Some Turbulence

We entered 2021 taking a balanced approach to most client portfolios with exposure to both growth and value stocks. As plans for a widespread vaccination program were rolled out, it seemed that the worst of the pandemic was behind us. Equity markets surged in the first half of the year as gross domestic product (GDP), consumer sentiment and industrial production all rebounded sharply from the self-imposed recession we experienced in 2020. The value side of the barbell jumped during the first five months of the year as many depressed travel, leisure, and restaurant focused companies saw improvements in demand. Growth companies, primarily in the technology area, then took the baton to drive the market to record highs in June through August.

Over the last 30 years, stocks have corrected by an average of 14% annually. Since the market bottomed in March of 2020, the S&P 500 has not experienced a retreat greater than 5%. Market rotations between growth and value stocks have driven many individual stocks into correction levels, but the overall index has remained strong. In September, the market declined nearly 5% due to uncertainty about the delta variant, the direction of interest rates, and budget policy discussions in D.C. As we enter the turbulent month of October, it seems another market rotation has begun. It is certainly possible that this period of weakness may persist and cause stocks to sell-off further toward the long-term average correction of 14%. Regardless, we view this as an opportunity.

The economy, as measured by GDP, surpassed its 2019 peak in the third quarter with consumer spending leading a very strong recovery. Investors are questioning the pace of economic normalization, but we still see low interest rates and solid fundamentals as an environment supportive for stocks. Growth rates will moderate in 2022 from very high levels this year, but consumer spending should remain robust benefiting both sides of our value vs. growth barbell.

Figure 1

2021 Performance by Sector

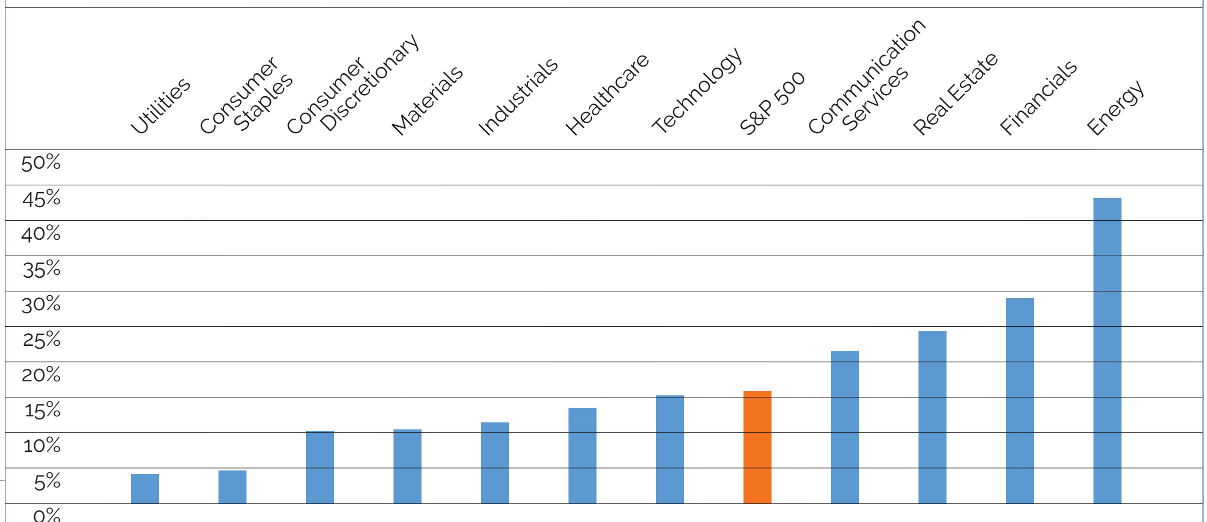


Figure 1 Source: Bloomberg. Data as of 9/30/21.

Inside

The S&P 500 reached a new all-time high on September 2nd, but then retreated by 5% to end the quarter basically flat. The Financials sector led the way this quarter and remains one of the top performing sectors for the year (see Figure 1). This group is highly correlated to interest rates and given the increase in the 10-year Treasury yield, the sector benefited. Laggards for the period included both the Industrials and Materials sectors, which have been impacted by larger than expected costs (shipping, labor, and commodities). Shipping ports have experienced major bottlenecks and many ships are anchored as they wait-in-line (see Figure 2). Interestingly, Covid cases seem to have been one of the leading causes for these bottlenecks, as certain ports have been closed due to infections. As infection levels now appear to have peaked, perhaps we have seen the worst of these delays and shipping costs should moderate.

As of the end of September, the S&P 500 was up 15.9% for the year. The traditional value sectors – Energy, Financials and Real Estate – have been the leaders all year. However, the more growth focused sectors – Technology and Communication Services – have also been strong performers after rallying this summer.

Figure 2

COVID Cases Have Led Vessels at Anchor by ~1 month

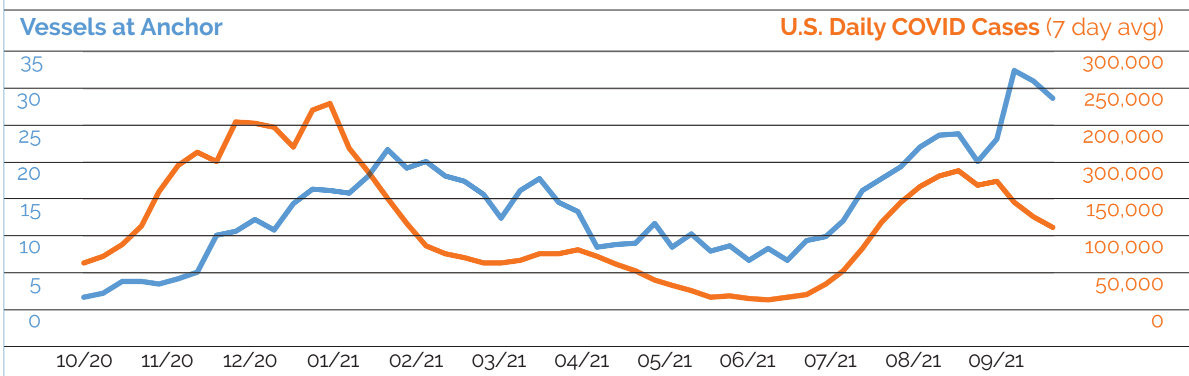


Figure 2 Source: Wolfe Research.

The End of Emergency Measures

The Federal Reserve and Congress acted quickly during the height of the pandemic in 2020 with enormous stimulus plans equal to 40% of GDP. These programs helped drive the V-shaped economic recovery we have experienced, but they also have stoked fears of inflation. Inflation as captured by Personal Consumption Expenditures (PCE) the Fed's preferred measure, is running at its hottest pace in nearly 30 years. Last quarter, we noted that many of the commodity inflation indicators we monitor seemed to be peaking and that eventually demand would slow, due to cost pressure. High prices along with slowing Chinese demand, resulted in significantly lower prices for many commodities in the third quarter (Figure 3). Vehicles are driving the bulk of the excess inflation today, as supply is constrained by the semiconductor shortage. Since we agree with the Fed that the supply chain should eventually catch up with demand, albeit with an uncertain timing, we also think the Fed's plan to begin to end emergency measures is a prudent move.

Since June 2020, the Fed has been making monthly purchases of $80B in Treasury bonds and $40B in agency mortgage backed securities. These moves helped drive interest rates to record lows. However, during the third quarter, Fed Chairman Jerome Powell managed market expectations towards a reduction (tapering) in the monthly purchases of these securities. As early as June, he introduced the concept of "talking about talking about tapering." Such gentle language was designed to avoid the "taper tantrum" of 2013 when Powell, as a new Fed board member, watched the markets become illiquid following casual comments made by then Fed Chairman, Ben Bernanke. Powell describes his memory of the taper tantrum as a "scar" heavily influencing his currently timid, but so far effective, approach.

As the quarter progressed, Powell transitioned from vaguely talking about tapering to saying in September that a moderation in the pace of asset purchases may soon be warranted. Interest rates, as measured by the 10-year treasury, began to firm at the end of the quarter, which perhaps sparked the

Figure 3

Inflation Indicators

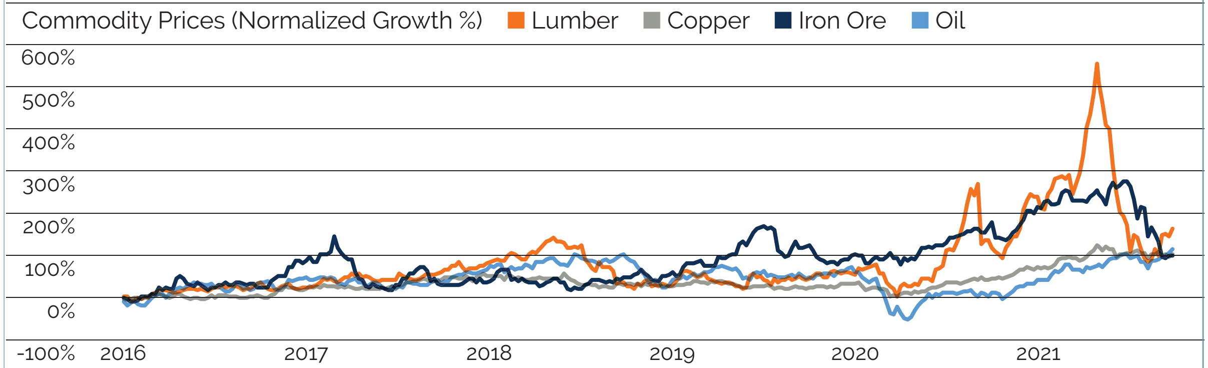


Figure 3 Source: Bloomberg. Data as of 9/30/2021.

latest market rotation we are experiencing. Expectations have now priced in the likelihood of tapering being introduced to the market during the next Fed meeting in November.

Tapering is expected to take about eight months to eliminate bond buying altogether. Once complete, and if the market continues to exhibit conditions which support growth, the Fed will begin to talk about raising short-term interest rates. Under current Fed thinking, this event will most likely take place late 2022 or early 2023.

Course of Action

We mentioned last quarter that we were beginning to tilt the positioning of the barbell back towards growth. During the third quarter, we continued this shift and exited some consumer-focused recovery stocks where we felt the "value" in the investment had been recognized.

Although we reduced our exposure in consumer recovery plays, client portfolios still have significant exposure in the Consumer Discretionary sector, as we expect robust consumer spending to drive this economic recovery forward. The pandemic has resulted in strong long-term trends for more goods being sold online and electronic payments being used in this process.

Given the most recent market rotation, we were able to increase our exposure in some attractive investments, specifically in the Technology sector. As we mentioned last quarter, we believe we are at an inflection point for technology adoption, with the transformation in digital spending accelerating at a double-digit pace worldwide. We see a long runway for this secular trend as the pandemic forced many users to adopt new technologies even faster than expected.

One Team

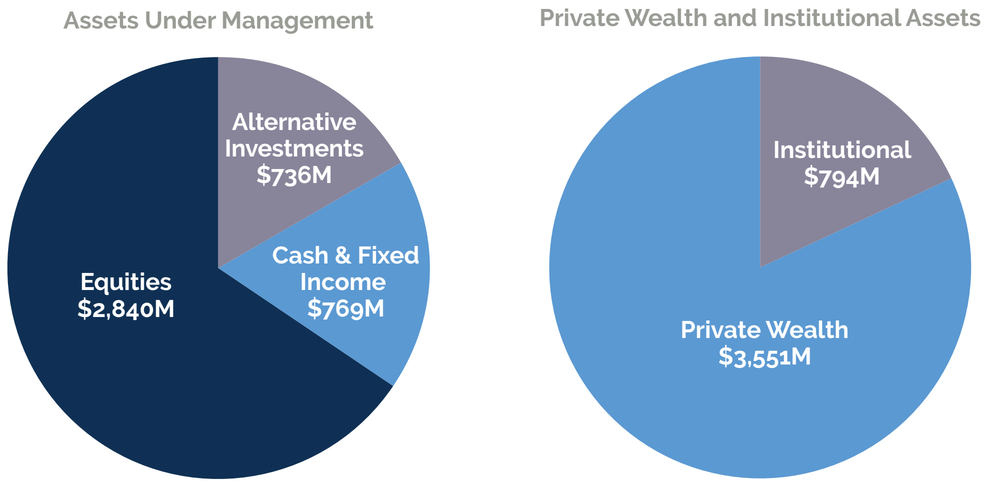
Our firm was founded in 1967. Many of our clients have been with us for decades, while others are relatively new. Over the years, we have continued to adjust our investment process to adapt to ever-changing market factors. In light of the unique times in which we are living and working, we thought all of our clients would appreciate an update.

Inverness actively manages $4.3B in client assets (see Figure 4). Roughly $800M of these assets come from institutional clients (pension funds, endowments, etc.), while the remaining $3.6B represent our work with private clients (individuals, families, trusts and foundations). More importantly, however, we have one investment team that focuses on managing all of these assets.

Team members who focus on our institutional clients have always used individual stocks and bonds to manage these portfolios. They are supported by four analysts who conduct extensive research on many companies to provide equity and fixed income recommendations. Many of these institutional team members also work with private clients. Although we manage customized portfolios based on client preferences, legacy holdings, risk tolerance and taxes, many of the holdings we own in the institutional portfolios are also held in private client portfolios. This is because we want to make

Figure 4

Client Assets as of September 30, 2021



sure all of our clients are exposed to our best thinking, requiring the entire investment team to meet numerous times a week to discuss company and market updates. Lastly, our overall investment approach is supported by technology that allows us to manage hundreds of accounts in an efficient manner, with a dedicated trading department that focuses on the best execution for portfolios.

Our approach is to invest in a core group of companies that we believe will create long-term value for shareholders. We look to invest in high quality companies with durable business models that we can own for many years. We also strive to express conviction in portfolios, evidenced by a concentrated number of total holdings.

Our team works to recognize long-term secular themes and narrow the universe of investment options, identifying a list of growth leaders with the potential for positive changes relative to consensus expectations. Individual positions are thoroughly analyzed and evaluated for a variety of criteria, including strong fundamentals, sustainable competitive advantages, superior management teams, and reasonable valuations (see Figure 5). Our focused process allows for a constant review of the investment thesis and a consistent sell discipline when important triggers occur.

Figure 5

Our Investment Process

Quantitative Screening

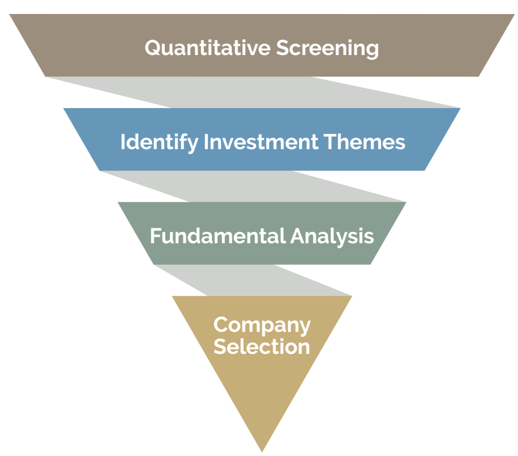
- High-quality earnings and cash flow growth
- Reasonable Valuation Metrics
- Areas we avoid: slow/no growth, excessive financial leverage, low ROIC, low profit margins, lack of operating history

Identify Investment Themes

- Industry growth leaders
- Sustainable competitive advantages

Fundamental Analysis

- Potential for positive changes
- Strong financial position
- Proven management team



Having a disciplined investment process in a rapidly changing environment has been very beneficial to portfolios over the last two years. Our investment team rapidly adapted to the situations with which we were presented – a global pandemic, the fastest S&P meltdown in its history, a V-shaped recovery and multiple market rotations to navigate. It is also critical to point out that one of the most important components of our research process is assessing the quality of management at the companies in which we invest. In the same way that our clients trust us to manage portfolios and adjust to the environment, we must trust the management teams of the companies in which we invest to do the same.

The Inverness Emissions Alpha Portfolio — A Differentiated Approach

Our disciplined investment process together with our focus on management teams paved the way for the launch of the Inverness Emissions Alpha Portfolio ("The Emissions Portfolio"). The strategy was developed to meet many of our clients' investment interests in companies that are adapting their businesses to address climate change.

Our Emissions Portfolio takes a differentiated approach that aims to quantitatively rank and invest in S&P 500 constituents based on their fundamental qualities versus the emissions generated from their respective operations. The process ultimately seeks to identify businesses that can produce more profits with less pollution than their peers.

The Emissions Portfolio couples well with our traditional investment strategy two-fold:

First, businesses that have sound fundamentals typically rank higher in this process than those that do not. In effect, the ranking system aims to invest in higher quality businesses like those that our traditional bottom-up process produces.

Second, businesses that tend to score higher, typically have superior management teams. The bias towards exceptional management teams becomes obvious once a deeper analysis is conducted. Companies with quality fundamentals and low relative emissions are born from well-run companies whose management teams can thoughtfully invest for the future. Businesses that are poorly run, which is typically evident in poor fundamentals and emissions, invest most of their time and resources reacting to emergencies.

Focusing on emissions efficiency has provided a unique lens for our investment team. For clients that are focused on climate change, we now have an offering that aligns with their interests. More broadly, we are using this approach to help validate the qualitative measures we have historically used to identify a successful quality management team – a critical component for long-term investment.

Important Disclosure Information

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Inverness Counsel, LLC ["Inverness"], or any non-investment related content, made reference to directly or indirectly in this commentary will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this commentary serves as the receipt of, or as a substitute for, personalized investment advice from Inverness. Please remember to contact Inverness, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services, or if you would like to impose, add, or to modify any reasonable restrictions to our investment advisory services. Unless, and until, you notify us, in writing, to the contrary, we shall continue to provide services as we do currently. Inverness is neither a law firm, nor a certified public accounting firm, and no portion of the commentary content should be construed as legal or accounting advice. A copy of the Inverness' current written disclosure Brochure discussing our advisory services and fees continues to remain available upon request or at www.invernesscounsel.com. **Please Note:** *if you are an Inverness client,* **please advise us** if you have not been receiving account statements (at least quarterly) from the account custodian.