2Q2020 Quarterly Commentary: **Navigating Through the Unknown**

In 2Q20, investors saw a shocking change of events. As quickly as the U.S. economy was drawn into the worst self-inflicted recession since the Great Depression, we also likely exited it in a similar swift fashion. As states starting to reopen, U.S. consumers (the powerhouse of the U.S. economy), did not disappoint. The earlier concern over the consumer's appetite to venture out of the unprecedented lockdown proved to be unfounded. Retail sales jumped at a record pace and other economic data bounced sharply off its record lows. One by one, data points on the economy were beating even the most optimistic Economist's estimates. As a result, a euphoric attitude spread over investors and filtered into the global equity markets. The MSCI AC World Index exhibited a sharp "v" shaped rally after the record run into bear market territory during 1Q20.

KEY TAKEAWAYS:

In this outlook, we will:

- Look at the rapid advancements made to combat the virus
- Highlight how much better prepared we are than we were just three months ago
- Outline the positive developments we have seen in the global economy and balance it with the risks that lie ahead
- Offer our recommended asset allocation entering the second half of 2020 as interest rates remain stubbornly low and public equity market valuations are looking frothy

Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com

While we welcome the positive change after the unsettling environment in 1Q20, we are cognizant not to be complacent about the magnitude of the global economic recovery. It is not surprising to see some jaw dropping positive economic data after data fell to the worst of the worst levels in 1Q20. The question remains, how sustainable is the recovery in economic data as we deal with the lingering effects of the global lockdown? Bankruptcies are beginning to rise and will likely continue and the destructive damage to the U.S. labor market may take years to repair. With so much uncertainty we take comfort in the fact that global governments and central banks have stepped up in an aggressive manner to avoid a depression-like environment and help those unemployed until we can resume a more normal way of life. In addition, the speed at which the scientific advancements are being made to treat and cure the virus are astonishing. Typically, it takes 10 years for a vaccination to be approved and our global scientists may pull this off within two years of the first case!

Economic Outlook: Game-Changing Scientific Advancements and Signs of Synchronized Recovery

As the world is slowly getting back to a sense of normalcy, it is important to realize how much better prepared we are to combat this virus than we were three months ago. Shown in **Table 1,** our testing capability has increased nearly 600%. With over 40 million tests conducted thus far, we have tested more than 10% of the U.S. population. What is even more encouraging is that in addition to testing people showing symptoms, we are also testing those asymptomatic. This is crucial in tracing and slowing the virus spread. Our hospitals and healthcare providers are much better equipped to handle the inflow of COVID-19 patients. In fact, we are expected to increase ventilator stockpile by 200K by the end of this year. Knowledge about the virus has grown immensely. We know what works (e.g. facemasks and social distancing), and Americans have widely adopted the new normal. This is important because the depression-like drop in 2Q2020 GDP was due to the mandated global lockdown. Following all these advancements, another country-wide lockdown is unlikely.

Table 1

Rapid Change in the U.S. Preparedness

Data most recent as of July 15, 2020. *Per the Society of Critical Care Medicine 2009 survey.
Source: CDC, WHO, covidtrackingproject.com, rt.live, New York Times, Bloomberg Finance LP, Verdence Capital Advisors.

	March/April 2020	Current	Change Since 1Q20
U.S. Covid Tests Per Day	112,335	760,157	647,822
U.S. Total Covid Tests Performed Thus Far	1,096,921	41,761,392	40,664,471
% of Total U.S. Covid Tests Positive	18.0%	9.0%	**-9.0%**
U.S. Covid Case Fatality Rate	7.2%	4.0%	**-3.2%**
% Total U.S. ER Visits Due to Covid Related Illness	6.9%	2.7%	**-4.2%**
% U.S. Inpatient Hospital Beds Occupied by Covid Patients	11.0%	7.4%	**-3.6%**
# of Ventilators in the U.S.*	177,586	377,586	**200,000**
# of Americans on Ventilator	7,070	2,263	**-4807**
Average U.S. Reproduction Rate (Rt)	1.50	1.10	**-0.40**
% of U.S. States with Reproduction Rate (Rt) Below 1.0	6.0%	14.0%	8.0%

Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com

As the world has opened, we have seen some eye-popping economic data. In fact, a common indicator that measures how much economic data beats the consensus estimate has risen to the highest level since 2009 **(chart 1).** While this has fueled investor euphoria, it also highlights how unprecedented the environment is and how difficult it has been to forecast the ultimate impact to the economy. We remain optimistic that the aggressive Government actions will help the current recession to go down as the shortest in history **(chart 2)** and should bridge the gap until we can find a vaccine and fully normalize. We also acknowledge the recovery is likely to be bumpy and we may not see the same type of "V" shaped economic recovery as we are seeing in the global stock markets. Below we highlight the tailwinds for the economy and balance them with some of the headwinds that we need to monitor.

Chart 2

Great Lockdown Recession Likely to be Shortest in History

Data is estimates as of July 16, 2020.
Source: Bloomberg Finance LP, Verdence Capital Advisors.

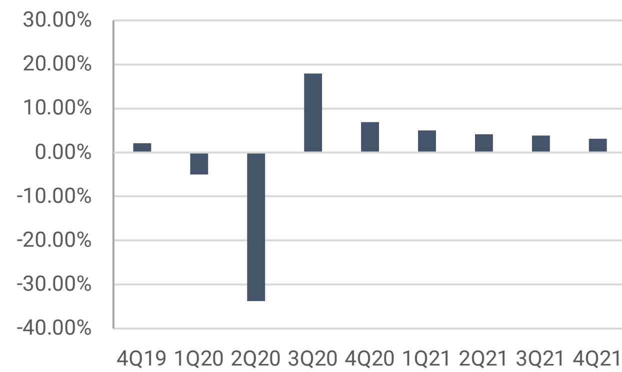
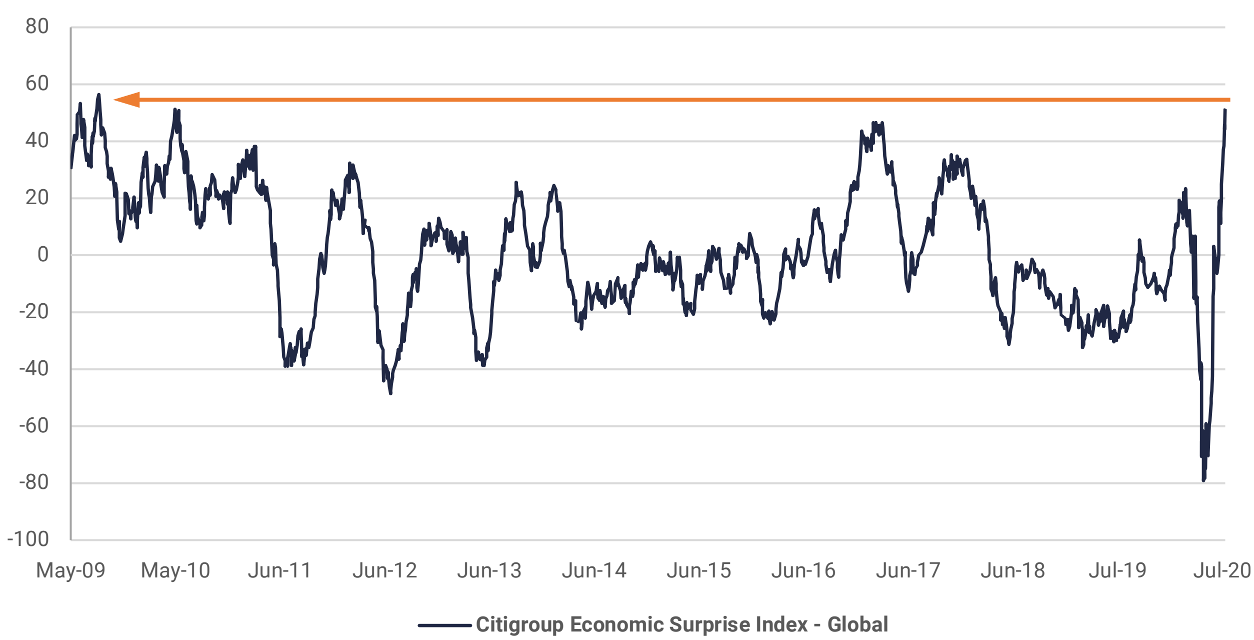


Chart 1

Economic Data Beating Estimates

Data as of July 15, 2020.
Source: Bloomberg Finance LP, Verdence Capital Advisors.



Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com

HEADWINDS: TAILWINDS:

Extremely Accommodative Federal Reserve: The FOMC released their forecasts for economic growth and, most importantly, their outlook for interest rates. At their June meeting, no member saw rates rising until 2022 at a minimum. Combined with the committee expanding their balance sheet to nearly $7 trillion, this has contributed to the money supply growing over 20% since last year.

Consumers Healthy: The Federal Government has acted swiftly to get direct relief where it is critical. But it is important to remember that households came into this crisis on very solid footing. Household debt service ratios are at an all-time low **(chart 3 – next page)** and household net worth is near a record high.

Fiscal Policy Supportive: The Federal Government has pushed their deficit to a record high and has released stimulus plans worth ~10% of GDP. In addition, there is likely to be another stimulus package before the election.

Consumer Appetite is Strong: One of the biggest unknowns in the depths of the crisis was the appetite for the consumer to go out after the lockdowns were lifted. While most economic data are released on a lag, we can get real time data to gauge their appetite to venture out. Whether it is the resumption of airline travel **(chart 4 – next page),** the improvement in restaurant bookings or the number of New Yorkers using the subway system, we are seeing activity slowly return to pre-pandemic levels.

Rising Bankruptcies: We are seeing bankruptcies rise in a speed not seen since the Great Recession. Since bankruptcies typically lag the cycle, we expect to see more in the second half of 2020, especially in the retail and leisure space.

Election Volatility: While it is way too early to consider political outcomes in our portfolio strategy, we are aware of the volatility that elections can bring to the economy and equity markets. The largest uncertainty at this time will be surrounding the increasing rhetoric around rolling back some of the tax relief programs released under the Trump administration.

Labor Market Uncertainty: In the worst two months of the pandemic, the U.S. economy lost double the amount of jobs that we lost in the Great Recession. It will take time to decipher how much of the jobs that we lost are temporary and how many are permanent. It is likely that due to the extent of the damage, it will take years to repair the damage created by the global lockdown.

Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com

*Household debt service ratios are at an all-time low **(chart 3)** and household net worth is near a record high.*

*While most economic data are released on a lag, we can get real time data to gauge their appetite to venture out. Whether it is the resumption of airline travel **(chart 4),** the improvement in restaurant bookings or the number of New Yorkers using the subway system, we are seeing activity slowly return to pre-pandemic levels.*

Chart 3

Household Debt Service Ratio was at a Record Low Coming into Pandemic

Data as of 1Q20.
Source: Bloomberg Finance LP, Verdence Capital Advisors.

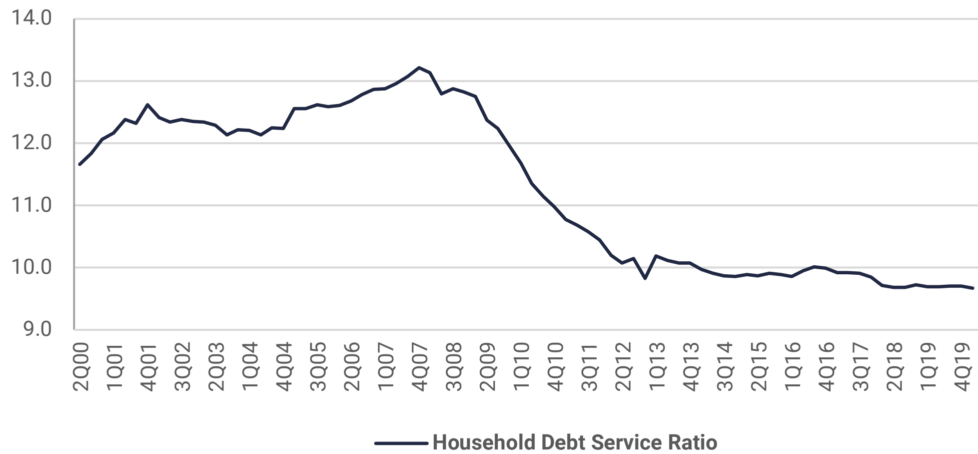
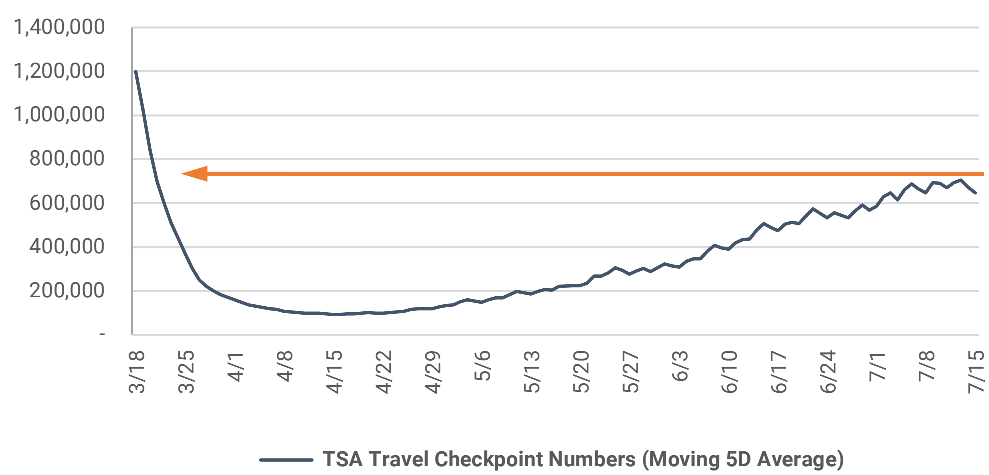


Chart 4

Americans Willing to Travel

Data as of July 15, 2020.
Source: tsa.gov, Verdence Capital Advisors



Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com

VERDENCE
CAPITAL ADVISORS

Fixed Income: Where to Find Value in a Near Zero World

The aggressive measures taken by global central banks has helped to avoid a health crisis from turning into a financial crisis. However, their actions come with consequences and that consequence is global interest rates at or near record lows. **(chart 5 – next page).** As these nontraditional programs remain in place and central bank's forward guidance is for no interest rate hike in sight, the rise in interest rates is likely to be muted. Therefore, we do not recommend eliminating your fixed income exposure. Fixed income still serves its purpose in these highly uncertain times for diversification and a hedge in the event of a steeper drop off in economic growth. However, in order to find value, we recommend focusing on the following fixed income sectors.

- **Defensive in Duration:** With interest rates at or near record lows, there is a significant amount of interest rate risk in long term bonds. As a result, we would focus on investing in bonds that mature in the short to intermediate term to mitigate losses as interest rates rise.
- **Credit is good; Quality is Crucial:** The Federal Reserve has already purchased $400 million worth of corporate bonds in order to limit any stress in the credit market. While the extra yield investors earn to own corporate bonds (spreads) has narrowed from the pandemic highs, we would still recommend corporate bonds as part of your asset allocation. However, we would focus on high quality investment grade bonds due to the uncertainty over bankruptcies as we move into 2H20. High yield bond spreads may not be rewarding investors for the forthcoming risk of defaults. **(Chart 6 – next page).** Already this year, there have been more than 1,000 downgrades in the high yield space compared to only ~200 upgrades. This is the highest ratio of downgrades since the Great Recession.
- **Emerging markets a better way to gain yield**: Emerging market bonds have also seen a significant amount of narrowing in yield compared to sovereign bonds. However, with inflation declining across the emerging markets in general, ~75% of the emerging market and low-income countries cutting benchmark interest rates and the World Bank and IMF pledging support we see widespread default risks low.

Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com

Chart 5

Fed Actions Have Pushed Interest Rates to Record Lows

Data as of July 15, 2020.
Source: Bloomberg Finance LP, Verdence Capital Advisors.

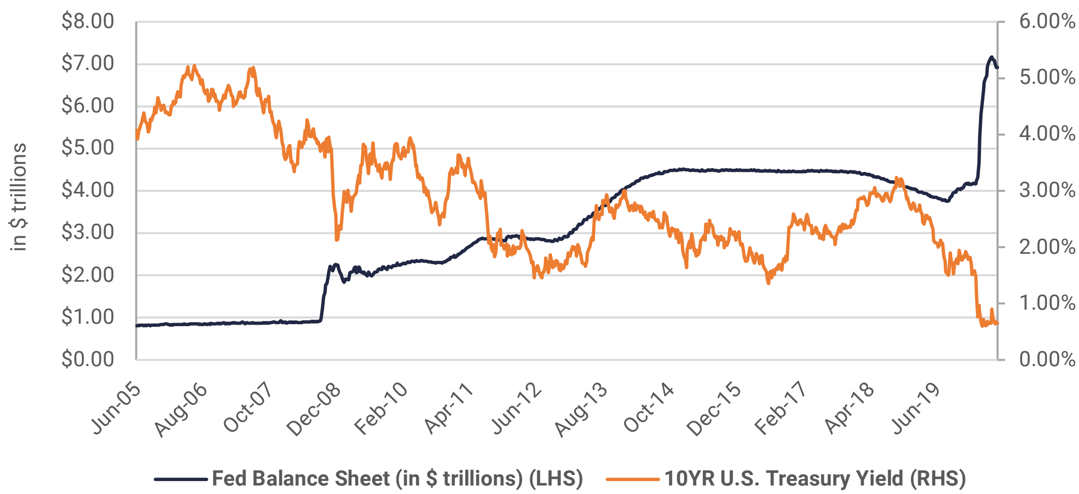


Chart 6

High Yield Spreads Have Narrowed and May Not Be Offering Enough Reward for the Risk

Data as of July 15, 2020.
Source: Bloomberg Finance LP, Verdence Capital Advisors.

Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com

Global Equities: Favor Equities Over Bonds but Selectivity Important in a Frothy Environment

Global equities have flourished in the euphoria of better than expected economic data, massive monetary and fiscal stimulus and the rapidly evolving scientific advancements in the fight against COVID-19. The S&P 500 is rallying off the bear market low (March 23, 2020) at a record pace. In fact, historically at this point after a bear market low (roughly 80 days), the S&P 500 has been up, on average ~20%. However, the current rise from the bear market low has been in excess of 40%, making this the strongest move out of bear market history on record. **(Chart 7 – next page).** Despite the rapid run out of bear market territory, we favor equities over bonds for the next 12-24 months for the following reasons:

- **Central bank supportive:** The central bank's decision to increase their balance sheet has pushed valuations to levels that would be expensive in a normal environment. However, history has proven that there is a tight correlation between a rise in the Fed's balance sheet and what investors are willing to pay for equities (price to earnings multiple). This is because the Fed is forcing bond yields lower and incentivizing investors to take on more risk, which has been in the equity market.

- **Massive amount of money on the sidelines:** The amount of liquidity that has been created by fiscal and monetary stimulus has not only pushed the money supply to grow more than 20% over the past year but the amount of money in money market mutual funds now exceeds $4 trillion. To put that in perspective that is more than 15% of the market cap of the Wilshire 5000. Therefore, there is a significant of money awaiting attractive opportunities in the equity market.

- **Relative to bonds; there is no choice:** With bonds giving investors little to no return potential over their coupon, yields in the equity market look attractive. In fact, the earnings yield of the MSCI AC World Index is exceeding the yield on the five-year Treasury and the five-year German Bund by 436 bps and 533 bps, respectively. **(Chart 8 – next page).**

Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com

Chart 7

S&P 500 Posting Best Move out of Bear Market Territory on Record

Data as of July 16, 2020.
Source: Bloomberg Finance LP, Verdence Capital Advisors.

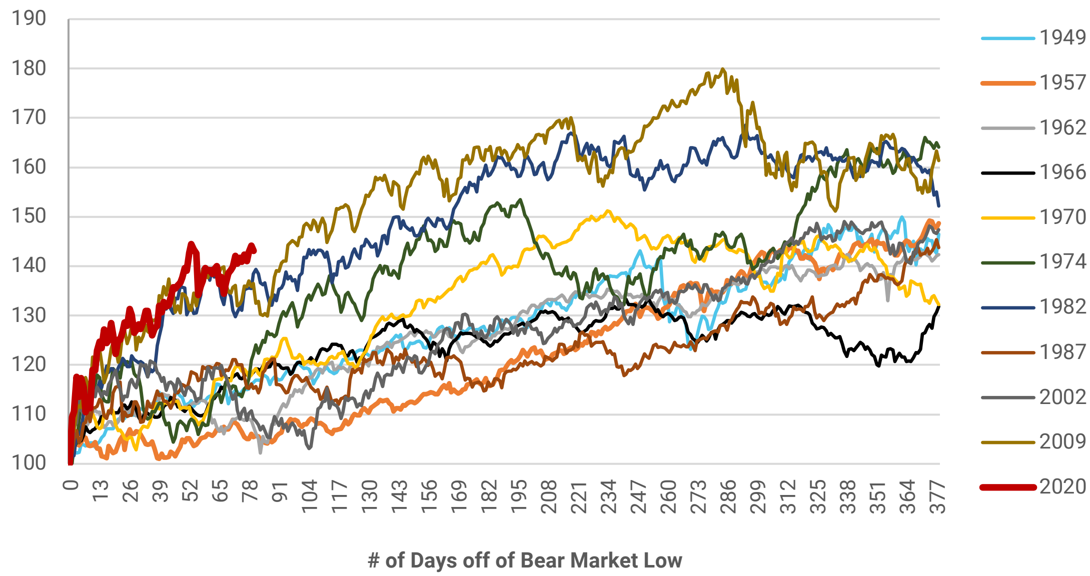
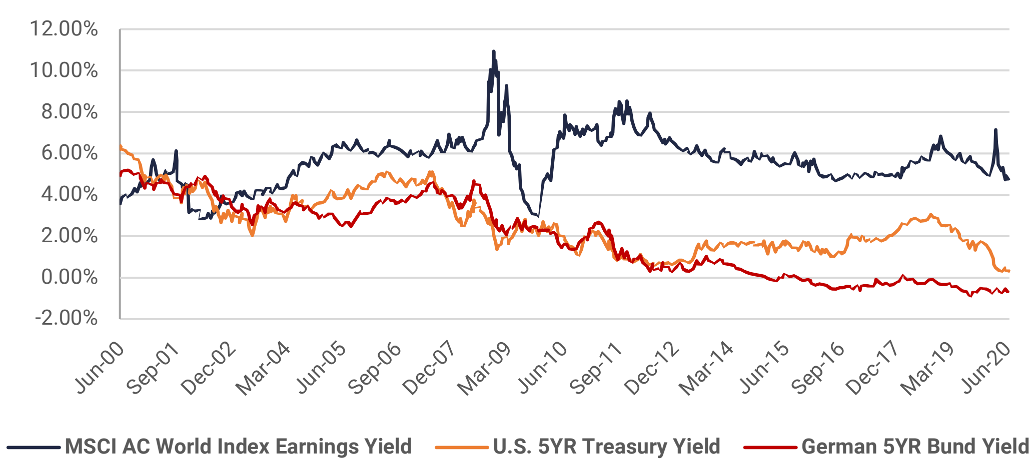


Chart 8

Equities Attractive Versus Bonds

Data as of July 16, 2020.
Source: Bloomberg Finance LP, Verdence Capital Advisors.



Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com

While we favor equities over bonds for the next 12-24 months, it does not mean that we are ignoring our disciplined approach to looking for value. Selectivity is important as most global equity markets look expensive on a variety of valuations metrics after the recent run. In addition, investors are chasing equities even while earnings estimates for the next year are being reduced.

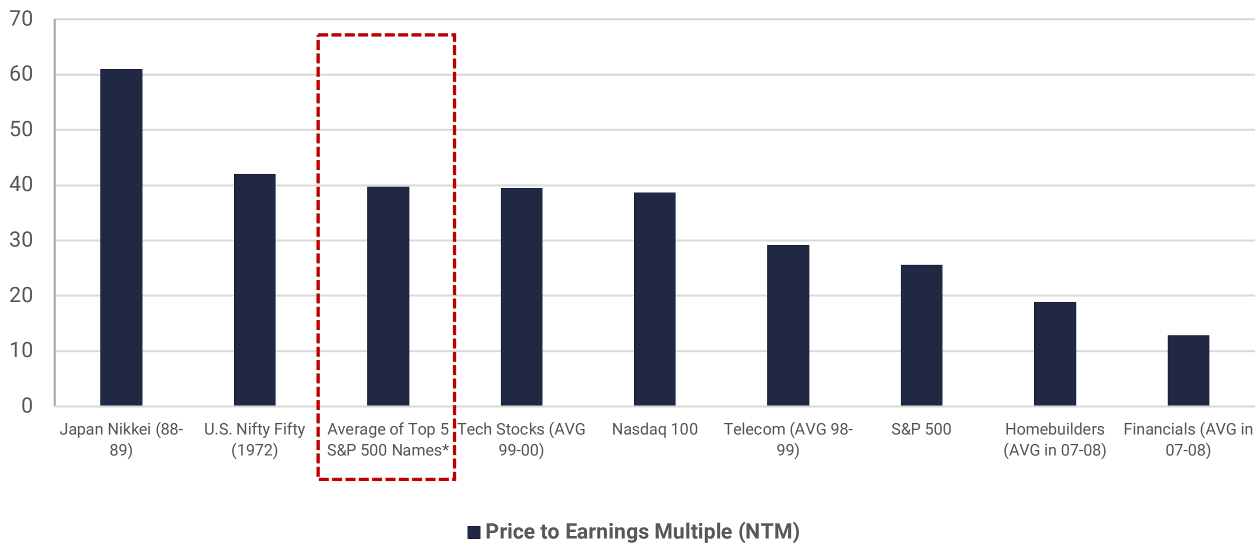
One area of concern is the dichotomy between the top names in the U.S. equity market and the rest of the Index. For example, year to date the S&P 500 is relatively flat for the year. However, Amazon, Microsoft, Apple, Google and Facebook are making up the entire return while the rest of the S&P 500 is down an almost equal amount. Some of the behaviors we have seen in chasing these top names is reminiscent of previous "bubble like" scenarios. For example, as can be seen in **Chart 9,** the average price to earnings multiple of Amazon, Microsoft, Apple, Google, and Facebook is higher than what was seen with the tech stocks leading up to the dotcom bubble, housing and financials leading up to the Great Recession and close to what was seen in the U.S. Nifty Fifty (U.S. growth companies in the early 1970s). As you can see, Amazon, alone has a price to earnings multiple more than double what we saw in tech stocks leading up to the dotcom bubble.

While we tactically made good decisions to add to the U.S. equity market in the depths of the bear market, we are patiently awaiting better entry points and are holding an overweight cash position to look for tactical opportunities. We favor the U.S. and developed international equity markets as the economic fundamentals are improving and the amount of fiscal and monetary stimulus should support the equity markets.

Chart 9

Select U.S. Names Looking "Bubble" Like

Data as of July 16, 2020.
Source: Bloomberg Finance LP, Verdence Capital Advisors.



Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com

Alternatives: Hedge Funds in an Uncertain World and Private Markets as the Public Market Looks Expensive

Investors have had to become more accustomed to volatility in 2020. The intraday swings have been difficult for investors to stomach and the Volatility Index even surpassed its prior peak reached in the depths of the Great Recession. **(Chart 10).** This has offered a good opportunity for quality hedge funds to capitalize on dislocations in the market. Given our expectation for a continuation of volatility as we navigate through the recovery, we recommend hedge funds for those investors that are suitable.

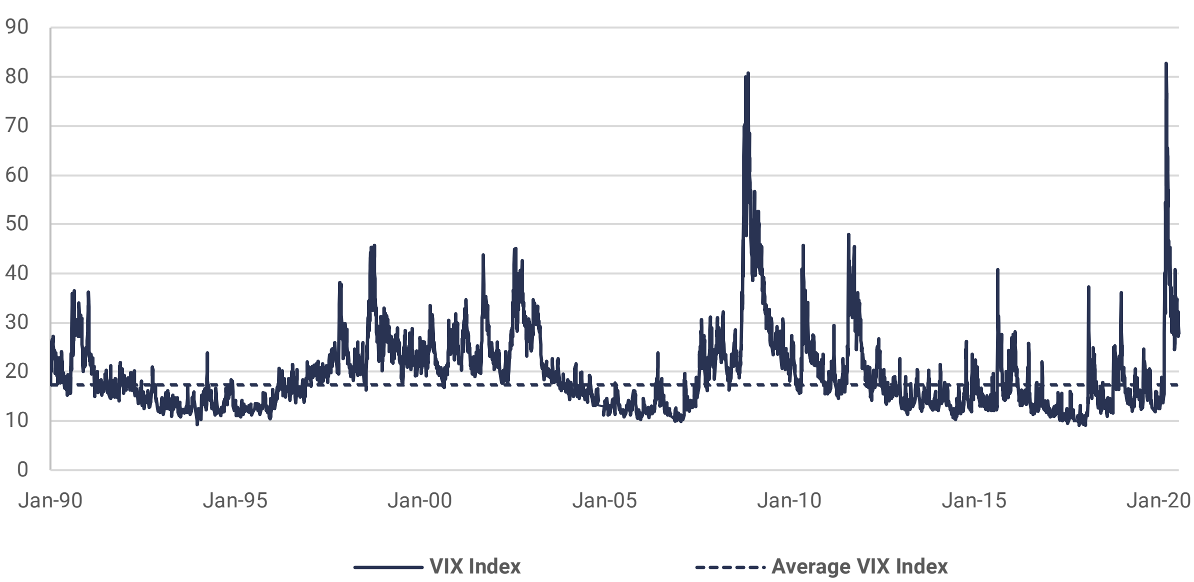
In addition, in an environment where finding value in the public equity and bond markets is starting to entail taking on more risk, the private markets look even more attractive. The demand for good quality private deals has far outstripped the supply in recent years and as a result the amount of money that private managers have been accumulating to find opportunity has grown in excess of $1.5 trillion. However, the market conditions and dislocations over recent months have resulted in attractive opportunities for that massive amount of money to be deployed. In addition, history suggests a good time to invest in the private markets is at the turn of a cycle when there is attractively valued investments for these managers to put money towards.

While every client's financial situation and investing goals may vary, the ability for a wide array of investors to access the private markets through different structures is growing. Therefore, we will continue to look for attractive private investments that offer our clients good risk adjusted returns, can enhance income opportunities and offer attractive diversification benefits.

Chart 10

Volatility Jumps to a Record High in 2020

Footnotes: Data as of July 16, 2020.
Source: Bloomberg Finance LP, Verdence Capital Advisors.



Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com

The Bottom Line

While we remain optimistic that the scientific advancements and aggressive actions taken by global governments will help us navigate through these unchartered waters, we also acknowledge that it will not be an uninterrupted race to the top. We have not eradicated the virus and even after a vaccination, precautions will likely be taken. We remind investors that we did come into this self-inflicted recession on extremely solid footing so we are confident we can move past this, but the road will be bumpy. Primarily due to the damage done to the U.S. labor market, the risk of rolling shutdowns and the changing dynamics of some industries (e.g. retail). We are continuing to monitor real time market indicators (e.g. jobless claims, confidence, travel) that can help us gauge the breadth of the recovery. From an asset allocation perspective, when there is uncertainty there is nothing wrong with holding an overweight cash position. This can not only help to hedge if the economy takes another turn lower, but it also offers us the flexibility to capitalize on pullbacks which are highly likely in such an overvalued world. As always, we will take all our client's investment objectives and risk tolerance into consideration when making portfolio changes.

As always, if you have any questions about our perspective, please do not hesitate to reach out to your advisor.

Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com

Past performance is not indicative of future returns

Disclaimer:

This material was prepared by Verdence Capital Advisors, LLC ("VCA"). VCA believes the information and data in this document were obtained from sources considered reliable and correct and cannot guarantee either their accuracy or completeness. VCA has not independently verified third-party sourced information and data. Any projections, outlooks or assumptions should not be construed to be indicative of the actual events which will occur. These projections, market outlooks or estimates are subject to change without notice. This material is being provided for informational purposes only and is not intended to provide, and should not be relied upon for, investment, accounting, legal, or tax advice.

Past performance is not a guarantee of future results.

Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product or any non-investment related content, made reference to directly or indirectly in these materials will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. You should not assume that any discussion or information contained in this report serves as the receipt of, or as a substitute for, personalized investment advice from VCA. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. All indexes are unmanaged, and you cannot invest directly in an index. Index returns do not include fees or expenses.

Leo J. Kelly III | CEO
lkelly@verdence.com

Megan Horneman | Director of Portfolio Strategy
mhorneman@verdence.com