# Core Investment Portfolio—Tax-Advantaged

**Portfolio Manager Commentary**

As of 6/30/2021

## Q2 2021 Overview

For the second quarter of 2021, the **Core Investment Portfolio–Tax-Advantaged (MCIP)** gained 6.82% (6.73% net) compared to its blended benchmark, which was up 5.47%. Year-to-date, MCIP is up 12.21% (12.01% net) compared to the benchmark, which gained 9.89%. Our long-term performance results can be found in the table below.

As expected the advent of the COVID-19 vaccination rollout that began in November of last year, has accelerated U.S. economic growth. After enduring a recession in 2020, U.S. real gross domestic product (GDP) growth advanced by 0.4% year-over-year in the first quarter of 2021—a small economic advance but definitely in the right direction. Now with the economy fully reopened, consensus GDP growth in the second quarter is expected to advance at 13.0% year-over-year—the fastest economic growth rate since World War II.

Last fall, we also suggested the most undervalued segment of the stock market was no longer growth stocks, which had gained substantially in price throughout 2020, but instead value stocks that had been largely dismissed by investors. Value stocks are the net beneficiaries of an expanding economy, and as a result of the recession from the second quarter of 2020 through year-end, many investors avoided these economically-sensitive stocks.

With the U.S. economy now strongly recovering, value stocks had indeed outperformed growth at the beginning of the year. The combination of improving economic data, accelerated vaccinations and declining virus cases, and rising interest rates created an environment much more favorable for value stocks than growth in the first quarter. With growth stocks up modestly in the first quarter, value stocks enjoyed double-digit returns and carried portfolio performance.

The second quarter witnessed a shift in the market narrative and investor preference. Attention turned to the possibility of inflation and the Federal Reserve (Fed) stepping up its timeline for a reduction in easing and raising rates, as well as the potential threat of virus variants to reopening. Lower-than-expected job growth and commodity inflation highlighted logjams in the supply chain for materials and labor. Bond yields retreated, as the bond market viewed inflation as most likely transitory, and focused on the potential economic headwinds that could result from Fed tightening, tight supply chains, or virus resurgence. The 10-year U.S. Treasury yield dropped from as high as 1.8% in the first quarter to below 1.5% at the end of the second quarter. While value stocks enjoyed solid gains in the second quarter, this backdrop strongly favored growth stocks, which posted double-digit gains.

### Objective

A multi-strategy wealth accumulation approach designed to provide long-term capital appreciation while helping to mitigate risk during bear market drawdowns

### Portfolio Management Team

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### About EquityCompass

EquityCompass is a Baltimore-based SEC registered investment adviser offering a broad range of portfolio strategies and custom plans for individuals, financial intermediaries, and institutional clients in the U.S. Formally organized in 2008, EquityCompass provides portfolio strategies with respect to total assets over $4.6 billion as of June 30, 2021.†

The EquityCompass team of professionals represents deep industry experience in security analysis, capital markets, and portfolio management. We are committed to a consistent investment process that relies on enduring principles, sound empirical reasoning, and the recognition of a dynamic investment environment with a global reach.

| | Total Returns | | | Annualized Returns | | | Calendar-Year Returns | | |
|---|---|---|---|---|---|---|---|---|---|
| | 3-Mos | 6-Mos | YTD | 1-yr | 3-yr | Inception | 2018 | 2019 | 2020 |
| Gross % | 6.82 | 12.21 | 12.21 | 33.51 | 9.42 | 8.07 | -8.12 | 18.61 | 7.30 |
| Net % | 6.73 | 12.01 | 12.01 | 33.28 | 9.13 | 7.78 | -8.44 | 18.20 | 7.21 |
| Benchmark % | 5.47 | 9.89 | 9.89 | 28.90 | 12.38 | 10.78 | -4.77 | 19.16 | 14.76 |

Inception – January 1, 2018; Net of fee calculated net of 35 basis points manager fee only; Benchmark = 25% S&P 500 TR / 25% MSCI All Country World Index / 25% HFRI Equity Hedge Index / Bloomberg Barclays Muni Managed Money Short/Intermediate Index, Rebalanced monthly.
EquityCompass claims compliance with the Global Investment Performance Standards ("GIPS®"). The information provided herein is supplemental to the GIPS performance presentation. To obtain a GIPS compliant presentation or a list of our composite descriptions and/or policies for valuing portfolios, calculating performance, and preparing compliant presentations, please call (443) 224-1231 or send an e-mail to info@equitycompass.com.

MCIP's equity strategy allocates 25% to global growth stocks and 25% to value stocks. The purpose of this allocation is to create balance in the portfolio. Investment styles move in and out of favor over time, and in recent years these shifts can happen quickly and with great magnitude. Having exposure to both growth and value allows MCIP to smooth out performance when these shifts occur. Since 2019, we've seen a dramatic advantage for growth through the third quarter of 2020 give way to strong relative performance for value in the next six months, and a reversal favoring growth again in the second quarter. The balance in MCIP allows a portion of the portfolio to benefit as performance trends shift.

Supplementing MCIP's growth and value equity investments, one-quarter of the portfolio is allocated to a tactical strategy that has the ability to invest in stocks, bonds, or cash based on market conditions. When technical and fundamental indicators are positive, the tactical allocation is fully invested in the stock market. If either or both indicators begin to signal a decline, the tactical asset allocation strategy can shift to bonds or cash. With future expectations for corporate earnings still on the rise, the fundamental indicator remains in a positive position. In our technical model, stock price volatility has remained within a normal range. In addition, we have seen no deterioration in one of our most important signals—credit spreads—thus, our technical indicator also remains in a positive position. As such, our tactical equity allocation has remained fully invested throughout the second quarter.

Our growth and value equity allocations, along with the tactical equity, have worked in tandem to generate benchmark-beating returns for MCIP year-to-date. Even so, our attention is keenly focused on the bond market, and one-quarter of MCIP is allocated to tax-free fixed income securities. While most sectors of the bond market experienced negative total returns during the first half of the year, the municipal sector represented one of the few exceptions. Despite the Bloomberg Barclays U.S. Aggregate Bond Index loss of 1.60% during this period, the Bloomberg Barclays Municipal Bond Index posted a positive total return of 1.06%. Two primary factors have supported the outperformance of municipal bonds relative to their taxable counterparts. First, the federal stimulus funds directed to state and local governments have shored up municipal finances and improved the credit quality of the sector, allowing credit spreads to tighten. Second, investor demand for tax-exempt income has increased significantly in response to various legislative proposals that would increase tax rates on high income households. Relative to its benchmark, MCIP's municipal fixed income portfolio has outperformed by approximately 50 basis points on a year-to-date basis. This performance advantage was primarily attributable to security selection, as several of our municipal closed-end fund holdings have generated year-to-date total returns in excess of 5%.

## Portfolio Outlook

In our view, the U.S. economy is in the midst of the strongest recovery since World War II. However, it is important to understand this flurry of activity is a direct result of the reopening of our economy after spending almost a year in lockdown due to the COVID-19 global pandemic. The unleashing of pent-up demand, by both consumers and businesses, in our opinion, is unprecedented and also unsustainable. Once businesses renormalize their supply chains, employees return to work, and consumer appetites have been satisfied, we believe the U.S. economy should reset to its long-term secular growth rate of 2%–3% real GDP. It is important to remember, the five-year average growth rate of U.S. real GDP prior to the global pandemic was 2.5%. Nothing about the pandemic has altered the long lasting impact of the structural factors (demographics, debt levels, and productivity) that ultimately drive long-term economic growth.

We have long argued aging demographics and rising debt levels, with productivity rates bound at the 2% level, would lead to a "lower for longer" economic landscape—lower growth, lower inflation, and, most likely, lower interest rates. Although rising prices—referred to as reflation—are normal during an economic recovery we do not believe the systemic hyperinflation of the 1970s is on the horizon. And although interest rates will likely rise from the 1.5% current level to a range of 2.0%–3.0% as the economy continues to recover, we believe interest rates should remain well below the averages of 20 years ago.

In the lower for longer environment, in our opinion, it is imperative that investors overweight equities relative to bonds in order to pursue their long-term objectives. When interest rates were much higher, allocating a substantial portion of one's portfolio seemed perfectly sensible. Today, with interest rates at historically low levels, we believe bonds must play a supportive—rather than a leading—role within an investment portfolio. MCIP's target allocation of 75% equities and 25% bonds, with the flexibility to adjust the tactical portion between equities, bonds, and cash when market conditions signal, in our opinion, allows an optimal mix for investors in the lower for longer world in which we now live.

We believe economic growth and earnings growth should decelerate as the economy reverts back to its long-term sustainable trend line. Oftentimes the stock market has struggled with the directional change of growth. Even so, we maintain the absolute level of growth over the next few years should remain attractive. And although we expect interest rates to rise as the

economy re-normalizes, we do not believe the probability of higher 2.0%–3.0% yields on the 10-year U.S. Treasury Note will jettison the current bull market in stocks that is currently underway. For example, we enjoyed a strong bull market in stocks in the 10 years leading up to the global pandemic with yields on the 10-year U.S. Treasury Note vacillating between 2.0%–3.0% during that time frame.

We continue to believe the current landscape of positive economic growth, improving employment, rising corporate earnings, and relatively low interest rates provides a favorable environment for the Core Investment Portfolio—Tax-Advantaged. In our opinion, the market environment remains positive for investors.

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*Total assets combines both Assets Under Management and Assets Under Advisement as of June 30, 2021. Assets Under Management represents the aggregate fair value of all discretionary and non-discretionary assets, including fee paying and non-fee paying portfolios. Assets Under Advisement represent advisory-only assets where the firm provides a model portfolio and does not have trading authority over the assets.

Gross-of-fees returns are not reduced by any fees, expenses, or transaction costs (i.e. Pure Gross). Net-of-fees returns are presented after the deduction of the manager fee of 0.35%. There will be additional wrap sponsor fees, including trading expenses and management fees, which will vary by wrap sponsor. These additional fees will lower overall net performance. Please consult the wrap sponsor ADV Part 2A for additional fee information.

A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques, strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios. All performance results presented are done solely for educational and illustrative purposes and are not intended for trading, or to be considered investment advice. No representation is made that any Strategy, model, or model mix will achieve results similar to those shown in these materials. It should not be assumed that any holdings included in these materials were or will prove to be profitable, or that recommendations or decisions that the firm makes in the future will be profitable or will equal the investment performance of the securities discussed herein.

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The S&P 500 Total Return Index tracks both the capital gains of the stocks in the S&P 500 Index over time, and assumes that any cash distributions, such as dividends, are reinvested back into the index. Looking at an index's total return displays a more accurate representation of the index's performance. By assuming dividends are reinvested, you effectively have accounted for stocks in an index that do not issue dividends and instead, reinvest their earnings within the underlying company. The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency). Indices are unmanaged, do not include fees and expenses, and it is not possible to invest directly in an index. The Bloomberg Barclays Municipal Managed Money Short/Intermediate Index is a rules-based, market-value-weighted index engineered for the tax-exempt bond market. To be included in the index, bonds must be rated Aa3/AA- or higher by at least two of the following ratings agencies: Moody's, S&P, Fitch. If only two of the three agencies rate the security, the lower rating is used to determine index eligibility. If only one of the three agencies rates a security, the rating must be at least Aa3/AA-. They must have an outstanding par value of at least $7 million and be issued as part of a transaction of at least $75 million. The bonds must be fixed rate, have been issued within the last five years, and must be at least one year from their maturity date. AMT, hospital, housing, tobacco, and airline bonds, along with remarketed issues, taxable municipal bonds, floaters, and derivatives, are excluded from the benchmark. The Bloomberg Barclays Municipal Bond Index measures the performance of the U.S. municipal bond market. It is composed of approximately 1,100 bonds; 60% of which are revenue bonds and 40% of which are state government obligations. MSCI All Country World Index captures large and mid cap representation across 23 Developed Markets and 21 Emerging Markets countries. The index returns are presented on a total return basis, which assume reinvestment of all cash distributions (such as dividends). With 2,434 constituents, the index covers approximately 85% of the global investable equity opportunity set. The HFRI Equity Hedge (Total) Index (HFRIEHI) is a fund-weighted index of strategies that maintain positions both long and short in primarily equity and equity derivative securities. The volatility of the indices identified in this report may be materially different from the volatility of the model portfolios presented by EquityCompass. Indices are unmanaged, do not reflect fees and expenses, and are not available for direct investment.

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