CAPITAL ADVISORS

Key Points

- Two important developments since our last quarterly *Overview* include the Biden-to-Harris cut-and-paste in the presidential election, and the "official" pivot to easier monetary policy at the Federal Reserve (Fed).
- Regarding the election, the most consequential investment implications seem likely to fall within the policy categories of Taxes, Trade, and Regulation.
- Neither candidate seems to care about the budget deficit or the national debt, but we hold out hope that the worst ideas of either candidate would be blocked by congress or the courts.
- Whoever wins in November must navigate an early test of the Nation's fiscal trajectory due to the scheduled sunsetting of the 2017 tax law that will require renegotiation by the end of 2025.
- Regarding monetary policy, the Fed confirmed its pivot to an easing cycle when it lowered the upper bound of its policy interest rate target by half a percent on September 18th, from 5.5% to 5.0%.
- Short-term interest rates are likely on a glide path toward 3% +/-, which is the Fed's best guess regarding the "neutral" setting for monetary policy.
- Historically, monetary easing cycles have coincided with favorable returns in the stock and bond markets, however, past easing cycles typically began when stocks were depressed due to a recession or financial panic – which is not the case today.
- We acknowledge that easier monetary policy is way better than the alternative, but we caution against using past market patterns to guide expectations for the current period due to the unusual pre-conditions of the current policy pivot – no recession, no financial panic, stocks near an all-time high.

Thoughts on the Election

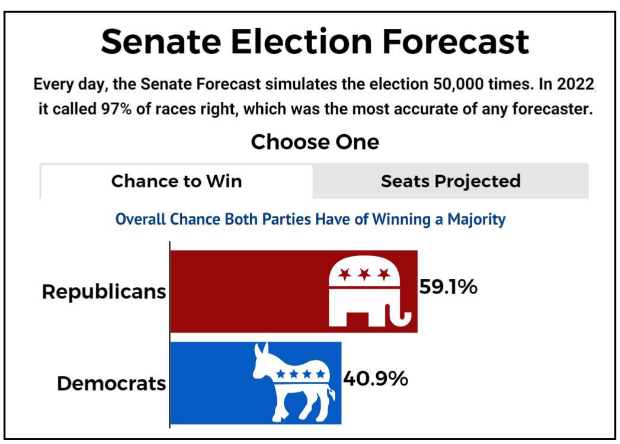
We wish to establish up front that we are making investment decisions under the assumption that life will go on after November 5th, regardless of which tribe wins the elections. Our attitude is shaped by a belief that the dumbest ideas of both presidential candidates would be checked by Congress or the courts.

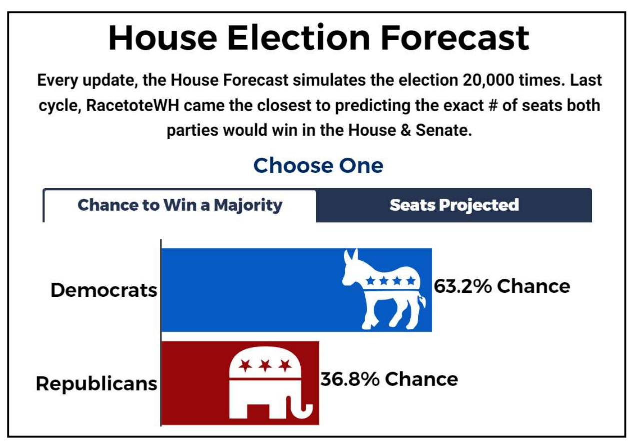
Even so, elections have consequences, and we suspect the most relevant *investment* considerations stem from the two parties' divergent ambitions for tax policy, trade, and regulation. We highlight these three categories because tax policy can have a direct influence on investment values, whereas trade and regulatory policies offer the president considerable leeway to operate outside the bounds of Congress.

Tax Policy

Tax policy will be a major topic throughout 2025 due to the scheduled sunsetting of the 2017 tax law that reduced tax rates substantially for households and businesses. If nothing is done to extend or modify the 2017 law, tax rates will rise for most households after next year, an outcome both parties say they do not want. The reduction in corporate taxes does *not* sunset automatically, but it is widely expected to be included in the negotiating process.

The profile of Congress and the white house may have a material impact on the future shape of tax policy, but we expect the checks and balances of our divided government and legal system can prevent either party from imposing a radical revision of the tax code, even in the event of an electoral sweep by either party. We base this hopeful forecast on the unlikelihood that either party will achieve a filibuster-proof majority in the senate based on the latest readings from polling data and betting markets.[1]





Source: www.racetothewh.com

[1] "Betting Markets" refers to online marketplaces like www.predictit.org where people wager real money on the outcome of elections and other current events. Prices in betting markets have demonstrated non-trivial predictive value in the realm of politics over the years since these markets have developed.

In considering what-ifs on tax policy, we suspect a Trump presidency would result in a tax regime that rhymes with current policy by extending much of the 2017 tax law beyond the sunset. We assume a Harris white house would pursue higher tax rates for corporations, high-income households, and capital gains, but the magnitude of any increase should be limited by Congress, in our view, even if democrats achieve a narrow majority.

One way to hedge against a possible increase in the corporate tax rate is to increase the allocation to companies domiciled outside the U.S. within an equity portfolio. This was a consideration behind the recent additions of **Mercadolibre (MELI: ~$2,055)** and **Sea Limited (SE: ~$96)** to the *Managed Equity Growth* strategy, both of which operate predominately outside the U.S. market.

Another investment consideration related to tax policy is the treatment of highly appreciated securities. For people who expect to harvest gains from their equity portfolios over the next handful of years, it might make sense to pull some stock sales forward into 2024 if an increase in the capital gains tax seems more likely after the election.

In the fixed income markets, tax-free municipal bonds would look more attractive to high-income investors if tax rates rise after the elections. We consider tax-equivalent yields in the municipal bond market to be attractive today, even without the assumption of higher income tax rates in the future.

Trade Policy

We believe Trump's campaign proposal to impose tariffs of 10%-20% on all imported goods would *not* be well received by the asset markets or the economy. Beyond the uncomfortable reality that our trading partners can retaliate with punitive trade restrictions of their own, tariffs of this magnitude would impact the domestic economy like a tax increase by raising the cost of products that include foreign inputs somewhere in their supply chain, which is almost everything. Since tariffs raise the cost of consumption, rather than taxing income, they are a highly regressive form of taxation borne disproportionately by the lowest-income households.

Defenders of Trump's trade proposal often claim it is just a negotiating tactic. Perhaps it is, but unlike tax policy, the president has far more leeway to execute trade policy outside the purview of Congress, so the investment risk of a disruptive trade agenda cannot be dismissed, in our view.

Vice president Harris has also revealed protectionist tendencies on trade policy as part of the Biden administration, but we assume her approach to trade restrictions would be more selective than the across-the-board philosophy being promoted by Trump.

Regulation

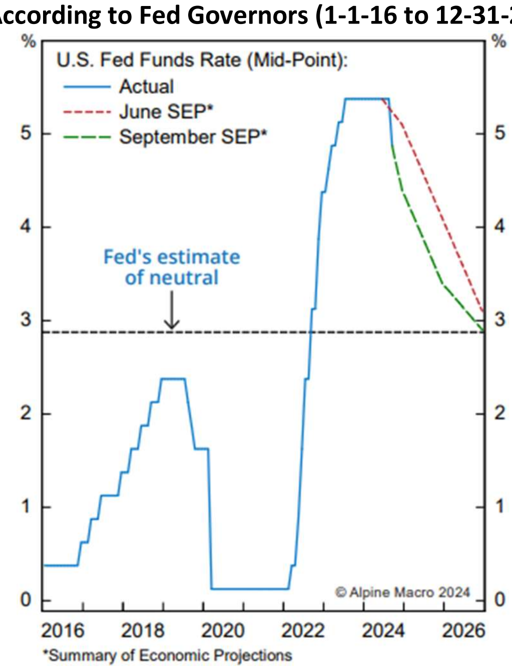
Whereas a Trump presidency may present more risk in the realm of trade policy, we suspect a Harris presidency would be more problematic for regulatory policy. It is not an original insight to suggest the private sector prefers less regulation to more. Trump was helpful on this front during his first term in office, and a return to his lighter touch philosophy on regulation would be well received by the business sector and the asset markets, in our view.

While we suspect a Harris presidency would pursue a more heavy-handed regulatory policy than Trump, her freedom to operate may be curtailed somewhat by the Supreme Court's recent decision to end the adherence to the so called "Chevron Doctrine," which said the courts needed to defer to the expertise of regulatory agencies when a law passed by Congress was unclear. Interpretations of this ruling seem to agree it should limit the enforcement power of government agencies relative to the environment of the past 40 years.

Interest Rates Headed to "Neutral"

On September 18th the Federal Reserve reduced its policy interest rate by 0.50% to a new range of 4.75%-5.0%, marking the official pivot to a monetary easing cycle. Much was made of the Fed's decision to cut rates by a half-percent, instead of its customary quarter-point moves, but we don't think the distinction is particularly relevant. What matters for investors is that short-term interest rates are headed lower, and the likely resting place should be 3.0% +/- based upon forward projections provided by the Fed Governors themselves. The message from the Fed is that the neutral setting for short-term interest rates is approximately 3.0% and we are on a path to get there by the end of 2026.

The Path to Neutral
According to Fed Governors (1-1-16 to 12-31-26)



Source: Alpine Macro

Financial market returns have typically been quite favorable for stocks *and* bonds during past rate-cutting cycles, and the markets' early response to the current cycle suggests an expectation for more of the same this time around. Our outlook is more subdued. This is not to say we are negative – lower rates are far better than the alternative for financial markets – but we are framing our investment decisions around a less robust outlook for stocks and bonds from today's starting point.

Historically, Fed rate-cutting cycles begin when the stock market is depressed due to a recession or a financial panic of some sort. In contrast, the current easing cycle coincides with a stable economy and stocks hitting all-time highs.

In the fixed income markets, investors can still lock-in attractive interest rates relative to the likely resting place for short-term rates in a year or two, but bond markets have already discounted 250 basis points of rate cuts for this cycle,[2] leaving little room for *incrementally* lower yields on intermediate and longer-maturity bonds unless the Fed cuts rates well below 3.0%, which would require a recession, in our view.

Current Design of Our Investment Strategies[3]

The remainder of this report addresses the current positioning of each of our investment strategies under current macro conditions. The specific design of *your* portfolio is customized to match your return objectives and risk tolerance. **For a refresher on how your portfolio is designed, and why, please reach out to your Wealth Advisor any time.**

ASSET LEVEL	Based on your investment objectives and risk tolerance, we set parameters for an optimal stock/bond mix. Instead of keeping your portfolio at a stagnant allocation, we have the ability to change the stock-to-bond-to-cash ratios as market conditions change.
PORTFOLIO LEVEL	By understanding the types of portfolios/accounts we're managing, we structure each portfolio to fit its stage in the investment life cycle (accumulation vs. distribution). We also take into account legacy positions and/or outside assets.
STRATEGY LEVEL	By understanding your optimal asset allocation range and the types of portfolios being managed, we determine how our specific strategies should be combined. We utilize both fundamental and tactical strategies to help take diversification one step further.
SECURITY LEVEL	Our team of CFA charter holders performs deep research behind each security selected and provides rationale for trades. We strive to position your portfolio for prevailing market conditions to participate in long-term trends.

[2] Source: Alpine Macro; Bloomberg

[3] The portfolio strategy discussions in this section are supplemental to a compliant GIPS Report. A complete list of Capital Advisors' portfolio models and compliant presentations are available by contacting Capital Advisors.

Managed Equity Strategies

Valuations, liquidity, and the economic outlook; these three, related things define the equity market at the moment. In sum, the adjectives for each are elevated, supportive, and sensitive. Let's take them in order:

<u>Equity Market Valuations</u>

High systemic liquidity, near-record corporate profit margins, strong balance sheets, and valuable innovation cycles justify higher valuations. The absolute level however makes the market vulnerable to more significant volatility and impacts the near-term risk-reward outlook. The S&P 500 PE is 22x, meaningfully above the post-Cold War 16x-17x "norm" (median) and not far off the post-Tech Bubble high of 25x-26x.

Source: Bloomberg

Last quarter, we discussed that the equal-weighted S&P 500 PE was in line with the ~17x historic "norm." That situation changed this quarter. Most of the Mag-7 stocks underwhelmed between June 30 and September 25 - with the notable exceptions of **Meta (META ~$568)** and **Tesla (TSLA ~$254)** - and the quarter featured a significant rotation towards the other 493. The equal-weighted S&P 500 PE is now 19x, near the highest it has been since the COVID period.[4]

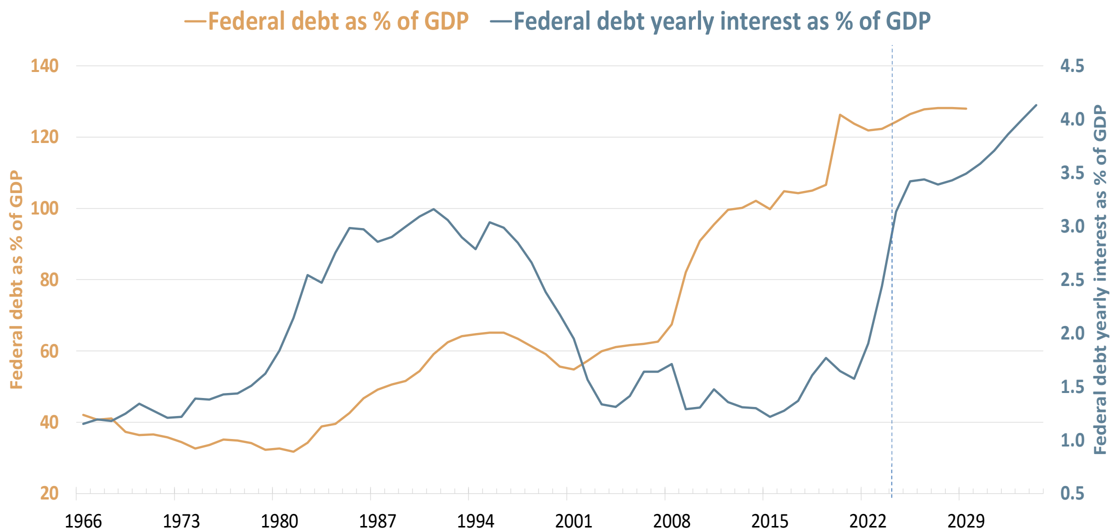
<u>Systemic Liquidity & Non-U.S. Additions</u>

The global financial system remains highly liquid which supports valuations. Deficit fiscal spending remains high (next page top), and the Fed drained the money supply only to pre-COVID levels before embarking on another rate-cut cycle (next page bottom).

[4] Source: Bloomberg.

U.S. Federal Debt vs. Interest on the Debt

Jan. 1966 through Dec. 2023

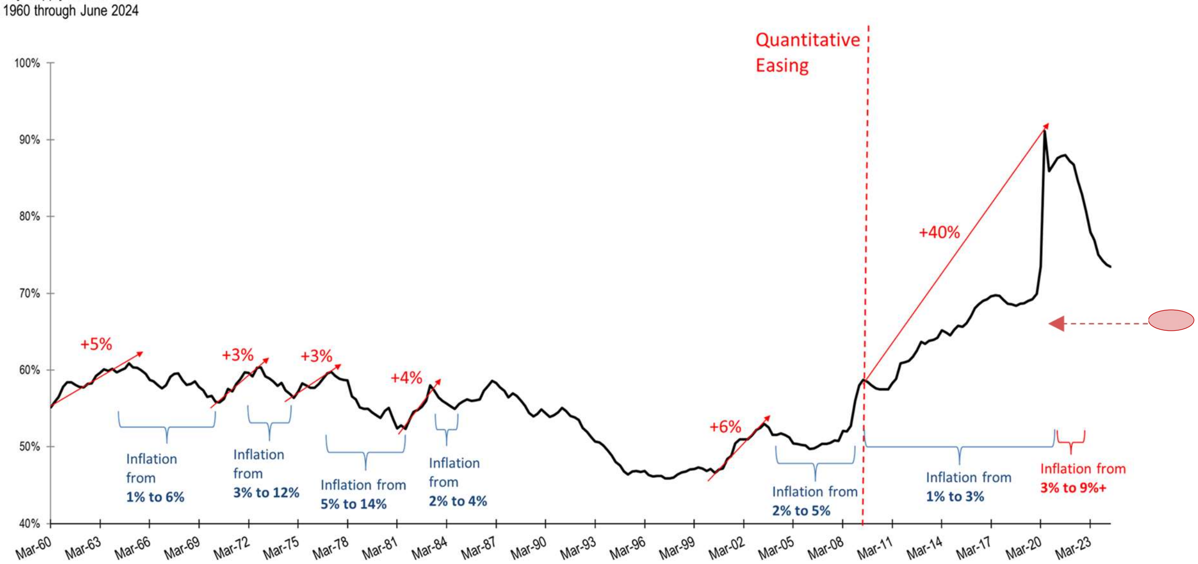


Source: Bloomberg

Money Supply and Inflation

M2 Money Supply as % of GDP

March 1960 through June 2024



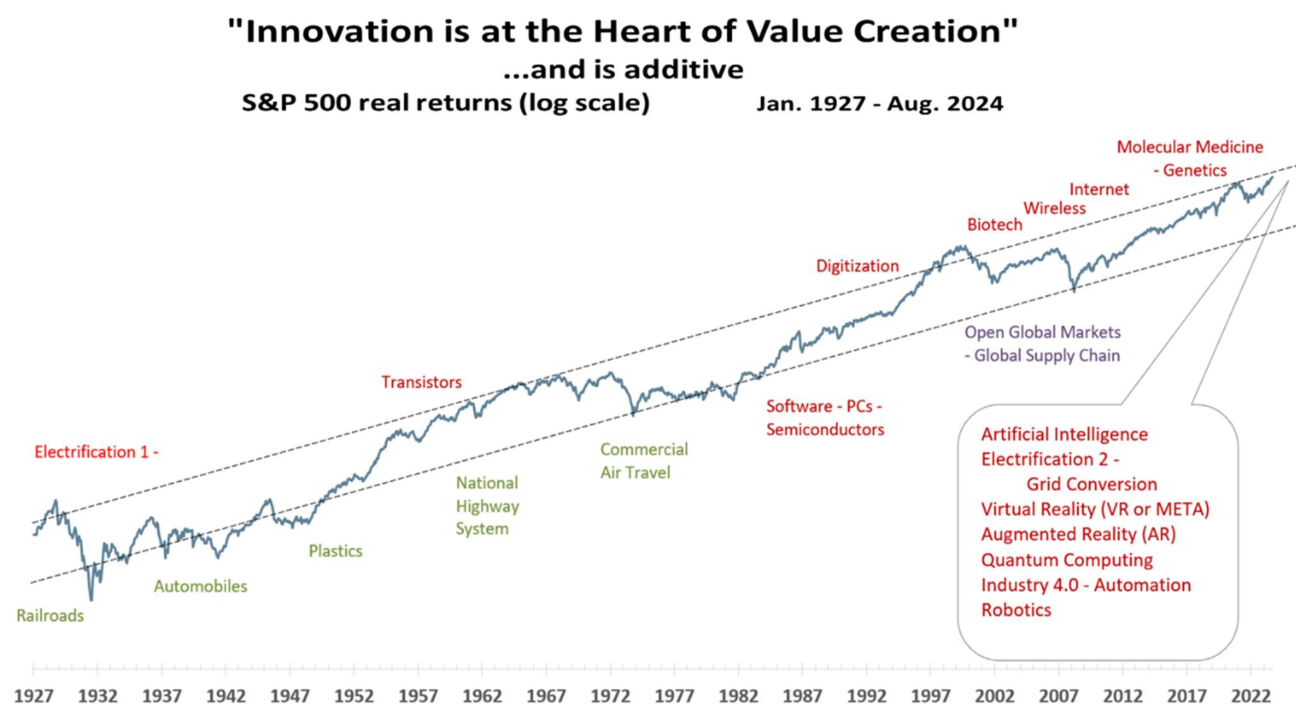
Source: Bloomberg

The massive amounts of debt accumulated by major industrial economies is a systemic risk that plays into our approach of keeping the *Managed Equity* strategies tilted decisively towards higher-quality balance sheets and cash flow structures. We also recognize the possibility that higher corporate or investment taxes could play roles in eventually addressing the record debt levels. Securities shielded from potentially higher federal taxes could rise in valuations. In the *Managed Equity* strategies, non-U.S. stocks could fit that description. The Fed's rate-cut cycle could also tilt global capital flows toward international stocks. Earlier this month, we added two non-U.S. stocks to the *Managed Equity* strategies; both generate all their earnings outside the U.S.

Economic Sensitivity: Lofty valuations demand that companies deliver all the earnings growth investors expect, which would become more difficult if the economic environment weakens. At the time of this writing, stimulus measures in China are boosting global equity markets, making such a scenario incrementally less likely. Next year's (or forward) earnings forecasts are key to the upcoming earnings season, far more than the latest quarter's results. So far this year, the S&P 500's 2024 EPS growth outlook has declined from 9% to 5%; the 2025 forecast is 14%. For context, a "normal" EPS growth rate is a little below 7%.[5]

Managed Equity Growth

Enabling innovations: The key reason for outsized earnings growth expectations and the elevated valuation ratios is the significant cluster of major economic innovations coming into the global economy now, or within the visible window (shown in the bubble below). The Growth Strategy focuses on enabling innovation leaders with proven management excellence, the ability to help shape those innovation's development curves, excellent balance sheets and cash flow structures, and (preferably) platform business models that directly benefit from other companies' investments and innovations. See the following chart and table.



Source: Bloomberg

[5] Source: Bloomberg

<u>Enabling Innovations & Megatrends:</u> As hockey great, Wayne Gretzky, once said, "*I skate to where the puck is going, not where it has been.*" That is key also to investing. We want to own leading companies in the best value-creation trends. Here, we list some of those "mega-trends" and how the Managed Equity Growth strategy is playing the game.
Artificial Intelligence (AI): AI is an "enabling technology" that can help develop new capabilities in every sector. **Nvidia** is a leader in designing the semiconductors that enable AI. **AMAT** supplies equipment needed to produce the chips. **Google**, **Microsoft, Amazon** and **Apple** are leaders in developing AI software and networks.
Business Complexity: Whether a change in payment structures, inventory sources, markets, sales methods or much more, businesses attempt to generate value in an economy that is undergoing accelerated change. **Accenture** and **Microsoft** are among the leaders in helping companies navigate that change.
Cloud Services: Involves businesses shifting their technology and information assets to the cloud for better capture and analytics. For example, technology is not Walmart's core competency; retailing is. **Amazon** and **Microsoft** are the clear leaders globally. **Google** is in third.
Cybersecurity: We believe the complexity and intensity of cybersecurity threats will continue to increase, particularly with the aid of state players and artificial intelligence (AI) capabilities. Cyber warfare is likely to accelerate in the evolving geopolitical climate, in our view. We believe the increasing sophistication of state and non-state actors will make it steadily more important that companies better understand their security risks and defenses. **Palo Alto Networks** is the largest cybersecurity pure-play while **Microsoft, Google**, and **Amazon** also offer exposure.
Electric/Autonomous Vehicles (EVs & AVs): Nvidia has leading semiconductor technologies for next-generation vehicles. EVs require far more copper in the car itself as well as in the charging infrastructure - **Freeport-McMoRan**.
Gig Economy: Work is becoming less tied to an office or factory. Innovative technologies and social change are evolving the nature of some types of work - particularly in transportation and mobility. It enables people to control their own schedules and make extra money during times of economic stress. Gig transport can move food, small items, people, and even bulky business supplies. As less developed economies mature inside a Gig Economy, their transportation and logistical systems can develop faster. **Uber** and **DoorDash** are Gig Economy leaders that are helping shape the industry's development path.
Industry 4.0: The integration of artificial intelligence, robotics, data analytics, device connectivity, edge computing, virtual/augmented reality, and additive manufacturing (CAD and 3D printing) is enabling more efficient product design, manufacturing, and distribution. **Honeywell** is a leader in industrial automation technologies.
Molecular Medicine: Healthcare innovation is one of the fastest evolving fields in the global economy, in our view. At the core are leading suppliers of the equipment and intellectual property necessary to develop these step-change treatments – **Danaher** and **Thermo Fisher**. Gene editing involves changing DNA strands and cells to eliminate or treat diseases – **CRISPR Therapeutics** and **Intellia. CRISPR** is the first company to commercialize a gene-editing drug.
Robotics: The next leg of the Industrial Revolution's use of machines to make tasks more efficient. At present, we view Medical Robotics as the highest-value segment. **Intuitive Surgical** is largely regarded as the #1 global provider of medical robots; **Stryker** is recognized as #2 and is the leading player in hips & joints.
Energy Grid Conversion: Renewables are at the center of the US energy transition. Renewable energy costs continue to fall and global regulations are pushing for more extensive use within power grids. We expect many billions of dollars to be spent transitioning energy grids towards renewables. **Freeport-McMoRan** is a leading supplier of copper, which is the most conductive metal that can be produced on a mass scale, and could be central to the transition towards a more electric future, including automobiles, solar, and wind. **Cameco** is a leading uranium supplier for the nuclear power industry which could serve an important purpose providing low-emission, baseload electricity; **Constellation Energy** is the largest nuclear power plant operator in the US. **GE Vernova** is a leading provider of energy transition solutions spanning power generation, transmission/distribution, storage, and management.
Net Zero - Water: Infrastructure stress, corporate carbon reduction (net zero) efforts, and emerging market development are making water availability, treatment, and recycling increasingly valuable, in our view. **Veralto** and **Ecolab** provide water infrastructure, treatment, and management solutions.
New Retail: Technology is transforming shopping experiences. Use a phone (or ask Alexa) to have food and other goods delivered to your doorstep; select items and check out of a store without stopping at the cashier; try on virtual clothes at home before ordering exactly what you want....**Amazon** and **Alphabet** are New Retail leaders; **DoorDash** and **Uber** are also reshaping the way consumers shop for a wide variety of goods. **MercadoLibre** and **Sea** are emerging market leaders that are helping shape the retail market development curves of key non-Western geographies.
Quantum Computing: Quantum mechanics opens doors to phenomena that defy the boundaries of classical physics. Quantum computing performs certain functions to levels not possible with traditional computers. We believe **Honeywell**, **Microsoft**, **Google,** and the *Managed Equity Dividend* strategy's **IBM** are among the clear leaders; **Nvidia** is also an emerging player here. Quantum computing may be central to the next wave of robotics, artificial intelligence, industrial automation, and healthcare. Quantum is currently in limited deployment and likely 5-10 years from general commercialization.
Metaverse - Virtual & Augmented Reality: Augmented (AR) and virtual reality (VR) technologies enhance the environment by adding useful data and other information to what people can see and interact with. **Apple** is among the early AR leaders with its *Vision Pro* headset; **Microsoft** and **Google** are also players here.
Wearable Electronics: Technology is proliferating throughout society and becoming increasingly centralized around the person. For instance, the wrist, pocket, and ear are often linked with smart watches, phones, and audio devices like *AirPods*. We view **Apple** as a clear leader in the wearables market.

<u>Global exposure</u>: Earlier this quarter, we added two non-U.S. innovation leaders who head their respective markets in Latin America and Southeast Asia. The moves have a dual-pronged strategy. They could benefit from a weaker U.S. dollar as the Fed reduces interest rates. They also diversify potential tax risk, should U.S. corporate rates rise due to the significant debt. As global economic leadership becomes increasingly multi-polar, an increasing amount of value-creating innovation is being generated in diverse geographic regions.

<u>Use of Cash:</u> We use cash to balance risk taken elsewhere in the portfolio and as risk capital, so we do not have to sell great companies to take advantage of opportunities during times of significant volatility. Over the past five years (including COVID), the Strategy's beta is 0.91.[6] This approach can enable us to build wealth from times of extreme volatility. Historically, the Strategy has held ~14% in cash and is currently ~9%.[7]

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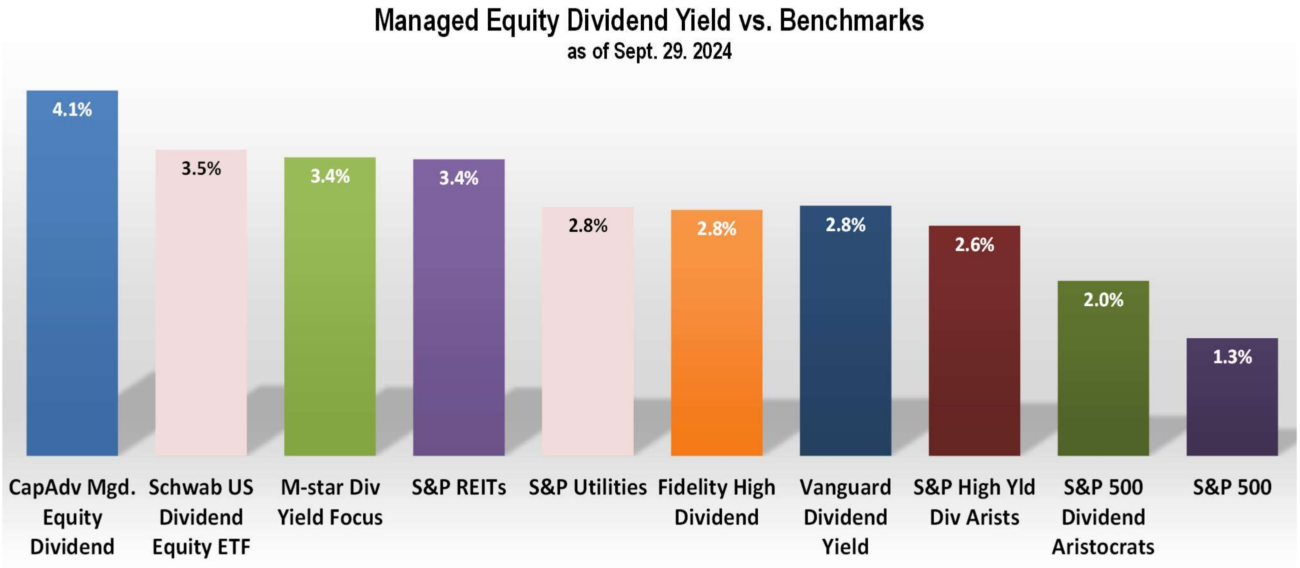
[6] Source: Bloomberg using a representative account
[7] Source: Orion

Managed Equity Dividend

Current yield: As the stocks in this strategy have appreciated, we have maintained approximately a 4% yield. We plan to keep the yield in that area given the current risk-adjusted opportunities. The Strategy has achieved far lower variability than the overall stock market. The following chart shows the Strategy's current yield in relation to publicly traded peers.[8]



Source: Bloomberg

Cash flow growth and Acquisition yield: We also manage the Strategy for long-term cash flow growth. Since its 2012 inception, the Strategy's cash flows have achieved a compound annual growth rate of 7.5%.[9] The table below highlights the following for each stock ticker added to the Strategy more than one and a half years ago: the current yield at the time we added it to the Strategy (the acquisition yield), the current yield now, and the amount that the stock's cash payout has increased since we initially added it. For instance, **Watsco (WSO ~$500)** stock had a 4.5% yield when we added it to the buy list. Despite a 52% increase in the cash each share pays out, the current yield is now 2.2% due to stock appreciation. The yield on the amount initially invested (the acquisition yield) is now 6.9%.[10] While we are holding the Strategy's current yield near 4%, we are also tracking measures of its acquisition yield for multi-year investment strategies.

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[8] Source: Bloomberg
[9] Source: Orion using a representative account. Compound annual growth rate represents the average annual cash flow increase assuming the reinvestment of excess cash as it accumulates.
[10] Source: Bloomberg, Orion.

The Power of Dividends As of 9/30/2024

Managed Equity Dividend Examples

Company	Bought	Acq Yrs	Acq Price	Current Dividend Yield	Yield at Time of Acq	Current Yield on Acq Price	Cash Dividend Growth
ARCC	May-2020	4	$15.50	9.2%	10.3%	12.4%	20%
SPG	Dec-2020	4	$92.98	4.9%	5.6%	8.8%	58%
CVX	Jul-2020	4	$86.33	4.5%	6.0%	7.6%	26%
AVGO	Feb-2020	5	$28.06	1.2%	4.7%	7.6%	63%
BX	Aug-2019	5	$47.23	2.2%	4.1%	6.9%	71%
WSO	Apr-2020	4	$156.00	2.2%	4.5%	6.9%	52%
ABBV	Mar-2020	5	$89.85	3.2%	5.5%	6.9%	31%
CSCO	Feb-2016	9	$24.60	3.0%	3.0%	6.5%	90%
XOM	May-2020	4	$62.33	3.3%	5.6%	6.1%	9%
SO	Jan-2013	12	$47.70	3.2%	4.1%	6.0%	47%
PAYX	Apr-2020	4	$68.65	2.9%	3.7%	5.7%	58%
TXN	Apr-2020	4	$99.98	2.6%	3.6%	5.4%	51%
GIS	Mar-2018	7	$47.00	3.3%	4.2%	5.1%	22%
IPG	Feb-2021	4	$26.29	4.2%	4.1%	5.0%	29%
ETN	Feb-2019	6	$77.61	1.1%	3.5%	4.8%	42%
HD	Mar-2020	5	$193.84	2.2%	3.2%	4.6%	50%
KO	Oct-2016	8	$42.40	2.7%	3.3%	4.6%	39%
LMT	Oct-2018	6	$334.00	2.2%	2.6%	3.8%	31%
Average		**6**				**6.4%**	**44%**

Company	Bought	Acq. Yrs.	Acq. Pr.	Accum Divs	Accum Divs % Acq. Pr.	Cur. Pr.	Current Price + Accum. Dividends
VZ	Jan-2014	11	$48	$26	54%	$45	$71
WMB	Sep-2013	11	$36	$19	53%	$45	$64
BCE	Mar-2019	6	$44	$16	35%	$35	$51
RIO	May-2021	3	$87	$21	25%	$71	$93
DVN	Jan-2022	3	$49	$5	11%	$39	$44
SCCO	Jul-2021	3	$64	$11	18%	$117	$128
UL	Apr-2020	4	$53	$8	16%	$65	$74

Source: Bloomberg

Acq. Pr: Share price at which the position was originally purchased (acquired)
Current Dividend Yield: Indicated dividend yield using current market prices
Yield at Time of Acq: Dividend yield at time of the initial investment
Current Yield on Acq Price: The current dividend yield using the initial purchase price
Div. Growth: How much the annual dividend has grown since the initial investment
Accum Divs: Amount of cash dividends per-share received since the initial investment
Accum Divs % Acq. Pr: Percentage of investment presently recouped through dividends

The Strategy's core investment objective is long-term total return (wealth accumulation) with an attractive cash component and advantaged risk management. Holdings include innovation leaders in artificial intelligence (ex., **Broadcom (AVGO ~$173)**), energy grid and data center power management (ex., **Eaton (ETN ~$328)**), fiber optic technologies (ex., **Corning (GLW ~$45)**), geopolitical tensions (ex., **Lockheed Martin (LMT ~$582)**), and other key global economic trends.

Fixed Income Strategies

Following the first two quarters of 2024's interest rate volatility (both higher and lower), the third quarter proved to be a bazooka shot one-way up in price! Two-year and five-year Treasury yields fell by nearly 1.15% and 0.85%, respectively, as the Fed began to loosen its restrictive monetary policy by 0.50% in September.[11] It seems the market has coalesced to an expectation of approximately 0.50% to 0.75% more in rate cuts by this year-end, and another 1%+ lower in 2025.[12] We remain steadfast that "locking in higher yields for longer" in our clients' bond strategies is a prudent investment. However, we are very cognizant of the nation's financing concerns and are currently focused on overweighting interest rate risk on the short-to-intermediate part of the yield curve, with limited exposures too far out the maturity spectrum after this massive drop in market yields.

[11] Source: Bloomberg, 9/27/24
[12] Source: Bloomberg, World Interest Rate Probability as of 9/27/24

Managed Credit Strategies

Within our *Managed Credit Strategies*, we are orienting the portfolios toward better credits, with roughly 70% of our clients' exposure in companies currently rated A- or better, on average.[13] We believe our BBB exposure has better balance sheets than the broad market, but we are willing and able to further reduce this allocation should we see specific situations worsen. We also hold a modest allocation to U.S. Treasuries, as applicable, to provide further credit diversification from any potential slowdown in the economy.

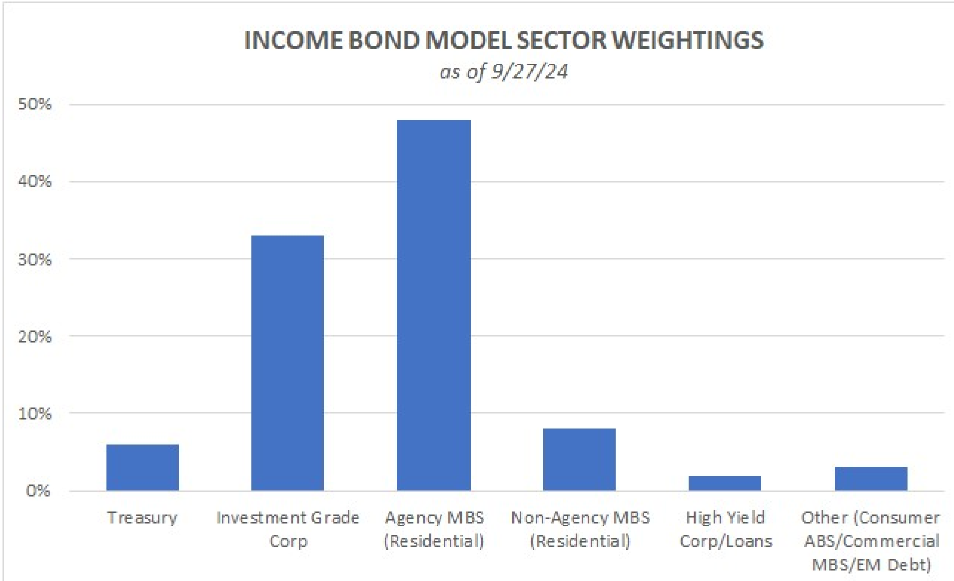
Our overweight to investment grade corporate credit outperformed Treasuries in the third quarter while our slightly defensive duration profile lessened the positive impact of falling rates. With interest rates still materially higher than in years past, we will look to add interest rate risk, but not go out much past 10-years. On a go-forward basis, portfolios are now yielding around 4.0%, depending on one's yield curve positioning.[14]

ETF Bond Models

Our *Aggregate Bond* ETF strategy remains 100% invested in "defined maturity," investment-grade corporate bond ETFs, which positively impacted the model's outperformance relative to the benchmark in Q3. Today, there is a relatively conservatively positioned laddered maturity structure of ETFs ranging between 2026-2030, and the model carries an average net acquisition yield of approximately 4.2%.[15]

The *Income Bond* ETF strategy has focused on maximizing cash flows within the construct of balancing risks, most notably through sector diversification (see chart below). In Q3, the model's strong positive performance was somewhat mitigated by a slightly defensive interest rate posturing relative to the index. Looking forward, "AAA-rated" Agency Mortgage-Backed securities remain the model's largest weighting, as relative yields versus both corporates and Treasuries look attractive on a both an absolute and historic basis.[16] The potential for stable to declining interest rates could bring back incremental buyers of this high-quality asset class (i.e. insurance companies, banks, etc.) over the course of the year. Today, the strategy carries an average net acquisition yield of approximately 4.8%[17].

[13] Source: ORION
[14] Source: Bloomberg, ORION, as of 9/30/24
[15] Source: Bloomberg, iShares, State Street, as of 9/30/24
[16] Source: Bloomberg, as of 9/27/24
[17] Source: Bloomberg, iShares, State Street, as of 9/30/24



Source: ORION, iShares, State Street, Doubleline, Janus Henderson

Municipal Bonds

Our *Municipal Bond* portfolios continue to be focused on "A" and above credits with strong debt coverage and liquidity profiles. We have also intentionally over-weighted essential service revenue bonds (water & sewer, utilities, etc.), and general obligation bonds with an average portfolio credit quality of "AA." High-quality municipal bonds may provide some stability going forward, especially as we move toward the national election where rhetoric about a larger federal budget deficit and a possible higher tax rate regime may make the asset class more attractive. Municipal bond portfolios are now yielding between 2.6% and 3.0% tax free *(between 4.4% and 5.1% at the highest marginal federal tax rate)*[18] depending on one's yield curve positioning.

Tactical Global Growth Strategy

The third quarter was one of just a handful of periods in the past decade when many international equity markets outperformed the *S&P 500 Index*.[19] Emerging markets were particularly strong during the quarter, with upside momentum accelerating after the U.S. Federal Reserve (Fed) cut interest rates by half percentage point on September 18th.

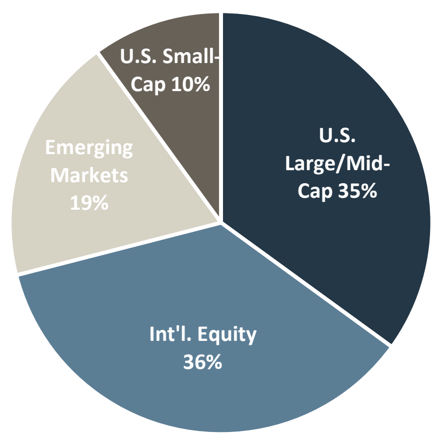
[18] Source: ORION, Bloomberg, highest marginal tax rate of 40.8% = 37% federal plus 3.8% net investment income tax, as of 9/30/24

[19] Source: Bloomberg

There is fundamental logic to this market behavior, in our opinion. Many countries outside the U.S. link their currencies to the U.S. dollar to varying degrees. This forces the central banks in these countries to shadow the monetary policy of the United States to prevent their home currencies from deviating too far from the target exchange rate with the U.S. dollar. For many countries – particularly among less developed nations – the Fed's aggressive monetary tightening policy of the past two years has been more restrictive than these economies needed. The Fed's official pivot to an easing cycle in September was welcome relief because it gave these countries breathing room to pursue stimulative policies of their own. The most high-profile example of this response was China, which announced a series of aggressive stimulus programs throughout the week of September 23-27 that was well received by the Chinese stock market at the time.

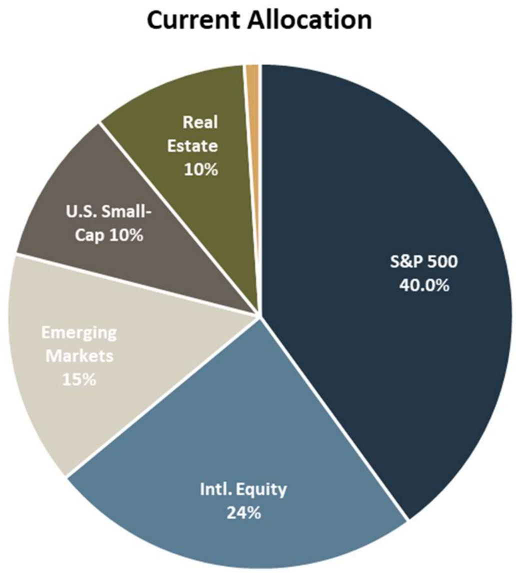
The current asset allocation for the strategy includes an overweight position in international equities and emerging markets relative to common benchmarks for the global equity asset class. We have also included a meaningful position in small-cap stocks to broaden the diversification of the domestic equities within the portfolio.

Strategy Model
Geographic Exposure
09-30-2024



<u>Dynamic Allocation Strategy</u>

This strategy held at least 85% of its allocation in risk market sectors throughout the first three quarters of the year, allowing healthy participation in the strong performance of global equities during this period. As of quarter-end the portfolio was invested in all five of its risk market sectors as follows:



We believe the *Dynamic Allocation* strategy can play a helpful role in the risk management discipline of a balanced portfolio. Each of the five equity market index funds (ETFs) within the strategy has an automatic sell discipline tied to its moving average trend line. In English, this means each sector will be sold when its trend line turns downward. Consequently, money allocated to this strategy can be expected to shift out of risk markets and into short-term U.S. Treasuries whenever downside volatility in the equity markets perks up.

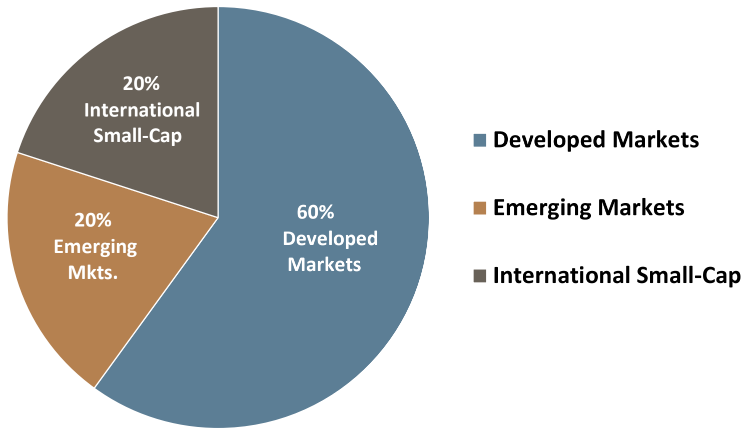
Despite having the flexibility to shift almost entirely into short-term U.S. Treasuries during times of market stress, the strategy can capture a large portion of the upside whenever global equities experience a sustained advance, like recently. The strategy has delivered a healthy double-digit return through the end of September on a year-to-date and trailing 12-month basis.

International Focus Strategy

The factor tilts embedded into the design of this strategy continued to be helpful during the third quarter, with the momentum factor and emerging markets being particularly beneficial. Of all the major risk markets globally, we believe emerging markets might have the greatest potential for positive reversion-to-the-mean following several years of relative under-performance versus U.S. stocks.

Recent upside momentum for emerging markets accelerated following the “official” pivot to easier monetary policy at the U.S. Federal Reserve (Fed) on September 18. As stated above, many emerging market central banks correlate their monetary policies with the U.S. Fed to maintain a stable currency exchange rate with the U.S. dollar. This can be problematic when the appropriate monetary policy for the U.S. economy is too restrictive for the foreign countries that must shadow it. For this reason, the Fed’s half-point rate cut on September 18th was welcome news far beyond the U.S. border.

Portfolio Allocation



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The **S&P 500 Index** is a stock market index based on the market capitalizations of 500 leading companies publicly traded in the U.S. stock market, as determined by Standard & Poor's. The index is calculated on a total return basis with dividends reinvested and is not assessed a management fee.

The **Russell 1000 Growth Index** seeks to track the investment results of an index composed of large- and mid-capitalization U.S. equities that exhibit growth characteristics.

The **Russell 1000 Value Index** seeks to track the investment results of an index composed of large- and mid-capitalization U.S. equities that exhibit value characteristics.

MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S.

MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

MSCI EAFE Small-Cap Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of small- and mid-cap stocks in the developed markets, excluding the U.S.

Vanguard High Dividend Yield ETF is an exchange-traded fund that seeks to track the performance of the FTSE High Dividend Yield Index, which consists of common stocks of companies that pay dividends that generally are higher than average.

Morningstar Dividend Yield Focus aims to track high-yielding, qualified dividend-paying, U.S. based securities screened for companies with financial health. The Index is calculated on a total return basis with dividends reinvested and is not assessed a management fee. It is not possible to invest directly in an index.

Bloomberg Aggregate Bond Index is an unmanaged index made up of U.S. Government, corporate, mortgage-backed and asset-backed securities rated investment grade or higher. The index is designed to measure the performance of the domestic investment-grade bond market.

Morningstar Dividend Yield Focus Index: A selection of 75 US stocks with relatively strong dividend yields and financial quality.

FTSE US High Dividend Yield ETF: Represents the performance of stocks characterized by above-average dividend yields based on the FTSE US High Dividend Yield Index.

Vanguard High Dividend Yield ETF: A passively managed ETF that seeks to replicate the FTSE US High Dividend Yield Index.

S&P US REIT Index: Defines and measures the investable universe of publicly traded real estate investment trusts domiciled in the United States.

S&P US Utilities Index: Defines and measures the investable universe of publicly traded utility companies domiciled in the United States.
S&P 500 Dividend Aristocrats Index: Designed to measure the performance of S&P 500 index constituents that have followed a policy of consistently increasing dividends every year for at least 25 consecutive years.
S&P High Dividend Yield Aristocrats Index: Measures the performance of the 50 highest yielding companies within the S&P Composite 1500 that have increased their dividends every year for at least 20 years.
Fidelity High Dividend Yield ETF: Tracks the performance of large- and mid-capitalization dividend-paying companies in the Fidelity High Dividend Yield Index that are expected to continue to pay and grow their dividends.
Schwab US Dividend Equity ETF: Tracks the Dow Jones US Dividend 100 Index with companies characterized by financial quality and high dividend yields.

Estimated portfolio yield represents the 12-month run-rate of interest and/or dividend payments in a strategy divided by the market value of the securities and cash reserves invested in the strategy. Estimated interest/dividend payments and market values are calculated by a portfolio accounting system from *Orion* using a single client portfolio that Capital Advisors believes to be representative of clients' portfolios invested in the same strategy. The actual portfolio yield for any single client portfolio may be lower or higher than the yield quoted. The underlying holdings of any presented portfolio are not federally or FDIC-insured and are not deposits or obligations of, or guaranteed by, any financial institution.

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