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SOL CAPITAL MANAGEMENT COMPANY

Client Investment Letter

Inside this issue:

Global financial markets extended their recovery during the first quarter of 2023, despite global instability and elevated volatility. January saw a strong rally in risk assets and risk-free bonds as longer-term interest rates receded. In the U.S., some of those gains were pared back in February, and especially March, as the rapid collapse of Silicon Valley Bank (SVB) caught markets off guard.

While the (now) third-largest bank failure in U.S. history was spawned by the confluence of several unique factors, including poor interest rate risk management, as well as a concentrated and particularly flighty deposit base, SVB's failure turned an indiscriminate spotlight on all financial institutions. Market volatility in the banking sector spiked over the course of the month as the visceral fear of another 2008 led many investors to dump shares of large, high-quality, well-capitalized banks alongside those of small regional banks that were facing a higher risk of deposit flight. In the span of four weeks, the collective share price of U.S. banks plunged 25%.[1]

Several institutions[2] later failed, yet another systemic financial crisis did not materialize, and the rest of the equity market escaped relatively unscathed. The speed at which regulators and larger banking peers acted to restore confidence, mitigate the risk of contagion, and coordinate the absorption of underlying assets and deposits from the failed banks reflects the industry's willingness to use its collective capital strength to avert the kind of systemic shock investors were fearing.

Markets have since recovered from their initial flight to safety (though bank shares remain a laggard), but the series of events has left many assessing the fallout of the U.S. Federal Reserve's historically aggressive policy tightening. Will the recent turmoil convince the Fed to ease off and risk a resurgence of inflation, or will it continue to hawkishly raise rates to get inflation back down to its long-term target, despite the added strains it could put on the banking sector?

For their part, markets are predicting an end to the current tightening cycle, with a growing expectation for policy rate *cuts* in the U.S. before the end of the year. Greater attention to financial stability will also lead many banking institutions to restrain credit extension going forward. This could further slow economic growth in the near term, on top of an already measurable deceleration in the manufacturing, real estate, and service sectors. Despite the negative headlines however, a recession is not guaranteed. Corporate earnings, while certainly under pressure, do not yet indicate a sharp contraction in economic activity.

More important than trying to predict the Fed's next move, the prudent course of action for investors is to heed the fundamental lesson markets have just offered. The recent mayhem in the banking sector comes on the heels of the significant correction in growth stocks last year and is yet another reminder of the critical role diversification plays in a

[1] As measured by the total return of the KBW Bank Index between 28 February and 31 March 2023.

[2] i.e., Signature Bank, Credit Suisse, First Republic Bank

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portfolio. If one business fails and the value of its stock is wiped out (or its convertible bonds in the case of Credit Suisse), it should be nothing more than a scratch to an investment portfolio, not a fatal wound. This is exactly why we seek to avoid large, concentrated positions and exposures in client portfolios. The quest for robust long-term returns must always be paired with disciplined risk management.

With both significant uncertainty and opportunity ahead, we are holding true to our core investment philosophy. We continue to focus on maintaining a well-diversified positioning across all economic sectors, investment styles, capitalization sizes, and market geographies, with a focus on quality and plenty of sources of dry powder to take advantage of temporary market dislocations.

Financial Markets Performance

"The interest rate policy of the U.S. Federal Reserve remains a key driver of asset prices globally. Equity investors entered 2023 hopeful for the end of the Fed's rate-hike cycle."

Equity Markets

The interest rate policy of the U.S. Federal Reserve remains a key driver of asset prices globally. Equity investors entered 2023 hopeful for the *end* of the Fed's rate-hike cycle. Interest rate forecasts began to predict cuts by the Fed before the end of the year, as inflation showed some meaningful declines at the start of 2023. A halt or pivot in U.S. rate policy would bode well for both U.S. equities (from a discount rate and cost of capital perspective), as well as for international equities (given the possibility of a weaker dollar).

U.S. equity markets were quick to price in potential Fed easing, with stocks managing a second consecutive quarter of positive gains between January and March, though performance varied widely (see Exhibit 1). Large-cap stocks outperformed mid- and small-cap stocks, with growth outpacing value. The prospects of lower interest rates in the near future (even if it may entail recession) helped propel gains in technology stocks, while continued growth in discretionary spending boosted the consumer sector. Financials and energy stocks lost ground as a result of the *mini*-banking crisis and lower oil prices, respectively.

The outlook for a pause or cut in U.S. rates benefited non-U.S. developed market stocks, which continued to move higher in the first quarter, led by European shares that enjoyed a better-than-expected economic backdrop. Lower-than-expected inflation (mostly due to declining energy costs following a mild winter) and the prospects of eking out positive economic growth were the main contributors. Investors, backed by the assurances of the European Central Bank of a resilient Euro-area banking sector, were relatively unphased by the banking turmoil in the U.S. and the state-orchestrated takeover of Credit Suisse by its rival UBS. Sentiment in Japan was also optimistic amidst China's reopening (and its positive effect on global trade), as well as the approaching peak in rate hikes in the U.S. Furthermore, a continued slump in the U.S. dollar provided a tailwind to returns. Performance of emerging markets stocks differed widely across countries, but on average finished the

Financial Market Performance Cont.

quarter to the upside. Mexican and Taiwanese shares advanced, benefiting from strong currency gains and a rally in technology stocks, respectively. Indian and Brazilian stocks gave up ground as inflation and growth prospects spooked investors in the former, while political instability remained a hindrance in the latter. Chinese stocks advanced early in the quarter on reopening euphoria but later gave up gains as economic normalization proved more chaotic than initially thought.

Exhibit 1

Total Return* for Selected Equity Indices	First Quarter 2023 (12/31/22 to 03/31/23) %	Year-to-Date (12/31/22 to 04/28/23) %
S&P 500 Index	7.50%	9.17%
S&P 500 Growth Index	9.63%	11.20%
S&P 500 Value Index	5.17%	6.97%
Russell 3000 (Total U.S. Market) Index	7.18%	8.32%
Russell 2000 (Small-Cap) Index	2.74%	0.89%
Russell 2000 (Small-Cap) Growth Index	6.07%	4.84%
Russell 2000 (Small-Cap) Value Index	-0.66%	-3.13%
MSCI All Country World ex-U.S. Index (Net)	6.87%	8.72%
MSCI All Country World ex-U.S. Index Growth (Net)	8.59%	9.69%
MSCI All Country World ex-U.S. Index Value (Net)	5.16%	7.77%
MSCI EAFE (International) Index (Net)	8.47%	11.53%
MSCI Emerging Markets Index (Net)	3.96%	2.78%
MSCI ACWI Commodity Producers (Net)	-1.25%	1.26%

Source: FactSet.

Fixed Income

Global fixed income markets continued their recovery from a dismal 2022 (see Exhibit 2). Yields in almost every market segment fell as investors priced in the nearing climax of policy rates. Additionally, banking fragility, investor flight to safety, and the approaching U.S. federal debt ceiling (which caps new issuance) led to a sharp rally in Treasury bonds. Yields on two-year Treasury notes dropped by a dramatic 1.3 percentage points within two weeks in March, worsening the yield

"Global fixed income markets continued their recovery from a dismal 2022 (see Exhibit 2)."

Financial Markets Performance Cont.

curve's inversion, a typical (but not foolproof) signal of an impending recession (see Appendix A). Developed market sovereign debt also experienced considerable gains with little dispersion among countries.

Returns on global investment-grade corporate bonds were positive, with U.S. securities outperforming other developed markets. Higher rated bonds in the U.S. outperformed versus lower quality paper thanks to their longer durations. A higher risk appetite for European debt yielded higher returns, particularly for lower rated bonds.

High-yield corporate ("junk") bonds posted stellar quarterly returns with lower quality names generally outperforming. Emerging market debt also advanced, yet gains were not as strong as in developed markets.

"Business cycles across major economies have become less synchronized in recent months (see Appendix B).

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One key contributor to this decoupling is how each economy responded to post-pandemic inflation."

Exhibit 2

Total Return* for Selected Fixed Income and Hedge Fund Indices	**First Quarter 2023** ***(12/31/22 to 03/31/23)*** **%**	**Year-to-Date** ***(12/31/22 to 4/28/23)*** **%**
Bloomberg Barclays U.S. Aggregate Bond Index	2.96%	3.59%
Bloomberg Barclays U.S. Government/Credit Index	3.17%	3.82%
ICE BofAML 1-3-year U.S. Broad Market Index	1.48%	1.83%
ICE BofAML U.S. High Yield BB-B Bond Index	3.57%	4.41%
JP Morgan Non-U.S. Global Bond Index (GBI) Hedged	3.82%	3.99%
JP Morgan EMBI Global Index in USD (Emerging Markets)	2.25%	2.76%

Source: FactSet

Global Economic Outlook

Business cycles across major economies have become less synchronized in recent months (see Appendix B). Manufacturing activity is decelerating in the U.S. and other developed markets, but industrial activity remains slightly expansionary in emerging markets. Meanwhile, economic activity in China is accelerating as the country leaves behind three years of relative isolation.

One key contributor to this decoupling is how each economy responded to post-pandemic inflation. Central banks in emerging markets with fresher experience with high inflation (e.g., Brazil, India, Indonesia) moved early and broke the acceleration of price increases sooner. This will offer them some breathing room as their trading partners in developed markets slow, however emerging economies broadly (but particularly south and southeast Asia) remain susceptible to shocks in food and energy prices.

Global Economic Outlook Cont.

Meanwhile, central banks in developed markets kept policy rates lower for longer, igniting an expansionary and inflationary fire that they are now quickly trying to extinguish. The effects of this monetary game of catch-up have been playing out in stock, bond, and currency markets, and will have a dampening effect on liquidity and global growth.

United States

The U.S. economy remains in late-cycle expansion, but the headwinds are gaining strength. In the first quarter, annualized real GDP growth slowed to +1.1%, down from +2.6% in the previous quarter. Even before the 2023's bank failures, lending standards had already begun tightening across multiple loan categories. The heightened focus on liquidity, solvency, and quality in the wake of the recent turmoil has only made credit conditions even tighter.

That said, despite the credit contraction, the aggregate consumer is in good shape. Household balance sheets are healthy, and while inflation has caused many to dip into savings, the aggregate level of excess savings built up since the pandemic remains well over $1 trillion (see Appendix C). Nevertheless, analysis of spending data compiled by large financial institutions shows that spending levels are trending downward and becoming more defensive in nature.[3]

The outlook for corporate earnings weakened during the first quarter, though many companies outperformed the market's heavily pessimistic expectations. Still, slower sales growth and negative earnings guidance for the remainder of 2023 will weigh.

Unemployment remains at a historic low of 3.4%, but the number of job openings dropped meaningfully over the first quarter. Furthermore, layoffs from the tech sector may soon filter through into jobless claims data as severance packages expire.

Overall, inflation is slowing, but is still nowhere near the Fed's stated 2% target. Supply chain disruptions have eased allowing goods inflation to decrease; in fact, supply chain conditions have finally normalized to pre-pandemic levels (see Appendix D). However, a tight labor market continues to boost wage inflation (albeit at a decelerating rate), which is causing higher service sector inflation. The steeply inverted yield curve suggests markets are predicting a recession may be necessary at this point to bring aggregate inflation back down to the central bank's target.

Indeed, the Fed seems to concur with markets; the central bank expects U.S. real GDP to manage only 0.4% growth for the entire year and for the unemployment rate to rise by more than one percentage point (to 4.5%) by December.[4] Even though markets soundly predicted one more 0.25% rate hike in May, they are also predicting a rapid pivot to rate cuts during the second half of the year as the economy loses momentum. However, if inflation numbers remain elevated, the Fed may not be able to ease policy as quickly as markets are currently predicting, certainly not back to the zero-bound (absent a major exogenous shock).

"Overall inflation is slowing but is still nowhere near the Fed's stated 2% target. Supply chain disruptions have eased allowing goods inflation to decrease; in fact, supply chain conditions have finally normalized to pre-pandemic levels (see Appendix D)."

Europe

The European economy also remains in late-cycle expansion, though several national economies have been oscillating between growth and contraction over the last several

[3] Source: JPMorgan

[4] Federal Open Market Committee forecasts, March 2023.

Global Economic Outlook Cont.

" In comparison to slowing economies in the U.S. and Europe, China has emerged into early-cycle expansion. The economy grew at an annualized 4.5% in the first quarter, and analysts are increasing their growth expectations for the year to 6% and above."

quarters. Falling energy prices have removed one major inflationary catalyst, but wage inflation pressures are still building. Germany, the region's largest economy, raised its minimum wage by nearly 15% in October, and the resilience of labor unions in recent wage negotiations point to further inflation ahead. As a result, even as economies teeter on the edge of recession, the European Central Bank, Swedish Central Bank, and the Bank of England have all reiterated hawkish language about the need for future rate hikes.

China

In comparison to slowing economies in the U.S. and Europe, China has emerged into early-cycle expansion. The economy grew at an annualized 4.5% in the first quarter, and analysts are increasing their growth expectations for the year to 6% and above.[5] Consumer spending has roared back amid the post-Zero-Covid reopening, but the magnitude and duration of this economic expansion is uncertain.

Fiscal and monetary policymakers appear to be working in tandem to further stimulate the economy, particularly through encouraging private investment in technology and innovation (in response to geopolitical tensions), as well as in other priority areas for the central government (infrastructure and carbon reduction). That said, many challenges to the longer-term trajectory of the Chinese economy remain. Excess leverage in the financial system, particularly in the housing sector, has been a consistent problem for well over a decade.

Furthermore, youth unemployment is approaching 20%, a third higher than in the euro area and nearly three times the rate in the United States.

Investment Strategy

Equities

Though the recovery in risk assets that began late last year continued through the first quarter, much uncertainty remains in financial markets. Sticky inflation, downward earnings revisions, a slowing economy, and recession worries persist. Meanwhile, fragilities in the banking system have emerged. These factors, combined with above-average valuation multiples relative to the last five-to-ten years, are headwinds for the performance of the overall equity market in the U.S.

Under the surface however, we continue to see styles, sectors, and companies that appear interesting long-term investment opportunities. For example, certain quality growth names remain attractively valued after meaningful corrections in 2022 and provide clearer visibility on future cash flows versus their riskier peers, even in the face of a more difficult economic environment.

Overall, we expect elevated levels of volatility for the remainder of the year. Pockets of value may temporarily emerge in certain sectors, as we witnessed in the banking sector; others may soon follow. Politics may also cause additional anxiety for markets over the coming months as federal debt

[5] Source: Bloomberg

Investment Strategy Cont.

ceiling negotiations between Congress and the White House will likely go into the 11th hour.

Fixed Income

We are generally more optimistic on fixed income than we have been in many years. While further Fed tightening to combat persistent inflation is an obvious risk, today's much higher yields versus recent history provide a reasonable cushion for investors. The disruption in the banking system also serves as a counterbalance to the Fed's tightening agenda, which could limit how high rates go and/or how quickly they could get to the terminal rate given the need to maintain stability in the financial system (and by extension the aggregate economy).

Should the economic environment deteriorate more drastically, we believe a quality fixed income exposure can offer reasonable protection to dampen portfolio volatility. Within our fixed income allocations, we see flexible-mandate managers moving up the quality spectrum and selectively adding duration to position for this outcome. We are also seeing more signs from bond managers of emerging opportunities outside the U.S. given elevated yields, a more constructive economic outlook, and a weakening dollar.

"We are generally more optimistic on fixed income than we have been in many years. While further Fed tightening to combat persistent inflation is an obvious risk, today's much higher yields versus recent history provide a reasonable cushion for investors.

In Conclusion

Despite the robust returns, the first quarter of 2023 certainly saw its fair share of market volatility. Several high-profile bank failures served as a sobering reminder of the impact interest rate policy has on the overall stability of the banking sector. While the *mini* crisis triggered turbulence in rates markets and bank stocks, the rest of the equity market remained relatively insulated and on track to continue its recovery from last year's declines. However, we are not out of the woods yet. The trajectory of inflation, interest rates, economic growth, and exchange rates are all far from certain. In environments such as this, diversifying away idiosyncratic risks and maintaining numerous sources of potential return in a portfolio is critical. It is not a time to take outsized positions in any specific company, industry, or sector, but rather to focus on long-term returns while managing short-term risks and requirements. The good news is that at current rates, investors are getting paid well to be patient while pursuing the most attractive long-term investment opportunities as they emerge. We, and the outside active managers we employ, continue to work hard to make our portfolios more efficient, take advantage of market volatility, and better position our clients to meet their long-term goals.

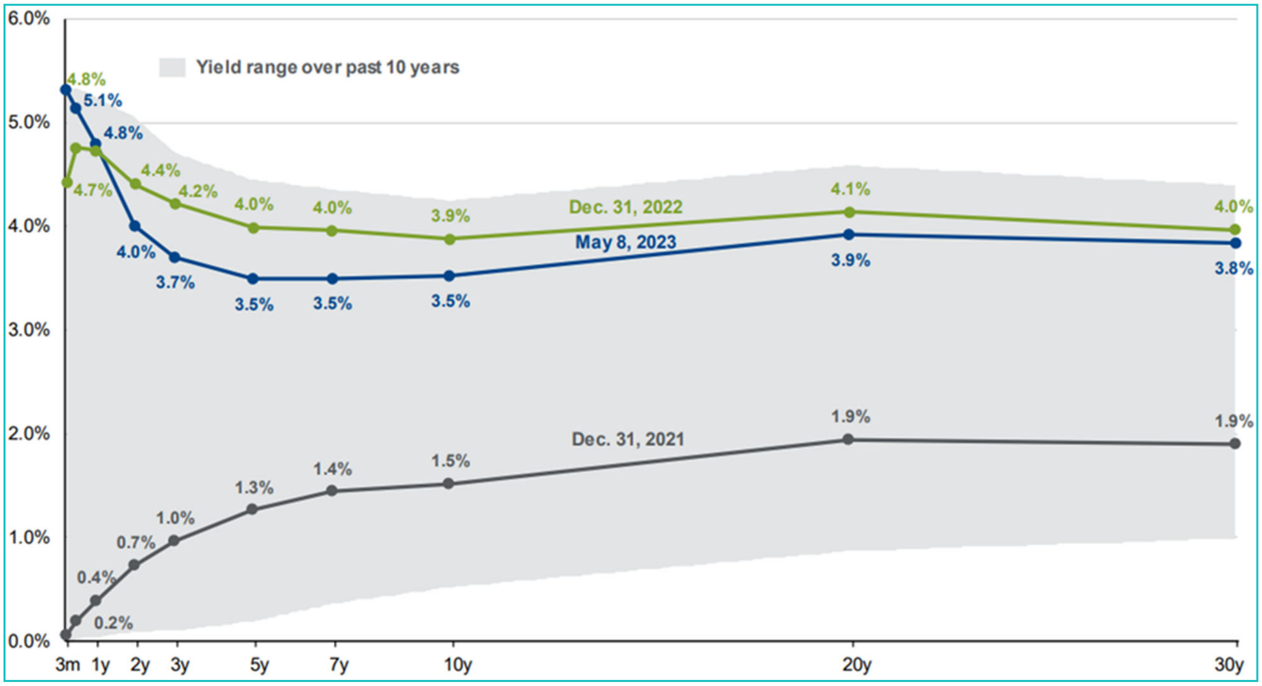
If there are any changes in your risk tolerance, liquidity needs, and/or investment goals, please contact us so we may have a constructive conversation about any changes that may (or may not) need to be made to your investment portfolio. Additionally, if you have any questions or concerns about financial markets, please never hesitate to call us at +1 (301) 881-3727 or email us at client.services@sol-capital.com.

With our best regards,

SOL Capital Management Company

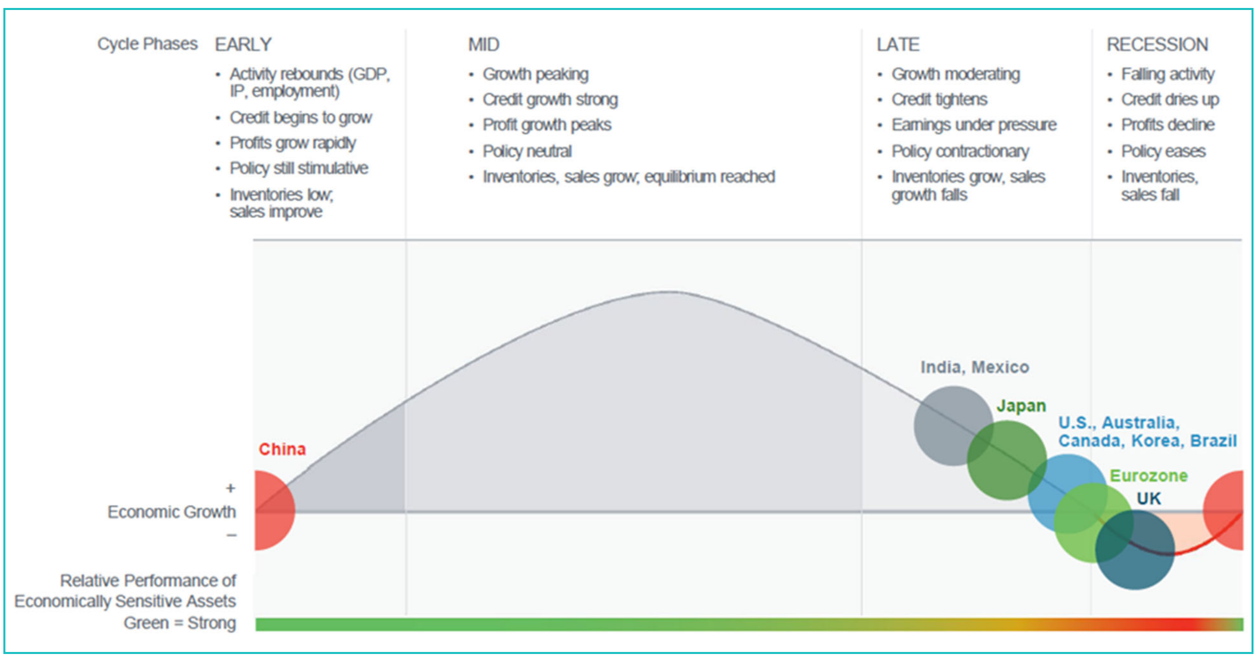
Appendices

Appendix A: The U.S. Treasury Yield Curve



Source: JPMorgan Asset Management.

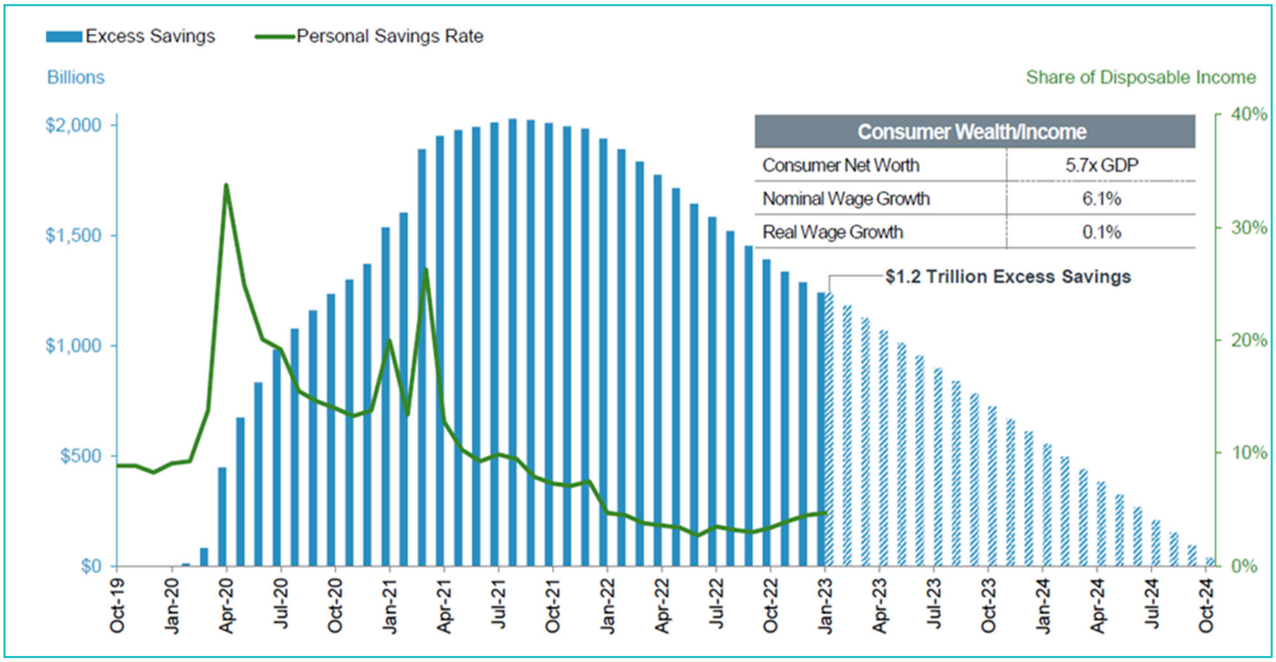
Appendix B: The Global Business Cycle Framework



Source: Fidelity Investments. Data as of 31 March 2023.

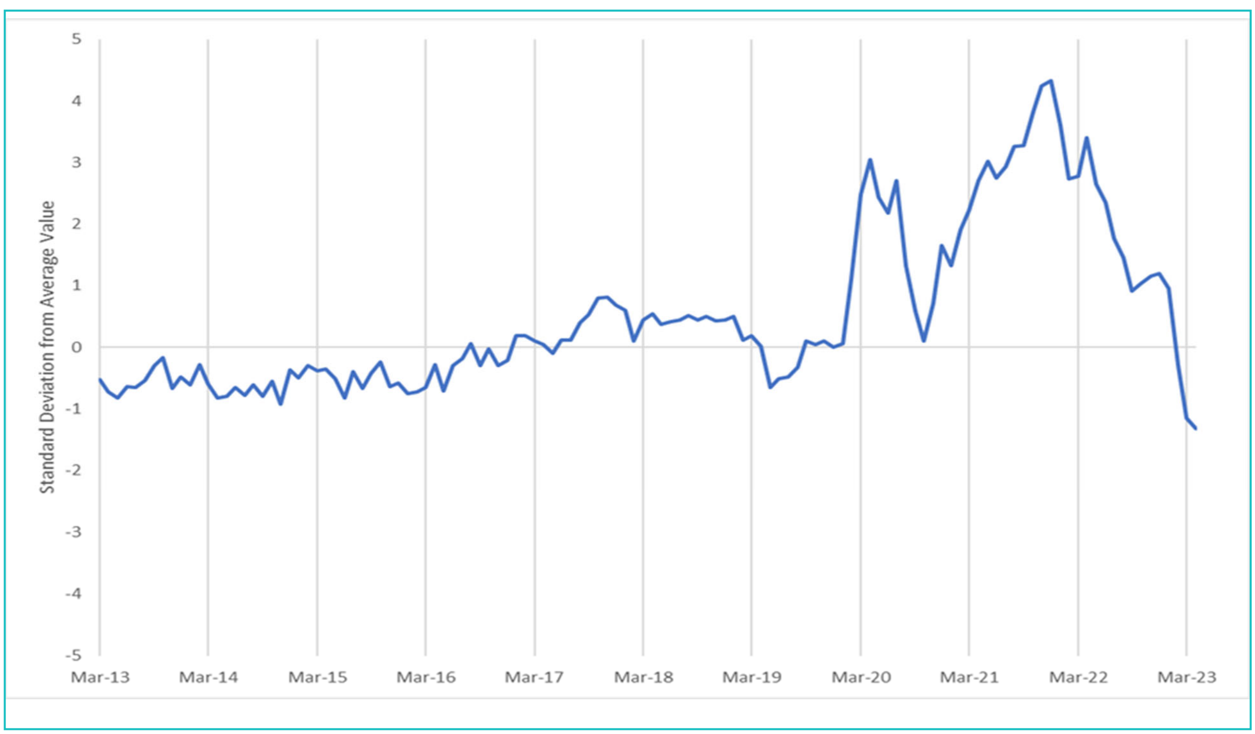
Appendices

Appendix C: Post-Pandemic Excess Savings



Source: Fidelity Investments. Data as of 31 March 2023.

Appendix D: Global Supply Chain Pressure Index



Source: Federal Reserve Bank of New York. Data as 30 April 2023.

SOL CAPITAL MANAGEMENT
111 Rockville Pike, Suite 750
Rockville, MD 20850
Phone: 301.881.3727

3 Columbus Circle, Suite 2120
New York, NY 10019
Phone: 212.710.4698

www.sol-capital.com
E-mail: sol@sol-capital.com

Disclosures

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