Quarterly NEWSLETTER

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Commonwealth Bank & Trust Company

4350 Brownsboro Road, Suite 210 • Louisville, KY 40207
502.259.2500 • www.CBandT.com

Fed Induced Melt-up Prevailing

Mark J. Kennedy, Executive VP
*p: **502.259.2517** e: **mark.kennedy@cbandt.com***

Although the S&P 500 experienced its fastest market decline in history of -34% during the five week period ending March 23rd, the second quarter saw a quick rebound and rise out of bear market territory in just more than a month – one of the quickest recoveries in history. The S&P finished up 20.5% for the second quarter, down only 3.1% year-to-date (-8% from 2020 peak high). In June, markets moved sideways after the sharp "V" recovery in April and May. Uncertainties surrounding the rise in new COVID cases in late June put the recovery in doubt and have investors questioning whether the market will be stuck moving sideways until new cases start decreasing or a vaccine is available. Despite the uncertainties, markets continue their "melt-up" to start the third quarter with the NASDAQ establishing all-time highs and the S & P 500 within 3% of all- time highs in early august.

Even though the S&P 500 is close to peak fundamental valuation and investors are ignoring the economic risk of a longer recovery as well as the inherent political risk of an incumbent administration loss, there is probably not much downside in the face of an active Fed. We believe the market is likely to continue with its upward bias through the election. In early 2021, fundamental data are likely to be lower and unlikely to support higher "melt-up" valuations, which could lead to a pullback. Nevertheless, an active Fed, along with the potential for a vaccine and forward 2022 fundamentals, would probably limit a pull back to current market ranges. Given the low expected returns for bonds, investors are likely better off remaining in equities even if lower than expected economic data materializes early next year.

For more details on CBandT's investment outlook, please visit our Investment Commentary page at: https://cbandt.com/wealth-trust/resources/.

Q2 2020
S&P 500 Sector Performance

	Q2	1 Year
Healthcare	13.59%	10.87%
Consumer Discretionary	32.86%	12.56%
Consumer Staples	8.12%	3.61%
Financials	12.20%	-13.94%
Communication Services	20.04%	11.05%
Information Technology	30.53%	35.78%
Materials	26.01%	-1.10%
Energy	30.51%	-36.01%
Industrials	17.01%	-9.03%
Utilities	2.74%	-2.10%

Proprietary Performance Results

Equities	**2nd Qtr**	**YTD**	**1 year**	**3 year**	**5 year**	**10 year**
Focused Equity Fund[1]	17.30%	-0.19%	8.76%	11.92%	10.97%	13.55%
Aggressive Growth Fund[2]	18.25%	-8.77%	-2.17%	13.83%	12.75%	14.96%[1]
Science/Technology Fund[3]	28.99%	16.11%	29.91%	23.23%	17.61%	18.07%
S&P 500	20.54%	-3.08%	7.51%	10.72%	10.71%	13.97%
Balanced	**2nd Qtr**	**YTD**	**1 year**	**3 year**	**5 year**	**10 year**
Strategic Income Builder Fund[4]	13.31%	-5.96%	2.29%	5.67%	5.69%	8.22%
60% Russell 3000 Value, 40% Barclays Aggregate Index	9.86%	-7.58%	-1.76%	3.41%	4.72%	7.93%
Alternatives	**2nd Qtr**	**YTD**	**1 year**	**3 year**	**5 year**	**10 year**
Liquid Alpha Fund	-5.10%	-4.93%	-3.01%	0.38%	n/a	n/a
Structured Alpha LP	-6.50%	-10.43%	-11.81%	n/a	n/a	n/a
SG CTA Index	-2.15%	-2.68%	-1.32%	1.11%	n/a	n/a
Tax-Free	**2nd Qtr**	**YTD**	**1 year**	**3 year**	**5 year**	**10 year**
Muni Funds Blend	2.56%	3.38%	5.45%	4.40%	4.04%	3.71%
Barclays 1-12 yr. Muni Index	2.69%	2.12%	3.83%	3.29%	2.97%	3.09%
Aquila Churchill Tax-Free Fund of KY	0.69%	0.99%	2.67%	3.04%	2.68%	3.18%
Dupree KY Tax-Free Income	0.79%	1.06%	3.07%	3.31%	3.07%	3.62%

*There is no assurance that any of these investment strategies will meet its investment objective. Performance results for each strategy are computed on the strategy's overall returns. Each strategy and index includes the reinvestment of dividends. Past performance does not guarantee future results. Current performance may be lower or higher than the performance results quoted. **[1]** Inception date 3/31/2006. **[2]** Net of management fees; Inception date 7/1/1989; performance results of SMC Capital and/or its principals as advisor from inception to 2/28/06 and as sub-advisors to CBandT since 3/1/06. **[3]** Inception date 12/31/2008. **[4]** Inception date 12/31/2008.*

Fixed Income

In June, the Federal Reserve kept the Fed Funds rate unchanged at 0-0.25%, while stating that "Financial conditions have improved, in part reflecting policy measures to support the economy and flow of credit..." The Fed tweaked its bond purchase plans by pledging to continue buying at its current pace. It repeated that "The ongoing public health crisis will weigh heavily on economic activity, employment, and inflation in the near term, and poses considerable risks to the economic outlook over the medium term." Echoing that sentiment in their forecasted rates, the so called "Dots" plot shows most members think rates will remain zero-bound through calendar 2022. At one point, Fed Fund futures were forecasting "negative" rates. Although the Fed has dismissed going "negative" for now, it is at least considering yield-curve control or rate targets for maturities "out the curve" as a policy tool.

The economic impact of COVID-19 has been unprecedented. Job losses in March were relatively small at -1.37 million, initially reported as -701k. In April, a revised 20.8 million jobs were lost in the height of the shutdowns, although 22 million job losses were expected. May's initial report had unexpected job gains of 2.5 million, or a 10 million "beat" as estimates were for another -7.5 million job losses. Fed Chair Powell described the May employment report as the biggest economic surprise ever and held it up as an example of how difficult it is to forecast in the current environment. Later, shrugging it off as a drop in the bucket after April's tremendous drop. June saw another 4.8 million of job gains putting the official unemployment rate 11.1%, down from 14.7% in April. There have been admitted data and collection issues that would have put the peak unemployed somewhere above 19%.

The Fed's late-March announcement of its move into corporate bond purchasing helped valuations rebound from their pandemic-induced lows. Initially they purchased only corporate exchange-traded funds (ETFs) including high-yield, but expanded this to individual bonds in June. Credit spreads tightened with this support as one would expect. Investment-grade spreads fell to 1.5% over Treasuries from 2.7% to start the quarter, down from its peak of 3.7% on March 23rd. High-yield spreads peaked at 11% and fell from 8.8% to 6.3% during the quarter, according to Bloomberg Barclays data. Treasury rates remain near record lows and were down slightly throughout most of the curve. The 10-year Treasury was virtually unchanged for the quarter at 0.66% vs. 0.67% from March.

For the quarter, the Bloomberg Barclays Aggregate index returned +2.90%, bringing it to a very strong +6.14% for the first half. This is surprisingly similar to the +6.11% last year through June. International bonds could not match the returns here in the U.S again this quarter. The "hedged" Global Aggregate ex-US returned +1.76% vs. +3.38% unhedged, or +2.28% and +0.61% so far this year.

Tax-exempt municipal bonds were also helped by the Fed's intervention efforts, a market that it had left untouched in prior crises. At its low point during March, municipal bonds were off over 10%, its worst rout in history. One of the turning points was the Fed's Municipal Liquidity Facility (MLF), announced on April 9th, despite it being more of a lender of last resort. Municipal bonds returned +2.72% and mostly in line with taxable returns for the quarter. But given the loss of -0.63% in the first quarter, tax-frees returned only +2.08% through June. We took advantage of the dislocations last quarter, when funds and ETFs were "forced" sellers, as clients redeemed shares.

Given the deep recession and anticipated slow recovery, interest rates will probably be range bound for some time. "Lower for longer" is back with vengeance to say the least. We find ourselves wondering if rates will be "Lower Forever", but hopefully that is not the case. Considering the rally discussed above, we are reducing our 3-5 year return forecast for investment grade bonds to 0-2%, down from 1-3%. Overall yield is a strong predictor of future returns and the Bloomberg Barclays Aggregate index is currently yielding around 1.25% versus 2.3% yield to start the year.

Focused Equity

For the second quarter and the twelve months ending June 30, the strategy returned 21.33% and 11.48%, respectively, versus a 20.54% and 7.51% gain for the S&P 500 Equity Index. Since inception, the strategy has outperformed the S&P 500's annual return of 13.68% by 0.27% with an annualized gain of 13.95%. The fund has achieved these results taking on meaningfully less risk than the S&P 500 with a beta of 0.89 and capturing only 91% of the index's annualized standard deviation, thus producing annualized alpha (the amount of risk-adjusted performance greater than the benchmark) of 1.54 since inception (12/31/2008).

Leaders: Quality-growth and size remained dominant factors across US equities through the recovery in Q2, with Information Technology (+35.66%), Consumer Discretionary (+33.20%) and Communications Services (+24.39%) sectors delivering the largest total returns within Focused Equity. Many factors that emerged alongside COVID-19 in Q1 continued to lead in Q2, benefitting companies involved in the work-from-home migration, cybersecurity, cloud storage, and internet retail including PayPal (PYPL, +81.98%), Apple (AAPL, +43.84%), Amazon (AMZN, +41.50%), Adobe (ADBE, +36.79%) and Facebook (FB, +36.13%), which produced the largest total returns in the strategy for the second quarter. Over the last twelve months, size, quality growth, and specifically FANMAG continued leadership, as Microsoft (MSFT, +53.99%), Apple (AAPL, +86.80%), Amazon (AMZN, +45.69%), PayPal (PYPL, +52.42%) and Alphabet (GOOGL, +30.95%) produced the largest contribution to returns in Focused Equity for the last year.

Laggards: As the market sharply rebounded in the quarter, value stocks, high-dividend stocks, and "risk-off" sectors fell out of favor, including Financials (+0.88%), Utilities (+2.96%) and Consumer Staples (+6.52%). Although the market has historically rewarded value stocks who focus on dividends and buybacks, the uncertainty of the COVID-19 pandemic particularly punished these companies with slower growth expectations during the quarter, including Nextera Energy (NEE, +0.38%), Mondelez International (MDLZ, +2.62%) and JPMorgan Chase (JPM, +5.46%). For the last twelve months, the -32.69% decline in the price of oil was the largest detractor to the strategy's return, with exploration and production companies Diamondback Energy (FANG, -48.72%) and EOG Resources (EOG, -25.92%) having the greatest sensitivity to oil prices.

PayPal Holdings, Inc. (PYPL)
4/1/2020 – 6/30/2020

Strategy Update: Focused Equity Fund invests in quality growth companies and select external managers. Our stock selection process and that of the managers we have selected is dedicated to identifying world-class companies that are positioned for sustainable growth and possess the characteristics needed to generate superior long-term performance. The portfolio is concentrated, usually owning approximately 30 to 50 high-quality companies that have a history of outstanding business results, are well managed and trade at values well below their long-term intrinsic value. Our approach is focused on companies that have sustainable advantages over their competitors, allowing them to consistently grow and generate value for shareholders.

Strategic Income Builder

It has been a difficult year for income investors, despite the rebound. For example, the Russell 3000 Value lagged its "Growth" counterpart by a growing margin, trailing -25.7% or -16.8% vs. +9.0% through June. U.S. investment-grade corporate bonds had tremendous volatility during the first quarter, but have recovered due to Fed's interventions (see fixed income commentary) with returns of +5.0% mid-year. High yield bonds have also recovered but remain negative on the year at -3.8% vs. +8.7% for Treasuries, per Bloomberg Barclays. For the quarter, the strategy (SIB) returned +13.31% vs. +9.86% (60% Russell 3000 Value & 40% Barclay's US Aggregate). These strong results pushed 12-month returns into positive territory, or +2.29% vs. -1.76% for its benchmark.

Discover Financial Services (DFS)
4/1/2020 – 6/30/2020

Since inception (1/1/09),

the SIB strategy has returned an annualized +8.62%, outpacing its benchmark return of +8.10%. The yield generated from the strategy has consistently exceeded that of its benchmark. On a risk-adjusted basis, the strategy has generated a positive alpha of +0.87% annualized with a volatility beta of 0.95. The success of the portfolio is the result of an attractive mix of income producing securities, asset class and sector allocations, and tactical positions in global markets.

For the quarter, our equities returned +18.72% compared to the Russell 3000 Value return of +14.55%. Twelve-month equity returns were +0.65% vs. -9.42%, respectively. The portfolio has benefited from an overweighting in stocks in recent years. We entered the year at 67.3% equities within the portfolio, or 7% over benchmark. During the volatility, we maintained basically a benchmark weighting and closed out the first quarter at 61.5% in stocks. With the recovery, we ended the second quarter with a 64.9% equity allocation. Dividend yield for the portfolio ended the quarter at 3.3%, or roughly 0.5% higher than the Russell 3000 Value and 1.4% more than the S&P 500.

Information Technology (+27.9% portfolio returns) and Financials (+18.6%) added the most in terms of total attribution and investment gains. Consumer Discretionary (+35.7% portfolio returns) was also notable, as the economy began to reopen. Communication Services (+4.6%) was a slight drag on the portfolio during the quarter. Overall, stock selection was the key driver of significant equity outperformance, although sector allocations were positive as well.

Apple Inc. (AAPL +43.9%) marched on an upward path after its -13.4% price decline in the first quarter. Apple's continued growth is driven by the increasing size and spending of its large installed base of loyal iPhone users and its ability to monetize the broader and deeper services portfolio. The 5G move amplifies its Product and Services growth potential, despite the current Covid-19 impact on sales. Microsoft (MSFT +29.4%) was a major contributor again this quarter after being our best performing tech stock during the first quarter by basically posting flat performance during the bear market correction, or -20% price decline in the S&P 500. Microsoft's vast infrastructure and productivity applications make it less vulnerable to economic shocks.

Discover Financial Services (DFS +40.6%) and Morgan Stanley (MS 43.4%) were our top performing financial stocks. We believe these rebounds are tied to the resumption of economic activity. By mid-July, Morgan Stanley had completely recovered from its -33.3% first quarter price decline. In reporting 2nd quarter earnings, the company reported $2.04 vs. $1.14 estimates. Morgan Stanley blew away estimates with its capital market activity. For instance, fixed income trading revenue almost tripled leading to a 73% jump in total trading revenue.

Quarterly fixed income performance was impacted by the credit comeback with returns of +5.14% vs. +2.90% for the Bloomberg Barclays Aggregate Bond Index. Our credit-based funds, and particularly high yield, were beneficial, as discussed above. Fixed returns still trail during 2020 at +2.80% vs. +6.14% for the Aggregate Index. Projected yield on the portfolio is currently 3.4%, which compares to the record low 1.2% yield for the Aggregate Index in mid-July.

Our risk-reducing alternatives produced bond-like results for the quarter, returning +2.0%. We also utilize short-term bond funds as cash alternatives, which returned 3.1% during the second quarter. Combined our alternatives and near-cash are roughly 9% of the strategy.

Science & Technology Strategy

The Science & Technology strategy fund (SciTech) returned a robust +29.0% in the second quarter, more than recouping modest losses from Q1 when markets broadly faltered. SciTech trailed the Lipper Science & Tech Fund Index (+30.6%) in the April-June period, but remains well ahead of the benchmark on a YTD basis (+16.1% vs +11.1%) and over the past 12 months (+29.9% vs +23.2%). For further comparison, the S&P 500 rebounded just 20.5% in the second quarter (still negative YTD), and is up just 7.5% over the past year.

Diversification was a headwind for SciTech versus its Lipper benchmark last quarter, as the latter holds higher exposure to the Information Technology sector. Tech stocks were the lone group to provide relative safety during the March meltdown, but also fully participate in the rally. As evidence of the importance of this composition divergence, the fund's holdings across all five owned sectors (Communications, Real Estate, Healthcare, Tech and Discretionary) each outperformed their S&P 500 sector returns last quarter, but the fund trailed its benchmark! Nonetheless, we are pleased with gains for SciTech last quarter. The fund was coming off strong outperformance in Q1, and many of the sharpest rallies were from beaten down stocks and industries that SciTech avoided.

Since inception of the fund (3/31/2006), the strategy has returned an annualized 11.76% versus 11.59% for the Lipper Science & Tech Index and just 8.56% for the S&P 500. Moreover, SciTech is beating the Lipper Science & Tech index on a risk-adjusted basis, with a Sharpe Ratio of 1.05 (vs 0.93) and annualized standard deviation of 15.77% (vs 16.82%).

Leaders: Apple Inc. (AAPL) gained 43.8% during the second quarter, which made SciTech's largest holding its biggest driver of gains in Q2. Optimism over the 5G rollout seemed to build over the past few months, and investors flocked to AAPL's resilient growth prospects amid continued economic uncertainty. SciTech's 2nd, 3rd and 4th largest holdings represented similar trades last quarter. Alphabet (GOOG), Microsoft (MSFT) and Amazon (AMZN) each received sponsorship from investors while navigating the COVID economy from a positon of relative strength.

The evolution of digital payments and the migration away from cash has been a profitable theme for SciTech for years, but the trade took a hit in Q1 on pandemic-related concerns toward consumer spending and small business viability. PayPal (PYPL) and Square (SQ) both soared in Q2 on a recovery in this theme, and were the portfolio's biggest percentage gainers last quarter at +82.0% and +100.3%, respectively. We believe quick action by federal entities to support consumers and businesses (e.g. unemployment subsidies, stimulus payments, Payroll Protection Program) likely served as the initial catalyst for the recovery.

Laggards: In somewhat of an anomaly, there were zero holdings in the SciTech fund that declined during the second quarter, although there were a handful that did not keep pace with the market or their respective industry. A couple of laggards include pharma giants Bristol-Meyers Squibb (BMY, +6.3%) and Novartis (NVS, +5.9%). The stable franchises did not benefit much from the risk-on move for markets in Q2, and neither company has been visible as part of the COVID-vaccine narrative. On the Technology side of the portfolio, SciTech's weakest holding was security software maker ProofPoint (PFPT). The stock rallied just 8% last quarter, but is still higher year-to-date as it held up quite well early in the year, benefiting from delivering its services via the cloud.

Small Cap Composite

Cannae Holdings, Inc. (CNNE)
4/1/2020 – 6/30/2020

The Small Cap Value Composite returned 19.55% for Q2 versus 18.91% for the Russell 2000 Value index.

A top contributing holding in the Portfolio during Q2 was BJ's Wholesale Club Holdings Inc. (BJ, +46%, +161 bps), a warehouse club retailer with more than 200 stores primarily located in the eastern United States. Stay-at-home orders related to the COVID-19 pandemic have caused surging demand for grocery and certain consumer products. BJ reported very strong Q1 results (ended May 2, 2020) despite high expectations. Same-store sales increased +27% excluding fuel prices while cash from membership fee income increased +16%. We maintained the position during the quarter. Another top contributor during the quarter was Cannae Holdings Inc. (CNNE, +23%, +111 bps), which owns a 19% stake in commercial data and analytics provider Dun & Bradstreet (DNB), an 11% stake in publicly traded HR software and services firm Ceridian (CDAY), as well as interests in life/health/retirement solutions marketer AmeriLife, restaurant brands (O'Charley's, 99), and two special purpose acquisition companies. The stock marched steadily higher as management executed a series of transactions in the second quarter, including additional monetization of Cannae's stake in Ceridian for more than $230 MM in gross proceeds, investing $225 MM in two newly formed Bill Foley-led Special Purpose Acquisition Companies (SPACs), and completing a secondary offering of Cannae shares worth more than $400 MM. Another positive contributor was Insperity Inc. (NSP, +75%, +110 bps), a Professional Employment Organization (PEO) that provides value-added, full-service human resources to small and medium-sized businesses (SMBs). We initiated the position

Small Cap Composite Continued

earlier in the year when elevated medical claims and COVID-19-related job losses caused negative sentiment for the industry and the stock. However, NSP's Q1 results were strong and supported our expectation for resilient pricing and lower insurance costs. The Paycheck Protection Program and sharp employment rebound also aided NSP.

One of the largest negative contributing holdings in Q2 was Liberty Latin America Ltd. (Cl C) (LILAK, -8%, -22 bps), a provider of broadband, TV, fixed voice, and mobile services in Chile, Puerto Rico, Costa Rica, and the Caribbean. The company continued to grow broadband, video, and mobile subscribers organically which drove constant currency EBITDA improvement of +4% year over year. However, Chilean peso depreciation relative to the U.S. dollar caused reported EBITDA to decline -1% year over year. Another poor performer was GrafTech International Ltd. (EAF, -2%, -15 bps), a manufacturer of graphite electrodes which are used for making steel in electric arc furnaces. During the quarter, COVID-19 caused global steel demand to fall which pushed some of EAF's customers to claim force majeure and attempt to back out of 2020 contracted volume commitments. The position was maintained as the stock continued to trade at a large discount to our assessed value. Another bottom contributor during the quarter was Viad Corp. (VVI, -10%, -14 bps), a small conglomerate with an exhibition/conference services segment (GES) and a travel/hotel/attractions segment (Pursuit). Both of Viad's business segments are directly impacted by COVID-19. GES continues to experience conference and event cancellations and deferrals while Pursuit remains challenged by declines in tourism from the United States-Canada border closure as we move into the important summer season. Although visibility for a rebound at GES remains exceptionally murky, we are encouraged by management's ability to dramatically reduce variable costs, essentially placing the segment in 'hibernation' until demand returns. We took no action on the position during the quarter.

Kentucky Municipals

Quarterly bond issuance by Kentucky municipalities fell to $479.5 billion from $1.3 billion in the previous quarter. Competitively awarded deals were $303 million with negotiated deals of $176 million. Deal size was relatively small averaging $14.1 million with 34 new issues in total. Non-BQ issuance was the majority coming in at $396 million or 83% with bank-qualified (BQ) issuance of only $48 million or roughly 10%. The remaining $35 million (7%) was a single taxable municipal issue. Visible KY supply is strong with $398 million on the calendar in coming months and issuers should benefit from the lower interest rates.

Issuers of note included Kentucky State Property and Buildings Commission's $125 million Revenue Bonds in June. Moody's maintained its A1 rating and stable outlook on these appropriation bonds. The stable outlook is important because many bonds share this rating, such as colleges, courthouses and school districts. Fitch also rated the deal an equivalent A+, but changed their outlook to negative. Fitch said, "The Outlook Revision to Negative from Stable reflects Fitch's concern that the economic and revenue decline due to the coronavirus pandemic will be substantial for Kentucky, deeper than in many other states, and limit the commonwealth's ability to quickly restore financial resilience as the economy begins to recover. Kentucky was already facing challenges in getting to structural balance and the current crisis will make that virtually impossible in the near term."

Moody's cited the following; "We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. The coronavirus crisis is not a key driver for this rating action. We do not see any material immediate credit risks for the Commonwealth of Kentucky. However, the situation surrounding Coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of Kentucky changes, we will update the rating and/or outlook at that time." We would note that Moody's rates far more Kentucky issues as compared to Fitch.

Barclays analysts' noted in a report and we agree that, "We believe that the current period of municipal stress will resemble that of the Great Recession." While "we see the risk of some defaults, especially for smaller names in stressed sectors, there will likely be very few large defaults if any."

KY bonds tracked the national market this quarter. The S&P Municipal Bond Kentucky Total Return Index returned +2.69% vs. +2.72% for the Bloomberg Barclays Municipal Index. Like the national market, this S&P KY Municipal Index declined over 10% at its trough on March 20th. Although Kentucky trails the national market this year, with returns of +1.41% vs. +2.08%. Its yield-to-worst (YTW) fell from 2.32% to 1.79% during the quarter, and peaked at 3.87% at the height of the stress. For comparison, the Bloomberg Barclays Municipal Index has a yield-to-worst of 1.50%, so the state has a yield advantage of 0.29%. As discussed in our fixed income commentary, we took advantage of the dislocations in municipals during the volatility.

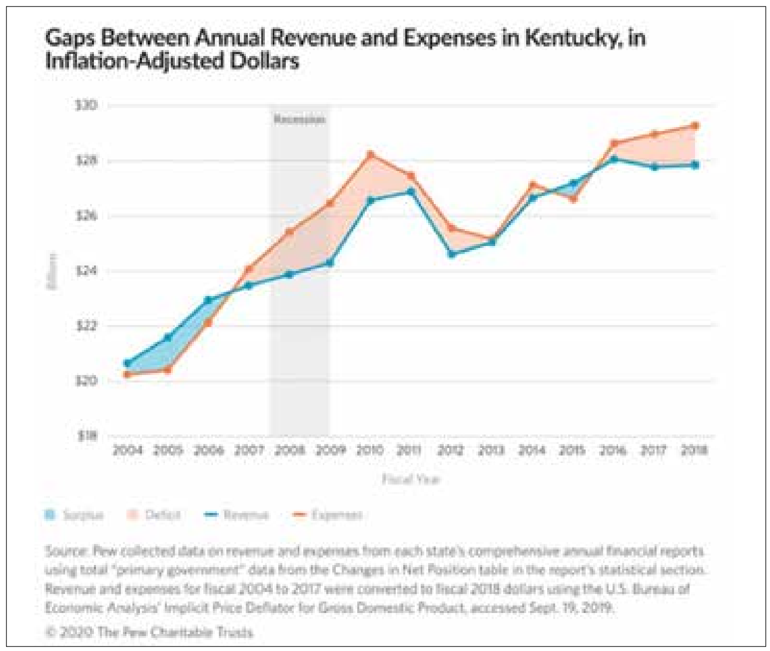
Kentucky Budget Update

<u>Already facing a significant budget gap, Kentucky is among states in particularly difficult situation after COVID-19.</u>

The coronavirus outbreak, recent market swings, and the drop in oil prices have introduced a high level of uncertainty into state budget development in recent weeks. Policymakers are scrambling to assess the potential risk and the available options for addressing it. For states that had already amassed significant budget gaps — such as Georgia, Kentucky, Massachusetts, and New York — the situation is particularly difficult. They must try to correct decisions made in past years that have proven unsustainable while developing contingency plans for the potential impact of adverse events on revenue and spending needs.

Budget challenges for many states are perennial and widespread. State fiscal policy often focuses on balancing the budget one year at a time, often to the detriment of long-term sustainability. This short-term focus can lead states to enact significant new commitments—and defer critical decisions on how to pay for them. States also may rely on anticipated revenue windfalls that don't materialize or shift costs for fixing structural problems into future years. Although the full picture of each state's budget is complex, these types of decisions have contributed to current shortfalls.

While Kentucky technically balances its budget each year, a fuller accounting of the state's finances shows that Kentucky is one of only nine states in which total expenses were higher than total revenues accumulated between fiscal 2004 and fiscal 2018 (see figure). In December 2019, the outgoing state budget director projected a $1.1 billion budget shortfall over the next two years.



Josh Goodman researches state fiscal and economic policy as part of The Pew Charitable Trusts' states' fiscal health initiative. Source: KyForward

Although the ultimate impact of the coronavirus and other adverse events remains unknown, addressing these long-term budget issues now will put states in a better position to face potential problems down the road. When an economic downturn, a natural disaster, or a public health crisis hits, states can quickly see declining revenue and increasing costs. If they lack enough reserves to fill the gap, they face difficult choices.

Raising revenue or cutting spending are deeply unpopular and often counterproductive during a crisis. In addition, policymakers often face restrictions on what they can do, from federal rules, state law, court orders, or just the time required to enact changes. These tasks are made all the more difficult if a state starts with a long-term budget deficit.

ASSET ALLOCATION OUTLOOK

LAST QUARTER			THIS QUARTER	
WE BELIEVED →	**ACTIONS TAKEN →**	**RESULTS**	**WE BELIEVE →**	**ACTIONS WE ARE TAKING**
DOMESTIC EQUITIES			DOMESTIC EQUITIES	
We favored large cap with stronger balance sheets over small/ mid-cap until we had greater clarity on treatment, vaccine and re-opening.	We held off trimming small / mid-cap and maintained model holdings as the gap widened between large cap expecting a rebound.	**Large Cap +20.5% in 2Q20, underperforming small cap +25.4% and mid-cap +24.1%**	We believe that small and mid-cap stocks will close much of the performance gap with large cap stocks in the next 6 - 12 months.	We are maintaining model weights established earlier in the year until we see a larger recovery in small and mid-cap stocks.
INTERNATIONAL EQUITIES			INTERNATIONAL EQUITIES	
We favored U.S. large cap over both international and EM holdings for the near term. Fed action is likely strong dollar near term, but lower in the long term.	We thought we may trim international to add to U.S. large cap. The dollar weakened during the quarter, so we maintained our international and EM weights. Our selections outperformed their benchmarks.	**International equities (+15.2%) underperformed U.S. large cap (+20.5%). EM (+18.1%) also underperformed U.S. large cap, but started to outperform late in the quarter and is outperforming in July.**	As the dollar remains lower, we believe that EM should show strong recovery and developed international will have a period of catch up to U.S. indices. We expect active managers with skillful security selection will outperform indices.	We expect to maintain our international allocation in the near term. We anticipate a catch-up rally on the back of EU fiscal stimulus. We are debating increasing allocation to EM.
FIXED INCOME			FIXED INCOME	
The Fed will keep rates low until the economy makes a robust recovery (24+ months). Returns likely between 1% and 2%.	We made a large overweight allocation to high yield (HY) in late March as yield spreads widened. The allocation is posting double digit returns and should continue to outperform core bonds near term.	**The BBG Aggregate returned +2.9%, while the High Yield index gained 9.6%. Local currency international and emerging market bonds gained 3.3% and 6.8%, respectively. Our bond selections outperformed the aggregate bond index during the quarter.**	The Fed will keep rates low until the economy makes a robust recovery (24+ months). Returns likely between 1% and 2% for core investment grade bonds.	We are maintaining our overweight to high yield. We believe there remains additional upside and high yield bonds should outperform core investment grade bonds during recovery.
We thought munis were oversold relative to the risks, particularly with Fed and fiscal action to aide states.	We made a large overweight allocation to munis in taxable accounts and taxable munis in non-taxable accounts in late March and have not trimmed.	**Munis underperformed core bonds in the quarter (+2.7% vs. +2.9%) on an absolute basis, but outperformed on tax-effective basis.**	We think munis remain attractive relative to investment grade bonds, considering the risks.	We are maintaining a slight overweight to munis and believe there remains additional upside. Longer-term: Biden tax reform could create a positive catalyst, if he is successful.
ALTERNATIVE ASSETS			ALTERNATIVE ASSETS	
We believed volatility would remain elevated until a coronavirus vaccine is widely available.	We maintained a 10% allocation to alternative strategies.	**Equity market volatility declined during the quarter, but remains above levels earlier this year and last year. Our alternatives baskets experienced a difficult quarter as equities rebounded sharply, falling -5.1% and -6.5% vs. -2.2% for the index.**	We believe volatility will remain elevated as new COVID cases rise, through the November election, and/or until a coronavirus vaccine is widely available.	We are maintaining our 10% allocation and continue to focus on strategies with no structural correlation to equities. We expect near term deflation due to growth stalled by COVID. Longer term inflation risks are rising upon recover due to record monetary & fiscal policy.

For more details on CBandT's investment outlook, please visit our Investment Commentary page at: https://cbandt.com/wealth-trust/resources/.

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Investment Research & Portfolio Management: Darrell R. Wells; Robert R. Hawkins, CFA; Brian S. Stivers; John M. Fidler; Erik N. Evans, CFA; Spencer E. Joyce, CFA; Christopher J. Beneke, Pete M. Ward; William T. Husband; Stephen L. McCool | Trust & Estate Administration: Jack M. Combs, Jr.; Mary Beth Byron; Michael R. Motsinger; Patricia L. Hayes; Mark J. Kennedy; Beth A. Russell; Christopher A. Nunnelley; Nancye W. Olt; Fran E. Clark; Robin A. Barnett | Private Banking, Family Office and Brokerage Services: Susan L. Roberts; Wendy O'Banion; H. Alex Campbell; Toby K. Nutt; Brian Cohoon, CFP®, CRPC®, AIF; Christine S. Gandara, Heather M. Hardin; Sam Ronald; Jill H. Cooper

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