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Thanksgiving Note and Year-End Investment Outlook

While 2020 has brought more than its fair share of surprises, there is still much to be thankful for. First and foremost, we personally are extremely grateful for the trust you have placed in us. We take the privilege of managing your assets very seriously and will continue to fight for every basis point of return. Although we are not quite ready to put a bow on 2020, and there certainly could be a few more surprises in its final weeks ahead, we are also pleased with the year-to-date returns delivered by most asset classes.

Cash and Bonds

In our outlook piece heading into 2020, we noted that we expected the Federal Reserve to keep yields on cash low. We planned to reduce our overweight to cash by buying on weakness and deploying into assets with better yield. We did not expect COVID, nor the resulting $3 trillion of cash flooded into the market by the Fed with its promise that it is "not even thinking about thinking about raising interest rates" for at least three years. We did, however, follow our playbook and reduced cash balances in favor of higher yielding assets during bouts of volatility. We are now just slightly overweight cash in discretionary portfolios and expect to work down these balances if we see further weakness ahead. Today, the three-month US Treasury Bill yields just 0.08% before even considering taxes or inflation. These are the lowest real rates we have seen since 1830 outside of our three major wars. At these rates, it will take almost 1,000 years for an investor to double their money in cash. We will continue to seek better opportunities elsewhere, especially on weakness.

Bonds are typically the next place investors look for better yield without taking excess risk. Unfortunately, high-grade taxable bonds currently offer some of the worst returns per unit of risk seen in history. $17 trillion worth of global bonds are trading with negative yields, meaning investors are paying others to hold their money. (We do not directly own any of these bonds.) The US bond market is what many consider to be the "cleanest dirty sheet" out there, but again, the risk-to-return tradeoff is poor. The Barclays US Aggregate, with the majority of its assets backed by the US government, yields just 1.2% despite carrying six years of interest rate risk. This is near the worst yield-to-interest rate risk investors have ever accepted, at time when our federal deficits and debts are expanding from near record levels. For these reasons, we remain quite underweight this sub-asset class.

We are, however, a bit more optimistic about high-grade municipal bonds and both high-yield corporate and municipal bonds, and we are neutral weighted to these sub-classes. We entered the year underweight these bonds and added to them following the tremendous dislocations we saw in March. Our core municipal portfolio yields roughly 1%, largely tax-free, with just four years of interest rate risk and solid credit quality. Although state and local revenues are off nearly 30% from last year, we believe these high-grade bonds still offer relatively adequate compensation for their risk. We also see good opportunities in the high-yield space, while recognizing that significant bankruptcies are likely to be filed in the near future. We continue identifying attractive taxable high-yield bonds with 4-6% yields and high-yield, tax-free municipal bonds with yields in the 3-6% range. Because purchases of these types of bonds continue to be dominated by both passive and retail investors, we believe active managers are well positioned to take advantage of opportunities.

Public Equities – Domestic and International

Similar to our exposure to bonds, as discussed above, we entered the year underweight public equities, and expected weakness and volatility at some point in 2020. When market declines emerged in March, we took advantage and stepped into markets, as planned. While we took a few chips off the table more recently before the election, over the past twelve months we have moved our US equity positioning from near the low end of our tactical ranges to just shy of neutral. The month of November has continued to deliver surprising upside with the S&P 500 index returning 9%, producing nearly 12% for the year. While the recent gains have been primarily attributed to the solid COVID vaccine news, it is important to note that the market was already up 7.2% in November prior to Pfizer's announcement of promising initial results on the 9th. We have concluded that the rally has largely been driven by an unwinding of the excessive pessimism and bearish positioning maintained by investors heading into the election. While both the Pfizer and Moderna vaccine news is encouraging and we hope we are starting to see the light at the end of the COVID tunnel, there are certainly obstacles ahead. The US presidential election is still making its way through the courts. The Georgia Senate seats await runoffs with a blue wave still possible. Even with the positive vaccine results, COVID cases and lockdowns continue to rise again. We also face one of the world's largest supply chain feats ever undertaken, to distribute a two-shot vaccine broadly. We continue to remain relatively optimistic on American businesses long-term and will likely use any weakness presented by these short-term challenges to invest further.

Turning to the international equities, we remain near neutral and relatively positive long-term. Our largest geographic overweight continues to be Asia. While we remain cautious about strained US-China relations, we also continue to see opportunity in China. An inefficient equity market, coupled with the rising, educated middle class consumer, is ripe for active management. Outside of China, we continue to be a bit skeptical and underweight other emerging markets. Of the developed countries, we are still overweight Japan and were encouraged to see Berkshire Hathaway entering Japan after avoiding it for decades. We are also becoming more optimistic on Europe, after its recent move toward a more unified fiscal stance.

<u>Private Assets – Hedge Funds, Private Equity and Real Estate</u>

As discussed in prior letters this year, we are skeptical of hedge funds as an "asset class." As a result, we continue to cull our manager count in favor of fewer managers that we have the most confidence in, while also reducing our overall exposure to the space. In our directional vehicle, we have trimmed our hedge fund manager count by seven and increased our liquid holdings by 30%. We have taken a similar path in our uncorrelated vehicle, reducing manager count by six while concurrently increasing our liquid holdings to 20% of assets. We rotated hedge fund proceeds back into liquid instruments, which allow us to reduce fees and enhance liquidity and flexibility. While we are not abandoning the space and our long-term results have been strong, we have set a very high bar for new funds entering the portfolio.

We are less skeptical about the prospects for private equity investments despite their illiquidity. We continue to believe that they can deliver excess returns over public markets. We see value in start-up formations, taking public companies private and transforming them, and in providing growth capital to unique firms seeking to expand their businesses. The public markets have been receptive to these types of firms, with 2020 being one of the strongest years for IPOs in terms of issuance and first day price movements. We had two private investments IPO recently, delivering approximately 14 and 32 times our initial capital invested. We fought hard to get an allocation to the fund that gave us the 32X and plan to partner with them again on their next fund. We have also recently made two new allocations to other hard-to-access funds that are newly launched spin-outs (from larger firms) we view as experienced, hungry and right-sized.

Finally, we retain our largest underweight to real estate and real assets. This has been the right call so far this year, with real estate and energy lagging all other asset classes, although both have rebounded significantly this month on the vaccine news. We recently increased our risk slightly within our liquid real estate vehicles and are spending a lot of time re-underwriting the space. For now, we remain skeptical that

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some of the more traditional real estate sectors, like office and retail, can continue their upward climb. We did recently commit to two new private real estate investments. The first is focused on “digital” real estate, or companies enabling the next generation of mobile and internet connectivity. The second is a smaller fund focused on more distressed assets, with a manager who has performed well historically and is seeing a robust opportunity set stemming from COVID. Finally, we continue to monitor the energy fields closely and are considering an allocation with one of our long-standing, favored partners in the space.

In sum, 2020 has been a year full of surprises. Despite the global COVID pandemic, a heated US election and countless other shocks, markets have largely climbed the proverbial wall of worry. We expect the next several months to deliver a few more surprises and challenges, but believe the light at the end of the tunnel is quite bright. We wish you and your families a happy and safe Thanksgiving and look forward to seeing you again – hopefully face-to-face and in person – in 2021.