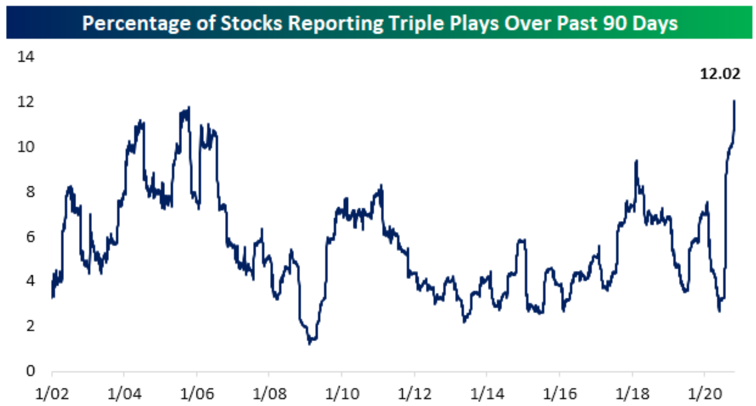
Quarterly Investor Letter – 3Q 2020

Market Overview

It was another very good quarter. After rebounding ↑ 20.5% for the second quarter of 2020, the S&P 500 returned ↑ 8.9% during the third quarter 2020. Despite the uneven re-opening of the economy and the confusion stemming from different standards across different states, counties and cities, the markets remained resilient, preferring to shrug off concerns over a resurgence in COVID-19 cases, the upcoming presidential election and the on again off again stimulus talks in Washington. We will see if this optimism continues into the fourth quarter, especially given the election on November 3rd.



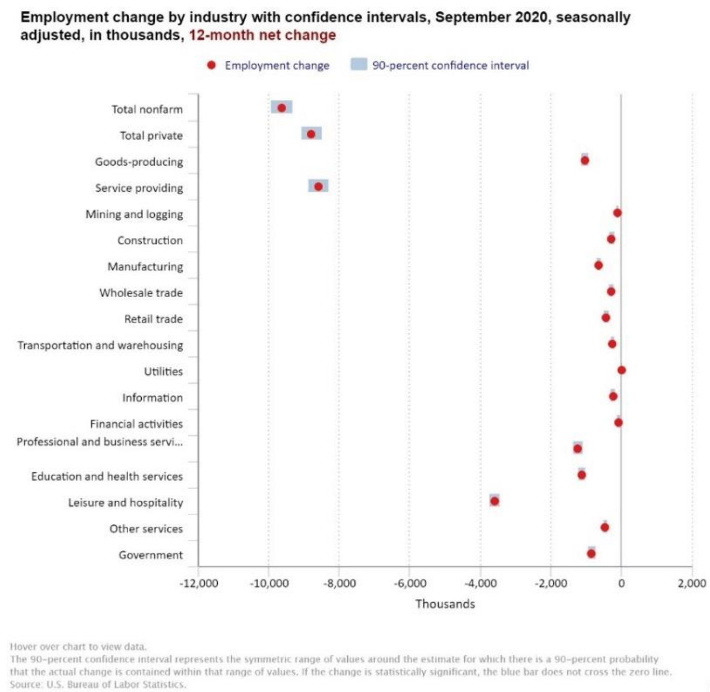
Source: Bespoke Investments

Perhaps supporting the general optimism in markets, so far in the 3Q earnings season (as of this writing), results have been strong. According to Bespoke, "…by nearly all measures the [Q3 earnings season] has been the strongest we've ever seen when it comes to EPS, sales, and guidance numbers. As shown below, the percentage of stocks that are reporting "triple plays" -- a stock that beats EPS estimates, beats sales estimates, and raises guidance -- is at a new record." This data is certainly encouraging since it is harder to fake top line growth and it is easier forgo guidance because of COVID-19. It suggests that many companies are effectively navigating through the difficulties rather than merely artfully managing EPS (Earnings Per Share). On the other hand, given the uncertainty, expectations were low and visibility was more limited than usual with many companies still declining to provide guidance.

Volatility, as measured by the CBOE VIX Index (the "VIX"), continued to decline from the elevated levels of the first quarter, declining ↓ 13.3% during the third quarter. Yet, the index fluctuated significantly month-to-month declining ↓ 19.6% in July, spiking ↑ 8.0% in August, and remaining elevated in September, essentially flat for the month. Year over year, the VIX closed the quarter at 26.37 vs. 16.24 the same last year. Blame COVID-19 and the uncertainties that have arisen from on-again off-again shutdowns and on-again and off-again fiscal stimulus expectations. In short, there still many things that are hard to forecast, not the least of which is the upcoming election and the market's response to the outcome (assuming we have an outcome, that is).

But, let's face it, this has been an uneven recovery and we expect that to continue. There are businesses that may never fully recover (to prior levels of activity) including airlines, hotels, retail, retail real estate, etc. In some cases, like gyms, movie theaters and local restaurants, there may be very few left standing at all. Mostly, this has been a direct about-face in terms of where trends were going -- consumers' desire for the experiential. For several years leading up to the COVID-19 crisis, businesses that had pivoted to address this consumer-driven phenomenon thrived. That's not to say that we won't eventually get back to some version of normal, but likely at activity levels well-below the peak. That said, we see most of the permanent change on the corporate side. Are businesses really going to be retaining their current real estate footprint as lease come up for renewal? Are employees going to be traveling with the same frequency as before now that there is comfort with ZOOMing in lieu of face-to-face meetings for most purposes? Or now that corporations are used to spending less in their T&E budgets? We don't think so. We expect many of the sectors most impacted by the crisis to find ways to pivot back to a focus on the consumer – the airline industry is a great example. We think this will mean more price competition, lower fares and lower margins. Additionally, for better or for worse, COVID-19 has accelerated trends that were already present and had been in place for some time. In technology, trends like cloud adoption and digitization. In retail, the demise of brick & mortar retail in favor of e-commerce.

We continue to be concerned with how much unemployment will become permanent. Even if we get more fiscal stimulus, eventually direct payments to those most impacted have to end (or maybe not if progressive socialists get their way on things like "universal income"). And, as we stated above, some of the changes in certain industries may be long-lived. The chart to the right shows that through the end of September, the Leisure and hospitality and the Service providing industries have not recovered yet. Further, despite the fundamental outperformance of Information Technology companies, they have only maintained employment levels, rather than increasing headcounts enough to offset declines in other industries.



Source: U.S. Bureau of Labor Statistics

Finally, the Fed seems to be out of the picture in terms of incremental action and therefore, incremental impact on markets. While there still seems that there is more the Fed can do should things deteriorate further, the idea of a Fed further accelerating real growth in the economy in the absence of fiscal stimulus and a Fed "put" helping markets seems dated at this point. That leaves markets vulnerable to the political winds in Washington, perhaps a bit "over its skis" fully pricing in more stimulus – with only the size and timing dependent on election results. There is danger here in assuming too much. In our view, it may be too little too late to help small businesses, which are the backbone of future employment growth.

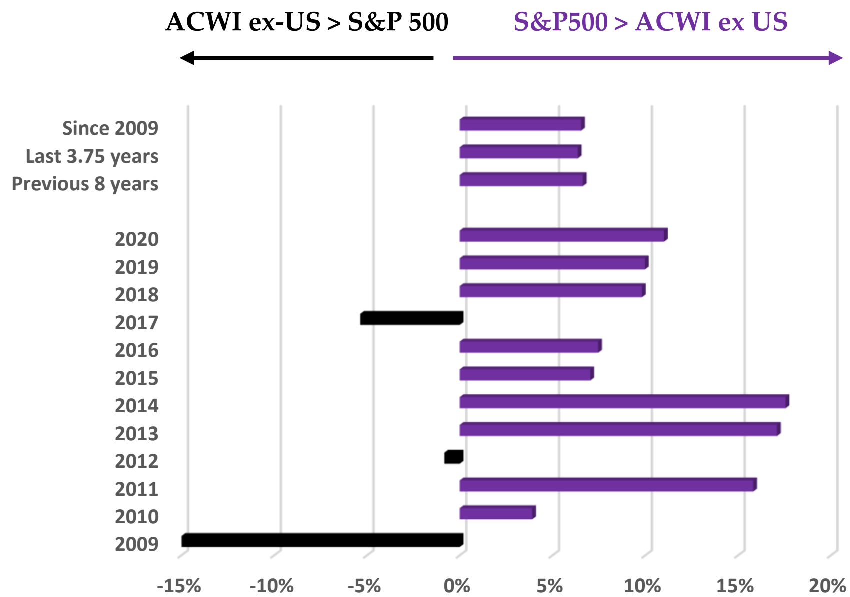
Asset Class / Style Performance

From an asset class perspective, results were positive almost across the board for stocks, bonds and most alternative investments. Notably, the dollar underperformed, as it did in the second quarter, which we think may be more typical than not for the foreseeable future.

- The S&P 500 continued its recovery in the third quarter, up ↑ 8.9%. Again, the US outperformed international stocks (MSCI ACWI ex-US Index), up ↑ 6.3%. Although, given US-specific issues surrounding the election, the disparate economic recovery in Asia without a COVID–related setback, and an expected weaker dollar, we believe international markets may start to claw back some of this disparity. Similarly, Growth (RLG Index) extended its dominance over Value (RLV) in 2020 by better than + 35.9%. While expect some reversion to the mean in the short-run, especially in the face of a sustainable economic recovery, progress in controlling COVID through a vaccine, and/or more fiscal stimulus in the meantime, we expect the tailwinds for growth to continue generally as technology becomes more essential across the economy. More detail on relative equity performance below.[i]
- Bonds were positive with the Bloomberg Barclays US Aggregate Bond Index up ↑ **0.6**% and the Bloomberg Barclays Global Aggregate Index up ↑ 2.7% for the quarter. With Fed buying, the short end of the curve saw yields decrease more than the yields on the long end, steepening the curve a bit. The spread on the US 3M – 10Y increased from 50 bps to 56bps. The spread on the US 2Y – 10Y treasuries increased from 66 bps to 69 bps.[ii]
- As mentioned earlier, the VIX (S&P 500 Volatility Index) decreased ↓ **13.3**% during the quarter.[iii] However, we would expect things to get more volatile the closer we get to the election and perhaps in the weeks thereafter depending on the timing of the result.
- Gold continued its upward march ending the quarter up ↑ 3.6%.[iv] We continue to be concerned that the massive monetary and fiscal stimulus injected into the financial system in reaction to the COVID-19 pandemic around the world will eventually erode investor confidence in fiat currencies including the US Dollar. Perhaps gold's move is a recognition that massive fiscal stimulus may be in the cards (and may have been priced into the markets in some fashion).
- During the quarter, it was hard to ignore the performance of cryptocurrencies, especially bitcoin. According to Coinbase, the price of a bitcoin rose from $9,136 to $10,780, up almost 18% for the quarter. And, as of this writing, it has continued its march higher so far in the fourth quarter. As holding cryptocurrencies becomes easier for institutional and individual investors alike, it appears that the seeds are being planted for a new "asset class." However, given the volatility (even if it's mostly been on the upside lately), cryptocurrencies seem more of a speculative version of gold rather than a medium of exchange. And we think that's unlikely to change any time soon.
- As is often the case, as gold (and cryptocurrencies) rose and concerns about profligate spending by fiscal and monetary authorities re-emerged, the US Dollar (as measured by the USDU) declined by ↓ 3.4%.[v] Investors may have also seen little need for safety and markets rose.

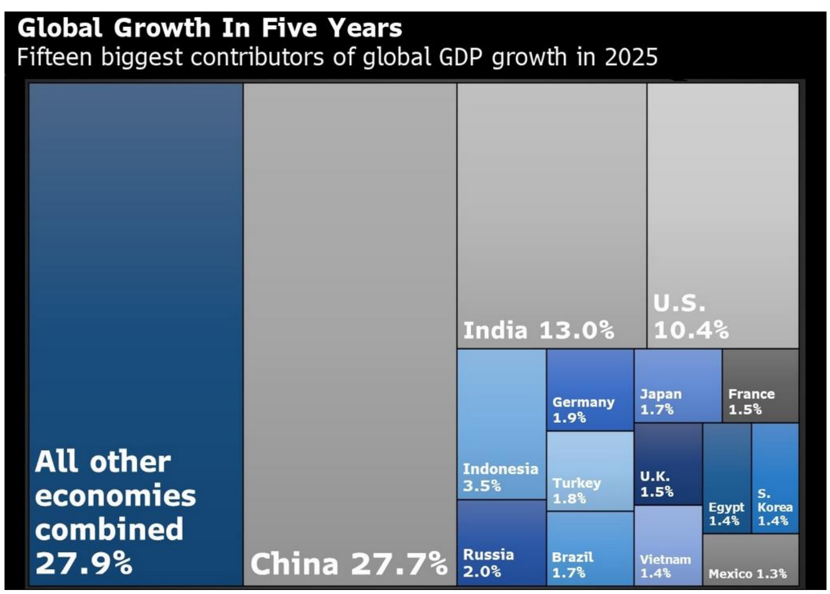
US Equities vs. International Equities. As stated above, the S&P 500 Index was up ↑ 8.9% in the third quarter. That compares with international markets as reflected by the MSCI ACWI ex-US Index up ↑ 6.3% in the third quarter. That said, The MSCI China Index rose ↑ 12.5%, outperforming the S&P 500 after underperforming in the second quarter.

Annual Return Spread between
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.

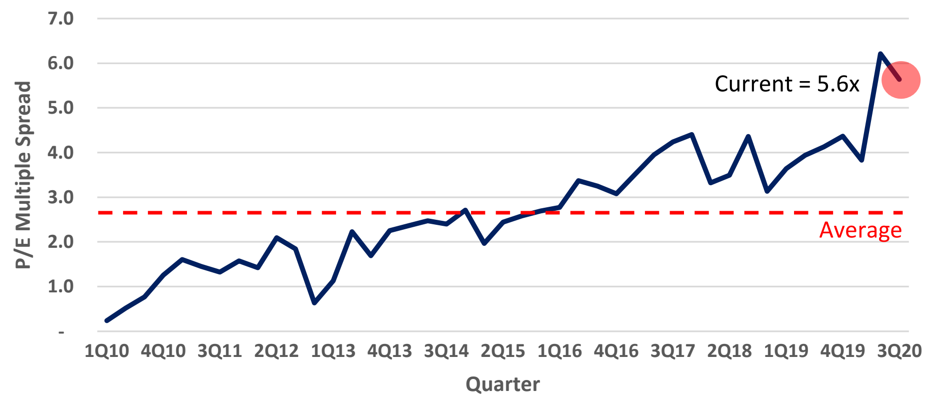
As the table above indicates, this trend of US outperformance continues and has been pervasive over the last ten years. However, unlike Growth's expected dominance of Value for secular reasons (see below), we don't expect the US advantage over international stocks to persist because we think secular trends favor international. According to a November 3rd Bloomberg article, the US is expected to contribute only 10.4% of global GDP growth in 2025, yet today accounts for over 41% of global market capitalization according to Bloomberg estimates.



Source: Bloomberg analysis of IMF data.

Further, valuation differentials seem overdone, even after considering that US stocks as a whole should trade at a premium to most other markets based upon the US market's size, stability, system of laws, and consistently applied accounting principles.

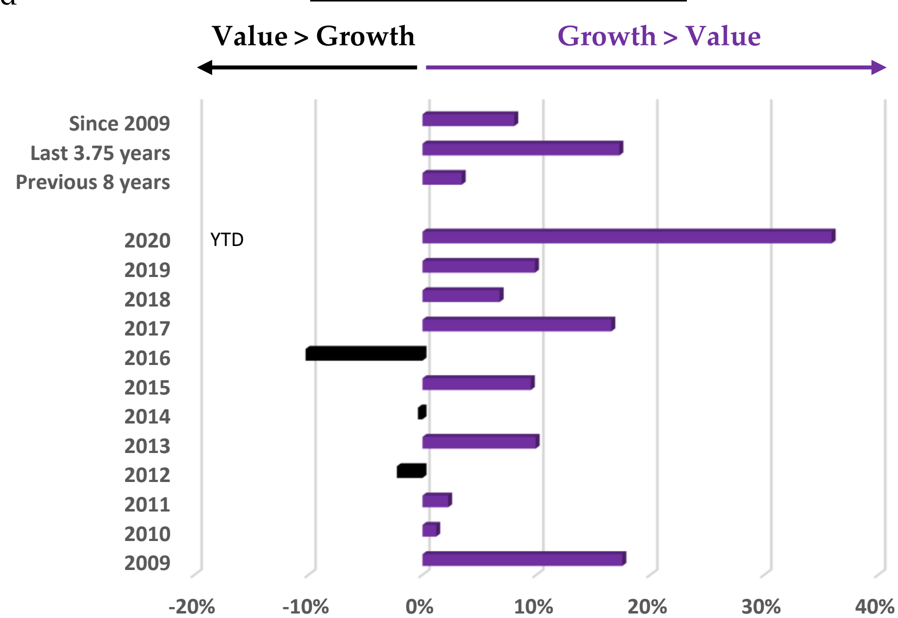
Quarterly P/E Multiple Spread between
S&P 500 (SPX) vs. MSCI ACWI ex-US (MXWDU)



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

Growth vs. Value. The Russell 1000 Growth Index (RLG ↑ 13.2%) continued to outperform the Russell 1000 Value Index (RLV ↑ 5.6%) during the quarter making the relative outperformance of Growth + 35.9% for 2020. As we mentioned above, we feel the unusually wide "spread" between the two cannot continue indefinitely. That said, we think it's interesting that many -- mostly Value managers who have massively underperformed growth over the last ten years in a sort of "triumph of hope over experience" kind of way -- suggest that this is largely the result of undisciplined "Robinhood-type" traders who wildly speculate as they blindly follow trends and momentum. Certainly there is some over-exuberance in certain names, some of which we have called out in the past, but this intentionally simplistic idea ignores the many growth-oriented equities benefit from secular trends that have accelerated as a result of

Annual Return Spread between
Growth (RLG) vs. Value (RLV)



Source: Bloomberg, Validus.
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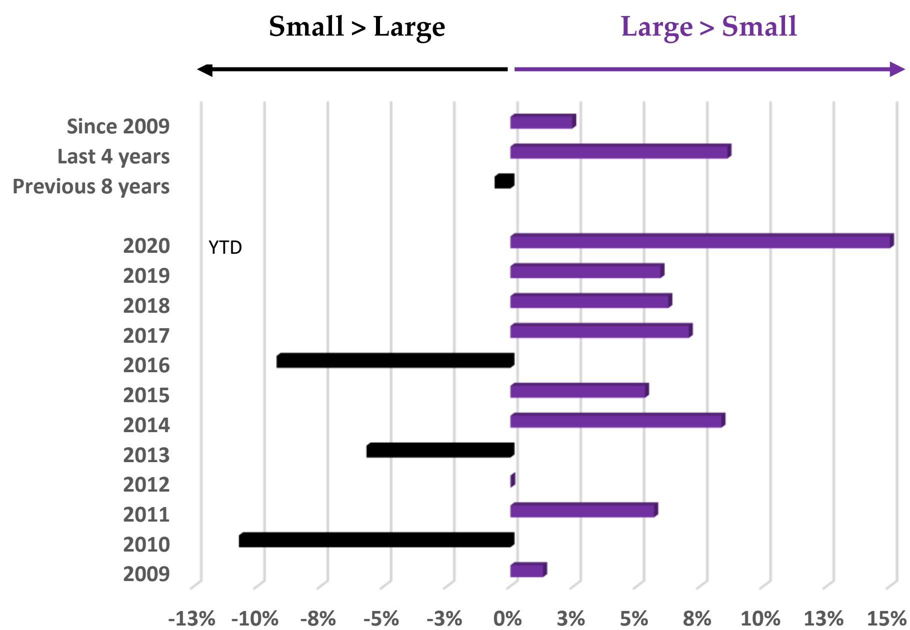
COVID-19 including the transition to the cloud, the digitization of data, the rise of ecommerce, and sophisticated and customized direct-to-customer sales and marketing strategies.

Large vs. Small. The Russell 1000 Index (Large Cap: RIY ↑ **9.5**%) continued to outperform the Russell 2000 Index (Small Cap: RTY ↑ **4.9**%) during the quarter making the relative outperformance of Large Cap **+ 15.1**% for 2020. However, as the table below demonstrates, Large Cap's performance advantage is a more recent phenomenon. While it's true that the largest companies, especially in the Tech sector, tend to have a competitive advantage as they swallow up many would-be competitors, we think small cap stocks will once again have their day in the sun, especially in exiting a recession.

Annual Return Spread between
Russell 1000 Index (RIY) vs. Russell 2000 Index (RTY)



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

Sector Performance. During the quarter, all sectors, except for Energy, posted positive returns. The recovery trade largely continued, though with waning enthusiasm as the economy trudged forward despite the pandemic. There seemed to be more enthusiasm for cyclical stocks that are expected to recover more rapidly in a return to normalcy. To that end, the top three performing sectors were: Consumer Discretionary (↑ **15.1**%), Materials (↑ **13.3**%) and Industrials (↑ **12.5**%). The bottom three performing sectors included: Financials (↑ **4.4**%), Real Estate (↑ **1.9**%), and Energy (↓ **19.7**%) -- all three have largely been underperforming all year. As you can see below, this continues a horrible run for the Energy sector that extends back over the last seven years.

Periodic Table of Sector Performance

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Q1 2020	Q2 2020	Q3 2020
CS	TECH	RE	UTIL	FIN	CD	UTIL	CD	ENER	TECH	HC	TECH	TECH	CD	CD
HC	MAT	CD	CS	CD	HC	RE	HC	CMS	MAT	UTIL	CMS	HC	TECH	MAT
UTIL	CD	IND	HC	CMS	IND	HC	CS	FIN	CD	CD	FIN	CS	ENER	IND
CMS	IND	MAT	RE	HC	FIN	TECH	TECH	IND	FIN	TECH	IND	UTIL	MAT	TECH
CD	RE	ENER	CMS	RE	TECH	CS	CMS	MAT	HC	RE	RE	CMS	CMS	CS
ENER	HC	CMS	CD	IND	CS	FIN	RE	UTIL	IND	CS	CD	RE	IND	CMS
IND	FIN	CS	ENER	MAT	MAT	IND	FIN	TECH	CS	CMS	CS	CD	HC	UTIL
TECH	CS	FIN	TECH	TECH	ENER	CD	IND	CD	UTIL	FIN	UTIL	MAT	RE	HC
RE	ENER	TECH	IND	CS	UTIL	MAT	UTIL	CS	RE	IND	MAT	IND	FIN	FIN
MAT	UTIL	UTIL	MAT	ENER	CMS	CMS	MAT	RE	ENER	MAT	HC	FIN	CS	RE
FIN	CMS	HC	FIN	UTIL	RE	ENER	ENER	HC	CMS	ENER	ENER	ENER	UTIL	ENER

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.
Past performance does not guarantee future results.
Investors cannot invest directly in a sector index.

Market Valuation

Despite the rapid recovery in markets that has substantially outpaced the economic recovery itself, we are not necessarily daunted by general market valuations, especially when you consider valuation on a company-specific basis as we do – we subscribe to the notion that the stock market is not a monolithic entity, it is a "market of stocks". Further, we would expect the market to "factor in" the economic environment six months from now, which should be substantially more favorable with more herd immunity, a vaccine and better therapies to deal with COVID-19, while recognizing current headwinds or tailwinds.

That all said, we acknowledge that on a macro basis markets seem on the expensive side of fairly valued even when considering a much lower for longer world in terms of interest rates and the resulting "T.I.N.A." (There Is No Alternative) philosophy that makes equities extremely attractive on a relative basis. In general, owning equities that do not have the capacity to dictate their own success regardless of the circumstances by "tacking" as economic winds change seems unnecessarily risky to us. As does betting solely on macro forces like "fiscal stimulus" or "infrastructure programs" that largely lie outside of the control of a single company.

As we enter the last quarter, we expect that volatility will pick up as we get closer to the election. Once we have certainty of an outcome, we think the equity markets could rally in relief, especially if the result increases the chances of a large stimulus package. The wild card, of course, is how COVID-19 behaves as we enter the fall and winter months and whether shut-downs become severe and/or widespread.

In any case, we will keep our focus on what we can control and understand – individual companies that have the opportunity for success no matter the circumstances.

Sincerely,

Mark C. Scalzo
Chief Investment Officer

Important Disclosures:

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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.

CAA-12589 (08/20)

Please contact VALIDUS Growth Investors for additional information

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