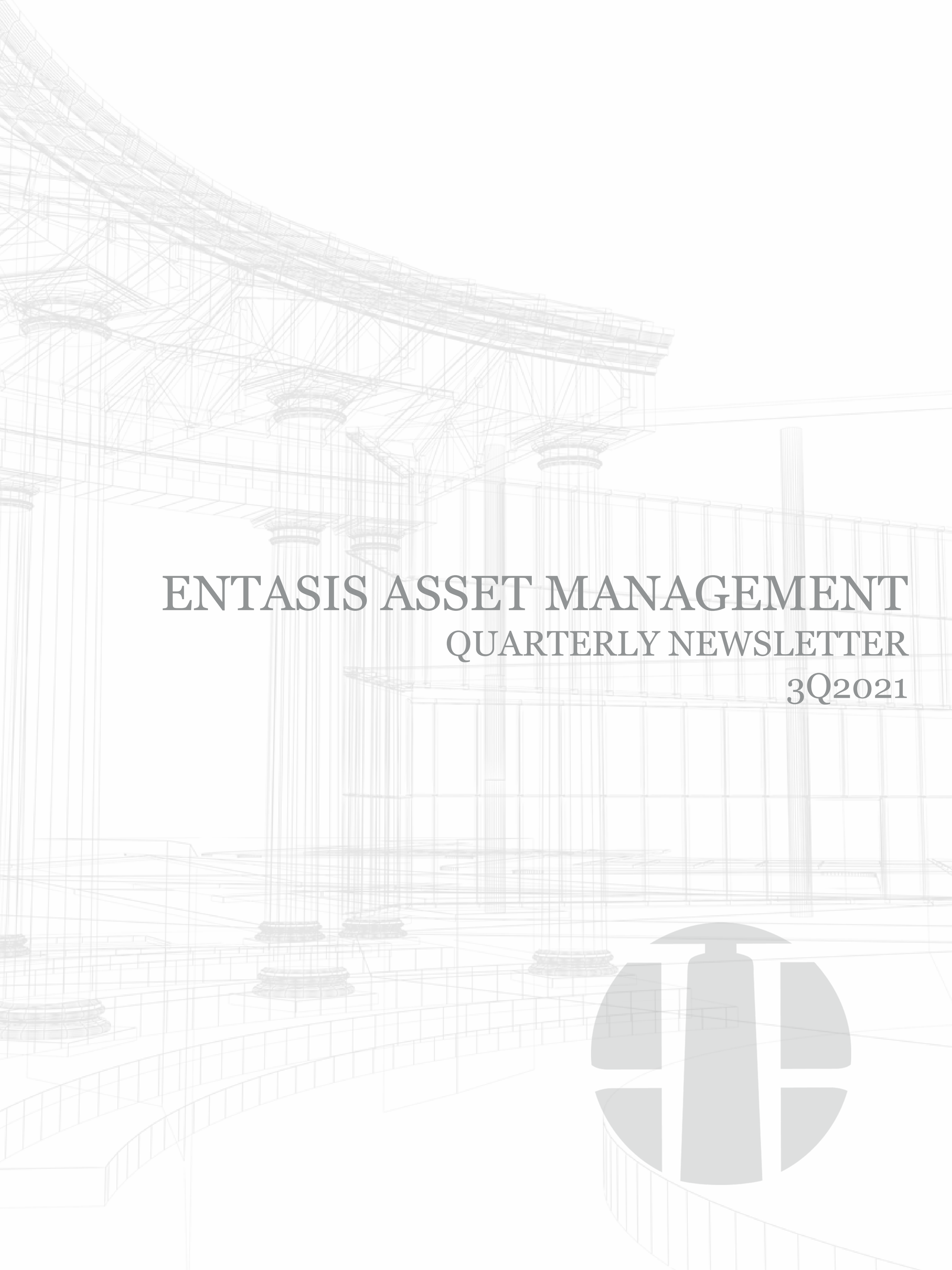


ENTASIS ASSET MANAGEMENT

QUARTERLY NEWSLETTER

3Q2021

CEO Comments

Every time I sit down to think about my comments in each of these newsletters the primary source of ideas is generally conversations with clients. Hearing your thoughts, and what is important to you, is not only critical to maintaining quality relationships, but also to our ability to grow and evolve as investment advisors. Our industry is under constant change and our clients represent the pulse of that change. Our discussions with clients make us better.

One recent discussion I had with multiple clients covered the topic of tax management. Tax management is a pretty wide topic that can be discussed from a variety of angles, but these recent discussions focused on the idea of capital gains realization.

<u>Tax Management</u>

The discussion I had with multiple clients focused on the idea of selling a position with a gain and what it meant for tax purposes in a non-qualified account. (Qualified accounts are generally tax deferred or tax free annually if the money remains in the account even if something is sold at a gain.) All of these decisions are personal and come with many nuances, but typically, if a position is held longer than a year it is taxed at the long-term capital gains rate of 0-20% and if it is held less than a year it is taxed as ordinary income. See the table below for current capital gains rules.

2021 Capital Gains Tax Rates & Brackets (Long-Term Capital Gains)			
	For Unmarried Individuals, Taxable Income Over	For Married Individuals Filing Joint Returns, Taxable Income Over	For Heads of Households, Taxable Income Over
0%	$0	$0	$0
15%	$40,400	$80,800	$54,100
20%	$445,850	$501,600	$473,750
Source: Internal Revenue Source			

With that quick backdrop, consider this example.

- Investor A purchases 100 shares of XYZ at $100 per share on November 1, 2020, for a total investment of $10,000.

- On November 5, 2021, XYZ stock is worth $120 per share, for a total value of $12,000.

In this situation, there is a $2,000 gain. Assuming the client is in the highest tax bracket, the tax bill if all 100 shares are sold would be $400, which is $2,000 x 20%.

The gut reaction many investors have is to quickly say, “I don’t want to pay taxes.” That reaction is normal. Who does? However, that innate reaction has some embedded assumptions that are not discussed or thought of nearly enough.

Bob Batchelor, CFA®, CFP®
Chief Executive Officer

Summary

Hearing your thoughts, and what is important to you, is not only critical to maintaining quality relationships, but also to our ability to grow and evolve as investment advisors.

Avoiding taxes is an innate reaction that is very normal.

Tax management should not be a substitute for portfolio management. Tax avoidance can potentially lead to gain avoidance.

CEO Comments

The assumptions are that XYZ stock will either continue to rise or, at minimum, not decline. But what if it does decline? In this example, a mere 3.3% decline in the price of XYZ results in a $400 decline in the value of the position. What was worth $12,000 is now worth $11,600. So, by avoiding a $400 tax payment, $400 in value was wiped out. In some ways that can be considered a break even point for the decision. If a bigger decline happens the client would be worse off and the client would STILL owe taxes – just not as much.

There are some important takeaways from this simple illustration that apply to all tax management strategies.

- Tax management should not be a substitute for portfolio management.
- Losses impact your full position. Taxes impact the gain in your position.
- Tax avoidance can potentially lead to gain avoidance.

In the coming weeks we will be touching base with clients that have tax considerations to review in their non-qualified accounts. We will review the alternatives and the implications to each client's personal situation. We look forward to connecting.

In the pages to follow, CJ and Mike will share their current market and portfolio perspectives. We hope you find the information useful.

Bob

Market Performance

Equity Portfolio Comments

Fixed Income Portfolio Comments

Click on any button to skip to a new section.

Market Performance

Annualized % Returns (As of 09/30/2021)

Source: Morningstar Direct

Index Name	Index Category	1 year	3 year	5 year	10 year
S&P 500 Index	Large Cap Stocks	30.00	15.99	16.90	16.63
Russell 1000 Index	Mid/Large Cap Stocks	30.96	16.43	17.11	16.76
Russell 1000 Growth Index	Growth Stocks	27.32	22.00	22.84	19.68
Russell 1000 Value Index	Value Stocks	35.01	10.07	10.94	13.51
Russell 2000 Index	Small Cap Stocks	47.68	10.54	13.45	14.63
MSCI EAFE Index	Non-U.S. Developed Market Stocks	25.73	7.62	8.81	8.10
MSCI Emerging Markets Index	Emerging Markets Stocks	18.20	8.58	9.23	6.09
MSCI ACWI Ex USA Small Cap Index	Non-U.S. Small Cap Stocks	33.06	10.33	10.28	9.44
BofAML Preferred Stock Fixed Rate Index	Preferred Stocks	6.86	7.09	5.54	6.79
Barclays Municipal Bond Index	U.S. Municipal Bonds	2.63	5.06	3.26	3.87
Barclays Aggregate Bond Index	U.S. Bonds	-0.90	5.36	2.94	3.01
Barclays Intermediate U.S. Gov/Credit Index	Government/Corporate Bonds	-0.40	4.63	2.60	2.52
BofAML U.S. Treasury Master Index	Treasury Bonds	-3.60	4.94	2.24	2.28
BofAML U.S. Mortgage Backed Securities Index	Mortgage Backed Bonds	-0.46	3.92	2.21	2.42
BofAML U.S. Corporate Master Index	Corporate Bonds	1.84	7.42	4.63	4.93
BofAML U.S. High Yield Master II Index	High Yield Bonds	11.46	6.59	6.34	7.29
BofAML Convertible Bonds Index	Convertible Bonds	28.85	22.32	19.57	15.78
BofAML Euro Broad Market Index	European Bonds	-2.21	2.74	1.86	2.19
BofAML Local Debt Market Plus Index	Emerging Markets Bonds	3.10	5.42	3.33	1.93

Calendar Year % Returns (QTD, YTD as of 09/30/2021)

	QTD	YTD	2020	2019	2018	2017	2016
S&P 500 Index	0.58	15.92	18.40	31.49	-4.38	21.83	11.96
Russell 1000 Index	0.21	15.19	20.96	31.43	-4.78	21.69	12.05
Russell 1000 Growth Index	1.16	14.30	38.49	36.39	-1.51	30.21	7.08
Russell 1000 Value Index	-0.78	16.14	2.80	26.54	-8.27	13.66	17.34
Russell 2000 Index	-4.36	12.41	19.96	25.52	-11.01	14.65	21.31
MSCI EAFE Index	-0.45	8.35	7.82	22.01	-13.79	25.03	1.00
MSCI Emerging Markets Index	-8.09	-1.25	18.31	18.44	-14.58	37.28	11.19
MSCI ACWI Ex USA Small Cap Index	0.00	12.23	14.24	22.42	-18.20	31.65	3.91
BofAML Preferred Stock Fixed Rate Index	0.22	2.21	6.95	17.71	-4.34	10.58	2.32
Barclays Municipal Bond Index	-0.27	0.79	5.21	7.54	1.28	5.45	0.25
Barclays Aggregate Bond Index	0.05	-1.55	7.51	8.72	0.01	3.54	2.65
Barclays Intermediate U.S. Gov/Credit Index	0.02	-0.87	6.43	6.80	0.88	2.14	2.08
BofAML U.S. Treasury Master Index	-0.03	-2.71	8.22	6.99	0.80	2.43	1.14
BofAML U.S. Mortgage Backed Securities Index	0.05	-0.79	4.09	6.51	1.00	2.45	1.67
BofAML U.S. Corporate Master Index	-0.06	-1.12	9.81	14.23	-2.25	6.48	5.96
BofAML U.S. High Yield Master II Index	0.95	4.68	6.07	14.41	-2.27	7.48	17.49
BofAML Convertible Bonds Index	-0.83	5.89	55.68	23.06	0.68	16.03	11.94
BofAML Euro Broad Market Index	-2.29	-7.44	13.35	4.11	-4.39	14.61	0.37
BofAML Local Debt Market Plus Index	-2.52	-5.54	4.50	16.44	-4.90	14.71	6.53

How should you use the information provided in the table?

- The returns are not projections. They are historical. Future returns will vary.
- Annualized returns can generally be used to understand historical return trends.
- Calendar returns provide a general understanding of year-by-year return volatility.

Corporate Earnings

Year-over-year earnings growth for the S&P 500® is expected to be approximately 30.0% in the third quarter. The sustained strength in earnings growth for the third straight quarter is a testament to the extremely low base effects companies were building off from the depths of the pandemic. Outside of base effects, companies also benefited from revenue growth of 15.1% (year-over-year) and record high profit margins. Analysts are currently calling for the earnings party to continue in the fourth quarter of 2021, as well as for calendar year 2022. For the full year 2021, earnings growth is expected to be 43.2%, driven in part by revenue growth of 15.0%. 2022 is projected to remain robust, albeit not as strong from a year-over-year perspective considering a much higher starting point for comparison. 2022 earnings growth is anticipated to be 9.5%, along with revenue growth of 6.8%. See the earnings chart below.

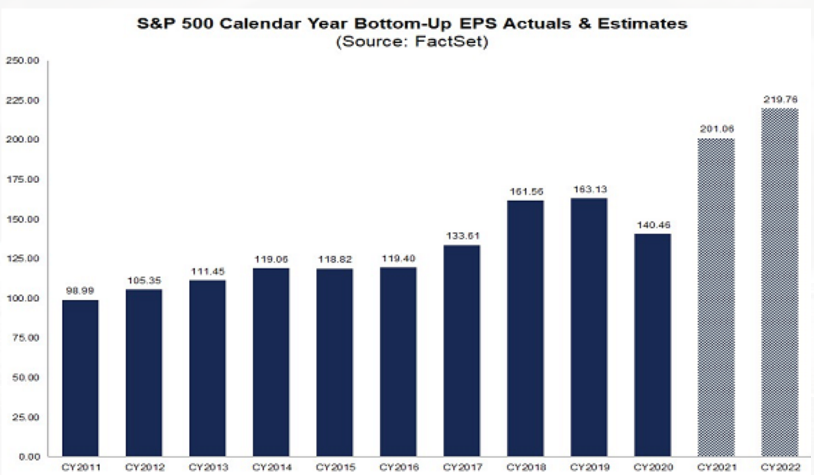


Chart courtesy of FactSet Earnings Insight

However, these projected earnings growth rates come with their fair share of risks. One of the primary risks in our opinion, is inflation. More specifically, persistently high levels of inflation. This is something that many businesses have not had to be overly concerned with for quite some time, and therefore, will be a central topic for much of our equity discussion this quarter. To be sure, inflation concerns did not "come out of the blue" in the third quarter, rather these concerns had been building gradually since mid-2020 as a result of the extraordinary actions from the U.S. Federal Reserve (Fed), along with massive amounts of spending by the government. The use of the word "transitory" was commonplace for much of the year to describe inflation, meaning that many economic forecasters and the Fed believed that any elevated levels of inflation that surfaced would only be temporary, the result of the economic shutdown and supply chain bottlenecks.

Charles (CJ) Batchelor, CFA
Chief Investment Officer – Equity

Summary

For the full year 2021, earnings growth is expected to be 43.2%, driven in part by revenue growth of 15.0%. 2022 is projected to remain robust, albeit not as strong from a year-over-year perspective considering a much higher starting point for comparison.

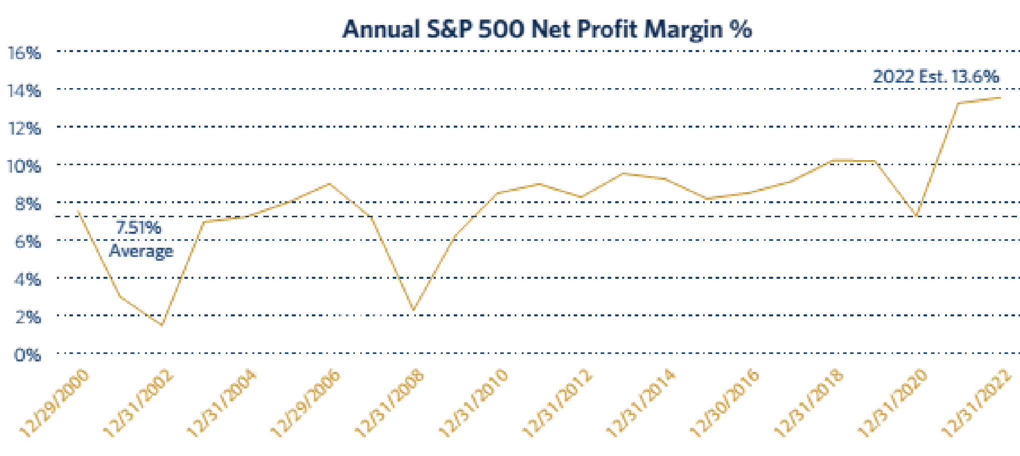
Thus far, businesses have largely been able to pass the increased costs along to consumers because demand has remained robust. However, what has become much more challenging for businesses from a cost standpoint going forward is a large labor shortage.

We believe value stocks (and cheap assets) should benefit from the on-going cyclical recovery around the globe and may also provide relatively better protection against inflationary pressures. Outside of the U.S., we have maintained a preference towards small- and mid-cap stocks in developed markets, and a relatively large investment in emerging markets equities.

In turn, as gas prices began to increase, and certain consumer goods edged higher, few people gave it more than a passing thought. And why would they? They were told that price increases were "transitory," and would moderate in short order.

Unfortunately, as months went by, it became apparent that price increases were not as "transitory" as many initially thought they would be, notably the Federal Reserve. Unlike short-term bouts of price increases in the past, which generally have come in the form of fluctuations in the price of energy, the recent period of sustained price hikes hit across a much broader range of goods and services. Home prices, cars, technology inputs (i.e. semiconductors), restaurants, gas prices, energy costs for businesses and homes, among many others, were impacted.

Thus far, businesses have largely been able to pass the increased costs from supply chain disruptions and rising commodity costs along to consumers without much fanfare because demand has remained robust. However, what has become (and will continue to be) more challenging for business costs going forward is navigating a large labor shortage. During the third quarter, the number of job openings in the U.S. rose to over 11 million. Meanwhile, the "quit rate" for employees increased to nearly 3% (employees job hopping). For businesses, there is only so long that companies can make do with the existing, reduced workforce, especially when the current environment is ripe for workers to look elsewhere for better pay or benefits. In the short run, the ability to pass costs on to consumers, and make do with their existing labor, has been a boon for profit margins. To be sure, corporate profit margins are forecast to hit a record high of 13.6% for 2022 (S&P 500®). This is approximately 80% higher than the average profit margin levels over the past 20 years. See the chart below.



Source: Bloomberg

In our opinion, with so many companies now scrambling to find workers, employee compensation only has one way to go from here. Up. We have already witnessed this at well-known companies such as Amazon, Wal-Mart, fast casual restaurants, across industries and among small and large businesses alike. The result has been large increases in hourly wages, to go along with signing bonuses as a way to attract new workers (or maintain their current workforce). From a worker perspective, this is excellent news. However, as investors, we are tasked with determining how changes in company fundamentals and metrics may impact future equity prices. From this standpoint, because labor is such a large component of company expenses, we believe corporate profit margins (in aggregate) only have one direction to go. Down.

How may a reduction in profit margins impact corporate earnings? Simply put, without a corresponding uptick in revenue growth, earnings may end up coming in lower than expected. The table to the right examines the potential impact to 2022 earnings based on various corporate profit margin levels.

2022 Net Profit Margin	2022 EPS Growth % vs. 2021
13.6%	8.7%
12.0%	-4.1%
10.0%	-20.1%
8.0%	-36.0%
6.0%	-52.0%

Table courtesy of Scharf Investments, LLC

As can be seen in the first row in the table above, current forecasted earnings growth estimates are banking on record profit margin gains, and an extended stay at record levels, for 2022 to achieve positive growth. However, if profit margins were to suffer, it could have an adverse impact on earnings growth. As we have discussed in previous newsletters, equity prices tend to follow the general path of corporate earnings over the long run, so if a decline in earnings were to occur, we would anticipate a more challenging period for the equity market.

One way for businesses to maintain, or grow, earnings despite lower profit margins would be to increase revenues. However, we believe there is a limit to how much revenues can increase from this point, especially if prices continue to rise, because consumers of goods will eventually become more cost conscious, which will result in demand destruction. This is why sustained levels of elevated inflation can become so dangerous – it results in a vicious feedback loop where prices increase, purchasing power erodes, and demand declines, which then triggers cost cutting from businesses in the form of labor, research and development, marketing, and other drivers of growth. These dynamics certainly do not occur all at once, or in rapid succession. However, it is important to remember that the equity market is a forward-looking mechanism. So, any potential negative changes to future earnings will be met with changes in underlying equity prices more quickly than what would occur if investors simply were to examine backward-looking economic data.

The current environment leaves the Fed in quite a predicament. It has been hesitant to withdraw liquidity or raise interest rates, even in the face of the largest increase in the consumer price index (+5.4% year-over-year) in 159 months, because of a desire to edge the economy back to full employment. The fear is that if it acts too quickly, it could result in an economic slowdown just as the economy regains its footing from the pandemic shutdown. So far, this posture has resulted in more persistent inflation. To say it's a delicate balancing act would be an understatement.

In summary, our opinion is that it will be a challenging time for many businesses, particularly from a profitability standpoint, as they face the prospect of continued inflation in the form of wage increases and input costs (if the Fed leaves elevated levels of inflation unchecked), or the possibility of reduced demand and higher interest expense (if the Fed is forced to withdraw liquidity and hike rates). Both paths pose significant challenges. At this juncture, we believe the Fed will continue to walk the tight rope of trying to say the right things to keep markets happy, while hoping that time will provide at least a partial solution to the inflation problem. One thing is clear at this point. The music is coming to an end, and decisions will need to be made. Those decisions will have consequences, many of which we do not believe will be viewed favorably by the market, notably by investors in segments of the market that have benefited disproportionately from historically easy fiscal and monetary policy. It is likely that speculation and investment gambling will diminish, and businesses that have been managed prudently will be rewarded at the expense of companies that have been managed with little more than hope and unfulfilled promises.

Market Valuation

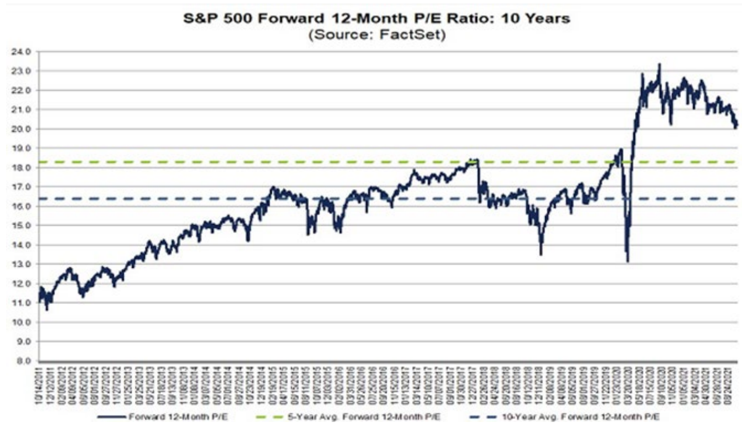
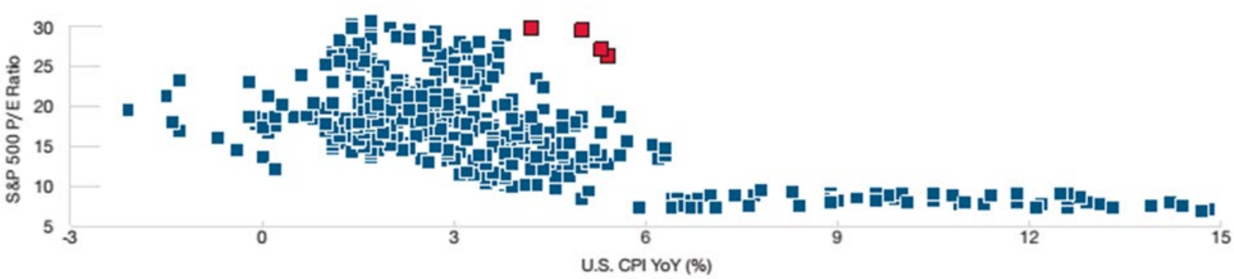


Chart courtesy of FactSet Earnings Insight

Even with the extraordinary earnings growth rates experienced so far this year, forward price-to-earnings ratios (P/E) have barely budged because of rising equity prices, speculative flows into equities and a positive outlook for future earnings. As a result, forward P/E ratios remain at historically high levels. See the S&P 500® forward P/E ratio chart to the right. The hope for many market participants (please remember that "hope" is not an investment strategy) up to this point in the market cycle has been that equity markets would be able to "grow into" their lofty valuations, meaning that earnings growth (the denominator in P/E) would increase at a significant enough rate to pull the entire ratio back to more reasonable levels. This may still occur if earnings continue to grow, prospects for future growth moderated and prices stabilized. This would result in stagnant, or at least less attractive, market returns than the recent past, but would also avoid a pronounced market downturn that would bring valuations closer to historic norms. This path could be achieved if the Fed and government are able to "thread the needle" between withdrawing liquidity and reducing spending (at least from initial expectations), while keeping elevated levels of inflation in check.

However, if inflation were to remain unchecked and continue at elevated levels, or increase further, it could necessitate a relatively larger (or sooner than expected) response from the Fed, which undoubtedly would be viewed as a negative by the market. This is because high levels of inflation have traditionally led the Fed to increase interest rates in an effort to "cool" the economy and get prices under control. The graph below looks at historical forward P/E ratios for the S&P 500® Index relative to changes in year-over-year U.S. CPI (consumer price index).



As of August 31, 2021.
Past performance is not a reliable indicator of future performance.
The chart shows month-end, YoY data from January 1978 through August 2021.
Sources: T. Rowe Price analysis using price earnings (P/Es) ratios (Standard & Poor's) of the S&P 500 (see Additional Disclosure) and U.S. CPI Urban Consumers YoY (U.S. Bureau of Labor Statistics).

The red boxes in the graph above show the most recent relationships between inflation (U.S. CPI) and the forward P/E ratio of the S&P 500® Index (April, May, June, July and August 2021). Given current levels of U.S. CPI, market valuations (forward P/E) remain historically high. This could be due to the belief by many market participants that current elevated inflation levels are transitory. However, if inflation proves to be more resilient and less transitory, market participants may quickly change their views on market valuation levels, especially if they lose confidence in the Fed's ability to "thread the needle" on getting inflation in check without negatively impacting economic activity. In this scenario, the Fed may be required to act sooner than they would like, which may result in rate increases. The rate increases would not negatively impact every industry or company to the same degree if this were to occur. As is always the case in markets, there are winners and losers. The chart below examines the S&P 1500® Index by industry groups (regression analysis) to determine which areas of the market are most sensitive to changes in the 10-year Treasury yield.

The bars above the "zero" line to the right represent industries that perform relatively well (compared to the S&P 1500® Index return) when interest rates increase, while the bars below the "zero" line to left represent industries that perform relatively poorly when interest rates increase (compared to the S&P 1500 Index return). Based on this analysis, so-called "value-oriented" or cyclical sectors such as financials, energy and industrials perform relatively well, while yield sensitive sectors such as REITs and utilities, and so-called "growth-oriented" sectors such as consumer discretionary and technology perform relatively poorly. In general, this has proven to be true in 2021. When the 10-year Treasury yield declined from 1.62% at the beginning of June to a low of 1.19% in August, growth-oriented stocks performed much better than value-oriented stocks. However, when the 10-year Treasury yield reversed course and increased over the last two weeks of the third quarter, value-oriented stocks outperformed growth-oriented stocks.

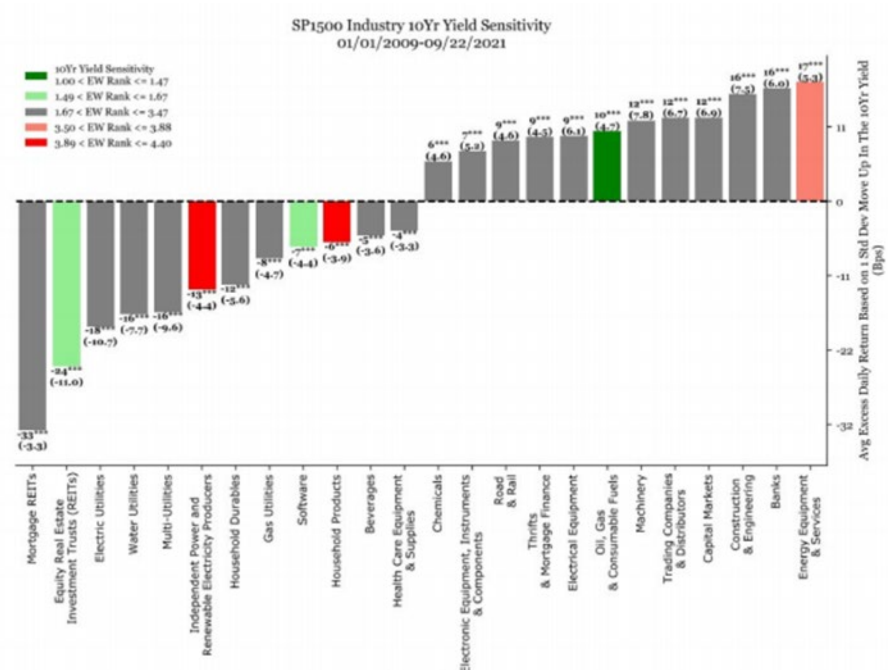


Chart courtesy of Renaissance Macro

We believe the potential for increased sensitivities of investing "styles" to factors such as inflation and interest rates is a key consideration moving forward, especially given the higher than usual uncertainty surrounding these factors. These factors may also help to provide investors with a "signal" as to when to expect a moderation in valuation differences between investment styles such as growth and value. Based on absolute and relative valuations, growth-oriented stocks remain at historically high levels. The chart on the top of the next page looks at valuations of growth stocks relative to value stocks going back to 1997. When the line is above the "zero" line, it represents periods when value stocks are relatively expensive compared to growth stocks, while the exact opposite is true when the line is below the "zero" line – growth stocks are relatively expensive compared to value stocks.

Equity Portfolio Comments

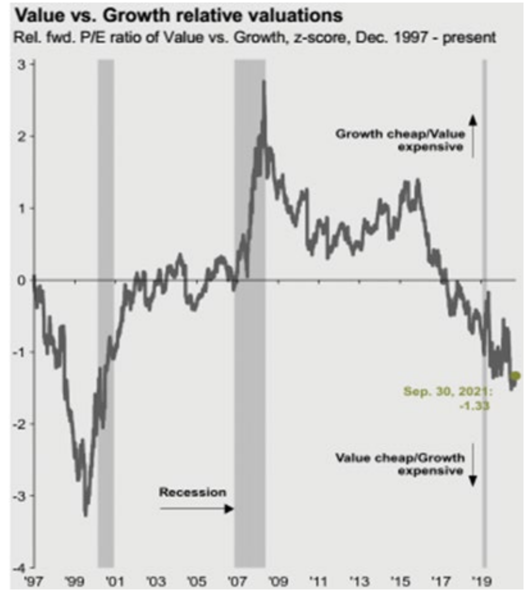


Chart courtesy of JP Morgan Guide to the Markets

At the present time, growth stocks remain quite expensive relative to value stocks. Tying valuations back to interest rates and inflation, growth stocks' relatively large valuation gains historically (multiple expansion) came during periods of low interest rates and inflation. If this were to change due to persistently high inflation, it may become a much more challenging period for investors in high growth businesses (in aggregate).

Another reason growth investors may be left with relatively weak results compared to value investors if this type of environment were to materialize is because of the broad makeup of so-called growth stocks. In a more challenging economic environment, with rising debt costs (increased interest expense), companies that have promised future growth, but have not yet delivered earnings to shareholders, may be at particularly high risk.

Chart courtesy of GMO LLC

The chart to the right looks at the Russell 3000® Growth Index and the percentage of companies in that index that currently have negative earnings. Well over 60% of companies in the index currently have no earnings. While this provides one piece of evidence as to the current speculative nature of the market, it also helps to bring to the forefront the potential risk of being highly exposed to money losing companies in a more challenging environment. This is because investors tend to look to the perceived safety of earnings during more difficult economic environments – stated differently, investors look to company fundamentals as opposed to storytelling. This is why the percentage of companies with negative earnings declined in each of the periods following the short-term highs noted in the red circles, most notably in the period following the tech boom/bust in 2000. Speculative, storytelling companies went out of business and were replaced by companies with earnings – something that investors demanded. Looking ahead, we believe relative performance between growth and value stocks will remain volatile in the near term but continue to think the longer-term trend will be in favor of value stocks.

While U.S. growth stocks are at historically elevated levels, other areas of the global market remain attractively priced (relative to the U.S. and to their own historical values), especially for investors with an investment horizon beyond next week. The chart below utilizes cyclically adjusted price-to-earnings ratios (CAPE) to examine various equity markets and regions across the globe. CAPE ratios are different from forward P/E ratios in that the measure looks at average earnings over a 10-year period, adjusted for inflation. Like many valuation metrics, it is a relatively poor indicator of short-term movements in stock markets. However, it is a useful tool to provide investors with a means of comparison across markets.

Each green "diamond" in the chart represents the corresponding country or region's CAPE value as of 5/31/21, while the bars (blue bars represent individual foreign countries and green bars represent developed and emerging regions and the U.S.) display the range of the CAPE value for each country or region over a 20-year period. The key takeaways from the chart include: 1) U.S. CAPE is at, or near, its 20-year high; 2) the U.S. is the most expensive market across the countries and regions shown; and 3) outside of the U.S., the other countries and regions shown are relatively inexpensive when compared to their own 20-year CAPE ranges. Similar to our views on U.S. growth and value stocks, we believe short-term relative performance between the U.S. market and foreign markets will remain volatile. However, we anticipate foreign markets to perform relatively better when viewed over a long-term investment horizon.

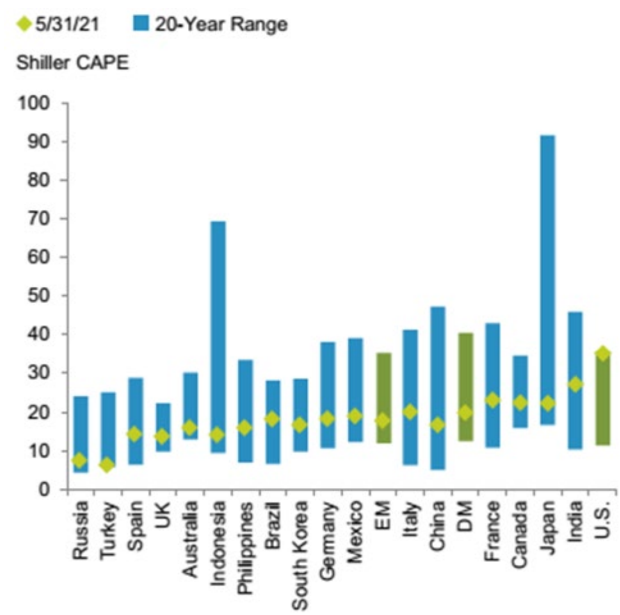


Chart courtesy of Fidelity Investments

<u>Outlook</u>

We believe one of the most effective ways to protect portfolios from inflationary risks is to buy cheap assets. As it relates to our discussion, cheap assets refer to assets that may have been (or continue to be) out-of-favor with investors for one reason or another, and therefore, has resulted in depressed prices when viewed in relation to their future earnings or growth potential.

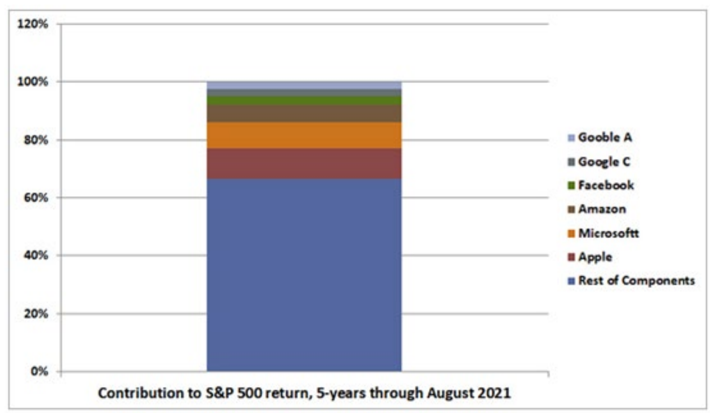
In the context of cheap businesses, these companies may not be in "hot" industries that capture daily financial headlines or offer investors the possibility of making a quick buck because of a "tweet" or post on a message board. Rather, many of these companies operate as businesses should, avoiding excessive leverage, making smart capital allocation decisions, and returning capital to shareholders when it is prudent to do so. While not exciting, these types of businesses tend to be able to grow their businesses at moderate rates, are successful in a variety of business environments and gain market share when less thoughtful and short-term oriented businesses falter. One good example of how we seek to invest in these types of companies would be our investment in a dedicated U.S. value manager.

In the context of cheap assets or sub-asset classes in equity markets, these may be assets or areas of the market that have been out-of-favor or misunderstood by investors, but which we believe have an attractive combination of growth, valuation and return potential based on our outlook for global markets and longer-term economic activity. Examples of this would include our investment in commodities and frontier equity markets in our firm's more eclectic strategy.

Equity Portfolio Comments

Areas of markets that have garnered significant attention, but which we will continue to avoid include asset classes and sub-asset classes that we believe have been inflated to extreme valuation levels, in part through artificial means such as Fed policy and government spending. We have seen this across both traditional (i.e. low quality, money losing U.S. growth stocks) and non-traditional asset classes (i.e. cryptocurrencies, collectibles, digital assets, to name a few), which have experienced rampant speculation and investment gambling. To demonstrate how excessive this "gambling" mentality has gotten, the *Financial Times* recently ran a story that discussed how gambling addiction recovery groups have seen a surge in calls from day traders seeking help. Needless to say, these types of behaviors are not indicative of healthy functioning markets. In turn, we will continue to eschew areas of the market that we believe are rife with speculation, lack attractive underlying fundamentals and are not in the best long-term interests of our clients.

From an equity return perspective, we also believe the next five years will be much different than the last five years. This is particularly true for the makeup of returns in the U.S. equity market where only 1% of stocks (i.e. 5 out of 500) accounted for over one-third of the S&P 500 Index cumulative return. See below.



Source: MorningstarDirect, S&P Dow Jones Indices, Research Affiliates

This does not mean the companies listed to the right are not good companies. It just means there is a significant difference between a good business and a good investment. At some point, price matters. As a result, we do not believe the five-year return profile of the S&P 500® Index is sustainable over the long-term given current valuation levels. Instead, we believe the return profile will widen out, which will provide "stock pickers" (individuals and investment strategies that focus on underlying company fundamentals relative to price) with a more fruitful environment for delivering attractive returns. Conversely, we believe passive investors (individuals that invest in market-cap weighted broad market indices such as the S&P 500® Index) will find it more difficult to generate attractive returns. In turn, we now have a smaller percentage of portfolios invested in passive, broad market equity investments than we did at the inception of our firm over five years ago.

As alluded to at the beginning of the outlook, we will continue to invest in areas of the market with a perceived margin of safety. A margin of safety does not mean assets do not have the potential to decline in value. However, we believe these assets may provide a relative degree of downside protection if markets were to decline when compared to speculative areas with much higher valuations. Among domestic equity investments, this means that we continue to favor value-oriented equities at the expense of high-growth, low quality (i.e. weak financial metrics), expensive equities. As we noted earlier, we also believe the best way to guard (on a relative basis) against persistently high inflation is to invest in so-called cheap assets. The line chart below provides an indication of how cheap U.S. value stocks are relative to their U.S. growth counterparts.

Based on GMO's Composite Valuation Measure, value-oriented stocks are quite inexpensive relative to history (4th percentile as of July 2021). Historically, growth stocks have traded at a "premium" to value stocks because of their higher growth characteristics.

As of 7/31/21 | Source: GMO

Composite Valuation Measure is composed of price/sales, price/gross profit, price/book, and price/economic book. Value and growth groups are both sliced over 12 months.

However, even when taking this "premium" into consideration, value-oriented stocks are at an approximate discount of 40% to their average historical relationship with one another. Examining the specific U.S. value manager that is currently owned in client portfolios, valuation metrics remain quite attractive despite strong gains since purchase. As of the end of the quarter, the manager's portfolio of investments had a forward P/E of approximately 10x, compared to the S&P 500® Index forward P/E of roughly 20x and the Russell 1000® Growth Index forward P/E of approximately 29x.

Among foreign equity investments, we continue to favor emerging markets equities and foreign small-/mid-cap stocks. Emerging markets equities were negatively impacted in the third quarter due to on-going concerns about China's property market. This tended to be a drag on emerging markets more broadly. However, the managers we have made investments in have minimal direct exposure (or no exposure) to the Chinese property market. In turn, while these markets may remain relatively volatile in the short-term, we continue to have a positive outlook for emerging markets more broadly, especially when viewed over a long-term investment horizon. On a more positive note, the foreign small-/mid-cap manager owned in portfolios continued to deliver attractive returns for shareholders. On this front, it is important to remember that we have constructed the foreign equity component of portfolios as a diversified group of investments. This means that the individual managers will inevitably perform differently in different periods because of differentiated investment strategies and areas of focus. Despite quarter-to-quarter and year-to-year volatility of these managers relative to one another, we believe the combination of these investments will produce relatively attractive returns for shareholders over the long-term.

While we view the aforementioned individual investments in a positive light when compared to the foreign equity asset class as a whole, we also view them favorably relative to domestic equity investments for the long-term. The table on the top of the next page displays various valuation and growth metrics for U.S. equity indices (S&P 500® Index for U.S. large-cap stocks and Russell 2000® Index for U.S. small-cap stocks) relative to their foreign equity counterparts (MSCI EM for emerging markets equities and MSCI World ex U.S. Small Cap for developed foreign small-cap stocks).

Equity Portfolio Comments

	S&P 500	MSCI EM	R2000	MSCI World ex US Sm Cap
Forward P/E	20.11	12.72	25.44	16.72
Price to Book	4.41	1.98	2.58	1.61
Price to Cash Flow	17.35	9.92	16.61	9.58
Price to Sales	2.98	1.63	1.59	1.14
Est 3-5 Yr EPS Growth (%)	15.28	17.87	16.96	17.80
5 Yr Dividend Growth Rate (%)	7.01	8.63	7.88	7.39

Source: FactSet courtesy of Eaton Vance Monthly Market Monitor - October 2021

From a valuation perspective, the MSCI EM Index is much more attractively priced compared to the S&P 500® Index across a variety of valuation metrics, and also displays more attractive intermediate growth rates (for earnings and dividends). A similar story can be seen when comparing U.S. versus foreign small-cap stocks. In aggregate, these stocks have more attractive valuation metrics and similar intermediate growth rates. As we have said in many prior newsletters, just because something is more attractively priced does not necessarily mean it will perform better in future periods, especially over the short run. However, over longer periods, valuation metrics do a much better job at providing clues as to the path of equity returns.

In summary, we believe value stocks (and cheap assets) should benefit from the on-going cyclical recovery around the globe and may also provide relatively better protection against persistent inflationary pressures. Outside of the U.S., we have maintained a preference towards small- and mid-cap stocks in developed markets, and a relatively large investment in emerging markets equities.

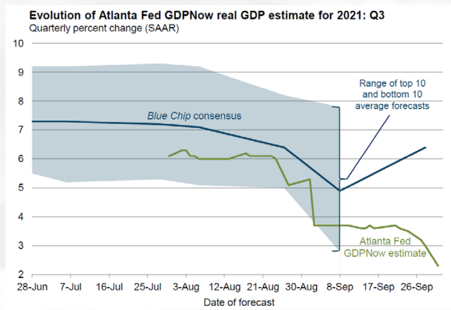
We anticipate there will be one or more notable changes in portfolios in the coming months. We will communicate these changes in greater detail with our clients as they occur.

Fixed Income Portfolio Comments

Economic and Policy Review

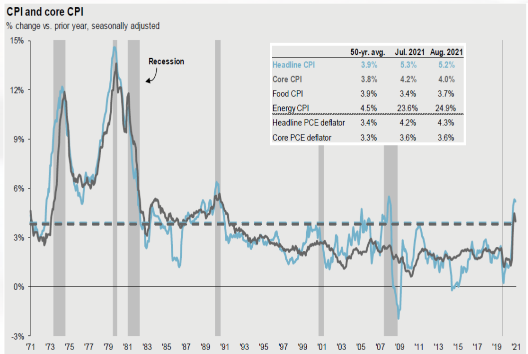
The U.S. economy continues to advance at a solid pace, but likely slowed in the third quarter as the delta variant caused unexpected disruptions. The Atlanta Federal Reserve GDPNow estimate suggests the economy grew between 2% and 3% during the quarter, which would be a meaningful decline from the 6% pace seen in the first two quarters of the year.

Under the hood, pandemic related distortions continued to affect the data. The unemployment numbers are a great example. Overall, the unemployment rate decreased to 4.8%, still above the 3.5% level seen pre-COVID. At the same time, the labor force participation rate is 1.5% lower than the peak levels seen early in 2020. Historically, this environment would suggest there is plenty of slack in the labor force to meet the growing demand for workers.



Source: Federal Reserve Bank of Atlanta

However, if we look deeper this may not be true. When examining the JOLTS (job openings and labor turnover survey) report there are many more job openings available than is typical given the same level of unemployment and labor force participation. This suggests many people are unwilling or unable to go back to work, likely arising from multiple factors including a lack of childcare, COVID fears, or favorable unemployment benefits. Some of these limitations may fade over time, but it's likely the labor force of today is fundamentally different than it was two years ago. If true, the labor market may be much tighter than current unemployment statistics indicate. Inflation is another good example. The consumer price index was up over 5% during the quarter. Supply chain issues are well publicized, including global factory shutdowns, backlogged ports, and parts scarcity driving prices higher. The U.S. Federal Reserve (Fed) believes these factors are temporary and will recede when



	50-yr. avg.	Jul. 2021	Aug. 2021
Headline CPI	3.9%	5.3%	5.2%
Core CPI	3.8%	4.2%	4.0%
Food CPI	3.9%	3.4%	3.7%
Energy CPI	4.5%	23.6%	24.9%
Headline PCE deflator	3.4%	4.2%	4.3%
Core PCE deflator	3.3%	3.6%	3.6%

Source: JP Morgan

Mike Peters, CFA
Chief Investment Officer – Fixed Income

Summary

The U.S. economy continues to advance at a solid pace, but likely slowed in the third quarter as the delta variant caused unexpected disruptions.

The improving labor market and elevated inflation data have given the Fed room to start tightening policy. It's expected it will begin tapering asset purchases later this year and start raising interest rates by mid-to-late 2022.

Securitized asset yields are low relative to history, but fundamentals are in a much better place, making them more attractive from a valuation perspective. Fundamentally, rapidly rising home and car prices have been beneficial to non-agency mortgages and asset-backed securities. In the agency mortgage arena, underwriting standards have also stayed robust.

COVID disruptions subside. The Fed sees inflation returning to a more tolerable level of 2-3% over time. However, the longer the COVID related disruptions fester, the higher the likelihood the temporary factors become ingrained in behaviors and expectations.

The improving labor market and elevated inflation data have given the Fed room to start tightening policy. It's expected they will begin tapering asset purchases later this year and start raising interest rates by mid-to-late 2022. On the fiscal side of the equation, the Biden administration is looking to provide further accommodation via an infrastructure and spending package. The final details are still being worked out in congress, but it's likely the rate of fiscal accommodation will be lower in 2022 than in 2021.

Over the short-term, it's likely the economy will reaccelerate in the fourth quarter as delta recedes and we claw back some of the missed opportunities from the third quarter. However, as we look out further (6-12 months), and take into consideration fiscal drag and monetary tightening, it's likely growth will decelerate in a meaningful way. Clouding the outlook even more is the likelihood of greater regulation and higher taxes, which may slow growth even further. Policy makers will have to manage the effects of all these factors converging at once, which will be extremely challenging. The risk of not tightening fast enough is burdensome for inflation. Conversely, if tightened too quickly it may cause a double-dip recession, exacerbated by the massive debt overhang that currently exists.

Fixed Income Market Review

Despite a volatile quarter, the U.S. Treasury curve (2–10-year yield differential) ended the quarter almost unchanged. The 10-year Treasury touched a low of 1.19% several times, before ultimately increasing 0.02% and finishing at 1.49%. The 2-year had a similar experience. It touched a low of 0.17% mid-quarter before ultimately ending 0.03% higher, finishing at 0.28%. Investment grade credit spreads had an uneventful quarter. Corporates, residential mortgages, commercial mortgages, and asset-backed securities all traded in a narrow range and finished the quarter slightly wider (0-7 basis points). As a reminder, one basis point equals 0.01%. High yield corporate bonds and emerging market debt, the lower quality sectors of the bond market, had a more eventful quarter. High yield corporate bonds traded in a 40 basis point range before ultimately ending 21 basis points higher. Emerging market debt also had a volatile quarter, finishing near the widest level of its 80 basis point range.

Fixed Income Performance Review

Despite the real-world drama in the third quarter, investment grade fixed income markets ended little changed. Returns generally were clustered around zero. The action occurred in the non-investment grade sectors. On the positive side, TIPS (Treasury Inflation Protected Securities) and high yield corporate bonds stood out, generating +1.75% and +0.89% returns, respectively. Emerging market debt stood out on the downside, producing a -1.57% return.

Option-Adjusted Spreads (in bps)

	12/31/20	6/30/21	8/31/21	9/30/21	1Mo Chg	Q3 Chg	YTD Chg
U.S. Aggregate Index	42	32	35	33	-2	1	-9
U.S. Agency (non-mortgage)	10	3	2	3	1	0	-7
Mortgage and ABS Sectors							
U.S. Agency Pass-throughs	39	27	33	27	-6	0	-12
U.S. Agency CMBS	44	25	30	29	-1	4	-15
U.S. Non-Agency CMBS	109	84	85	85	0	1	-24
Asset-Backed Securities	33	22	27	29	2	7	-4
Corporate Sectors							
U.S. Investment Grade	96	80	87	84	-3	4	-12
Industrial	101	83	90	88	-2	5	-13
Utility	106	93	100	96	-4	3	-10
Financial Institutions	83	71	76	75	-1	4	-8
Non-Corporate Credit	66	56	50	52	2	-4	-14
U.S. High Yield Corporates	360	268	288	289	1	21	-71
Emerging Market Debt	503	501	526	581	55	80	78

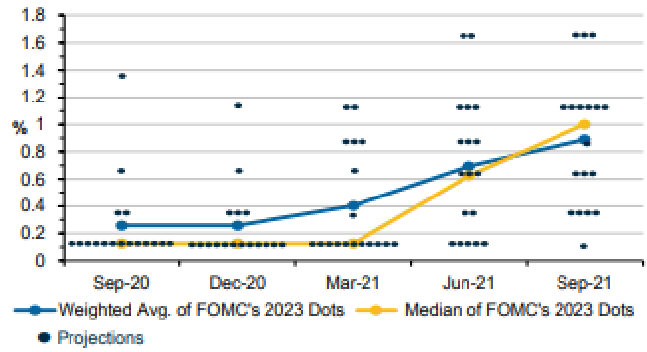
Source: Bloomberg Indices

Source: Baird Asset Management

Fixed Income Outlook

<u>Interest Rates</u>

Monetary policy continues to be highly accommodative with most COVID-era policies still in place. However, it's broadly expected the Fed will announce a gradual tapering of asset purchases during the fourth quarter. The implementation will likely start in December with new purchases ending sometime in the middle of 2022. The Fed doesn't plan to raise interest rates before asset purchases are removed, which means lifting off zero is likely a mid-to-late 2022 phenomenon. The current Fed dot plots suggest three rate hikes by the end of 2023 and two more in 2024. See below.



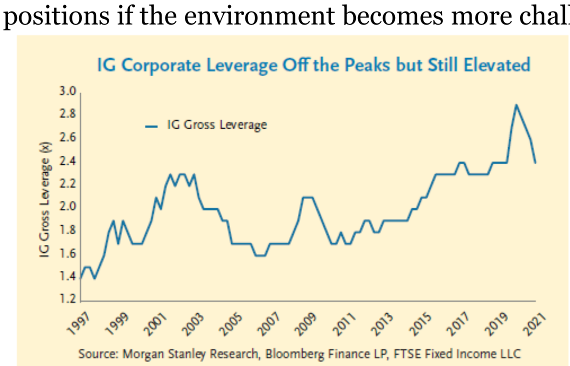
Source: PGIM Fixed Income and Bloomberg as of October 2021

The Fed has a difficult job in front of them as it tries to keep the economy growing while fighting inflation through the withdrawal of monetary stimulus. If it threads the needle, it's possible, but may be improbable, when taking into consideration the likely evolution of the fiscal and regulatory environments. If a challenge to growth becomes too great, it's likely the Fed will skew in a dovish (accommodative) direction based on precedent (even with the potential for a new chairman). Inflation can be painful but is a problem with a known solution. Taking everything into consideration, we believe interest rates will continue to drift higher with the U.S. Treasury yield curve continuing to steepen (the spread between short- and long-term interest rates getting wider). As a result, we continue to position client portfolios to have less interest rate risk than their investment policy statement (IPS) benchmarks. We prefer a more bulleted portfolio, focused on strategies with intermediate durations (3-7 years). Our approach is designed to capture yield while also playing defense against rising yields on the long end of the yield curve (10-30 years).

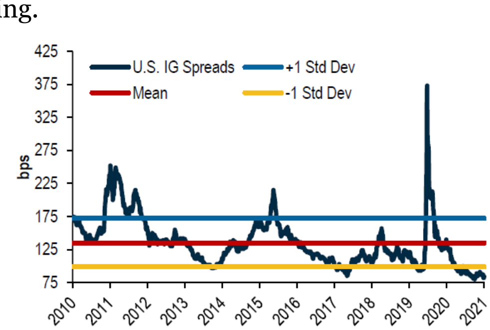
Corporate Bonds

Corporations have proven to be resilient throughout the pandemic recovery with better-than-expected earnings and free cash flow growth. While still elevated, gross leverage has recovered from the pandemic lows and is now in line with 2015-2019 levels (see chart on left below). Overall debt loads continue to be high, as companies issued massive amounts of debt to shore up balance sheets. Corporate debt-to-GDP has come down but is still well above pre-pandemic levels. Post re-opening, corporate credit metrics have improved, but on balance continue to suggest a late-cycle environment.

With yields hovering near 4.0% in high yield and 2.0% in investment grade, corporate credit does not offer adequate compensation for taking on excess risk (see chart below on right). As a result, we have positioned client portfolios near their IPS benchmarks from a corporate credit perspective. Most of our exposure comes from actively-managed mutual funds that have flexibility to reduce their positions if the environment becomes more challenging.



Source: Morgan Stanley Research, Bloomberg Finance LP, FTSE Fixed Income LLC



Source: Bloomberg as of October 2021

Fixed Income Portfolio Comments

Securitized Credit

Like corporate credit, securitized asset yields are low relative to history, but fundamentals are in a much better place, making them more attractive from a valuation perspective. Fundamentally, rapidly rising home and car prices have been beneficial to non-agency mortgages and asset-backed securities. In the agency mortgage arena, underwriting standards have also stayed robust. Gone are the days of loans with cheap teaser rates, negative amortization and 100% plus loan-to-value ratios. This bull market has primarily been driven by increasing demand due to the pandemic, and the desire for space coupled with a low supply of homes over the last decade. Together, these factors suggest the appreciation in home prices may be more durable this time around.

Most of our client portfolio yield advantage, relative to client IPS benchmarks, can be attributed to our overweight in securitized assets. We continue to gain exposure through diversified actively-managed mutual funds, which can add value through sector and credit selection.

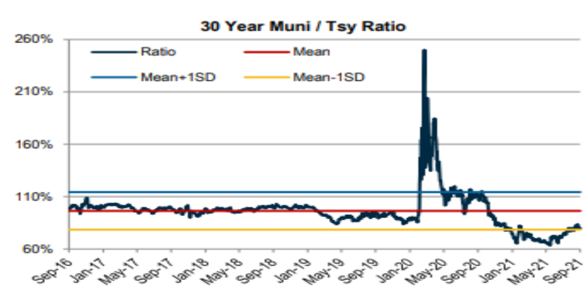
Non-U.S. Credit

Internationally, news out of China dominated the quarter. The likely default of property developer Evergrande, a potential Lehman Brothers-like moment for the Chinese markets, generated significant volatility. Based on initial reports, the government is likely to take steps to mitigate losses for domestic investors. Those offshore are not likely to fare as well.

Outside of China, many economies continue to improve as they recover from the virus. Several central banks are readying to withdraw stimulus to keep inflation in check, which may provide support to their currencies. Low- to negative rates still dominate much of the developed world, predominately in Europe and Japan, which make them unattractive from an investment perspective. Emerging markets continue to offer attractive opportunities, particularly when compared to other risky fixed income sectors. It is important to remain selective, as compensation and fundamentals vary greatly across the landscape. As a result, client portfolios are gaining exposure via actively-managed mutual funds where portfolio managers can be selective. Our intermediate and core plus strategies are gaining access though multi-sector and non-traditional bond funds, while our high-income strategies have a dedicated emerging markets fund.

Municipal Bonds

Short-dated municipal bond yields remained stable during the quarter, anchored by Fed rate policy. Long-dated municipal bond yields rose sharply in September, leading to higher rates and a steeper yield curve for the quarter. The rise in long-term tax-exempt yields exceeded the yield rise in comparable maturity Treasuries, which helped to improve the cross-market valuation. However, the 10-year and 30-year Municipal/Treasury ratios finished the quarter at 75% and 80%, respectively, which is still expensive historically (See chart below). As a result, municipal bonds no longer offer the attractive relative value they did in late 2020. However, because of their strong fundamentals and solid technical backdrop, we continue to emphasize them in our tax-aware strategies.



Source: PGIM Fixed Income and Bloomberg Indices.

Our Team

Bob Batchelor, CFA®, CFP®
CEO
Co-Founder

Bob J. Batchelor, CFA®, CFP® is Co-Founder and Chief Executive Officer of Entasis Asset Management. Bob has 22 years of experience in the investment industry. Prior to founding Entasis, Bob worked at Artisan Partners where he held a variety of roles including Head of Corporate Communications, Managing Director, Head of Marketing and Technology and Head of Marketing and Communications. He also served as a member of Artisan Partners Executive Committee. Before Artisan Partners, Bob worked at Strong Capital Management as Client Account Manager and Director of Investment Research and Communication.

Bob holds an M.B.A. from Marquette University and a B.B.A. from the University of Wisconsin-Madison. He has earned the right to use the CFA designation. Bob is a member of the CFA Institute and CFA Society of Milwaukee. Bob has also earned the Certified Financial Planner™ certification.

C.J. Batchelor, CFA®
CIO – Equity
Co-Founder

Charles J. (C.J.) Batchelor, CFA® is Co-Founder and Chief Investment Officer – Equity of Entasis Asset Management. C.J. has 17 years of experience in the investment industry. Prior to founding Entasis, C.J. worked at Cleary Gull, a multi-billion dollar investment advisory firm, as Director of Investment Research. He also served as a member of Cleary Gull's Investment Policy Committee, Investment Committee and Equity Strategy Group.

C.J. holds a B.B.A. in Finance from the University of Wisconsin-Milwaukee. He has earned the right to use the CFA designation. C.J. is a member of the CFA Institute and CFA Society of Milwaukee.

Mike Peters, CFA®
CIO – Fixed Income
Co-Founder

Mike Peters, CFA® is Co-Founder and Chief Investment Officer – Fixed Income of Entasis Asset Management. Mike has 17 years of experience in the investment industry. Prior to founding Entasis, Mike worked at Cleary Gull, a multi-billion dollar investment advisory firm, as Fixed Income Portfolio Manager. In his role he served as voting member of Cleary Gull's Fixed Income Strategy Group and Complement (Alternative) Strategy Group. Before Cleary Gull, Mike worked for several years at Madison Investment Advisors, a multi-billion dollar asset management firm, as a Fixed Income Analyst.

Mike holds a B.B.A. in Finance from the University of Wisconsin-Milwaukee. He has earned the right to use the CFA designation. Mike is a member of the CFA Institute and CFA Society of Milwaukee.

David LaCroix
Senior Financial
Advisor

David D. LaCroix is a Senior Financial Advisor at Entasis Asset Management. David has more than 49 years of experience in the investment industry. Prior to joining Entasis, David worked at Cleary Gull Advisors, a Johnson Financial Group Company, and Cleary Gull Inc., a prior affiliate of Cleary Gull Advisors, where he most recently served as Vice President, Relationship Manager responsible for high net worth clients. Before Cleary Gull, David worked in a variety of portfolio management and client relationship management positions with A.G. Edwards and M&I Capital Markets Group.

David received his M.B.A. and B.B.A. in Finance from the University of Wisconsin-Madison. He has served as a member of the Archdiocese of Milwaukee Investment Committee, as a Trustee for the Village of Shorewood and as Director/Treasurer of Milwaukee Summerfest.

IMPORTANT INFORMATION

Statements may be forward looking and are not intended as specific investment advice without further review of individual circumstances. Commentary, opinions, analysis, and recommendations may be subjective, do not guarantee future performance, and could change at any time without notice. Under no circumstances does the information contained within represent a recommendation to buy or sell any security. Charts and graphs provided are for illustrative purposes only.

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The **Dow Jones Industrial Average℠** is a price weighted index that measures the performance of thirty component large-cap U.S. stocks. The **S&P 500® Index** is a market capitalization weighted index that measures the performance of 500 leading companies in leading industries of the U.S. economy. The **Russell 1000® Index** measures the performance of roughly 1,000 U.S. large-cap companies. The **Russell 1000® Growth** Index measures the performance of U.S. large-cap companies with higher price/book ratios and forecasted growth values. The **Russell 1000® Value Index** measures the performance of U.S. large-cap companies with lower price/book ratios and forecasted growth values. The **Russell 2000® Index** measures the performance of roughly 2,000 U.S. small-cap companies. The **MSCI EAFE® Index** is a market capitalization weighted index that is designed to measure the performance of developed markets, excluding the U.S. and Canada. The **MSCI Emerging Markets Index** is a market capitalization weighted index that is designed to measure equity market performance of emerging markets. **The MSCI ACWI Ex USA Small Cap Index** is a market capitalization weighted index that represents the performance of smaller capitalization companies in developed and emerging markets excluding the U.S. The **Barclays Aggregate Bond Index** tracks the performance of intermediate-term government bonds, investment grade corporate debt securities and mortgage-backed securities with at least one year to final maturity. The **Barclays Intermediate U.S. Gov/Credit Index** tracks the performance of intermediate U.S. government and corporate bonds. The **Barclays Municipal Bond Index** is considered representative of the broad market for investment grade, tax-exempt bonds with a maturity of at least one year. The **BoAML Fixed Rate Preferred Securities Index** tracks the performance of fixed rate U.S. dollar denominated preferred securities in the U.S. domestic market. The **BoAML Treasury Master Index** tracks the performance of the direct sovereign debt of the U.S. Government. The **BoAML U.S. Mortgage Back Securities Index** tracks the performance of U.S. dollar denominated fixed rate and hybrid residential mortgage pass-through securities publicly issued by U.S. agencies in the U.S. market. The **BoAML U.S. Corporate Master Index** tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the U.S. domestic market. The **BoAML High Yield Master II Index** is a broad based index consisting of all U.S. dollar-denominated high-yield bonds with a minimum outstanding of $100 million and maturing over one year. The **BoAML All Convertibles All Qualities Index** measures convertible securities' performance of U.S. dollar denominated convertible securities not currently in bankruptcy with a total market value greater than $50 million at issuance. The **BoAML Euro Broad Market Index** gives exposure to euro-denominated investment grade debt publicly issued in the Eurobond or euro member domestic markets including government, quasi-government, corporate, securitized and collateralized securities. The **BoAML Local Debt Markets Plus Index** is a broad composite designed to track the performance of local currency sovereign debt of emerging markets countries. Past performance is no guarantee of future results. All indices are unmanaged. Investors cannot invest directly in an index. Index returns do not include expenses.

Investment Terms

Valuation levels are typically shown by calculating the price level of an index or a company relative to any number of characteristics of an index or company. For instance, the price-to-earnings valuation metric looks at the price of an index (or stock) divided by the total earnings of an index (or stock). Based on the multiple (in this instance, the multiple is how much investors are willing to pay – the price – for a given amount of earnings), it provides investors with a general sense of how expensive, or cheap, the overall market is at the present time. While there are a significant number of valuation metrics that are used in practice, and many ways to vary/modify the calculation of the price-to-earnings ratio, in this summary we are focused on the price investors are willing to pay (the level of the S&P 500® Index) divided by earnings expectations for the equity market (S&P 500 Index) over the next 12 months. This valuation metric is referred to as the forward P/E. A **yield curve** is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. A **basis point** is a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01% (0.0001). **Interest coverage** is a measure of a company's ability to meet its interest payments on its debt. **Federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. It is one of the most influential interest rates in the U.S. economy, since it affects monetary and financial conditions, which in turn have a bearing on key aspects of the broad economy including employment, growth and inflation.

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