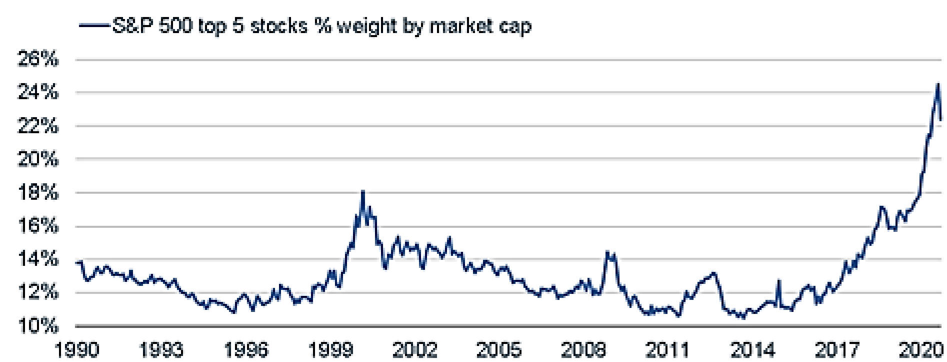
Market Review and Outlook

Global equities turned in their second consecutive quarter of solid returns during the third quarter. By August, the S&P 500 Index fully recouped its pandemic-fueled losses and it reached a new all-time high in early September. A subsequent stretch of volatility dampened that momentum, but the S&P 500 Index still gained 8.9% in the quarter (+5.6% YTD) and finished the period up more than 50% from its March bottom. International markets also tallied positive returns for the quarter, though they remain below their pre-pandemic levels. Developed international equities (EAFE) posted a third-quarter gain of 4.9% (-6.7% YTD) and emerging markets (EM) climbed 9.7% (-0.9% YTD).

The domestic equity market recovery is the quickest on record, with the S&P 500 Index setting a new bull market high just 126 trading days from the prior bull market high (versus a historical average of 1,542 trading days and the previous record of 310 trading days in 1967). The unprecedented velocity and strength of this upturn is attributed to a steady improvement in the economy, massive injections of fiscal support, and a powerful surge in technology stocks that have benefited from the stay-at-home transition.

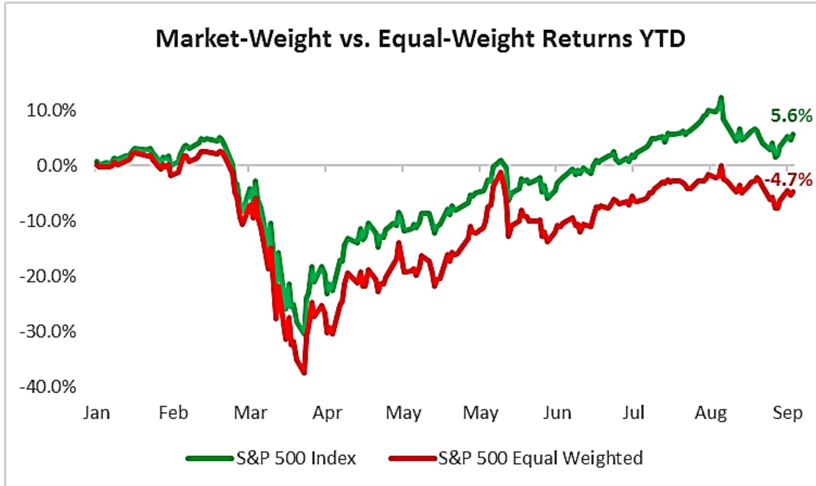
While certainly encouraging, the market's record recovery has also been perplexing given that COVID-19 infections remain elevated in the U.S. and social distancing protocols will continue to restrain economic fundamentals in the coming months. Unemployment in September fell to 7.9% (down from the April peak of 14.7%), but that is still a long way from the 3.5% rate just prior to the pandemic. Even if distribution of a vaccine commences in early 2021, unemployment could stay elevated with the leisure and hospitality industries (10% of U.S. employment) likely to remain constrained for an extended period (with some of those jobs never returning). Federal aid has helped cushion the blow to the labor force, but it will take time for stranded assets and affected employees to be retooled/redeployed and more economic disruption may occur if fiscal stimulus runs out.

The economic challenges that still lie ahead have not been completely ignored by the market, but they have been masked by the run-up of index returns – which have been skewed by the outperformance of a small number of stocks. Five companies (Apple, Microsoft, Amazon, Alphabet, and Facebook) accounted for 23% of the S&P 500's market value at the end of the third quarter.



Source: Charles Schwab, Bloomberg (as of 9/30/20)

Because the S&P 500 is a market cap weighted index, these large market capitalization companies have had a disproportionate impact on the index's return. To date, the top five stocks in the index generated an average return of 35.4%, while the remaining 495 stocks posted an average return of -3.9%. While year-to-date equity returns are impressive on a market-weighted basis (+5.6% YTD), an equal-weighted measure (-4.7% YTD) reflects a more balanced picture of how companies in the index are performing overall.

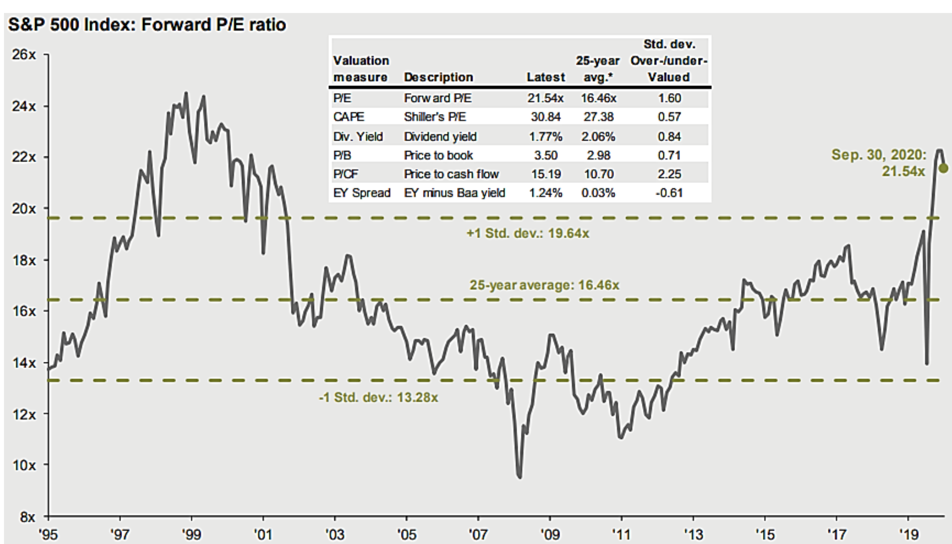


Source: FactSet (as of 9/30/20)

The narrow leadership exhibited in the current market rally is reminiscent of the 1990s technology bubble and the "Nifty Fifty" phenomenon in the late 1960s and early 1970s. The problem with having such an elevated concentration of the index in a handful of stocks is that it decreases diversification of the overall market and has often preceded large selloffs in the past. As a result, the durability of this impressive bull market rally will hinge on the ability of non-technology stocks to close the performance disparity with the "new economy" companies.

We believe economic fundamentals are moving in the right direction to support broader participation in the market recovery. Economic data has consistently beaten expectations since the economy reopened. Gross domestic product (GDP) fell an astounding 31.4% during the second quarter, but it is projected to recoup most of that loss with a 25%-30% gain in the third quarter – as businesses have re-opened and millions of people have gone back to work. Economists expect full-year 2020 GDP to decline an estimated 4.7%, followed by a 4.0% increase in 2021. The projected GDP recovery next year will largely rely on the rollout of effective COVID-19 vaccines (and/or therapeutics) over the coming months, enabling the economy to more fully open by year-end 2021. In the interim, additional fiscal stimulus will likely be required. While a return to pre-pandemic economic conditions may take longer to achieve, sustained economic expansion should start to drive improved prospects for the more cyclically-sensitive sectors of the market (energy, industrials, materials, and consumer discretionary).

With the 50% run-up in equity markets from the March lows, valuation has become an increased focus for investors. At 21.5x forward earnings, the S&P 500 Index is trading more than 30% above its historical average.



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	21.54x	16.46x	1.60
CAPE	Shiller's P/E	30.84	27.38	0.57
Div. Yield	Dividend yield	1.77%	2.06%	0.84
P/B	Price to book	3.50	2.98	0.71
P/CF	Price to cash flow	15.19	10.70	2.25
EY Spread	EY minus Baa yield	1.24%	0.03%	-0.61

Source: FactSet, FRB, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.

Outsized gains in a concentrated basket of high-flying stocks are certainly contributing to this elevated valuation multiple. While we question the sustainability of a few favored companies continuing to drive equity returns, we do not believe the market is due for another sharp decline so long as fiscal and monetary policies remain supportive. Instead, we expect broader market contributions and leadership to shift towards value equities as the economy continues to improve. In the same way that the technology sector has benefited from a work-at-home environment, more cyclical sectors have the opportunity to lead the market over the next few years as their earnings are highly levered to an improving economy.

In this transitory environment, investment selectivity could be more important than ever and actively picking individual asset classes, industries and companies should prove beneficial in generating performance and managing risk. Importantly, we continue to assess these opportunities with an elevated level of caution given that much remains unknown about the path of the virus and economy.

Core Portfolio

The third quarter was relatively quiet in terms of transaction activity. We did not initiate any new positions in the portfolio, nor did we exit any established holdings. We believe the portfolio holdings are well positioned to continue to benefit from the rebounding economic activity, both domestically and abroad. Contrary to the volatility experienced in the markets, most portfolio companies have managed through the initial phase of the pandemic very well, in large part due to strong management teams, fortress balance sheets, as well as leading market positions for their key business lines. We continue to closely monitor market fundamentals, and will adjust our portfolio holdings and allocations accordingly.

Fixed Income

The yield curve slightly steepened in the third quarter, as longer dated (10-, 20-, 30-year) Treasury yields rose marginally and shorter duration yields modestly contracted from the second quarter. The benchmark 10-year Treasury finished the quarter at a still-depressed 0.69% yield, well below the 1.92% where it started the year.

In August, the Federal Reserve approved a methodology shift in interest rate policy, saying that it will allow inflation to run hotter than normal in order to support the labor market and broader economy. In other words, the Fed signaled it won't be raising rates anytime soon and will likely be leaving rates low for years.

Our primary fixed income allocation strategy has been to focus on high-quality and low/medium duration investments that will exhibit minimal volatility and stable returns under a variety of credit and rate environments. While falling rates over the last couple of decades provided a beneficial total return (the combination of interest income plus price appreciation) outcome for bond investors, today's ultra-low rates suggest fixed income should be viewed mainly as a source of principle protection – which we still believe has merit in this uncertain environment.

Final Thoughts

As has been the case through much of 2020, the markets are facing a series of unknowns in the final quarter of the year that are sure to keep investors on edge. We appreciate the continued confidence you have placed in us during this turbulent period. Should you have any questions or concerns, please don't hesitate in reaching out to us. We wish you and your family health and prosperity in the final months of 2020.

Parkside Investments, LLC

October 8, 2020

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Benchmark performance shown for various market indices is shown with interest and dividends reinvested and gross of all fees and expenses. An investor's individual performance would include interest and dividends reinvested, but would be net of all fees and expenses incurred from transactions and management of their portfolio. No one can invest directly in a benchmark.

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