Current Investment Strategy and Themes

- ***.September financial asset returns were negative across most all classes.***
- ***The long-awaited pause was as much political as economic.***
- ***Assets with record high valuations lead to keeping a portfolio in balance of opportunity and quality.***

The Markets in Review: September

- September was the month that equity markets decided to take a rest from the relentless upward recovery from the Covid-19 induced market meltdown in the spring. The equity results were the same across the globe, styles, and sizes. While US Treasury interest rates remained stable during the month, assets across the financial spectrum declined. Gold, Bitcoin, oil, and other commodities all edged lower during the month.
- The S&P 500 decline during the month hides the fact that it set record highs early in the month. The fall in September had no single cause. The strong up months since the April market bottom always latched on to a few economic and earnings statistics to justify the upward movement in prices. This month the market ignored most fundamental data and focused on "soft" issues such as perceptions of politics and uncertainty.
- Despite the September drop in the S&P 500, the quarterly data continued the recent trend of Technology, NASDAQ, and large-cap growth stock dominance. The NASDAQ ended the quarter up 11.02%. The index increased 24.46% year-to-date, and 39.61% for the trailing 12-months. The false signal that the NASDAQ gives to the overall health of the equity market is seen by comparing NASDAQ returns to the returns of the S&P 500 equal-weighted calculation (a better measure of the performance of the "average" stock). The S&P 500 equal-weight index rose 6.75% for the 3rd quarter, 5.57% YTD, and 15.15% for the trailing 12-months. Return discrepancies in the equity market were most pronounced in the style indices; growth and value. The RU1000 Growth Index rose 37.53% for the trailing 12-months. In comparison, RU1000 Value Index fell -5.03%.
- The wide variation in returns better reflect true market conditions and risks. Portfolios need to be quality oriented to handle the volatility, while positioned for the shift in economic leadership.

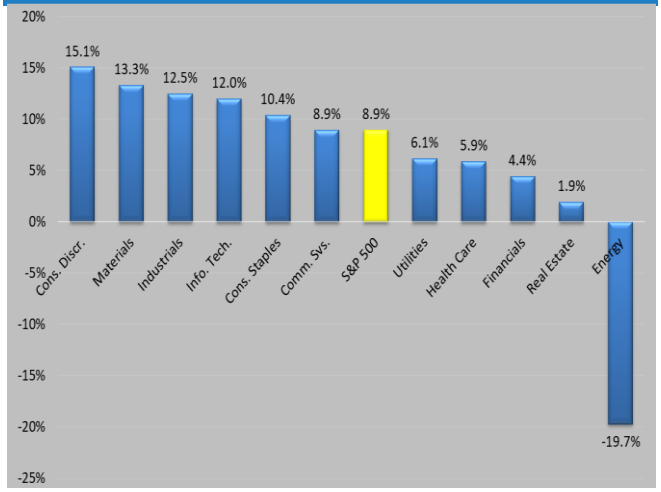
Key Market Indicators

Bullish	Favorable	Neutral	Cautious	Bearish

Equities	Sept 2020	YTD 2020	Last 12 Months	Current View
U.S. Large Cap	-3.80%	5.57%	15.15%	Neutral
U.S. Small Cap	-3.34%	-8.69%	0.39%	Cautious
International Developed	-2.60%	-7.09%	0.49%	Cautious
Emerging Markets Equity	-1.60%	-1.16%	10.54%	Cautious
Fixed Income				
U.S. Aggregate	-0.05%	6.79%	6.98%	Cautious
U.S. Government	0.14%	8.81%	7.97%	Neutral
U.S. Corporate	-0.27%	6.39%	7.50%	Neutral
U.S. High Yield	-1.03%	0.62%	3.25%	Cautious
Non-U.S. Developed	-0.41%	6.07%	6.11%	Cautious
Emerging Market Debt	-1.79%	-5.70%	-1.51%	Bearish
Alternatives				
REITs	-3.26%	-17.54%	-18.16%	Bearish
Commodities	-2.83%	-14.92%	-10.48%	Neutral
Managed Futures	-2.63%	-4.46%	-8.45%	Neutral
Hedge Funds	-0.17%	1.61%	4.24%	Favorable

Source: Morningstar, data as of9/30/2020

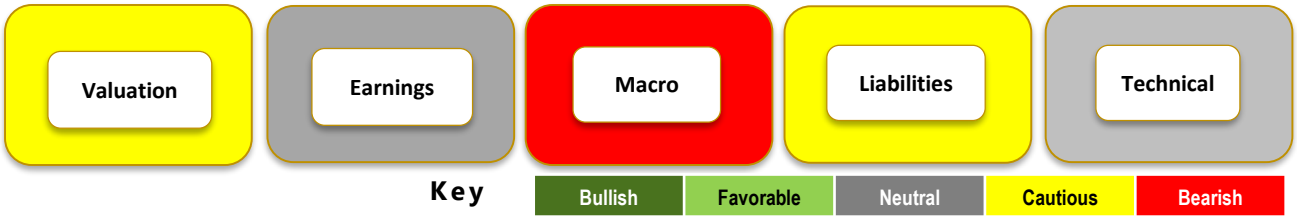
Economic Sector Returns 3rd Quarter 2020



Source: Morningstar

Risk Examination

A quarterly update on our views of the complex risk factors in global markets



Valuation

- Global asset valuations remain high in cap weighted indexes with the majority beta risk being driven by technology stocks. Growth continues to outpace value because the market is focused on committing capital to innovation and disruption, rather than shopping for the best price. Our view is that markets will continue to be driven by the ebb and flow of investor sentiment tied to the recovery from COVID-19. Market uncertainty will remain high.

Earnings

- Earnings growth is being led by the beneficiaries of the rapid transformation to digitization by many industries as a result of the onset of COVID 19. On the other side of this phenomenon, earnings are struggling as those companies have been the victim of a dramatic fall-off in demand.

Macroeconomic

- Global economic growth and inflation have fallen and will move lower throughout the course of the year or at least until more certainty is evident with respect to testing, tracing and treating COVID-19. We believe the economy is in severe recession already, and at risk for a deflationary spiral.
- Large scale labor dislocations and oncoming credit concerns suggest much additional fiscal stimulus, not monetary, will be needed.

Liabilities

- Liabilities have exploded on government and corporate balance sheets over the last cycle. Household borrowing rates are not far behind. The shift now will be on balance sheet repair and debt repayment and not on earnings growth and increased individual spending This will place additional pressure on growth and governments to provide extra stimulus programs to re-start the global economy.

Technical/Sentiment

- The biggest driver of security price swings since COVID-19 has been investor psychology and sentiment, not investment or macroeconomic fundamentals. The radical uncertainty with the onset of the global virus pandemic has resulted in highly volatile equity and credit markets.
- In our view, recent market rallies are more likely consistent with a bear market rally as opposed to “coming off the lows” of an extended bull run. There is very little fundamental nor economic support for any extended rally at this time.

2020 – 2021 Scenarios

Our assessment of potential macro scenarios

	Great Depression II	Extended Recession	Return to New Normal	Robust Recovery
Economy / Geopolitical	▪Growth rates around globe between -10% & -15%. ▪Unemployment rates above 25% ▪Globalization is dead	▪Excess supply & weak demand persists ▪Excessive stimulus continues & MMT is fully adopted ▪Moral hazard issues	▪Gradual recovery with radically different labor market ▪Inward focus ▪Deflation	▪Labor market bounce-back ▪Earnings and growth increases ▪Globalization returns
Markets	▪Prolonged sell-off in risky assets ▪Rush to safe haven assets such as digital currency, gold and cash	▪Most risky assets suffer ▪Flight to safety ▪Defensive assets benefit	▪Equity markets grind higher ▪Interest rates remain suppressed ▪Deleveraging - Quality matters	▪Risky assets benefit ▪Markets dominated by new technologies ▪Interest rates and inflation remain under control
Focus	▪Flight to quality: U.S. Treasuries, U.S. Dollar, Crypto Currencies & Gold benefit	▪Premium for safety & return of principal ▪ Capitalize on disruptive technologies	▪Focus shifts from sentiment driven markets to fundamentals	▪Fully invested, but highly diversified
Probability	**15%**	**40%**	**35%**	**10%**

< < < Downside < < < | > > > Upside > > >

Risks

- A return to isolationist policies and continued explosion of public sector debt
- Social unrest, supply chain disruptions and food shortages
- Pandemic concerns continue
- Higher rates of poverty and social displacement
- High geopolitical risk leads to major conflict

- Effective use of fiscal stimulus spurs economic growth
- Globalization returns
- Labor market returns with shift in focus and higher productivity
- Strong real economic growth and productive use of credit
- Raises the wealth effect across multiple sectors

Asset Class Positioning

PORTFOLIO SEGMENT / SEGMENT OBJECTIVE	SEGMENT CONSTITUENTS	SEGMENT COMMENTS
Equity *Low-Cost, Systematic, and Factor Exposure*	▪ Global systematic equity beta exposure to investment & economic fundamentals ▪ Increased emphasis on quality, low volatility and low levels of leverage (defensive)	▪ Favor higher quality equities ▪ Favor higher growth regions and sectors with attractive valuations ▪ Longer-term, market driven by value, but in shorter-term growth and momentum can dominate
Fixed Income *Seek to Preserve Capital, Generate Income, and Diversify Equity Exposure*	▪ Broad, core plus exposure ▪ Emphasis on short duration credit & treasury notes ▪ Not a time to "reach for yield"	▪ Favor intermediate duration or less ▪ Favor quality credit over rates ▪ Selective, short duration high yield ▪ Issuer selection critical ▪ BBB segment is crowded
Opportunistic *Highest Conviction Ideas Based on 12-24 Month Proprietary Forecasts*	▪ Emphasis on disruptive innovation themes ranging from 3D technologies to immunotherapies ▪ 5G Technology	▪ Reflects Palladiem's shorter-term model (value and momentum) ▪ Seeking participation in select themes with attractive return potential based on innovative technologies such as 3D printing, gene therapies, digital wallets and AI.
Alternative *Anticipated Risk Mitigation with Alpha Opportunities*	▪ Global Macro ▪ Risk Managed Digital Assets ▪ Risk Managed Gold ▪ Hedged Equity ▪ Long/Short Credit ▪ Merger Arbitrage	▪ Low return and higher risk expectations for equities and bonds in the near future presents the challenge of providing uncorrelated sources of risk and return. ▪ Focus here will be on risk mitigation with potential for extra return. Strategies that we favor in the space include liquid and transparent hedge fund replication strategies. ▪ We also favor exposure to risk managed approaches to investing gold and cryptocurrencies where the goal is to participate on the upside but only capture 25-30% of the downside.

All investments are subject to risk, including the loss of principal. For additional information about the Palladiem Investment Portfolios, please refer to the Disclosures at the end of this report.

Important Disclosures

The statements contained herein are based upon the opinions of Palladiem LLC (Palladiem) and the data available at the time of publication and are subject to change at any time without notice. This communication does not constitute investment advice and is for informational purposes only, is not intended to meet the objectives or suitability requirements of any specific individual or account, and does not provide a guarantee that the investment objective of any model will be met. An investor should assess his/her own investment needs based on his/her own financial circumstances and investment objectives. Neither the information nor any opinions expressed herein should be construed as a solicitation or a recommendation by Palladiem or its affiliates to buy or sell any securities or investments or hire any specific manager.

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Palladiem has sole discretion to change allocations to styles and vehicles at any time.

Index definitions:

"U.S. Large Cap" represented by the S&P 500 Index.
"U.S. Small Cap" represented by the Russell 2000 Index.
"International" represented by the MSCI Europe, Australasia, Far East (EAFE) Net Return Index.
"Emerging" represented by the MSCI Emerging Markets Net Return Index.
"U.S. Aggregate" represented by the Bloomberg Barclays U.S. Aggregate Bond Index.
"U.S. Government" represented by the Bloomberg Barclays U.S. Government Bond Index.
"U.S. Corporate" represented by the Bloomberg Barclays U.S. Credit Bond Index.
"U.S. High Yield" represented by the Bloomberg Barclays U.S. Corporate High Yield Index.
"Non-U.S. Developed" represented by the S&P International Treasury ex U.S. Index.
"Emerging Market Debt" represented by the JP Morgan GBI-EM Global Core Index
"REITs" represented by the FTSE North American Real Estate Investment Trust (REIT) Equity REITs Index.
"Commodities" represented by the Dow Jones Commodity Index .
"Managed Futures" represented by the Credit Suisse Managed Futures Index.
"Global Macro" represented by the Credit Suisse Global Macro Index

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