropriate. Once the Form 10 for the GPB II fund is issued we expect an update to fund value (NAV) to follow shortly thereafter.

Although this is positive news, risks remain in terms of access to financing from banks, liquidity available for future dividends, and the relationship between Prime Auto Group and certain car manufacturers. As a reminder, within the GPB II fund in addition to the auto division, there is a material cash position, a large physical therapy business, and a healthcare/IT division.

Private Equity (KKR Fund): Under their new management team the I-Capital KKR Commitments funds has flourished so far in 2021 with a 16.8% year to date return through the end of May. Several successful IPOs in the quarter was a driving factor, along with a much-improved economic backdrop for small and mid-sized businesses. The fund continues to focus on wellness/healthcare, certain areas of technology, and companies that can take advantage of the demographic shift towards millennials.

Private Real Estate Credit (Mosaic): Mosaic returned 1.3% in Q1 2021 and we are awaiting Q2 2021 return figures. Mosaic will sell their NYC condo property on July 18th, which will remove one of the ‘non-performing’ properties from their portfolio and increase liquidity. In addition, as other tranches of loans are sold on larger properties such as the Portland Ritz the yield on the fund should increase towards the end of 2021. And as communicated earlier, despite returns averaging over 8% per year and virtually no volatility, we are gradually exiting this position over the next several years for most clients as other investments we view as superior are available for investment.

Private Real Estate Equity (Blackstone Fund): This private real estate equity fund continues to perform above expectations. The fund retains a core of high-quality multi-family residential and warehouse/industrial properties, but over the past 1-2 years also has added select single family homes, self-storage units, and RV properties. So far in 2021 the fund is up 9.8% through May 30 with roughly 2.2% of that return coming from income and the remainder from price appreciation.

H2 2021 Market and Economic Outlook Update:

The ’delta’ variant will be a concern over the next couple months, and we are monitoring the latest trends in relation to potential future lockdowns and/or more restrictive business policies. That said our base case for the US and most developed nations is a continued economic recovery, solid corporate earnings, accommodative fiscal policy, possible passage of a US infrastructure bill, and no meaningful ‘tightening’ on the monetary side until very late 2021 or early 2022.

With the above thesis and our Traphagen Recession Index (TRI) currently indicating the lowest chance of recession in it’s history at only 12.4%, we do not see any significant risk of an economic slowdown/recession through at least mid-2022 (outside of a black swan event).

Despite ‘full’ or even ‘stretched’ valuations for many stocks and risk assets, we see little chance of a sustained 15% - 20%+ pullback in the market given all the above. Not until a number of these facts change would we look to pull back into cash or bonds for additional portfolio defense.

We hope all our clients have taken advantage of the receding COVID-19 pandemic and have returned to a more ‘normal’ life including visiting friends, family, and taking some much needed time for relaxation and hopefully some vacations.

As always, we thank you for the continued trust you place in us as a firm, and we are always here for any additional questions you may have.

Best regards,
Your Traphagen Investment Team