PrivateWealth Partners, LLC

SECOND QUARTER 2020 REVIEW

Dear Client,

July 14, 2020

The first half of 2020 was one of the strangest, most unpredictable starts to a year anyone has ever experienced—no matter what generation you are from. The pandemic triggered a black swan economic event, where for the first time in history, the entire global economy was forcibly shut down. Stocks immediately repriced the risk of a major economic downturn, but prices have also snapped back quickly with extraordinary stimulus measures and gradual economic reopening. The S&P 500 posted its best quarter (+20.5%) in over 20 years, bringing its year-to-date total return to -0.88%[1].

Technology stocks continue to be the driving force behind the dramatic rebound, though by the end of June every sector had rallied off the bottom. The Consumer Discretionary sector led the way higher for the second quarter with a +32.9% gain, fueled in part by a strong, unexpected rebound in May retail sales.

Technology and Energy were not far behind, each notching +30.5% gains. Meanwhile, traditionally defensive sectors underperformed cyclical stocks by 9% for the quarter, with Utilities (+2.7%), Consumer Staples (+8.1%), and Health Care (+13.6%) all lagging. Overall, we have observed that growth, defensive growth, and companies with strong balance sheets (quality) have done the best in 2020 so far, which aligns well with Private Wealth Partners' current strategy.

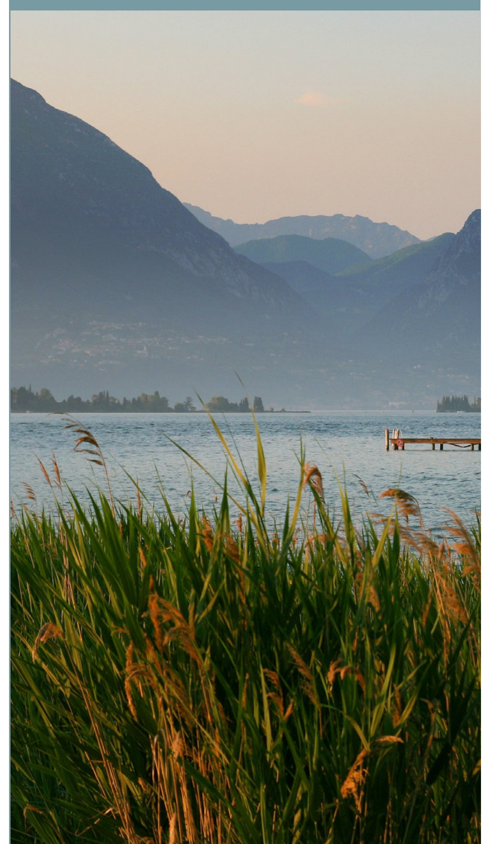
TECHNOLOGY LED WHAT EVENTUALLY BECAME A BROAD-BASED REBOUND

Source: Strategas Research

[1] Total Return as of July 8, 2020.

"The stock market is designed to transfer money from the overly active to the patient."

-WARREN BUFFETT



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Covid-19 cases continue to rise throughout the country, and states are increasingly pausing reopening plans. This trend poses significant risks to the speed of the economic recovery, but does not necessarily imply another full-on recession. The health system is better equipped to handle and treat cases today than it was three months ago, and from an investment standpoint, the key point to remember is that *recessions end when the economy begins to grow*—even if that growth does not seem very strong at first.

PRIVATE WEALTH PARTNERS BRIEF STRATEGY NOTE

In the short-term (3-6 months), much uncertainty remains about how the pandemic will unfold and what the economic recovery will look like. Longer-term, however, it has become clear that the pandemic is accelerating a handful of secular economic trends that were already underway. Many Americans are adjusting—and will continue to adjust—to working remotely, visiting fewer restaurants and retail stores, taking fewer flights, and so on. We see a 'new economic normal' that exists beyond Covid-19, and our portfolio is positioned to participate as the transition unfolds.

The commercial economy can operate pretty well without commuting to an office or cross-country business travel, for instance. Broad-based digitization, video-conferencing, and cloud software make this possible. Cloud adoption in particular is poised to disrupt the $1.5 trillion enterprise IT market, moving leadership away from legacy IT providers like IBM, Dell, Oracle, and Cisco and towards leading cloud providers like Amazon, Microsoft, Salesforce, and Google.

No one can say when the unemployment rate will retreat back to 5% and GDP growth will steady at 2%, but there is more certainty that e-commerce will continue to replace brick-and-mortar shopping, streaming video/gaming will see exponential user growth, digital advertising spending will rise, and 5G will work its way into hospitals, factories, laboratories, and our cars and homes. These trends are happening now, and this experience with the pandemic will only accelerate these changes.

Private Wealth Partners is aligning our strategy with many of these secular themes.

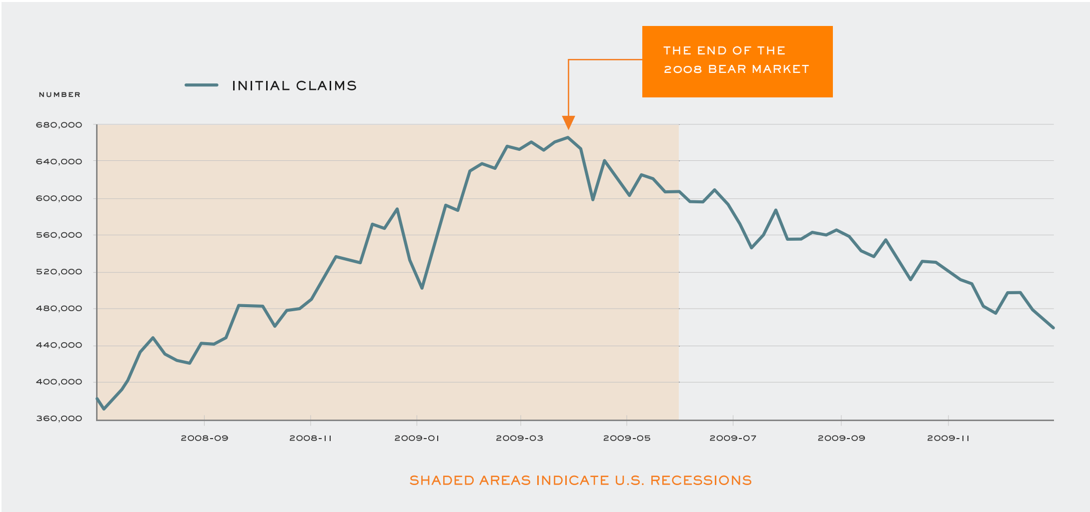
INSIGHT FROM THE U.S. LABOR MARKET

One underappreciated signal of an economy returning to life is the initial jobless claims number. An 'initial claim' happens when an individual applies for unemployment insurance, which has happened by the millions this year-to-date. The hardest hit sectors have been hospitality, travel, retail services, and energy.

Historically, the initial jobless claims number rises during a recession, and then reaches a peak just as the recession is about to end. For the stock market, a peak in the initial jobless claims number means the economy is ready to shift from contraction back to growth, which has also historically signaled the end of a bear market. *In fact, the stock market's best forward one-year returns have historically come after the worst decile of U.S. nonfarm payroll reports.*

The chart below shows initial jobless claims from July 2008 to December 2009. You can see the pattern clearly: the initial jobless claims number peaked at 665,000 for the week ending March 28, 2009, while the bear market ended on March 9, 2009—a near-perfect correlation.

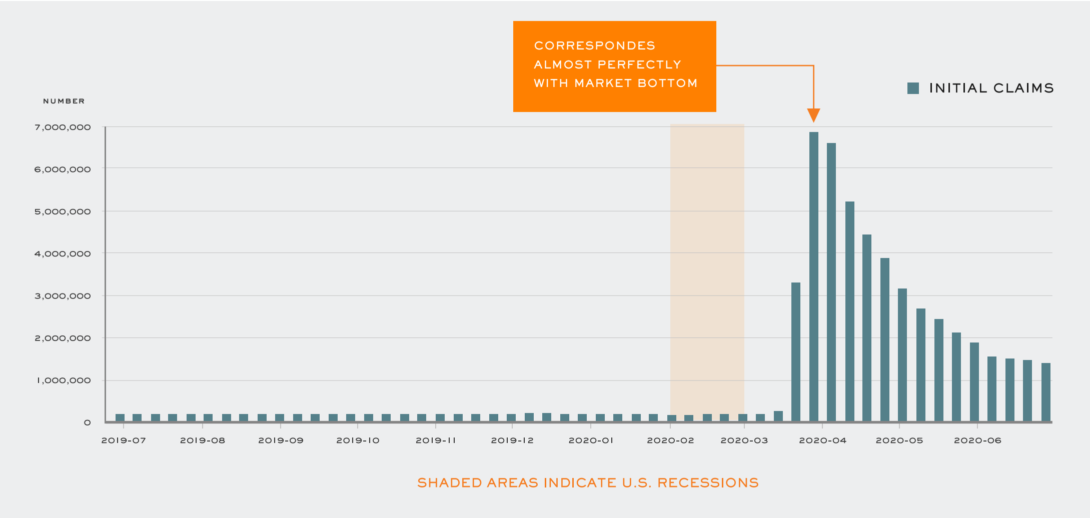
INITIAL JOBLESS CLAIMS KEEP RISING THROUGHOUT A RECESSION, AND PEAK NEAR THE END



Source: Federal Reserve Bank of St. Louis

We are seeing a similar pattern today. Initial jobless claims peaked at 6,867,000 for the week ending March 28, and the stock market bottomed on March 23—another near-perfect correlation. A national lockdown in the coming weeks or months could absolutely reverse this trend, but if the very worst of the economic fallout from the pandemic is behind us, the chart below confirms the same pattern we have seen in previous recessions.

INITIAL JOBLESS CLAIMS, JULY 2019 - JULY 2020



Source: Federal Reserve Bank of St. Louis

In our view, many economists and the financial media in general assumed that the pandemic-induced recession would cast a much wider net on job losses than it actually did. For the stock market, when expectations for an outcome are worse than the actual outcome, prices tend to rise. Case-in-point: in May, consensus was for 8.3 million jobs lost and a 19.5% unemployment rate. The actual result? 2.5 million jobs *gained* and a 13.3% unemployment rate. The "worse than the Great Depression" narrative did not materialize, and stocks rallied.

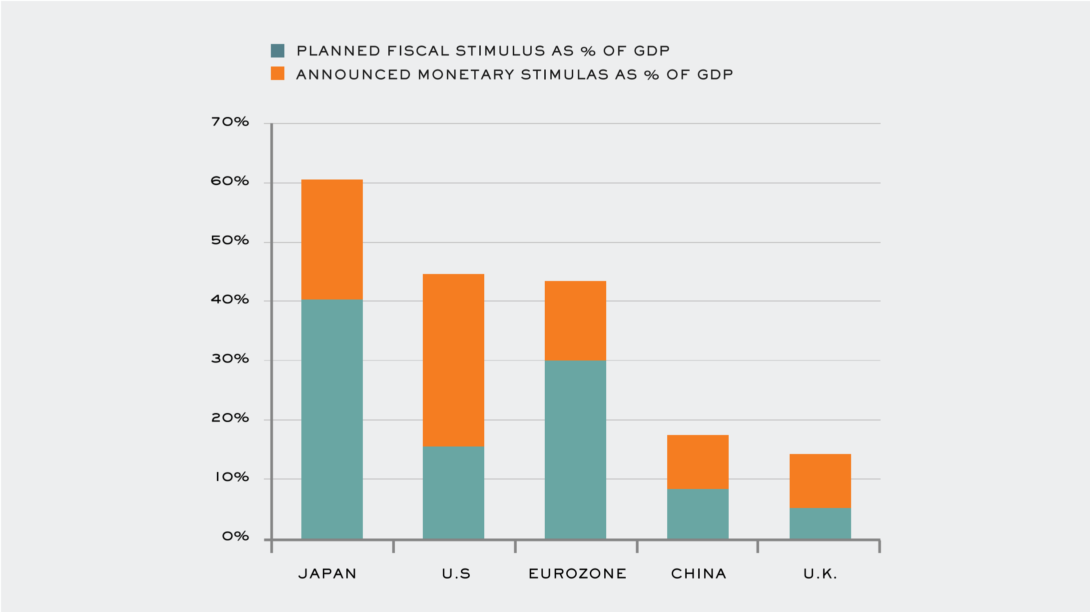
A similar outcome took place in June. The 4.8 million payroll increase was far higher than virtually anyone expected, and it was also a signal that the economic recovery was not only underway—it was accelerating. Because expectations were so low, the jobs market had a low hurdle to clear. The unemployment rate (11.1%) has now retraced about half of its pandemic-fueled increase, and the stock market has arguably been pricing-in this better than expected outcome throughout the quarter.

THE OUTSIZED ROLE OF THE FEDERAL RESERVE AND CONGRESS

Investors may be pricing-in expected growth in six to twelve months, but in our view, the real catalyst behind the strong equity market surge is the combined power of monetary and fiscal policy. As reports of labor market deterioration grew, the Federal Reserve and Congress acted quickly and decisively with extraordinary stimulus measures. We would argue that this 'wall of liquidity' is coursing its way through the capital markets.

This stimulus is not unique to the United States, either. The amount of global stimulus is absolutely massive, and by comparison is many times bigger than the stimulus deployed during the late stages of the 2008 Financial Crisis in 2008-09. It is a bit wild to realize, but the total fiscal and monetary stimulus being deployed globally amounts to approximately *28% of world GDP*. The world has never seen this type of liquidity event before.

MASSIVE GLOBAL ECONOMIC STIMULUS



Source: Charles Schwab, official policy announcements from start of February through June 6, 2020.

When money supply growth exceeds nominal GDP growth, as is presently the case (by a long shot), this liquidity flows around the capital markets—bidding up asset prices in the process. No matter what one may assume about the economic growth trajectory or earnings or jobs, it is difficult to make a case for being outright bearish against this type of liquidity backdrop.

The stimulus may increase from here. In a congressional hearing at the end of June, Federal Reserve Chairman Jerome Powell and Treasury Secretary Steven Mnuchin both pledged to consider additional relief measures to support the economy as the pandemic drags on. Congress is currently negotiating another round of stimulus measures.

The 10-year U.S. Treasury closed the second quarter at 0.66% even as bond issuance surges, suggesting that many investors see inflation as a low risk in the coming years. All signs also point to the Federal Reserve repeating its post-2008 Financial Crisis playbook of leaving the federal funds rate near the zero bound for at least the next year or two.

CONCLUSION

As we mention earlier in the review, the United States and the world are by no means out-of-the-woods on the pandemic or the economic downturn. But the question that ultimately matters for markets is whether the very worst of the crisis is behind us. While we do not have a definitive answer for that question, we think the likelihood of another national and global lockdown is low at this stage, and we also believe developed countries are better equipped to handle outbreaks today than they were three months ago.

The Federal Reserve, Congress, and other governments and central banks around the world have also made it clear to markets that additional stimulus and liquidity is 'on the table.' Goldman Sachs posits that with interest rates in the U.S. near the "effective lower bound, investors have been focused on finding the upper bound of equity valuation multiples." Historically, a forward P/E of 18x or 20x on the S&P 500 was viewed as fairly expensive, but at the same time, interest rates have never been this low for this long. No one can say what the upper bound is, but all signs point to it being higher than historical averages.

We understand this period has been challenging for many people, affecting us all in many different ways. It may seem odd or perhaps even paradoxical that the stock market is holding up remarkably well as the country and the economy struggle to move forward. But the disconnect really just underscores how markets work—throughout history, the best times to invest have usually been when the volume of bad news hovers around a crescendo, which is where we are today.

Please do not hesitate to reach out to us with any questions or concerns you may have. We hope you have a safe and healthy summer, and as always, we thank you for your continued confidence in Private Wealth Partners.

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