

2021 OUTLOOK

The Great Reset



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Outlook 2020	1
2019 Review	1
2020 Intro	3
Investment Themes 2021	5
Reopening or Reversal	5
No Fix for Fixed Income	7
The Market Carousel	9
Don't Fight The Fed, Don't Fight The Government	11
Domestic Equity	14
Foreign Equity	18
Eurozone	18
United Kingdom	19
Japan	21
Emerging Markets	22
China	24
Fixed Income	26
Domestic	26
Foreign	28
Alternative Assets	30
Real Assets	30
Private Equity	33
Private Credit	34
Hedge Funds	35

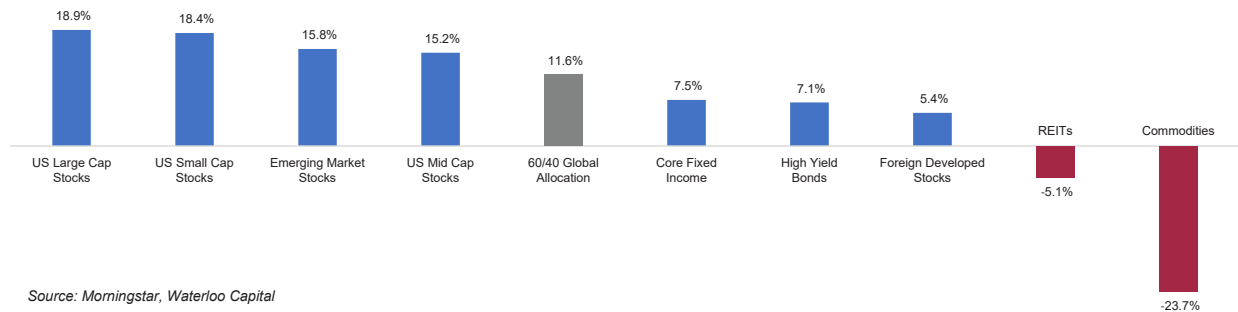
2020 Review

Traditional wedding vows include a promise to remain devoted in sickness and in health. In 2020 many investors applied this vow to the stock market. The year began with optimism. The roaring 20s were back, and the only things to worry about were quips between world leaders and whether the economy was too strong for the Fed's liking.

By February most people had heard of the new flu strain in China. The news was interesting, but it was almost spring in the US when traditional virus seasons typically dissipate, and fevers and body aches were far down on the list of the world's worries. Yes, it looked bad in China, but a massive government response appeared like it was working to contain the virus's spread. Stateside, the markets hit an all-time high in late February, and the outlook was for strength to continue building throughout the year.

What happened over the coming weeks will be remembered forever. In March, the world acknowledged that a once in a century pandemic was upon us. The new flu strain, COVID-19 was anything but contained. It ripped through China and spread westward like wildfire. Countries began to shut down, fear gripped the markets, and we experienced the fastest sell off in stock market history. The bond market nearly broke when the overnight lending markets between banks froze and required Fed intervention. Correlations went to one and there was no place to hide. The S&P 500 was in a bear market in 16 days and fell nearly 34% in less than a month.

2020 Asset Class Returns



Source: Morningstar, Waterloo Capital

Everyone became an armchair scientist with new theories, preventions, and treatments everywhere you looked. The key components missing from early prognostications were essential to the outlook of not only the markets, but of everyday life around the world. When would we have a vaccine, and would it be effective enough for the world to get back to normal? The economy and the stock market hinged on those questions throughout the year.

By early April we began to see signs of a recovery in the markets. The Fed pulled out all the stops and launched unprecedented monetary policy stimulus measures. Initial fears of a historically deadly global contagion of historic proportion began to subside, and markets began to look forward again. While it was impossible to see through the fog, the confidence that something better and brighter was on the other side may have been all that investors needed. The rebound was as incredible as the downturn.

Outlook 2021: The Great Reset

From March to early June the markets experienced the fastest recovery in the history of the stock market. After a few hiccups we were back on track for a “normal” year.

While the overall market direction was positive, underneath the surface we saw a different story playing out. The most significant impact of COVID on the market was the rapid separation between the companies benefiting from the COVID economy and those afflicted by it. Investors took a more binary approach to allocating capital which resulted in a “K” shaped return outlook benefitting the “new” economy at the detriment of the “old”. Later in the year, positive vaccine trials were announced, and the ever forward looking and fickle markets shunned COVID beneficiaries for the re-opening trade. We saw small-cap equities, basic materials, and industrials stage a comeback. Ongoing vaccine test results continued to spur optimism for 2021 and beyond.

In the end, intervention by the governments and central banks, and the power of optimistic market psychology further defined the gap between the real economy and the stock market. It was a banner year for the major indexes, and a historical year for the tech heavy NASDAQ, all while economic activity failed to rise above pre-COVID levels. 2020 was a year that we will not soon forget, and the economic environment left in the wake of the COVID pandemic will take time to heal. Looking ahead, a fresh year brings a fresh outlook, and we are seeing signs of momentum building to send us full speed ahead to the light at the end of the tunnel.

2020 Included the Fastest Bear Market Decline and Ensuing Recovery in Market History



Source: Morningstar, Waterloo Capital

2021 Intro: '20s Roaring Back

Aggressive policy responses from governments and central banks last year effectively hit the reset button, and now we are waiting for the global economy to power back on. Markets have recovered swiftly, but many parts of the real economy are still wrestling to overcome the economic costs of COVID. The path of both the virus infection trends and vaccine distributions are paramount to the 2021 synchronous global growth story. Vaccines are coming, but logistical challenges and new variants are creating speed bumps that will need to be maneuvered around.

<i>Tactical Decision</i>	2021 Investment Outlook
Relative Risk	Risk Off ←———— ————→ Risk On
U.S. Equity Style	Value ←———— ————→ Growth
U.S. Market Cap	Large-Cap ←———— ————→ Small-Cap
Regional Equity Selection	U.S. ←———— ————→ Non-U.S.
Non-U.S. Equity Market Preference	Developed ←———— ————→ Emerging
Fixed Income Quality	Investment Grade ←———— ————→ High Yield
Fixed Income Duration	Short ←———— ————→ Long
Regional Bond Selection	U.S. ←———— ————→ International

Source: Waterloo Capital

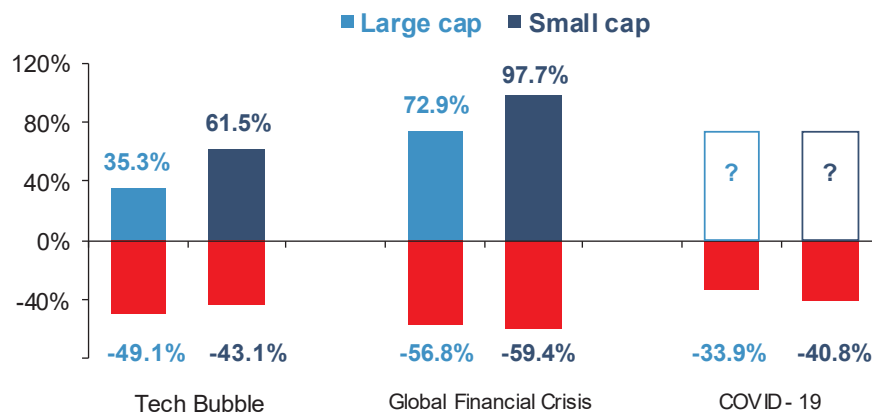
In Washington, reconciling this drastic disconnect between Wall Street and Main Street onto a parallel recovery path will be top priority for the new administration. The implications of fiscal policy decisions will be a major theme this year. With wins in the senate run-off in Georgia, Democrats hold a majority in all three branches of government. These victories are more meaningful than in years past because policy initiatives like fiscal aid, changes to corporate taxes, and regulatory measures will have a greater influence on the future path of markets. Additionally, the dynamic playing out between the Federal Reserve and Washington will be important to follow. Measures taken by both liquidity providers have reinforced our positive outlook for global equities while weakening our outlook for traditional fixed income. A deeper overlap between the two could also be key to restarting a new market cycle for recovery levered equities. Investors have long stood by the mantra “Don’t fight the Fed”, and this year “Don’t fight the government” will likely be added to investment aphorisms.

In equity markets we are entering the year with high valuations and sentiment. Where you start from still matters, yet we have reentered the TINA environment in which There Is No Alternative to investing in risk-on assets. Recent market rotations have been increasingly driven by headlines and sentiment rather than fundamentals. The shift from COVID beneficiaries to industries levered to a global reopening gained momentum heading into the year, and the question now is whether this narrative can continue. Valuations are also an issue for bonds. The Fed has driven rates to near zero, rendering the upside for bonds nearly non-existent. The expectation of fiscal stimulus measures coming out of Washington also creates headwinds for bonds by putting pressure on real yields.

Fulfilling return expectations in fixed income allocations will require more creativity, and we expect alternative yield strategies to gain prominence this year. The backdrop of high valuations in both stocks and bonds, easy money policies, and sentiment outweighing fundamentals will continue to lead to faster rotations across markets. It will be increasingly important for investors to be tactical and take advantage of trends within markets and across global economies.

We enter 2021 with an optimistic perspective but recognize serious investing implications from one of the deepest and fastest economic collapses in our nation's history still linger. Old risks may be coming back, new risks will be revealed, and COVID is still affecting our everyday lives. Some industries may never fully recover from the effects of COVID, but in the investment world, when one door closes many more tend to open. Overall, we think the narrative of the roaring '20s reset and reopening will lay the foundation for a restart of the global business cycle and strong risk asset returns. We are relieved to be closing the door on 2020, and we are excited for the opportunities we see ahead in 2021. On behalf of Waterloo Capital, we want to thank you for reading our 2021 Market Outlook.

Historical Markets Drawdown and Next 12-Month Rebound



Source: FactSet, FTSE Russell, NBER, JP Morgan

THE GLOBAL RESET FROM POLICYMAKERS LAID THE FOUNDATION FOR A NEW BUSINESS CYCLE

Reopening or Reversal

Possibly the most pressing question entering 2021 is whether the global economic recovery will follow the “V” shaped pattern we witnessed in equity markets or if growth prospects will ultimately fade. We believe the scale is tipped in the right direction and see significant upside for global growth this year. Our expectations are driven by the unique nature of the COVID recession, improved visibility in the vaccine outlook, and the accommodative global policy landscape.

The 2020 recession was unique in that it was not triggered by market disruptions or excesses, but by a global health crisis and large-scale government restrictions on businesses’ and peoples’ daily lives. The shutdown put the outlook for nearly every industry on hold and essentially stopped the business cycle in its tracks. The unprecedented fiscal and monetary measures that followed helped prevent a lengthy economic disaster and loaded up the kinetic energy of the economy. We see a global business cycle powering back on this year as the release of energy stored during the crisis drives a synchronous global rebound. We expect GDP and profit growth to be the strongest we have seen in a decade and believe the reopening trade will continue to gain momentum during 2021.

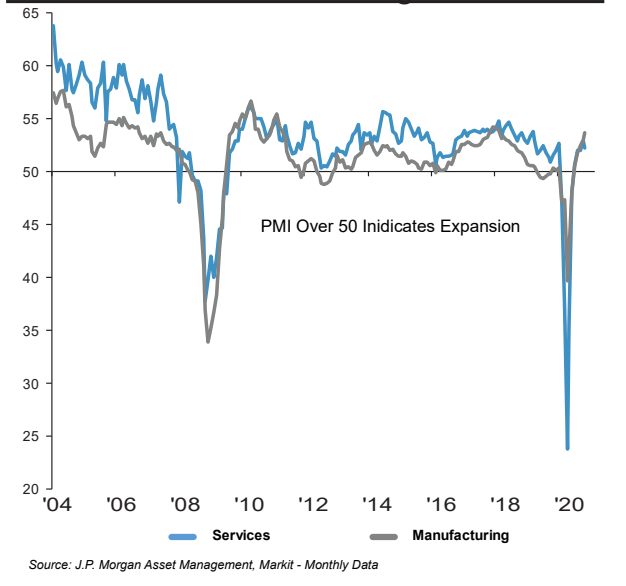
The beginning of a business cycle is marked by GDP and industrial production growth moving from negative to positive as easy financial conditions aid rapid spending by both businesses and consumers. We are seeing positive progress on these new cycle conditions entering the year. This dynamic bodes well for our positive outlook on equity markets and specifically benefits cyclical industries and foreign markets. Additionally, because the crisis was not financial in nature, banks are positioned extremely well to support a recovery. Borrowing money is as easy and as cheap as it has ever been. Many companies raised cash last year to bolster balance sheets for a long-term recession and the speed of the recovery has left these businesses with large cash reserves. Additionally, companies which may have had credit access restricted because of COVID related business disruptions are finding it easier to raise capital as the negative virus outlook has tempered. Ongoing support from open credit markets and low-cost capital will help broaden the reopening push this year. We expect much of this cash to be put to work later this year as a long-term suppression of COVID becomes more concrete resulting in an improved employment outlook and increases in business and consumer spending.

Some may argue, however, that the equity markets have already caught onto the reopening trend and that we may be closer to a top. We believe high consensus expectations should always be looked at with an air of caution, but note rising sentiment tends to precede rising demand. Additionally, high prices and high sentiment are rarely the sole cause market sell-offs. It is likely we would need to see an external catalyst to spark a deep market sell-off and reversal of the reopening trend. In general, our view is the opportunities provided by an optimistic outlook outweigh near-term risks.

GDP Projections	2020	2021 Est.
Global	-3.5%	6.0%
Developed Markets	-5.4%	4.9%
US	-3.5%	5.5%
Euro Area	-7.2%	5.0%
Japan	-5.2%	2.3%
UK	-11.4%	4.5%
EM	-2.0%	7.5%
China	2.3%	9.0%
India	-5.7%	9.5%
Brazil	-4.0%	4.0%
Russia	-4.0%	3.5%

Source: Morningstar, Waterfo Capital, MS Research, Bloomberg, Haver Analytics

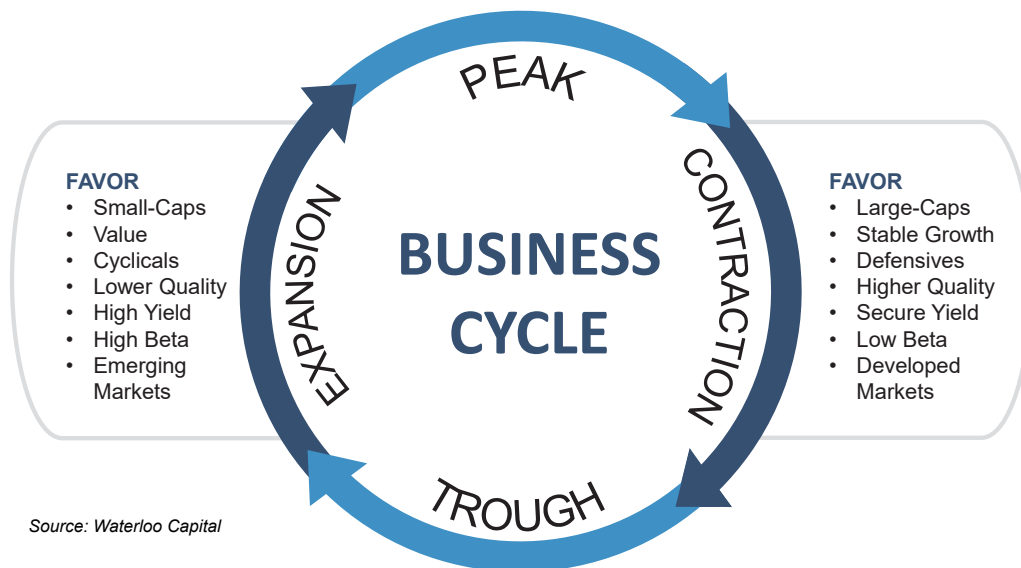
Global PMI for Manufacturing and Services



Potential downside risks to our outlook include a failure to pass additional stimulus measures, a lack of shared optimism from company leadership on profit and earnings forecasts, and COVID infection spikes leading to renewed lockdown orders. Expectations for additional fiscal stimulus are high. If Washington pulls back on stimulus promises, we will see a repricing in equity markets with the most likely outcome being a rotation out of cyclical sectors. On the earnings front, a lack of conviction from corporate leadership for a recovery in 2021 earnings will be a serious disappointment. Markets hate uncertainty, and with projections elevated for a rebound in profits and earnings growth, negative or non-existent forward guidance will be a detriment to equity sentiment and momentum.

Finally, while severe cases of COVID have declined overall, infection rates have been more stubborn. New strains have been identified in multiple countries, and in the Northern Hemisphere we are entering peak flu season. A period of immune susceptibility and additional health threats are far from the ideal landscape for a global vaccine distribution project. Investors should be prepared for heightened volatility and deeper downside corrections if we begin to see these reversals emerging or COVID trends heading in the wrong direction.

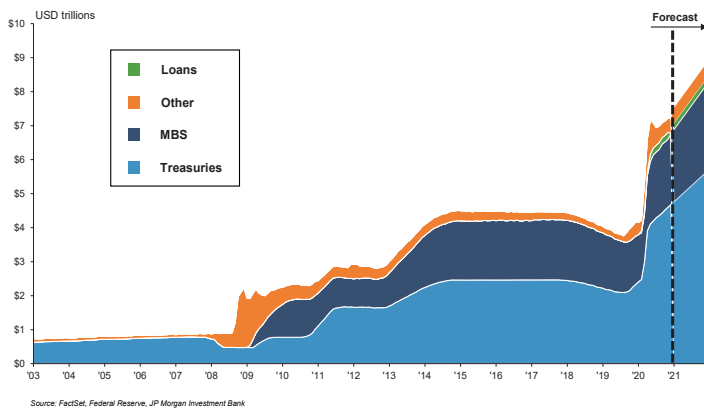
The Expansion Phase Favors Cyclical, Small-Caps, and Emerging Markets



No Fixes In Fixed Income

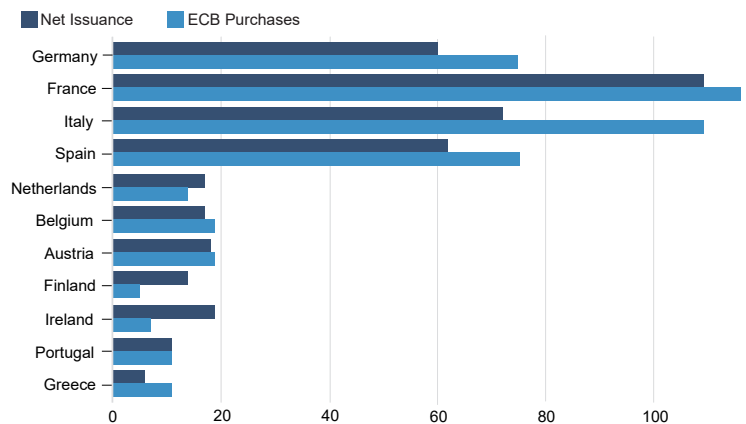
The search for yield will continue for at least another year as markets contend with the massive amounts of liquidity introduced to the markets. The massive campaign to backstop the global economy during the COVID crisis deepened central banks' foothold in global bond markets and once again pushed interest rates to historical lows. In the US, the Federal Reserve now owns 25% of all US Treasury debt, and in Europe, the ECB is expected to buy 100% of all new government debt issued in 2021. Additional monetary policy measures are unlikely to be announced this year, but the markets will be dealing with central banks' influence for years to come.

Federal Reserve Balance Sheet Holdings



ECB Epected to Buy All New Government Bonds Issued

Citi forecasts for 2021 (€bn)



Our outlook once again puts bonds in the return free risk category. A rebound in global economic growth and an increase in money velocity as a consequence of fiscal stimulus will put upward pressure on interest rates. With interest rates beginning the year near historical lows, the negative effects of rising rates become amplified. For example, an increase of just over 0.10% in the US 10-year Treasury bond would wipe out nearly a year of income from the bond's price, and a rise of just 1% could lead to losses of around 9%. Alternatively, if interest rates fall to 0% the estimated price return for the US Aggregate Bond Index is just over 5%. This negative skew in the return probabilities will make it difficult to reach out on the yield curve and increase portfolio duration this year.

Higher inflation poses another risk for fixed income. Inflation typically portends higher interest rates as expectations for growth rise and lenders demand higher rates to compensate for a decrease in future purchasing power. Investors will need to be cautious as we enter this transition phase. Higher inflation and a steeper yield curve will inhibit total returns and real income generation from bond investments. Real interest rates, which subtract inflation from current rates, have been negative since February 2020 meaning, all things equal, investors are actually losing spending power by holding US Treasury bonds with durations of 10-years or less.

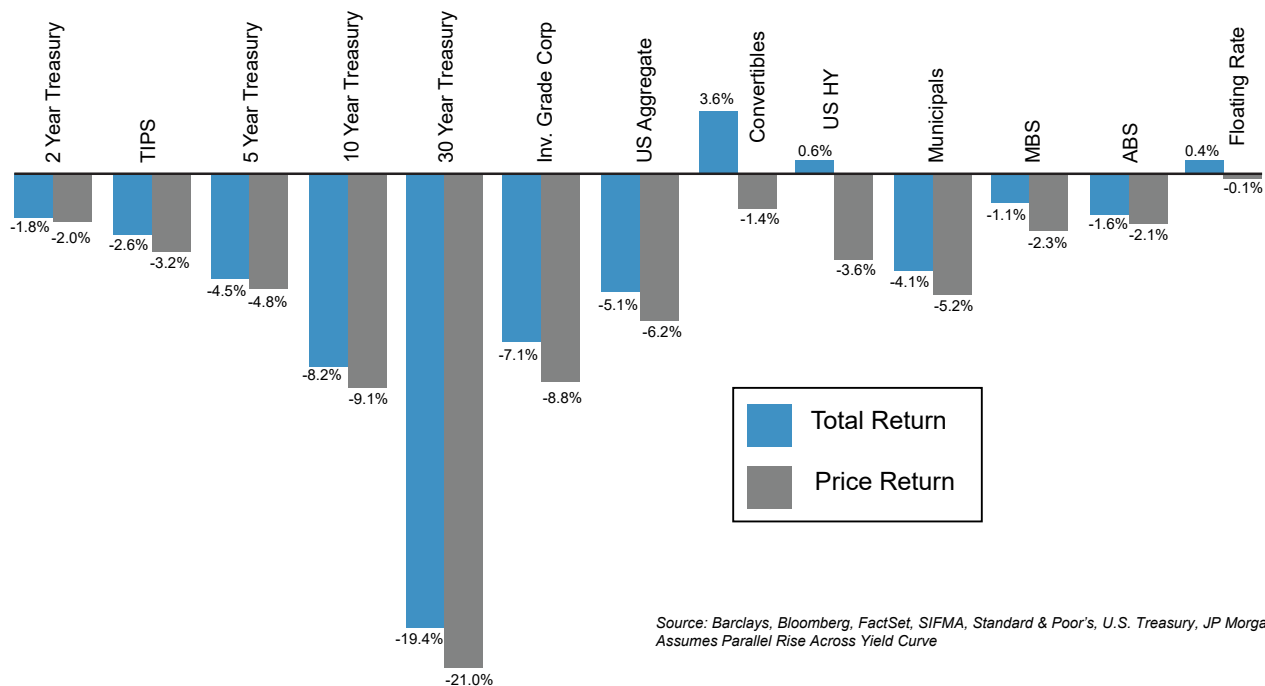
Ultimately, we find ourselves in an environment where the dynamic between the economy and central banks is likely to push long-term rates higher while keeping short-term rates from giving up or gaining too much ground. The environment creates a catch 22 for yield oriented investors. Income generating investments have historically been viewed as lower risk, but this year, achieving a reasonable yield will

Outlook 2021: The Great Reset

require taking more risk. In our opinion, fixed income investors should expect total returns from their bond allocations to be similar to their coupon. This will force investors to be more active and creative within their fixed income allocations in 2021 and beyond. We recommend a barbelled approach with a higher allocation to short-term bonds and cash paired with holdings which benefit from the synchronous global growth story such as private market lending, floating rate funds, and TIPs. Investors may also benefit from opportunistically laddering out a portfolio as rates rise. This strategy would involve holding short-duration bonds and cash to begin the year and gradually adding longer-duration, higher yielding positions after rates move higher. A laddering strategy could help hedge duration risk while adding to total return over time.

Finally, for investors able to access private markets, we believe alternative debt strategies offer attractive solutions to the yield generation puzzle. Alternative assets offer many advantages, and going forward, we expect them to comprise a significantly higher portion of the fixed income component in the traditional 60/40 allocation. Many alternative income strategies are offering significantly higher yields, with comparable or lower risks, than traditional high yield debt. Also, alternative lenders typically have more pricing power which means higher interest rates can actually be a benefit. In our opinion, alternative income strategies offer the most attractive risk and return outlook in fixed income this year.

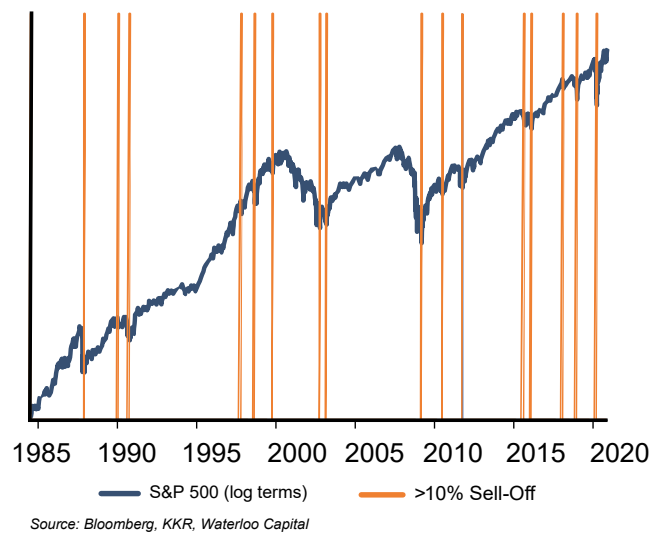
Impact of a 1% Rise in Interest Rates Across Yield Curve



The Market Carousel Ride

In 2020 we witnessed the fastest bear market decline and ensuing recovery in market history. Prices on the surface appeared to settle later in the year, but the underlying movement among sectors and individual names was continuously volatile. Sizeable rotations in sector and factor leadership resulted in headaches for investors as many trends appeared to have staying power, but only lasted a few weeks or even days. These rapid shifts in leadership were driven mostly by changes in behavior and sentiment rather than fundamental factors, which added to overall market volatility. Additionally, low interest rate levels have increased the sensitivity of market prices to valuation changes. Interest rates factor into the denominator of most traditional valuation measures which means rates falling closer to 0% creates a positive multiplier effect on valuation outputs. The effect reverses as interest rate rise

Market Corrections Are Becoming More Common



and markets re-price assets. Because we are starting from such a low basis, a small change in the inputs, interest rates, can have an outsized effect on the stock prices. The Federal Reserve’s cheap money policies are also contributing to the speed and strength of market rotations. Equities continue to look more attractive than bonds, and we are seeing more instances of risk-off and risk-on allocation changes happening within equity sectors rather than between equities and bonds. This leads to larger and faster increases and decreases within the market as we see shifts completely into or completely out of positions. We expect this trend to persist in 2021, and it will be essential for investors to quickly recognize when to take part in the market’s game of musical chairs, and when to grab a seat before the music stops.

One of the biggest story lines for equities moving into 2021 concerns the resurgence in value sectors and companies correlated to economic activity closing the performance gap with high-flying growth stocks. The rotations into the re-opening trade moved in fits and starts until positive vaccine testing results catalyzed a rush into the lagging cyclical names. The question that remains is whether the rotation into these beaten down names becomes more of a long-term allocation and less of a trade in 2021?

We believe the answer is yes. The backdrop of a sharp global recovery on Main Street in the second half of the year, led by the COVID vaccine rollout, suggests recovery levered names such as cyclicals, value, and international stocks can maintain a positive growth trajectory. That said, we recognize the margin for error remains small, and the trade opportunity could unwind as quickly as it began. Cyclical positions are more susceptible large drawdowns if unanticipated pockets of weakness regarding the vaccine or the global recovery emerge. We expect heightened volatility for the re-opening trade early in the

Positive Vaccine Outlook Led to Inflection in Outperformance from Cyclical Sectors

1/1/2020 - 9/1/2020	9/1/2020 - 12/31/2020
33.8% - Technology	26.14% - Small Cap
23.4% - Growth	17.31% - Financials
8.3% - Large Cap	14.06% - Emerging Mkts
6.2% - Materials	12.66% - Industrials
-0.9% - Emerging Mkts	12.16% - International
-6.1% - Industrials	11.78% - Materials
-6.2% - International	10.91% - Value
-6.3% - Small Cap	7.03% - Energy
-10.8% - Value	6.04% - Large Cap
-18.5% - Financials	4.18% - Growth
-40.9% - Energy	3.26% - Technology

Source: Google Finance, Waterloo Capital

Outlook 2021: The Great Reset

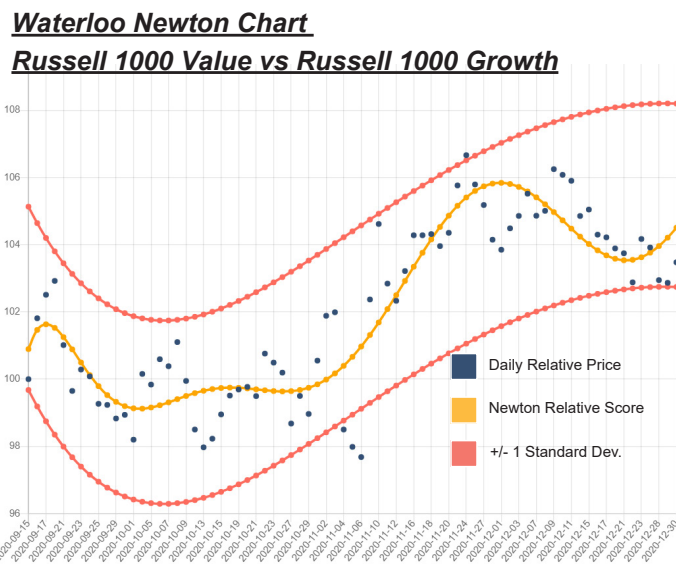
year as the initial investment push subsides and consolidates ahead of more news on the virus outlook. There will be slips along the way as the recovery gains traction, but we are optimistic the cyclical rebound will gain its footing and continue climbing through 2021.

On the other side of the equation, we do not think rotation will be a zero-sum game. Secular growth stocks can still perform well on an absolute basis. For us, secular growth companies are typically defined by growth at a reasonable price, or GARP, attributes. GARP companies exhibit consistent earnings growth and a low price to earnings growth (PEG) ratio. A low PEG indicates the current price is more likely to be an accurate valuation based on future earnings projections. This measure tends to exclude high flying names with unsustainable valuations, while homing in on companies with a higher probability of consistently meeting their growth expectations. Due to this dynamic, we argue for taking a barbell approach heading into 2021, balancing the secular growers with cyclical investments which are levered to the economic recovery.

Tactical investing approaches will continue to perform well in an environment which is still being driven more by sentiment than fundamentals. Volatility spikes have become more commonplace and tactical investors stand to benefit by being able to capitalize on rapid internal rotations in market leadership. As with traditional allocation strategies which focus on stocks and bonds, we believe investors should also look to diversify between passive and active management. This added layer of diversification allows investors to take advantage of short-term opportunities which we believe will continue increasing in occurrence due to heightened volatility and the lack of better alternatives to investing in stocks. Additionally, as the risk and return outlook for fixed income has deteriorated, we think that investors can benefit from holding a higher allocation in cash or short-term bond alternatives as “dry-powder” to take advantage of trading opportunities throughout the year.

At Waterloo we supplement our decision-making process by utilizing our neural network powered screening and trend identification tool, Newton. Our Newton models serve to provide opportunities to catch price shifts to the upside and protect portfolios on the downside by identifying potential trend reversals before traditional analysis techniques, staying in harmony with underlying market trends, and avoiding outsized drawdowns. As prices and optimism continue to climb, we are persistently pursuing strategies to take advantage of attractive short-term opportunities while refraining from adding unnecessary risks.

Our proprietary Newton model shows how volatile the rotations have been between growth and value.



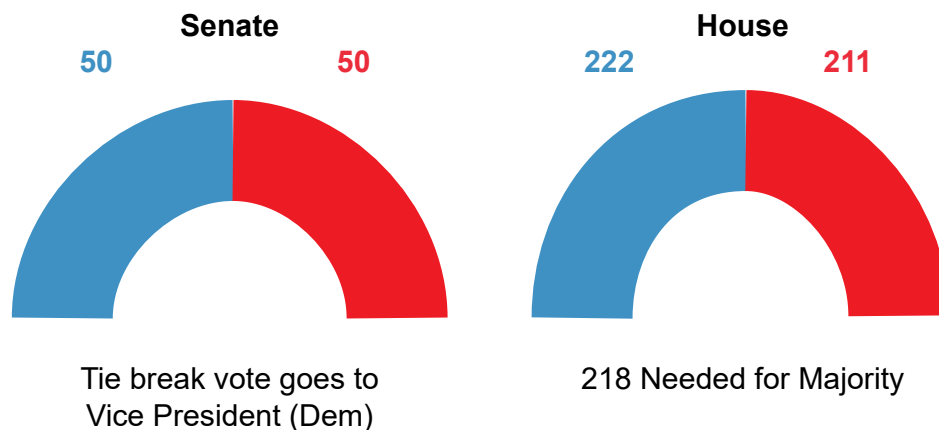
Don't Fight The Fed, Don't Fight The Government

In the bull market run leading up to the COVID crisis the markets were fueled by monetary stimulus from the Federal Reserve. The Fed's policies still support a strong stock market, but the central bank's influence on market upside outside of a market collapse may be fading. In fact, based on comments from Federal Reserve Chairman Jay Powell and changes which add flexibility to the Fed's calculation of policy success, you may argue the Fed prefers to take a step back. For investors, this means fiscal stimulus is now in the spotlight.

Fiscal stimulus, which is determined by Congress and the President, includes government spending and changes to tax policy. We expect additional fiscal spending measures to be a highlight of President Biden's first year in office. Democrats campaigned on a message of action and energizing economic growth in a post-COVID world, and their new majority in Washington will likely make it easier to turn that message into reality. The landscape is prime for passing more spending bills than normal. Many congressional elections were nearly as contentious as the presidential election, and recently elected law makers do not want to be seen as an obstruction in a time of crisis. We are expecting a push for more direct payments to individuals and families, the extension of COVID related debt relief and unemployment payments, and support for the healthcare industry as the COVID vaccine is distributed. A renewed push for infrastructure, clean energy, and healthcare spending as we approach the second half of the year is also anticipated.

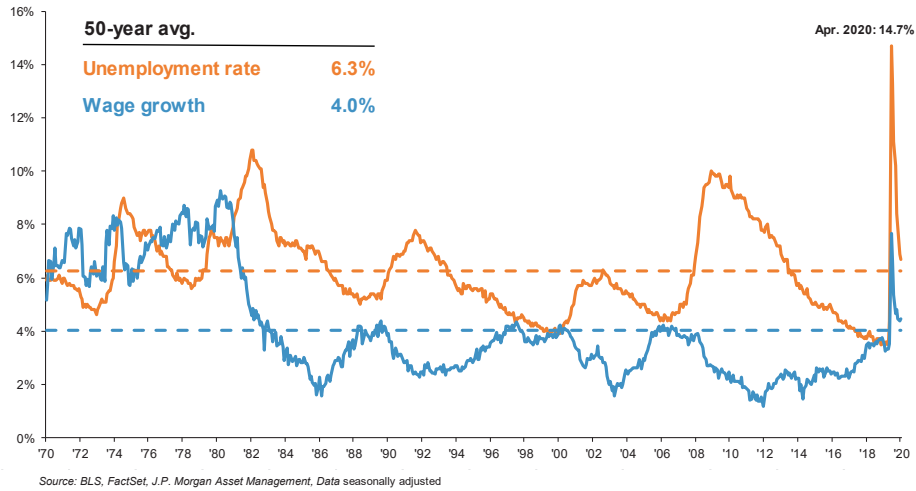
While we expect early stimulus packages to have support from both sides of the aisle, further out on the calendar, the strength of the Democratic majority may hold less sway. In the House, Democrats hold only a 12-seat advantage and just 4 seats above the 218-vote simple majority threshold. In the Senate, the split is 50/50 with the Vice President acting as the tie breaking vote. We have seen more party line voting as politics have become increasingly polarizing, but with a new regime it would not be surprising to see more conservative Democrats more comfortable to oppose policies viewed as obstructive to business growth.

2021 Congressional Splits



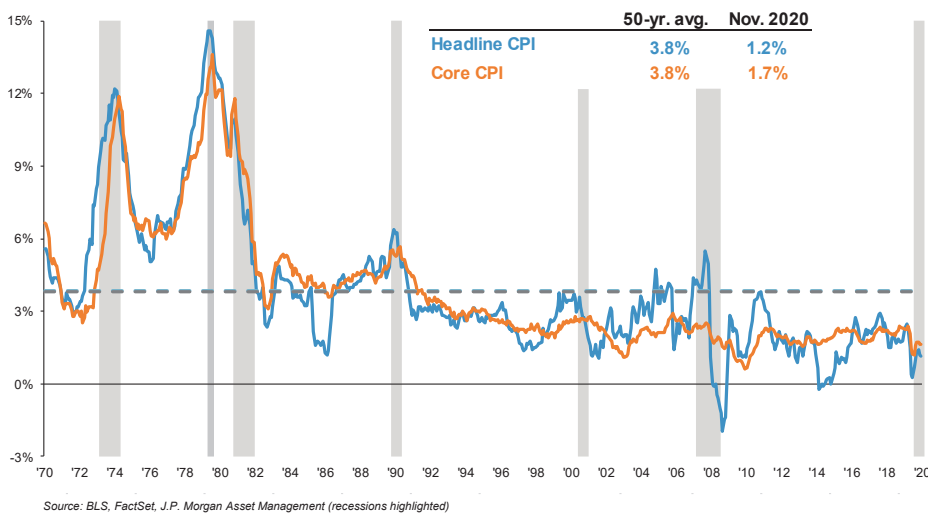
Source: AP, Waterloo Capital

Unemployment Rate and Wage Growth



Fiscal policy will be the headline focus entering the year, but the Fed's influence on the market is not going away. In fact, it is possible we may see further blurring of the lines between the Federal Reserve and the US Treasury. Crisis forced the two financial authorities closer together last year, and this year, former Fed Chair Janet Yellen will take over as the head of the Treasury. We think the goals, analysis, and activities of both institutions are likely to show deeper overlaps this year. The Treasury effectively bridges the gap between monetary and fiscal policies which we expect to lead to more coordinated policy measures going forward. Monetary policy will remain ultra-accommodative, and we expect the Fed's purchases continue throughout the year. Comments from Fed Chair Powell indicate the Fed is comfortable with overshooting their 2% inflation target and focusing on pre-pandemic levels of unemployment as a measure of success. We do expect inflation to increase this year, but we do not expect levels to rise beyond the Fed's comfort zone. In the labor market, the unemployment rate has plateaued around 6.5% which is still higher than we saw during the middle of the 2008-2009 recession and well above the 3.5% level we saw in February 2020.

CPI and core CPI % Change vs. Prior Year



These policy targets leave the Fed with plenty of runway to continue supporting the markets behind the scenes. The fact that the Fed still has the capacity and tools to provide support may be all the market needs. Tangible fiscal policy measures will likely allow the Fed to signal ongoing support without having to significantly change current policies. Maintaining the promise to do whatever it takes to support economic growth will likely be enough to backstop periods of market deterioration and support more aggressive risk-on asset classes.

For a decade, the market's mantra has been don't fight the Fed. With fiscal support now in the same corner, the team is even more formidable. The addition of a new liquidity provider will continue to lower the risk premium for defensive holdings and drive capital into risk assets. The collective impact of our expectations should lead to ongoing weakness in the US dollar, an increase in consumer spending activity, higher inflation, and stronger GDP growth. This strengthens our outlook for global equities while lowering our expectations for fixed income and interest rate sensitive sectors. The COVID vaccine rollout will support a rebound in consumer activity, which will be a tailwind for small and mid-cap equities, and the consumer discretionary sector. Finally, a weaker dollar and a recovery in business activity will support demand for commodities, industrials, and foreign markets.

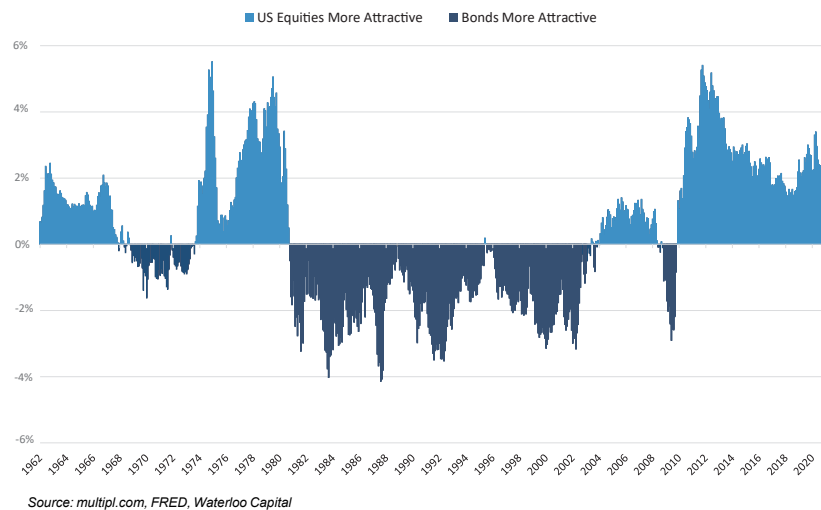
**FOR A DECADE THE MANTRA HAS BEEN
DON'T FIGHT THE FED. THIS YEAR WE
ADD, DON'T FIGHT THE GOVERNMENT**

Domestic Equities

US markets have shown remarkable resiliency considering the structural damages experienced in the real economy last year. The harshest contraction in history was offset by massive stimulus measures, and investors looked towards the light at the end of the tunnel and a return to normalcy. In 2021, we believe this return to normalcy from the widespread vaccine distribution provides significant tailwinds for a strong recovery which broadly benefits equities. Aside from the vaccine, stronger corporate earnings, and an extremely favorable backdrop on monetary policy, will continue to support risk on assets. Entering the year, we are expecting heightened relative performance from sectors more levered to the reopening, at least temporarily. As the year progresses, we expect elevated valuations, rising government debt levels, considerable economic slack, and the lower for longer mentality from the Fed will bring about the need to be more tactical within equity allocations.

A common financial saying states that, where you start from matters. To begin 2021, most traditional financial metrics suggest that domestic equity markets are expensive relative to history. That being said, while valuations do tend to dictate long term results, narratives and psychology can often have greater influence over short term market action. The narrative which has gained the most traction coming out of COVID is the return of the low-rate TINA (“There Is No Alternative”) environment and the transitory nature of last year’s economic shock. After cutting key rates to 0% during the pandemic and shifting easing into overdrive, Fed Chair Jerome Powell said the bank was “not even thinking about raising rates”. In December, Powell reiterated that interest rates will likely stay at or near zero through 2023, and asset purchases will remain at historically high levels until “substantial further progress” is made toward employment and inflation goals.

S&P 500 Earnings Yield Minus 10-Year Treasury Yield Suggests Equities Are More Attractive Than Bonds

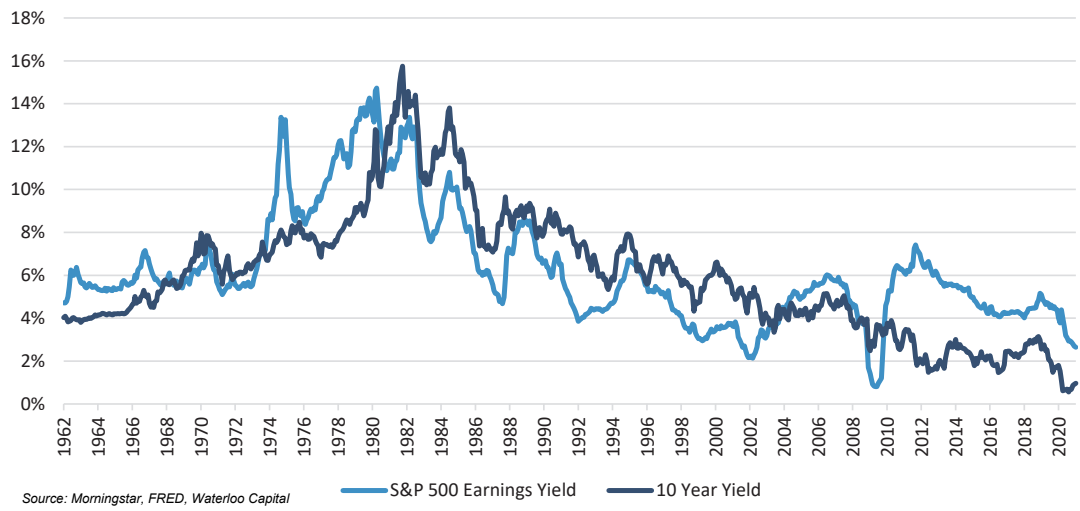


In this exceedingly expansionary monetary policy regime we would also argue markets can support higher valuations because of their relative risk premium. One way to demonstrate this is by comparing the market’s earnings yield with US Treasury rates. Taking the earnings yield on the S&P 500 and subtracting out the 10-year Treasury yield reflects the premium investors receive from holding equities compared to bonds. Simply put, if the earnings yield on the market is greater than the treasury rates, equity valuations are more likely to look attractive relative to bonds. As Fed action has driven rates lower and lower US equity markets have remained attractive relative to fixed income. The higher risk

Outlook 2021: The Great Reset

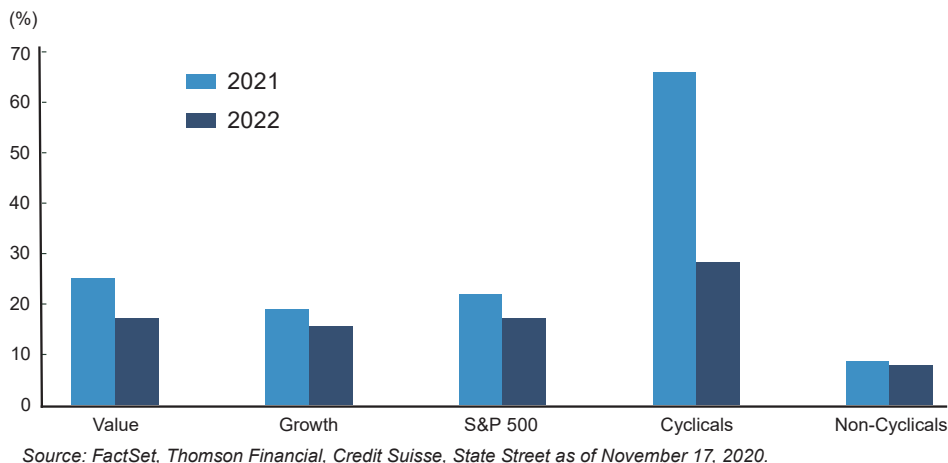
premium and greater appreciation upside afforded by stocks means equity markets can continue to attract more capital despite high valuations. Beneath the broader surface, we see the rotation that began at the end of 2020, away from the highflying growth names into more value, cyclical, and

S&P 500 Earnings Yield & 10-Year Treasury Yield Over Time



smaller cap names persisting. As the recovery plays out, the conditions for higher nominal growth are strong. Pricing power for businesses should pick up as pent-up consumer demand propels a period of sound spending activity. As the pandemic fades in the rearview mirror, this improving profit and reflation outlook should benefit industries more levered to the economy. The question remaining is how much optimism is already priced into the markets and how much can the improving data buoy sentiment early in the year. While earnings growth expectations are high on a percentage basis, the absolute bar set for cyclical names is relatively low. In this environment earnings do not need to be flawless; they just need to be better than expected.

Earnings-per-Share Growth Projections

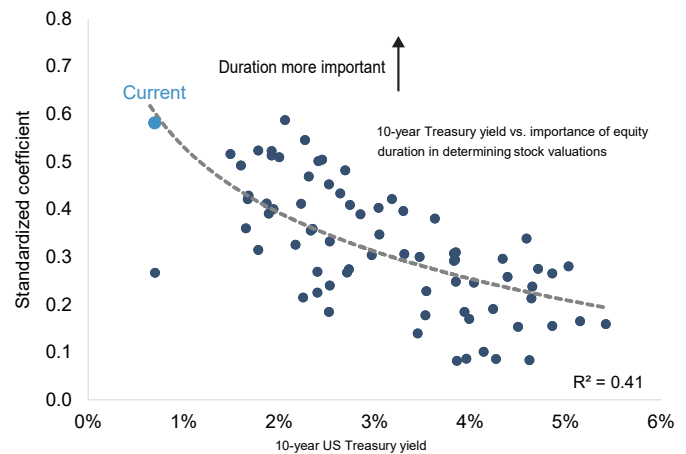


Outlook 2021: The Great Reset

The macro backdrop benefits adding a tactical allocation to cyclicals, but secular growth equities continue to command a position within portfolios. The pandemic has accelerated secular changes in the digitization of customer and business interactions. Since 2005, the digital economy has grown 6.8% per year on average, which is four times the average growth rate of the overall economy. The growth cohort that led much of last year can still perform well on an absolute basis, and the changes to remote work, healthcare, and e-commerce will continue to shape the future of consumer activity and the economy. For these reasons we advocate balancing an allocation to cyclicality and secular growth. We prefer higher quality names with strong fundamentals and an earnings growth history showing strength beyond the COVID environment.

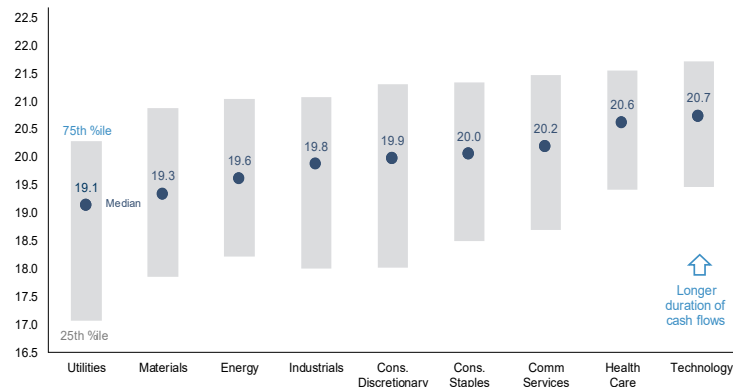
While we are constructive on the outlook for domestic equities, the path forward will not be a straight line. We expect price movements to be more aggressive on both the positive and negative side as volatility remains elevated with prices being increasingly influenced more by external market factors and sentiment rather than fundamentals. The vast amount of liquidity provided by the federal reserve and government has helped drive markets to all-time highs but has also created fragility by disrupting traditional asset pricing formulas. Last year, the S&P 500 Index posted the highest percentage of 1% daily gains in a calendar year since 1938, but also posted losses of greater than -1% on 20% of the trading days, the most since the Great Financial Crisis. Additionally, an unexpected spike in interest rates is a potential risk for valuations. Stocks are long duration assets, and interest rates have a strong influence on how these assets are valued. Fundamentally, the current value of a stock is the value of the expected future cash flows discounted by the “risk-free” rate which is typically represented by the rate paid on cash savings. Therefore, lower interest rates increase the present value of a stock. The longer the duration, and lower the discount rate, the higher the expected value. But the knife cuts both ways. If interest rates rise too far too fast, a higher discount may cause markets to reset at lower stock valuations.

Low Rates Explain Valuation Premium For Duration



Source: Compustat, Goldman Sachs Global Investment Research.

Equity Duration By Sector



Source: Goldman Sachs Global Investment Research. As of November 4, 2020.

Outlook 2021: The Great Reset

Finally, for cyclical positions, the long-term follow through for the reopening trade depends on getting COVID under control in a reasonable timeframe. If we do not continue to see positive virus, vaccine, and stimulus headlines it is possible the broad-based recovery trade may run its course more quickly than expected. We expect a challenging market environment in this scenario with more volatility for cyclical equities as they are more susceptible to policy and vaccine disappointments. These binary risks will make it imperative to determine when to rotate positions to take advantage of relative strength in short-term opportunities and when to avoid increasing portfolio risk. Based on this higher probability of a volatile future market environment, we will put significant emphasis on utilizing a dynamic and tactical approach to identify market opportunities. Taking these risks into account, we are still confident the 2021 backdrop sets up equities for strong returns. The resurgence of the TINA environment, attractive risk premiums for equities, and the coordinated recovery in global cyclical industries supports our outlook for equities.

S&P 500 Return Potential: Earnings Growth Will Be Key

P/E \ EPS	19.0X	20.0X	21.0X	22.0X	23.0X	24.0X	25.0X
15.0%	(20.2%)	(16.0%)	(11.8%)	(7.7%)	(3.5%)	0.8%	5.0%
20.0%	(16.8%)	(12.4%)	(8.0%)	(3.6%)	0.8%	5.1%	9.5%
22.0%	(15.4%)	(10.9%)	(6.5%)	(2.0%)	2.4%	6.9%	11.3%
24.0%	(14.0%)	(9.5%)	(4.9%)	(0.4%)	4.1%	8.6%	13.2%
26.0%	(12.6%)	(8.0%)	(3.4%)	1.2%	5.8%	10.4%	15.0%
28.0%	(11.2%)	(6.6%)	(1.9%)	2.8%	7.5%	12.1%	16.8%
30.0%	(9.8%)	(5.1%)	(0.4%)	4.4%	9.1%	13.9%	18.6%
35.0%	(6.4%)	(1.4%)	3.5%	8.4%	13.3%	18.3%	23.2%

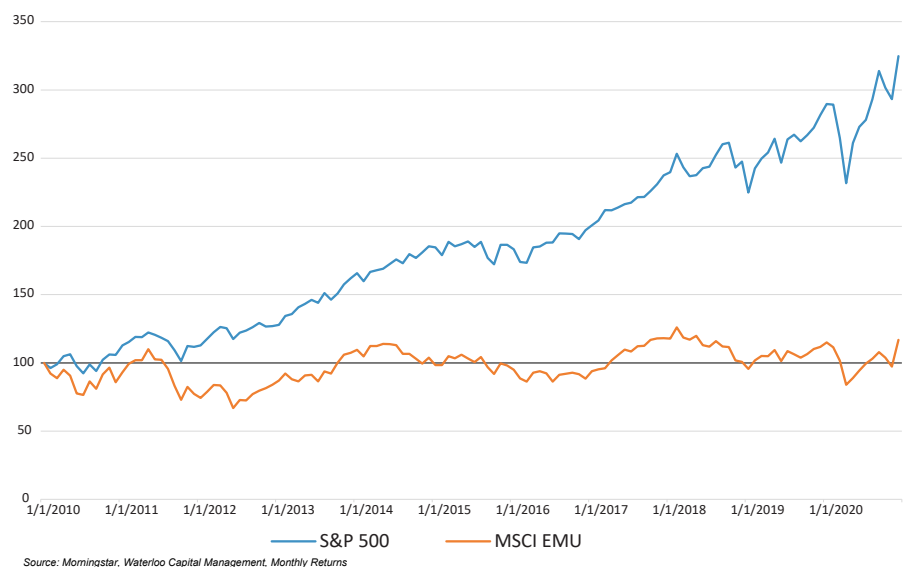
Source: Waterloo Capital Management

Foreign Equities: European Equities

European equities rebounded significantly in late 2020 and we expect the momentum to continue as the market flirts with 10-year highs. European markets have generated weak relative performance versus global equities almost every year since the global financial crisis. We like the prospects of foreign developed markets this year, but getting back to full power will require the synchronous global growth story to gain sustainable traction.

Recent momentum in the region has been driven by the initial Brexit trade resolution, which clears the path for the European Commission (EC) to distribute fiscal stimulus later this year, and general optimism surrounding the trajectory of the global economy in 2021. Over the short-term, we expect consolidation as the details of both the Brexit deal and fiscal stimulus measures are reviewed. Additionally, entering the year with the most restrictive COVID lockdowns in place since last spring has us cautious and is a reminder that the virus threat has not completely diminished. Local measures are likely to remain in place during the first quarter which will delay a rebound in business and consumer spending as governments try to gain an upper hand on the virus spread while vaccines are dispersed. These issues, along with Europe's deeper dependency on external demand, are likely to impede an economic recovery breakout for the region until later in the year.

10-year Performance MSCI EMU vs S&P 500 (indexed to 100)

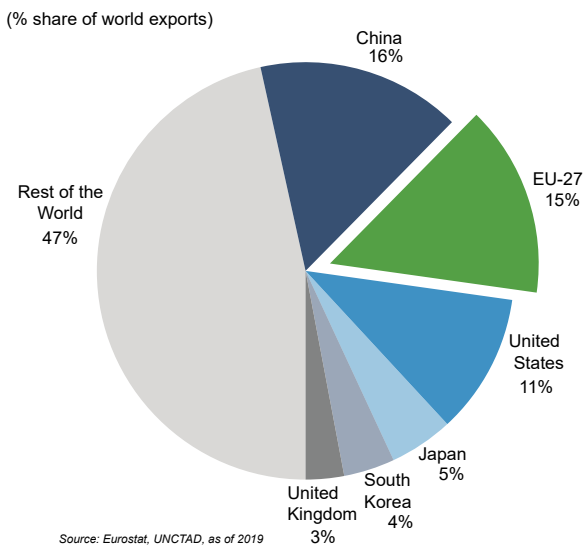


We are keener to focus on the region in the second half of 2021. Momentum in the global rebound story would be a tailwind given Europe's position in the global economy which is acutely linked to cyclical sectors and export heavy industries. European equity markets have higher weightings to these more cyclical sectors which stand to benefit the most from a fresh business cycle. Additionally, €750 billion of EC recovery funds are expected to be disbursed during Q3 and Q4 which would add meaningful fiscal support to the equation. Recovery funds have been earmarked for fiscal aid for local government spending and EU wide "economic resiliency" initiatives including infrastructure and clean energy projects.

Europe is more exposed to global trade than many people realize. The region is a major exporter, a fact that is rarely touched on when the markets are discussed. The EU-27, which does not include the UK, accounts for 15% of the world's trade, a higher contribution than the US and second only to China who accounts for around 16%. Furthermore, exports account for 28% of the European economy, higher than both the US and China by a wide margin. Europe's entrenchment in global trade may prove to be

a double-edged sword. Expectations for widespread improvements in global GDP growth are high, but our forecasts do not have growth markedly improving until the third quarter. We have seen investors' ability to be enthusiastic about investment prospects well beyond six months, but these expectations mean more emphasis will be placed on short-run data. Expect heightened volatility around reports highlighting economic expansion, such as PPI and PMI, and European Central Bank (ECB) meetings. Lastly, with a large portion of growth drivers dependent on external demand, Europe is more susceptible to being caught in the fallout of other markets. Any fears of renewed lockdown measures or contractions in the growth trajectories of the region's trading partners will force a reconsideration of our recovery and return prospects for the EU. For these reasons, we recommend an underweight to the region within international equities with the expectation of ramping up exposure towards the middle of the year as the recovery trajectory takes shape.

Shares in the World Market for Exports of Goods



Foreign Equities: United Kingdom

UK equity markets have lagged their regional counterparts primarily due to restrained business and consumer activity amidst Brexit uncertainties and difficulty controlling a rebound in COVID infections. 2020 hit the country especially hard. GDP expectations are the lowest they have been in over 300 years at a decline of more than (-11%). The swift and positive market reaction to the trade deal struck with the European Union in December 2020 was encouraging, but while a deal has been signed the details are far from complete.

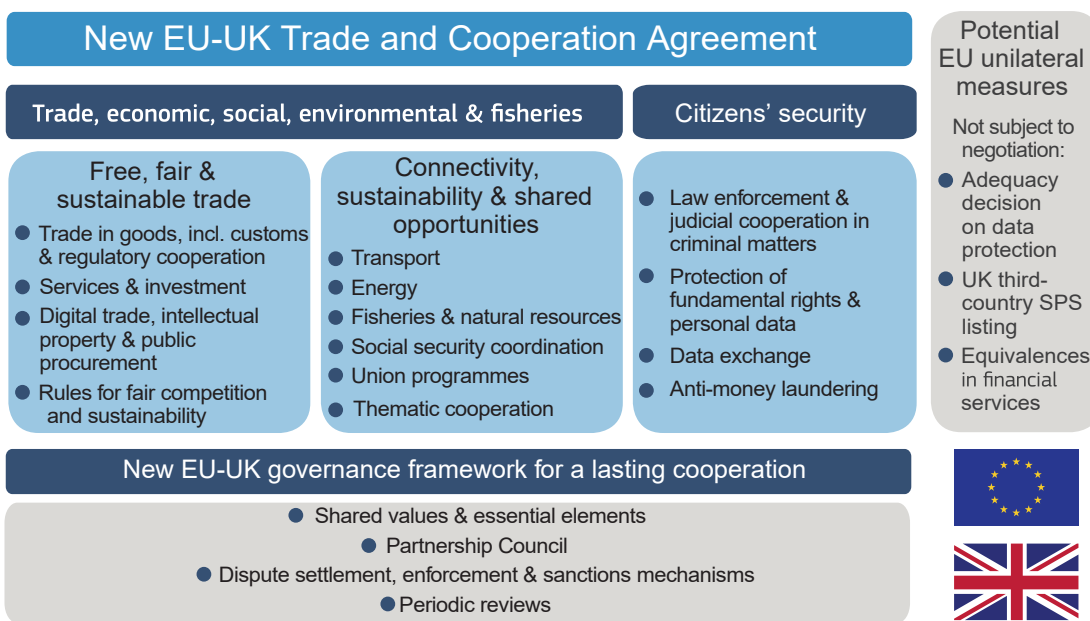
For example, specifics regarding how trade in services will be handled between the UK and the EU lack key details on regulations, one of which being the Mutual Recognition of Professional

Qualifications (MRPQs). MRPQs allow workers such as doctors and engineers to have their qualifications recognized across EU member countries. These provisions for services are especially important for the UK as 40% of the country's exports to the EU are services. More importantly, the sector accounts for around 70% of domestic economic activity. Another industry with terms still on the table is the financial services industry which is regionally dominated by the UK. It has been a focus of the EU which is trying to gain influence in euro-denominated financial transactions. Both sides have affirmed the importance of finalizing service sector agreements with a target date of March 2021 for most industries. We are wary of trusting any deadline in these negotiations. If the Brexit timeline is any indicator of speed, it will take much longer than a few months to iron out the details.

The UK was the first country in Europe to begin vaccinations, and the rollout has been efficient. The question now is will it be effective. So far, the positive progress has not made its way into the economy or slowed COVID infection rates. The region is still a long way from showing a sustainable rebound as the combined weight of government-imposed lockdowns and Brexit uncertainty will take time to lift completely. On a potentially positive note for the markets, we think there is a high likelihood of additional fiscal and monetary support from the UK government and the Bank of England (BoE). The UK government has outlaid plans to introduce £280 billion into the economy through direct assistance

to businesses and infrastructure spending along with allocating an additional £50 billion that could be put to work later this year. Prime Minister Boris Johnson has also hinted at pushing for a corporate tax cut to help businesses rebound and re-allocate capital to hiring and growth projects. Additionally, since cutting rates at the onset of the pandemic the BoE has been relatively quiet compared to its global contemporaries. Policy makers have been able to hold back on more aggressive moves under the pretense of Brexit uncertainty. Clarity on both the fight against COVID and the Brexit deal may allow policymakers to be more confident in a step up in stimulus.

Overall, our outlook for the UK is like our outlook for the rest of Europe. The factors exposing the market to the upside of a durable global recovery also expose an investor to significant downside risk. Additionally, while the UK is undervalued relative to other developed economies when looking at traditional measures such as P/E ratios, we have seen over the past decade that the market has tended to be cheap for a reason. For these reasons we would like to see a more crystalized path towards sentiment driven margin expansion or material earnings growth before increasing allocations to the UK equity market and are recommending an underweight for the region.

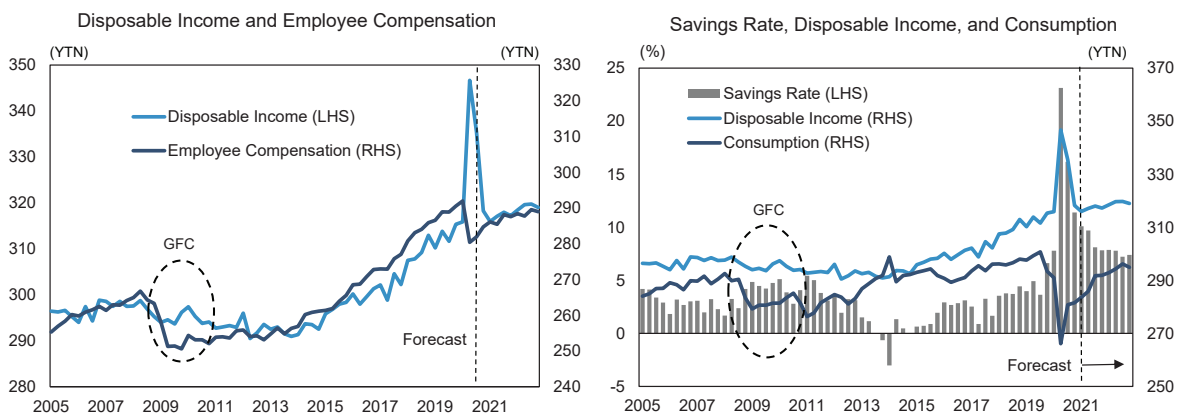


LOOK TO TARGET EUROPEAN EQUITIES IN THE SECOND HALF OF THE YEAR

Foreign Equities - Japan

The world's third largest economy enters the year in an interesting position from both a policy and economic standpoint. Japan was at the forefront of the quantitative easing experiment following the global financial crisis, and now has the most experience with what many other countries are focused on achieving this year; a coordinated stimulus push from the government and the central bank. The country's former Prime Minister, Shinzo Abe, pioneered "Abenomics", which focused on linking fiscal and monetary policies and has deeply linked the government, the Bank of Japan (BoJ), and the Japanese stock market. Japan's new Prime Minister, Yoshihide Suga, has endorsed Abenomics principals and is working closely with the BoJ as the recovery unfolds. Suga's administration has announced nearly \$3 trillion worth of COVID related stimulus measures which include direct payments, credit guarantees, and new loan facilities for small businesses. We expect the focus to remain on fiscal stimulus measures as the country continues to test whether it can spend its way to faster growth. As with the US, we do not expect the central bank to completely step away from the markets. The BoJ will continue its asset purchase program and will keep its yield curve control policies in place to help limit the debt servicing costs of the government under new fiscal programs.

Japan's Consumption Rate Has Significantly Trailed Income Growth Rates



Source: Cabinet Office, Goldman Sachs Global Investment Research

While the government has not had any issues opening its pocketbooks, the rest of the country has been slower to take up the cause. Japan has always been a country of savers, both at the consumer and business level. Currently, the savings rate is higher than during the '08-'09 global financial crisis despite wages and disposable income rising steadily and an unemployment rate of only 3%. However, we are hopeful that both parties will follow the government's lead and increase spending activity this year. Consumer spending should be buoyed by strong household balance sheets and employment metrics. Also, the country has seen less severe cases of COVID than in the US or Europe potentially due to the Japanese population's more stringent adherence to lockdown and social distancing measures. As voluntary activity restrictions are reduced, consumer activity will be poised for growth.

Even if we see a slower ramp up in domestic consumer activity, Japan is poised to ride the coattails of a rebound in a global recovery. The country has long been a manufacturing and export driven economy and is positioned well to take advantage of a bounce back in demand from both developed and emerging economies. Japan should also get an added benefit from the recent Regional Comprehensive Economic Partnership (RCEP) trade deal which will lower tariffs, open service sectors, and streamline trading rules among 10 emerging ASEAN countries, China, South Korea, Australia, and New Zealand. Current valuations are a bit high following a late 2020 rally, which gives us some concerns over the

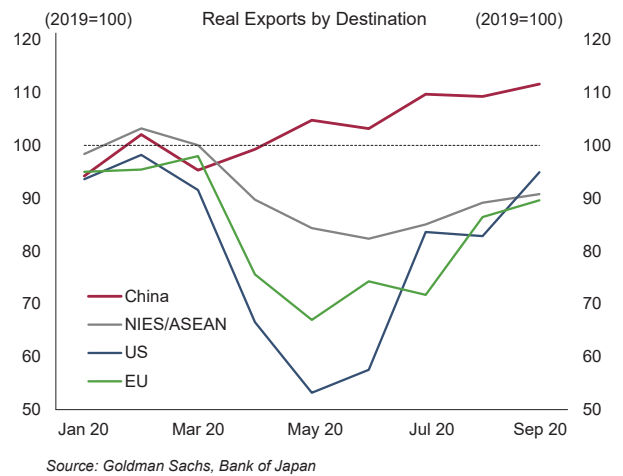
short term. With rebound expectations elevated it is more likely we will see volatility around earnings releases, especially if the bar may have been set too high. Additionally, as with other export heavy economies, Japan's downside risks are potentially higher if we see a rise in virus cases and a pullback in growth expectations. Over the full-year, fiscal programs providing capital expenditure rebates and promoting B2B activity as well as a rebound in global demand should help boost earnings growth and support a positive outcome for the markets.

Foreign Equities: Emerging Markets

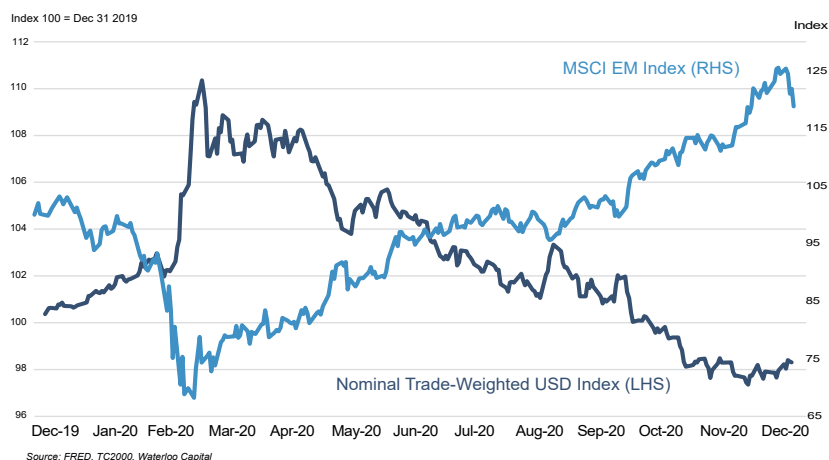
Emerging markets have rarely been set up with such a coordinated global macro restart at their backs. The path forward will certainly vary from region to region, but the overall trend of normalization for both consumer and business activity is set up to fuel a synchronized rebound in global growth. We expect a considerable rebound in relative performance for emerging markets this year. Our positive outlook is driven by a weaker US dollar trend, the introduction of new business cycle dynamics, and attractive valuations relative to developed market equities.

The most significant tailwind for emerging market equities is a weaker US dollar. A weaker dollar eases financial conditions for emerging markets governments and companies, many of which have local currency revenues and US dollar denominated debt. Therefore, stronger emerging markets currencies have an immediate positive impact on businesses bottom lines because they lower debt servicing costs. Historically, US dollar cycles last for multiple years. With the Federal Reserve expected to keep interest rates lower through 2023 and additional fiscal spending measures coming down the pipeline this year, we expect the current depreciation cycle to draw-out well into the future. The combination of low US interest rates and a weaker dollar also allows emerging markets central banks to keep their policy rates lower. In the past we have seen emerging markets struggle to manage keeping their own interest rates low while trying to maintain a strong currency. The downward pressure on the dollar gives emerging markets central bankers more room to maneuver and high relative rates and risk-on sentiment should keep emerging markets currencies in a strong position.

Japan Exports Are Recovering Quickly



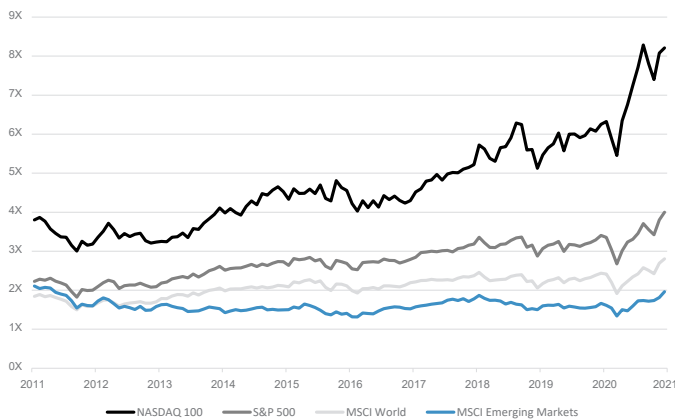
Currency Tailwinds Boost MSCI EM Index



Outlook 2021: The Great Reset

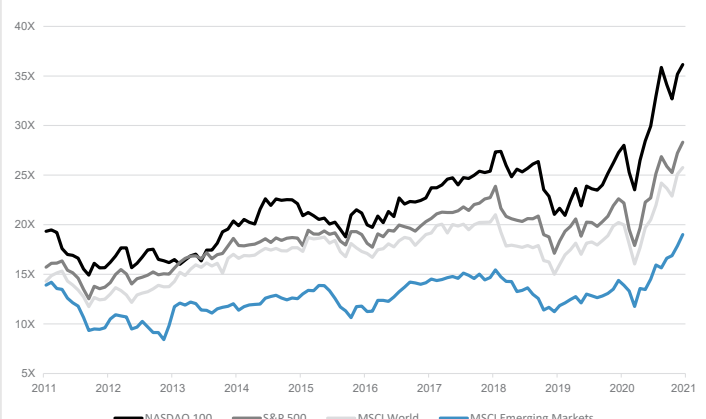
The global push to restart economies in the wake of the pandemic directly benefits emerging markets. We are entering an extraordinary time for the global economy where nearly all players are starting from a similar point. Business cycles around the world were effectively halted last year and we are now facing a coordinated global effort to return to normal business and consumer activity. Emerging markets play a key role in the global economy as major manufacturers and exporters. The exposure to cyclicality which has hampered emerging markets equities in the past is now a positive attribute. We expect emerging market businesses to see significant increases in demand this year as developed economy production ramps up. Additionally, we expect commodity demand to remain elevated as companies increase capital spending projects and governments include infrastructure spending plans in fiscal packages. Lastly, the asset class tends to go as China goes due to its significant demand pull and large weight in emerging markets indexes. This dynamic will benefit emerging markets overall this year as China continues to lead the global recovery. China has already rebounded to positive GDP growth and demand from the country is poised to gain momentum. Furthermore, new policy goals in China are focused on promoting more upscale manufacturing which shift demand for many goods to emerging markets countries. China has set a stable foundation for a stronger rebound for additional emerging markets economies, and a meaningful recovery in developed markets will add to our supportive outlook.

Historical EM Index Price-to-Book Ratio



Source: Morningstar Direct, Waterloo Capital

Historical EM Index Price-to-Equity Ratio



Source: Morningstar Direct, Waterloo Capital

Finally, emerging market equities are entering the year with attractive valuations relative to developed markets. In previous years emerging markets have had low valuations which we felt were deserved given the slow pace of the previous recovery and threats from protectionist trade policies. This year we are expecting the dynamic to begin shifting from emerging markets being cheap for a reason to emerging markets simply being cheap. While we expect to asset class to see its fair share of volatility this year, we think the supportive macro environment and growth prospects will make the relative value trade into emerging market equities more attractive.

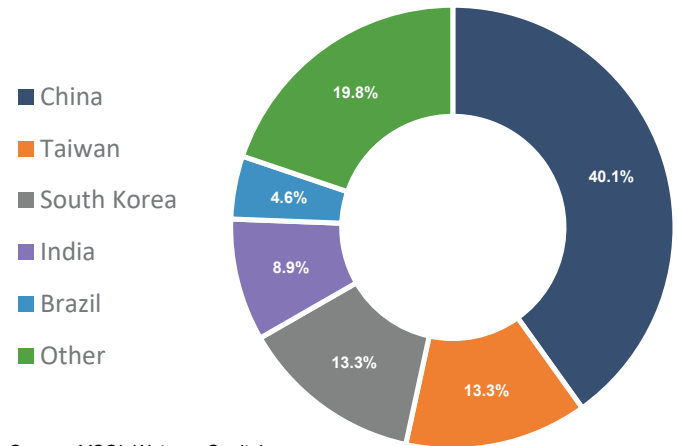
Foreign Equities - China

China was the first country to encounter the COVID-19 virus and was also the first to show signs of a sustainable recovery. They were the only major developed economy to grow last year and estimates for 2021 GDP growth for the world's second largest economy are near the top of the global charts at nearly 8%. Given the recovery we have already seen in the country and China's position as a cornerstone of global growth, we expect China to maintain its economic momentum in 2021. Tailwinds outside of the expected return to global synchronous growth include the Regional Comprehensive Economic Partnership (RCEP) going into effect, President Xi opening more of the economy to outside investment, and domestic policies stimulating demand from China's growing middle class.

The RCEP partnership focuses on tariff reductions and supply chain security within Eastern Asia. The 15 countries who have joined the partnership make up around 30% of global GDP. Many countries involved in the deal have grown their manufacturing bases in recent years as companies attempted to reduce the impact of geopolitical spats between the US and China on their operations. China's industrial production has already surpassed pre-pandemic levels and exports have continued to improve as the country's trading partners have begun to lift COVID related trade restrictions. We expect the positive trajectory for industrial and import/export activity to continue as other countries in the region rebound.

Domestically, President Xi has continued to push for policies which emphasize self-reliance and domestic innovation rather than relying on cyclical industries and manufacturing businesses which power many emerging economies. Chinese leadership believes that over the last decade the country has become overly reliant on excess demand and dependent on foreign markets for high-tech products. The country's recently updated "dual circulation" plan focuses on growing domestic consumption through supply-side reforms while also encouraging investment from foreign markets.

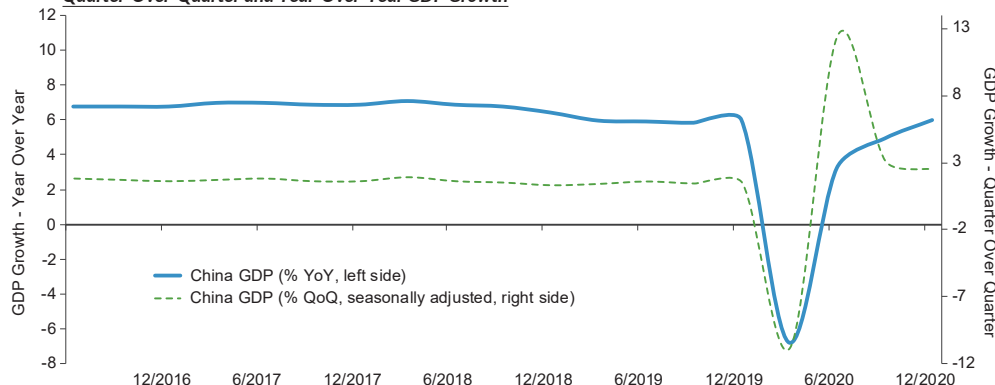
Country Weighting in MSCI EM Index



Source: MSCI, Waterloo Capital

China's GDP rebounded sharply in 2020

Quarter-Over-Quarter and Year-Over-Year GDP Growth



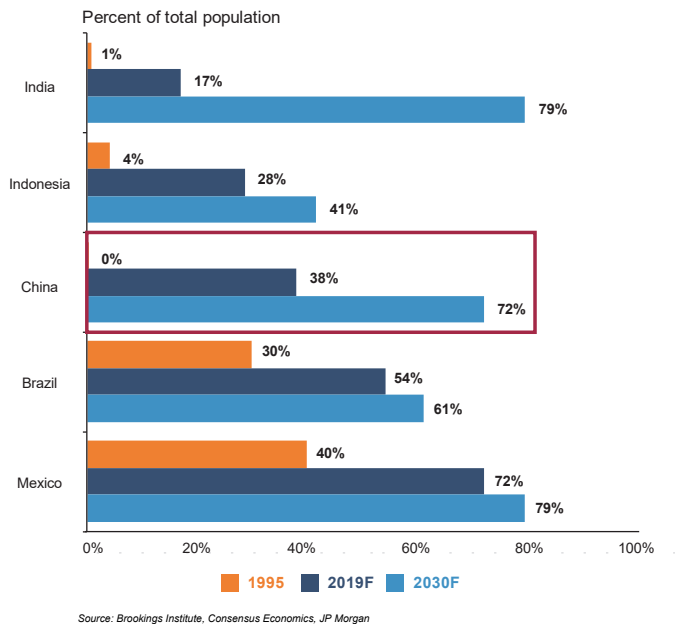
Source: Bloomberg, CEIC, Allianz Global Investors. Data as at September 2020.

Outlook 2021: The Great Reset

The goal of the dual circulation plan is to create multiple supply and demand sources to protect the economy from an immediate decline in economic activity like we saw in 2020. By focusing on shifting manufacturing and service capabilities towards higher value products China is trying to kill two birds with one stone. The hope is that improved capabilities will create new higher paying jobs and attract new investment which will boost domestic consumer activity and overseas export demand.

The government's emphasis on the dual circulation goals were clearly the motivation for changes to China's most recent 5-year plan. The definitive version of the plan will not be released until March 2021, but the initial details show plans to expand the government's role in the economy, using the RCEP and the One Belt, One Road global network to exert influence over supply chains, establishing research and development centers both domestically and overseas, and promoting investment in technology, education, and financial services. If China can pull off this complicated maneuver, it would go a long way towards boosting the output of the domestic middle class. Around 30% of the Chinese population is now considered middle class by global earnings standards. Though incomes have risen, Chinese consumers have not yet adopted the spending habits of other middle-class countries. Middle class consumers in developed countries spend much more of their disposable income and purchase more big-ticket items. As China continues efforts to shift its focus away from cheap labor and manufacturing this burgeoning middle class will be major tailwind for growth for China and potentially the rest of the world.

Growth of the Middle Class

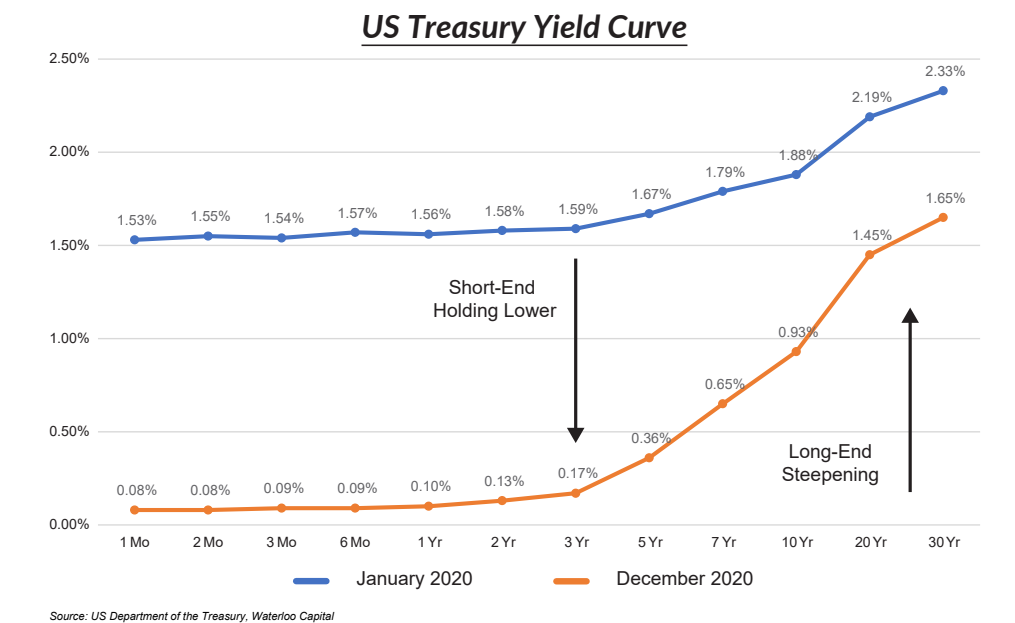


Risks for China are intricately linked to factors influencing global demand. Many of the changes in policies and practices which support an optimistic outlook for the country are still in their infancy. China is still the leader in global exports, and a collapse in global demand will have a detrimental effect on our outlook. Additionally, while the RCEP is important for China, the US trading relationship is still key to long-term success. Uncertainty regarding the outcome of a US and China trade deal was one of the largest threats to equity markets pre-pandemic. It would be a surprise for negotiations between the two countries to remain on the backburner for long. We are hopeful the new US administration will take a more cooperative approach to future negotiations. Protectionist policy proposals have waned as world leaders push to bring global economic activity back on track, but the threat of a future power struggle remains.

Fixed Income: United States

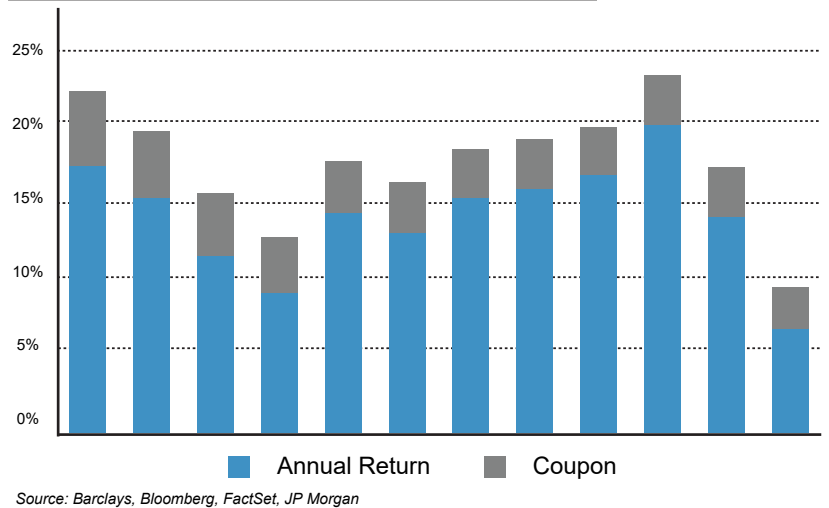
The Fed has entrenched itself as the cornerstone investor in the US bond market. Their unprecedented actions in 2020 were warranted given the severity of the health and economic crisis at hand and likely protected the stock market from a lengthy downturn. The Fed's message is loud and clear. Policy makers are willing and able to pull out all the stops to keep the economy and the markets running smoothly. This stance was reinforced at the December meeting where Powell essentially confirmed the Fed will be standing at the ready, keeping rates at zero while continuing its asset purchase program over the course of 2021.

Despite central bank intervention, we do think the path of least resistance favors higher interest rates in 2021. A rebound in economic activity, depreciating currency, and signs of inflation will buoy rates. As long as the Fed keeps monetary policy accommodative, the likelihood of a dramatic spike across the entire interest rate curve is unlikely. Long-term rates are much more likely to rise given the Fed's reduced influence on long end of the curve. The short and intermediate sections of the curve are likely to resemble a balloon tied to a handrail. They may be blown around here and there but will only rise so far. For bond allocations this has important implications. First, bonds are back to being boring; and second, the search for yield is as hard as it has ever been.



The resolution of the US Presidential election, positive news on the timeline of a COVID vaccine, fiscal stimulus promises from Capitol Hill, and the patronage of the Federal Reserve have all led to a reset of the risk and return outlook for credit markets. Interest rate spreads have rapidly declined to near pre-COVID levels and concerns of a credit market lock-up or collapse have practically evaporated. With banks, consumers, and the corporate credit markets healthy, yield curve steepening is increasingly likely. Based on the insignificant incremental pickup in yield as you increase duration combined with the higher potential for yield curve steepening this year, we are recommending investors maintain a low duration bond and higher cash proxy allocation in the risk-off section of their portfolio. Positions with extended durations should be viewed as trades or short-term hedges rather than passive core holdings. While shorter duration issues lack an attractive yield component, they will continue to add value to a portfolio by dampening volatility and providing some downside protection during market corrections. The search for yield will continue to be challenging this year as we expect

Impact on Barclays US Agg Index if Yields Fall to 0%



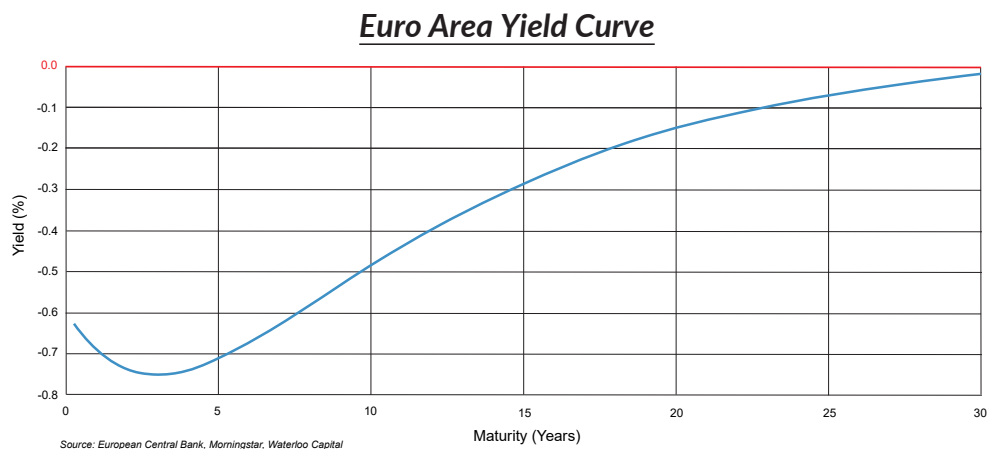
both monetary and fiscal policy to remain historically accommodative despite optimism of a sustainable post COVID economic rebound. The flood of liquidity into the economy has been a massive tailwind for the equity markets, but cash has been slow to penetrate the broader economy. This bifurcation between the stock market and the economy makes it difficult for the Fed and other policy makers to remove stimulus. Efforts at quantitative tightening in the past have led to significant market corrections, which in turn have caused a contraction in economic activity. The Fed will be stuck in this precarious cycle in 2021 and potentially for many years to come. Going forward, this means the return on bonds will likely come from the coupon earned rather than price appreciation from rate compression.

Low rates on short-term bonds are here to stay, and while we expect to see rates tick up for longer-term bonds as the economy improves, they will not be anything to write home about. We have come a long way from the 30-year bond averaging a yield between 4% and 5% which was commonplace prior to the Global Financial Crisis. Since then, we have seen 30-year rates slide to an average of 1.55% and 10-year rates fall to an average of 0.89%. The decline in yields has created a challenging environment for savers and income-oriented investors. This year we think investors will benefit from a more tactical core satellite approach within their fixed income allocations. We advocate maintaining a core allocation to shorter duration positions while adding limited exposure to positions with a higher correlation to rising inflation and yields such as Treasury Inflation Protected Securities (TIPS) and floating rate bonds to begin the year. During the year investors can benefit by taking a laddered approach to increasing yield exposure. Periods of elevated volatility are likely to provide opportunities to tactically add to longer duration and higher yielding sectors. This strategy will incrementally improve total return and help manage risk should rates rise more than expected.

Fixed Income - International

With foreign developed market yields sitting firmly near 0%, or in some cases in negative territory, we do not recommend adding foreign developed bonds to fixed income allocations this year. As with the United States, a rebound in economic activity and inflation will put upward pressure on interest rates while central bank purchases and fiscal spending from local governments will put downward pressure on rates. We expect demand for the asset class will remain stable due to central bank purchases and traditional asset class diversification coming back in vogue after 2020 highlighted the benefits of risk-management and lowering portfolio correlations. That being said, a fear of missing out in another equity market run and positive outlook for a rebound in sectors which dominate many foreign stock markets is likely to tilt capital allocation towards riskier assets. In a bond market with negligible yields and government and central bank activity expected to keep rates within a tight range we have low expectations for developed foreign bond returns in 2021.

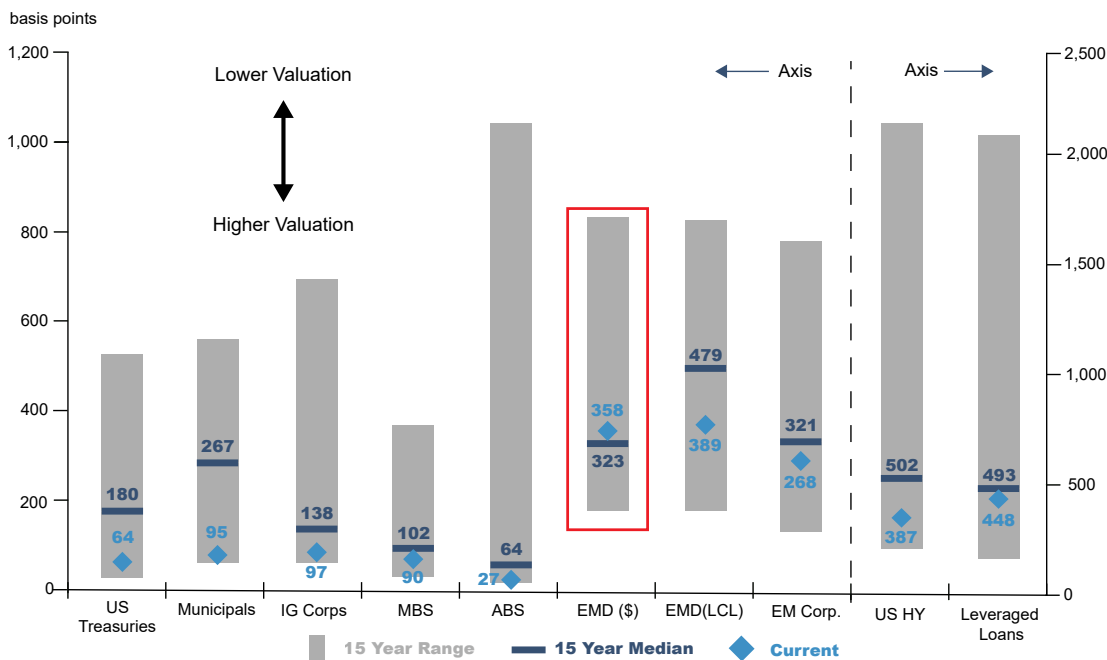
Christiane Lagarde faced unprecedented challenges in her first full year as the President of the European Central Bank (ECB). Some analysts had postulated Lagarde would take a firmer stance on monetary policy while passing policy responsibilities by pushing EU governments to enact fiscal stimulus measures. Any plans on this front were quickly scrapped as Europe became the epicenter of the COVID breakout. While once again, central bank liquidity served as a backstop for the market, the ECB's actions have led to unbalanced risk and return outlooks for European bonds. Last March the ECB removed issuer limits from its emergency bond purchase program. The ECB had been allowed to purchase up to 33% of a specific country's debt. Removing this limit effectively allows the central bank to manage the shape of the yield curve in riskier countries such as Italy and Spain. Take the 10-year interest rate in Greece, Spain, and Italy, for example. These are all countries which have recently experienced or are still fighting significant economic, social, and government fallouts in recent years, yet their 10-year yields are all significantly lower than the US 10-year rate. Additionally, with rates already below 0% for most of the yield curve, it is highly unlikely we see deeper rate cuts from the ECB this year.



In Japan, the BoJ will continue working behind the scenes to buy up bonds to help fund fiscal stimulus measures and manage interest rates. After shifting strategies from directly lowering or raising interest rates to targeting yield curve control through purchasing specific bonds, the BoJ has been more hesitant to lower rates. We expect this trend to continue this year as the country focuses on rolling out fiscal reforms. The long-end of the yield curve has been steadily steepening and yield-curve control on the short-end will keep rates rangebound. As with bonds in other developed market economies, we do not find the risk and reward outlook attractive enough to warrant an allocation.

Outside of foreign developed markets we are seeing some signs of opportunities in emerging market bonds where a weaker US dollar, higher commodity prices, and the global re-opening trade are all tailwinds for EM countries this year. EM central banks have had more room to ease rates as developed economy rates have declined, especially in the US. Also, spread-to-worst for EM local currency bonds show attractive valuation levels versus historical spreads against US Treasuries. Our expectation of limited activity in the rate markets from developed economies and ongoing weakness in the US dollar will allow EM countries to keep rates lower for longer. Notably, the demand for EM bonds will also be supported by the continued search for yield. With a more comfortable outlook for EM economies, and the US dollar continuing its downward slide, the extra yield generated by EM bonds can add value for a yield-oriented investor comfortable with adding risk to their fixed income allocation.

Spread-to-Worst Across Fixed Income Sectors



Source: Barclays, Bloomberg, FactSet, JP Morgan Asset Management

EMERGING MARKET BONDS HIGHLIGHT A SHORT-LIST OF OPTIONS IN INTERNATIONAL FIXED INCOME

Real Assets

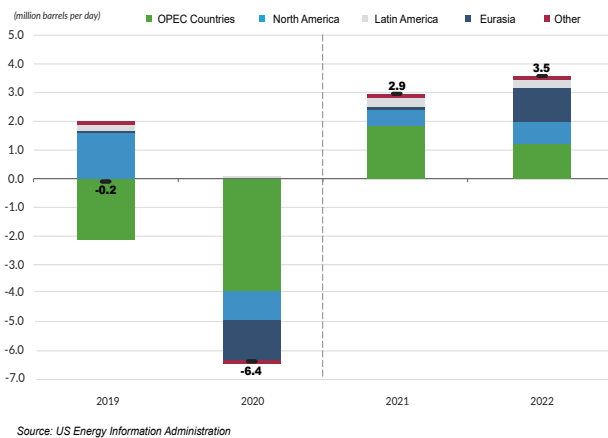
This year we expect to see a lift in demand for commodities due to a coordinated global recovery and rising inflation expectations. Supply and demand imbalances in many commodities are still tilted towards over-supply, but the return of the synchronous global growth story should improve the potential upside for the asset class this year. Within commodity sub-sectors we are positive on oil services, like base metals over precious metals, and remain particularly selective in the real estate space given the long-term structural implications.

Oil

2020 was a wild ride for oil prices given the pandemic fueled demand shock. History was made when US crude oil futures sank to -\$37, falling into negative territory for the first time ever while Exxon Mobil was dropped from the Dow Jones Industrial Index. Producers are trying to leave the nightmares of 2020 in the past, as oil bankruptcy filings climbed to four times the amount experienced in 2019. Going forward, the pace of bankruptcies will slow given the stabilization of prices and expectations, but Chapter 11s will likely still bleed into 2021. In 2021, oil prices will be characterized by growing the delayed rollout of the vaccine and thus a slower acceleration in demand for oil. Additionally, consumer

behavior will be a key catalyst concerning whether pent-up demand in areas like air travel materializes towards the back half of the year. The commodity is unlikely to gain significant momentum until the outlook for demand materialized. Until then, much of the price movement will be driven by expectations and not by immediate realities which increases the risk of price reversals over the short-term. Overall, we expect economic growth will help support oil prices, but the speed and ease of bringing supply back online could cap prices to the upside. Additionally, the push for an acceleration in the clean energy transition may begin to weigh on the growth prospects in the oil sector. The industry is out of favor with the

Energy Outlook by Region



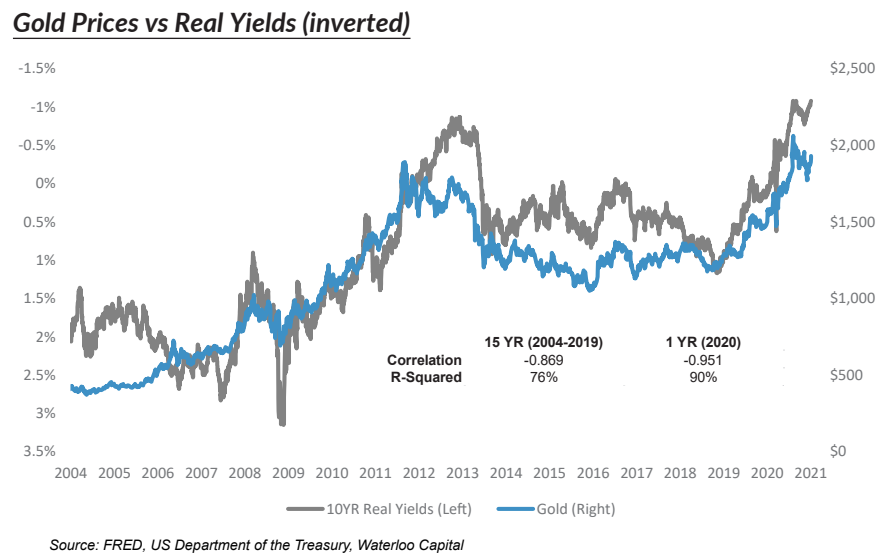
new administration which could cause headwinds over the long-run, but ironically, may lead to short-term price support if regulations or restrictions affect supply.

Metals

With the improved global growth outlook from the pandemic's effects, we favor base metals over precious metals. Demand from China's early and mammoth manufacturing recovery, a weaker dollar, and a slew of supply disruptions helped base metals surge into the end of 2020. We think demand for the metals will remain strong due to the global recovery backdrop and increased infrastructure spending by governments.

After a banner year, precious metals have recently stabilized given the improving prospects for the global economy. We still think the asset class will see demand this year, specifically gold, considering a softer US dollar and lower expected real yields. Real yield is the return on a bond adjusted for inflation

and historically it and the US dollar, have an inverse relationship with gold. This makes sense because the possibility of rising inflation and thus lower real yields typically increases the demand for precious metals based on the view that the asset can protect against eroding purchasing power. Most notably, the negative correlation between gold and real yields was one of the strongest readings in 2020 and we believe this will be a crucial catalyst to watch in the new year. Given the prospects and increased bets on further central bank support, ongoing fiscal aid, and the broad recovery on main street, inflation expectations could move faster than underlying interest rates, further driving down real yields. If this reflation scenario emerges, it could recharge demand for precious metals.



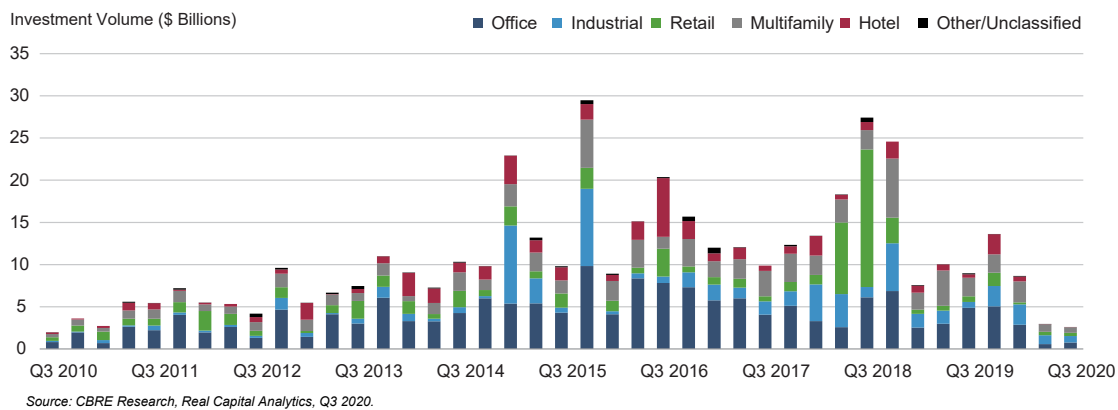
Real Estate

The dislocation between the winners and losers in the real estate market was clear last year as the disruptive effects of COVID showed the industry how quickly demand can change. Yet, unlike the last major real estate downturn, which was caused by excess and exuberance, the pandemic has reorganized fundamentals as people have changed the way they work, learn, live, and shop. The question for real estate investors is whether 2020 trends are transitory or signs of structural changes in the market. For now, uncertainty looms large. One positive note for the industry is high demand entering the year. An abundance of capital remains on the sidelines after uncertainty depressed deal activity last year and could be put to work quickly if optimism for the industry recovers. Real estate is also likely to see increased demand from yield-oriented investors as interest rates remain low.

In the office space, the largest impact has been the acceleration in the shift to remote working for employees. Analysis in the space shows this trend could cut the overall need for office space by 15%. For now, it is too soon to know the full effects, although when companies do return to the office, we expect many to favor a hybrid work style. Overall, we believe the office sector will have the slowest recoveries back to pre-pandemic volumes constrained by uncertainty on renewal demand as occupiers reevaluate their office space needs.

For retail, traditional brick-and-mortar was already being threatened by ecommerce and the surge from the pandemic only expedited the pain. Brick-and-mortar retail sales will almost certainly rebound this year as consumers move back into the physical economy, but we caution confusing this year-over-year

Investment By Property Type



change with a long-term trend. The larger picture shows a downbeat view on pure retail spaces implying investors should approach cautiously. The growth in e-commerce demand does come with a benefit for the industrial market, though. The sector will continue to thrive next year highlighted by low vacancy rates and growth in both location and size of distribution and warehouse facilities. However, although it has the strongest fundamentals, investor interest has caused skyrocketing valuations, which is a potential headwind.

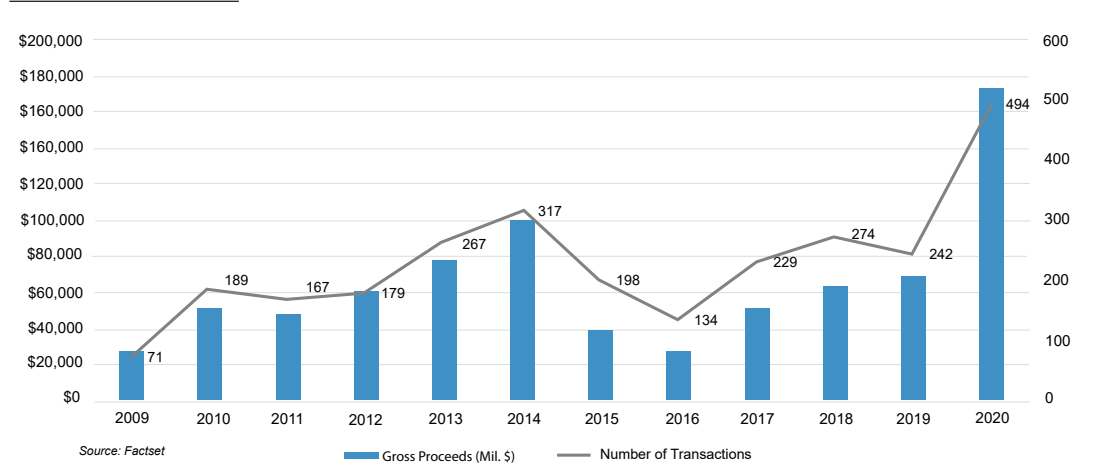
One area where we are finding opportunities is in the real estate debt market. Real estate debt is still attractive from a risk and return standpoint relative to other income focused strategies. We expect demand for core real estate assets to build as the year continues which will stimulate financing needs. Additionally, the fallout from COVID has given strong lenders more pricing power and flexibility within the deal structuring process. Overall, the long-term shift in commercial real estate dynamics because of COVID is still a moving target, and it will take time to fully understand how trends may be changing. For that reason, we prefer to target more senior positions in the capital stack with strong collateral rather than ground up development projects.

**RISING INFLATION AND A WEAKER
DOLLAR SUPPORT HIGHER COMMODITY
PRICES THIS YEAR**

Alternative Investments: Private Equity

Private market valuations rebounded quickly alongside public market valuations while transaction multiples have remained near pre-pandemic highs. Private equity saw a strong influx of capital last year as investors looked to take advantage of market dislocations due to COVID disruptions and low interest rates continuing to push investors out on the risk spectrum. The industry is holding around \$1 trillion dollars in investable capital to begin the year, and we expect fundraising to continue building. We favor middle market growth equity strategies as well as private debt and alternative income strategies in 2021. With the tailwinds of high demand, monetary and fiscal liquidity, and a perpetuating low yield environment, private markets are poised for a bullish year.

Annual IPO Activity



We continue to focus on partnering with managers targeting middle-market growth opportunities. While deal flow and exits were down last year, deal multiples remained elevated. As mega-funds struggle to deploy capital, we believe the future environment will provide ample opportunities for managers targeting small to mid-size companies. Deals in the middle market space tend to be less competitive and provide general partners more flexibility when structuring terms. Additionally, smaller companies typically have less crowded capital structures which allows for more direct cooperation between company leadership and private equity partners. The pandemic reinforced the importance of allocating to private equity managers with industry specific expertise, strong corporate networks, and a hands-on approach to portfolio company strategy. The issues facing private companies last year were deeper than funding needs, and managers who were able to help portfolio companies navigate through the pandemic will afford a premium for their efforts in coming years.

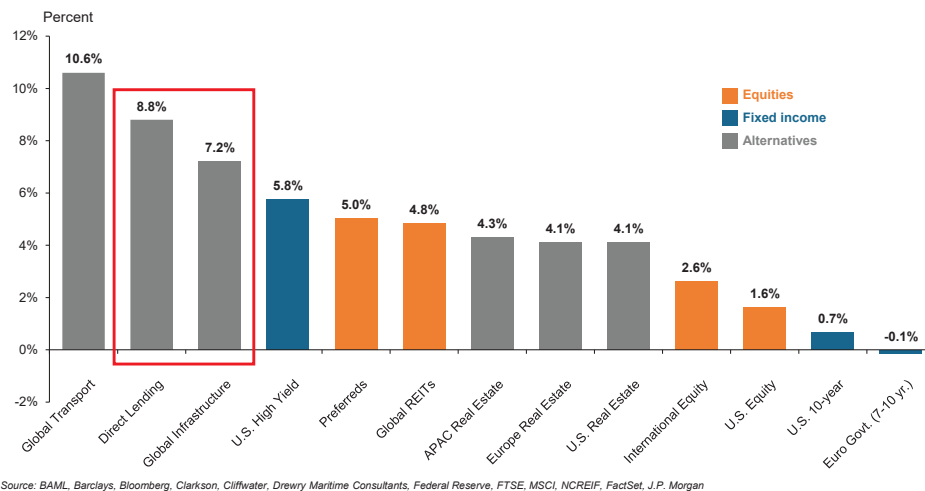
For funds further into their life cycle we see additional upside based on strong deal making activity in both private and public markets. Exit opportunities have expanded as the IPO and SPAC markets remain strong. Total IPOs, which include SPACs, more than doubled from 2019 to 2020 to nearly 500 listings and saw a 150% increase in capital raised. Over 200 SPACs were launched in 2020, three times more than 2019, and the trend does not look like it will be slowing down anytime soon. SPACs generally have at least two years to identify and complete a deal before being forced to return capital to shareholders, which means there are plenty of opportunities for PE backed companies to go public through SPAC deals. Private equity managers have been slower to adopt SPACs as a viable exit strategy, but we expect to see more deals as the quality of SPAC sponsors improves and the market environment remains positive.

Private Debt

Unprecedented central bank and government intervention to combat COVID lockdowns protected many economies from lengthy recession but also confirmed public market interest rates will remain lower for longer. The low interest rate environment will once again stimulate investors' search for yield which, in our opinion, will be difficult to come by in traditional fixed income markets. Direct lending yields have remained elevated and now stand at some of the widest spreads we have seen relative to traditional bonds. At over 8%, it is easy to see why we expect demand for the asset class to grow significantly this year. Given this environment, we believe private credit and alternative lending strategies offer compelling opportunities in 2021.

In the private credit space, we prefer asset-backed finance deals which provide built in downside protection while still offering attractive yields. Additionally, we are finding opportunities in consumer lending and infrastructure lending and financing. The consumer lending has recovered quickly from a substantial 2020 drawdown and improving economic factors should continue to support low default rates in the sector. Since the global financial crisis, we have seen private lenders consistently grow their market share in areas previously filled by traditional banks. Banks have worked hard to keep their balance sheets healthy and given the uncertainty regarding the strength of the post-COVID consumer market, we expect private lenders to continue growing their influence in the consumer space. Regarding infrastructure, we believe capital demand will ramp up as fiscal programs highlighting the sector are rolled out later this year. Infrastructure investment income has typically been correlated with inflation given their relationship with hard asset demand. We find this built-in component of cash flow increases as an attractive form of risk management.

Direct Lending and Infrastructure Offer Attractive Yields



ALTERNATIVE DEBT STRATEGIES WILL FILL THE GAP LEFT BY TRADITIONAL BONDS

Outlook 2021: The Great Reset

Hedge Funds

Hedge funds inflows continued in 2020 pushing assets in the space to over \$3.6 trillion. Demand was high for equity strategies with a focus on event driven and macro driven managers. Overall, risk adjusted returns were positive for the asset class and we expect ongoing strength this year. Hedge fund performance will be supported by an increase in global volatility across equity, credit, and currency markets. We continue to advocate for allocations to low-correlation strategies which can take the place of traditional fixed income allocations within portfolios. With interest rates near historical lows there is little room for bond price appreciation. Hedge fund strategies offer investors an attractive asset to fill the gap left in the wake of central bank manipulation of global bond markets. We expect macro hedge funds, which invest in directional trends in bonds, currencies, and equities, to provide diversification and return benefits for alternative asset investors this year. Hedge funds continue to offer attractive risk management, alternative yield, and risk adjusted returns which will improve portfolio efficiencies in 2021.

Hedge Fund Strategy Returns *(as of November 2020)*

2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	YTD	2010 - 2019	
											Ann.	Vol.
Global Equities 13.2%	Global Bonds 5.6%	Global Equities 16.8%	Global Equities 23.4%	Global Macro 5.6%	Eq. Market Neutral 4.3%	Distressed 15.1%	Global Equities 24.6%	Merger Arbitrage 3.3%	Global Equities 27.3%	Global Bonds 5.7%	Global Equities 9.4%	Global Equities 13.2%
Distressed 12.1%	Merger Arbitrage 1.5%	Relative Value 10.6%	Equity Long/Short 14.3%	Global Equities 4.7%	Merger Arbitrage 3.3%	Global Equities 8.5%	Equity Long/Short 13.3%	Relative Value -0.4%	Equity Long/Short 13.7%	Equity Long/Short 2.5%	Relative Value 5.2%	Equity Long/Short 8.0%
Relative Value 11.4%	Relative Value 0.1%	Distressed 10.1%	Distressed 14.0%	Relative Value 4.0%	Relative Value -0.3%	Relative Value 7.7%	HFRI Composite 8.6%	Eq. Market Neutral -1.0%	HFRI Composite 10.4%	Global Equities 1.8%	Equity Long/Short 4.7%	Distressed 6.6%
Equity Long/Short 10.5%	Distressed -1.8%	Equity Long/Short 7.4%	HFRI Composite 9.1%	Eq. Market Neutral 3.1%	Equity Long/Short -1.0%	Equity Long/Short 5.5%	Global Bonds 7.4%	Global Bonds -1.2%	Relative Value 7.4%	Distressed 1.0%	Distressed 4.5%	HFRI Composite 5.5%
HFRI Composite 10.2%	Eq. Market Neutral -2.1%	HFRI Composite 6.4%	Relative Value 7.1%	HFRI Composite 3.0%	HFRI Composite -1.1%	HFRI Composite 5.4%	Distressed 6.3%	Distressed -1.7%	Global Bonds 6.8%	HFRI Composite 0.8%	HFRI Composite 4.0%	Global Bonds 5.1%
Global Macro 8.1%	Global Macro -4.2%	Global Bonds 4.3%	Eq. Market Neutral 6.5%	Equity Long/Short 1.8%	Global Macro -1.3%	Merger Arbitrage 3.6%	Relative Value 5.1%	Global Macro -4.1%	Merger Arbitrage 6.8%	Global Macro 0.5%	Merger Arbitrage 3.7%	Relative Value 3.8%
Global Bonds 5.5%	HFRI Composite -5.3%	Eq. Market Neutral 3.0%	Merger Arbitrage 4.7%	Merger Arbitrage 1.7%	Global Equities -1.8%	Eq. Market Neutral 2.2%	Eq. Market Neutral 4.9%	HFRI Composite -4.7%	Global Macro 6.5%	Eq. Market Neutral -1.6%	Eq. Market Neutral 2.6%	Global Macro 3.7%
Merger Arbitrage 4.6%	Global Equities -6.9%	Merger Arbitrage 2.8%	Global Macro -0.4%	Global Bonds 0.6%	Global Bonds -3.2%	Global Bonds 2.1%	Merger Arbitrage 4.3%	Equity Long/Short -7.1%	Distressed 2.9%	Relative Value -1.8%	Global Bonds 2.5%	Eq. Market Neutral 2.7%
Eq. Market Neutral 2.9%	Equity Long/Short -8.4%	Global Macro -0.1%	Global Bonds -2.6%	Distressed -1.4%	Distressed -8.1%	Global Macro 1.0%	Global Macro 2.2%	Global Equities -8.9%	Eq. Market Neutral 2.3%	Merger Arbitrage -3.7%	Global Macro 1.3%	Merger Arbitrage 2.3%

Source: MSCI, Bloomberg Barclays, HFRI, FactSet, J.P. Morgan Asset Management.

**“A STRATEGIC ASSET
ALLOCATION PAIRED WITH
ACTIVE QUANTITATIVE
ANALYSIS IS THE BEST
FOUNDATION TO PREPARE
YOUR PORTFOLIO FOR
WHATEVER THE FUTURE
HOLDS.”**

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