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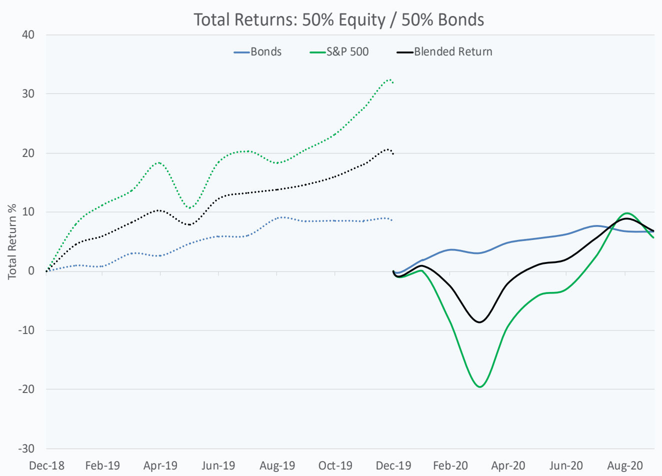
WHERE WE STAND – Q3 2020

The S&P 500 Total Return Index was up 8.9% (including dividends) in Q3 2020. See the solid green line to the right in the chart below. The Aggregate Investment Grade Bond Index (including interest) was unchanged for the quarter (blue line). If your portfolio comprised 50% S&P 500 and 50% Bonds, your YTD return would be 6.8% (black line). Data for 2019 is shown, broken lines, to the left.

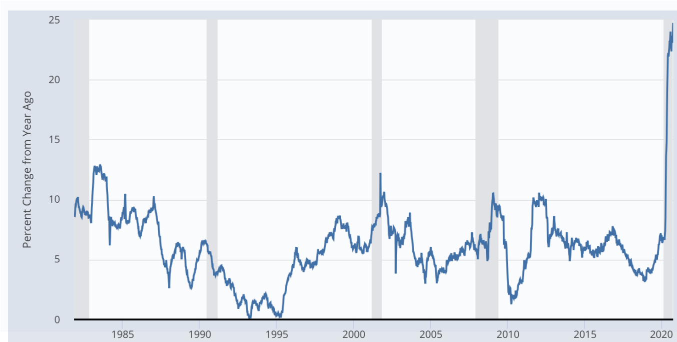


Overview

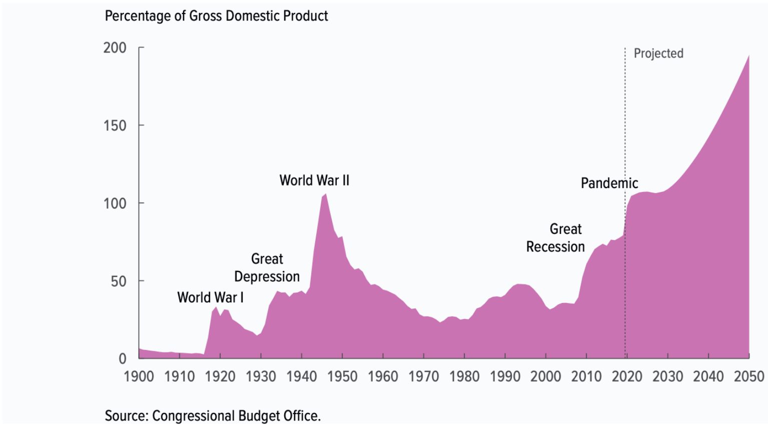
The S&P 500 index was up 8.5% in the 3rd quarter, recovering most of the sharp sell-off of earlier this year. Underneath the surface of the broader indices being up slightly on the year is a tumultuous churning of various sectors as shown, along with explanation for the YTD change, in the table below.

Ticker	Sector	Performance (YTD)	Reason
IYW	Technology	28.47%	Work from home demand
IYK	Consumer Goods	10.99%	Government transfers to individuals
IYC	Consumer Services	8.48%	Amazon and Home Depot
IYH	U.S. Healthcare	3.81%	Concern over Dem President
IYM	Basic Materials	-0.18%	China buying prevent collapse
IYJ	U.S. Industrials	-0.30%	Bumping along the bottom
IYZ	Telecommunications	-8.94%	Verizon and ATT suffer non payment
IDU	Utilities	-10.74%	Customers not paying bills
IYR	Real Estate	-14.50%	Commercial Real Estate suffering
IYF	Financials	-18.37%	Bad loan provisions and zero % rates
IYE	Energy	-50.16%	Collapse in demand

There are tectonic economic shifts at play in 2020: deep recession with massive job loss and societal shifts hurting the economy on the one hand; and unprecedented monetary and fiscal stimulus desperately trying to help, on the other. Money supply has been expanding at a 25% YOY rate recently, as the Federal Reserve is flooding the system as never before, as shown below.



Government deficits, which were already problematic entering 2020, have exploded this year to levels not seen since WWII. According to the non-partisan Congressional Budget Office, government debt is about to exceed 100% of GDP, deemed to be somewhat of a potential tipping point unless action is taken to rectify the trend. See the figure on the next page. This is a moment of economic triage for the US (and many other global economies), the repercussions of which are still to be seen. For now, the panacea that investors and policymakers are clutching onto is the extremely low level



of global interest rates, both in terms of buoying the valuations of equity, bond and real estate markets and in terms of the way they help public and private entities service the growing mountain of debt they owe. Growth and inflation outcomes for the next number of years have become extremely uncertain. If growth disappoints or inflation/deflation becomes unstable, the system is vulnerable especially given how overvalued equity and bond markets have become.

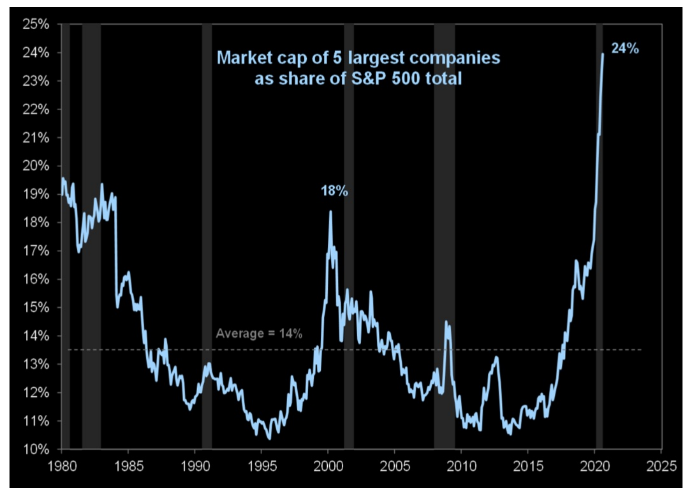
Aside from the economics, there are domestic and geopolitical issues that financial markets can't fully discount, so therefore, for now, ignore. The outcome of next month's US presidential election is uncertain, and at issue and subject to overhaul are environmental policies, geopolitical tensions, health care, corporate tax rates, education, race and distribution of income, and US foreign policy.

The period ahead is flush with risks (and opportunities) for investors.

Where We Stand

We continue to position our portfolios for reduced expected returns from financial assets over the medium term and for increased market volatility. Going forward, we plan to protect against the former and take advantage of the latter to gain performance, as we have done so far in 2020. Our returns this year are matching our benchmarks, and, at the same time, our portfolio drawdowns and volatility have been de minimis.

The chart below shows how concentrated the rise in the S&P500 has become: how 5 companies (Apple, Amazon, Microsoft, Google and Facebook), now comprise almost a quarter of the index market capitalization, surpassing that at the end of the 1999 tech bubble.

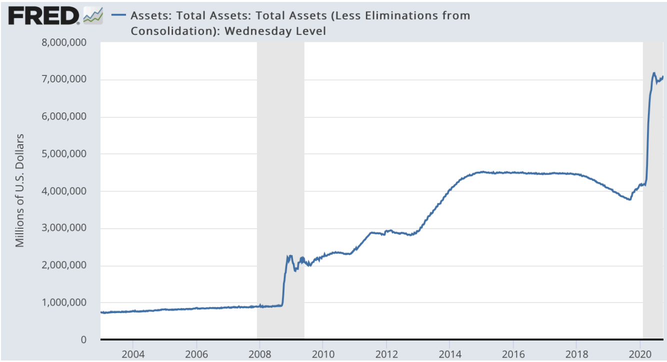


Underlying this phenomenon are investors ploughing money into various funds and ETFs so as to be indexed to the S&P 500. Regardless of valuation. When the feedback loop is virtuous, this strategy works, but when it becomes negative it can feed on itself in a disastrous fashion.

For years now policy makers have ensured the loop is positive:

- deficit financed corporate tax cuts in 2017
- cutting interest rates in 2018 as soon as equity markets showed any vulnerability
- exploding the money supply, cutting interest rates to zero and unprecedented buying of corporate, municipal and government bonds in 2020
- and running up the budget deficit by $4trn (15% of GDP) in 2020.

In the process Fed has increased its balance sheet (almost doubling it this year alone - see chart below) to undesirable levels. Additionally, government deficits are becoming unsustainable as mentioned above.



Meanwhile valuations have risen enormously for individual stocks, particularly for the dominant sectors of the US equity market: Apple (30x forward earnings), Amazon (70x), Microsoft (30x), Google (26x) and Facebook (26x). In some instance, these are treble the valuations earlier on in this bull market. The S&P 500 forward PE ratio is over 25x earnings (even assuming a healthy economic improvement next year) and Price-to-Sales ratios and Market Cap to GDP ratio are at all-time highs.

For now, very low interest rates, speculative momentum driven flows and investor over-confidence are holding these valuations together, and may continue to do so for a while, but at these levels, and for now, our emphasis is on capital preservation.