February 2020

SOL CAPITAL MANAGEMENT COMPANY

CLIENT INVESTMENT LETTER

The fourth quarter of 2019 closed a year of surprisingly strong returns from global financial markets. Coming off a down market in 2018, global equities (led by the U.S.) rallied in the face of slowing economic activity, falling business confidence, and heightened trade and geopolitical tensions. Central banks provided fresh support to the financial system to keep markets stable through the uncertainty, but also in the hope of generating long-elusive inflation, especially in developed economies.

The end of the quarter also marked the turn of the decade and serves as an opportune moment for us to reflect on the trends we witnessed in the past ten years and talk about expectations for the decade to come. As such, we are diverging from our letter's typical structure to spend more time discussing how we interpret the current economic and market environments and how we plan to navigate them.

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Global Markets & Economic Update

Equity Markets

Global equities exhibited strong gains during the fourth quarter, adding to an already robust performance for 2019 (see Exhibit 1). A return to more accommodative interest rate policy, a pending "phase one" trade deal between the U.S. and China, and receding recession fears buoyed investor sentiment. In U.S. markets, growth in

Exhibit 1: Total Return for Major Equity Indices

Major Equity Indices	Total Return* Quarter-to-Date (%)	Total Return* Year-to-Date (%)
S&P 500 Index	9.1	31.5
Russell 3000 Index (Total U.S. market)	9.1	31.0
Russell 2000 Index	9.9	25.5
MSCI All Country World ex-U.S. Index (Net)	8.9	21.5
MSCI EAFE (International) Index (Net)	8.2	22.0
MSCI Emerging Markets Index (Net)	11.8	18.4
MSCI ACWI Commodity Producers (Net)	7.6	13.0

Source: Bloomberg LP. Data as of 31 December 2019
*Includes price appreciation plus dividends and/or interest.

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Global Markets & Economic Update Cont.

corporate earnings continued its slow decline, pressured by rising wages and input costs, yet the backdrop of a tight labor market and a strong consumer eased market anxiety. Developed non-U.S. equity returns were strong as well, though not enough to match their U.S. peers. Reduced global trade tensions, easing monetary and fiscal conditions in many countries, and an approaching consensus on a Brexit deal contributed to positive returns. Additionally, emerging market stocks rallied during the final three months of the year, outpacing most major global indices. Nevertheless, the robust advances were insufficient to make up for a weaker start to 2019, underperforming developed market indices for the year.

Fixed Income Markets

Bond markets around the world were generally flat in the fourth quarter after accumulating significant gains during the first three quarters of 2019 (see Exhibit 2). In the U.S., the yield curve un-inverted[1] as longer-term interest rates rose in response to diminishing recession fears, and the Federal Reserve cut short-term rates in October. Tax-exempt municipal bonds fared slightly better than taxable bonds, as demand for municipals remained strong.

Outside the U.S., bonds in developed markets produced small gains in U.S. dollar terms, aided by stronger European currencies. Emerging market debt appreciated strongly in dollar terms and outperformed bonds in developed markets, as the asset class continued to benefit from global investors' hunger for yield.

"Bond markets around the world were generally flat in the fourth quarter after accumulating significant gains during the first three quarters of 2019 (see Exhibit 2)."

Exhibit 2: Total Return for Major Fixed Income & Hedge Fund Indices

Major Fixed Income & Hedge Fund Indices	Total Return* Quarter-to-Date (%)	Total Return* Year-to-Date (%)
Bloomberg Barclays U.S. Aggregate Bond Index	0.2	8.7
Bloomberg Barclays U.S. Government/Credit Index	(0.0)	9.7
ICE BofAML 1-3 year U.S. Broad Market Index	0.6	4.1
ICE BofAML U.S. High Yield BB-B Bond Index	2.6	15.1
JP Morgan Non-U.S. Global Bond Index (GBI) Hedged	(1.9)	8.0
JP Morgan EMBI Global Index in USD (Emerging Markets)	2.1	14.4
HFRX Equal Weighted Strategies Index (Hedge Funds)	1.9	5.3

Source: Bloomberg LP. Data as of 31 December 2019
*Includes price appreciation plus dividends and/or interest.

[1] As measured by 10-year minus 3-month U.S. Treasury yields.

The Global Economy

Global economic growth remains positive but sluggish. After a sharp tightening in financial conditions in late 2018 and the prolonged trade policy uncertainty that followed into much of 2019, leading economic indicators are showing signs of improvement. A combination of monetary easing and a perceived de-escalation of trade tensions should benefit export-sensitive economies such as Germany, South Korea, and Taiwan the most. Germany's manufacturing sector, which accounts for twice as much of relative GDP than in the U.S., is already showing signs of stabilization.

Given this backdrop, estimates of global GDP growth are marginally higher for 2020 (see Exhibit 3), and we believe the risk of immediate global recession has receded.[2] In addition to the extensive stimulus from central banks, most advanced economies (especially the U.S.) are benefitting from the solid financial position of households. A tight labor market, rising wages, and a recovery in the U.S. housing market have allowed for robust consumer spending, offsetting the slowdown in business investment over the past several quarters.

While China's economic growth levels are still much higher than developed market

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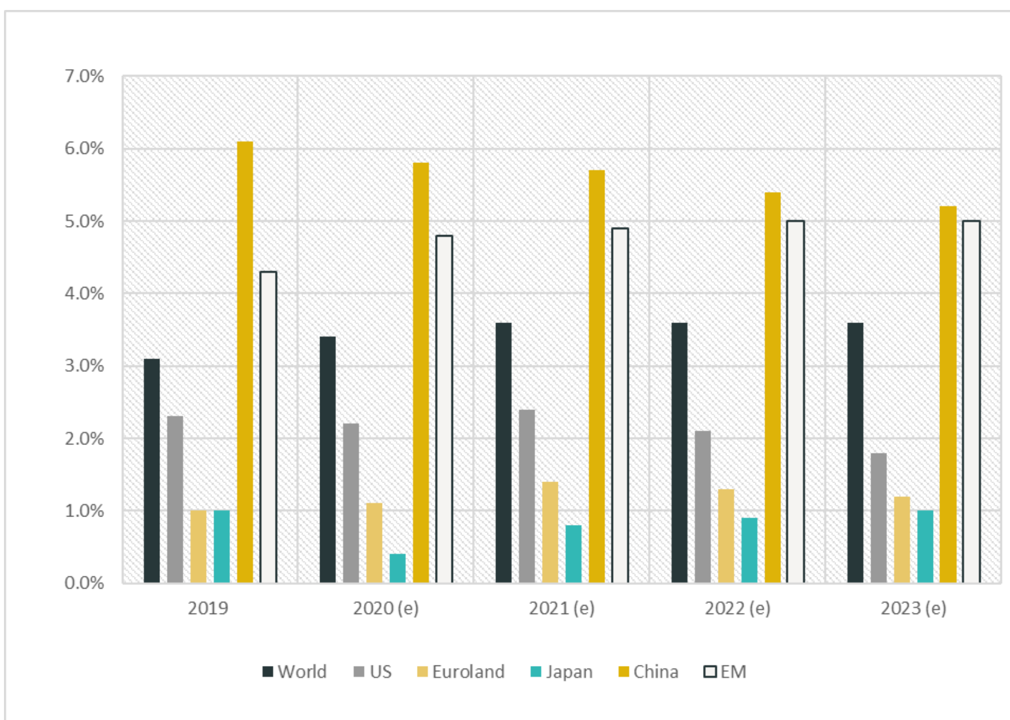
Exhibit 3: Real GDP Growth Estimates



[2] Goldman Sachs Economic Research, 20 November 2019

Global Markets & Economic Update Cont.

> *"In Europe, beyond the recovery in the German manufacturing sector, headwinds from the prolonged Brexit uncertainty should begin to abate, easing financial conditions in the United Kingdom."*

economies, its rate of expansion continues to moderate as the economy matures. The central government emphasizes that it will provide just enough fiscal and monetary support to maintain stability (but not acceleration) in order to keep credit growth under control. Furthermore, the recent outbreak of coronavirus, whose risk is not yet fully understood, presents a new challenge for the government, economy, and markets to absorb. Therefore, going into 2020, China may not be the main engine of global growth.

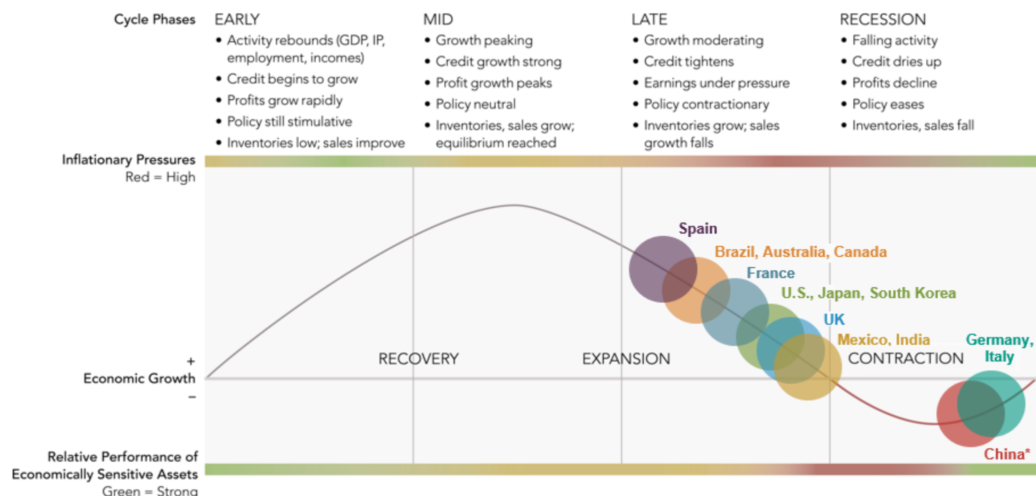
In Europe, beyond the recovery in the German manufacturing sector, headwinds from the prolonged Brexit uncertainty should begin to abate, easing financial conditions in the United Kingdom. Also, after years of austerity, government budgets are turning more expansionary across the continent, even in Germany. However, the level of fiscal stimulus announced so far will most likely fall short of what new ECB President Christine Lagarde has called for and is therefore not expected to significantly boost growth.

Outlook & Positioning

Late-Cycle Dynamics

In previous Client Investment Letters, we have commented on most major economies finding themselves in the later stages of the economic cycle (see Exhibit 4). It has been nearly 11 years since the bottom of the Global Financial Crisis and despite a few mild bumps along the way, the U.S. is experiencing its longest economic

Exhibit 4: Current Status of the Business Cycle



Note: The diagram above is a hypothetical illustration of the business cycle. There is not always a chronological, linear progression among the phases of the business cycle, and there have been cycles when the economy has skipped a phase or retraced an earlier one. * A growth recession is a significant decline in activity relative to a country's long-term economic potential. We use the "growth cycle" definition for most developing economies, such as China, because they tend to exhibit strong trend performance driven by rapid factor accumulation and increases in productivity, and the deviation from the trend tends to matter most for asset returns. We use the classic definition of recession, involving an outright contraction in economic activity, for developed economies.
Source: Fidelity Investments (AART), as of 12/31/19.

Fidelity INVESTMENTS

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expansion and bull market on record, the lengths of which have market participants endlessly postulating what it all means.

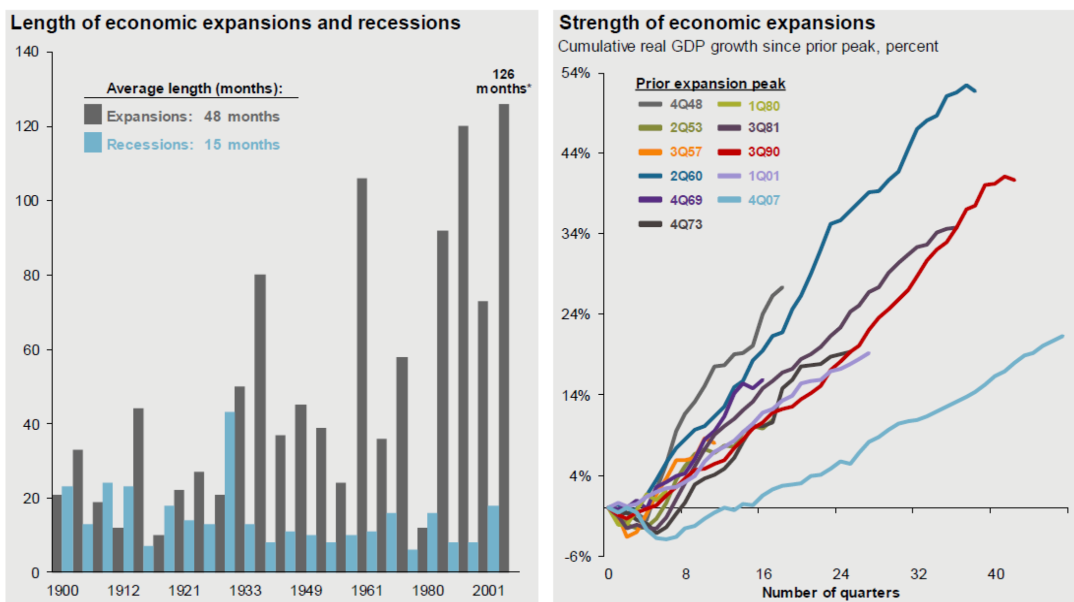
Time suggests the current investment cycle is well past late stage. On average, bull markets last five years.[3] Yield curve inversions often appear late in economic cycles (as it did in August[4]) as investors grow anxious about signals of an approaching recession, such as slowing growth. Indeed, and by several measures, the global economy showed signs of slowing growth and investment in 2019.

However, while the market cycle is surely ageing, we are encouraged by the fact that many other late-cycle signals are notably absent. Compared to historical averages, wage pressure remains muted, only recently breaching 3% in late 2018. Also missing are extreme pent up imbalances, such as leverage, housing costs, and commodity prices. The lack of these bubbles is unsurprising if one considers that this expansion, despite being the longest in recent history, has also been one of the tamest (see Exhibit 5).

More importantly for a late-cycle economy, the Fed remains ready and willing to help, not hinder. In addition to cutting rates and buying billions of dollars' worth of assets, the central bank was particularly proactive in averting a global liquidity panic in early autumn by soothing short-term funding markets, whose health is crucial to global banking and the flow of funds. The Fed's unremitting support, through a steady series of non-traditional measures, helped avert a repeat of the risk-off

"...while the market cycle is surely ageing, we are encouraged by the fact that many other late-cycle signals are notably absent."

Exhibit 5: The Length and Strength of Expansions



Source: BEA, NBER, J.P. Morgan Asset Management. *Chart assumes current expansion started in July 2009 and continued through December 2019, lasting 126 months so far. Data for length of economic expansions and recessions obtained from the National Bureau of Economic Research (NBER). These data can be found at www.nber.org/cycles/ and reflect information through December 2019. Past performance is not a reliable indicator of current and future results.
Guide to the Markets – U.S. Data are as of December 31, 2019.

J.P.Morgan Asset Management

[3] Bloomberg LP, Invesco

[4] As measured by the more closely followed 10-year minus 2-year U.S. Treasury yields.

Outlook & Positioning Cont.

market correction seen in the fourth quarter of 2018, and we would not be surprised to see the Fed make this liquidity injection a more permanent policy – even if it resists assigning another "Quantitative Easing" title.

"..Over the next 10 years, a consensus of institutional asset managers expects U.S. equities to continue to produce positive returns (around 6%), but less than in the previous decade, and potentially less than their international counterparts."

Looking Ahead

While we look to moderating growth in the United States and a soft landing elsewhere, the longer this period of globally-synchronized central bank easing continues, the more markets may become reliant on excess liquidity and develop imbalances that make them even more vulnerable to deeper corrections.

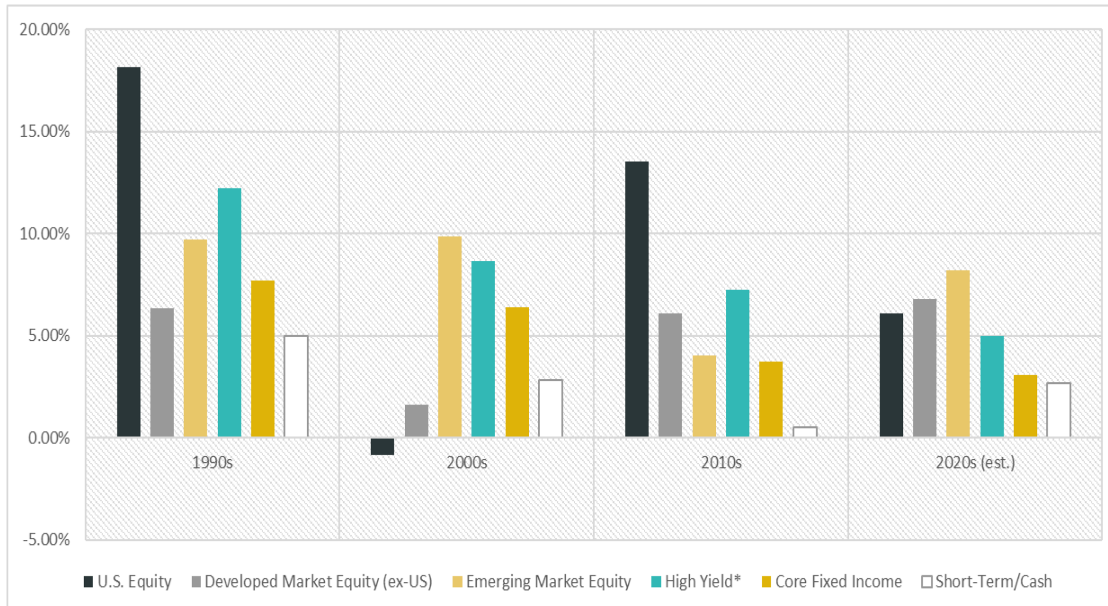
A key item for investors to monitor is how low interest rates are impacting the pricing of financial assets. Since rates have been so low for so long, investors have continuously been pushed into pursuing higher risk assets (e.g., equities, below-investment-grade debt) to achieve necessary returns. This steady demand, not to mention the near-absolute commitment from central banks to purchase assets, has created a tide in financial markets over the past decade – lifting asset prices up while at the same time crushing market volatility underneath. This is a major reason for the exceptional and relatively smooth returns of risk assets over the past decade, particularly U.S. equities.

As shown in Exhibit 6, over the past 30 years, longer-term returns of U.S. equities have exhibited the same type of volatility one might expect on a year-by-year basis. The U.S. in the 1990s witnessed a booming economy that generated over 18% annualized returns (and bloated market valuations). By contrast, investors saw an annualized negative return (-0.85%) in the 2000s as the U.S. economy and markets traversed the bursting of the Dot Com Bubble and the Global Financial Crisis. Finally, during the 2010s, U.S. equities produced the best return versus all other major asset classes, returning an average 13.5% per year.[5] We do not believe these kinds of returns are sustainable over the long term (i.e. the same time horizon one needs when investing in equities). Extraordinary monetary policy may extend them, but cycles, as described above, still exist in the global economy, as well as in financial markets. Over the next 10 years, a consensus of institutional asset managers expects U.S. equities to continue to produce positive returns (around 6%), but less than in the previous decade, and potentially less than their international counterparts.

[5]As measured by the total return of the S&P 500 Index.

Outlook & Positioning Cont.

Exhibit 6: Annualized Returns Across the Decades



The return estimates for the 2020s are the average 10-year capital market assumptions of BlackRock, Bank of New York Mellon, Invesco, JPMorgan, UBS, Envestnet, Voya Financial, and Prudential, as published in 2019. Indices used are the S&P 500 Index, MSCI EAFE Index, MSCI Emerging Markets Index, Bloomberg Barclays Global High Yield Index, Bloomberg Barclays U.S. Aggregate Bond Index, and the S&P U.S. Treasury Bill 0-3 Month Index, respectively. *Inception date of the high yield index was 31 January 1990; all other indices were incepted prior to 31 December 1989.

Portfolio Positioning

In the nearer term, global markets remain vulnerable to several sources of volatility this year, including any change in central bank policy, the persistent long shadow of existing (if not new) trade disputes, geopolitical flare ups, the general election in the United States, and any worsening of the coronavirus outbreak in China.

Given the potential imbalances accumulating and the broad range of downside catalysts, we remain cautious and prudent. We are taking gains from the most over-valued sectors and asset classes and re-deploying the proceeds into more attractively valued areas, with an emphasis on quality (i.e. strong competitive advantages and sustainable revenues).

Furthermore, we continue to rebalance portfolios to their long-term targets. We want to ensure (where appropriate) that clients remain exposed to equities (as they continue to offer greater expected future returns versus bonds), but that they also have full fixed income allocations to provide stability and meet any liquidity needs during volatile episodes.

"We want to ensure (where appropriate) that clients remain exposed to equities (as they continue to offer greater expected future returns versus bonds), but that they also have full fixed income allocations to provide stability…"

In Closing

> "Given the last decade, though no one can be certain, the consensus opinion is that we need to be prepared for lower returns."

The fourth quarter of 2019 ended a decade of exceptional returns for risk assets, most notably U.S. equities. The decade began with global economies pulling up from the depths of the Global Financial Crisis, but with most individuals anxious and uncertain about the future, not least about investing. Nevertheless, apart from a few mid-cycle slowdowns, the U.S. economy has now broken the record for its longest expansion in history, and markets have rejoiced.

The outsized returns of U.S. equities over the last ten years have been exhilarating for investors, drawing in money from the sidelines for fear of missing out. One could attribute the rally to a recovery from the "lost decade" of the 2000s, the tidal wave of cheap money provided by global central banks, investors fleeing traditional (i.e. less volatile) investments to find sufficient return, and/or simply a reflection of the U.S. economy being the "best house in a bad neighborhood" in a slow-growth environment. However, as we enter a new decade, we believe it is time to begin sobering up.

Global economies are much farther along in the cycle than at the start of the 2010s. While there is no reason to assume that markets must naturally turn negative, with such strong returns now in the rearview mirror (and developed markets growing older and more indebted), investors should not have unrealistic expectations for the future. Given the last decade, though no one can be certain, the consensus opinion is that we need to be prepared for lower returns.

Experience teaches us that trends do not last indefinitely, and the cyclical nature of economies and markets endures. Broad diversification serves as your best protection against an uncertain future. We would prefer to forego some relative performance in the short term, as certain markets push past

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new records if it means outperforming in the long term, after cycles have turned over. We would like our worst-case scenario to be that we were overly cautious.

Our number one priority is to seek to protect our clients' assets as much as possible against the permanent loss of capital, consistent with the guidelines established in each client's Investment Policy Statement. *We would not recommend investing all your assets in one asset class simply because it has done well in the recent past, nor would we advise putting 100% into another because it looks like a bargain. Further, we would not typically liquidate an entire portfolio due to doubts and uncertainties in the marketplace. Our job is not to buy into fads, or to chase the highest performing assets, but rather to invest your hard-earned wealth in a diversified manner to meet your goals and liquidity needs, in line with your risk profile.*

As always, please call us at +1 (301) 881-3727 if you have questions about your portfolio or to notify us of any changes in your circumstances, including your liquidity needs.

Sincerely,

The SOL Capital Investment Committee

"Our number one priority is to seek to protect our clients' assets as much as possible against the permanent loss of capital, consistent with the guidelines established in each client's Investment Policy Statement."

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