

LOOK AHEAD

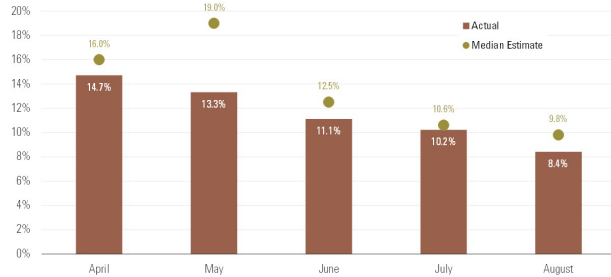
Q4 2020

DISCLAIMER

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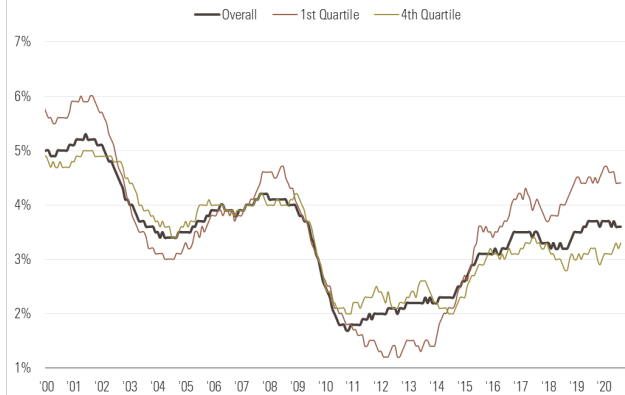
Will They Consume?

U.S. Unemployment Rate



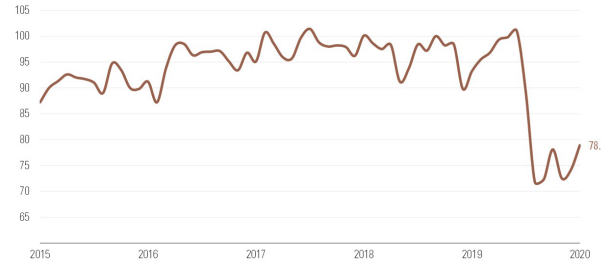
Wage Growth Tracker by Wage Level

12-month moving average of median wage growth for top and bottom wage cohorts

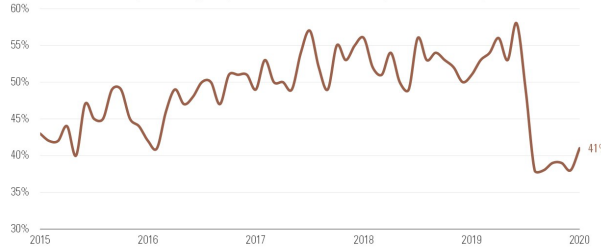


- Consumers still need to spend and for them to do that on any sustained basis they need to have two things: jobs and confidence. Jobs have been recovering at a faster rate than anticipated and that is certainly good news.

University of Michigan Consumer Sentiment Survey

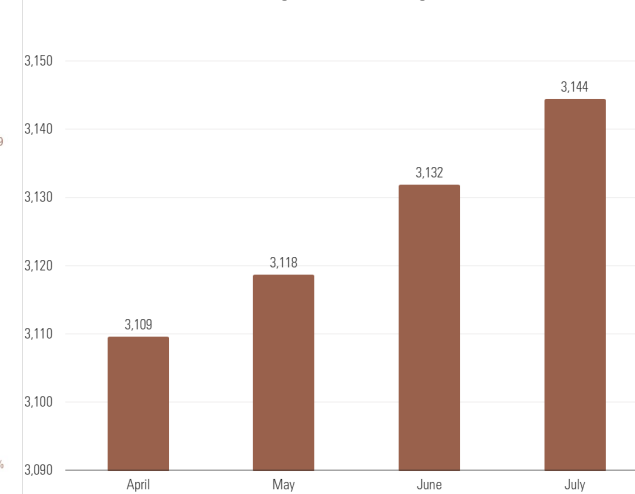


University of Michigan Consumer Sentiment Survey
Respondents Reporting Better Financial Situation Compared with a Year Ago



- The University of Michigan Consumer Confidence index surprisingly rose in September. With increases in infection rates, political instability, and social unrest, the consumer seems to be more optimistic than expected.
- Further, the share of respondents reporting their finances improved over the last year reached 41%—the highest reading since March—but remains below the all-time peak of 58% in February.

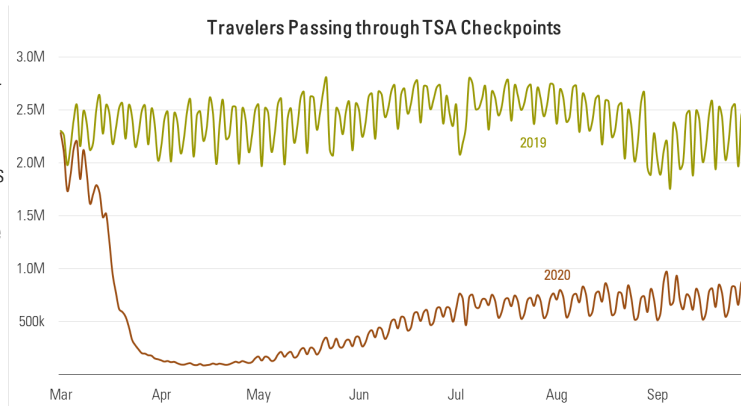
Non-Revolving Credit Outstanding (\$ billions)



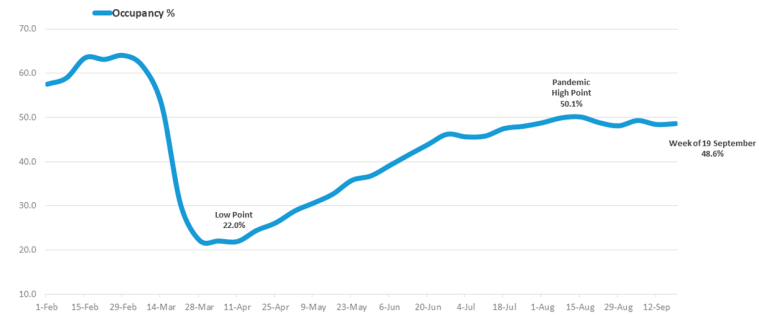
- Looking at the U.S. Consumer's willingness to use credit to make purchases sheds more light on their ability to spend.
- Non-revolving credit (like mortgages) has been expanding during the COVID-19 pandemic. In fact, new mortgage applications have risen 12.6% since April.

Path to Recovery in the U.S.

Although the number of people flying remains well below 2019 levels, travelers passing through TSA checkpoints continue to increase



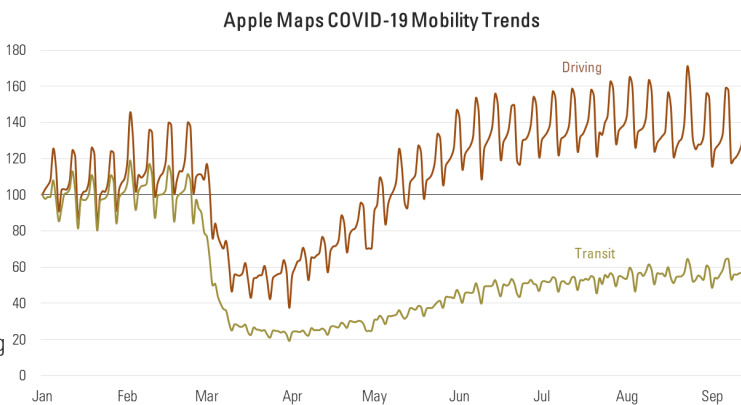
U.S. Hotel Occupancy
Weeks ending with specified dates



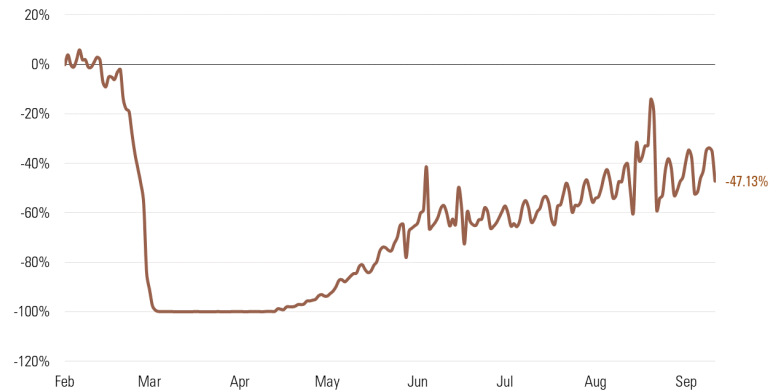
While hotel occupancy is trending higher, occupancy rates remain about 12% below pre-COVID levels

Driving data from Apple Maps has continued to increase, turning positive compared to January

Transit data remains below January levels, but is trending higher



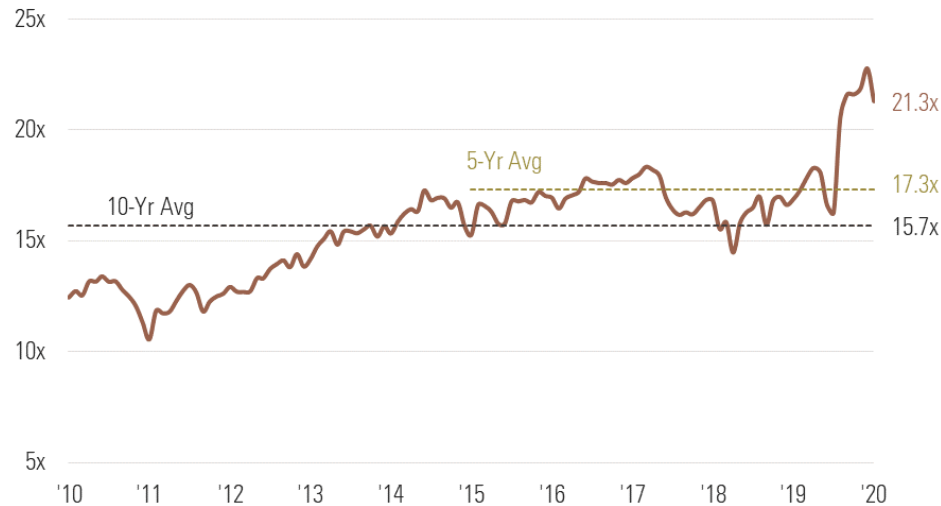
Year-over-Year Change in Seated Diners



Similar to hotel occupancy, Americans have begun to dine out again as measured by OpenTable

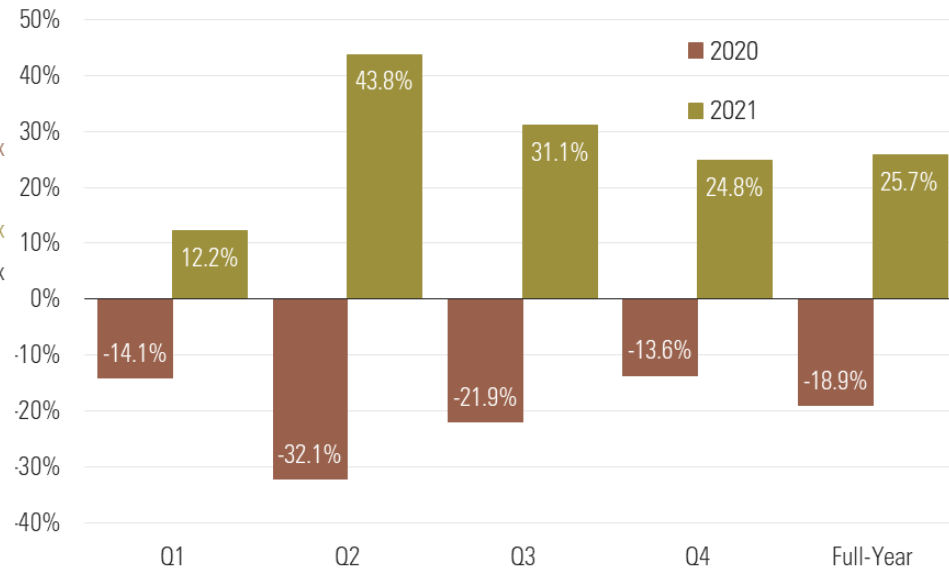
The Cycle

S&P 500 Forward Price-to-Earnings (Next Twelve Months Estimates)



- Are stocks overvalued? By the conventional wisdom, the answer is a resounding: Yes! When you look at valuations, stocks look overvalued versus their 5-year and 10-year averages.

S&P 500 Earnings Growth 2020 vs. 2021



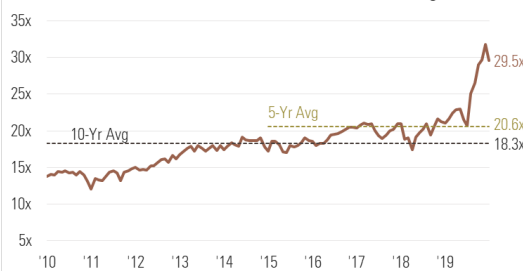
- While the S&P 500 is currently overvalued, we are entering a year-over-year earnings growth cycle with the easiest comps to beat in a generation.

Growth vs. Quality Earnings

Growth vs. Value



Russell 1000 Growth Forward Price-to-Earnings

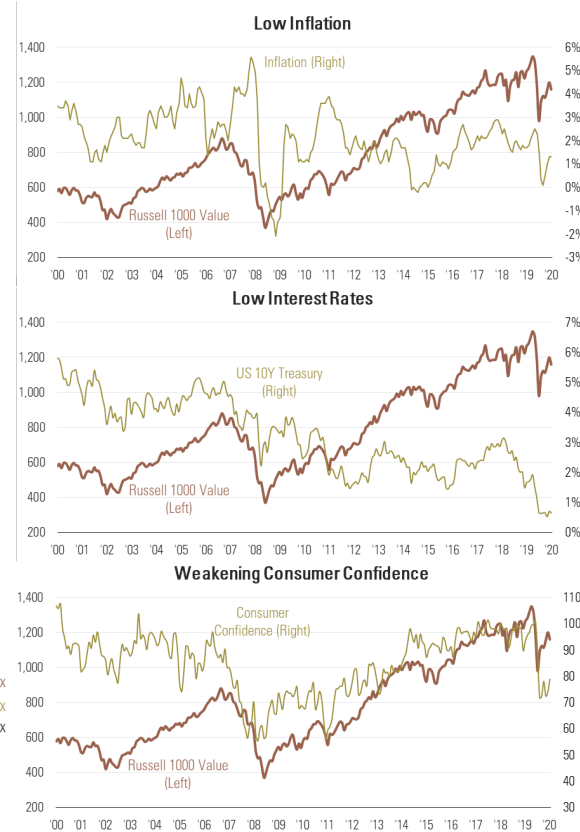


Russell 1000 Value Forward Price-to-Earnings



- Growth sectors & companies have led the market recovery

Economic Factors that Help Value Stocks

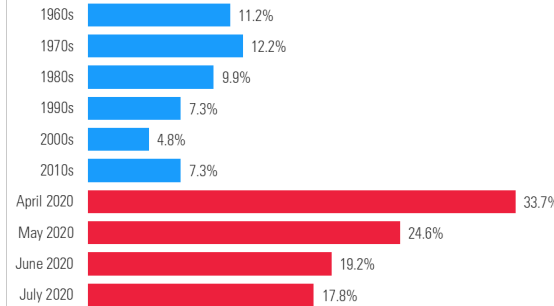


- During times of rising inflation, look for quality companies that have the pricing power to pass increasing product cost to consumers
- As fixed income returns decline below historical rates, quality dividend-paying companies become more attractive to income seekers
- When less confident in the economy, investors rotate to quality companies with more secure and established streams of cashflows

A World Still Full of Cash

Rainy Day?

Savings rate as a % of disposable income



Money Market Funds: Retail



Money Market Funds: Institutional



Retail & Institutional Money Funds have shattered any measurable past record, topping \$4.1 trillion through the second week of September

U.S. Bank Deposits



- The definitive question is: Will the U.S. consumer and businesses spend down to maintain their lifestyles and supply chains?
- With consumer confidence rising, the marginal propensity to spend should grow for both the consumer and institutions.
- If spending habits do return to normal levels, it could add approximately \$1.97 trillion back into the economy (9.1% of GDP).

Emerging Markets

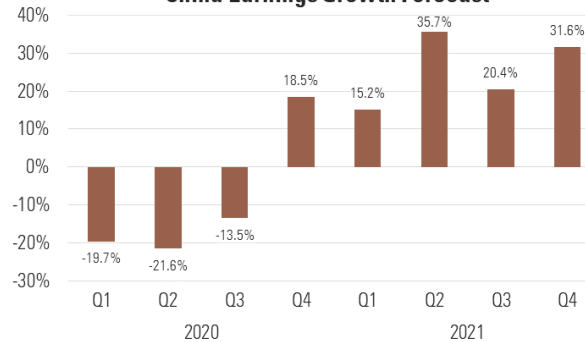
CSI 300 Forward Price-to-Earnings



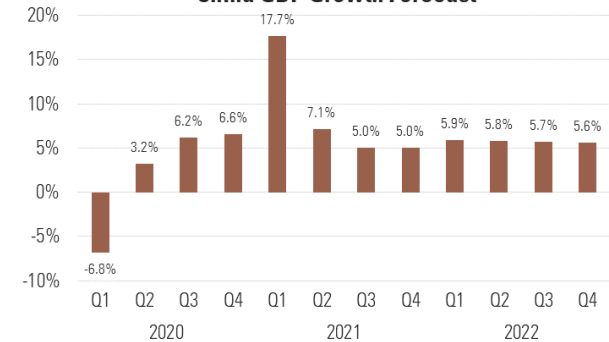
MSCI Emerging Markets Forward Price-to-Earnings



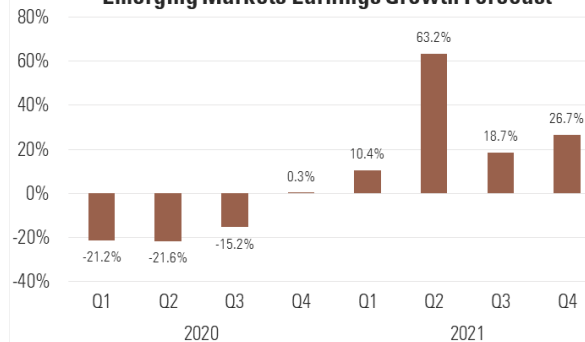
China Earnings Growth Forecast



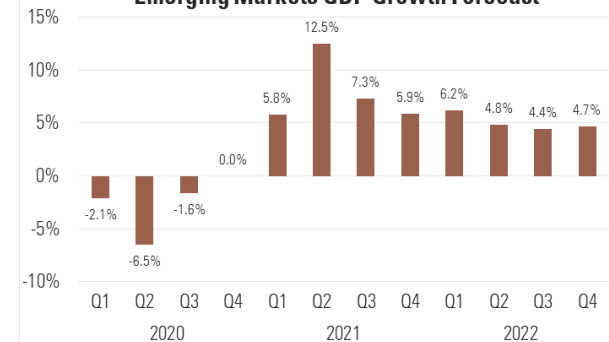
China GDP Growth Forecast



Emerging Markets Earnings Growth Forecast



Emerging Markets GDP Growth Forecast

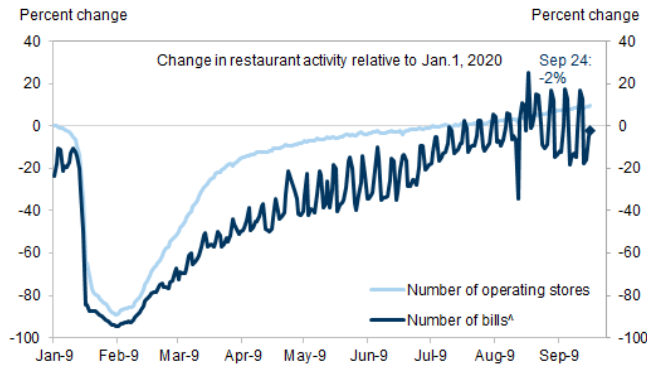


- Major emerging markets are buoyed by better earnings, GDP growth rates, and lower forward valuations.
- We remain overweight in Emerging Markets.

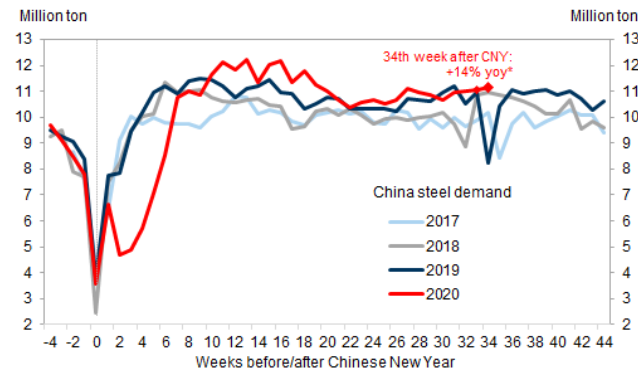
China Mean Reversion

China's Long Road Back to Global Dominance

Real-Time Recovery Indicators



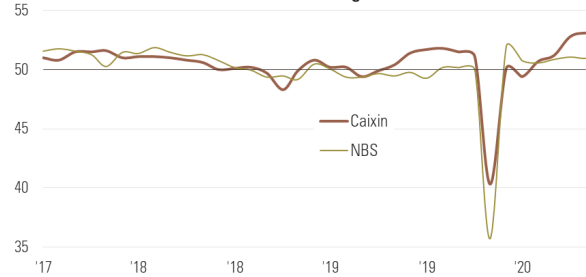
^aincluding takeout bills



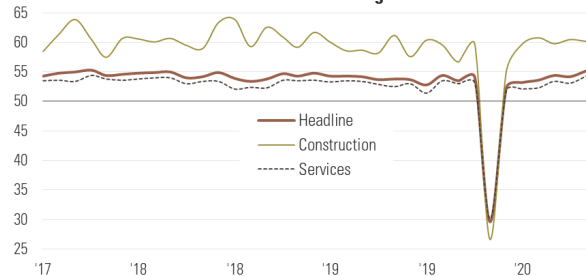
*Percentage change relative to the same week in 2017-19

PMI Recovery

China Manufacturing PMIs

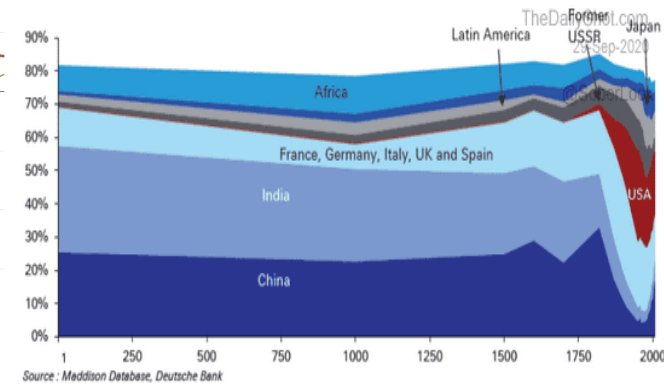


China Non-Manufacturing PMI



- China's PMI is at a current level of 51.5, up from 51.0 last month and up from 49.8 one year ago.
- This is a change of 0.98% from last month and 3.41% from one year ago.

Share of Global GDP through history



- Economies, like stocks, can mean revert. What we may be experiencing at this moment in history is China ascending back to a position of global leadership and as a strong competitor to the United States.
- For more on the China-U.S. Tech War, please see [our interview](#) with China Tech expert Kevin Xu.

Developed Markets

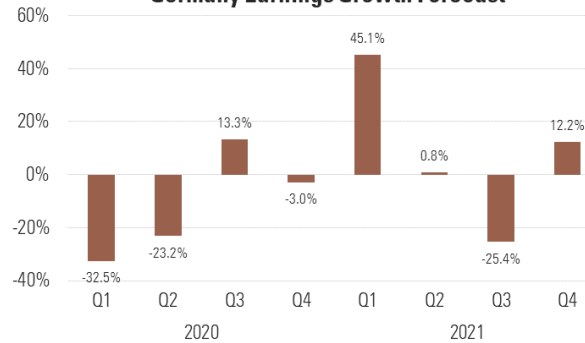
MSCI Germany Forward Price-to-Earnings



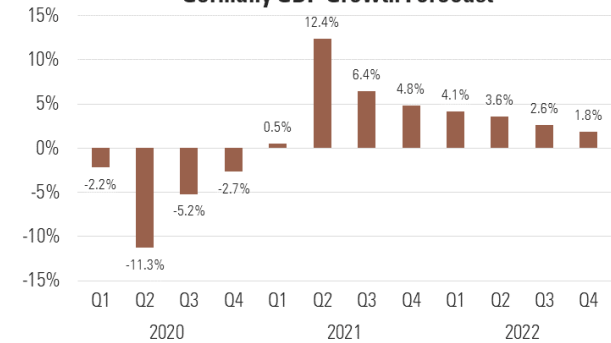
MSCI Developed Markets Forward Price-to-Earnings



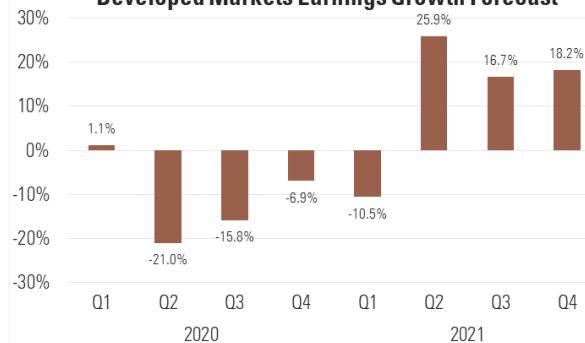
Germany Earnings Growth Forecast



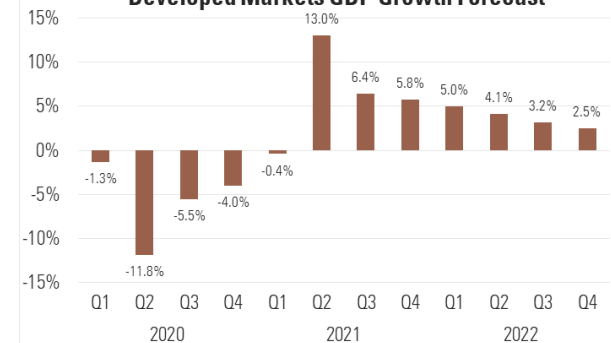
Germany GDP Growth Forecast



Developed Markets Earnings Growth Forecast



Developed Markets GDP Growth Forecast

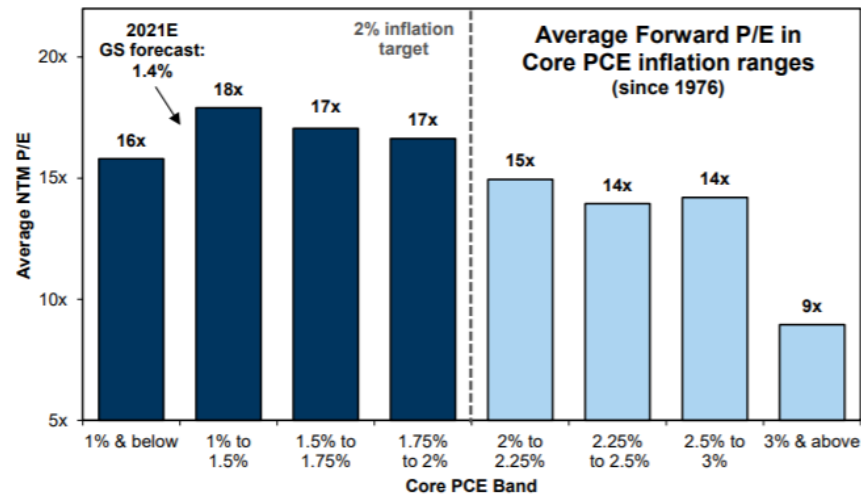


- Stagnant earnings and GDP growth expectations combined with high forward valuations underscores our underweight in Developed Markets.

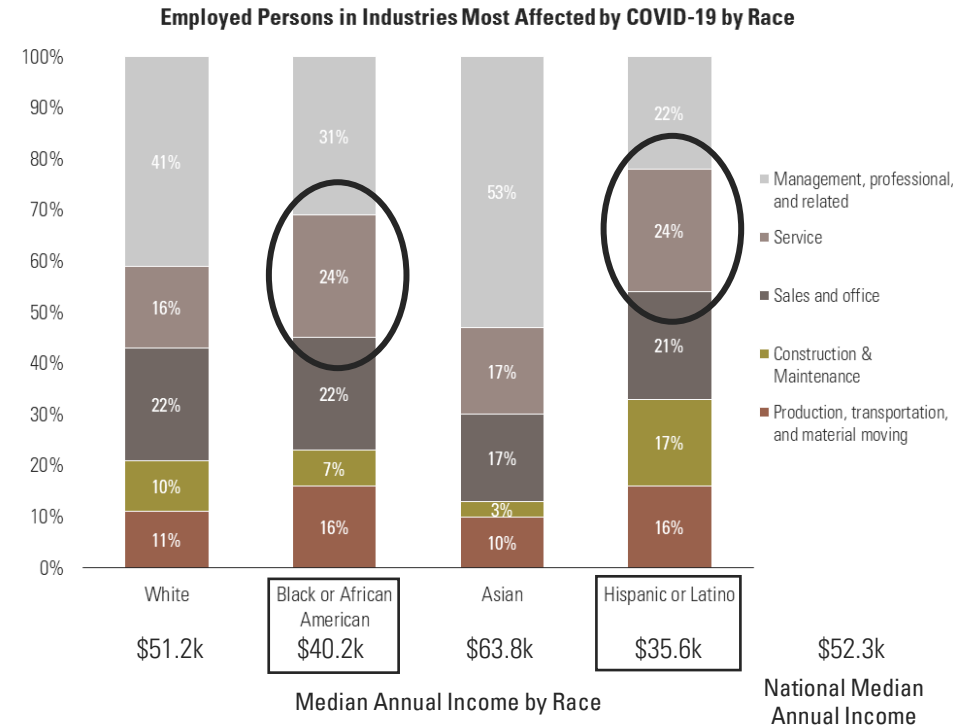
Inflation, Income, Interest Rates & Race

- Chairman Powell's statement said as it relates to the new policy:
 - "Inflation that is persistently low can pose risks...The result can be worse economic outcomes in...both employment and price stability...with the costs likely falling hardest on those least able to bear them."
- Fed Chairman Jerome Powell called the move a "robust updating" that will allow inflation to run "moderately" above the 2% goal "for some time" following periods when it has run below 2%.
- The bottom-line is the Fed has now changed the paradigm and institutionalized lower rates for longer.

Exhibit 2: Sub-2% inflation has generally not been a headwind to valuations
as of September 24, 2020



When you look at what general occupations Black and Hispanic workers occupy at a higher rate than other groups and segments, it is in service occupations.

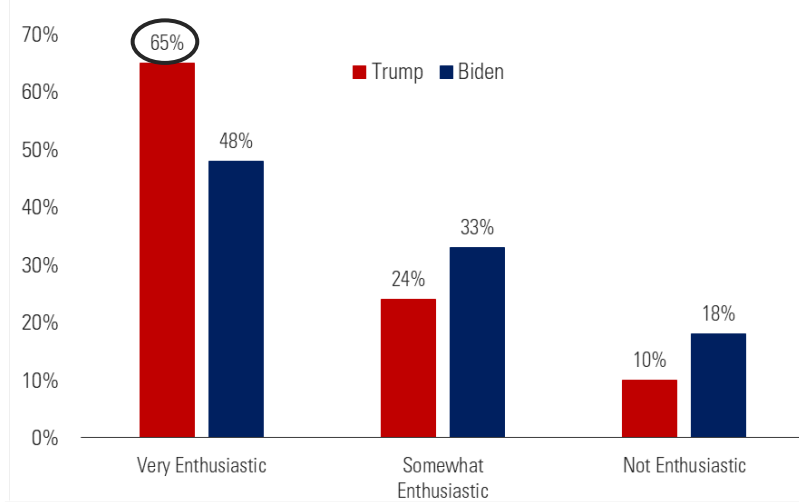


Gaming a Biden Presidency

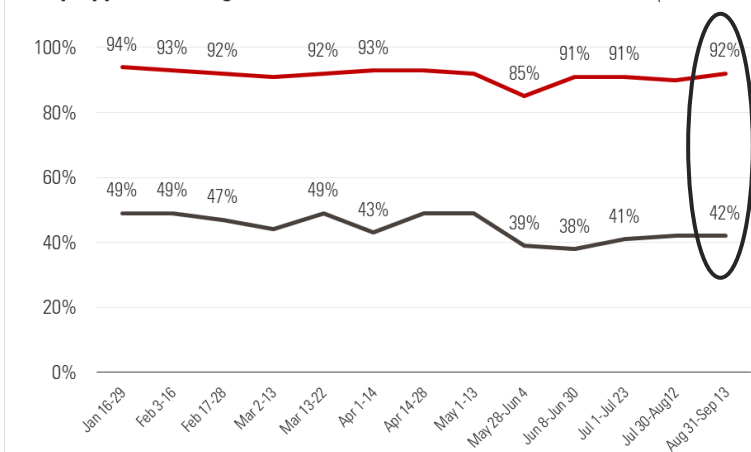
Enthusiasm Gap

A potential weakness for Biden is the enthusiasm gap: Trump voters are more excited to vote for Trump than Biden voters are for Biden

Supporter Enthusiasm



Trump Approval Ratings



Biden's Tax Plan: What Can Get Done?

With little in the way of new policy from Trump, a deep dive on Biden tax policy

Measure	Revenue/ (Cost)	Comments	Probability of Passage
Individual Tax Rates			
Reinstate 39.6% for Top Earners (\$400k+) + Limit Deductions at 28%	~\$500bn	House passed bill to reinstate top income rate in Dec. '19, which most Democrats +5 Republicans supported	High
Expand Earned Income Tax	(\$300bn)	A priority for the Democratic party. An existing Senate bill would quadruple EITC, 46 of 47 Democratic senators are cosponsors	High
Reduce Estate Tax Exemption	~\$60bn	A more palatable version of a wealth tax; reduce to \$6mm	Moderate to High
Tax Capital Gains as Ordinary Income for \$1MM + Abolish Step-up	~\$500bn	Biden supports, but a scaled Phase-in may be more realistic; abolishing step-up basis has support	Moderate
Reinstate SALT Deduction	(\$200bn)	2-year measure passed House in Dec. 2019, but some liberal Dems opposed; could target increasing deduction instead	Moderate
Financial Transaction Tax	~\$780bn	Only 3 Democrats have cosponsored similar Senate bill (.1% tax)	Low
Wealth Tax	~\$1T	Biden has not supported explicitly +Constitutionality issues	Low
Corporate Tax Rates			
Increase Corporate Tax Rate	~\$700bn-\$1T	More likely to land on 24-25% than 28% given Senate moderates	High
Close Carried Inters Loophole	~\$15bn	Biden supports + lots of Congressional Democratic support	High
Impose Minimum Tax / GILTI changes	~\$500bn	Minimum tax (~15%) is a priority for Democrats + fixing GILTI	High
Eliminate 20% Deduction for Pass-Thrus	~\$200bn	Targeted only at high earners (\$400k+)	High
Impose Industry-Specific Taxes	~\$200bn	Biden's plan would eliminate industry-specific tax credits (e.g. real estate, pharma)	Moderate
Expand Payroll Tax	~\$800bn	Impose payroll tax (12.4% evenly split) on high earners (\$400k+); similar House bill has 200 cosponsors, but Senate bill only has 1	Low to Moderate

Mean Reversion Dashboard

Style Forward P/E as a % of 20-Year Average

		Style		
		Value	Blend	Growth
Size	Large	124.7%	137.5%	166.1%
	Mid	122.0%	137.4%	191.3%
	Small	111.9%	150.7%	284.4%

Regions & Countries Forward P/E as a % of 20-Year Average

Regions			Countries						
World	Developed Markets	Emerging Markets	United States	Germany	United Kingdom	China	Brazil	India	Russia
131.8%	117.6%	99.5%	148.0%	111.8%	97.4%	102.0%	93.7%	149.0%	57.3%

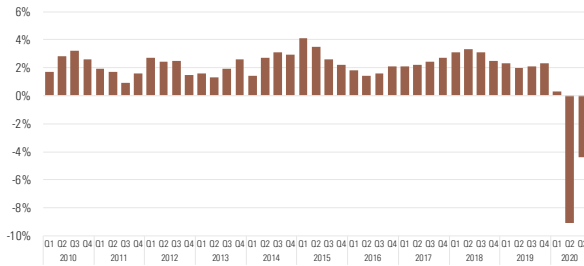
Sector Forward P/E as a % of 20-Year Average

Sectors										
Energy	Materials	Industrials	Consumer Discretionary	Consumer Staples	Health Care	Financials	Technology	Telecom	Utilities	Real Estate
179.5%	106.0%	116.2%	162.8%	103.6%	80.6%	67.9%	130.6%	101.5%	90.5%	219.4%

Economic Dashboard

U.S. GDP Growth (YoY %)

Latest Level	-9.10
Change from Prior Quarter	-9.40
Latest Direction	Contracting
Frequency	Quarterly



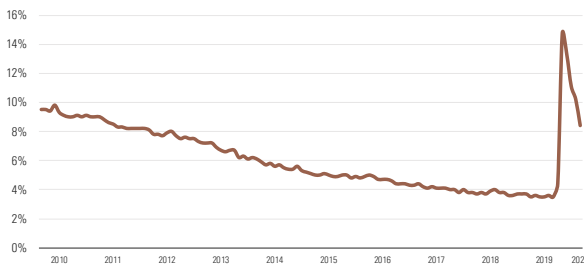
U.S. Inflation (YoY %)

Latest Level	1.30
Change from Prior Month	0.30
Latest Direction	Rising
Frequency	Monthly



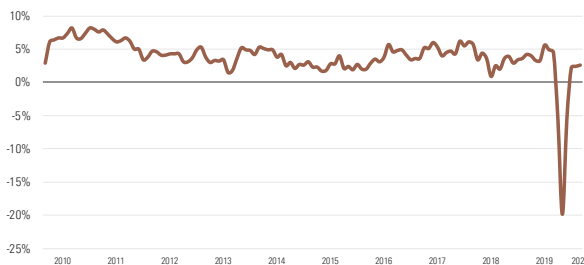
U.S. Unemployment (YoY %)

Latest Level	8.40
Change from Prior Month	-1.80
Latest Direction	Falling
Frequency	Monthly



Retail Sales (YoY %)

Latest Level	2.60
Change from Prior Month	0.20
Latest Direction	Increasing
Frequency	Monthly



U.S. Treasury Spread (10 Yr vs. 2 Yr)

Latest Level (basis points)	53
Change from Prior Month	-4
Latest Direction	Flattening
Frequency	Monthly



S&P 500 Forward P/E Ratio

Latest Level	21.1x
Change from Prior Month	-1.7x
Latest Direction	Increasing
Frequency	Monthly



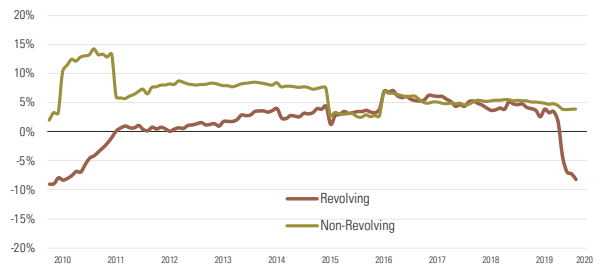
Case-Shiller Home Prices (YoY %)

Latest Level	3.60
Change from Prior Month	0.14
Latest Direction	Increasing
Frequency	Monthly



Consumer Credit (YoY %)

Latest Levels	-8.3% +3.9%
Change from Prior Month	-1.0% +0.0%
Latest Direction	Decreasing
Frequency	Monthly



Our View & Recommendations

Our View

- Political silly season will be a disruptor to markets during the quarter to include post-election disputes (possible 10%-20% drawdown).
- Cash flows will continue to improve as more businesses continue to open up and consumers return to more activity, with the combination of COVID-19 testing, treatments, and vaccines dominating post-election headlines.
- The Federal Reserve is prepared to institutionalize lower rates as a way to lift lower income Americans' wages, including racial minorities.
- China is continuing to increase their global presence and influence with the use of debt forgiveness and vaccine access in Africa. Africa as a continent represents 54 United Nations votes and 1.2 billion people.
- A right-leaning U.S. Supreme Court will overturn the 3.8% tax surcharge on investment that was instituted as part of Obamacare.

Recommendations

- Continue to rebalance back to policy targets.
- Remain underweight Developed Markets, in particular the European Union countries as fiscal stimulus will be harder to deploy and Brexit controversies persist.
- Overweight Emerging Markets as valuations compared to earnings growth present a clear opportunity.
- Redeploy cash into reasonably lower risk alternatives to increase income.

Strategy Update

- Review [our discussion with China tech expert Kevin Xu](#) on the dispute between China and the U.S. in the Technology sector

THANK YOU

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🌐 www.phillipsandco.com

Data Sources

Slide 3	Will They Consume? https://fred.stlouisfed.org/series/UNRATE https://www.frbatlanta.org/chcs/wage-growth-tracker https://fred.stlouisfed.org/series/NONREVS1 http://www.sca.isr.umich.edu/
Slide 4	Path to Recovery in the U.S. https://www.tsa.gov/coronavirus/passenger-throughput https://covid19.apple.com/mobility https://str.com/press-release/str-us-hotel-results-week-ending-19-september https://www.opentable.com/state-of-industry
Slide 5	The Cycle Bloomberg terminal https://insight.factset.com/topic/earnings
Slide 6	Growth vs. Quality Earnings https://fred.stlouisfed.org/graph/?g=vP8V https://fred.stlouisfed.org/series/DGS10 http://www.sca.isr.umich.edu/
Slide 7	A World Still Full of Cash https://fred.stlouisfed.org/series/PSAVERT https://fred.stlouisfed.org/series/WRMFSL https://fred.stlouisfed.org/series/WIMFNS https://fred.stlouisfed.org/series/DPSACBW027SBOG
Slide 8	Emerging Markets Bloomberg terminal
Slide 9	China Mean Reversion https://research.gs.com/ https://www.rug.nl/ggdc/historicaldevelopment/maddison/?lang=en
Slide 10	Developed Markets Bloomberg terminal
Slide 11	Inflation, Income, Interest Rates & Race https://research.gs.com/ https://www.bls.gov/data/tools.htm
Slide 12	Gaming a Biden Presidency https://www.washingtonpost.com/context/washington-post-abc-news-poll-aug-12-15-2020/ https://www.pewresearch.org/topics/presidential-approval/ https://www.pimco.com/en
Slide 13	Mean Reversion Dashboard Bloomberg terminal
Slide 14	Economic Dashboard Bloomberg terminal