NEWSLETTER

THIRD QUARTER 2020

Guided by value.

KOVITZ

MARKET INSIGHTS

THIRD QUARTER 2020

Ain't nothin' gonna break my stride
Nobody gonna slow me down, oh no
I got to keep on moving
Ain't nothin' gonna break-a my stride
I'm running and I won't touch ground, oh no
I got to keep on moving

| MATTHEW WILDER, "BREAK MY STRIDE"

On August 10th, after eking out a modest 0.28% gain on the day, the stock market[1] recovered the last bit of the ground it lost during the pandemic-induced sell-off earlier this year. All told, it took 33 days for the market to lose nearly 34% and 140 days to gain it all back. Not even six months elapsed from start to finish.

Since 1929, there have been nine instances of the stock market declining 25% or more following an all-time high. As you can see in the table below, the 2020 drawdown is notable for both the speed of the decline, but even more so for the rapidity of the recovery. You would be forgiven a sore neck from the whiplash.

Drawdowns since 1929

Rank	Drawdown	Dates			Days		
		Peak	Trough	New Peak	Drawdown	Recovery	Total
1	-86.19%	9/16/1929	6/1/1932	1/28/1946	989	4,989	5,978
2	-55.22%	10/9/2007	3/9/2009	4/2/2012	517	1,120	1,637
3	-47.42%	9/1/2000	10/9/2002	10/23/2006	768	1,475	2,243
4	-44.80%	1/11/1973	10/3/1974	7/9/1976	630	645	1,275
5	-33.79%	2/19/2020	3/23/2020	8/10/2020	33	140	173
6	-32.93%	8/25/1987	10/19/1987	5/15/1989	55	574	629
7	-32.58%	11/29/1968	5/26/1970	3/15/1971	543	293	836
8	-26.88%	12/12/1961	6/26/1962	4/15/1963	196	293	489
9	-25.22%	5/29/1946	5/19/1947	9/30/1949	355	865	1,220

Source: Kovitz, using data from Bloomberg.

"But, is it real?" This is a question we often receive. It might seem odd that the stock market is oscillating around its all-time high while unemployment remains above 8%, around 200,000 deaths in the U.S. have been attributed to COVID-19 over the last six months, and the country continues to lose roughly 750 more people per day to the pandemic. In addition, many feel detached from the world from being cooped up in our houses and practicing social distancing for the past six months.

[1]All references to the "stock market" or the "market" refer to the S&P 500 Index and all returns include the reinvestment of dividends into the index, except periods prior to 1936.

Yet, as we discussed in our commentary last quarter, there are two main factors that are strongly supportive of current stock market valuations. First, the accommodative monetary policy enacted by the Federal Reserve – exemplified by near-zero interest rates – is making all forms of credit, from home mortgages to commercial loans, easier to attain by businesses and individuals. Earlier this month, Jerome Powell, Chairman of the Federal Reserve, declared that the fed funds target rate will likely remain in its current 0%-0.25% range until at least 2023. In such an environment, stocks become relatively more attractive purely for a lack of alternative means of generating returns.

Second, and perhaps more important from a mathematical perspective, the effects of COVID on various industries are not evenly distributed and those companies least impacted happen to already make up the lion's share of the stock market's total capitalization.

It is often said in some circles that the stock market does not equal the economy. It would be inaccurate to believe the two are completely unrelated, but a more apt phrasing would be that the stock market roughly approximates future expectations for the economy, while neither the stock market nor the overall economy necessarily reflects the experience of the median person in the economy.

In some ways, the recession is essentially over for a certain subset of the population – mainly those with college degrees and higher incomes. These two factors are strongly correlated with the ability to work from home. On the other end of the spectrum are those with only a high school diploma or who never completed high school. These individuals – who tend to have lower incomes, jobs disproportionately located in the hospitality, food service, and retail sectors that have been decimated by COVID, and no ability to work from home – continue to experience what feels to many of them like a deep recession.

To be sure, there is some diversity of experience among these groups. Not everyone in the former group is unaffected by the pandemic, just as not everyone in the latter group is struggling. However, on the whole, the fortunes of these two groups continue to diverge.

Nevertheless, current stock market valuations express the long-term view that better days are ahead for the overall economy and that hypothetical median person. At Kovitz, we are generally supportive of this view. The United States and the world are not faced with an intractable credit crisis coupled with a loss of confidence such as that faced during the Great Depression, or even the 2008 Global Financial Crisis. There is a singular problem faced by humanity: COVID-19. There is merit in the idea that a combination of continuously improving treatments for COVID-19 and the scientific community inching closer to a vaccine will eventually lead to an end to the pandemic. At the very least, these developments will result in a dramatic decrease in the impact of the disease.

In the long run, human progress through technological innovation, rising living standards, increasing life expectancy, and virtually every other metric moves forward. Always forward. We would not bet against that changing.

"IS NOW A GOOD TIME TO INVEST?"

There are many reasons we are asked this question, but the one with the most practical implications is when it comes from a client who finds herself in possession of a significant amount of cash. There is often much hand-wringing – from clients and advisors alike – over whether to get that money invested in stocks right away or to invest it over time. The latter method, referred to as dollar-cost averaging ("DCA"), might appear to be the sensible approach. After all, what if you invest the entire amount on day one and the market embarks on a significant decline on day two? Following periods of increased volatility, such as the last seven months, it may seem even more sensible to take a measured approach.

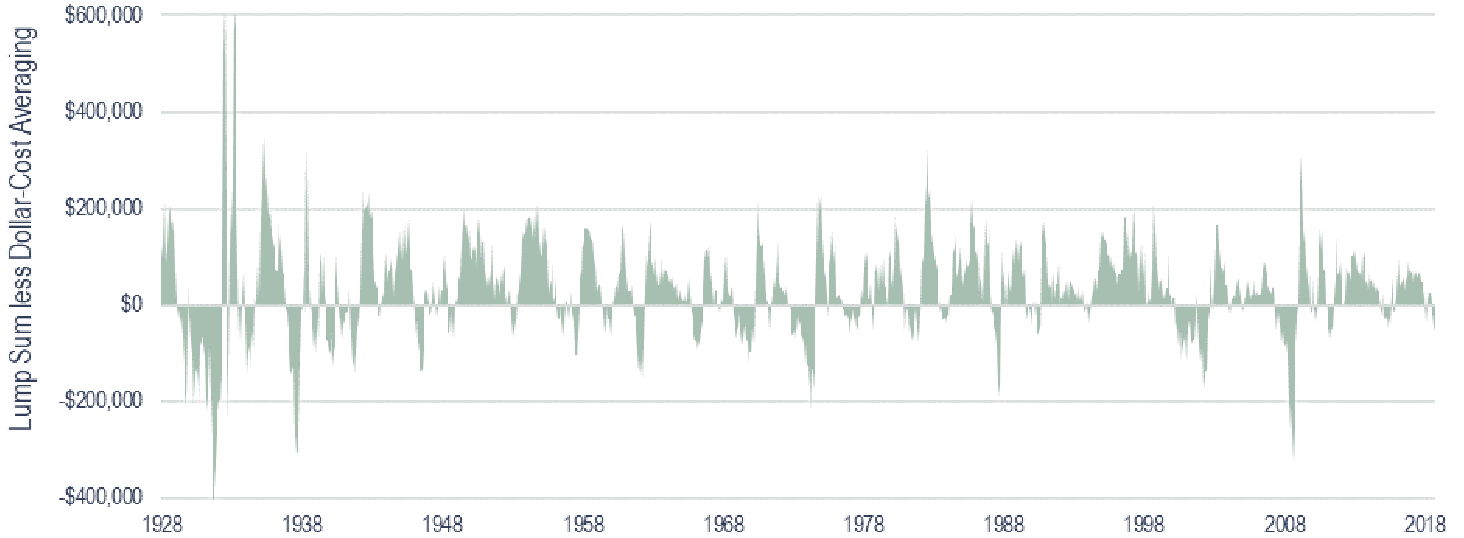
However, the experience over the 93-year history of the S&P 500 tells us the more profitable approach is to just hold your nose and dive in all at once. Intuitively, this should not come as much of a shock for two reasons:

1. No one can predict short-term market movements.

2. The stock market has produced a 9.4% average annualized return since 1928. On average, it was better to be invested in the stock market than to hold cash.

The following chart shows the difference in dollars between investing a $1 million lump sum into stocks and dollar-cost averaging using quarterly investments over the course of a year for each of the 1,102 months since January of 1928. This assumes uninvested cash earns 3.3%,

which is the average annualized return on Treasury bills during the period being analyzed[2] . This return on cash also happens to be about 3.2% higher than the current yields available on T-bills.



Source: Kovitz, using data from Bloomberg and Kenneth R. French Data Library

As you can see, for most periods, the lump sum invested on day one resulted in a larger portfolio value at the end of the year. In fact, the lump sum approach produced a better result 67% of the time, or twice as often as the DCA approach. On average, the lump sum approach resulted in an extra $31,000 in the investor's pocket at the end of the year. Furthermore, when the lump sum approach was better, it produced an average $81,000 gain relative to DCA, while periods where the DCA approach was superior resulted in a smaller average gain of $69,000 relative to the lump sum approach.

Lump Sum vs Quarterly Dollar-Cost Averaging			
	All Periods (Lump Sum less DCA)	If Lump Sum Wins (Lump Sum less DCA)	If DCA Wins (DCA less Lump Sum)
Number of Periods	1,102	738	364
Average	$31,000	$81,000	$69,000
Median	$31,000	$66,000	$49,000
90th Percentile	$46,000	$163,000	$148,000
10th Percentile	$(79,000)	$14,000	$10,000

Source: Kovitz, using data from Bloomberg and Kenneth R. French Data Library

At this point, it is reasonable to wonder if the results are different if the market is trading at an "expensive" valuation. To answer this question, we reviewed the results for the 10% of periods in which the stock market had the highest, or most "expensive," valuation[3]. Even in these periods, the lump sum approach still produced an average advantage of nearly $11,000 relative to the DCA approach.

Further adjusting our definition of "expensive" to account for the prevailing level of interest rates at the time[4], the results are the same. Once again, in the 10% of periods beginning when the stock market was the most expensive relative to the level of interest rates at the time, the lump sum approach left an investor $14,000 better off on average.

[2] Source: Kenneth R. French Data Library

[3] Here, the valuation of the stock market is measured by the cyclically adjusted price-earnings (CAPE) ratio developed and published by Robert Shiller at Yale University.

Most “Expensive” Decile for Stocks		
	Highest Valuation	Adjusted for Interest Rates
Number of Periods	110	110
Average, Lump Sum vs. DCA	$11,000	$14,000

Source: Kovitz, using data from Bloomberg and Kenneth R. French Data Library

Lastly, since it is a period in which we currently find ourselves, we reviewed periods that began in Presidential election years. Some may assume the potential for a change in leadership of the United States would lend itself towards a more cautious approach. If history is a guide, the more cautious approach would be to invest that lump sum right away because that has generated an average of $32,000 in incremental portfolio value.

There are of course a number of periods where an investor would have been better off – sometimes substantially so – using the dollar-cost averaging approach. Also, an extra $31,000, or only 3% of the assumed lump sum amount in this analysis, is unlikely to mean the difference between achieving one's financial goals and not.

The important take-away from this exercise is that the conventional wisdom of dollar-cost averaging being the more prudent approach when investing cash into the stock market is not supported by the past 93 years of market data. Hopefully this helps reduce some of the consternation and second-guessing that often accompanies the question, “Is now a good time to invest?”

STRATEGY HIGHLIGHTS

CORE EQUITY

In the Kovitz Core Equity strategy, we continue to locate opportunities that we believe upgrade the overall business quality of client portfolios and that can be purchased at reasonable prices.

FIXED INCOME

We remain defensively postured and keenly focused on the asset allocation benefits of core fixed income: diversification, stability, and liquidity.

HEDGED EQUITY

The Kovitz Hedged Equity strategy continued to perform above our expectations. The strategy has generated a positive return during each of the three quarters in 2020 while displaying a very low correlation to both stocks and bonds. This is an attractive combination in almost any environment, but even more so during a time period with both an extraordinary amount of stock market volatility and a historically low level of interest rates that we've witnessed throughout 2020.

Be well. Stay safe. And wear a mask.

Your Kovitz Team

[4] A stock market that trades at 20x earnings, which is equivalent to a 5% earnings yield, is not as expensive when the yield on 10-year Treasury notes is under 1% as it is when the 10-year Treasury yield is at 5%. If we take the reciprocal of the Shiller CAPE, we get a cyclically adjusted earnings yield. Deduct the prevailing yield on Treasury bills at the time and we are left with an approximation of the amount of return investors are demanding to take on the risk of investing in stocks relative to a risk-free instrument like a Treasury bill. When that spread is low, stocks are relatively expensive.

Kovitz Hedged Equity strategy is for accredited investors only.

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CORE EQUITY COMMENTARY
THIRD QUARTER 2020

MARKET AND PERFORMANCE SUMMARY

For the quarter ending September 30, 2020, the Kovitz Equity Composite[1] (the "Composite") increased by 10.9%. During the same time frame the S&P 500 increased 8.9% and the Russell 1000 Value Index increased 5.6%.

The S&P 500 ended the quarter roughly 52% higher than the panic-induced low on March 23, and slightly above its pre-virus high reached on February 19, 2020 (all figures include the effect of dividends reinvested into the index.) Included in this period was the U.S. stock market benchmark's largest 100 trading day rise since 1933 – a fairly befuddling achievement in the midst of a pandemic which has seen large swaths of the economy closed for months at a time.

Conventional wisdom suggests that the economy and the stock market move somewhat in tandem; what's good/bad for one should be good/bad for the other. While it may be counter-intuitive, there are many times where this relationship does not hold and "Wall Street can be completely disconnected from Main Street." Certainly, in the time of COVID-19, the stock market couldn't be more divorced from the United States' broader economic situation.

Why? The vast majority of stock investors look beyond present economic conditions toward what they believe will likely happen in the future. In other words, the economy measures where we are today, while the stock market attempts to predict where the economy is going. Since markets tend to be forward-looking, investors have already accounted for what was an expected cataclysmic drop in economic activity and are forecasting a relatively rapid economic recovery in the coming year.

The pandemic has also highlighted a deeper trend. For decades, the market has been growing increasingly detached from the mainstream of American life, mirroring broad changes in the economy. Part of the reason for this is the makeup of the stock market, and the fact that the giant companies that make up the S&P 500 operate under very different circumstances than the nation's small businesses. Larger companies tend to be highly profitable, hold significant sums of cash, and have regular access to public debt markets. With roughly 40% of the revenues of S&P 500 companies coming from outside the U.S., they are also far more global than the typical American firm.

"The stock market is comprised of the biggest and strongest companies.... It is not representative of the entire economy," William Ackman, founder of Pershing Square Capital Management LP, wrote in a recent letter to shareholders. "If there were a stock market index of private, small businesses, it would likely be down 50% or more."

In fact, there are more than one million U.S. companies with at least 10 employees and only about 3,600 of those — or less than ½ of 1 percent — are publicly listed. Because the financial strength of big companies makes them more likely to survive a downturn, business values are more durable despite the impact of a widespread economic collapse. Even more to the point, market indexes like the S&P 500 are weighted to reflect the performance of the largest and most profitable companies. In recent months, the stocks of such companies have not only veered in the opposite direction of the outlook for the U.S. economy, but from the rest of the stock market itself.

The five largest listed companies — Microsoft, Apple, Amazon, Alphabet and Facebook — have seen their businesses minimally impacted by COVID-19, and some have even benefitted. Each has seen its shares climb this year, as investors bet these goliaths will continue to press their advantages and will emerge in an even more dominant position after this calamity is through. Year-to-date, through the end of September, shares of these companies rose on average over 40% and accounted for over 125% of the S&P's return. These five firms now make up approximately 23% of the market value of the index, the highest level for the five largest constituents in 30 years.

One way to gauge the outsize influence of those stocks: A version of the S&P 500 that gives every stock an equal weighting, ended September down 5% year-to-date. Within the S&P 500, the energy, financials, utilities, real estate, and industrial segments are still in the red.

Another likely cause of the current distortion between Wall Street and Main Street is that market participants see a bullish asymmetry in the market's current set-up. First of all, the Federal Reserve has reduced short-term interest rates and expanded its balance sheet through open market purchases of securities, primarily treasury and mortgage-backed bonds. The Fed has signaled they will do whatever it takes to prop

[1] The returns for the equity portion of your individual account will differ somewhat from the Composite due to variations in account holdings, cash position, and other client-specific circumstances.

up the economy. Secondly, despite current wrangling in Washington D.C., investors believe there will likely be more fiscal stimulus similar to the previously passed Coronavirus Aid, Relief and Economic Security (CARES) Act if things get materially worse in the economy.

On the other hand, if the economy continues its slow improvement, the Fed is most likely not going to immediately begin tightening interest rates. In a new policy announcement, the Fed recently stated it is moving to a more flexible form of inflation targeting. Rather than maintaining its prior objective- to keep inflation at 2 percent, the Fed will aim for an average inflation level of around 2 percent. In other words, they will hold off on raising rates until it sees persistent demand-driven inflation above 2% (i.e. they will let inflation run "hot" to restore the 2% average). (Note: while the intent of the Fed policy is to fortify expectations around how long short-term rates will remain low, we have no confidence in our ability to predict whether the Fed will be successful in threading this proverbial needle.)

As we know too well, there are always many unknowns that could upset this bullish tilt to the market. London Business School Professor Elroy Dimson once said, "Risk means more things can happen than will happen." This simple statement encapsulates why uncertainty and risk are inescapable, particularly in the field of investing. Understanding that this is just a natural and ordinary part of the investment landscape is why we remain singularly focused on ascertaining the difference between what we think a business is worth and its current stock price. This emphasis on business value, as opposed to share price action, empowers us to act when others may be fleeing the markets. Through experience, we know that business values are far less volatile than stock prices and with patience, share price ultimately converges with business value.

We believe there are certain stocks of great businesses, with durable balance sheets and reasonably predictable cash flow streams, that are undervalued relative to their future earning power. For those focused on long-term horizons, it's a good time to be investing in such opportunities. Just like always.

The chart below summarizes annualized performance over various standard time periods ending September 30, 2020 and cumulative performance results from January 1, 1997 through September 30, 2020 for the Composite.

KOVITZ CORE EQUITY COMPOSITE[1]
ANNUALIZED AND CUMULATIVE EQUITY PERFORMANCE (NET OF FEES)

	Average Annual Total Returns							Cumulative
	Quarter to Date	Year to Date	1 Year	5 Year	10 Year	20 Year	Since Inception (1/1/97)	Since Inception (1/1/97)
Core Equity Composite	10.9%	-3.6%	2.9%	9.1%	10.1%	7.1%	9.9%	842.3%

[1]The returns for the equity portion of your individual account will differ somewhat from the Composite due to variations in account holdings, cash position, and other client-specific circumstances. Please refer to the last page for a complete GIPS compliant presentation, along with important disclosures.

The table below lists the results for the same time periods as above for the S&P 500 and many of the other benchmarks widely held as investments via a style-box approach.

OTHER MARKET INDICES
ANNUALIZED AND CUMULATIVE EQUITY PERFORMANCE

	Average Annual Total Returns						Cumulative
	Year to Date	1 Year	5 Year	10 Year	20 Year	Since Inception (1/1/97)	Since Inception (1/1/97)
S&P 500	5.6%	15.1%	14.1%	13.7%	6.4%	8.6%	610%
Large Cap Value (Russell 1000 Value)	-11.6%	-5.0%	7.7%	9.9%	6.2%	7.7%	478%
Small Cap Equity (Russell 2000)	-8.7%	0.4%	8.0%	9.9%	6.9%	7.6%	470%
International Developed (MSCI EAFE)	-7.1%	0.5%	5.3%	4.6%	3.6%	4.4%	177%
International Emerging (MSCI EEM)	-1.2%	10.5%	9.0%	2.5%	7.8%	5.9%	293%
Gold	21.4%	25.4%	10.0%	2.9%	9.3%	6.7%	362%
Commodities (CRB)	-19.8%	-14.0%	-4.1%	-5.8%	0.2%	0.9%	24%

Source: Bloomberg

Below is a graph of the Kovitz Composite's cumulative return since inception relative to the cumulative return of the S&P 500 over the same time period. The area between represents the Composite's excess return over the benchmark.

Since inception on January 1, 1997, our investors' equity capital has compounded at a rate of 9.9% annually versus 8.6% annually for the S&P 500. The Composite's cumulative return since inception is 842%, versus 610% for the S&P 500. While the outperformance on an annual basis may not seem that significant, the extraordinary power of compounding is such that this relative outperformance over 23 and three-quarter's years has generated considerable rewards for our clients. In dollar terms, $1 million invested in the Composite at inception would now be worth $9.4 million at September 30, 2020. By comparison, a similar investment in the S&P 500 would now be worth $7.1 million.

KOVITZ DIFFERENCE
GROWTH OF $1 MILLION INVESTMENT

Source: Kovitz using data from Bloomberg

PORTFOLIO ACTIVITY

When the dust settled after two of the most unforgettable and unpredictable quarters in market history, we were fortunate to have been able to initiate numerous new positions, add to several existing positions, and generally upgrade the quality of the portfolio. As such, we entered the second half of the year with a well-balanced portfolio of businesses we believe are positioned to generate solid returns amidst a variety of market conditions. Despite the myriad risks, the expected forward returns of the portfolio today look substantially better than it did even a year ago, and we would argue the quality is also higher.

Our activity during the first half centered around optimizing our portfolio's expected return profile and balancing risk and reward through adjusting position sizes based on our conviction of each company's intrinsic value estimate. An identifiable theme of this positioning was to focus on outstanding businesses that we believed would weather any coronavirus-related macroeconomic downturn well and emerge stronger on the other side due to the possession of one or more competitive advantages.

This quarter's activity continued along similar lines, though was somewhat more subdued as the opportunity set became much more limited due to the surge in market levels. However, we were still able to build two new positions and add to several others, while pruning a few companies where price-to-value gaps have narrowed or we felt risk-reward was more attractive elsewhere.

ARISTA NETWORKS (ANET)

Arista produces switches and routers that help power the networks for both the large cloud vendors (i.e., Microsoft) and other enterprises that place speed and functionality at the top of their priority list (i.e. banks or tier 2 cloud/SaaS providers like Adobe and Salesforce.com). From a nearly standing start nine years ago, they have grown to take almost 18 percentage points of market share against entrenched competition from Cisco (CSCO) and Juniper (JNPR). While some market participants are worried about white-box (or, un-branded) solutions becoming more prevalent and the possible lumpiness in near-term demand driven by cloud capital expenditure cycles and a concentrated customer base, we see a business where hardware solutions should see solid secular growth trends as network compute demand grows and a widening moat as their industry leading software architecture becomes more widely adopted.

Arista's business embodies many of the qualitative factors we look for in businesses that we feel can compound value over time, including:

- Solid returns on invested capital with a long runway to re-invest internally generated capital at attractive rates,
- An 'A' management team that is aligned with shareholders and owns a significant portion of the company, and
- A pristine balance sheet with no debt and nearly $40 per share in cash.

If Arista can simply hold their market position during the coming upgrade cycle, we see a path towards double-digit earnings per share growth. Given the current price, adjusted for the net cash, we are paying a below-market multiple on normalized earnings power, which looks attractive for a conceivably secular growth company.

KEYSIGHT TECHNOLOGIES (KEYS)

Keysight Technologies is a leading company in the testing and measurement industry where the company sells hardware and software that facilitates their customers' research and development (R&D) and manufacturing efforts. Keysight's products are used in all phases of the product development life cycle, from design and prototyping through manufacturing and optimization. With hardware and software used to emulate analog and digital signals, electrical currents, network traffic, and many other uses, Keysight's customers include virtually all of the leading companies in telecom equipment, semiconductors, aerospace and defense, technology, telecom operators, and university labs around the world.

Between their leading market share in most of the markets they compete in and management's concerted effort to "lead the cycle" and become ingrained in the operations of companies at the leading edge of technological change, Keysight stands to benefit from the ongoing secular shift to a digitally connected world and the penetration of communications technology into many industries where it previously played only a small role (i.e. the auto industry).

We believe the market is underestimating both the potential for growth and the stability of that growth. This is as a result of the company's intentional transition from primarily a hardware supplier weighted towards more cyclical manufacturing end markets to a supplier of integrated hardware and software weighted towards more stable R&D end markets. Further, 20% of overall revenue is currently of a recurring, subscription-based nature. That proportion is expected to grow substantially because the software and services that make up this portion are growing faster than the overall company and the company is pushing hard to transition legacy perpetual software licenses to subscriptions. Overall, we see the potential for mid- to high-single-digit long-term organic free cash flow growth with the potential for prudent capital allocation through share buybacks and acquisitions to push free cash flow per share growth into the low-double-digits. At current prices, our base expectation is for our capital to compound at that same rate and potentially supplemented by moderate multiple expansion if our expectations come to pass.

Among current positions we added exposure to during the quarter were **Autodesk (ADSK)**, A**mazon (AMZN), Becton Dickinson (BDX), Blackstone (BX), JP Morgan (JPM)** and **Motorola Solutions (MSI).**

AMERCO (UHAL)

We exited our position in Amerco, parent company of U-Haul. We have been disappointed by our investment in Amerco. Some of the strategic decisions UHAL management has made have caused us to lose confidence in their ability to compound our capital at satisfactory rates over a longer horizon. As such, we believed the capital was better placed in other portfolio companies where we have higher conviction in good outcomes.

VIACOMCBS (VIAC)

Along similar lines as UHAL, ViacomCBS is a long-term holding that has underperformed our expectations. At its core, we still believe their position as one of the top five global content producers will allow them to monetize its portfolio at attractive rates. That said, we recognize the challenges they face and acknowledge that the range of outcomes is wider than we first believed. Therefore, we decided to reduce ViacomCBS's weight in the portfolio as a reflection of our risk management practice in relation to the portfolio as a whole and the ability to recognize a loss for tax reasons, where applicable.

KOVITZ

FIXED INCOME COMMENTARY
THIRD QUARTER 2020

MARKET AND PERFORMANCE SUMMARY

Despite continued uncertainties from the pandemic, tranquility persists in the bond market. Bond yields remain low and no sector is immune. The U.S. government can borrow at an interest rate of 0.7% for the next ten years. The Coca-Cola Company issued corporate bonds this quarter paying 1% until the debt matures in 2028. The state of Maryland recently borrowed within the tax-exempt municipal bond market at a rate of 0.5% until 2027.

Low rates are also being passed through to residential homeowners. Agency mortgage-backed securities, which comprise roughly one-third of all publicly traded US debt, currently yield around 1%. Broadly measuring the U.S. investment-grade bond market, the yield on the Aggregate Bond Index[1] is down to 1.2% from 2.2% last year. Opportunities for yield are few and far between.

U.S. AGGREGATE BOND INDEX YIELD

Source: Bloomberg

The depressed yield environment is partially attributable to increased investor demand for safe-haven assets, but it is largely fabricated by the Federal Reserve ("Fed"). Fed officials expect to keep interest rates near zero through at least 2023 as they try to revive the economy and stir inflation. Their language has been stronger than during past crises, going as far as to say their goal is to overshoot the typical inflation targets. There are certainly scenarios where interest rates return to more normal levels sooner than Fed expectations, but it's not an outcome that we believe investors should be banking on.

As always, we prepare for the worst and hope for the best.

Given the meager yield opportunities across most of the fixed income landscape, we feel our approach to managing relatively concentrated fixed income portfolios is especially beneficial today. We've found our style as fixed income value investors to be surprisingly rare in the market. Most core bond managers have a broad-based strategy invested in an array of thousands of bonds, swaps, currencies, and funds. To us, these strategies ultimately look, smell, and act like the "market." Since roughly 80% of the fixed income market now yields less than 1%, we don't believe over-diversification adds value for bond investors.

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[1] Measured by the Bloomberg Barclays Aggregate Bond Index

We take a more flexible approach to fixed income investing without dedicated sector allocations. We evaluate each opportunity from the bottom-up and weigh each investment based on the relative attractiveness of the expected risk-adjusted returns. This unconstrained mindset empowers us to think and invest differently from benchmarks. The result is a composition of our best ideas that we believe still provide satisfactory absolute returns without sacrificing the safety of client principal.

We remain defensively postured and keenly focused on the asset allocation benefits of core fixed income: diversification, stability, and liquidity.

BDC BONDS

> *"A defensive investor can always prosper by looking patiently and calmly through the wreckage of a bear market."*
>
> | BENJAMIN GRAHAM

We started adding bonds issued by Business Development Companies ("BDCs") to clients' fixed income portfolios within the last few months. BDCs are publicly traded investment companies that lend to and invest in small- to middle-market businesses. Like most large companies, BDCs leverage their business by issuing corporate bonds. BDC bond prices have collectively suffered due to a perceived increase in default risk from the coronavirus pandemic. While we agree that some BDC issuers have become a credit concern, we believe that some other issuers have incorrectly been deemed guilty by association and that current depressed pricing more than compensates for the risk. Currently, BDC bonds offer some of the highest yields among bonds with an investment-grade rating.

To understand our decision to lend to Business Development Companies, it helps to understand their line of work. Congress laid the foundation for BDCs in the 1980's, seeing the need for growing companies to get access to capital where traditional banks weren't eager to lend. In other words, BDCs operate like a bank, but their loans tend to be riskier and usually offer a higher return. They play a pivotal role in keeping the private credit market functioning.

BDCs are subject to numerous regulations, and most of these restrictions are intended to create a large safety net for us as debt investors. Generally, a BDC may not issue additional indebtedness unless its asset values surpass total debt by at least 150%. If a BDC were to breach this regulatory limit, it would be forced to get back into compliance by taking such actions as selling assets to repay debt, issuing new equity, or ceasing dividends to common stockholders.

To seek even greater downside protection, we're generally limiting our investments to issuers whose level of debt is well below regulatory limitations. We're typically lending to BDCs that have 200% asset coverage. For example, with simplified numbers, if a BDC had $2 million of assets, $1 million of those assets would be financed by issuing debt and another $1 million would be financed through equity. For debt investors to suffer even $1.00 of loss, equity investors need to be completely wiped out – meaning the asset value would need to fall more than 50% in a relatively short period of time. We feel this is a significant cushion given the nature of their assets.

We focus primarily on the highest quality assets within the BDC sector, such as issuers that predominately make first-lien, senior loans which receive maximum lender protections. We're avoiding BDC issuers with high concentrations in COVID-sensitive sectors, such as energy, retail, and travel. Additionally, we're aligning ourselves with management teams with a history of conservative investment decisions.

In short, we believe BDC bonds offer some of the best risk-adjusted returns within the investment-grade bond market. Like all our core bond investments, BDC bonds exhibit limited interest rate risk and, in our opinion, negligible odds of default. We find that most of our best fixed income investments come from the most out of favor and overlooked sectors, and we believe BDC bonds fit that mold.

[2]Measured by the Bloomberg Barclays Intermediate Government/Credit Index.

Kovitz Equity Composite									
Year	Gross Return	Net Return	Benchmark Return	Internal Dispersion	Composite 3-Year SD	Benchmark 3-Year SD	# of Portfolios	Composite Assets ($mm)	Firm Assets ($mm)
2010	17.59%	16.17%	15.06%	1.62%	22.07%	21.85%	144	118.4	1,768
2011	2.78%	1.52%	2.11%	1.69%	19.36%	18.70%	154	118.4	1,974
2012	20.59%	19.14%	16.00%	1.70%	14.20%	15.09%	172	160.4	2,404
2013	34.36%	32.82%	32.39%	2.80%	11.19%	11.94%	208	291.2	3,023
2014	7.69%	6.43%	13.69%	1.82%	9.28%	8.97%	223	278.3	3,040
2015	-5.82%	-6.96%	1.38%	1.29%	11.36%	10.47%	263	287.3	2,703
2016	20.90%	19.49%	11.96%	2.10%	12.85%	10.59%	203	256.2	2,696
2017	17.81%	16.43%	21.83%	1.79%	12.28%	9.92%	219	314.7	3,139
2018	-9.97%	-11.09%	-4.38%	1.44%	12.86%	10.80%	211	265.1	3,674
2019	27.83%	26.32%	31.49%	2.45%	13.99%	11.93%	195	323.9	5,061

DISCLOSURES

Fees: Returns shown incorporate the effects of all realized and unrealized gains and losses and the receipt, though not necessarily the direct investment of, all dividends and income. Net-of-fees returns are calculated by deducting model investment management fees, which are defined as the highest, generally applicable fees of 1.25% of equity assets and 0.50% of cash assets, from the gross composite return. The management fee schedule is as follows: 1.25% per annum on assets up to $5 million with reduced fees at multiple breakpoints thereafter. Such fees are negotiable. Gross-of-fees returns are presented before management fees, but after all trading expenses.

Definition of the Firm: Kovitz Investment Group Partners, LLC (Kovitz) is an investment adviser registered under the Investment Advisers Act of 1940 that provides investment management services to individual and institutional clients. From October 1, 2003 to December 31, 2015, the Firm was defined as Kovitz Investment Group, LLC. Effective January 1, 2016, Kovitz Investment Group, LLC underwent an organizational change and all persons responsible for portfolio management became employees of Kovitz. From January 1, 1997 to September 30, 2003, all persons responsible for portfolio management comprised the Kovitz Group, an independent division of Rothschild Investment Corp (Rothschild).

Composite Definition: The Core Equity composite includes all fee-paying, discretionary portfolios managed to the Kovitz Core Equity strategy. The Kovitz Core Equity strategy utilizes a private owner mentality to purchase equity securities issued by companies with durable competitive advantages and strong balance sheets that are trading at a significant discount to their intrinsic value. The goal of this strategy is to maximize long-term total return. The inception date for this strategy is January 1, 1997, and the Composite was created on January 1, 2001. The minimum portfolio asset size for the Composite is $250,000. The benchmark is the S&P 500.

Valuations are computed and performance is reported in US dollars. The measure of internal dispersion presented above is an asset-weighted standard deviation. The 3-year standard deviation presented above is calculated using monthly net-of-fees returns. The 3-year standard deviation is not presented when less than 36 months of returns are available. A complete listing of composite descriptions and policies for valuing portfolios, calculating performance, and preparing compliant presentations are available on request.

GIPS: Kovitz Investment Group Partners, LLC (Kovitz) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Kovitz has been independently verified for the periods January 1, 1997 through December 31, 2018. The verification report is available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation. A complete list of firm composites and performance results is available upon request.

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