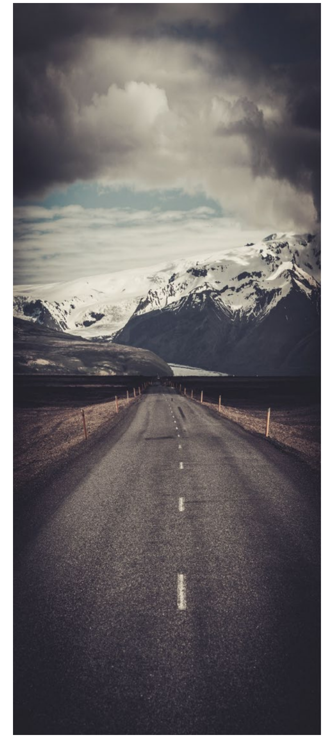
SILVER HAWK
PRIVATE WEALTH

Period Ending July 20, 2020

QUARTERLY

Investment Review & Outlook



Silverhawk Private Wealth

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Executive Summary

The rebound in the equity markets continued in 2Q 2020 as global Central Banks ramped up Stimulus in the form of Asset Purchases funded through the printing press.

This stimulus has helped to support financial markets and reduce liquidity risk, but pandemic caused financial crisis appears to be a solvency problem as opposed to a liquidity problem (like we saw in 2008 – when Fed stimulus through liquidity injections worked quite well as the medicine matched the illness). Short term the Fed action has worked to buoy markets (and if you believe in Modern Monetary Theory, it has also improved the Economy), but the medium and longer-term impacts from such massive borrowing and spending could present large headwinds for financial markets on the other side of this crisis.

Our rules-based Asset Management methodology has helped to position portfolios to both benefit from the recent rebound, but also reduce risk substantially during the correction as we saw in Q1. We are headed into a period where some key Stimulus benefits are ending, markets are at substantial overvaluation levels with Market Cap-to-GDP levels above 150% (historic), with a second wave of the Virus appearing imminent. Whether that wave leads to delayed re-openings and further lockdowns remains to be seen, but it nonetheless should have a negative impact on consumer spending and prolong unemployment, both of which increase the risk of solvency issues as we head into the third quarter.

Included in the report are:

- Some key highlights of our Portfolio decisions toward the end of Q1 and during Q2.
- Our thoughts on the disconnect between Financial Markets and the Real Economy.
- Why the widening Wealth Inequality Gap is not bullish for Stocks or the Economy.
- What we see as the biggest risks to financial markets longer-term from all of this fiscal and monetary stimulus.

Investment Committee
Silverhawk Private Wealth

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Active Management Decisions During the Quarter

Key Takeaways

- Our systematic Risk Management rules triggered on February 26th, and therefore we increased the cash position across Equity portfolios by 20%. The signal began to reverse in late April and the portfolio cash position was fully allocated into the US Equity portfolio by May 8th.

- The past two years have been “Buy the index and chill” as passive investing outperformed most active managers. However, we believe there are periods of time in which active management is needed to navigate volatility and position portfolios as the cycle unfolds, which is where we believe we are now. After rotating 20% of the passive US Large Cap Equity exposure into actively managed, high-quality US Stock selection sleeve the market proved resilient in the face of extreme uncertainty during the quarter.

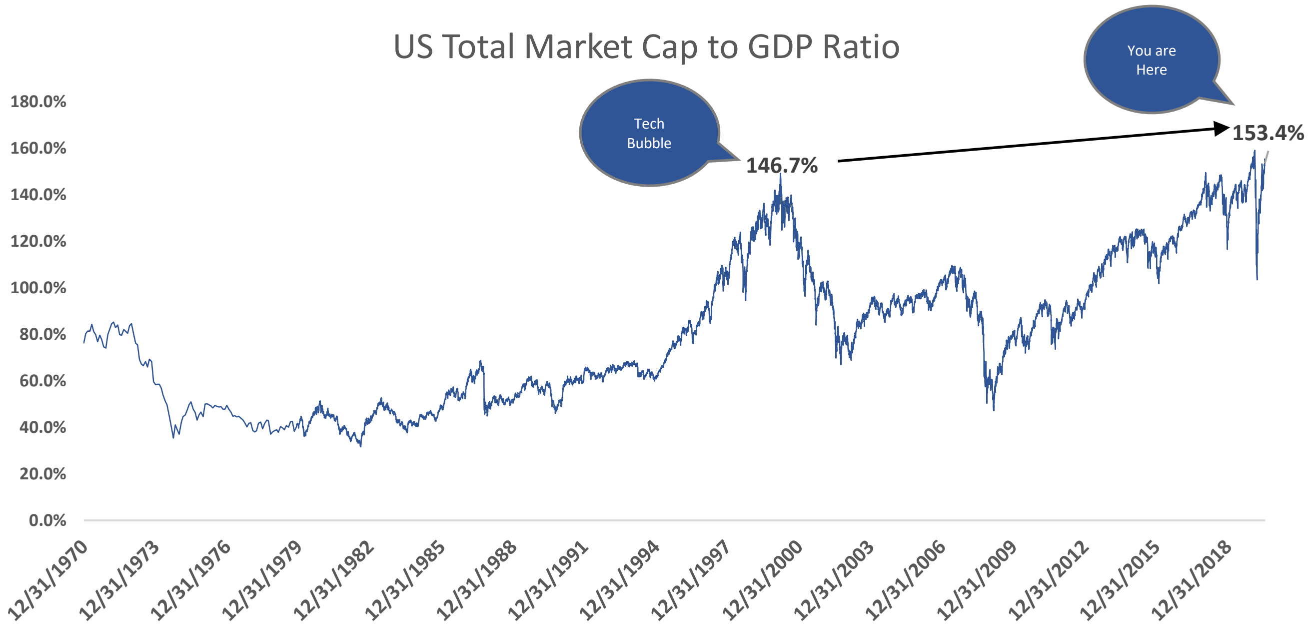
- On April 8th we added preferred stock allocations into high-quality financial and insurance entities with low leverage, high common dividend coverage ratios, along with 13 other data points used to determine which stocks met our quality criteria. The goal here was to increase cash flow/yield and possibly gain some Alpha as well.

- Gold and Silver remain one of our highest conviction allocations. Historic Fiscal and Monetary Stimulus flooding the market liquidity combined with reduced production by Gold miners as price per ounce nears all-time-highs.

- Technology stock valuations are near Tech-Bubble era levels, and the top 8 Technology Stocks (FB, AMZN, NFLX, MSFT, APPL, GOOG, TSLA, NVDA) now make up 49% of the Nasdaq 100 Composite Index We feel that red flags for a technical correction in this sector have begun to emerge. Very recently, we rotated out of our Large Cap Technology as we saw the extreme disconnect between prices and reality given revenue and earnings levels.

Call us at 480-296-0200 if you want to discuss any of these portfolio decisions as we held daily investment committee meetings throughout the crisis and into April to ensure allocation decisions were made prudently, and with sufficient evidence.

The (growing) Disconnect between Financial Markets and Real Economy



- The US Total Market Cap (the combined value of all publicly traded US Securities divided by US Gross Domestic Product) is now at 153.4%, the highest level in recorded history and 6.7% higher than the Tech Bubble (Ycharts).
- 32.9 million Americans received some sort of unemployment benefits the last week of June, comprising 23.77% of the workforce despite the official unemployment rate (U-3) being 11.10% (Bianco Research).
- United States Total Debt to GDP (similar to a person's debt-to-income ratio) was at 106.9% as of Dec 31, 2019 – the highest level since World War II. This is before the Pandemic, mind you.
- Over 3600 companies have filed for bankruptcy halfway through the year, with 600 filing in June alone (an increase of 43% from one year prior). Edward Altman, the creator of widely accepted "Z" score, which measures a company's probability of bankruptcy based on a handful of profitability and solvency ratios, is predicting 2020 will set a record for "Mega" bankruptcies, which are companies with $1B or more in debt.

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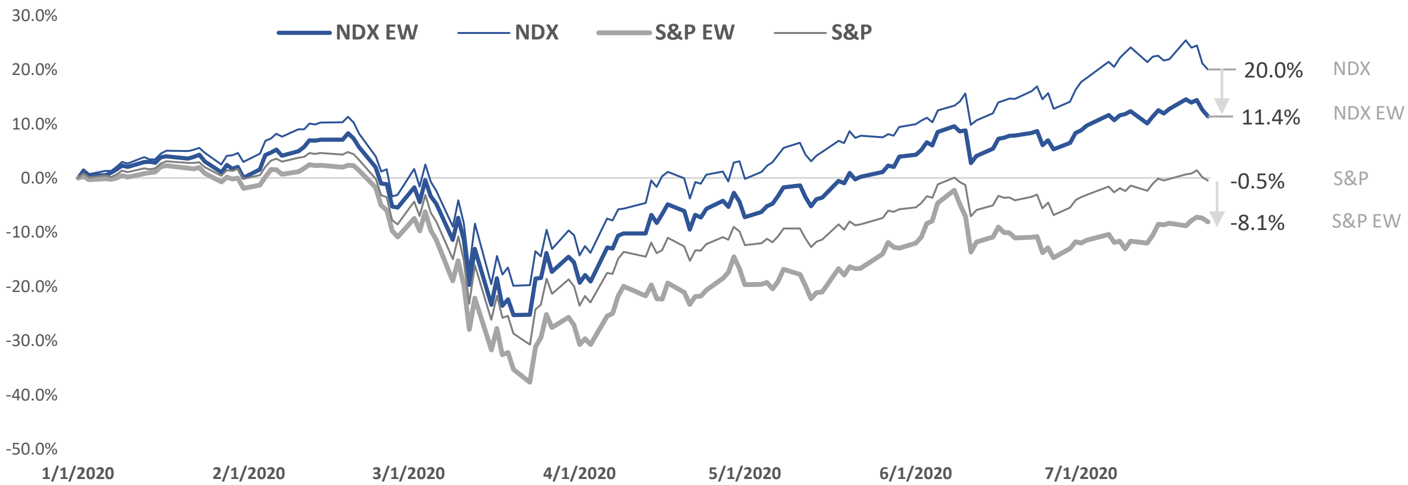
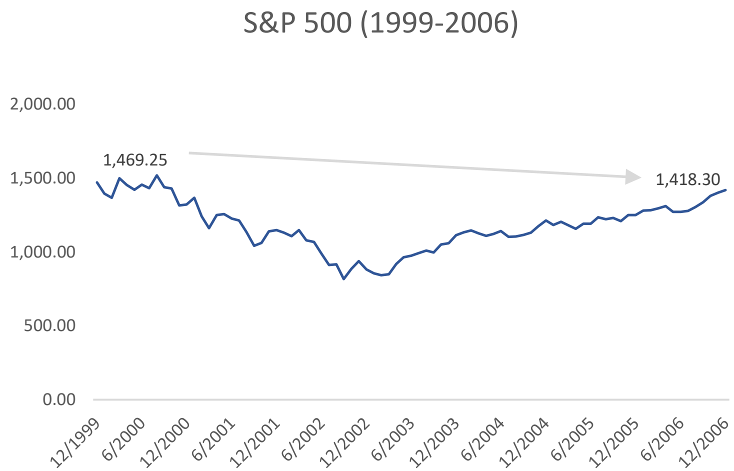


Source: ycharts

- The stock market rally off of the March 23rd lows has largely been driven by a handful of Mega-Cap Technology stocks, with the S&P 500 equal weight down -8.1% YTD versus -.50% on its Market Cap weighted index, and the Nasdaq 100 equal weight up 11.4% versus 20.0% for the cap weighted index.

- The Federal Reserve's "easy button" via the printing press has helped to stabilize financial markets, and many see their actions as necessary. But what is the cost? What are the long-term implications of trillions upon trillions of liquidity injections into the US Economy through money printing and asset purchases? One would argue that higher inflation and structurally lower GDP growth are the base case result from this stimulus. Under these assumptions, we believe that looking ahead, there is a higher likelihood that we experience a recovery similar to that of the 2000 – 2003 time period and not the 2008-2010 period.

Looking Ahead – Which Recovery Path is Most Likely?



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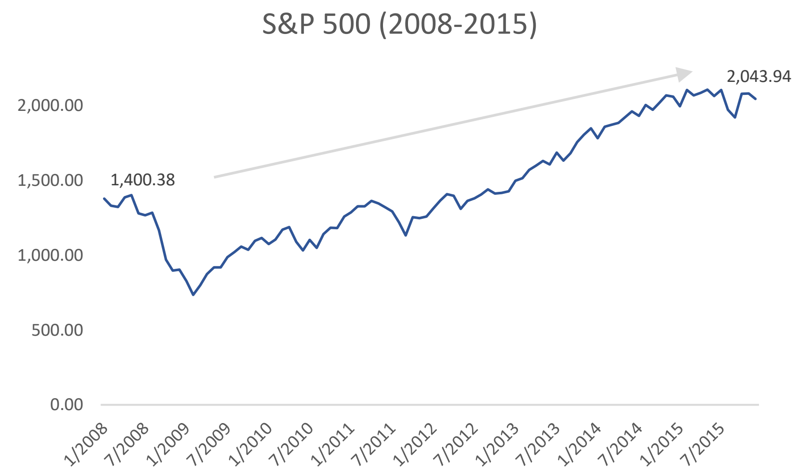

- ECRI, the world's leading business cycle analysis firm that has been around since the 1940s, has been correct on their recession call in 2000-2003 period, and the 2008 Great Recession. They've stated this recession would be very deep (severe), but very short (perhaps one of the shortest on record). However, they've also shown a slowdown in the recovery (using their publicly available weekly leading index) which is likely caused by this second wave of infections and does not support a "V" shaped recovery.
- Debt levels are much higher than they were in 2008, which limits both the Government and Central Banks' ability to provide prolonged stimulus as the Economy recovers without posing significant risks to the real economy.
- The spending and stimulus will have to be paid for, which could result in a combination of higher tax rates on consumers and massive government treasury bill sales in the open market to fund deficit. Both of these are very bearish on the US Stock market and the US Economy as it would squeeze discretionary income at a time when consumer spending is critical to the recovery, and the large level of bond issuances may crowd out private investors and flood the market with an over-supply of bonds (leading to lower prices, and higher interest rates).
- The bond market is a key indicator to watch going forward. If (when) we see inflation, the Fed will need to raise interest rates to maintain stable prices in the economy and we would see this in bond yields (particularly the 10-year treasury yield) as bond market participants expect higher inflation. So far, 10-year yields have remained relatively stable.

Ending Comments

Key Takeaways

- Risk in the financial markets appears to be building, particularly in the Technology sector and Communications Sectors. Additionally, the massive reversal in the US stock market has led to questionable valuations across most publicly traded stocks, leading to a more defensive stance heading into the end of summer.

- The labor market appears to be cooling once again from the recent spike in positive Covid tests nationwide. This is occurring at a time when the unemployment stimulus benefits are expected to stop at the end of July unless Congress passes another Stimulus bill.

- Inflation continues to be something rarely discussed as the often-quoted Core CPI (a common basket of goods one may purchase, less Food and Energy) remains within the Federal Reserves target. However, food prices have skyrocketed as global supply chains were squeezed (and continue to be squeezed), and the Federal Reserve's historically large money printing is flooding the market with currency. Also more and more small businesses are filing for bankruptcy each week. That is more money chasing fewer goods, which is the definition of inflation.

- The Covid vaccine conversation is starting to look a lot like a Fiscal Policy tool, rather than evidence-based trial results spawning further progress toward a safe, widely-available vaccine.

- A vaccine would change our baseline outlook of a slower than expected recovery. A quickly developed, FDA-accelerated vaccine that may require multiple "re-ups" during the year does not sound like something most people are going to be eager to take a risk on.

- We will continue to position our Core portfolios to be long equities; however, we recognize we are headed into a very sensitive window where Stimulus is ending, the stock market is near historical over-valuation levels, the Coronavirus appears to be spiking, many businesses will face solvency issues headed into the late Summer, and the election season is right around the corner. We believe that our Evidenced-Based allocation methodology allows us to execute prudent decisions on behalf of our clients as these various market and economic outcomes unfold.

Disclosures

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