Client Investment Letter

November 2023

Despite a promising start to the third quarter, the reality of higher-for-longer interest rates, given a slower-than-expected decline in inflation, soured investors' outlook in September and October. Furthermore, while reported earnings for the third quarter have been rather robust, and the U.S. economy delivered a knockout GDP figure for the quarter, markets have been looking beyond to the macroeconomic headwinds on the horizon.

Compounding this uncertainty is a fresh conflict in the Middle East after the abominable terrorist attacks committed by Hamas and the mounting military response by Israel. While a traditional "flight to safety" in markets has not occurred and commodity prices (oil in particular) have receded back to pre-October 7th levels, this new conflict is unquestionably of a different magnitude, and the risk that other regional and global powers could be drawn in remains very real.

For investors in this volatile and uncertain environment, discipline is essential. These are times when our emotions tend to get the better of us, but it is critical to try to separate them from our portfolios. On the one hand, short-term outperformance of a few large, index-dominating stocks can trigger a human's inherent sense of greed and "FOMO."[1] It is important not to get swept up in a crowded momentum trade, as the tide can go out just as quickly as it comes in. Only perfect market timers can profit off those scenarios; and in all our years, we have not found any that can consistently time the tops and bottoms of each and every cycle over each and every hour, day, week, and month.

At the same time, terrorist attacks, war, and heightened geopolitical risk feed on our personal fears and anxieties. It is just as important to hold tight, remembering what your portfolio's goals are and how it is positioned. Diversification across numerous sectors and markets protects against an existential crisis in any one company or country. Maintaining broadly diversified exposure to equities is still one of the easiest and least-expensive ways to make sure one's wealth is growing above and beyond the rate of inflation. Furthermore, if all near-term liquidity needs have already been set aside in short-term, high-quality bond and/or money market funds, then there would be no need to sell out of longer-term investments at an inopportune time.

[1] Fear of Missing Out

While the circumstances surrounding each episode of market volatility are always different, we have been through many cycles in the past. We know these are not the moments to make any big changes to long-term strategies, but we can still tinker under the surface. Through every crisis, there are always benefits to staying invested and opportunities to make portfolios more efficient as we wait to emerge on the other side.

Q3 Financial Markets Performance

EQUITIES

U.S. stocks advanced through the early part of the third quarter, as prospects for a "soft landing" of the economy increased. However, a strong labor market, along with resilient consumer spending, forced the Federal Reserve to remain hawkish and raise rates once more at the end of July. Interest rate-sensitive sectors such as technology, consumer staples, and real estate led broad market indices lower in late September erasing earlier gains (see Exhibit 1). Supply cuts by OPEC helped energy stocks gain ground. Large-cap stocks declined less than mid and small caps, while growth generally outpaced value.

Stocks in non-U.S. developed markets also moved lower, as major central banks indicated policy rates would remain elevated despite evidence of economic slowdown. Additionally, the U.S. dollar strengthened against most currencies during the period, further restraining returns for U.S. dollar-based investors. European stocks[2] were also negatively affected by the ongoing weakness of China's economy – a major market for European exports – and by higher government bond yields. Japanese stocks ended the period slightly negative (though positive in local currency), as the historically weak yen benefited local exporters.

Performance of emerging markets stocks was negative, albeit ahead of developed world equities. Chinese stocks lost ground on continued economic stagnation and resurfacing of problems in the property sector. Shares in Taiwan and South Korea also declined as economic prospects for their largest trading partners (the U.S. and China) dimmed. Meanwhile, shares in India and Malaysia advanced as internal economic indicators improved.

[2] As measured by the STOXX Europe 600 Index.

SOL CAPITAL MANAGEMENT

Financial Markets Performance cont.

Exhibit 1 – Equity Market Returns

Benchmark Index	3rd Quarter 06/30/2023 – 09/30/2023	Year-to-Date 12/31/2022 – 09/30/2023	Year-to-Date 12/31/2022 – 10/31/2023
S&P 500 (*Large Cap*)	-3.27%	13.07%	10.69%
S&P 500 Growth	-2.59%	18.11%	15.26%
S&P 500 Value	-4.09%	7.56%	5.71%
Russell 2000 (*Small Cap*)	-5.13%	2.54%	-4.45%
Russell 3000 (*Total U.S.*)	**-3.25%**	**12.39%**	**9.41%**
MSCI EAFE (*Developed Markets*)	-4.11%	7.59%	2.74%
MSCI EM (*Emerging Markets*)	-2.93%	2.16%	-2.14%
MSCI ACWI ex-U.S. (*Total Int'l*)	**-3.77%**	**5.82%**	**0.99%**

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.

FIXED INCOME

Market anticipation of a longer period of elevated rates was the key driver of global bond markets during the third quarter. Duration (interest rate sensitivity) affected returns the most, delivering mixed results across the various segments of the fixed income market (see Exhibit 2).

In the U.S., broad market indices lost ground for a second consecutive quarter, largely attributable to the hawkish tone set during the September Fed meeting. Most declines occurred on the long end of the curve, where interest rate sensitivity plays a more significant role. Conversely, prices of Treasuries with maturities under two years rose slightly.

Global investment-grade bonds had mixed results, with U.S. securities underperforming other developed markets. Lower quality bonds outperformed their higher quality counterparts due to their shorter durations. Junk bonds had positive returns, with lower quality names outperforming.

Developed market sovereign debt posted losses with little dispersion among countries. Meanwhile, emerging market debt also lost ground, with sovereign U.S. dollar-denominated debt declining more than corporates and local currency debt.

Exhibit 2 – Bond Market Returns

Benchmark Index	3rd Quarter 06/30/2023 – 09/30/2023	Year-to-Date 12/31/2022 – 09/30/2023	Year-to-Date 12/31/2022 – 10/31/2023
Bloomberg U.S. Gov't/Credit	-3.00%	-0.85%	-2.26%
ICE BofAML 1-3 Year U.S. Broad	0.79%	1.98%	2.30%
Bloomberg U.S. Aggregate Bond	**-3.23%**	**-1.21%**	**-2.77%**
ICE BofAML U.S. High Yield BB-B	0.22%	5.09%	4.10%
JPM Non-U.S. GBI (hedged)	-1.89%	-3.26%	0.11%
JPM EMBI Global (in USD)	-2.63%	1.09%	-0.38%

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

Global Economic Update

While the global economic cycle remains in the expansion phase, it is less synchronized and is facing downward pressure. The Fed and many other central banks appear to be nearing the end of their hiking cycles, but tighter global monetary conditions have affected liquidity and add to growth risks going forward. Many emerging market central banks tightened earlier than their developed market counterparts and are now pausing or even cutting rates. Still, the global business cycle has been unexpectedly durable, with leading indicators continuing to rise across most of the world's largest economies.

UNITED STATES

The U.S. economy appears to be less sensitive to interest rates than it has in past cycles. In fact, the higher than expected third quarter U.S. GDP number (+4.9% annualized) reflects the health of the consumer and the increase in consumer spending in both goods and services. Many consumers locked in ultra-low mortgage rates in recent years (though that has "trapped" many in their current homes, paralyzing the real estate market). A tight labor market has increased wages and kept unemployment low, and aggregate savings remain at an elevated level. However, many lower income earners are experiencing higher rents and higher prices on food and gas, which drastically reduce their purchasing power. Furthermore, with the resumption of student loan payments, this sector of the consumer base is more rapidly depleting the excess savings it has accumulated since the start of the pandemic.

Corporations are also somewhat less sensitive to interest rate increases as they too locked in lower borrowing rates in 2021. Smaller companies, however, are still more sensitive to higher rates as they typically do not have access to capital markets and their borrowing costs are relatively high (usually in shorter-term and/or variable-rate loans). While successful companies should be able

Global Economic Update cont.

to withstand the higher rates, less productive companies might not.

Government spending at all levels also increased this past quarter, yet non-residential fixed investment decreased, suggesting companies remain concerned about future growth and higher input costs (primarily labor).

EUROPE & JAPAN

In contrast to the U.S., Europe is losing momentum. The German economy contracted in the third quarter after barely managing to expand in the second. Fiscal policy across the continent may turn more contractionary next year as governments ease off emergency energy subsidies (barring a harsh winter) and further reduce post-pandemic fiscal support.

Japan's economy also appears to be in late-cycle expansion, but further from the recession threshold. So far in 2023, consumption has slowed, particularly in the services sector. While "occasional" spending on leisure (e.g., long-distance travel, large events) has returned to pre-pandemic levels, "everyday" spending on necessities (e.g., dining, fitness, commuting) remains muted due to well-established working-from-home preferences.

CHINA

China, on the other hand, is experiencing a more challenging economic environment. Ongoing weakness in the property market could reduce GDP growth by 1.5% in 2023 and remain a persistent drag on growth for the foreseeable future. In recent years, property-related construction has accounted for nearly 18% of China's GDP (30% if infrastructure and real estate-related services are included). However, from the peak levels in 2020-21, sales are down nearly 30% and starts are down 60%.[3]

This slowdown in the real estate market is exacerbating stresses in China's financial system. According to Goldman Sachs, total non-financial debt will have nearly doubled from less than 150% of GDP during the Global Financial Crisis to an estimated 289% by the end of this year. Property debt remains nearly 50% of GDP, and while default risk in mortgages is low (given the large down payments required at initiation), the one-third of all outstanding property debt that is owed by developers is cause for concern.

Around 70% of Chinese property bonds denominated in U.S. dollars have defaulted or have conducted bond exchanges, and the default rate for high-yield property bonds this year may hit 28%.[4] While the banking system at large should be able to absorb the defaults in aggregate, it may prove more challenging for smaller banks, requiring recapitalization either via consolidation or direct bailouts from the central government.

[3] The Goldman Sachs Group, Inc.

[4] The Goldman Sachs Group, Inc.

Finally, China continues to struggle with a gloomy demographic outlook. While the total population likely peaked in 2021, the ratio of working age-to-dependent age population reached its peak over 13 years ago and continues its steady decline. To counter this trend, more investment will be required in improving total factor productivity in the economy. However, central policymakers appear to have other priorities as relations with the U.S. continue to deteriorate.

As China slows, the impacts will be felt (to varying degrees) across the region. Economies such as Thailand, Taiwan, and Malaysia are more intertwined, and their markets more correlated, to China. Whereas others, such as India, Indonesia, and Vietnam stand to be the clear winners as supply chains continue to shift away from China.

Investment Strategy

EQUITIES

It is difficult to understate how far equity markets have moved in such a short period of time. After July 31, rates volatility, geopolitical risk, and near-term earnings uncertainty contributed to recent weakness in share prices. Most major indices, covering large-cap, small-cap, non-U.S. developed, and emerging market stocks entered or were hovering near correction territory[5] by the end of October. Then, in the first week of November, markets received long-awaited signals that the Fed was finally finished raising interest rates and indices soared, fully recovering (if not exceeding) all of October's declines in just five trading days.

Since this spring, the U.S. equity market has grown increasing concentrated at the top end (last quarter we discussed "the Magnificent Seven"). In fact, we estimate that 82% of the 2023 return of S&P 500 Index through November 3 was attributable to those seven companies. As valuations of the top constituents grind higher, we have been focused on adding exposure to higher-quality companies as well as relatively smaller-cap names that appear more attractively valued, though less exposed to investor and market momentum.

For the time being, we are also maintaining exposure to other riskier areas of the equity market, such as small cap and non-U.S. developed and emerging. Valuations in these areas are even more compelling, and historically tend to outperform at the end of a U.S. rate hiking cycle, but the expected volatility is quite high. We continue to evaluate what our neutral weighting to these areas should be going forward.

[5] A correction is defined by a price decline of more than 10% from a previous peak.

FIXED INCOME

There has been much volatility in rates markets in recent months as investors have tried to guess the Fed's next move, the next inflation print, and longer-term growth prospects. However, just like with equities, it is impossible to time the bottom of bond prices (or rather, the top in yields). Therefore, we are taking a disciplined approach of gradually stepping up portfolio duration now that Treasuries are offering positive real yields. Even so, the duration of most client portfolios, on average, remains well below the benchmark index.[6]

Furthermore, it is important that investors not get distracted by the high yields currently offered by money market funds. While they are indeed higher than they have been in over 15 years, the rate received is only guaranteed for a very short period. Once the market begins to believe that a rate cut is widely expected (usually well before the Fed actually begins cutting rates), investors with too much in money markets will find themselves exposed to reinvestment risk. As rates come down, bonds (even those with only a few years to maturity) may get a big, one-time tailwind to their return (i.e., the duration effect), as might equities should longer-term rates also come down (i.e., a lower discount rate on future earnings). By then, an investor seeking to step out from cash will have already missed some of the upside potential. For this reason, we are being diligent by beginning the move now.

In Conclusion

As interest rate hikes come to an end, most major economies begin to cool down, and several wars rage around the globe, we are entering yet another period of heightened uncertainty and volatility in financial markets. Though it is never relaxing, this is the natural state of markets, and it is something a successful investor must accept and know how to navigate. There is never a clear path forward or a certain outcome on the horizon. The most important step one can take is to position a portfolio's exposure within the levels of potential return one needs at the level of volatility one can tolerate, and to protect against the permanent loss of capital by diversifying across all styles, sectors, sizes, and regions.

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, please never hesitate to call us at +1 (301) 881-3727 or email us at client.services@sol-capital.com.

[6] As of September 30, 2023, the duration of the Bloomberg U.S. Aggregate Bond Index was 6.1 years.

With our best regards,

SOL Capital Management Company

Disclosures

IMPORTANT DISCLOSURE INFORMATION

Please remember that past performance is no 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 (including the investments and/or investment strategies recommended or undertaken by SOL Capital Management ["SOL Capital]), or any non-investment related content, made reference to directly or indirectly in this commentary will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this commentary serves as the receipt of, or as a substitute for, personalized investment advice from SOL Capital. No amount of prior experience or success should not be construed that a certain level of results or satisfaction if SOL Capital is engaged, or continues to be engaged, to provide investment advisory services. SOL Capital is neither a law firm, nor a certified public accounting firm, and no portion of the commentary content should be construed as legal or accounting advice. A copy of the SOL Capital's current written disclosure Brochure discussing our advisory services and fees continues to remain available upon request or at www.sol-capital.com. Please Remember: If you are a SOL Capital client, please contact SOL Capital, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services, or if you would like to impose, add, or to modify any reasonable restrictions to our investment advisory services. Unless, and until, you notify us, in writing, to the contrary, we shall continue to provide services as we do currently. **Please Also Remember** to advise us if you have not been receiving account statements (at least quarterly) from the account custodian.

Historical performance results for investment indices, benchmarks, and/or categories have been provided for general informational/comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your SOL Capital account holdings correspond directly to any comparative indices or categories. Please Also Note: (1) performance results do not reflect the impact of taxes; (2) comparative benchmarks/indices may be more or less volatile than your SOL Capital accounts; and, (3) a description of each comparative benchmark/index is available upon request.