REDHAWK

QUARTER 3 COMMENTARY

September 30th, 2020

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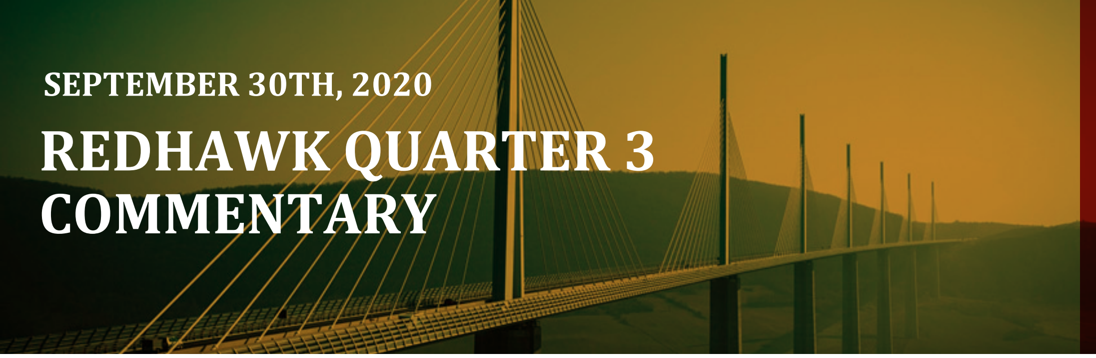

SEPTEMBER 30TH, 2020

REDHAWK QUARTER 3 COMMENTARY

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Each quarter, Redhawk's Investment Committee provides a Quarterly Commentary. We look at what's going on in the investment landscape and provide our perspective on a variety of topics. These aren't predictions and it represents our perspective on important market and economic information designed to help make decisions affecting your long-term financial strategy. Our goal is to help you understand what is going on in the markets so you can more clearly define investment goals, diagnose unintended risks, and utilize portfolios that can achieve a better financial outcome.

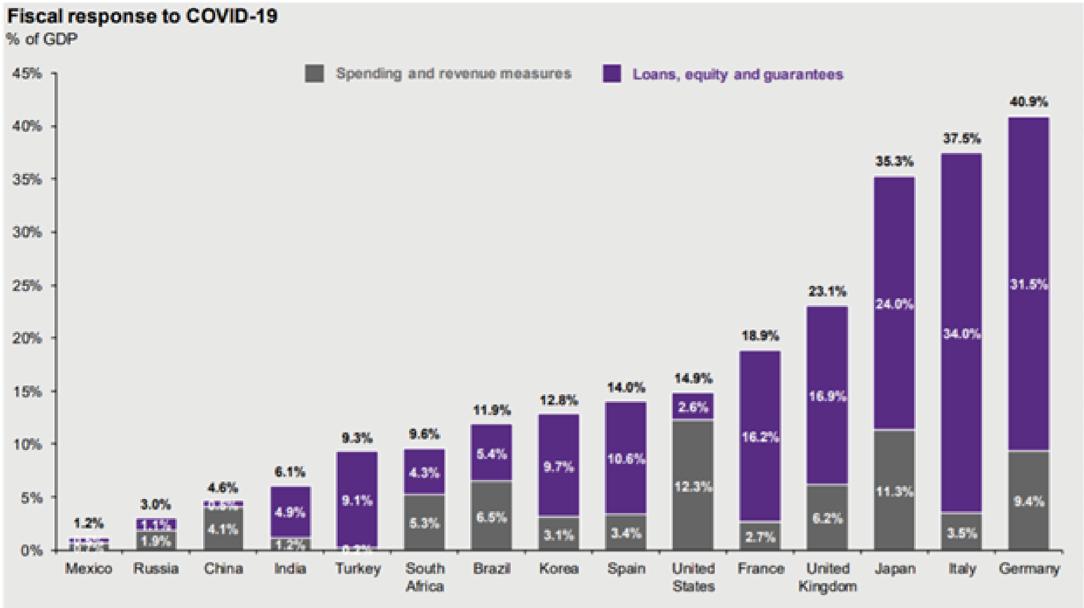
Market Commentary

U.S. equities gained in the third quarter despite a decline in September as consumer sentiment slipped. Overall, the U.S. economy's recovery continued, and the Federal Reserve's ("Fed") messaging remained highly accommodative. The Fed will now use average inflation targeting ("AIT") in setting the policy interest rate. The new policy means the Fed is willing to wait until the average inflation has gone above 2% until it responds. Furthermore, the latest dot plot, the Fed's own projection of the future path of interest rates, suggests that policymakers see rates at the zero lower bound through to and including 2023. However, U.S. markets stumbled late in the quarter amongst a resurgence in European COVID-19 cases, as well as questions over additional fiscal stimulus measures. Adding to these worries was uncertainty over a smooth transition of power if President Trump loses his re-election bid[1].

The U.S. unemployment rate dropped to 8.4% in August, down from 10.2% in July and below consensus expectations of 9.8%. The labor force participation rate also improved, but it is still below its February pre-pandemic level. Industrial production rose for the fourth consecutive month in August, which was at a much lower rate than earlier in the summer, signaling a slowing recovery in manufacturing. Similarly, retail sales increased in August, but again at a slower rate and below consensus expectations. Spending at food and beverage stores continued to be strong.

Consumer discretionary stocks, particularly restaurants, appliances, or clothes retailers, performed well. Distribution companies were stronger and helped to lift the industrials sector, even though several airlines are facing headwinds from extremely low passenger numbers. Similarly, energy names were broadly weaker on expectations that fuel demand will remain subdued.

Since March, global central banks have injected more than 6 trillion of liquidity into world financial markets. As shown in the chart below, the fiscal response to COVID-19 has been significant. Most of the easing came in the form of quantitative easing ("QE"), which helped support asset prices. In the United States, the Fed's creation of extraordinary facilities such as the Main Street Lending Program and the Corporate Credit Facility restored calm in the financial markets. The 3 trillion of fiscal stimulus in the first half of 2020 provided crucial support to the U.S. economy.



Source: IMF Fiscal Monitor, J.P. Morgan Asset Management.
Fiscal measures are estimates from the IMF's Fiscal Monitor Database from June 2020.
Guide to the Markets – U.S. Data are as of September 30, 2020.

The overall trend for sector performance since the end of the first quarter has been mixed, as performance leaders and laggards have rotated all year. For example, at the end of the first quarter, every single one of the eleven S&P 500 sectors turned in negative numbers whereas the end of the second quarter, all eleven sectors turned in positive numbers.

The sector returns for the third quarter are shown in the chart to the right and some of the notable results are as follows:

- Ten of the eleven S&P 500 sectors were positive for the quarter.
- The Consumer Discretionary sector was the best performer for the quarter as it gained over 18%.
- The Energy sector was the worst performer for the quarter as it lost 12.49%.
- For the quarter, the differences between the best and worst performing sectors was over 30%, with the Consumer Discretionary sector up over 18% and the Energy sector down over 12%.

Sector	Performance
Consumer Discretionary	18.01%
Information Technology	12.78%
Materials	11.83%
Industrials	11.26%
Communication Services	7.37%
Consumer Staples	7.37%
Health Care	4.75%
Utilities	4.17%
Real Estate	2.18%
Financials	1.57%
Energy	-12.49%

Source: Chautauqua Capital.

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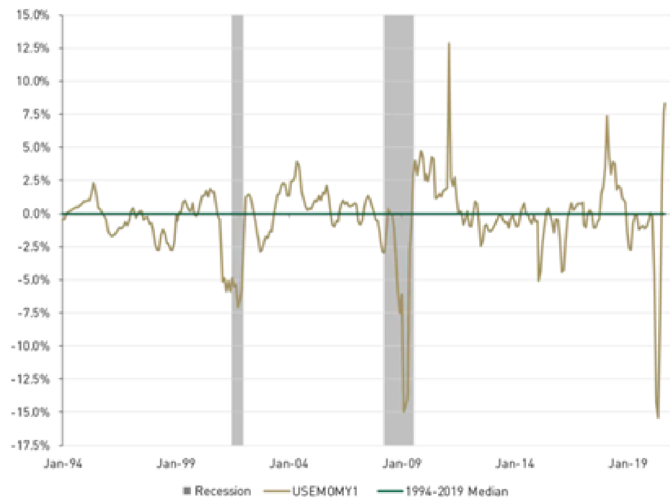
As the quarter ended, investors were looking past the uncertainties of the U.S. election and government's relief package because of the market's earnings momentum (see the chart on the right and the USEMOMY1).). The magnitude of U.S. analysts' revisions in their earnings estimates, the direction and breadth of changes in company earnings estimates, was extraordinarily positive. This most likely implied that the negative impact from COVID-19 related issues has not been as bad as feared. If a vaccine is not developed as expected, however, these estimates would see significant downward revisions[3]. Overall, the economic recovery in the U.S. has somewhat flattened after the initial recovery. Retail sales have lost momentum since August. Labor markets, unsurprisingly, are soft after extended unemployment benefits came to an end in July, and employers have been reluctant to hire in this uncertain economy. Bi-partisan disagreements over additional COVID-19 stimulus relief has continued and there has been little progress on the next bill. Additionally, many state and local governments are facing budget troubles.

Figure 3: Near-term U.S. Earnings Momentum Is Extremely Strong

The magnitude of revisions in analysts' earnings estimates has soared.



Source: JP Morgan, *The Earnings Landscape*. October 2, 2020. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment.

International Markets

European equities were virtually flat over the quarter. The rate of improvement in economic data slowed over the quarter and worries took hold over sharply rising COVID-19 infections in many European countries. The energy and financials sectors saw the sharpest falls while materials and consumer discretionary advanced, with automotive and luxury goods holding their own.

Country	Performance	Country	Performance
Taiwan	17.10%	Netherlands	5.97%
Denmark	15.40%	Switzerland	5.10%
India	15.11%	Australia	2.84%
China	12.57%	Singapore	-0.99%
United States	9.64%	Israel	-1.96%
Japan	7.08%	Austria	-4.74%
Canada	6.37%	Indonesia	-6.80%

Source: Chautauqua Capital.

As shown in the chart to the left, the Japanese equity market returned 7.08% for the quarter and this was despite a strengthening of the yen against the U.S. dollar over the period. The quarter was dominated by the change in Japan's prime minister when Shinzo Abe announced his resignation.

Asia ex Japan equities recorded a strong return in the third quarter led by Taiwan returning 17.10%, where information technology stocks lead the way. India and China all posted double-digit returns and outperformed the MSCI Asia ex Japan index. In China, economic data signaled ongoing recovery and the second quarter corporate earnings results were positive. However, tensions with the U.S. escalated, which included new restrictions on Chinese telecoms.

Emerging market equities had a robust return in the third quarter, supported by optimism towards progress on a COVID-19 vaccine and ongoing economic recovery. U.S. dollar weakness proved supportive and the MSCI Emerging Markets Index increased in value and outperformed the MSCI World.

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Fixed Income Markets

The Bloomberg Barclays U.S. Aggregate Bond index ("Agg"), which acts as a proxy for the investment-grade bond market, increased by 0.6% in the quarter as the decline in credit spreads and the flat interest rate environment were positive for returns (bond prices move inversely to interest rates and credit spreads). Bonds with higher credit risk were the outperformers as high yield increased by 4.6% and corporates were up by 1.5%. Additionally, interest rates are at historically low levels and stayed there throughout the quarter. The 2-Year Treasury yield decreased from 0.15% to 0.13% while the 10-Year Treasury increased from 0.66% to 0.68%.

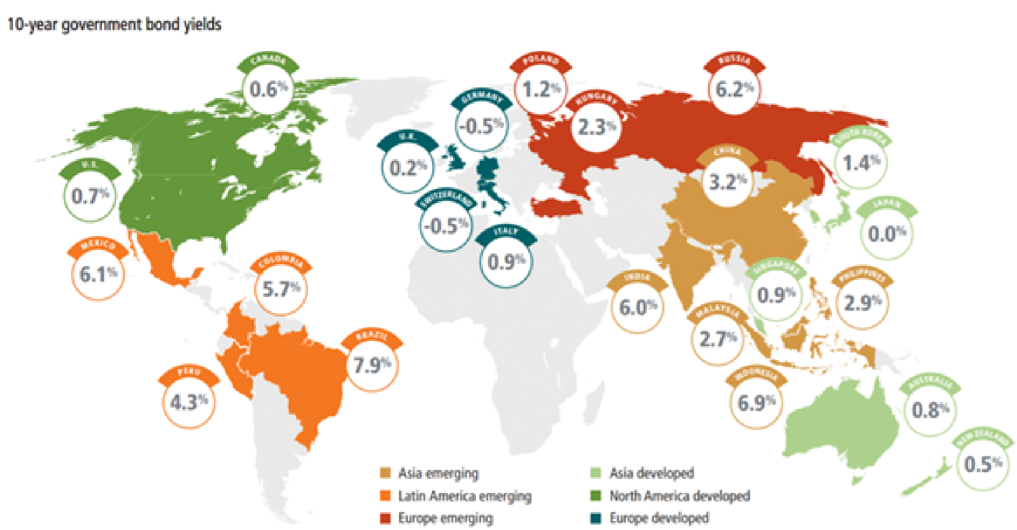
The investment-grade credit markets were most impacted by weak macroeconomic data as the global economy was at a standstill. Investors looked passed record unemployment numbers, stagnate consumer spending, and weak corporate earnings. Instead, the market focused on the speed of reopening the economy. In U.S. markets, this came on the back of the Fed's announcement on March 23rd relating to their bond-buying program focused on shorter-dated corporate bonds. Since the Fed's announcement, credit spreads across investment grade credit have tightened.

Government bond yields were mixed. The United Kingdom yield fell in September as Brexit uncertainty resumed and there was further discussion of negative interest rates from the Bank of England. Conversely, European government bonds performed well as sentiment toward the region improved markedly after the European Union announced a pandemic recovery fund. The German 10-year yield fell by 0.07%, finishing at a negative 0.52%, while Italy's yield fell by 0.39% and Spain's by 0.22%. The euro gained over 4% against the U.S. dollar, while the dollar index lost just over 3.5% overall.

Corporate bonds had a positive quarter. Investment grade returned 1.8%, while high yield debt returned 4%. Investment grade bonds are the highest quality bonds as determined by a credit rating agency and high yield bonds are more speculative with a credit rating below investment grade.

In emerging markets, government bonds returned 2.3% and corporate bonds returned 2.6%. Local currency bonds made a modest positive return, while emerging markets currencies were mixed, but slightly negative overall.

The chart below shows the 10-year government bonds across various countries.



Source: FactSet, as of 9/30/20. Foreign investing, especially in emerging markets, has additional risks, such as currency and market volatility and political and social instability. Past performance does not guarantee future results.

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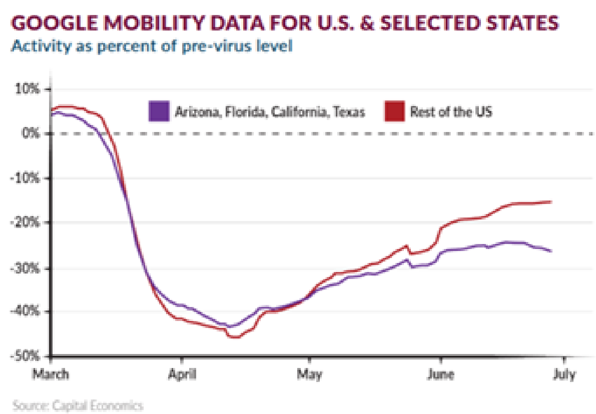
Economic Outlook

The headwinds are easy to identify. Fiscal policy is a critical tool to support the economy in difficult times, but political gridlock has made it difficult to provide any stimulus relief. In the U.S., both parties are still far apart on the size and scope of a potential plan. This will further stress labor markets and consumer spending trends that have stagnated after the quickest rebound in history.

Election uncertainty remains and not only is the outcome still uncertain, but President Trump has also refused to say whether he would honor the transition of power if he loses in November. There is still a lot of skepticism whether the Fed can improve inflation and the Fed's balance sheet ballooned to approximately 8 trillion in June but since then has been largely stagnant. Markets sold off when the Fed did not expand the size of its asset purchase program, even though it had formalized a new longer-term framework for accommodative policy, showing the effects of reliance to accommodative monetary policy[4].

The election outcome and legislative priorities will affect markets and fiscal policy. A Biden presidency would likely mean higher corporate and capital gains tax rates. Even if Democrats win a majority in the Senate, they will almost certainly fall short of a supermajority, making it harder to enact significant tax reform. Nonetheless, a reversal of the 2018 corporate tax cuts would reduce earnings and thereby result in more elevated valuation levels.

The pockets of virus outbreaks in certain U.S. hotspots, especially in Arizona, California, Florida, and Texas, are concerning. Other states also have increasing case trends, but not at the same alarming rate. Certain states have started to scale back reopening activities. In the hardest hit states, which are also among the country's most populous, containment measures are being re-imposed and have begun to see the resultant impact on mobility. The chart to the right shows Google mobility data, which tracks the movement of phone locations over time and is a good barometer of economic activity. While mobility has improved from April's lows, the purple line shows how states with an escalation in cases (Arizona, California, Florida, and Texas) are now seeing mobility flatten and turn lower. The rest of the U.S., shown in red, also is starting to flatten.



Market conditions have clearly improved since the March lows. However, the long-term economic recovery will in part be based on whether there is a reescalation of coronavirus cases that may cause the shutting down of businesses. Research efforts and the continued development of more effective treatment options and/or vaccines would allow for a clearer path to recovery. Given the uncertain path to recovery and many unknowns, expectations for gross domestic productivity ("GDP") vary widely. International financial institutions such as the International Monetary Fund ("IMF"), the World Bank, and the Organization for Economic Cooperation and Development ("OECD"), as well as the U.S. Federal Reserve, expect the U.S. economy to post a decline of 6% to 8% in calendar 2020, which would be twice as deep as the Global Financial Crisis and the worst since WWII[4].

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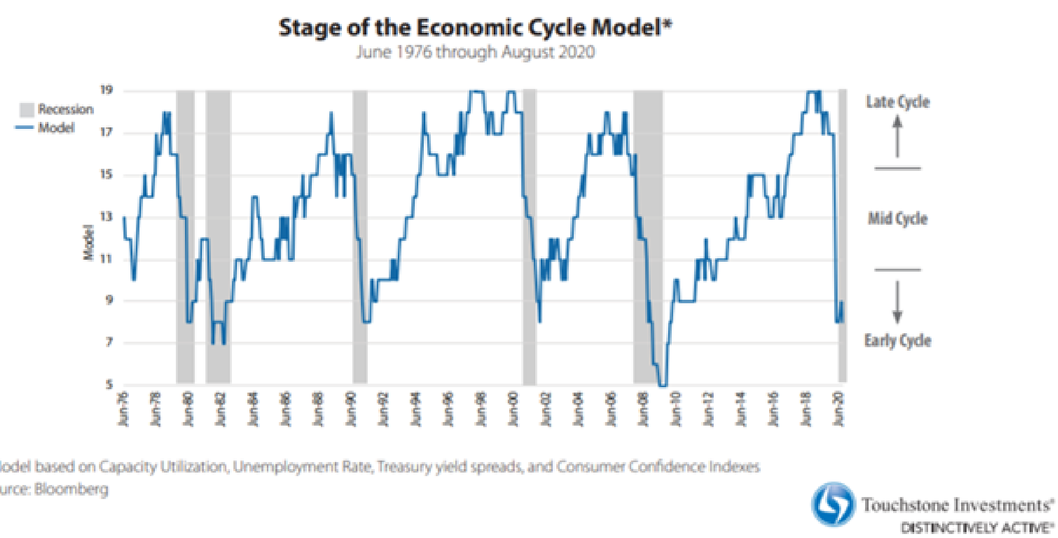
The chart on the right shows the IMF's forecast for GDP for world economies, which generally reflects current consensus expectations for the path of the recovery, barring a second wave of infections. As the graph depicts, economies are expected to have different recovery trajectories. China and other emerging economies are expected to rebound most quickly, with China potentially eclipsing pre-pandemic GDP levels by the end of this year. China was first to cycle through the coronavirus curve and was aggressive with providing stimulus relief and enforcement of shutdowns.

Their measures were aggressive by U.S. standards, but effective. Developed economies are expected to have a slower pace of recovery. In the U.S., prior peak GDP levels may not be surpassed until early 2022 and expectations for Europe and other developed economies are similar[4].

As the chart on the following page indicates, in the blink of an eye we have gone from late cycle to early cycle, something that typically takes at least 12-18 months. Typically, the economy takes the elevator down and the stairs back up. This time may be different given the significant monetary and fiscal response to the crisis. Another stimulus package would certainly be well received by the markets and likely further support the recovery. However, it may not be completely necessary should there be continued progress in containing the virus, drug or vaccine development, or test kits that can provide results in minutes as opposed to days[5].



Given the uncertainties surrounding the U.S. election, the federal relief package, and a COVID-19 vaccine, investors are understandably concerned about the economy. But it seems that regarding the stimulus package and the election, the market is viewing these potential setbacks as only temporary. The development of a vaccine, however, remains a wild card. Failure could lead to a recession and another market downturn.

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Acknowledgements

1. "Quarterly Markets Review – Q3 2020," October 6, 2020. Schroder Investment Management North America Inc., an indirect wholly owned subsidiary of Schroders plc and SEC registered adviser providing asset management products and services to clients in the US and Canada.
2. "Quarterly Markets Summary: 7 Charts on Q3 Stock and Bond Markets," Katherine Lynch, October 7, 2020. https://www.morningstar.com/articles/1003238/quarterly-markets-summary-7-charts-on-q3-stock-and-bond-markets
3. "The U.S. Election, Recessions and the Stock Market," Giulio Martini, October 13, 2020. https://www.lordabbett.com/en/perspectives/economicinsights/us-election-recessions-stock-market.html?utm_source=wp-newsletter&utm_medium=email&utm_campaign=lord-abbett&utm_content=10192020&et_cid=83485496&et_rid=10007283&et_fc=RIA&cid=
4. "Economic & Market Outlook – Third Quarter 2020." Johnson Financial Group, Inc. https://www.johnsonfinancialgroup.com/siteassets/documents/wealth/q3-2020-quarterly-outlook-final.pdf
5. "Quarterly Themes Q4 2020." Touchstone Investments. https://livesharewest2.seismic.com/i/CDS1oLT73CS0q7sLD5Hjpta8MpZkrUPLUSSIGNXlwbPLUSSIGNicUbZIvuXwN13DweUXqLDyImxpGGc5CB9CZZ3wElGQINdc3tBR4kJGXMFf7yjpdGk6J7dFeh___AxS6NI4rKNG6bHun7by

It is not enough to own a portfolio personalized for your situation, based on your comfort with risk and long-term financial goals. You must be patient and disciplined, too. With our risk management process, our investment committee is reviewing the market conditions and underlying investments on a weekly basis. Please contact your Redhawk financial advisor to learn more.

For more information, please contact Redhawk at either research@redhawkwa.com or (952) 835-4295.

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