PARKSIDE INVESTMENTS

Market Commentary

October 1, 2020

Dear Clients/Friends:

It has been said that equity markets "climb a wall of worry," and that was certainly the case during the summer as the S&P 500 rose 16% from Memorial Day to Labor Day. With the index giving back about 4% of these gains in September, we wanted to provide some thoughts on our market outlook for the remainder of the year, and how we are positioning portfolios accordingly.

A combination of factors have helped stock prices recover faster than expected:

1. Unprecedented stimulus actions taken by Congress and the Federal Reserve could possibly lead to a 30% jump in GDP during the third quarter. Though total economic activity remains well below where it started the year, so long as the largesse provided by Washington continues and Covid positivity rates do not spike nationally, we expect the economic recovery to continue.

2. Mega-cap technology and communications companies have actually benefited from societal changes forced by the pandemic. As for the companies negatively impacted by Covid, while bankruptcy levels have ticked up a few percentage points, most publicly traded businesses have quickly adapted business models, and raised capital when necessary, in order to sustain themselves until the economy returns to normal.

3. Momentum trading by quantitative managers and individual investors are driving prices higher. Like a flywheel, stock purchases move prices higher which leads to more investors piling in merely because they see stock prices moving higher. Though this can only be sustained for so long, it has been a factor moving markets.

Although we have questions about the longevity and unintended consequences of the above, each factor provided markets with short-term confidence that helped sustain the market rally. Over the medium and longer term, however, we expect that additional recovery in corporate earnings and cash flows are needed to move markets further.

Where does this leave us today?

The current low interest rate environment will likely persist for at least a few more years. The Fed confirmed this view with their recent policy shift in which they intend to let the economy overheat (for a period of time) in order to make up for recent periods of sub-par economic growth. The unfortunate consequence of this policy is that income earned from an investment grade corporate bond portfolio is roughly 2% annualized, while high quality municipal and U.S. government bonds

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pay about half of this amount. Given these low rates, many investors have shifted assets from bonds to stocks in a quest to seek higher returns.

While stock prices have recovered sharply since hitting March lows, the pullback in September is likely a precursor to a more volatile environment through the remainder of the year. Upcoming challenges include:

- A slower pace of rehiring and additional corporate layoffs;
- Hesitancy about the pace of economic growth and corporate earnings;
- Uncertainty about the timing of a widely distributed Covid-19 vaccine, and skepticism about the effectiveness and side effects; and
- Potential political, economic and social unrest associated with the upcoming U.S. elections.

We have taken a slightly more cautious approach short term, particularly as it relates to segments that are more susceptible to valuation contraction. We are placing additional emphasis on cash flow generation and stable business models that can operate in a range of economic environments.

Though we are cognizant of short-term market risks, our outlook over the medium term is more constructive. Equity valuations, though elevated, can be justified given the low-interest rate environment. While certain companies in the most momentum-driven segments have seen their stock prices run up too far and too fast, there are many companies where continued bearish sentiment is holding back price appreciation even as these companies report better than expected revenues and earnings. Although it will take at least a few more quarters for these companies to regain their growth trajectory, their leaner operating structure will lead to record earnings once demand returns.

Lastly, we are keeping a keen eye on ensuring portfolios maintain their purchasing power. While inflation still does not appear to be a near-term risk, inflationary pressure seems inevitable given the ballooning U.S. government deficit and the Fed's policy shift. Through our disciplined, diversified, and valuation based approach, we believe client portfolios are positioned to better protect against potential volatility in the short-term, while have an opportunity to maintain purchasing power and capture market growth when the health, political, and economic environment become more clear.

Should you have any questions or comments about our outlook (or any other issue), feel free to reach out to any of us on the Parkside team.

Sincerely,

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President Managing Director

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