SOL CAPITAL MANAGEMENT

Client Investment Letter

August 2023

Global financial markets delievered mixed results during the second quarter. Risk assets built strongly on their robust first-quarter returns. The equity market rally, which since March had been dominated by just a handful of giant-cap companies, began to broaden out. Meanwhile, bond markets gave up on their expectations for interest rate *cuts* by the Federal Reserve any time in 2023 (see Appendix A). Sustained (though easing) inflation numbers and a resilient labor market continue to suggest the U.S. economy will glide to a soft landing or light recession rather than crash into a deeper recession, as analysts had previously forecasted.

While the increasing breadth of the equity market's rally is encouraging, thanks to the upward charge of the "Magnificent Seven,"[1] valuations are no longer cheap. At the end of July, the S&P 500 Index was trading at over 19.5 times forward earnings, nearly one standard deviation above its 25-year average, which notably still includes the dot-com bubble. Furthermore, the dispersion in valuations between the top 10 and remaining 490 stocks in the Index is returning to the lofty levels witnessed in 2020-21 (see Appendix B). Earnings disappointments, either due to a continued squeeze in profits from rising input/labor costs, a slump in demand as economic growth continues to cool from the post-pandemic peak, and/or a policy surprise from the Fed could trigger a quick revaluation of U.S. equities.

That said, while high valuations set high expectations that S&P 500 firms will have to meet quarter-to-quater, there is still cause for optimism over the medium- to long-term. As the Fed nears the end of its most aggressive rate-hiking cycle in four decades, tamed inflation, a strong job market, and a healthy consumer base offer hope that the the U.S. market will remain a global growth star, especially as China's economic engine continues to sputter.

Amid the uncertainty, we continue to focus on balancing upside return potential with the downside risk. Broad exposure to the market, even at higher valuations is essential, especially as passive indexing strategies add momentum to a rally. However, complementing that exposure with active strategies that seek to avoid the most challenged high-fliers and that offer

[1] Apple Inc. (AAPL), Microsoft Corp. (MSFT), Alphabet Inc. (GOOGL + GOOG), Amazon.com Inc. (AMZN), NVIDIA Corp. (NVDA), Tesla Inc. (TSLA), and Meta Platforms Inc. (META).

exposure to undervalued quality companies is also prudent. While this top-heavy market environment is reminiscent of 2020-21, a noticeable difference is the incredible opportunity offered to investors in the fixed income market. While risk abounds in equity markets, it is now significantly easier to balance out that risk with high-quality bonds that offer compelling yields. We do not know how the market will perform between now and the end of 2023, but we continue to prudently rebalance portfolios, improve tax efficiency, and stand ready to take advantage of market volatility should it pick up in the remaining months of the year.

Financial Market Performance

EQUITIES

Global equity markets delivered positive returns during the second quarter, as investors closely monitored central banks' interest rate policies (see Exhibit 1). Inflationary pressures, geopolitical tensions, and economic headwinds were still a concern, but the growing likelihood of an easing of monetary policy (now seemingly in 2024) helped market participants focus on the potential for better earnings down the road.

U.S. stocks posted another strong quarter. Large-cap growth stocks, led by the Magnificent Seven significantly outperformed all other market caps, largely due to increased interest in generative artificial intelligence (AI). Stocks in the consumer discretionary and communication services sectors also benefited from the

Exhibit 1 – Equity Market Returns

Benchmark Index	2nd Quarter 03/31/2023 – 06/30/2023	Year-to-Date 12/31/2022 – 06/30/2023	Year-to-Date 12/31/2022 – 07/31/2023
S&P 500 (*Large Cap*)	8.74%	16.89%	20.65%
S&P 500 Growth	10.59%	21.25%	24.94%
S&P 500 Value	6.64%	12.15%	15.98%
Russell 2000 (*Small Cap*)	5.21%	8.09%	14.70%
Russell 3000 (*Total U.S.*)	**8.39%**	**16.17%**	**20.33%**
MSCI EAFE (*Developed Markets*)	2.95%	12.13%	15.28%
MSCI EM (*Emerging Markets*)	0.90%	5.10%	11.42%
MSCI ACWI ex-U.S. (*Total Int'l*)	**2.44%**	**9.86%**	**13.92%**

Source: FactSet. Performance data presented above is total return (price appreciation plus dividend and/or interest income). Non-U.S. equity benchmark returns are presented net of foreign taxes.

Financial Markets Performance cont.

enthusiasm around AI. On the value side of the market, financial stocks stabilized as the fallout from March's regional banking crisis appeared to be contained.

Non-U.S. developed market stocks also gained ground amid expectations of slowing inflation and a nearing end to monetary policy tightening by the European Central Bank. However, gains were somewhat muted, as the post-pandemic economic recovery in China (a key trading partner) was moving at a much slower pace than expected. Major equity benchmarks in Germany, France, and Italy moved higher, but U.K. stocks declined due to a strengthening pound. Meanwhile, foreign investors poured money into Japanese stocks. The weak yen has benefited local exporters and supports a rebounding tourism industry.

Stocks in emerging markets managed small gains despite significant losses in Chinese equities. A contraction in manufacturing activity, a slowdown in consumer spending, and increasing inflationary risks (not to mention rising tensions with the U.S.) kept investors on the sidelines. Still, shares in India, Taiwan, and Brazil advanced on encouraging economic data, AI optimism, and easing fiscal policy concerns, respectively.

FIXED INCOME

Global fixed income markets were generally weaker during the second quarter (see Exhibit 2). The realization that policy rates would likely remain higher for longer than previously anticipated led to a sell-off across almost all fixed income sectors.

U.S. Treasuries delivered negative returns with rates on shorter maturities rising more than those on longer maturities, further inverting the yield curve. Most other developed market sovereign bonds lost ground as well.

Exhibit 2 – Bond Market Returns

Benchmark Index	2nd Quarter 03/31/2023 – 06/30/2023	Year-to-Date 12/31/2022 – 06/30/2023	Year-to-Date 12/31/2022 – 07/31/2023
Bloomberg U.S. Gov't/Credit	-0.93%	2.21%	2.13%
ICE BofAML 1-3 Year U.S. Broad	-0.30%	1.18%	1.62%
Bloomberg U.S. Aggregate Bond	**-0.84%**	**2.09%**	**2.02%**
ICE BofAML U.S. High Yield BB-B	1.25%	4.86%	6.22%
JPM Non-U.S. GBI (hedged)	-1.36%	1.96%	2.21%
JPM EMBI Global (in USD)	1.53%	3.81%	5.48%

Source: FactSet. Performance data presented above is total return (price appreciation plus dividend and/or interest income).

Financial Markets Performance cont.

U.S. corporate bonds fell modestly and lagged their eurozone counterparts. Sterling corporates were significantly lower, as core inflation intensified in the U.K. Meanwhile, lower durations and improved risk appetites generated positive returns for high-yield bonds, both in the U.S. and in the eurozone. Emerging market debt, both in local currency and U.S. dollars, also delivered positive returns.

Global Economic Update

Global economic growth persisted in the second quarter but continued to cool from its post-pandemic peak. Inflation continues to decelerate, yet it has not reached levels at which global central banks would feel comfortable declaring victory.

There are risks of further slowing ahead, particularly if financial conditions remain restrictive for an extended period and begin to constrain demand. That said, there are still several structural factors that may allow many economies to avoid falling into recession, barring an exogenous shock.

UNITED STATES

Despite historic monetary policy tightening, a mini-banking crisis, and deep (yet improving) pessimism among consumers, the U.S. economy remains in late-cycle expansion, staving off recession thanks to a relatively healthy consumer base.

However, the housing market, a key leading indicator of economic activity, would suggest otherwise. Residential investment has indeed declined over the last twelve months, but the tight supply of available homes is helping to support the market, even in the face of higher mortgage rates.

More promising for the U.S. economic outlook, consumer spending remains robust, corporations have plenty of cash on hand to service debt obligations (even at higher borrowing rates), and the banking system remains well capitalized, especially as banks (large and small) continue to shore up their balance sheets amid closer scrutiny from investors and regulators.

While the Fed is approaching the end of its rate-hiking cycle, a tight labor market and continued wage inflation in the services sector may make the central bank's goal of reducing core inflation to 2% more difficult to achieve. This translates to higher-for-longer interest rates, which will most likely worsen prospects for medium-term growth.

EUROPE

Headwinds appear more pronounced for the European economy. While the region avoided recession over the winter, second-quarter GDP growth was likely flat. A slowdown particularly in German manufacturing, due in

Global Economic Update cont.

part to tighter financial conditions, excess inventories, and weaker demand from China, is weighing.

However, headline inflation is easing, and wage growth remains firm amid a rebounding job market. Real disposable income is expected to increase at over 2% this year, and consumers (in aggregate) are still sitting on their pandemic-era excess savings, in stark contrast to their U.S. peers (see Appendix C). All this could bode well for future consumption.

CHINA

Much enthusiasm surrounded China's re-opening from pandemic-era lockdowns, however the economy so far has not lived up to expectations. A continued slump in the country's property market, weak consumption, high youth unemployment, and overall investor pessimism will require further stimulus from central policymakers. Weakness in the world's second-largest economy will likely further weigh on the growth prospects of other economies in developed Asia, as well as broad emerging markets, in the near term.

Investment Strategy

EQUITIES

While it is too soon to declare victory on the inflation front, recent trends are encouraging and have buoyed prices of risk assets in recent months. While we acknowledge that conditions have improved at the margin, we remain cautious as equity valuation multiples sit at relatively high levels. Furthermore, it is challenging to build a high degree of confidence in the trajectory of corporate earnings through 2024 and 2025. Moreover, sustained restrictive policy by the Fed may put pressure on liquidity in financial markets, triggering more volatility than we have experienced so far this year.

Amid the mixed outlook, we continue to maintain a well-diversified equity exposure, in-line with policy targets. We continue to rebalance portfolios with a preference for large- and mid-cap stocks over small caps, where we suspect the risk-reward trade-off will be more challenged over the next few years. This does not mean that we are concentrating solely on the handful of giant-cap companies that have been driving overall market returns so far this year. Rather, we see attractive opportunities, both in growth and value, as this year's rally broadens out beyond the top five-to-ten names.

In international markets, we remain cautiously optimistic, particularly in developed markets such as Europe and Japan. Despite a reasonably strong first half of 2023, the risk-return outlook remains attractive as the economic picture resembles the U.S. but with a lag. We see greater breadth in these markets (more diverse sector exposure and less extreme technology concentration). Furthermore, a rather large valuation gap versus the U.S., as well as the projected depreciation in the U.S. dollar, may serve as positive catalysts for improved returns in the medium term.

In emerging markets, we still see promising long-term potential, though we recognize China's ever-increasing dominance in the index, as well as the many economic challenges that the country is facing. Currently, we favor gaining exposure to the emerging market growth theme (particularly its growing consumer base) via established multinational companies that already have a significant presence. That said, we still maintain a meaningful local exposure, albeit less than in the past.

FIXED INCOME

We remain optimistic on fixed income given their current attractive risk-adjusted returns as we enter the final stages of the policy tightening cycle. While the probability of a recession in the U.S. has declined considerably, it is still an outcome that prudent investors should consider. Whether it comes to fruition or not, a quality bond portfolio, particularly one that starts at higher yields, has proven over time to be a beneficial hedge against risk-off episodes in equity markets.

Within fixed income allocations, we are beginning to add back core bond exposure, locking in higher yields, and buying more protection against future equity market volatility. This, we believe, combined with many of our flexible-mandate managers increasing duration within their funds, can help client portfolios achieve attractive levels of income and lower re-investment risk.

In Conclusion

Financial markets continue to post robust returns, further recovering from the declines of 2022. However, the thin leadership in the equity market (particularly the U.S. market) should lead investors to be more cautious. While these high-flying tech companies maintain good prospects for the future, starting valuations are no longer a bargain. Lofty expectations and reduced market liquidity could trigger more volatility going forward. Thankfully, well-diversified portfolios, particularly those with fixed income allocations, stand prepared to take advantage of that volatility to rebalance.

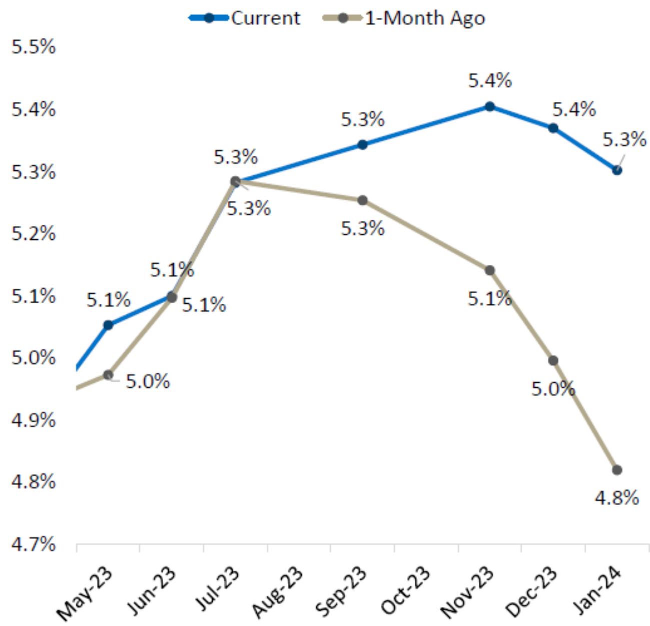
As always, we continue to work hard to make our clients' portfolios more efficient and better positioned to meet their long-term goals. If there are any changes in your risk tolerance, liquidity needs, and/or investment goals, please contact us so we may have a constructive conversation about any changes that may (or may not) need to be made to your investment portfolio. Additionally, if you have any questions or concerns about financial markets or your portfolio, 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

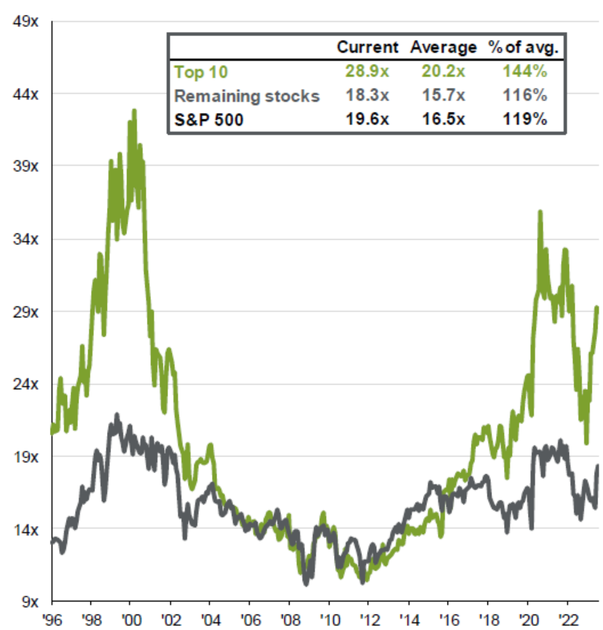
APPENDIX A: Market Implied Fed Funds Rate



Source: DoubleLine. Data as of 30 June 2023 and is based on Fed Funds Futures.

APPENDIX B: S&P 500 Concentration, Valuation, and Earnings

P/E ratio of the top 10 and remaining stocks in the S&P 500
Next 12 months, 1996 - present

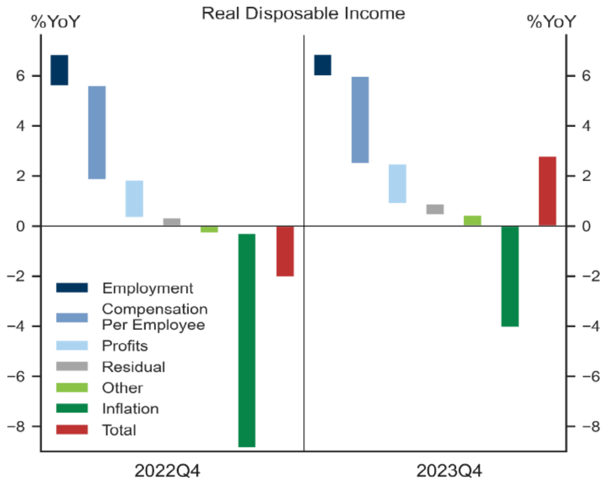


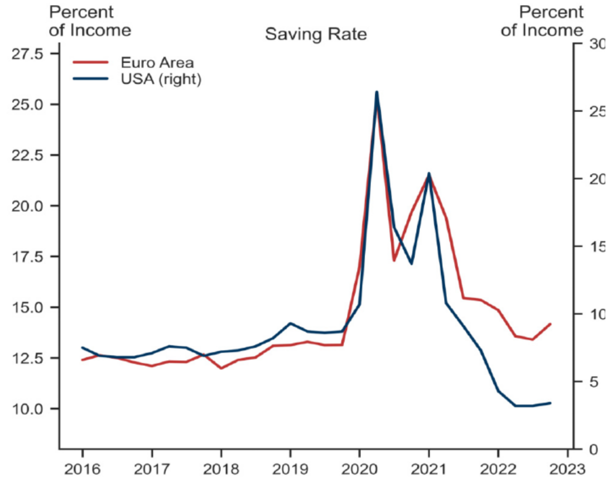
Weight of the top 10 stocks in the S&P 500
% of market capitalization of the S&P 500

Earnings contribution of the top 10 in the S&P 500
Based on last 12 months' earnings

Source: JPMorgan Asset Management. Data as of 31 July 2023.

APPENDIX C: European Disposable Income & Savings





Source: Goldman Sachs Global Investment Research, Haver Analytics. Data as of 25 July 2023.

Disclosures

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