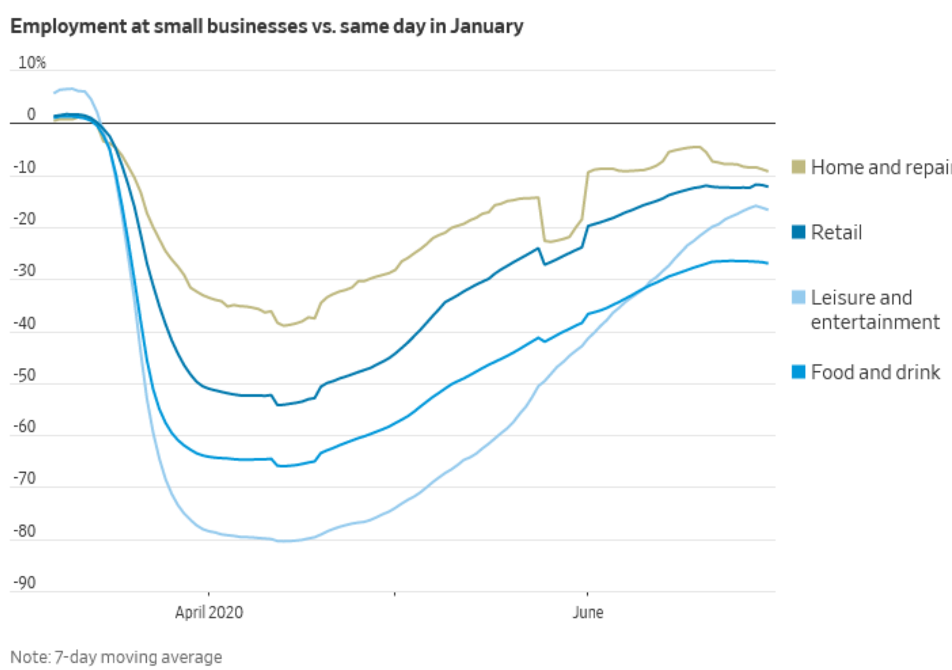
Quarterly Investor Letter – 2Q 2020

VALIDUS

Market Overview

What a difference a quarter makes – at least in the equity markets. The second quarter of 2020 was as unprecedented as the first quarter of 2020, only in the opposite direction. After a first quarter where the S&P 500 was down ↓**19.6**%, the index bounced back dramatically, up ↑**20.5**% for the second quarter. With economic activity on the rebound as businesses reopened around the country, it seems like markets have assumed a quick and sharp recovery, despite the lack of clarity and conviction by companies (or analysts) about current and upcoming earnings. These are clearly unprecedented and uncertain times and yet it would appear that investors are more focused on the signs that things are returning to normal rather than potential downside risks. That said, for many of the quarter's winners, first quarter earnings confirmed that things were not as dire as expected and that those with stout balance sheets were able to weather the storm and even bolster their finances with debt issuance at historically low rates induced by Fed chatter and some action. With some hindsight, it's clear that some companies can succeed and even flourish under these conditions – an outcome we suspected albeit with a great dose of caution.

Volatility opened the quarter at elevated levels (53.5), peaked in early April at 57.1 and closed the quarter at 30.4, as measured by the CBOE VIX Index (the "VIX"). Overall, the VIX declined by 43.2% during the quarter. While it's easy to feel more comfortable with volatility off of extreme levels, the VIX remains at elevated levels relative to historical trading ranges reflecting continued uncertainty. We think there continue to be reasons to be cautious – November election, cold war with China, fits and starts in the reopening picture, likelihood of continued fiscal support, etc. Further, the withdrawal or lack of guidance by most publicly traded companies creates the possibility of larger swings in individual stock prices as actual results are eventually reported in the second quarter.



Source: Homebase, WSJ

As noted in our Q1 2020 commentary, the hastily created pandemic response programs passed in the CARES Act, such as the Paycheck Protection Program (PPP) came into effect during the quarter. While it remains to be seen how effective the specific programs will be, I think we can agree that it hasn't cured every economic ill. The chart to the right from the WSJ: Real Time Economics blog on July 2nd, shows the depth of the drop in employment by four specific sectors which we think are good gauges of activity around the re-openings. We see the increase in employment from the depths of

April, however, the recovery has seemed to stall and may even be rolling over in some industries as re-openings were paused or rolled back in some states as COVID flared back up.

In short, what we have seen during the second quarter is the "push" and "pull" between two opposing forces. On the one hand, with the Fed providing unlimited support and fiscal authorities cooperating for now, **T**here **I**s **N**o **A**lternative ("TINA") to stocks as an investment vehicle and according to some, there is a lot of cash still on the sidelines. Yields remain so low that bonds are still unattractive relative to equities in all but the most extreme market conditions. On the other hand, there is the real disconnect between equity markets (and potentially valuations, depending which ratio you use and how much you believe the underlying data) and the real economy. Based on recent data, it certainly appears that it will take a while for employment to come back and a significant number of jobs may not come back at all. Practically, for most people it doesn't feel like the kind of economy that suggests markets should be at all-time highs.

So far, TINA fueled by the Fed seems to be winning. But that may not be the case for long. This uncertainty reinforces our view that active management and understanding the secular growth drivers of each company in a portfolio will continue to be important. Further, it seems like our old mantra of playing "offense" and "defense" in portfolios still applies. Certainly, holding gold in lieu of cash in portfolios has been a big win so far. According to the Bloomberg Gold Subindex, gold prices have increased ↑12.1% in the second quarter and ↑8.6% as of this writing in the third quarter to date. We think gold will continue to have buy side interest dues to several factors. First, with yields so low, there is very little opportunity cost to holding gold over bonds for "safety", especially considering that some bond yields are still negative. Secondly, there have been and continue to be shortages of physical bullion around the globe. Finally and most obviously, central banks around the world continue to provide almost unlimited liquidity, further debasing currencies over time. The poster child for this is the US Dollar, which has struggled significantly in July.

Asset Class / Style Performance

In terms of asset class performance, almost everything that got hit in the first quarter recovered in the second quarter. Some safe havens such as the US dollar gave up gains while gold managed to post another positive quarter.

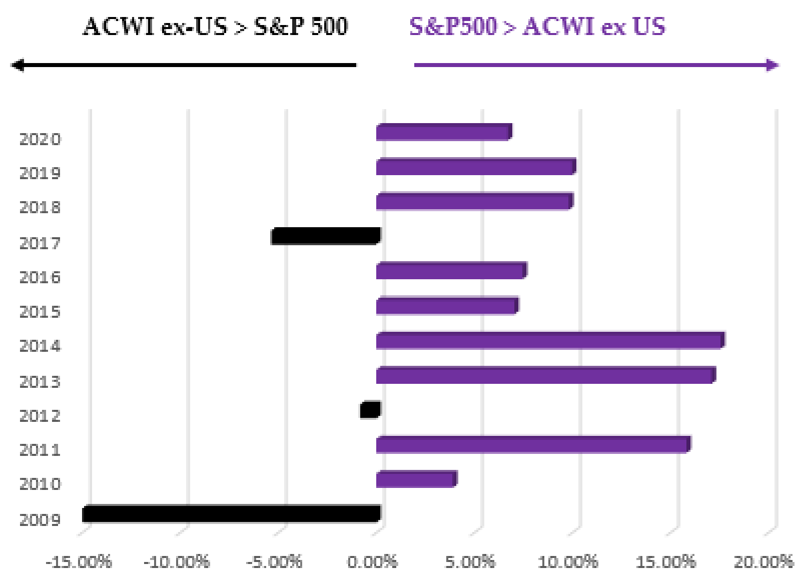
- The S&P 500 recovered in the second quarter, up ↑20.5%. Again, the US outperformed international stocks (MSCI ACWI ex-US Index), up ↑16.1%. More detail on relative equity performance below.[i]
- Bonds were positive with the Bloomberg Barclays US Aggregate Bond Index up ↑2.9% and the Bloomberg Barclays Global Aggregate Index up ↑3.3% for the quarter. With Fed buying, the two yield curve spreads typically cited converged to the same spread, from different directions. The spread on the US 3M – 10Y increased from 47 bps to 50bps. The spread on the US 2Y – 10Y treasuries decreased from 59 bps to 50 bps.[ii]
- As mentioned earlier, the VIX (S&P 500 Volatility Index) fell ↓43.2% during the quarter. The TYVIX, which we usually cite for Treasury bond volatility, was discontinued due to a lack of trading in the instrument.[iii]

- Gold continued its upward march ending the quarter up ↑12.1%.[iv] To reiterate what we said last quarter, the massive monetary and fiscal stimulus injected into the financial system in reaction to the COVID-19 pandemic may eventually be inflationary. In our opinion, this will continue to erode investor confidence in fiat currencies if debt growth does not abate.

- In a nod to the risk-on nature of the quarter, the US Dollar (as measured by the USDU) declined by ↓2.4% as investors tip-toed out of safe-haven assets.[v]

US Equities vs. International Equities. As stated above, the S&P 500 Index was up ↑20.5% in the second quarter. That compares with international markets as reflected by the MSCI ACWI ex-US Index up ↑16.1% in the second quarter. Although recently, we have seen some momentum in markets outside the US including Europe, where fiscal authorities agreed on significant additional economic stimulus, and Asia, where economies seem to be returning to normal more rapidly than in the US.

S&P 500 (SPX) vs. MSCI ACWI ex-US (MXWDU)

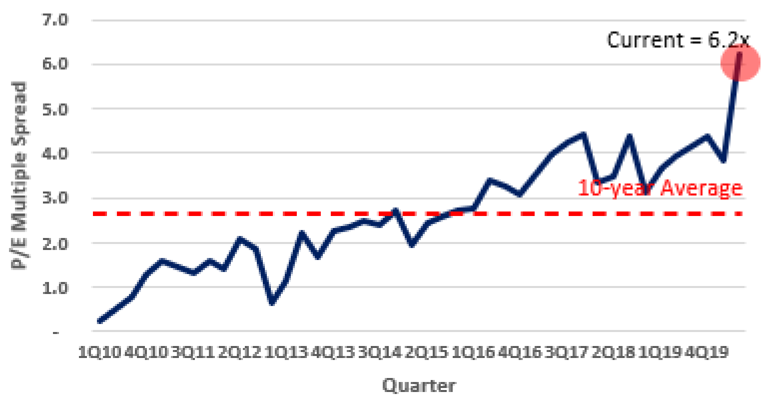


Source: Bloomberg, VALIDUS.
Past performance does not guarantee future results*. Investors cannot invest directly in an index.*

The MSCI China Index rose ↑15.3%, underperforming the S&P 500 after outperforming in the first quarter. This was partially due to a "catch up trade" as the recovering US outperformed on the back of its technology sector. In addition, as tensions have ramped up between the US and China across a variety of fronts (i.e., Hong Kong, South China Sea, closing of consulates, tech wars, potential US changes to listing requirements for Chinese companies), Chinese markets have been impacted.

Finally, fundamentally, there continues to be a large disparity between the relative valuation of international markets and the US market, and these spreads have moved significantly higher during the quarter. However, as we mentioned above, with earnings estimates so unclear and tenuous, we think there is a lot of "noise" in the current data in the near term. That said, to the extent that the valuation disconnect continues, we would expect the gap to narrow over time, at least back to historical averages.

P/E Multiple Spread - S&P 500 (SPX) vs. MSCI ACWI ex-US (MXWDU)



Source: Bloomberg, ***VALIDUS****.*
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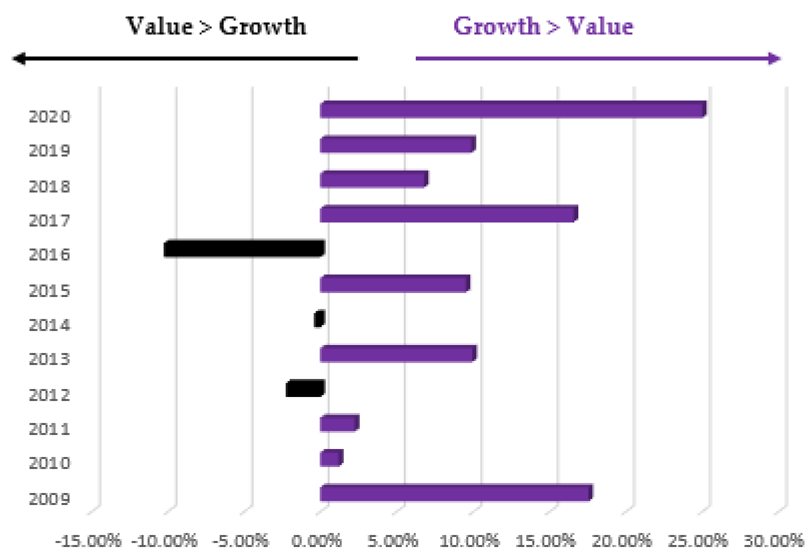
Growth vs. Value. The Russell 1000 Growth Index (RLG +7.7%) continued to outperform the Russell 1000 Value Index (RLV ↓17.3%) in the first half of the year – making the relative outperformance of growth +25.0% for 2020. Some would argue that such a large "spread" between the two cannot continue indefinitely and we would tend to agree up to a point. That is because COVID-19 has accelerated digital, cloud and ecommerce trends that helped to create the premium for growth stocks to begin with. In short, there is more reason than ever for many of these secular growth companies to continue to deliver attractive fundamental results and likely trade at higher valuations. With certain sectors like Energy, Financials (Banks) and Industrials continuing to struggle, in our opinion, it will be very hard for "value" to make up significant ground on "growth" until the economy stabilizes at higher levels.



Source: Bloomberg, ***VALIDUS****.*
Past performance does not guarantee future results*.*
Investors cannot invest directly in an index.

Sector Performance. During the quarter, all sectors benefitted – some, like those leveraged to more purchasing activity by consumers and leveraged to the technology trends discussed above, fared better than most. Other sectors benefitted from the recovery trade. Consumer Discretionary was the top performing sector (up ↑32.9%), followed by Information Technology (up ↑30.5%) and Energy (up ↑30.1%). Utilities (up ↑2.7%), Consumer Staples (up ↑8.1%), and Financials (up ↑12.2%) underperformed on a relative basis.

<u>Periodic Table of Sector Performance</u>

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Q1 2020	Q2 2020
CS	TECH	RE	UTIL	FIN	CD	UTIL	CD	ENER	TECH	HC	TECH	TECH	CD
HC	MAT	CD	CS	CD	HC	RE	HC	CMS	MAT	UTIL	CMS	HC	TECH
UTIL	CD	IND	HC	CMS	IND	HC	CS	FIN	CD	CD	FIN	CS	ENER
CMS	IND	MAT	RE	HC	FIN	TECH	TECH	IND	FIN	TECH	IND	UTIL	MAT
CD	RE	ENER	CMS	RE	TECH	CS	CMS	MAT	HC	RE	RE	CMS	CMS
ENER	HC	CMS	CD	IND	CS	FIN	RE	UTIL	IND	CS	CD	RE	IND
IND	FIN	CS	ENER	MAT	MAT	IND	FIN	TECH	CS	CMS	CS	CD	HC
TECH	CS	FIN	TECH	TECH	ENER	CD	IND	CD	UTIL	FIN	UTIL	MAT	RE
RE	ENER	TECH	IND	CS	UTIL	MAT	UTIL	CS	RE	IND	MAT	IND	FIN
MAT	UTIL	UTIL	MAT	ENER	CMS	CMS	MAT	RE	ENER	MAT	HC	FIN	CS
FIN	CMS	HC	FIN	UTIL	RE	ENER	ENER	HC	CMS	ENER	ENER	ENER	UTIL

TECH = Information Technology
CMS = Communication Services
FIN = Financial Services
IND = Industrials
RE = Real Estate
CD = Consumer Discretionary
CS = Consumer Staples
UTIL = Utilities
MAT = Materials
HC = Health Care
ENER = Energy

Source: Bloomberg, Validus

Market Valuation

At this point, we think it is hard to argue that market valuations don't seem elevated and that there isn't some "froth" in particular names. At the end of the second quarter, on a Forward P/E Basis (according to Bloomberg), valuations jumped to 24.7x from 17.1x at the end of first quarter. That said, as we cautioned above, we have to take current valuations with a grain of salt – many companies have withdrawn guidance due to a lack of visibility into demand for their products and services. That leaves Wall Street analysts "flying blind" as they struggle to project earnings across a wide range of various outcomes – in short, we expect more significant "beats" and "misses" relative to estimates than usual. As usual, earnings were generally better than expected and that continues to be the case so far as second quarter results are reported in July, especially for New Economy companies. Earnings reports continue to highlight the massive digital push by companies across the board. So far, the current earnings season seems to be further separating companies that were able to pivot their strategies and accelerate their growth even in the face of such uncertain circumstances.

Stay tuned. We think there are many shoes still to drop. Many large employers such as airlines will have to right-size their business once they are no longer bound by the terms of the PPP grants they received which will slow a 'normalization' of the unemployment rate. We worry that many jobs will never come back as companies realize they can "get by" and even flourish with fewer employees and less space. There may be some significant impacts on commercial real estate going forward that have yet materialized. Further, the consumer may face additional challenges. In addition to the employment picture, the restrictions on evictions imposed by many states are expiring as are limitations on foreclosures. And, unless Congress gets its act together, income support payments are going away at the end of July.

We continue to believe that the “general” is the enemy of the “specific” in the current market environment and we will continue to seek individual company stories that can continue to weather the storms and even flourish.

Sincerely,

Mark C. Scalzo

Mark C. Scalzo
Chief Investment Officer

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It is important to keep in mind that investments in fixed income products are subject to liquidity (or market) risk, interest rate risk (bonds ordinarily decline in price when interest rates rise and rise in price when interest rates fall), financial (or credit) risk, inflation (or purchasing power) risk and special tax liabilities. Interest may be subject to the alternative minimum tax. Treasury securities are backed by full faith and credit of the U. S. Government but are subject to inflation risk.

Mark Scalzo is the Chief Investment Officer of **VALIDUS** Growth Investors ("**VALIDUS**"), a registered investment adviser and the Chief Investment Officer of and has an ownership in Pinhook Capital, LLC ("Pinhook"), a registered investment adviser. **VALIDUS** provides model portfolio sub-advisory services to Pinhook and Lucia Capital Group ("LCG"), a registered investment adviser. Mr. Scalzo is a Securities Principal and Registered Representative of Lucia Securities, LLC ("LSL"), a registered broker/dealer, member FINRA/SIPC. **VALIDUS**, Pinhook, LCG and LSL are all under common ownership.

Definitions Are Listed Alphabetically:

Bloomberg Barclays US Aggregate Bond Index is an index commonly used as a benchmark by both passive and active investors to measure portfolio performance relative to the U.S. dollar-denominated investment-grade fixed-rate taxable bond market. It is also an informational measure of broad market returns commonly applied to fixed-income instruments. An investment may not be made directly in an index.

Bloomberg Barclays Global Aggregate: The index measures the performance of global investment grade fixed-rate debt markets, including the U.S. Aggregate, the Pan-European Aggregate, the Asian-Pacific Aggregate, Global Treasury, Eurodollar, Euro-Yen, Canadian, and Investment Grade 144A index-eligible securities.

Commercial Paper is an unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts payable and inventories and meeting short-term liabilities. Maturities on commercial paper rarely range longer than 270 days.

MSCI ACWI: The MSCI ACWI Index, a benchmark for the **VALIDUS** Classic Global Growth strategy, is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 49 country indexes comprising 23 developed and 26 emerging market country indexes.

MSCI ACWI ex USA: The MSCI ACWI ex US Index capture large and mid-cap representation across 22 of 23 developed markets (DM) countries (excluding the US) and 26 Emerging Markets (EM) countries. With 2,408 constituents, the index covers approximately 85% of the global equity opportunity set outside the US.

MSCI EAFE: The MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets in Europe, Australasia and the Far East, excluding the U.S. and Canada. As of June 2020, it had more than 900 constituents and covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI Emerging Markets: The MSCI Emerging Markets Index is designed to represent the performance of large and mid-cap securities in 26 Emerging Markets. As of June 2020, it had more than 1,400 constituents and covered approximately 85% of the free float-adjusted market capitalization in each country.

P/B or Price to Book Ratio: Companies use the price-to-book ratio to compare a firm's market to book value by dividing the price per share by book value per share (BVPS). An asset's book value is equal to its carrying value on the balance sheet, and companies calculate it netting the asset against its accumulated depreciation.

Russell 1000 Growth: The Russell 1000 Growth Index measures the performance of the large-cap growth segment of the U.S. equity universe. The Index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect growth characteristics.

Russell 1000 Value: The Russell 1000 Value Index measures the performance of large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect value characteristics.

Shiller CAPE: Shiller CAPE is the cyclically adjusted price-to-earnings ratio and is a valuation measure usually applied to the US S&P 500 equity market. It is defined as price divided by the average of ten years of earnings (moving average), adjusted for inflation. As such, it is principally used to assess likely future returns from equities over timescales of 10 to 20 years, with higher than average CAPE values implying lower than average long-term annual average returns. It is not intended as an indicator of impending market crashes, although high CAPE values have been associated with such events.

S&P 500: The S&P 500 Index is a gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

TYVIX is the first exchange-traded volatility benchmark for U.S. Treasuries. Similar to the CBOE Volatility Index.

(VIX®) - CBOE Volatility Index® was created by the Chicago Board Options Exchange (CBOE), is a real-time market index that represents the market's expectation of 30-day forward-looking volatility. Derived from the price inputs of the S&P 500 index options, it provides a measure of market risk and investors' sentiments.

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Please contact VALIDUS Growth Investors for additional information

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[i] Bloomberg Terminal
[ii] Bloomberg Terminal
[iii] Bloomberg Terminal
[iv] Bloomberg Terminal
[v] Bloomberg Terminal