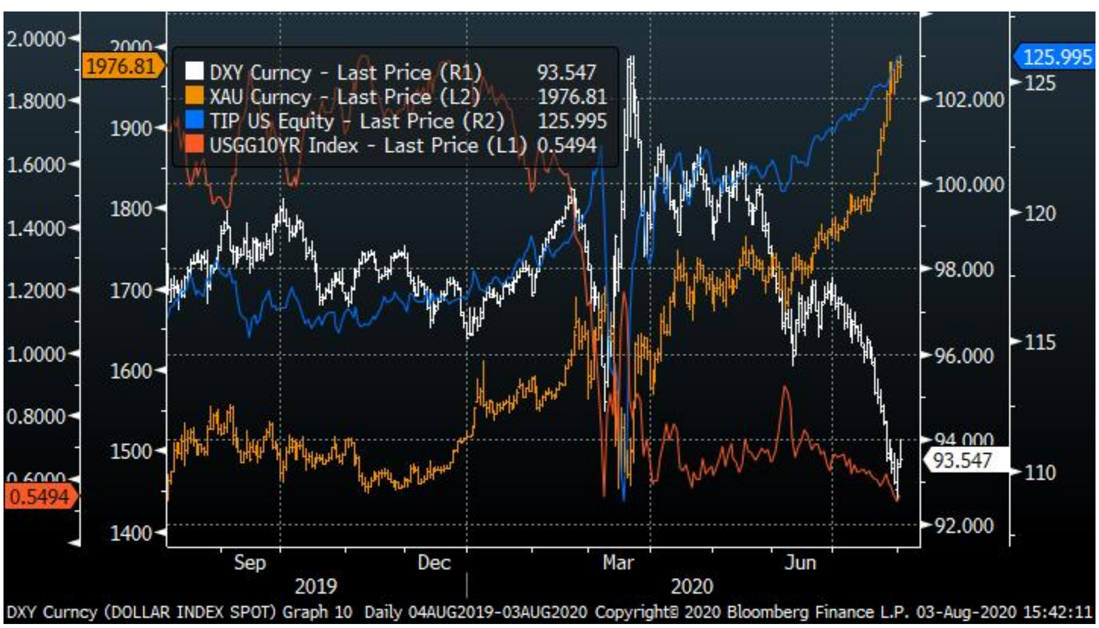
FROM THE DESK OF ERIK OROS

AUGUST, 2020

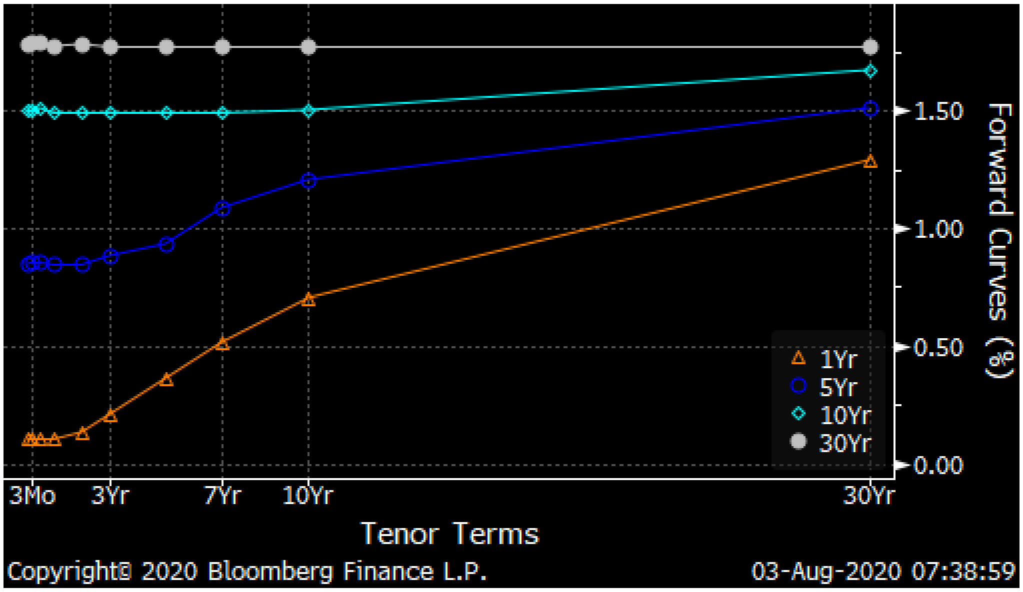
Investor focus over the past month was pulled in just about every direction as global markets grappled with increased geo-political tension, evolving fiscal support, and a better look at second quarter earnings and economic output. On the backs of strong earnings reports and outlooks from Apple, Amazon and Facebook, domestic indices finished the month broadly higher as market leadership continued to narrow to a select handful of mega-cap companies. While there were incremental green shoots towards vaccines and therapeutics, markets continued to contend with tremendous uncertainty around the duration of the pandemic. Congress continues to skirmish over an additional stimulus package as we head closer towards the election and the Federal Reserve remained steadfast in their support of markets, remaining deliberate with forward guidance. Trade tensions continued to escalate. Given this dichotomous backdrop, we remain focused first and foremost on capital preservation in our investments as uncertainty and risk continue to exacerbate.

In a month characterized by no shortage of dramatic moves in equities, from a 875% gain in shares of Eastman Kodak, to a single day gain of $173bn in AAPL's market cap on the final day of the month, perhaps the most notable and telling was the 4.15% drop in the US Dollar (as measured by DXY). The dollar's move lower stemmed largely from the agreement of an EU Recovery Package and the continued compression across the Treasury curve as 10-year yields closed the month at 0.5282%, their lowest closing level in history. This dynamic has resulted in increased inflation expectations as costs of overseas goods increase, as well as a dramatic increase in the price of gold and other precious metals, with the former breaking out to an all-time high. A depreciating dollar is a tailwind for domestic equities, particularly those larger companies with large businesses overseas. This dramatic reversal from the March highs, when a rush to cash pushed the dollar to its highest level since 2016, shows the Fed's success in its injection of liquidity into markets and bears close attention.

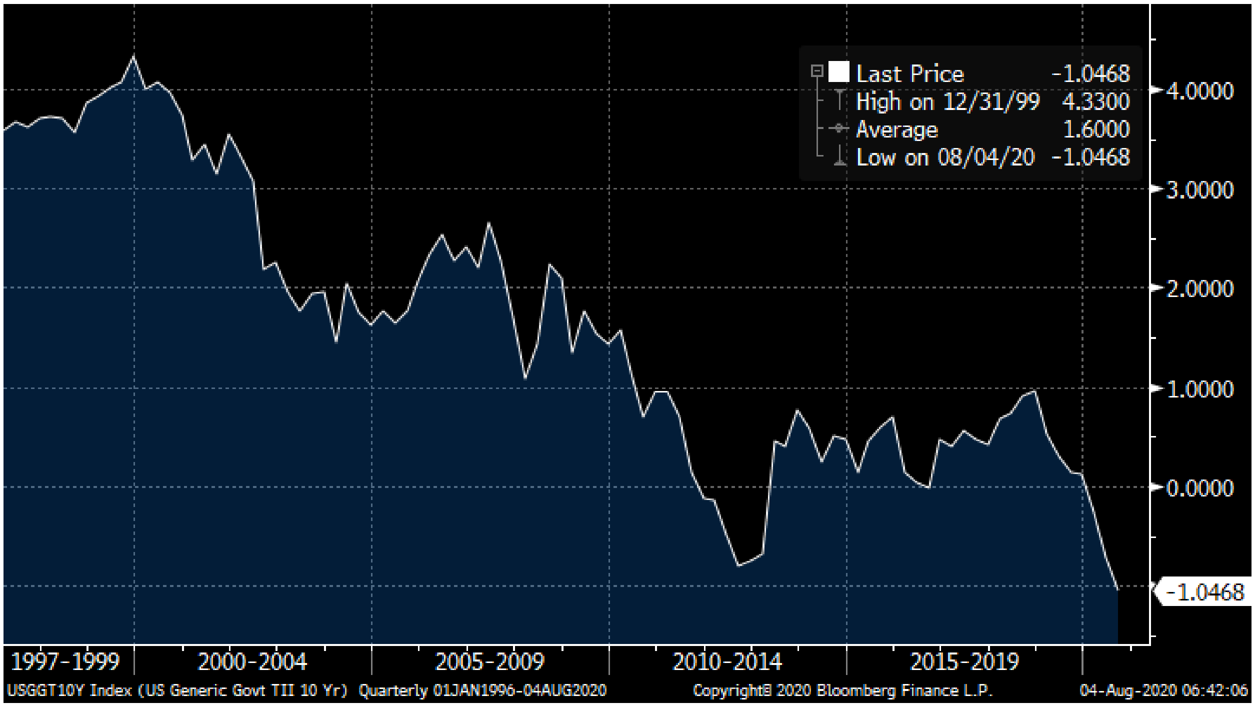
US Dollar Index, Gold, TIPs, & US 10-year Treasury Yield



Treasury Forward Curves

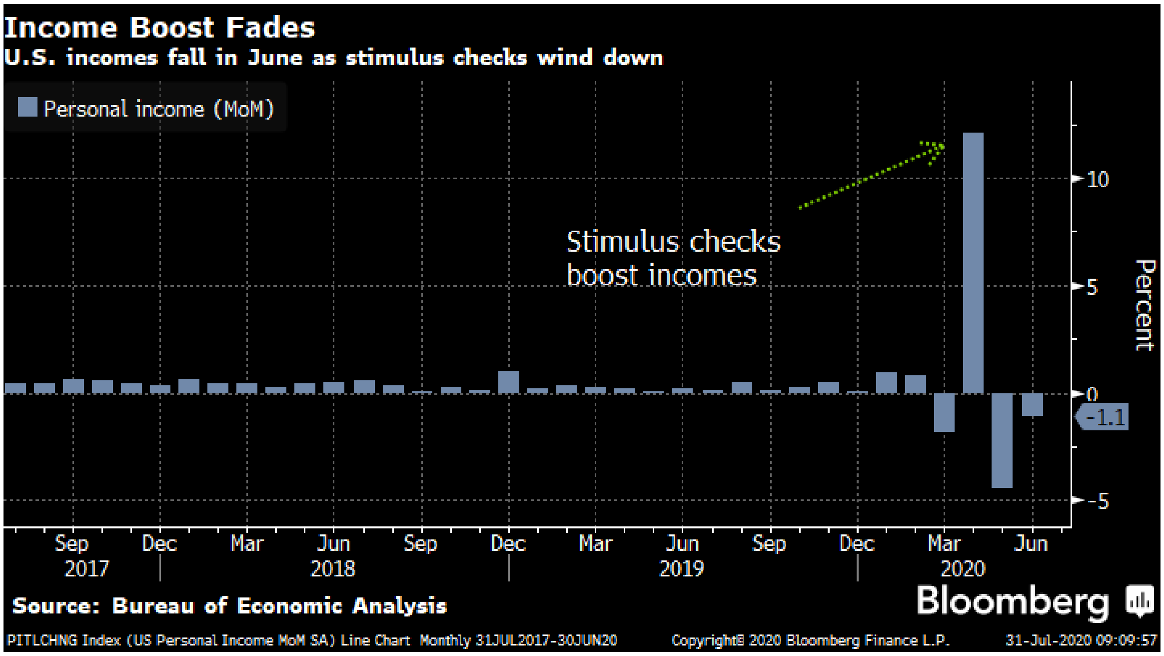


10-year TIPS Yield

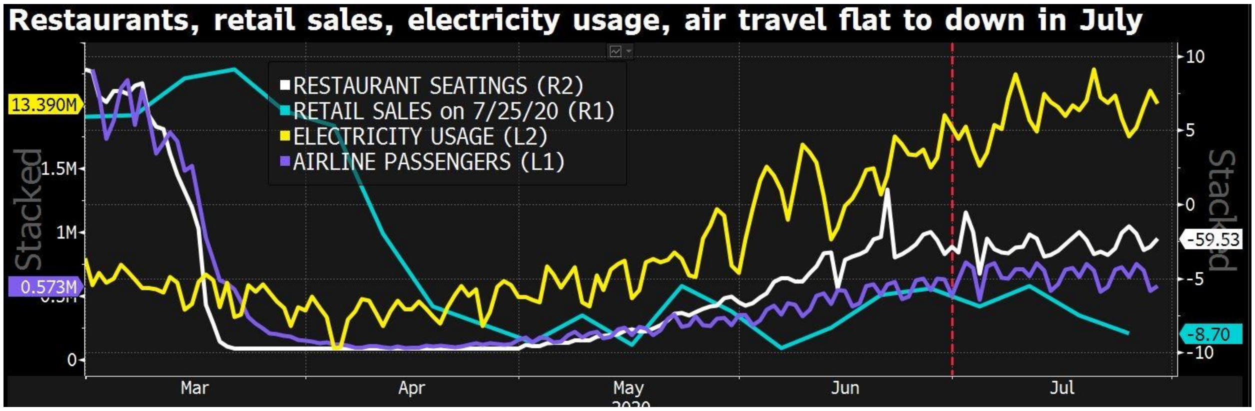


As we move closer to November's critical election, attention this month will be centered on Washington's efforts to pass an additional stimulus bill as benefits from March & April's herculean efforts begin to roll off. More than 25m Americans received a benefit of $600 per week until its July 31st expiration. As these benefits inevitably roll off, there is considerable risk that consumer spending cools from the Q2 sugar high that these direct payments provided. Jobs protected by the PPP legislation are at risk in September and we have already begun to see companies that were especially hard hit, such as the airlines, begin to notify employees about the potential for widespread layoffs.

US Personal Income MoM

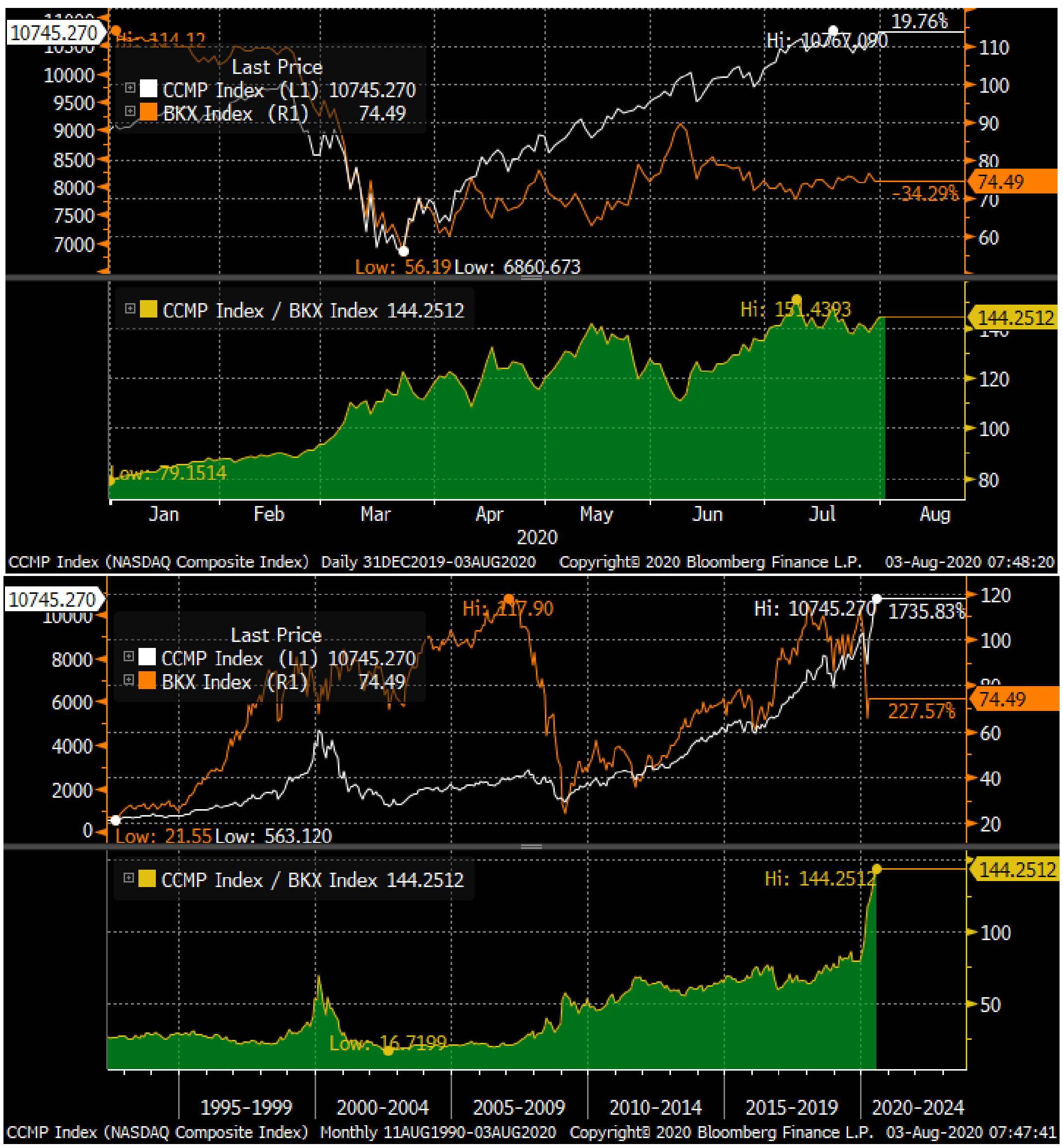


Economically Sensitive Sectors Stall in July



This increasingly uncertain dynamic around the performance of the more cyclically driven parts of the economy has led to a widening of performance between sectors deemed to be insulated from the effects of the pandemic such as tech and those such as the banking sector thought of as more economically sensitive. This narrowing breadth in the equity markets is of particular concern to our assessment of risk/reward generally. While Q2 earnings reports for the five large tech monopolies showed the resilience and strength of these businesses during the pandemic, their valuations have become increasingly stretched as we head into the back half of 2020 where the expectations for growth and earnings have reset to levels that are unlikely to deliver the sort of upside surprise we saw in Q2. There have been several transient rotations from these large tech names back towards value and the "old economy" stocks since the outbreak in March that have not had a dramatic effect on the indices. However, our concern is that the next pullback in large tech does not result in a rotation but rather a spill over across the entire market.

NASDAQ COMP vs BKX Index



Against this backdrop, our focus has increasingly turned towards private markets and alternative investments. As a result of the Fed's aggressive accommodation, the opportunities in public markets to generate current period income has become increasingly challenging as spreads and nominal yields continue to compress. In private markets however where central bank intervention has not (yet) distorted pricing, strategies such as private credit, particularly those strategies employing fresh capital towards loans underwritten with full awareness of the pandemic are likely to offer compelling returns that are simply unavailable in public markets. There is likely to be no shortage of new funds and strategies looking to capitalize on this dynamic.

Finally, we conclude this month's letter with a refresh on the risks on the periphery as we approach the back half of 2020. Trade tensions globally have continued to escalate, risking the Phase One deal with China as rhetoric around espionage, blame for the pandemic, and tensions over Hong Kong continue to build. In fact, these tensions seem to no longer be bi-lateral between the US and China, but have begun to spill over to Europe where the UK and Germany have started to press China on such issues.

The election and the potential for a Democratic control of the Presidency, House, and Senate has continued to grow as a risk to markets. Details around Mr. Biden's tax plan have become clearer over the past months and we have begun urging clients to prepare for the number of changes potentially on the horizon. Of immediate concern to financial markets is the proposal to raise corporate tax rates to 28% from 21%. Considering over 50% of the earnings growth since 2018 has come from the lowering of the tax rate, this is of immediate concern to markets, especially big tech who has been a notable beneficiary. On the personal side, the repeal of step-up of basis upon death for estates, a dramatic increase in capital gains taxes from 23.8% to 39.6% for anyone making over $1m a year and a repeal of a cap on the social security tax of 12.4% on incomes over $400,000 constitute dramatic changes that warrant preparation and planning Gideon is uniquely suited to provide.

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