3Q 2020 Review & 2020-2021 Outlook

Commonwealth Bank & Trust Company

FALL 2020

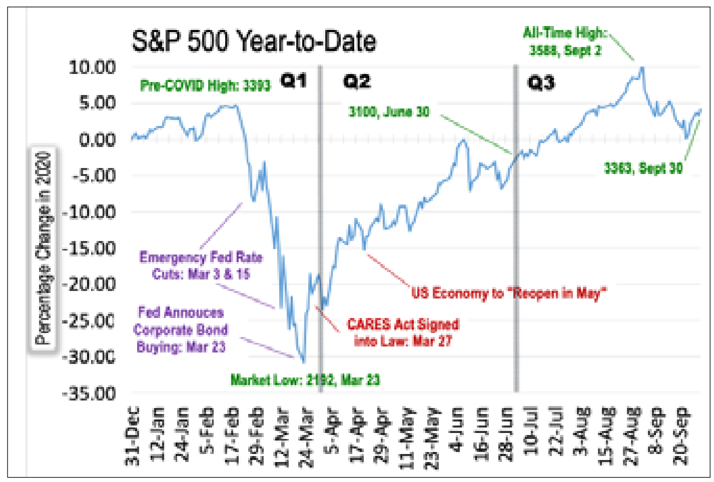
4350 Brownsboro Rd.
Suite 210
Louisville, KY 40207

p 502.259.2500
f 502.259.1501
www.cbandt.com

SUMMARY: Shutdown – Re-open Tug-of-War

After a steady run up in the second quarter, the market made a volatile advance and retreat in the third quarter. The S&P 500 continued its rally in the third quarter, fully recovering on August 18 and surpassing the prior peak of 3,393 (February 19) in less than five months from the bottom made on March 23 (a peak to trough drop of 34%). During the quarter, the market rallied over 15% into September to make a new all-time high of 3,588 on September 2, and then sold off almost 10% over the next three weeks. In the last few days of the quarter the S&P 500 recovered about 4% of the lost ground to finish at 3,363 netting to an 8.9% return for the quarter and a 5.6% return year-to-date (YTD). A variety of cross-currents spurred the volatility during the third quarter including deliberations about monetary and fiscal policy, a rise in COVID cases followed by a pause in re-opening activity, a surge in speculative retail trading and uncertainty surrounding the election.

Figure 1: S&P 500 Rebounds Aided by Monetary & Fiscal Policy



Source: CB&T; Thomson Reuters

The Yin & Yang of Monetary & Fiscal Policy: As states shut down in the first quarter, the Fed cut rates to zero on March 15 and enacted more stimulus by the end of March than it did over the first 12 months of the financial crisis. On March 27, President Trump signed the CARES Act authorizing almost $2 trillion in direct aid. These two unprecedented actions marked the largest monetary and fiscal stimulus package in U.S. history and formed the basis for a strong market recovery in the second and third quarters.

The Fed continued to support markets in the third quarter with two key statements. First, it indicated that it expected to keep rates near zero until at least the end of 2023. While zero interest rate policy lowers the cost to finance expansion, the Fed's stance also sends a message to markets that it will take longer than expected to recover to pre-COVID growth. Second, the Fed declared it would relax its inflation target of 2% and permit inflation to rise higher, or "run hot", before raising rates to curb it. The move signals that the Fed will not remain on autopilot with inflation policy, lowering the risk of raising rates before the economy and employment have recovered, which can result in stagflation. On the other hand, it increases the risk of higher inflation. Netting the ramifications, the market viewed the measures favorably and the S&P 500 rallied in July and August reaching a new all-time high of 3,588 on September 2 (an 11% return YTD).

The Fed also underscored the necessity of fiscal policy to speed recovery and prevent longer term structural damage to the economy. Investors expected Congress to compromise and pass additional fiscal stimulus upon returning from summer recess after Labor Day. Additional stimulus is particularly important as income and other supports in the March CARES legislation started to run off in late July. Statements that the parties were far apart and a deal would not happen until after the election contributed to the September sell-off, while a rumor of a potential deal helped markets rally in the final days of September.

COVID Third Wave Likely, but Less Deadly? Vaccine Announcement Soon?: The first COVID wave occurred in March and April, with the second wave hitting in late June and July. We believe a third wave started in September and will increase with the flu season. We believe greater access to testing, the re-opening of schools, particularly colleges, "shutdown fatigue" and flu season will contribute to a third wave. Nonetheless, we think the percentage of hospitalizations and deaths are likely to be lower than the first two waves, because we believe positive tests will be skewed to a younger population and more treatment options are now available. Although cases are rising, the percentage of deaths and hospitalizations has been falling. It appears the rise in testing has resulted in more reported cases, but the percentage of positive tests have declined (please see Figure 2).

Figure 2: Percent of Positive Tests vs. Daily Tests

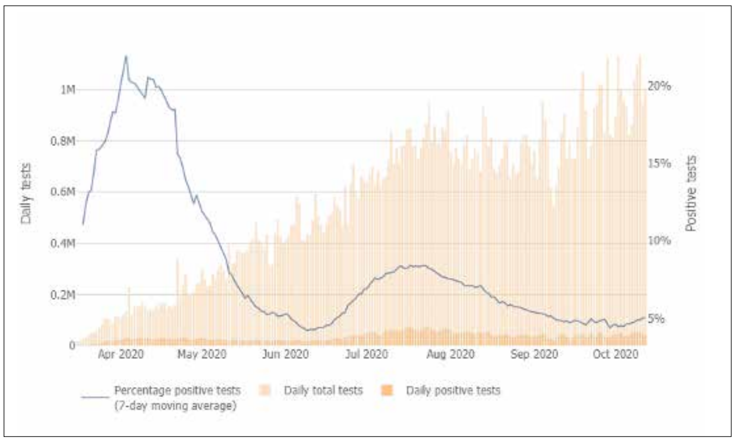
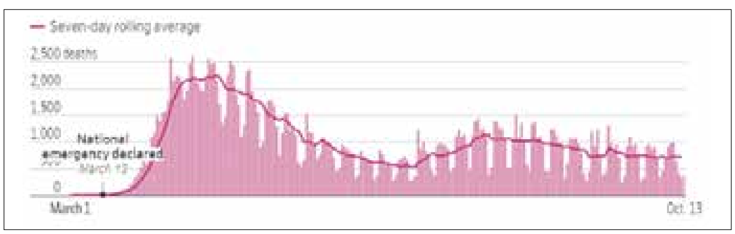


Figure 3: Daily Deaths



Sources for Figures 2 & 3: WSJ; Johns Hopkins Coronavirus Resource Center

Jump in Speculative Retail Trading: The COVID crisis has increased savings as consumers' opportunities to spend have decreased as access (or the "supply" of services) has been blocked or shut down. Funds typically spent on restaurants, travel, entertainment, apparel, etc., have been saved or redirected to higher spending on staples and home improvements. Additionally, when sporting events were halted, there were fewer gambling

Table 1: YTD Market Returns

As of 9/30/2020 (except 1Q & 2Q Data)	Sept. YTD	3rd Quarter	2nd Quarter	1st Quarter	Last 12 Month	Last 3 Years	Last 5 Years	Last 10 Years
S&P 500	5.57%	8.93%	20.54%	-19.60%	15.15%	12.28%	14.15%	13.74%
Russell 2000 (Small Cap)	-8.69%	4.93%	25.42%	-30.61%	0.39%	1.77%	8.00%	9.85%
MSCI EAFE (International)	-7.09%	4.80%	14.88%	-22.83%	0.49%	0.62%	5.26%	4.62%
MSCI EME (Emerging Markets)	-1.16%	9.56%	18.08%	-23.60%	10.54%	2.42%	8.97%	2.50%
BBG BARC Aggregate Bond	6.79%	0.62%	2.90%	3.15%	6.98%	5.24%	4.18%	3.64%
BBG BARC Municipal Bond Index	3.33%	1.23%	2.72%	-0.63%	4.09%	4.28%	3.84%	3.99%
ICE BofAML High Yield Index	-0.30%	4.71%	9.61%	-13.12%	2.30%	3.83%	6.61%	6.28%
BBG BARC Global Aggregate Bond	5.72%	2.66%	3.32%	-0.33%	6.24%	4.10%	3.92%	2.36%
BBG BARC Emerging Markets Bon	1.93%	2.37%	10.00%	-9.48%	4.05%	4.20%	6.17%	5.41%

Table 2: Sector Returns

As of 9/30/2020 (except 1Q & 2Q Data)	Sept. YTD	3rd Quarter	2nd Quarter	1st Quarter	Last 12 Months	Last 3 Years	Last 5 Years	Last 10 Years
S&P 500	5.57%	8.93%	20.54%	-19.60%	15.15%	12.28%	14.15%	13.74%
Communication Services	8.60%	8.94%	20.04%	-16.95%	18.37%	9.31%	10.59%	9.43%
Consumer Discretion	23.38%	15.06%	32.86%	-19.29%	28.89%	20.48%	17.03%	18.17%
Consumer Staples	4.13%	10.38%	8.12%	-12.74%	7.79%	9.04%	9.40%	11.77%
Energy	-48.09%	-19.72%	30.51%	-50.45%	-45.24%	-20.42%	-9.70%	-3.16%
Financials	-20.22%	4.45%	12.20%	-31.92%	-11.87%	-0.14%	7.82%	9.69%
Healthcare	5.01%	5.87%	13.59%	-12.67%	20.11%	11.08%	11.88%	15.40%
Industrials	-3.99%	12.48%	17.01%	-27.05%	1.32%	4.53%	10.84%	11.58%
Info. Tech	28.69%	11.95%	30.53%	-11.93%	47.23%	28.10%	27.18%	20.50%
Materials	5.47%	13.31%	26.01%	-26.14%	12.19%	6.22%	12.18%	9.42%
Real Estate	-6.78%	1.92%	13.22%	-19.21%	-7.28%	6.67%	7.92%	10.49%
Utilities	-5.68%	6.14%	2.73%	-13.50%	-4.97%	7.53%	10.33%	10.68%

Source for Tables 1 & 2: Informa & Bloomberg

opportunities. Some of the higher net savings have found their way into the market as a record number of new accounts were opened at retail discount brokerages, such as Schwab, TD Ameritrade and Robinhood. The brokerages attract retail customers by offering low cost stock trading, but make most of their money in higher margin activities, such as paying out lower money market rates, fees on internally run mutual funds, and expensive options trading as well as selling their trading flow. Encouraged by video tutorials espousing the simplicity and potential profitability, the volume of options trading by retail investors jumped 50% over the summer (please see Figure 4).

Further, small lot options volume associated with retail investors increased by 50% and made up 45% of options volume vs. 30% for large institutional lots (please see Figure 5). The mix of options buying also changed significantly. More single stock options were purchased, particularly those for large tech stocks, than index or ETF options favored by institutional investors. The retail investors purchased out-of-the money call options speculating on a bigger jump in price for stocks already with stretched valuations. Normally near market highs, more at-the-money put options are purchased to hedge against a downturn and protect gains earned in the market. In July and August an increasing number of short term, out-of-the-money call options were purchased. To hedge the surge in call option buying, institutional desks purchased shares of the underlying stocks causing the S&P 500 and NASDAQ to rise further.

Since the call options were short-term, many expiring September 18, and out-of-the-money, many would expire worthless. This started a wave of option selling leading to the sale of the underlying positions owned by institutional desks. As a result the 10% rise for the five weeks leading up to the peak on September 2, was followed by a 10% drop heading into the last week of September.

Figure 4: Surge in Retail Options Trading

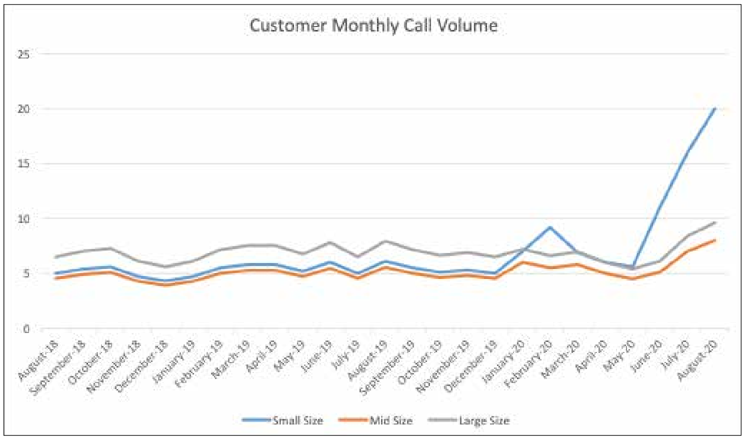
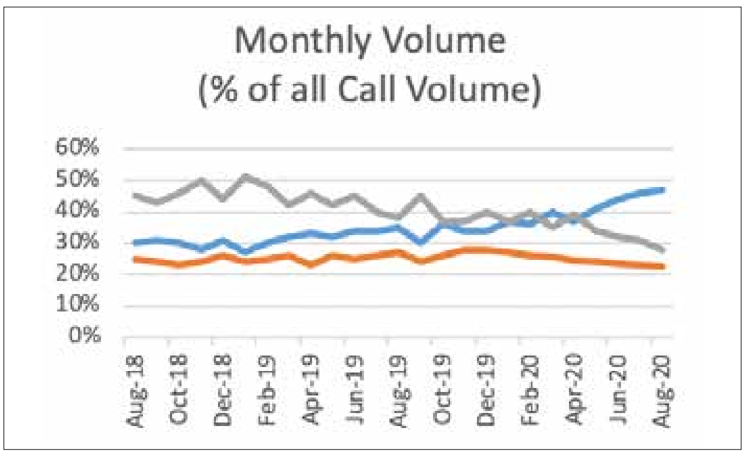


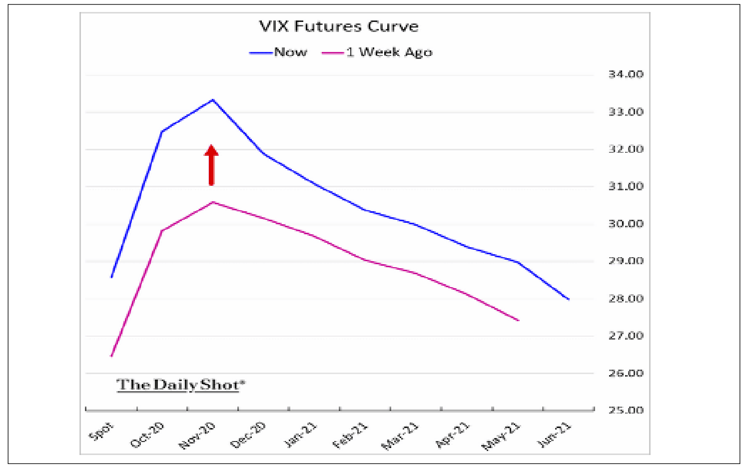
Figure 5: Retail Outpaces Institutional Options Volume



Source for Figures 4 & 5: Barclays Research

Election Uncertainty: Trump continues to lag Biden in the polls, however, the margin of error is large enough that the outcome remains uncertain. Historically when the incumbent candidate loses, the market sells off between 6% and 7% on average from late September through late November, but typically recovers those losses by end of the subsequent first quarter. Investors started to hedge some of this risk in September. The spot rate for the Volatility Index or "VIX" has been relatively steady. The October and November futures contracts, however, are 20% higher than the spot rate, which indicates heightened fear of a market sell-off in October and/or November (please see Figure 6).

Figure 6: VIX Futures Cost Hedge Election Risk



Source: The Daily Shot

CB&T'S PANDEMIC RESPONSE: Generating Higher Returns for Clients

CB&T's client portfolios outperformed in the downturn and have continued to gain ground against indices during the recovery of the second and third quarters. Our investment style focuses on buying Quality Growth (companies) at a Reasonable Price or allocating to managers that invest in these companies. Quality growth companies include many tech, healthcare, consumer and communications firms with large net cash positions. Many of these businesses are less impacted by the pandemic and in some cases have benefited. The S&P 500 growth index is outperforming the S&P 500 value index by 30% this year, which has been reflected in our results.

Rebalancing to Lagging Asset Classes: The rebalancing initiatives we took in March and early April, when we bought equities that had sold off more than 20%, paid off for our customers in the second and third quarters. By May, several market dispersions reached record levels and we made additional advantageous reallocations to portfolios. Initially, U.S. mega cap growth stocks led the recovery by a wide margin. We expected other asset classes to catch up and narrow this gap over the next 6 to 12 months. For instance, the average S&P 500 stock was underperforming the index by 12 percentage points in early May. Many of the financial, staples, consumer discretionary, industrial, energy, and materials stocks remained in a bear market down more than 20%. With almost half of the S&P 500 constituents trailing mega cap stocks by 10% or more, we swapped a portion of large cap holdings for the S&P 500 "equal weight" index (RSP). The RSP outperformed the S&P over 2% in the last two quarters. Small, mid-cap, international and emerging market equities trailed the S&P by 12% to 14% at the end of the first quarter. We did not change our weightings to these asset classes, but we rebalanced to bring the holdings back to target weights. Small and mid-cap outperformed large cap stocks during the last two quarters and cut the large cap

Figure 7: Muni Bond Returns

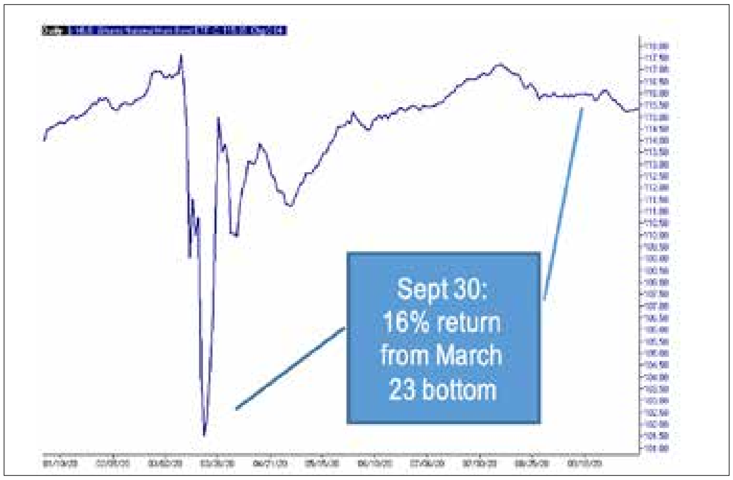


Figure 8: High Yield Bond Returns

Source for Figures 7 & 8: CB&T, ThompsonOne

lead four percentage points. International stocks only closed the gap by two percentage points, while emerging market stocks cut the large cap lead by nine percentage points.

Capitalizing on "Fat Pitches": We look for significant dislocations or "Fat Pitches" in asset class values that present a rare profit opportunity for client portfolios. As in prior crises, high yield bonds and munis sold off sharply setting up a "fat pitch". We made a heavy allocation swap from investment grade to high yield and muni bonds or taxable munis in client accounts and the pivot was a home run. The muni position generated a 10% to 12% return and the high yield position returned 16% to 18% for accounts on average, before we closed these positions in late August and early September.

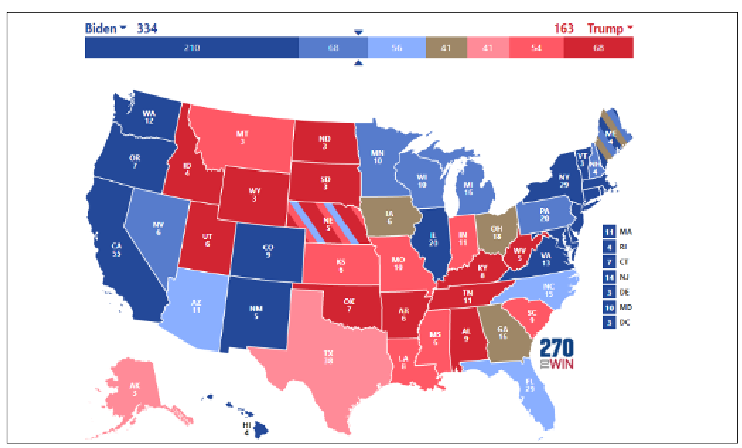
OUTLOOK: Is the Market being Short-sighted about a "Blue Wave" Election?

A strong rebound in the market in the last days of September and the first days of October has investors puzzled. Over the last 70 years, the market pulled back about 6% on average when the incumbent lost. The pullback often starts in late September, when it becomes apparent the current President may lose, but the opposite is happening in this election cycle. Biden's lead in the polls has widened and the S&P 500 has rallied 5% since the first Presidential debate on September 29.

Biden substantially pulled ahead in polls in early October after a contentious Presidential Debate was followed by a positive COVID test and hospitalization for Trump. Over the summer, Biden appeared to lock up several traditional blue states with large electoral blocks such as California, Illinois and New York. The two Presidential campaigns are expected to spend $11 billion. Currently over half of TV spending is being spent in only three states: Wisconsin (10 electoral college votes), Pennsylvania (20 votes) and Florida (29 votes). It has been apparent since mid-summer that Trump would likely need to win Florida and Pennsylvania plus three of four of the remaining states up for grabs (AZ, GA, NC and WI). Those states appeared to be toss-ups in September, but now appear to be leaning towards Biden (Please see Figures 9 and 10).

Figure 9: Race Closer in July

Figure 10: Gap Widening in October



Source for Figures 9 & 10: 538 July & October 2020

Biggest Near-term Downside Market Risk – Contested Election: Even with the recent Biden gain, the margin of error in election polls suggests Trump could win re-election. Hilary Clinton led by 7% in polls prior to election and election forecasters put her chance of winning between 70% and 99%. A lot can change in three weeks. Based on statements made by Trump, a close election with a record number of uncounted mail-in ballots could be contested and potentially take weeks to sort out. We believe uncertainty surrounding a contested outcome would likely cause a market sell-off until resolved. Many key battleground states make it easy to cast mail-in ballots, permit mail-in votes to be cast up to election day, and do not start their counts until November 3. Ohio, North Carolina, Arizona and Florida, while currently leaning blue, are less than four percentage points apart. Pennsylvania and Wisconsin are less than seven points apart. Georgia leans red, but is within one percentage point. With the exception of Ohio, those states permit "no excuse" absentee or mail-in ballots. Most states permit absentee ballots post-marked up to the day of the election. Georgia, Pennsylvania and Wisconsin may not begin counting absentee ballots until the day of the election. Ohio's counting process is vague.

Table 3: Battleground States Could Delay Results

State	Absentee/Mail Ballot Processing Can Begin	Absentee/Mail Ballot Counting Can Begin
Arizona	Tallying can begin 14 days before Election Day.	Tallying can begin 14 days before Election Day, but results may not be released before all precincts are reporting or one hour after the closing of polls on Election Day.
Florida	Signature verification can begin at 7 a.m. 22 days before Election Day.	7 a.m. 22 days before Election Day.
Georgia	Signature verification conducted upon receipt.	7 a.m. on Election Day.
North Carolina	The fifth Tuesday before Election Day.	Two weeks prior to Election Day, provided the hour and place of counting is announced. Results shall not be announced before 7:30 p.m. on Election Day.
Ohio	Processing may begin before the time for counting ballots.	Absentee ballots may be scanned prior to the election, but the count may not be disclosed prior to the closing of the polls.
Pennsylvania	At 7am on Election Day.	At 7am on Election Day, but the votes may not be recorded or published until after the polls close.
Wisconsin	After the polls open on Election Day.	After the polls open on Election Day.

Source: CB&T, National Conference of State Legislatures

Biggest Near-term Upside Market Risk – Vaccine Approval: We do not believe investors fully appreciate the speed at which a vaccine could be approved and made available for distribution. In the first quarter of 2020, the Trump Administration with the Department of Health and Human Services (HHS) created Operation Warp Speed (OWS) an emergency plan funding COVID research, drug trials and the production of at least 500 million doses of vaccine to be available by January 2021. We believe it is highly likely that at least one of the five vaccines that entered Phase III trials in the third quarter will be successful (please see Table 4). We think results from the Pfizer and Moderna studies may be released as early as the end of the October. Vaccine trials are designed with event and time waypoints. At these points trial data can be collected and independent investigators can perform interim analyses (IAs) to verify vaccine efficacy. If results are robust, the companies submit the interim data for FDA approval. Pfizer says that it will likely submit data for approval by the end of November. Typically vaccines are placed into production after approval, but the OWS program funded production ahead of approval. If a vaccine failed, the doses produced would be destroyed. On the other hand if a vaccine is approved, the vaccine should be ready to ship immediately. Between May and August, OWS funding paid for the manufacturing of 300 million doses of the AstraZeneca vaccine (first doses available as early as October 2020), 100 million doses of the Novavax vaccine (January 2021), 100 million doses of the Pfizer vaccine (October 2020), 100 million doses of the Johnson & Johnson vaccine (Janssen), 100 million doses of the Moderna vaccine, and 100 million doses of the Sanofi – GlaxoSmithKline adjuvanted vaccine. Assuming that two or three of the vaccine candidates are approved by year end, we think most of the U.S. population could be vaccinated in the first half of 2021. We do not believe the market is pricing in such a near-term vaccine approval and distribution scenario, and we estimate it could result in a positive 5% to 10% impact on the S&P 500.

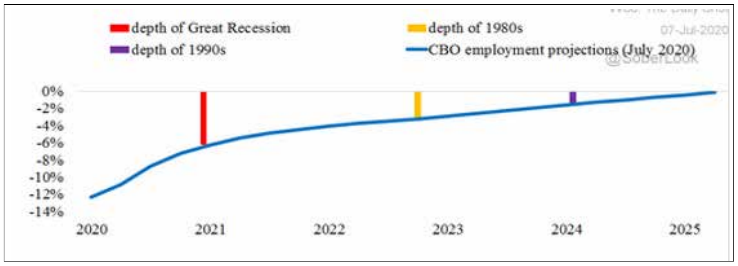
Table 4: Vaccine Trials

	Pfizer	Moderna	AstraZeneca	JNJ	Novavax
Vaccine Type	mRNA	mRNA	Adenovirus	Adenovirus	Sub-unit
Booster Required	Yes	Yes	Yes	No	Yes
Cold Chain Required	Yes	Yes	Yes	No	No
Date Phase 3 Started	28-Jul	28-Jul	31-Aug	23-Sep	24-Sep
Size of Phase 3	44,000	30,000	30,000	60,000	10,000
Efficacy Target	60%	60%	50%	60%	60%
Events to Trigger 1st IA	32	53	75	--	--
Doses Purchased (millions)	100	100	300	100	100
Doses Available	Oct-20	NA	Oct-20	NA	Jan-21

Source: CB&T and Barclays

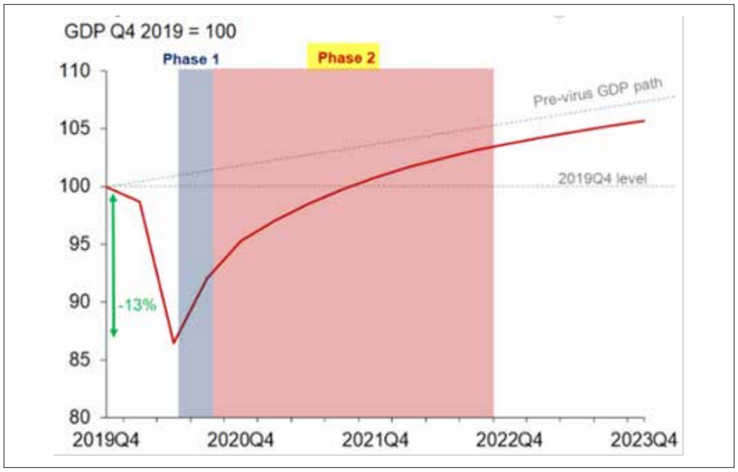
Economic & Earnings Data Also Boosting Market: The market is getting a shot in the arm from a faster than expected recovery in some economic and earnings data released in the third and fourth quarters. U.S. GDP did not fall as far as expected in the second quarter and readings improved throughout the third quarter from -8.2% to -7.8% (-32.9% to -31.4% annualized). GDP is forecasted to grow 7.1% (+28.5% annualized) in the third quarter and grow almost 1% in the fourth quarter (+3.8% annualized). In the second quarter, U.S. GDP was expected to decline roughly 6.0% for 2020 and now is forecasted to fall closer to 3.6% for the year. Data for consumer confidence, manufacturing, construction, and housing has been stronger than expected. Earlier forecasts projected the U.S. unemployment rate would end the year around 9.0%, but unemployment has already

Figure 11: Years for Employment to Recover



Source: CBO, BLS, WSJ, The Daily Shot

Figure 12: 2 Phase Recovery Likely



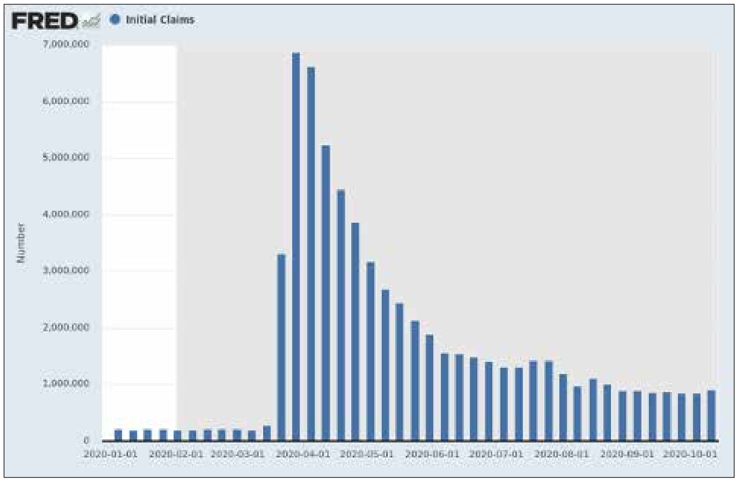
Source: CBO; WSJ, The Daily Shot

fallen to 7.9% in September. Although better than expected, improvement in jobless claims and unemployment are slowing as a result of the pick up in COVID cases and a pause to reopening. We believe it may take longer for employment and income to recover to pre-pandemic levels (please see Figures 11, 12, and 13) than other parts of the economy.

Earnings reports have also been better than forecasted. On an absolute basis, earnings have declined in 2020 due to the COVID crisis. Before COVID, earnings of $177 or 9% growth was forecasted for the S&P 500 this year. The estimate was reforecast to $115 to $120 per share in the second quarter and has been revised upward to $130. The upwardly revised forecast, however, represents a dramatic 20% downturn from 2019 results. Part of the improvement in projected earnings relates to guidance. About half of the companies in the S&P 500 stopped providing regular earnings guidance as the pandemic hit, causing analyst forecasts to vary more widely than usual. Earnings were supposed to fall 44% in the second quarter, but only fell 32% (please see Figure 13). Earnings are expected to fall 20% in the third quarter vs. last year, but some pundits believe the drop may only be 12% to 15%. Overall, the market has been bolstered by the quicker than expected recovery in economic activity and corporate earnings.

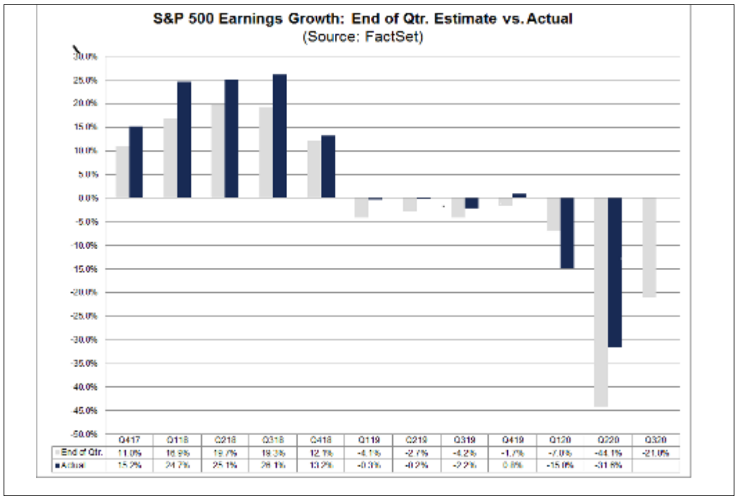
Why Would a Biden Win be Positive for the Market?: Biden's tax policies should be particularly bad for the stock market. His proposed increase in corporate taxes would reduce S&P 500 earnings by 6%+. This alone should result in a 200 point pullback for the S&P 500. Additionally, his tax policy will move the top tax bracket for individuals / families from 37% to almost 44%. Furthermore, Biden wants to do away with favorable 15% / 20% capital gains tax rates in favor of treating capital gains as current income to be taxed at his higher bracket rates. Finally, Biden proposes changing the tax deductibility for tax deferred retirement savings such as IRAs and 401Ks to a capped tax credit, which will reduce the incentive associated with the majority of funds saved for retirement annually. All of these measures significantly reduce incentives and cash flows available for investment, particularly for equities.

Figure 13: Employment Recovery Slowing



Source: St. Louis Federal Reserve Bank

Figure 14: EPS Recovering Faster than Expected



Source: FactSet

Why then would the market rally amid media speculation of a "Blue Wave" victory, where Biden posts an uncontested win and the Democrats gain a majority in the Senate, which improves the odds for Biden to carry out his tax policies? In a nutshell, the market is being short-sighted. The market is partly rallying in relief that current polls signal a drawn-out, contested election process is less likely. On the other hand, it is also rallying over the prospect of a larger fiscal stimulus via a Blue Wave victory. Republicans have argued for a smaller $1.6 trillion stimulus package, while the president has pushed for a $1.8 trillion stimulus in recent days or packages representing 8% to 9% of GDP. Democrats initially wanted a $3.0+ trillion stimulus and have cut their proposal to $2.2 to $2.4 trillion in recent weeks. The market is pricing in larger near-term stimulus. Helicopter money (four figure checks paid directly to taxpayers) from a stimulus package that represents 12% to 15% of GDP doled out over the next two quarters (possibly ahead of the Christmas season) would stimulate savings and consumption.

Mostly Positive Short-run Market Implication of Biden Policies: In the short-run stimulus spending will boost 2020 and at least first half 2021 results. Signs that a large stimulus package is expected, however, is beginning to impact rates. The stimulus will initially be funded by a large issuance of Treasuries. Longer term treasury rates have started to rise and the overall yield curve has steepened in the last two weeks in expectation of the large increase in supply of Treasuries. Furthermore, helicopter money and other forms of fiscal stimulus could be inflationary, which further pressures rates up but also tends to result in a weaker dollar. Some market pundits are touting the pressure via the stimulus could be so great it could result in a crash of the dollar (drop of 20%+). In our opinion, the market has the ability to soak up the increase in Treasury issuance without a large back up in rates or crash in the dollar. Additionally, attractiveness of U.S. equities relative to other markets will provide support. Overall we think the dollar weakness is likely to result in a low to mid single digit impact in the short run, but inflation concerns could keep the dollar depressed longer term.

Negative Long-run Market Implications for Biden Policies: While the market is rallying on the short-run hope of a Biden Blue Wave election and large stimulus before year end, investors are significantly discounting the possibilities of Biden enacting his large tax and spending policies. To this point, it is unlikely the Democrats will gain 60 Senate seats, which means that legislation will be subject to filibuster and cannot be rubber-stamped. Tax policies will not be able to be legislated independently and will have to become part of budget reconciliation or continuous resolution bills. Nevertheless, the rally ignores Biden's vow to reverse executive orders that relaxed costly Obama regulatory restraints. Tax and spending legislation as well as tighter regulatory constraints could have a greater impact in 2022 and beyond.

Figure 15: Biden Tax Increase Largest Since LBJ

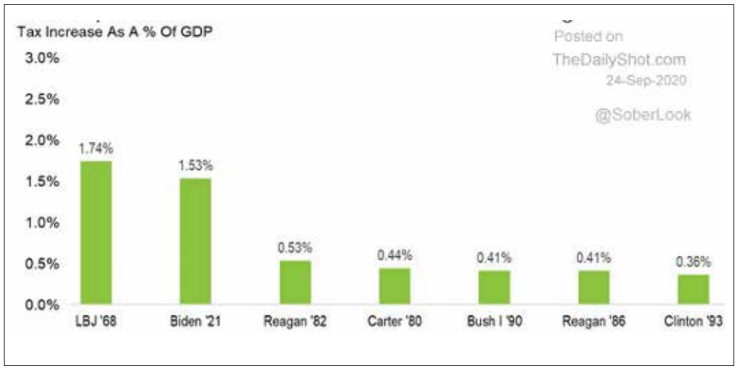
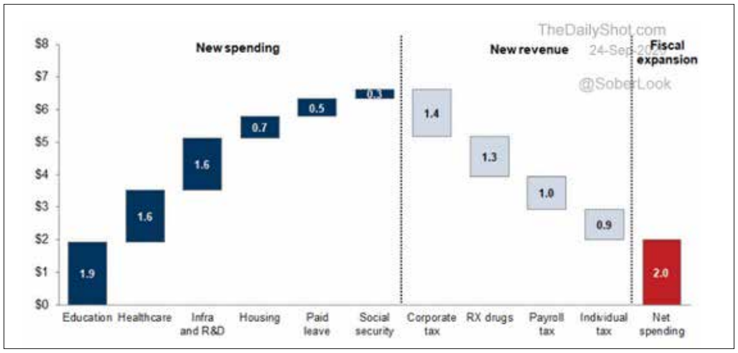


Figure 16: Large Tax Increase + Larger Spending = $2T Deficit



Sources for Figures 15 & 16: The Daily Shot, Goldman Sachs, U of Pennsylvania

Democrats criticize of the deficit created by Trump's tax cut. Nevertheless, Trump corporate tax cuts halted a decades-long relocation of some of the largest and most innovative U.S. companies to European countries with lower corporate taxes. Over $1 trillion in cash was repatriated by U.S. corporations for reinvestment domestically in a little over 12 months. Unfortunately, the return of capital from deficit generating tax policy can take over a decade as new capital reinvestment is deployed and generates higher revenue growth and profitability. Biden's tax policy will be the largest tax increase since LBJ established "The Great Society" Medicaid and Medicare programs and permanently boosted social security benefits (please see Figures 14 and 15). The policy fails to fund $2 trillion of spending over ten years. Only about $2 trillion of the $7 trillion spending proposal invests in productivity enhancing policies. Furthermore, Biden's policies disincentivize capital formation for future investment. Biden's proposals leave a similar $2 trillion deficit as Trump's tax policy, but there is little hope of repaying the deficit via higher productivity or new tax revenues resulting from increased investment.

We believe as early as 2022, Biden's policies could become inflationary causing rates to rise. If not managed correctly rates could rise too quickly before unemployment recovers, the U.S. could face a period of stagflation similar to that experienced in the early 1970s. We believe Biden's policies are at least short-term and possibly long-term bearish for U.S. bonds. A weak dollar may be positive for emerging market bonds and equities and possibly international equities. These policies may be bullish for gold and possibly commodities, if global growth outpaces U.S. growth.

Market Valuations May Not Be Stretched on Closer Inspection: The S&P 500 finished the quarter at 3,363, which is roughly 18.3x 2022 EPS estimate of $184. When the 10-year treasury rate was closer to 2%, the market traded at 17.0x to 17.5x forward earnings. When the 10-year rate was closer to 3.0%, the forward market traded between 15.0x and 16.0x forward earnings. We do not think it is too much of stretch to value the market between 18.0x to 18.5x normalized earnings, when the Fed has cut Fed Funds rates to zero and the 10-year treasury yields ~0.75%. Furthermore the S&P 500 has reached a record concentration in large mega cap technology and growth stocks. The six "FANMAG" stocks (Facebook, Apple, Netflix, Microsoft, Amazon and Google/Alphabet) make up 24% of the S&P 500, these stocks are trading at 21.9x forward earnings where the rest of the S&P 500 are trading at closer to 17.9x.

Recommendation: The current economic, political and market backdrop is challenging for asset allocation. Investing in fixed income markets is particularly difficult as the Fed maintains a focus on keeping short-term rates near zero. Money markets yield around 0.01% as they did after the financial crisis and with ten-year rates near 0.75% traditional bonds offer less diversification protection from an equity bear market. A second stimulus package potentially followed by Biden tax policy is likely to be inflationary and pressure rates up creating downside risk for bonds of longer duration. The market is back to the "There Is No Alternative" aka "TINA" scenario. This time rates are lower than after the financial crisis and fixed income presents higher potential risk, giving investors little choice than to

Table 5: S&P 500 Valuation

- S&P 500 Value 09/30/20:	3,363
- S&P 500 Multiple 19A:	20.6x
- S&P 500 Forward Multiple 20E:	25.9x
- S&P 500 Forward Multiple 21E:	20.3x
- S&P 500 Forward Multiple 22E:	18.3x

	Pre Covid-19	Cons/ CB&T	CB&T Growth %
- 2019 Actual:	$163	$163	0.6%
- 2020 Estimate:	$177	$130	-20.2%
- 2021 Estimate:	$196	$166	27.7%
- 2022 Estimate:	NA	$184	10.8%

Implied S&P 500 Valuation

	$160	$165	$170	$175	$180	$185	$190	$195
13.0x	2,080	2,145	2,210	2,275	2,340	2,405	2,470	2,535
13.5x	2,160	2,228	2,295	2,363	2,430	2,498	2,565	2,633
14.0x	2,240	2,310	2,380	2,450	2,520	2,590	2,660	2,730
14.5x	2,320	2,393	2,465	2,538	2,610	2,683	2,755	2,828
15.0x	2,400	2,475	2,550	2,625	2,700	2,775	2,850	2,925
15.5x	2,480	2,558	2,635	2,713	2,790	2,868	2,945	3,023
16.0x	2,560	2,640	2,720	2,800	2,880	2,960	3,040	3,120
16.5x	2,640	2,723	2,805	2,888	2,970	3,053	3,135	3,218
17.0x	2,720	2,805	2,890	2,975	3,060	3,145	3,230	3,315
17.5x	2,800	2,888	2,975	3,063	3,150	3,238	3,325	3,413
18.0x	2,880	2,970	3,060	3,150	3,240	3,330	3,420	3,510
18.5x	2,960	3,053	3,145	3,238	3,330	3,423	3,515	3,608
19.0x	3,040	3,135	3,230	3,325	3,420	3,515	3,610	3,705
19.5x	3,120	3,218	3,315	3,413	3,510	3,608	3,705	3,803
20.0x	3,200	3,300	3,400	3,500	3,600	3,700	3,800	3,900

Implied S&P 500 Price Change

	$160	$165	$170	$175	$180	$185	$190	$195
13.0x	-38%	-36%	-34%	-32%	-30%	-28%	-27%	-25%
13.5x	-36%	-34%	-32%	-30%	-28%	-26%	-24%	-22%
14.0x	-33%	-31%	-29%	-27%	-25%	-23%	-21%	-19%
14.5x	-31%	-29%	-27%	-25%	-22%	-20%	-18%	-16%
15.0x	-29%	-26%	-24%	-22%	-20%	-17%	-15%	-13%
15.5x	-26%	-24%	-22%	-19%	-17%	-15%	-12%	-10%
16.0x	-24%	-21%	-19%	-17%	-14%	-12%	-10%	-7%
16.5x	-21%	-19%	-17%	-14%	-12%	-9%	-7%	-4%
17.0x	-19%	-17%	-14%	-12%	-9%	-6%	-4%	-1%
17.5x	-17%	-14%	-12%	-9%	-6%	-4%	-1%	1%
18.0x	-14%	-12%	-9%	-6%	-4%	-1%	2%	4%
18.5x	-12%	-9%	-6%	-4%	-1%	2%	5%	7%
19.0x	-10%	-7%	-4%	-1%	2%	5%	7%	10%
19.5x	-7%	-4%	-1%	1%	4%	7%	10%	13%
20.0x	-5%	-2%	1%	4%	7%	10%	13%	16%

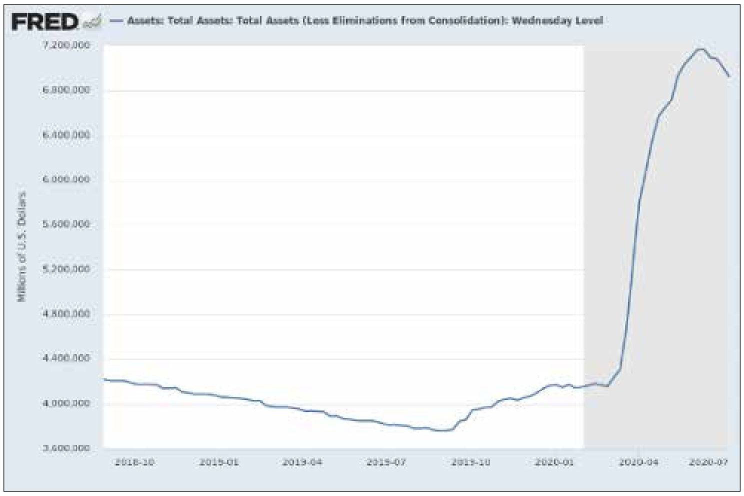
Source: Yardeni Research & CB&T. Note add ~2% in dividends for S&P 500 total return

Pink Shade - Bear Market from 3,394 2020 peak; Yellow Shade - Expected Levels; Green Shade - Irrational Exuberance allocate more to equities and other risk assets.

In the face of the "TINA" set up, we find it difficult to allocate funds into equities ahead of the election, when there is a strong chance it could be contested in a prolonged recount process. As previously discussed there are pockets of opportunity within the market. For instance, the average large cap stock in the S&P 500 is trading closer to historical norms vs. the mega cap tech and communications stocks. Financials, industrials energy and other sectors are still down for the year. Small and mid-cap stocks and international stocks have significantly lagged U.S. large cap returns this year. Carefully rotating into lagging asset classes and sectors, particularly those that may get a boost from a vaccine / re-opening scenario, created incremental returns for our portfolios this year and should generate stronger returns over the next six to twelve months.

Active monetary stimulus coupled with fiscal stimulus should continue act like a "put" option, which limits the downside risk of a security. In this case, the Fed Put is expected to "put" a floor in the overall stock market. Nevertheless, an active Fed, the potential for a vaccine and forward 2022 fundamentals, would probably limit a pull back to around the 3,000 level. Given the low expected returns for bonds and inflation risk, we think investors will be better off remaining in equity markets. We think the S&P 500 should be locked in a range of 3,200 to 3,600 until more is known about the election and resulting fiscal policy as well as the timing for the distribution of a vaccine. Both of these data points may be known by year end. Given the faster than expected recovery in economic data and corporate earnings, if Trump wins or Biden's policies are muted or blocked, there is strong potential to break out beyond 3,600 early next year. Post-election fiscal stimulus from either party will likely lead to a lower dollar. We believe the growth prospects of select emerging markets will make them more attractive than equities of advanced economies. Furthermore, we have started to add to emerging market bond allocations, which look like a better risk/reward than high yield or advanced economy bonds.

Figure 17: Record Federal Reserve Balance Sheet



Source: St. Louis Federal Reserve

ASSET ALLOCATION OUTLOOK				
LAST QUARTER			**THIS QUARTER**	
WE BELIEVED →	**ACTIONS TAKEN →**	**RESULTS**	**WE BELIEVE →**	**ACTIONS WE ARE TAKING**
DOMESTIC EQUITIES			**DOMESTIC EQUITIES**	
We believed that small and mid-cap stocks will close much of the performance gap with large cap stocks in the next 6 - 12 months.	We will continue to maintain model weights established earlier in the year until we see a larger recovery in small and mid-cap stocks.	**Large Cap +8.9% outperformed small cap +4.9% and mid-cap +4.8%. Our large, small and mid cap selections outperformed their benchmarks during the quarter. Small and mid cap did not beat the S&P 500.**	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 believed 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 maintained our international and EM weights. We anticipate a catch-up rally on the back of EU fiscal stimulus.	**International equities** (+4.8%) **underperformed U.S. large cap** (+8.9%). **EM** (+9.6%) **outperformed U.S. large cap as the dollar remained weaker than in the first quarter. Our developed international** (+10.0%) **and EM** (+17.1%) **selections outperformed the S&P 500 and their benchmarks during the quarter.**	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 thought the Fed will keep rates low until the economy makes a robust recovery. Returns likely between 1% and 2% for core investment grade bonds.	Fed announced it expected to keep rates near zero through 2023. We made a large overweight allocation to high yield (HY) in late March as yield spreads widened. We exited trade in late August, booking gains of 16% to 18%. We are maintaining short duration HY exposure.	**The BBG Aggregate returned +0.6%, while the High Yield index gained 4.7%. Local currency international and emerging market bonds gained 2.7% and 0.6%, respectively. Our bond selections significantly outperformed the aggregate bond index during the quarter.**	The Fed will keep rates low until 2023. It relaxed its inflation policy, which enables Fed to use judgment on raising rates as inflation rises. Returns likely between 1% and 2% for core investment grade bonds.	We cut our exposure to high yield with a 16%-18% average profit in portfolios. We have a little weight via shorter duration high yield. We increased weight to EM bonds and changed exposure from hedged to local currency as the dollar dropped.
We thought munis were attractive relative to investment grade bonds, considering the risks.	We started reducing an overweight to munis during the quarter and exited the trade with 10% to 12% profits.	**Munis outperformed core bonds in the quarter (+1.2% vs. +0.6%) on an absolute basis and tax-effective basis. Our fixed income selections outperformed the benchmark.**	We think munis are about equally attractive investment grade bonds, considering the risks.	We are continuing to reduce muni exposure in 4Q20.
ALTERNATIVE ASSETS			**ALTERNATIVE ASSETS**	
We believed volatility would remain elevated as new COVID cases rise, through the November election, and/or until a coronavirus vaccine is widely available.	We maintained a 10% allocation to alternative strategies.	**Equity market volatility increased during the quarter. Our alternatives baskets outperformed their index 2.0% to 3.0% vs. 0.50% for the benchmark.**	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/.				