EQUITY STRATEGY FOCUS

JULY, 2021

IN VIEW: The Economic Landscape

The Federal Reserve met again in June to review the current state of economic and financial conditions. In the meeting, the Fed raised their inflation outlook but highlighted that any uptick is anticipated to be transitory. They believe pressures from supply disruptions should subside as demand eases after its initial surge brought on by vaccinations and business re-openings. As a result, the Fed expects inflation to revert back to target levels in 2022 before rising modestly again in 2023. The members agreed to maintain current interest rate and bond purchasing programs, until labor market conditions return to maximum employment levels and inflation at risk of exceeding 2% for a longer period of time.

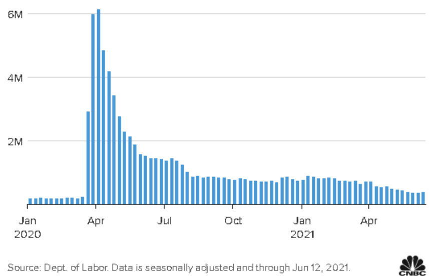
The Biden Administration is proposing to lift taxes on households as well as corporations, in an effort to raise $3.6 trillion over the next decade for investment back into the U.S. economy. Although still a way off with plenty of negotiations to play out, as it stands today, strategists at Bank of America, Morgan Stanley, and RBC Wealth Management estimate the current proposal for corporate tax hikes could reduce S&P 500 profits by 6-8% next year. Of course, with some give and take, the corporate rate may wind up closer to only 25%. And any changes to capital gains taxes are not widely supported on either side of the isle, thus reducing the potential impact tax reform may have on earnings substantially. An additional risk is an imbalance in the timing between the impact from tax hikes being much more immediate, and the effects from higher government spending.

GDP jumped 6.4% in Q1, following strong growth in the previous quarter of 4.3%. The main drivers were a function of a continued economic recovery, business re-openings, and continued government spending support. Private services which include industries like technical services, waste management and real estate leasing and rentals were the largest contributors to growth. Strength from consumer spending largely emanated from spending on goods as opposed to services which grew at rates of 23.6% and 4.6% respectively. Growth was partially offset by other services in non-durable goods (coal and petroleum) and agriculture. The trade balance will be a drag on growth, as long as the U.S. plows ahead of the rest of the world in terms of vaccination rates and the economic recovery.

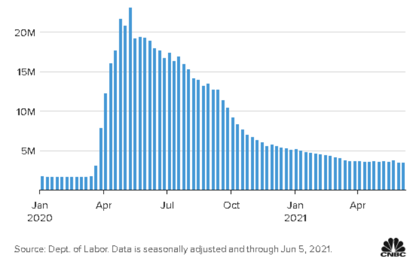
Personal incomes declined in April and May. This decline is largely attributable to the tapering of government aid via the America Rescue Plan and the Pandemic Unemployment Compensation program. Personal consumption expenditures rose modestly while the personal savings narrowed significantly after peaking in March. This report reflects the eagerness of consumers to resume normal activity levels with the lifting of restrictions and summer months ahead.

Despite an unexpected uptick in initial jobless claims in June, the overall trend is improving. Continued re-openings throughout the summer months, along with the phasing out of federal enhanced unemployment benefits should keep the labor market on its path towards recovery. The overall unemployment level stands at 5.8% as of May compared to 3.5% pre-pandemic.

Initial claims for Unemployment



Continuing Claims for Unemployment



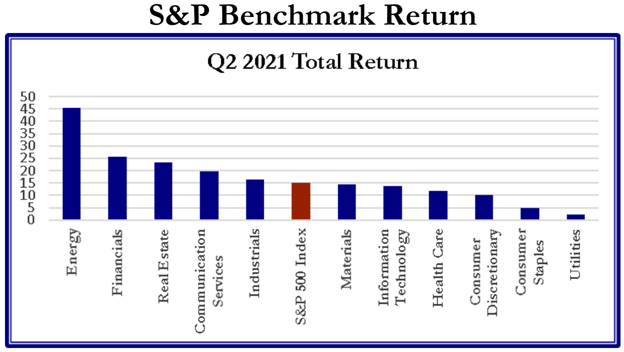
The Leisure and Hospitality industry saw the largest uptick in employment gains this quarter, making up nearly 75% of jobs lost in the industry since early 2020. As the cloud from the pandemic recedes, more people are emerging from their homes to travel and thus creating demand for employment within the service industry, particularly in restaurants and hotels.

The May ISM Services Index came in at 64%, a level that registered 1.3% higher than the previous month. Throughout a majority of this past year, it has been the manufacturing sector that was supporting the economy. But during the more recent months it's been the services sector that has gained momentum, even outpacing the manufacturing sector and thus broadening the recovery. Ned Davis Research cites several sources of evidence, such as mobility trends (the measure of human engagement in the economy), and breadth of easing of government stringencies to support the case that the services sector is poised to continue on this path towards more accelerated growth.

CLOSE-UP: Equity Investment Overview

Market Performance & Earnings:

S&P Benchmark Return



Source: Bloomberg and Altman Investment Management, LLC

The S&P benchmark index rose 15.2% year-to-date through June. Energy produced the largest gains, up over 45%, followed by Financials, and Real Estate. All sectors reported positive returns including modest returns from Utilities and Consumer Staples.

Q1 earnings came in 23% above consensus estimates at $49.13. Share buybacks and dividends paired back some, but remain above long-term averages at roughly 31% and 27% of operating cash flows (OCF), respectively. Capex was still an area of uncertainty at nearly half its long-term average of 60% of OCF. Cyclical sectors were the largest headwind as corporations navigated re-opening efforts while attempting to gauge the timing and volume of an anticipated resurgence in demand. Corporate net margins and sentiment reached all-time highs setting the stage for a rally in cyclical and value stocks.

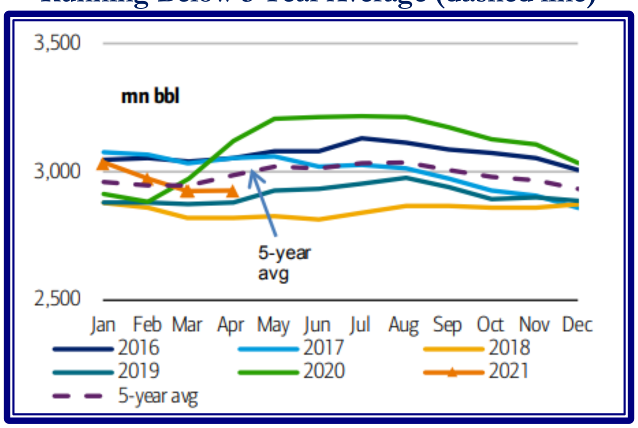
Bottom line earnings grew 64% while top line sales grew 18% year-over-year with cyclicals leading the way. Inflation emerged as a common theme in earnings calls. To date, pricing and volume growth has outpaced wages growth, but growing concern around transportation costs is brewing. Labor inflation will be a key indicator to watch over the coming months as it has the potential to negatively impact net margins if it moves up too quickly.

Earnings estimates for Q2 have risen since March fueling investor confidence for a cyclical recovery favoring value stocks. Consensus sets estimates up 61% for the coming quarter which bodes well for market expectations. The newly emboldened consumer should support demand giving corporations the visibility necessary to lift capex adding sustenance to the recovery that is already underway. Consensus estimates for 2021, as reported by both Yardeni Research and FactSet, are in excess of 35% growth for 2021, and 12% for 2022.

Equity Strategy:

Our portfolio positioning for a secular and cyclical market rally includes an overweight in Energy. Our theory for oil is based upon a recovery in demand alongside current supply cuts. Pent up mobility from the pandemic, a shift in traveler preference for personal vehicles over mass transit, and the newly found flexibility afforded to remote workers have all worked to lift oil prices above $70 throughout the month of June. On the supply side, crude oil inventories running 6% below 5-year averages are also adding to upward pricing pressures.

2021 Crude Oil Inventories (orange line)
Running Below 5 Year Average (dashed line)



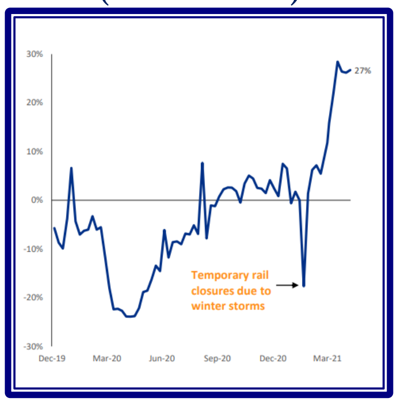
Source: International Energy Agency and BofA Global Research

In June, OPEC+ failed to reach an agreement on production policy, knocking oil off its recent peak which created uncertainty around anticipated production hikes throughout year end. Prices could fall further if the U.S. and other countries outside of OPEC+ ramp up production to pick up the slack. However, we feel the long-term story favors higher oil prices.

At a time when global demand is on the rise, any perceived delay to anticipated OPEC+ production hikes have the potential to pressure prices higher as supplies fail to keep up with demand. Keep in mind, the proposed production hikes were being phased in on top of current cuts in order to gradually return some production to market. Either way, oil production is running below capacity. The current cuts are due to expire in April 2022 with a proposal on the table to extend them through year end. Additionally, through the Paris Climate Agreement, the U.S. along with other nations will likely cut oil production as one way to combat CO_2 emissions. The longer-term story will revolve around how to manage the response to supply cuts, in order to eliminate an uptick in imports to meet demand.

Railroads are another industry we anticipate benefiting from the broadening global economic recovery. The U.S. is out front in terms of vaccinations and re-openings, and we anticipate others countries like Europe and Japan will soon follow suit. In June, we established a position in CSX Corporation to take advantage of what we believe will be a resurgence in global demand. Global GDP, industrial production, housing starts and light vehicle sales are all indicating higher freight traffic throughout 2021 and into next year.

Change in U.S. Freight Rail Carloads
(Year over Year)



Source: Cohen and Steers

Precision scheduling has been widely adopted in the industry and is working to improve efficiencies. More specifically, CSX recently purchased Quality Distribution, a bulk tank trucking company with the aim of providing better multimodal shipping solutions and they are gaining share against regional peers. On a secular basis, CSX has also worked to significantly reduced its reliance upon coal with revenues from the sector nearly halved since 2014.

Lowering Telecom and Technology Exposure:

In the second quarter, we sold our position in AT&T Inc., a leading telecom company operating in three main segments: mobility, entertainment (broadband and video), and Warner Media. The company was a long-term holding in our portfolio for many years in the Telecom Services sector and offered a measure of defensiveness with good dividend yield support. In 2015, the company began implementing a diversification strategy by introducing an online pay preview entertainment platform by acquiring DirecTV for $49 billion. This was ill-timed given the then-emerging trend in "cord-cutting".

In recent years, AT&T took steps to transform its footprint beyond the traditional wireless business, most notably its $85 billion acquisition of Time Warner in 2018. This venture expanded AT&T's presence in media and entertainment with the additions of HBO, Turner Broadcasting, and Warner Brothers. The end result of this strategy placed pressure on the shares with concerns of both increasing AT&T's leverage as well as its ability to integrate Time Warner. However, we were encouraged to remain holders in the company shares as it met its deleveraging targets through a combination of cash flow and non-core asset sales. Additionally, the integration of Time Warner proceeded reasonably well. In 2019, AT&T was one of our better performing investments in the portfolio. Since then, the stock has been a laggard in both absolute terms and relative to the new Communications Services sector – formed in 2018 to combine the increasingly interrelated entertainment, media, interactive media, and telecom industries. AT&T's underperformance seems to be driven, in part, by uncertainty around its long-term strategy and ability to effectively compete across the telecom and media landscape.

The dividend yield on AT&T's stock had risen to close to the 7% range. Valuation remains still reasonably inexpensive and the stock trades below its 5-year average on a P/E basis, but slightly above average based on EV/EBITDA (enterprise value-to-earnings before interest, taxes, depreciation and amortization) when considering the company's debt. We share the market's broader concerns about AT&T's longer-term strategy and it has become increasingly evident that the company would need to make significant investments in its media businesses and in spectrum assets (to support its 5G wireless network) to remain competitive. The payoff from these investments appears to carry an increased amount of uncertainty and risk. The company does not appear to be getting credit for its high dividend yield and it was increasingly unclear what the street would require to rerate the shares higher. Furthermore, based on our belief that we are in the more cyclical stage of the economic cycle, we believe there are investment opportunities with more attractive risk-reward profiles.

Based on relative overvaluation of the Technology sector, we again scaled back our holdings by rebalancing various investments in the semiconductor and application software space - we reduced positions in AMAT, KEYS, and ACN. We used the cash to lower the risk exposure in the sector by adding another secular growth name to the group, diversifying industry exposure by creating a target weight position in **Fidelity National Information Services, Inc. (FIS),** a leading technology solutions provider for banks, merchants and capital markets firms. As an IT services company, FIS is primarily involved in data and transaction processing. The company operates in three business segments: Banking Solutions (49% of total revenue), Merchant Solutions (31%) and Capital Market Solutions (20%). From a geographic perspective, the majority of the company's revenue (76%) is generated in North America. FIS traditionally focused on banking and capital markets clients; however, in July 2019, it acquired Worldpay for $35 billion. The acquisition further diversified the company, giving FIS exposure to a processing/payments business for merchants of all sizes across a wide range of customer types, including grocers, pharmacies, restaurants and retailers. The COVID-19 pandemic caused disruptions in FIS's business. Transaction volumes shifted from higher-yielding segments, such as discretionary retail, restaurants, and travel, to lower-yielding segments like grocery and pharmacy, creating a drag on the company's overall results.

In the second quarter, FIS shares continued to hit our valuation screen and its spread had widened against its peers. The shares currently still trade in line with their 5-year average current fiscal year P/E ratio. On a relative basis, FIS continues to trade at a 25% discount to the S&P 500 Index compared to an average premium of 8% over the past five years according to Bloomberg Research. We believe the banking and capital markets solutions businesses offer several attributes, including a diversified client base, low client turnover and high recurring revenue. It's worth mentioning that FIS's largest customer represented less than 3% of annual revenue. Client retention rates are above 90%, with only an estimated 2% of the market changing their core processor each year due to the high costs of switching.

In the banking segment specifically, large regional banks are increasingly outsourcing their core processing functions. FIS has high market share among banks with assets over $1 billion and stands to continue to benefit from this trend, which is being driven by heightened regulatory oversight, rising demand for digital banking, high legacy costs associated with older systems, and a focus on customer retention.

The payments market has benefited from the secular trend of consumers moving from cash and check payments to card payments – a trend that accelerated during the pandemic. Credit and debit comprised 62% of payments in 2017, up from 48% in 2010. Card payments are expected to hit 82% by the end of 2022 and continue growing from there. The card issuer processing market is dominated by four players that account for 90% of the market - and FIS holds approximately 20% market share. FIS had been an active acquirer over its history, which helped diversify its business and resulted in a market leadership position across its business segments.

FIS also has a strong track record of successfully integrating acquisitions and integrating synergies ahead of schedule. The ability to drive cost down allows for faster margin expansion. These margin improvements in our estimate have the potential to drive double-digit earnings growth in the next several years. We also view FIS as having an attractive capital return policy, improving balance sheet, and solid free cash flow generation. FIS raised its dividend annually over the past decade, and recently announced a share repurchase program targeting 100 million shares (about 16% of shares outstanding). The company, in their last conference call, has forecasted that it expects to reduce leverage to 3.0x net debt/EBITDA by the end of 2021. Free cash flow in 2020 was approximately $3.0 billion, up nearly 50% from 2019. Overall, we have concluded that FIS is a quality company that broadens our portfolios within the IT sector, with attractive growth and valuation characteristics. Our reduction in three positions and addition of FIS has had the net effect of reducing our overall exposure to the sector by approximately 2.0% to 21.3% from 23.4%.

Increasing Financial/Cyclical Exposure:

We added to MetLife Inc. during the quarter, bringing it up to a target weight position. MetLife is one of the largest life insurers in the United States, who continues to benefit from a transformation that began several years ago when we established our initial investment position – the company shifted its business from underwriting products with interest rate guarantees to selling high free cash flow products with shorter payback periods. Over the holding period, Met life has demonstrated a willingness to continue to sell and spin off various business lines. For example, in 2017 MetLife created Brighthouse Financial which was comprised of the retail life and annuity business. While these changes created near-term disruptions when first announced, we continue to believe that the company has positioned itself better for the long term by decreasing capital markets sensitivity, bolstering free cash flow, and reducing sales of higher-risk products such as variable annuities and reducing its exposure to a rising interest rate environment. The changes also improved the overall business model by lowering MetLife's direct expense ratio from 14.3% in 2015 to 12.5% in 2019.

The COVID-19 global pandemic and resulting recession created fundamental headwinds for the life insurance industry - largely related to low interest rates, increased credit concerns, heightened mortality rates and a rise in unemployment. However, MetLife performed better than expected and bolstered the case to increase our investment in the company, as the economic recovery unfolds in the U.S. The largest part of the company's customer base in the U.S. is national accounts, which turned out to be better insulated from the pandemic's negative economic effects than small and medium-sized businesses. MetLife is a market leader with a particularly strong position in group benefits, which is considered by most analysts to be a higher-multiple business within life insurance. This is due to the high degree of visibility the business carries, with 80-85% of annual revenue coming from existing customers. The group benefits business also carries limited volatility and low capital requirements relative to the premiums it generates. MetLife's valuation continues to be an attractive investment, in our view, with the shares trading around 0.83x expected 2021 book value. If optimism concerning long-term interest rates were to rise, we believe the valuation gap should narrow. MetLife still trades at a 41% discount to the Russell 1000 Value Index on a P/E basis compared to its 5-year average discount of 46%. From a balance sheet perspective, MetLife continues to be well-positioned relative to other financials.

MetLife stock offers a dividend yield of 3.3% with a dividend cut less likely at this point in the economic cycle. While share repurchases were halted last year, MetLife has announced a resumption of that buyback program. The company has limited short-term debt due through 2022, giving it ample financial flexibility. MetLife also had a strong liquidity position with almost twice management's targeted range of $3.0-4.0 billion. MetLife represents a relatively high-quality defensive investment in the Financial sector, in our view, because of its valuation, less volatile underwriting exposures, and strong capital position that cushions any potential losses. MetLife also added a degree of geographic diversification to the portfolio's Financial sector allocation, with more than a third of its earnings coming from outside North America. Overall, we believe MetLife continues to offer an attractive long-term risk-reward tradeoff. The steps the company took to reduce its equity market and interest rate exposure, improve its capital position, and emphasize more stable business lines should lead to increasing returns on equity (ROE), book value growth and ultimately, multiple expansion.

During the quarter, we added another regional bank to our Financial sector by purchasing the Minneapolis based US Bancorp (US Bank). US Bank, as a super-regional, is the fifth-largest commercial bank in the U.S., with roughly $558 billion in total assets. It has a relatively diverse revenue mix compared to other regional banks. According to Morgan Stanley, total spend is now higher than pre-covid levels in each of the 3 payments businesses – merchant, corporate and retail. This has driven payments revenues up 16% q/q and 39% y/y to $908M, just 5% below the pre-covid peak. And there is more room to grow, with corporate T&E and Merchant Airline spend still lagging but moving upward. Prepaid spend related to the stimulus programs and customer acquisition costs (to fund long term growth) are the only headwinds to revenues in the near future, but that should be more than offset by the broader rebound. Payments are expected to rise 15% in 2021 and another 11% in 2022.

Historically, the stock behaved more defensively given its low efficiency ratio (expenses as a percentage of revenue) and diversified business model. The nature of the recent downturn, however, created particular challenges for US Bank's payments business, especially in areas most impacted by COVID-19, such as travel, retail, and hospitality. Other developments that caused the shares to fall out of favor included investor concerns about an increase in US Bank's efficiency ratio, which was trending closer to peer levels, and improving sentiment for banks with more exposure to changes in short-term interest rates (compared to peers, US Bank's business is more sensitive to changes in longer-term rates). US Bank's valuation is attractive, in our view. The stock's price/tangible price-to-book (P/B) ratio is 1.9x, below its 5-year average of 2.2x. Meanwhile, the broader regional bank group is trading at a 10% premium to its 5-year average. From a balance sheet perspective, the company appeared to be better positioned than its peers. Unlike most other regional banks, US Bank held back on releasing reserves in 4Q20, increasing its tier 1 capital ratio to a pandemic-high of 9.7%, well above the regulatory minimum of 7.0%. This allowed the bank to avoid cutting its dividend in 2020 and positioned it well to avoid cuts in 2021. Over the last decade, US Bank maintained fairly consistent capital and payout ratios. The stock offers a solid dividend yield of 3.0% and the company has authorized a $3 billion share repurchase. US Bank was a strong performer among regional banks in Pre-Provision Net Revenue (PPNR) under the Fed's Dodd-Frank Act Stress Test (DFAST) process. US Bank also screened with lower credit risk than most peers, in part because management de-emphasized higher risk commercial real estate and commercial & industrial loans late in the economic cycle when its risk-adjusted returns deteriorated.

As the economy moves toward recovery following the pandemic, we believe regional banks are poised to outperform the broader Financial sector - and that US Bank, specifically, would benefit from a rebound in its payments business and the composition of its loan portfolio. In addition, our view of rising long term interest rates and a sizeable fiscal stimulus package are tailwinds for banks and financial service companies. While lending remains challenging in the short term for the industry, we believe that adding exposure to the group (close to 18.0%) at this point in the cycle is warranted. Overall, we view US Bank as a high-quality regional bank with defensive characteristics (diversified business model, solid balance sheet, strong capital position) whose long-term prospects investors have overly discounted.

IN CONCLUSION:

The economy is continuing on its path forward with the support of consumer and government spending, accommodative Fed policy, and business re-openings. Earnings are recovering in conjunction with consistent consumer demand. We expect corporate capex to rebound lending additional support to economic growth.

On a macro basis we estimate GDP to run upwards of 5% for 2021, before moderating somewhat in 2022. The Fed agreed to maintain current accommodative policies until evidence of more sustained inflationary pressures exist and labor market conditions reach maximum employment. Our bias towards a cyclical recovery leads us to favor stocks over bonds with an emphasis in Energy, Financials, and Industrial sectors.

Market leadership continues to send mixed signals as the third quarter unfolds - with better quality companies trading based on fundamentals falling behind lower quality companies with high valuation characteristics. However, these rallies don't tend to persist indefinitely. There also appears to be an appetite by investors to return to the pandemic beneficiaries when the economic recovery appears challenged. We view this phenomenon of flipping between investor complacency buying low quality stocks to the large cap tech companies that dominate the indices as defensive trades in market corrections. Our conviction is that an economic recovery is imminent once vaccination rates climb as the variant strains of Covid-19 encourage the unvaccinated. In this vein, we have continued adding economic sensitivity to the portfolio in the context of higher quality businesses (those with attractive balance sheets, capital positions, and cash flow generation). We've also focused on the portfolio's margin of safety such that its valuation multiples are at a larger discount to the benchmark's than they have been historically. In our opinion, the combination of higher quality and lower valuations position our portfolios during periods of uncertainty. While we don't expect our portfolios to keep up with the benchmarks in low quality rallies, we believe that we can outperform in up markets when investors begin to refocus their attention back to fundamental characteristics of a company's long term earnings growth potential that is not fully recognized in the share price. This should buffer the downside risk during corrective phases.