STRATEGIC *Insights*

Section 1: Market and Economy

This quarter, the Strategic Income Group Investment Committee met with the following companies: Voya Investment Management, CION Investments, BlackRock, SharesPost, Columbia Asset Management, StepStone Group, and MFS Investment Management.

In addition to meeting with these companies, the committee reviewed research from several other companies and outputs from our technologies to determine the most appropriate investments and advice for our clients.

Strategic Income Group Current Views (Q3 2020)

		Bearish	Slightly Bearish	Neutral	Slightly Bullish	Bullish
Capital Market Outlook			X ←			
		Bearish	Slightly Bearish	Neutral	Slightly Bullish	Bullish
Equities	U.S. Large Cap			X		
	U.S. Mid Cap		X			
	U.S. Small Cap	X				
	International		X			
	Emerging Markets		X			
Fixed Income	U.S. Government				X	
	U.S. Investment Grade Corporate				→ X	
	U.S. High Yield				X	
	International		X			
Alternatives						X
Cash				X		

Please Note: These are 12- to 18-month views from the published date of the applicable commentary. Arrows represent movement from Q2 2020.

It seems like the world has changed just in the last few months. There is so much going on. There is so much uncertainty.

At times like this, it is understandable to feel uneasy about your investments and about your future. In order to give you continued confidence in us and in your tomorrow, we felt it would be good to look back over our track record of research and recommendations so that you can not only understand the changes that we have made, but also our recommendations on how we will continue to help you into the unknowns of the next 12 to 24 months.

Capital Market Outlook

In starting out with our capital market outlook, we have downgraded our overall outlook to be slightly bearish. Please remember this is a 12- to 18-month outlook while things are changing weekly, and sometimes daily.

While many investors use the price movement of the markets to determine if things are good or bad, we try to focus on the fundamentals of the economy. As the economy moves, the markets will eventually follow. Because of this, we have made more investment changes in the past nine months in the Strategic Portfolios than we normally do.

		Fourth Quarter 2018	Third Quarter 2018
Financial	Yield Curve	●	⬆
	Credit Spreads	●	⬆
	Money Supply	●	●
Inflation	Wage Growth	⬆	⬆
	Commodities	●	⬆
Consumer	Housing Permits	⬆	⬆
	Jobless Claims	⬆	⬆
	Retail Sales	⬆	⬆
	Job Sentiment	⬆	⬆
Business Activity	ISM New Orders	⬆	⬆
	Profit Margins	⬆	⬆
	Truck Shipments	⬆	⬆
	Overall Signal	⬆	⬆

⬆ Expansion ● Caution ✖ Recession

(ClearBridge Investments, 2018)

As seen above in the 12 leading economic indicators that we track, during 2018, the economy was humming along — so much so that the Federal Reserve was taking as much as $50 billion out of the economy, reducing their balance sheet that had been increased during the global financial crisis (GFC).

With the Fed doing this, it put pressure on the yield curve and money supply. It was also a smart move by the Fed as they were using good economic growth to put some of the tools that were used during the GFC back in the toolbox, allowing them more room to move at a later date if they needed to.

You might recall that the fourth quarter of 2018 saw a 20% decline in the S&P 500 from October through December. At that time, we were not concerned and called it a buying opportunity. Our view came from a drop in stock prices that was accompanied with very strong economic numbers. When this happens, we usually see a very quick recovery and 2019 proved this to be true.

While 2019 might be remembered as a strong year for U.S. stock market performance, it should also be remembered as a year of economic slowdown. In 2019, the Federal Reserve continued to take out money from the economy to the tune of about $500 billion.

As you can see from the chart below, from the second quarter to the fourth quarter of 2019, there was a steady decline in the leading indicators. This along with a market that was continually reaching new highs caused some concern for our investment committee that the market was getting overvalued and that it might be time to take some profits.

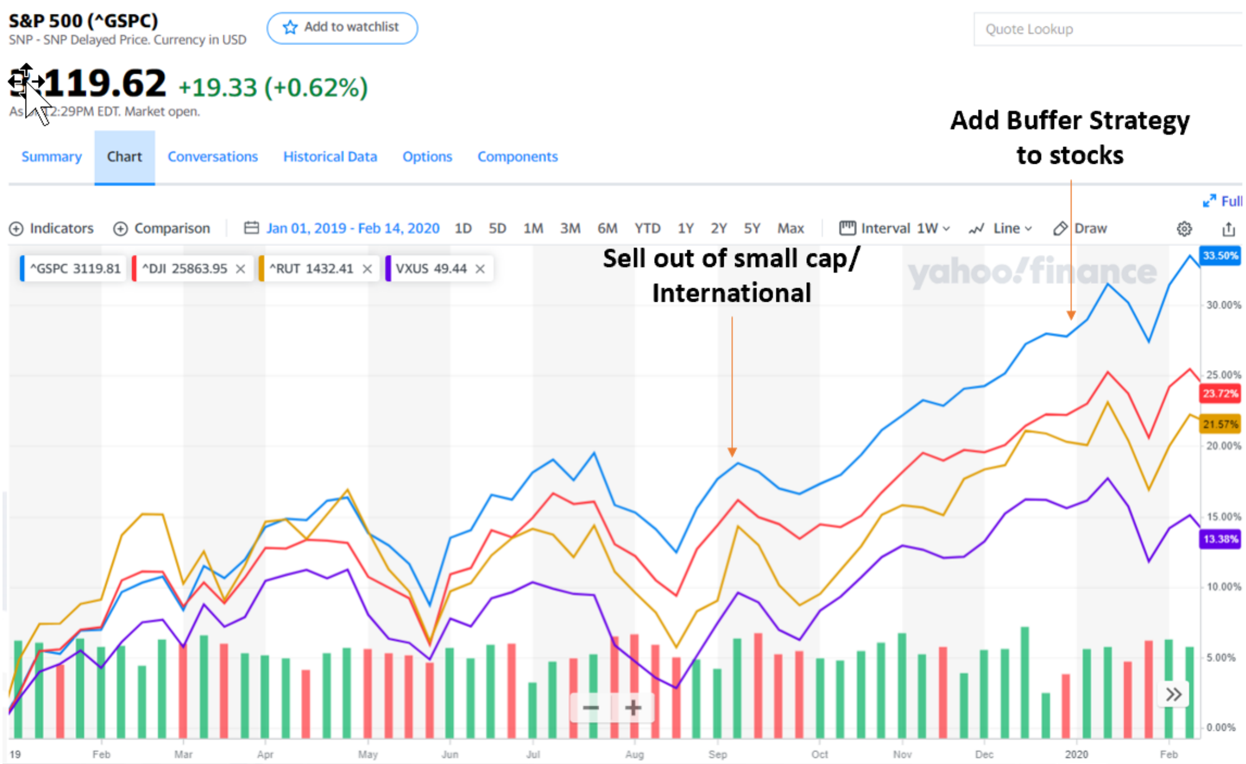
		Fourth Quarter 2019	Third Quarter 2019	Second Quarter 2019
Financial	Yield Curve	✕	✕	✕
	Credit Spreads	⬆	⬆	⬆
	Money Supply	●	●	●
Inflation	Wage Growth	✕	●	●
	Commodities	●	✕	✕
Consumer	Housing Permits	⬆	⬆	⬆
	Jobless Claims	⬆	⬆	⬆
	Retail Sales	⬆	⬆	⬆
	Job Sentiment	⬆	⬆	●
Business Activity	ISM New Orders	✕	✕	●
	Profit Margins	●	●	⬆
	Truck Shipments	⬆	⬆	⬆
	Overall Signal	●	●	●

⬆ Expansion ● Caution ✕ Recession

(ClearBridge Investments, 2019)

The leading risk indicators in the third quarter of 2019 led us to believe that we were in the late stages of an economic expansion. Historically, large-cap stocks outperform during these late stages. We made the decision to not only get out of small-cap stocks, but also to eliminate our international positions within our Strategic Portfolios as the strength within the U.S. fundamentals was much better than overseas.

The stock market was continuing to make new highs which also caused some concern within the investment committee as there was a lack of volatility. The China and U.S. trade talks were getting louder and 2020 was set to be an election year. It was time to protect some of our gains and have more of a flight to quality — all the makings of increased volatility.



(Yahoo Finance)

Proactive vs. Reactive

Let's look at what we have already done. These changes were made because our investment process is sound: we have quarterly meetings with investment managers, gain information and research, and then apply what we have learned.

In September 2019, the investment committee decided to rotate out of the remaining allocations of our small-cap and emerging markets equities. From September 17, 2019 through March 6, 2020, emerging markets fell by (11.44%).

The small-cap index we exited from when we made our trades fell (19.39%) during the same time period.

The U.S. large-cap (S&P 500) position we moved to fell (1.32%). This change helped our portfolios hold up better as we saw much more volatility in areas of equities that we no longer owned.

We continue to love alternatives and private or illiquid investments for longer-term buckets and have been increasing this allocation for clients over the last several years. These positions have also held up extremely well during the recent volatility.

In December, for clients in the Strategic Income Phase, we replaced a third of our direct exposure to the S&P 500 with a buffer strategy to help reduce the downside volatility while not completely losing some of the upside potential. Again, this was done two full months before we saw the volatility.

The stock market started the first month and a half of this year on the same path as 2019 making new highs. On February 19, however, that drastically changed. The economy shut down due to the coronavirus and we immediately fell into a bear market and a recession with tens of millions of people being furloughed or laid off in the following weeks.

At the beginning of this year we called for volatility to return to normal. This is easy to overlook when the markets are making new highs. We asked the question, "Are you prepared for a 10% to 20% drop in the market?"

We felt strongly that we would see volatility in 2020 and that a 10% to 20% drop was quite possible. However, we did not see the coronavirus coming nor did we expect a 34% drop in the

		May 31, 2020	April 30, 2020	March 1, 2020
Financial	Yield Curve	✕	✕	✕
	Credit Spreads	✕	✕	✕
	Money Supply	⬆	⬆	⬆
Inflation	Wage Growth	✕	✕	✕
	Commodities	✕	✕	⬆
Consumer	Housing Permits	●	⬆	⬆
	Jobless Claims	✕	✕	⬆
	Retail Sales	✕	✕	⬆
	Job Sentiment	✕	✕	●
Business Activity	ISM New Orders	✕	✕	●
	Profit Margins	✕	✕	✕
	Truck Shipments	✕	⬆	⬆
	Overall Signal	✕	✕	●

⬆ Expansion ● Caution ✕ Recession

(ClearBridge Investments, 2020)

market. The good news, however, is that due to the changes that we made in September and December, we were well-prepared and our portfolios held up much better than had we not made those changes.

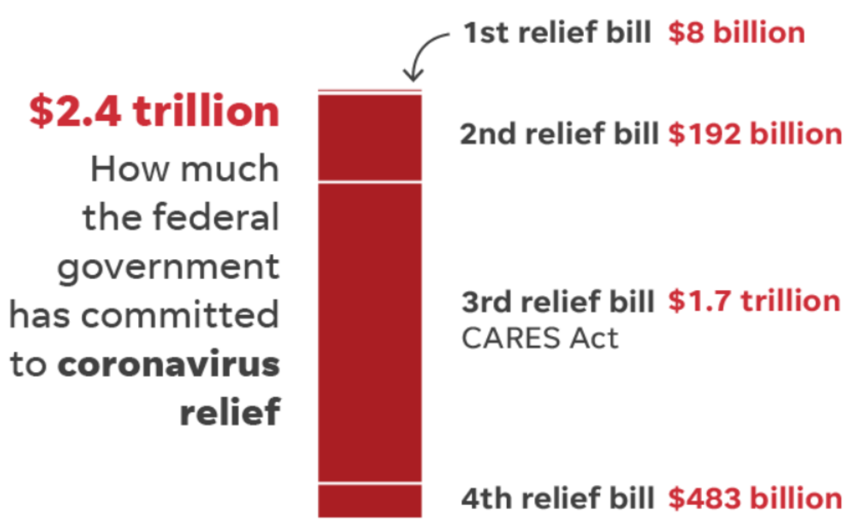
Given the levels of uncertainty in the economy, along with the election and with the pandemic, it is very likely that we will continue to see an elevated amount of volatility over the next several quarters and into next year.

Our base case right now is that we are likely to stay in a trading range of +/– 10% to 20% of current market values until unemployment comes back down and earnings catch up with the current values of stock prices. Until then, we feel it is smart to stay in higher-quality stocks, and investments that demonstrate lower volatility and higher income.

The Federal Reserve

So much of what we have seen in the last several years has been due to the policies of the Federal Reserve. During the Great Depression, the Fed had “no” tools. During the financial crisis of 2008, the Fed “created” tools. During this COVID-19 pandemic, the Fed “used” all the tools and they did so with quickness and effectiveness.

Not only has the U.S. government given out trillions of dollars of stimulus money through different programs, the Federal Reserve and other central banks around the world have taken substantial measures in creating additional stability. This has been done by dropping interest rates to zero as well as injecting trillions of dollars through asset purchase programs.



(USA Today, May 8, 2020)

In essence, the Federal Reserve prints up trillions of dollars and then uses those funds to buy bonds in the marketplace. Not only did this stabilize the markets, they did this within weeks of the initial downturn. In comparison, during the 2008 global financial crisis, similar actions took the Fed almost a year.

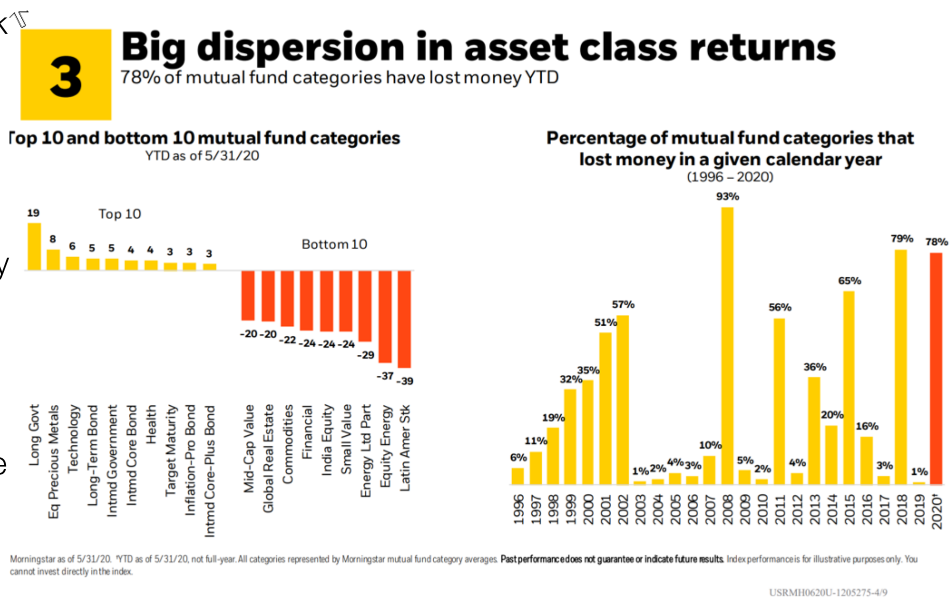
The Federal Reserve pivoted from taking roughly $50 billion out of the economy each month to pumping trillions of dollars into the economy almost overnight.

At a risk of being too technical, when people hear that trillions of dollars are being printed, they get concerned with inflation. Inflation happens not only by the money supply (M1) but also by the velocity of money (M2) or how quickly money is changing hands. That is not happening right now and therefore we are not concerned with inflation. Just as the Fed was taking money out of the system a few months ago, we believe they are positioned to do that again once the economy can support it.

The global economic shutdown due to the coronavirus caused massive issues through supply chains, caused oil to crash, and caused tens of millions to get laid off from their jobs and trillions of dollars to be lost in earnings. During the initial month, we saw a 34% sell-off in the S&P 500 with many individual companies and sectors faring much worse than that. We saw the bond market lock up and even saw select bonds fall more than the S&P 500.

With a very quick reaction, the government and the Fed injected trillions of dollars into the economy and markets. This not only brought stability back to the bond market, we saw the broad stock indices recover most of what they lost within a fairly short time frame.

Good From the Bad



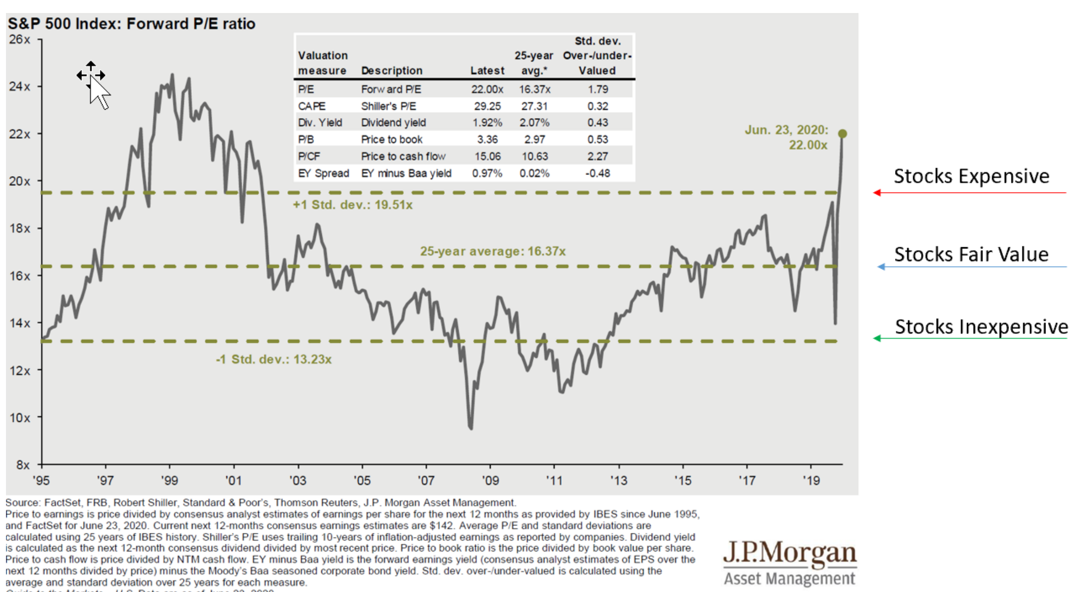
(Morningstar, 2020)

However, as you look closer at the markets, you will notice that the rising tide did not lift all boats. There has been a huge disparity between the winners and losers. Where you are investing today is more important than where you were investing 12 or 24 months ago. There are times in investing that all we need to do is own the market and use low-cost ETFs to do so. Today is different. You do not want to own everything.

According to our research meeting with Columbia Asset Management during the investment manager week, even in favored sectors there are “unloved areas” of those sectors. For instance, in the technology sector the top 20% of companies are up 30% YTD, and the bottom 20% of companies are down 30% YTD. As of last week, during our meeting with Columbia Asset Management, the S&P 500 was down 3% YTD, the average stock was down 10%, 257 companies were down more than 10%, and 159 companies were down more than 20% YTD. This disparity is due to the market-weighted average, meaning that the larger companies have a larger impact on the overall return of the market. In fact, the top five largest companies in the S&P 500 represent over 20% of the total market (Microsoft, Apple, Amazon, Facebook, and Alphabet/Google). Those five companies alone account for approximately 50% of the market rally.

In addition to the leading indicators that we watch, we also track the trailing and forward price-to-earnings ratios of the stock market. This valuation measure allows us to understand if stocks are historically expensive, inexpensive, or around fair value. This adds another element into our decision-making of when we should make certain changes.

As we discussed, in December 2019, we added the buffer strategy for our Strategic Income Phase portfolio (for those that are retired) when we saw that stocks were getting expensive and we felt that we could see some type of sell-off. Once the coronavirus hit and the stocks sold off, they actually got to the point that they were much closer to being inexpensive. This happened really quickly. We sold out of the buffer note and added higher-quality growth names and even started to move into our high-yield strategy. In addition, we recommended for those in the Accumulating Wealth Phase to increase their 401(k) contributions, invest idle cash, and max out their 529 plan contributions for the year.



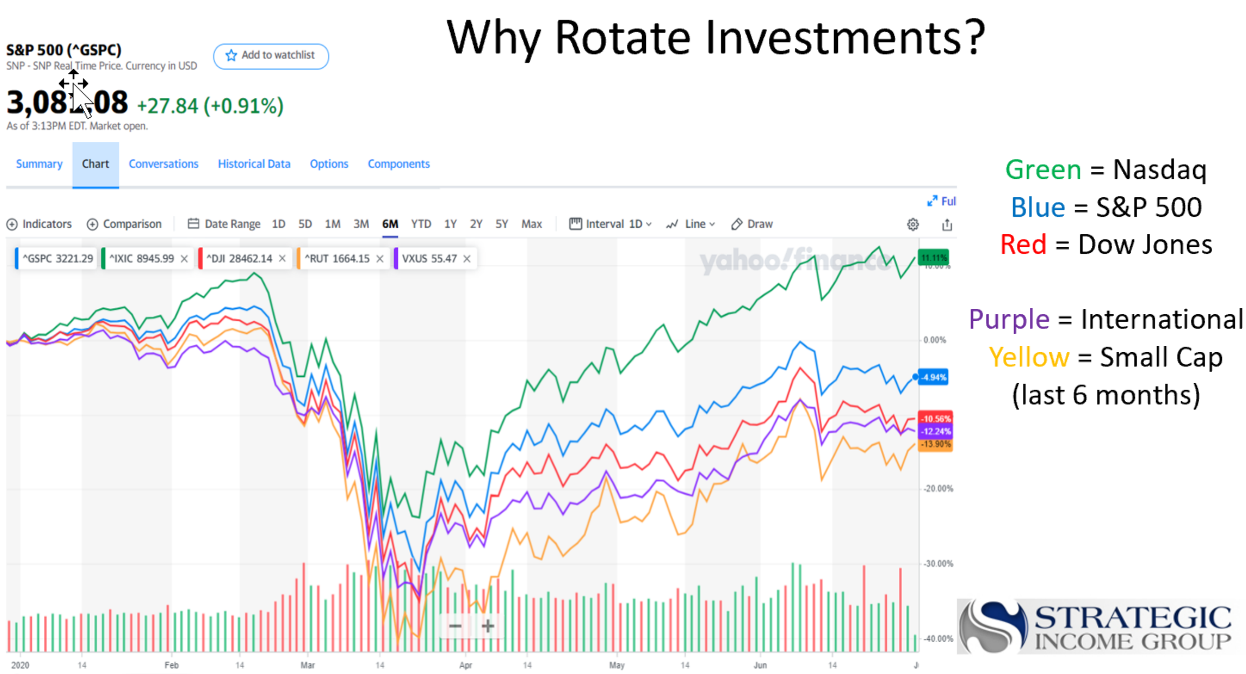
(J.P.Morgan Asset Management, 2020)

As you know, the stock market made a huge recovery and is now back to a point that we believe stocks are expensive again. There is a lot of question as to what earnings will be and the forward projections could be way off. If we look at the known or the trailing earnings (what has already happened), stocks still look expensive right now.

Section 2: Practical Applications

Investment Rotation Strategy

As you can see from this chart below representing the Dow Jones, NASDAQ, and S&P 500, there is a huge disparity of almost 25% returns in just the last six months. There are winners and losers and what you own — or possibly more importantly, what you don't own — matters.



(Yahoo Finance)

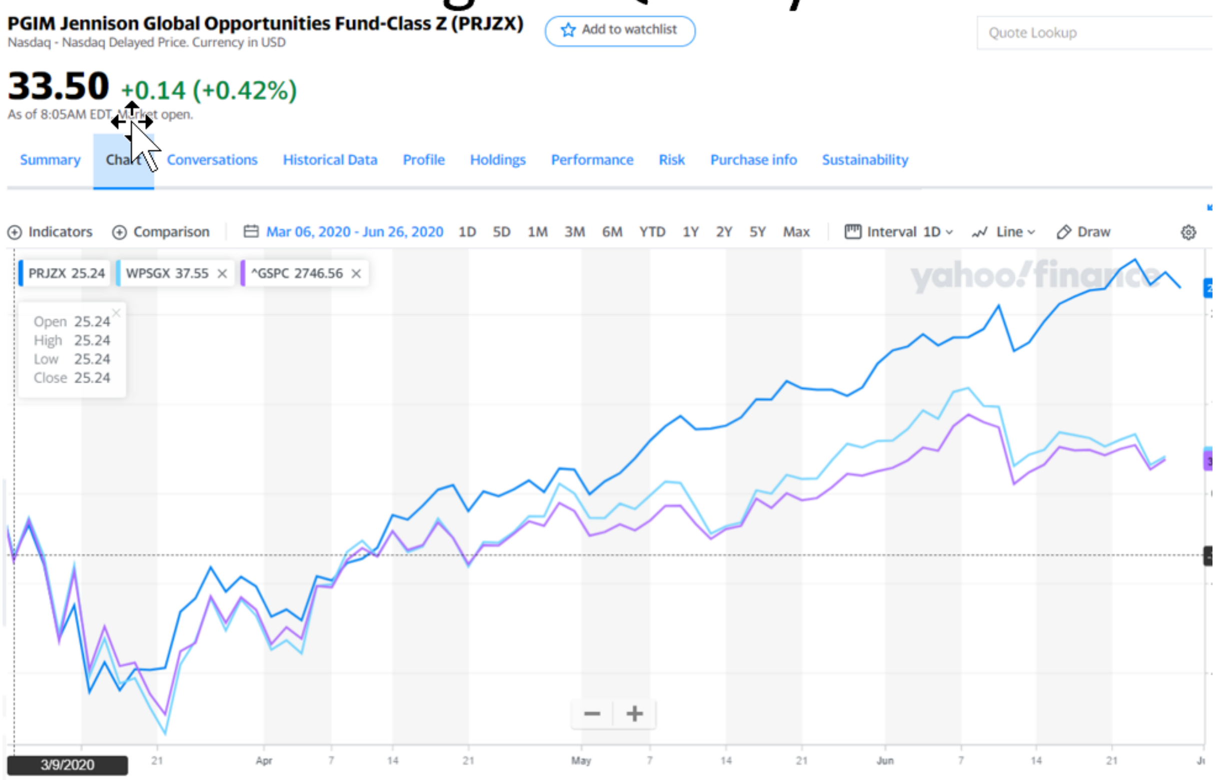
If you will recall, we got out of small-cap and international positions back in September of last year. We overweighted the higher-growth stocks that fall more in line with the NASDAQ.

Focus on Quality

When we decided to add higher-quality growth stocks at the beginning of March, we chose to do so by adding two separate mutual funds that had very specific, highly concentrated (but different) positions.[1] This is sometimes called a split-ticket trade where we want some manager diversification.

As you can see, our investment in AB Concentrated Growth (WPSGX) has slightly outperformed the S&P 500; however, there is no significant difference. Our PGIM Jennison Global Opportunities (PRJZX) (which is mostly U.S. exposure), however, has seen a significant outperformance and has helped to contribute good returns for our Strategic Portfolios.

Add Higher Quality Growth



(Yahoo Finance)

In Closing

We don't have a crystal ball. We cannot see into the future. What we have done in the past and will continue to do in the future is use the tools, resources, and our collective experience to make the best decisions possible for our clients.

[1]These two positions are represented in most of the Strategic Portfolios; however, not in all of them. Please refer to your statement for actual holdings.

Our investment process has proven to be a valuable asset during this unique time of uncertainty. We will continue to always put your best interests first, and scour the globe for compelling investment opportunities. In making small tweaks every once in a while, we can make a huge impact in the likelihood of success in your financial plans.

Remember: discipline is the key to success.

Strategic Income Group Investment Committee

Chad Manberg, CFP®, Chairman

Michael Gauthier, CFP®, Vice-Chairman (past Chairman 2013–2018)

Bob Stamm, CFP®, Member

Laurie Simons, CFP®, Member

What Are Investment Manager Meetings?

At Strategic Income Group, we believe in reviewing detailed investment research. Every 90 days we set aside a week during which around 7 to 10 investment managers give us recommendations on our current portfolios as well as share their firms' current views on the market and economy. This recap is our commentary on the most recent meetings.

Are You an Accredited Investor?

1. Did you have an annual income of $200,000 (or $300,000 for joint income) for the last two years and have the expectation of earning the same amount or higher in the future?

2. Do you have a net worth exceeding $1 million (excluding the value of your primary home)?

If you meet these criteria, you are considered to be an accredited investor. This allows you to have access to special investments not available to all investors. The Strategic Income Group Investment Committee has researched and screened out specific opportunities that might be right for you. Please contact your advisor to learn more.

Did You Know?

Strategic Income Group has an official financial planning process called "The Three Phases of Wealth" designed to help you wherever you're at in your financial journey.

Visit https://strategicincomegroup.com/start/ to learn and set some financial goals!

Questions?

If you have any questions whatsoever regarding our investment manager meetings or any of the notes, give us a phone call or stop by our office:

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My Notes and To-Dos