CHILTON TRUST

Quarterly Commentary: First Quarter 2021

Introduction

PEPPER ANDERSON, Chief Executive Officer

The start to 2021 has evoked imagery of the clichéd duck swimming calmly on the water, while under the surface everything is in motion. As the U.S. has continued on the path to recovery from the pandemic, markets rewarded this progress with strong returns. That said, under the surface of those returns there have been waves of uncertainty accompanied by volatility among sectors and companies that we had anticipated. While conviction in the recovery's traction seemed high across market participants, investors have had to overlay on this unprecedented path with additional questions on taxes and public policy. As we continue to evaluate the various tax proposals (both their probability and potential impact) you can expect us to be actively engaging with you to consider any actions that may be appropriate for your specific circumstance. We recognize that the intersection of markets and planning will have differing impacts which are highly personal to you and your family.

While we are always grateful for the confidence you place in us, it has been particularly meaningful given the complexity of the landscape we have been navigating together. Many of us have not been able to visit one another in person, adding to our confidence that the personalized nature of our approach has value beyond measure.

Market Overview: The Duck Has Room to Run

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

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

TIMOTHY W. A. HORAN, Executive Vice President & Chief Investment Officer - Fixed Income

LOUISA M. IVES, Managing Director & Head of Manager Research

During the first quarter, the move in the 10-year Treasury rate pressured the most expensive as well as high quality stocks. We see the move in rates as an indicator of a strengthening economy, and the effect that it has had in broadening out the market has been healthy. The March 11 passage of the "American Rescue Plan" which added another $1.9 trillion in fiscal relief, bringing the total fiscal relief of the past thirteen months to just over $5 trillion, is the one macro event that we believe matters most for this moment. With Chairman Powell promising to stay the course on easy monetary policies even in the wake of higher inflation (reflation) readings, the equity markets remain awash in liquidity. Re-opening is upon us in the U.S. and the early evidence suggests that the consumer is spending strongly with very high household savings (estimated at over $2 trillion), especially on categories that were not accessible during the heart of the pandemic. "Don't fight the Fed" comes to mind and makes us believe that the liquidity induced rally has further to run. "If it looks like a duck, walks like a duck, and quacks like a duck, it's probably a duck," or so they say. The temptation is not to overthink this liquidity-induced rally, and just enjoy the ride.

Equities

The equity markets for the first quarter were very robust as optimism spread around economic recovery, the successful roll out of the vaccine program and the increased Federal stimulus package under the Biden Administration. Even though the underlying trends were choppy and produced some excessive single stock volatility, the trendline for the market indices was very strong.

The market has certainly had a very large move year to date and is susceptible to a correction at any time. Given the dramatic GDP and S&P 500 earnings growth coupled with low interest rates, we believe we are in a good environment for equities.

In the first quarter of 2021, global equity markets demonstrated a pronounced rotation to pro-cyclical companies. Markets became mired in a strong factor rotation from growth and quality to value (e.g. the MSCI ACWI Growth Index advanced 0.3% while the MSCI ACWI Value Index surged 8.9%) as investors clamored for companies deemed to benefit from the re-opening of economies as vaccine distributions raised hopes and showed us the light at the end of the tunnel. Further, markets experienced a wide dispersion in performance among market caps, with small and micro-cap companies far outpacing larger cap names. As we look broadly at trailing 12 month returns, back to the lows of the uncertain days of March 2020, markets have staged a remarkable recovery surging more than any other 12-month period in the past 38 years.

Parsing deeper into the performance of the U.S. markets during the quarter, the sectors that outperformed were Energy, Financials and Industrials (all sectors left for dead during the pandemic) and beneficiaries of economies reopening. In particular, Energy surged on strong indications of the resumption of travel along with the acceleration of spending trends.

	Q1	1 Year
S&P 500	6.2%	56.4%
NASDAQ	3.0%	73.4%
MSCI ACWI ex-U.S.	3.5%	49.4%
MSCI EM	2.3%	58.4%
Russell Midcap	8.1%	73.6%
Russell 2000	12.7%	94.8%

Source: FactSet

Fixed Income

The first Quarter witnessed the most dramatic steepening of the U.S. Treasury Yield Curve since the “2013 Taper Tantrum”. The primary trigger for this move up in longer-end U.S. Treasury rates was an increasing concern in the bond market about the growing risks that inflation would rise significantly and would negatively impact the U.S. economy as it re-opened, following the successful rollout of COVID vaccines.

Despite the yield differential favoring the U.S. versus European or Japanese Government Bonds, the U.S. Treasury 10 Year Note, which had begun the year at a yield of .91% rose to 1.77% before both domestic as well as foreign buyers found our yields attractive enough to cap off the yield curve steepening. In the process, our yields pulled-up — yields throughout the developed world — which resulted in the European Central Bank protesting the market move by expanding its Quantitative Easing program. That crowding out in European markets led European institutional investors back into purchasing U.S. Treasuries as well as U.S. Corporate bonds to gain yield versus the negative yields (almost $13 trillion) prevailing through European bond markets.

Our Portfolios

Equities

Chilton Trust equity portfolios generally underperformed the Index as the market continued to penalize quality in favor of cyclicality. In mid-March we felt this changing as the pendulum had shifted too far. Quite simply… quality growth had gotten too cheap and lower quality cyclicals too expensive. We have seen a nice improvement in many of our investments' performance over the last several weeks.

The underperformance occurred despite some exceedingly great performance by some of our leading investments. Strong performance in March as the market started to rotate back to quality helped the portfolio. Unrealized losses in the quarter were from some of our highest conviction investments whose fundamentals are also performing well but were mired in this factor rotation. As of the date of this letter, these investments have recovered well, and we feel that the market is rewarding once again those companies that are market leading quality business models. The fear that the market had for these businesses not being able to continue their success after a strong 2020 or to use Wall Street jargon "not being able to comp the comp" was overblown to an extreme degree. One of our leading investments exhibited this fear cycle during the quarter. After a great fourth quarter earnings release that beat expectations, this leading home improvement retailer was penalized for fears of future "tough comps" causing its stock to pull back 11%, only to rebound in the ensuing weeks by 30%! Mr. Market sometimes suffers manic periods which can produce some volatility, but our approach of long-term investing which patiently invests in businesses rather than stocks allows us to ride out these bouts of depression and achieve long term growth for your portfolios.

We have long talked of our "Investment Wish List" which is our list of very high-quality business models where we would love to own the entire company. Over the years we have done work on these names and continued to research and listen to their quarterly calls. For us it is just a matter of price and when we can initiate a position; the severe market downturn for quality allowed us to purchase new positions at great prices in several new companies. This included a domestic semiconductor company that has the enviable position of controlling its own manufacturing and therefore has ample supply when its peers are constrained; a digital marketing platform company with leading market share and tremendous free cash generation; a leading digital payments company; an omnichannel retailer whose solid execution has allowed it to take share during COVID; and a leader in the bio-pharm equipment and services space. You will hear more about these fine businesses over the coming quarters.

Our multi-manager solutions, which are also focused on long-term sustainable growth, underperformed in the first quarter. The growth/ value divergence, which was particularly pronounced amongst small caps, weighed heavily on performance of the growth-focused Chilton Select Equity Fund (CSEF). The CTC Access Fund (CAF) also experienced a challenging quarter as its technology-focused hedge fund was hit hard by losses in its short book. The January short squeeze proved painful, resulting in the worst month of short alpha in the firm's history. The manager's quarterly underperformance was further exacerbated by the severe correction of high growth stocks in the second half of the quarter but their long-term conviction in the powerful digital secular trends that are driving high sustainable growth for their portfolio companies remains firm. CAF's REIT manager experienced a nice quarter of returns and continues to deliver an attractive yield. Importantly, the majority of the yield is tax-deferred basis. Their performance was driven by their multi-family, industrial, and net lease holdings, all of which continue to see very nice tailwinds. Also of note, the fund owns just one office building and hotels comprise just 5% of the portfolio. The cash flows generated by their properties should continue to be steady and the fund should benefit from the appreciation of its properties.

Fixed Income

Throughout the first quarter, while much of the U.S. Treasury curve experienced a repricing, the front end remained relatively stable quarter over quarter. U.S. Treasury yields inside of 1-year actually decreased, while the remainder of the curve increased dramatically with duration, resulting in a significant steepening of the yield curve.

- In Chilton's Short-Term strategies, we modestly extended duration by increasing 2-3-year exposure to capture the attractive pickup in yield and rolldown.
- Within the corporate exposure there was an increased focus on solid BBB-rated names, specifically in the semiconductor, hardware, and healthcare sectors.
- In the municipal market, we targeted high-quality general obligation bonds, essential service revenue bonds, and pre-refunded municipal bonds.
- With U.S. Treasury rates offering little yield, we strategically utilized pre-refunded municipal bonds, supernational bonds, and callable agencies to maintain the liquidity focus but pickup additional income.

The main risk factor that negatively impacted performance for the quarter was interest rate volatility. Throughout the quarter, the fixed income markets were encouraged by the signs of an economic recovery in the U.S. However, the passage of the Administration's American Rescue Plan raised investors' concerns on increased government spending and potential inflationary pressures, thus leading to a sharp increase in fixed income yields. Municipal yields rose in sympathy with their taxable counterpart but the steepening across their term structure was much less extreme. Not so coincidentally, tax-exempt securities outperformed for the quarter. Even with the volatility, retail investors were not swayed from the asset class given the potential for future tax increases. In March, the Biden Administration announced their plan for the first federal tax hike since 1993 in an effort to help pay the Administration's next economic plan centered on infrastructure. As reported by the Investment Company Institute, municipal funds experienced inflows with retail investors contributing approximately $30 billion in the first quarter.

Preferreds saw weakness in the first two months of the year but rebounded in March. The ICE BofA Fixed Rate Preferred Securities Index (P0P1) was down 2.62% after the first two months as interest rates rose at one of the fastest paces since the "taper tantrum" in 2013. The index rebounded 1.65% in March as preferred credit spreads tightened around 100 basis points, offsetting rising interest rates. Despite the strong turnaround in the Preferred space, the Index was still down 1.03% for the quarter, contributing to underperformance in the portfolios. We found the most value adding Preferreds in the primary market at discounts compared to secondary offerings.

We continue to closely monitor the strengthening of the U.S. economy, economic data, and communication from the Federal Reserve to appropriately structure the portfolios to be well positioned throughout this recovery.

External Managers

We saw a relatively wide dispersion of returns from our external managers during the first quarter of 2021. Equity hedge funds had a challenging quarter due in large part to their short exposures as companies with questionable prospects and low-quality balance sheets surged along with the Gamestop/retail-fueled frenzy in January. That, coupled with outflows from higher quality and growth names which hurt names on the long side, caused many of our strongest performing equity hedge fund managers from 2020, to underperform this quarter. Our long only managers generally kept pace with their relative indices, navigating challenging markets well. Not surprisingly, those more exposed to higher growth names underperformed slightly. While near-term underperformance is never fun or easy to endure, we continue to believe the managers with whom we partner are poised for superior, long-term outperformance. Good, sustainable returns are achieved by investing with companies able to generate long-term earnings growth. Our managers are focused on doing just that.

Our Outlook

U.S. households are sitting on an exceptionally large amount of savings which will fuel consumer spending growth. We believe additional stimulus will only add to this imbalance. The N.Y. Fed survey of consumer expectation indicates that 2021 will see the largest growth of household spending since 2015 and the economic backdrop of high saving rates, an improving labor market and a strong housing market is particularly favorable to the consumer. Investors have flowed more money into stock-based funds over the past five months than the previous 12 years combined, $569 billion vs. $452 billion in 2009-2020. The retail investor now accounts for the largest portion of trading volumes and almost as much as mutual funds and hedge funds combined. Household wealth continues to grow at rates well, in excess of CPI and PPI inflation.

In addition, buybacks will accelerate as S&P 500 companies are sitting on $2.2 trillion in cash. Buybacks are still well below the $197.7 billion recorded in the first three months of 2020; to get back to the average levels of the last five years, buybacks would need to be up 50%.

However there are a few nagging thoughts that require monitoring while still being positively exposed to equities. Though the Fed won't pull back on monetary liquidity anytime soon, fiscal policy makers are brewing up their own tightening which could be unleashed later this year. President Biden's Infrastructure bill comes along with nearly $3 trillion in tax increases over 10 years, many of which will hit shortly after passage. Higher corporate taxes and individual taxes (for the highest payers), higher capital gains and dividend taxes, more inheritance tax, and more aggressive taxes on foreign profits for U.S. Multinationals are all proposed in the Biden Tax package. On paper this is designed to pay for the nearly $4 trillion in infrastructure spending that President Biden is proposing over the next 10 years. The problem is one of a timing mismatch - the fiscal spending is likely to move slowly starting in 2022, while the tax increases may go into place almost immediately. Additionally, we will be lapping the incredible COVID relief that was made available in '20/'21. The results of these tough comparisons coupled with the onset of new taxes could be a meaningful fiscal tightening that the markets will have to digest. It is possible that the tax bill will be pared back from its original outline by pressure from moderate Democrats, and that the strength of the U.S. economy will digest the additional taxes with ease, but all of these parts are still in motion and bear watching.

The economic recovery is real, and is just getting started with vaccines now covering over 40% of our adult population and making their way to younger cohorts. The corresponding move in mobility data is strong, and not surprisingly consumers are focused on travel and entertainment. Already Delta airlines, restaurants and others are reporting a lack of labor availability suggesting the demand is stronger than anticipated. Economic readings should continue to tell this positive story, and GDP growth estimates for this year are pushing 9% which would be exceptionally healthy. The strength of the reopening is causing some challenges for supply chains which are in disarray and likely to be the source of some disappointment this earnings season. Overall, we expect the message from management teams to focus on the positive demand picture, with potentially some jawboning about higher taxes. Weather challenges, shipping bottlenecks, and chip shortages are some areas where supply may be constrained and cause problems.

Additionally, we are likely to see official inflation readings jump as we lap the lockdowns of 2020. As demand pressures supply chains, this could lead to some commodity price spikes. We believe these will be temporary instances of reflation rather than worrisome, systemic inflation. With the amount of government stimulus and monetary policy it is not out of the question that we will see inflation down the road, but with labor market slack and automation serving as antidotes, we don't see this as a huge near-term concern.

2021 consensus S&P 500 earnings estimates have moved up to $175, about 5% higher than they were at the start of the year. It is possible that earnings revisions continue to climb, and that $185 is a reasonable target. The S&P 500 is currently trading at 22x this higher estimate, a multiple consistent with where it ended last year. This is above the historic range of 16x though it is below the high 20's level of the late 90's. Equity valuations are a cause for concern, but during a liquidity fueled rally it becomes very difficult to predict exactly where the multiple will go. We are not planning for a meaningful lift in equity prices across the board but look instead for individual companies where strong fundamentals and reasonable valuations will create value for shareholders. As the equity markets digest the introduction of new taxes and possibly higher interest rates, we expect volatility which may provide opportunities for good entry prices. We are content sticking to our Quality investing mantra. Though Quality Stocks slightly underperformed during the first quarter because of the lower leverage component of companies considered high quality, we remain confident in their ability to outperform in the long run. In a bull market, especially during the early innings, companies with leverage often outperform because of the higher beta attributes that they possess.

Against the backdrop of an accelerating U.S. expansion in the second half of 2021, our central case for rates continues to focus on the possibility of further curve steepening. The U.S. Treasury 10 year will likely retest its recent high yield (1.77%) and continue to price somewhat higher yields to offset any further inflationary risks accompanying the broadening of the U.S. recovery. Municipal tax-free securities will continue to be especially attractive given the likelihood of Biden tax increases later this year. Likewise, in our strategies, we will continue to look for the after-tax value both in investment grade and some selective "high-conviction" high-yield corporates, as well as in some QDI Preferreds. Our active management and dynamic credit process will continue to inform our decision-making.

As we look forward to the second quarter and the remainder of 2021 with an eye on potential fiscal changes and continued asset reflation, we remain convicted in the long-term durability offered by clean balance sheets. We believe high quality names will live up to their reputation and begin to outperform again. We are optimistic on the resiliency of U.S. economic recovery and will continue to seek out quality business opportunities for your portfolios in the potentially volatile months ahead.

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.

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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 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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