

Quarterly Commentary: Second Quarter 2020

Introduction

PEPPER ANDERSON, Chief Executive Officer

The second quarter of 2020 was characterized by much of the same volatility and dispersion across asset classes and sectors that we commented on earlier in the year. Markets broadly rebounded throughout the quarter, which has left many investors feeling a combination of relief and uncertainty looking forward. Many are questioning what actions, if any, they should be taking to protect their assets while still participating in higher return potential of equities. We are not advocates of market timing, given the challenges of doing so accurately. We also believe that our

focus on quality and resiliency of investments will continue to serve our clients well.

As election season approaches, and the COVID-19 landscape evolves, we expect volatility to remain relatively high. This should present opportunities for attractive long-term investing and active management generally. That said, we are committed to our clients' portfolios being personalized to maximize tax considerations, liquidity needs, risk and return objectives and look forward to continuing to partner closely with you to achieve your goals.

Market Overview: The Tsunami of Liquidity Lifts All Markets

RICHARD L. CHILTON, JR, Chairman & Chief Investment Officer – Equities

JENNIFER L. FOSTER, Co-Chief Investment Officer & Portfolio Manager- Equities

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Markets across the globe staged a remarkable rebound during the second quarter, as hopeful progress in the fight against Covid-19 together with fiscal and monetary support measures, helped credit and equity markets alike. As we've seen in recent quarters and even recent years, markets continued to reward growth over value, supported by both fundamentals and the benefits of historically low interest rates. The stock market has strongly rebounded after bottoming on March 23rd with technology stocks leading the way,

driving a meaningful dispersion in results across sectors and industries. While the S&P 500 gained an impressive 20.5% this quarter, the tech-heavy Nasdaq surged 30.9% in the second quarter. International markets delivered strong returns as well but continue to lag domestic markets.

Global Central bank Quantitative Easing (QE) has resulted in a "tsunami of liquidity" that has been raising asset classes throughout the world and the cross-correlations have been unprecedented. Led by the U.S. Federal Reserve, this global monetary stimulus has been a critical support to all fixed income markets and ultimately to the real global economy, but has also raised long term questions about the value of the U.S. Dollar, inflation risks, and whether there will be sufficient growth to pay

	Q2	YTD
S&P 500	20.5%	-3.1%
NASDAQ	30.9%	12.7%
MSCI Europe	15.6%	-11.1%
MSCI EM	18.2%	-9.7%

Source: Bloomberg

back the debt that is being accumulated to keep the economy going.

Here in the U.S. during Q2, monetary stimulus – in tandem with fiscal stimulus via the CARES Act – has been aggressive and so far, effective.

- Enormous expansion of the Fed’s balance sheet – now exceeding \$7 trillion.
- Freshly minted Main Street Lending Program which was central to setting the stage for the reopening of the U.S. economy during the Quarter.
- A multitude of macro-economic data showed that the early stages of a recovery were under way.

- Consumption and domestic demand that has held up remarkably well—led particularly by the housing market and by the technology sector. This has been supported by U.S. Treasury transfer payments especially for unemployment— supplementing state benefits.

Questions remain as to the likely duration and shape of a recovery – whether V-shaped, U-shaped or W-shaped. Nonetheless, the re-liquification of markets in the second quarter provided a necessary condition precedent for whatever “letter” recovery would ultimately take shape.

Our Portfolios

In our equity portfolios, our investments performed exceedingly well during the quarter with returns that were generally ahead of the S&P. We remain highly committed to their business models and for many of them, this crisis has strengthened their dominant franchises for the long term.

During the market lows, we also added to many of our existing investments in the healthcare sector and initiated two new investment positions in companies at terrific entry prices for the long term. Rarely does the valuation of these unique businesses become attractive enough for our return profile, so when it did during the crisis, we jumped at the chance.

The S&P 500 performance is being dramatically skewed by the six largest companies, which are all technology in nature and are performing exceedingly well for the year. These six largest companies now make up 26% of the index, which is the largest concentration in 30 years, even eclipsing the 2000 time period. To capture the real essence of the market’s performance for the year you need to look deeper at the non-cap weighted return of the S&P 500 which stands at -

10.77% for the year; this is in stark contrast to the current performance of the S&P 500 which stands at -3.08% year to date. Our portfolios have participated somewhat in the technology renaissance by owning Microsoft and Intuit which have been terrific investments for us over the last four years [as of June 30, 2020].

Our external managers demonstrated very strong performance, with only a handful of exceptions, during the second quarter. A strong focus on quality, a theme we’ve long espoused, proved beneficial as the economic damage ravaging companies, small and large, is significant. This pandemic is shining a spotlight on companies that benefit from WFH (tech, cyber) while decimating others (hospitality and travel sectors). The second quarter was one in which companies like Zoom and DocuSign became verbs, while companies like Hertz, J.C. Penney and Brooks Brothers declared bankruptcy. We are living through very interesting times as dynamics like the digital disruption of key industries, businesses and socialization moving increasingly online, cloud computing, etc. continue to impact our lives and behaviors at an ever-quicken pace. As a result, investing in companies and with

managers that focus on quality businesses, with strong balance sheets and cash flow dynamics, led by proven management teams, is more important than ever. We feel that the managers with whom we work do just that.

For our tax advantaged clients, municipal market exposure in the second quarter provided opportunities for out-performance, relative to respective benchmarks. With the Federal Reserve purchasing municipal bonds for the first-time ever, a process of recovery in municipal markets unfolded—from the complete deep freeze in market-making in March to re-liquification by quarter-end. With the front-end of the municipal market highly impacted by a further compression in U.S. Treasury rates, our customized portfolios benefited from our focus on Pre-Refunded Municipal Bonds as well as on General Obligation and Revenue bonds rated AA and above.

The continued demand for Pre-Refunded Municipals in the second quarter helped us to deliver positive outperformance in short and intermediate-term strategies. That performance was also driven by some credit spread tightening in our Crossover strategies through our high-quality corporate exposure and in our strategic duration positioning.

For our taxable customized portfolios, the Federal Reserve's liquidity efforts in purchasing

for the first-time corporate bonds including high yield set the stage for massive spread compression. Investment grade spreads narrowed from 271 basis points (2.71%) to 150 basis points (1.50%) over U.S. Treasuries.

High yield improved even more dramatically before giving back some of the gains, with spreads compressing from 882 to 546 basis points in mid-June, before widening some to end the quarter at 646 basis points. Despite the improvements in spreads, pressures remained on specific retail, leisure and oil exploration/production names. Some of that pressure, particularly in high yield energy, had been widely anticipated even before the pandemic crisis.

Throughout the quarter in our Taxable strategies, we focused on security selection, looking specifically for strong evidence of near-term liquidity and to stress test all cash flows given the new COVID risks.

We also took advantage of the new issue corporate market as so many corporate treasurers rushed to market to shore up their liquidity. There was an unprecedented \$757 billion in investment grade credit issuance, more than double any second quarter in the past ten years. And as we put our clients' money to work in our various strategies, we witnessed investors putting \$183.5 billion of net new money into bond funds throughout the quarter.

Our Outlook

There are so many opposing signals at this moment in time, it is hard to know how to position for success in equities. On the one hand, the economy remains in a state of recovery. Jobs, housing and even some manufacturing readings are coming in stronger than expected. The initial wave of demand upon reopening was much stronger than expected in many industries including home improvement, dental, elective medical procedures, used autos, and auto parts.

The Fed stands ready to support markets with additional Quantitative Easing, and credit spreads remain low. IPOs and financings continue, and Moody's and S&P Global - both bond ratings agencies - are trading at all-time highs, reflecting the strength in the issuance markets. There is talk of a 4th fiscal stimulus from Congress which could be \$1T in size, possibly as early as this summer, and confidence readings remain high - both consumer and small

business. Perhaps the most sustainably positive development which could add growth to U.S. GDP for years to come, is the return of the manufacturing supply chain from China back to the U.S. (or Mexico). Last year's trade war forced U.S. companies to begin thinking about shifting their supply chains back home. This year's COVID pandemic and the travel restrictions that went along with it, as well as worrisome actions by China's Communist party to exert control over Hong Kong and remove political freedoms of dissenting citizens, is potentially speeding up the capital exit. By some estimates, this return of manufacturing supply chains could add 1% to GDP growth for years to come, which is meaningful and positive.

But this list of positives only accounts for one side of the ledger. Unfortunately, the other side has plenty of entries which are increasing in merit by the day.

Valuations for equities appear stretched, though even this analysis is not clear cut. If you use the most common valuation metric – Current Price to Earnings (P/E) Ratio on the next twelve months' earnings estimates of \$145 for the S&P – you would calculate a P/E of 22x which is seven turns above the historical average. When you measure equity valuation relative to bonds using the “equity market premium” method, you can still make an argument for further expansion since the S&P Free Cash Flow Yield is offering investors more than 4% while the 10-year yield on U.S. Treasuries is only offering investors .63% – something capital allocators will continue to ponder in their search for yield. Additionally, if you remove the concentration of “FAANGM” (Facebook, Apple, Amazon, Netflix, Google and Microsoft) stocks that make up about 26% of the S&P, valuations throughout the index appear more palatable. But suffice it to say the debate about rich valuations will persist given the strong snap back in stock prices.

Further, though many parts of the economy are

enjoying the resumption of economic activity, some large industries are not participating. Travel, Leisure, Hospitality and parts of the retail sector are still suffering, and the trajectory of when these industries recover and how much economic damage will be done remains unclear. In July, American and United Airlines warned of severe lay-offs coming. Cruise lines have had to reach for emergency funding, and headlines about more retail store closures and bankruptcies populate the headlines every day. Until we have a reliable therapy or vaccine for COVID-19 – estimates range from November 2020 to well into 2022 – many of these industries will limp along. Structural behavior changes beyond COVID-19, especially regarding business travel, will remain open questions.

Another source of uncertainty for the future direction of equities is the looming U.S. Presidential Election in November. No longer a referendum solely on economic success during the President's first term, this year's election will also focus on his handling of the COVID-19 pandemic, the widespread social unrest stemming from police brutality, and the strong pull of the left, which is moving former Vice President Biden from his moderate positions and closer to Senators Warren and Sanders for policy advice. Betting odds have swung to favoring a Biden win over Trump in the last several weeks, and more importantly, a possible Democratic sweep, which could have far ranging economic policy implications. Higher taxes under a Democratic sweep are inevitable. But perhaps more important to consider is this: will social engineering creep into economic policies? And if so, what effect will this have on business confidence, on capital spending, and on employment? These questions are likely to come into focus in the months leading up to the election, and the markets are likely to react to these concerns as they emerge.

Perhaps the most important consideration for the future direction of equities is the course of the

virus itself. With more widespread testing available, we are currently seeing a swell of cases throughout the South and the West, though the Northeast remains low in its count of new cases. Mortality rates are improving with more testing and a better understanding of treatment protocols, but the virus still threatens to overwhelm hospitals in certain regions. Monoclonal antibodies and Messenger RNA approaches to vaccine development both offer the hope of a cure or a vaccine by year end 2020, and we are watching these developments closely. Should the cases start to decelerate nationally, or a therapy, cure or vaccine come through, we believe this would be decidedly bullish for the markets. Short of this happening, we see at best a choppy market propped up by Fed action, and the possibility for an equity sell off if dramatic policy change is at hand.

With such a backdrop, we are emphasizing more than ever the defensive growth characteristics and business model durability attributes in our stock selection process. Free cash flow and high returns on invested capital empower companies with needed flexibility for times such as these. Many of the companies in our portfolios are thriving in this current environment as their value propositions are as relevant as ever. We will continue to trust fundamental, bottoms up business model analysis as our true north during such confusing and chaotic times. We leave the heavy lifting to the strong models that make up our portfolio.

What can our clients expect from Fixed Income in this pandemic environment? —lower for longer Fed rates, and a yield curve that continues to flatten.

Our strategies will continue to focus on capital preservation. Depending on a client's risk budget and specific needs, we will look to harvest yield both in the tax-advantaged market – through our usage of pre-refunded municipals, essential service/revenue bonds as well as general

obligation bonds – and in the taxable markets – through inflation-linked U.S. Treasuries, Investment Grade Corporate Bonds and Preferred securities providing qualified dividend income. We are also opportunistically adding for some clients through high conviction investments in high yield opportunities and emerging markets.

We continue to always be on the lookout for additional areas of opportunity. Distressed credit is one in which we have focused on recently, given the pronounced dislocations we saw in March and into April 2020. The Fed's open checkbook, however, drove quick price recovery and we saw 12-24 month price targets in many credit instruments achieved in the second quarter alone. Our current thinking is that the distressed cycle is starting to shift from "when" to "if" thanks in large part to the actions of the Fed. That said, meaningful risks and opportunities are still out there given, among other things, the unknown duration of high unemployment and the size of the government's balance sheet. While we do think there will be idiosyncratic opportunities, we will likely approach this sector with a seasoned team and in a more liquid structure than a traditional 10 year lock up fund. We will certainly communicate to you all if and when the right opportunities develop.



Richard L. Chilton, Jr. is the founder, Chairman and Chief Investment Officer of Chilton Trust Company, which in April 2012 was the first company in eight years to be awarded a trust charter in Florida. Mr. Chilton also serves as the Chairman, CEO and Chief Investment Officer – Equities of Chilton Investment Services and is the founder, Chairman, CEO and Chief Investment Officer of Chilton Investment Company.

Since founding Chilton Investment Company in 1992, Mr. Chilton has built a team of investment professionals focused on building wealth in favorable markets and preserving capital in declining markets. Under Mr. Chilton's leadership, Chilton Investment Company has developed an investment approach committed to fundamental, bottom-up stock selection and disciplined portfolio management.

Prior to forming Chilton Investment Company, Mr. Chilton was a managing director of Allen Value Incorporated and a vice president and equity portfolio manager at Alliance Capital Management Corporation. Mr. Chilton began his career in the Mergers and Acquisitions group at Merrill Lynch and Company.

Mr. Chilton is a trustee of The Metropolitan Museum of Art and a trustee of the Classic American Homes Preservation Trust, both located in New York.

Mr. Chilton received his B.S. in Finance and Economics from Alfred University.



Jennifer L. Foster is an Executive Vice President, Co-Chief Investment Officer & Portfolio Manager– Equities and is an equity specialist who has worked at Chilton Investment Company for over 20 years. Prior to taking on her role as Portfolio Manager in September 2012, Ms. Foster served as Chilton Investment Company's Director of Research for seven years. She also serves on the Chilton Investment Company Risk Management Committee, Board of Directors, and Executive Board. Preceding her tenure as Director of Research, Ms. Foster served for seven years as an equity analyst at Chilton covering the Software and Technology sectors.

Before joining Chilton, Ms. Foster worked at GE Capital as a financial analyst in several divisions of the company including commercial finance, commercial real estate, equipment leasing and corporate planning. Ms. Foster graduated summa cum laude with a B.A. in English from Boston College and earned an M.B.A. with distinction from Harvard Business School. She is a current trustee of St. Luke's School and the Calvin Coolidge Presidential Foundation.



Timothy W.A. Horan is an Executive Vice President & Chief Investment Officer – Fixed Income. With over 30 years of experience, Mr. Horan is a specialist in fixed income investing, ranging from municipal and US taxable securities to international bonds and currencies. He leads a team of nine professionals managing client assets across a variety of strategies including intermediate liquidity, tax-advantaged, taxable, international and global.

Prior to joining Chilton Trust, Mr. Horan was a Managing Director at Morgan Stanley Smith Barney and served as MSSB's Chief Investment Officer of Fixed Income Investment Advisers, a division of MSSB, providing customized portfolio management to ultra-high net worth private clients, charities, endowments, foundations, and family offices, primarily in North America, the Caribbean and Latin America. Earlier, Mr. Horan led Morgan Stanley's Private Wealth Management Fixed Income business in London serving European, Middle Eastern and Swiss private bank clients. Mr. Horan also served on the Morgan Stanley Global Asset Allocation Committee. Before joining Morgan Stanley, Mr. Horan was Director of International Fixed Income at Lord Abbett & Co. He also held senior management positions in fixed income and foreign exchange portfolio management at Credit Suisse, Aubrey G. Lanston & Company, Inc. and Bankers Trust. At Bankers Trust, he helped pioneer the fixed income risk management frameworks. Mr. Horan began his career at the Federal Reserve. During the Volcker years, he was an Economist in the Sovereign Debt Unit at the New York Fed, working on the debt restructuring of Brazil, Mexico and Argentina. Following the Plaza Accord, he also served as a foreign exchange trader for the Federal Reserve Bank of New York. Mr. Horan earned an AB with honors in Economics and History from the University of Pennsylvania, Wharton-Sloan Program. He was an Andrew Mutch Scholar in Economics and Politics at the University of Edinburgh and holds a post graduate law degree from the University of Cambridge, where he was a Thouron Scholar.



Louisa M. Ives is a Managing Director & Head of Manager Research. Ms. Ives is responsible for external manager selection and due diligence for Chilton clients and is also a member of the Executive and Investment Committees at Chilton Trust. Prior to joining Chilton, Ms. Ives was a Managing Director at Chilton Investment Company, where she was a research analyst covering the financial services sector. She also served on the company's Board of Directors. Prior to joining Chilton, she worked at Coopers & Lybrand Consulting Group, reporting directly to the CEO, and began her career at Chemical Bank in their Middle Market Lending Group. Ms. Ives graduated cum laude from St. Lawrence University with a B.A. in English Literature and earned an M.B.A from Harvard Business School.

Ms. Ives serves on the boards of The First National Bank of Long Island, the North Haven, ME Casino (Yacht Club), The Project Y Theatre Company, and on the Investment Committee of Vinalhaven, ME Land Trust.



Pepper Anderson is a President & Chief Executive Officer. Pepper Anderson is President and Chief Executive Officer of Chilton Trust, with nearly three decades of experience in financial services and wealth management. Prior to joining Chilton, Ms. Anderson spent more than 20 years with J.P. Morgan Private Bank, where she most recently served as Managing Director and Market Manager for Connecticut and Westchester County, NY. During her tenure at J.P. Morgan, Ms. Anderson developed a deep understanding of both technical investing and private client relationship management, holding roles of increasing responsibility across a diverse range of businesses, including U.S. Head of Discretionary Fixed Income, Head of the Private Bank's Fiduciary Investor Group, and Investment Team Lead for High Net Worth and Fiduciary. After obtaining her B.A. degree from Tulane University, Pepper's successful foray into the financial world began in equity trading at Bear Stearns & Co. She then held roles in fixed income portfolio management at Meredith, Martin & Kaye and the Union Bank of Switzerland.

Pepper serves on the board of the Greenwich YWCA, as a committee chair for Impact Fairfield County and enjoys additional volunteer opportunities with her church and children's schools.

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