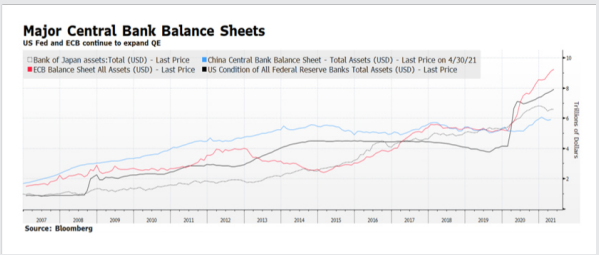
WCM | WILDE CAPITAL MANAGEMENT

Newsletter and Capital Markets Review

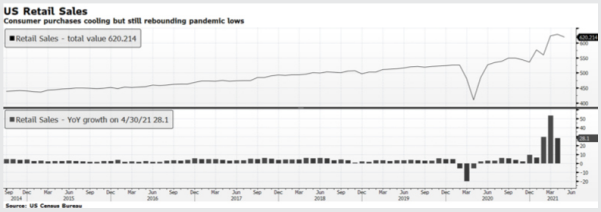
May - June 2021

The US Federal Reserve (The Fed) and European Central Bank (ECB) continue to pursue aggressive quantitative easing while the two dominant Asian central banks, the Bank of Japan and the People's Bank of China, have slowed their securities purchases, at least so far this year. The ECB's activity is of particular interest not only because of the size of the balance sheet ($9.4T, €7.8T) but also the pace that it has expanded over the course of the past year. The ECB's monetary support continues at a critical time as the EU economy appears to be emerging from the pandemic induced slump. Lock downs are slowly



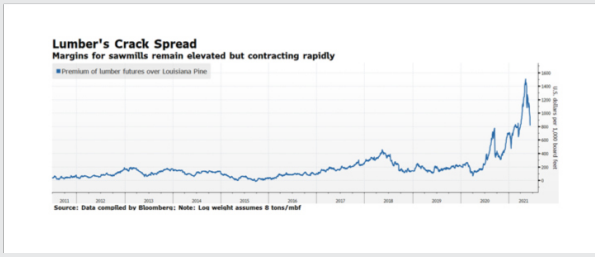
being lifted and infection rates are plunging (in developed countries) from the March and April spikes. Another reason for optimism is the gradual upward trend in sovereign interest rates in the region which appears to be a precursor to stronger economic activity in the months ahead.

The Fed continues to do its part with the bank's monthly commitment of $120 billion of asset purchases ($80 billion of US Treasuries and $40 billion in mortgage securities) bringing the current size of the balance sheet to nearly $8 trillion. The western central banks appear not to be concerned about the recent surge in consumer, producer and commodity prices and, in particular, the Fed has communicated that these inflationary trends are temporary. Below we cite a few examples that may explain their perspective.



The US Census Bureau's latest survey of retail sales for May was reported on June 15th. The year-over-year growth rate registered a strong 28.1% annual pace, but is eclipsed by April's blistering 53.4% clip. The annual growth figures are no doubt outliers given last year's depressed basis but retail sales growth has been positive since June 2020. Retail sales growth remains elevated but the pace appears to be decelerating and consumption trends are clearly on the Fed radar screen.

Consumers of lumber products may finally see an end to soaring prices. Lumber crack spreads (the difference in prices of finished lumber and raw timber) have been rapidly falling since peaking in early May. Specifically, the measure on this week's chart uses the CME futures spot rate of random length softwood 2x4s used in construction minus the Timber Mart-South US Louisiana Pine Sawtimber spot rate. Both indices are falling with finished board prices falling at a faster pace.



There are a variety of reasons why finished lumber prices surged, ranging from a beetle infestation in western Canada and the US Pacific Northwest, strong pandemic-stimulated single family housing demand, glue shortages related to the storm-induced petrochemical plant shutdowns in Texas earlier in the year, and a lack of truckers and workers for sawmills. This confluence of events may be playing out in other industries and be part of why the Fed considers rising key consumer and producer prices transitory and not permanent. Nonetheless, inflationary concerns that recently unnerved the capital markets will likely continue to arise for some time to come.

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Portfolio Positioning

Stability seems to be the current state of affairs after a chaotic 2020, with an expectation that resurgent developed economies tempered by ongoing challenges in the developing world will be generally good for equities. Central bank policy and the whiff of inflation pose challenges but not a crisis for fixed income. We continue to hold an overweight allocation to equities overall as well as a modest underweight in fixed income, also leaving cash meaningfully underweight. Within global equities, we are overweight with respect to the US, modestly overweight to Asia x-Japan and slightly underweight in Emerging Markets. We are neutral with respect to Eurozone stocks and underweight Japan. Within fixed income, we are overweight in the US with a preference for mortgages and investment grade corporate credit. We have little to no exposure to non-US fixed income except through Green Bonds in our ESG series portfolios. All portfolios holding fixed income maintain lower duration than the benchmark.

Risk Outlook

- Concerns about inflation have loomed over the market in recent months, although not so much so that asset prices have been adversely affected or that central banks have taken action. There have been flashes of what would, under ordinary circumstances, signal inflation. We have seen spikes in prices of building materials and scarcity of new cars for purchase as examples. But, while we cannot discount those observations entirely, we principally see them as graphic examples of how interdependent world economies and supply chains are and how fragile they were with just-in-time inventory management. While investors have extolled just-in-time since Toyota popularized it, it introduced an inelasticity into global supply chains that was not capable of absorbing the blow of COVID. This was further exacerbated by climate-related issues with beetle infestation and fire affecting Western timber stocks and storms knocking petro-chemical production capacity off line among several other challenges. The results were issues such as a microchip shortage affecting the ability of factories to finish automobiles for delivery. We believe as major parts of the global economy get back on pace that the current situations will self-correct, but as investors and market watchers we are looking longer term at the confluence of business practices that are not sustainable, resilient or adaptive and externalities like global health and climate change which can and will disrupt businesses and markets again.

- Benign conditions do not always result in benign outcomes. As discussed elsewhere, even a slight normalization of the rate environment, which would reflect stabilizing economic conditions, could have profound effects in fixed income markets, severely dragging down assets like 30-year Treasury Bonds which are normally seen as safe harbors from risk. Wall Street has been cautioning about the risk of rising rates since the end of the Financial Crisis in 2009, but we have yet to actually have to live with those risks because a slow grind recovery followed by a series of crises including COVID have conspired to hold central bank policy where it has been – accommodative. A mild turn of phrase by the Fed Chair has resulted in temporary shocks in the bond and even equity markets, so we can anticipate that rising rates are not welcome in markets that have enjoyed easy money for more than a decade now. This compels us to think about risk in globally diversified portfolios differently, where the traditionally more conservative parts of asset allocations may actually represent more material risk in the nearer term.

- Big questions about the social contract will continue to play out in the months ahead. The ratio of constructive to destructive discourse and activism will weigh heavily on the impact to investors and the economy. Advancements in diversity, equity and inclusion, civil debate about justice reform, building back better and stronger as part of the COVID recovery, and improving participation in the US (and global) economy will be positive drivers. Putting that at risk, and with it capital formation and job creation, would be more violent and destructive actions that focus attention and resources away from serving and supporting the individuals and communities and their families, businesses and livelihoods who are struggling everywhere from the urban Northeast to the rural Southwest.

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Risk Outlook [cont'd]

- We are beginning to see a separation between countries enjoying a post-peak social and economic resurgence and those that are still in the grasp of the pandemic. We say "post peak" and not "post COVID" because we see a lack of certainty about the global community's ability to put the coronavirus completely behind us as new variants circulate that are more transmissible and more infectious. Curiously, our expectation was that the division between vaccinated/open-for-business and not would be almost entirely across socio-economic lines, with developing nations lagging behind developed. In a broad sense this is true, but in the wealthy developed world we still find a spread from Israel at better than 50% completely vaccinated to Japan at barely above 7%. There are also indeed dozens of nations that have not even cracked 1%. Pledges are coming in that will help the WHO COVAX program to begin to address the divide in access to healthcare resources, but there is still a daunting gap between the 2.6 billion doses already administered and the number needed to end the pandemic and allow the global community to fully return.

- One of our long-term risk themes continues to be our focus on Chinese Communist Party actions which have not materially shifted for the better in the COVID era. From aggression in the Asia-Pacific region to military tension along the border with India to suppression of Hong Kong citizens' rights and the interests of the Uighur population and the lack of contrition for their early role in failing to stop COVID-19 in its tracks, all may contribute to China-directed backlash or retaliation. There does seem to be regional coherency in the response as nearly all Pacific nations have aligned with the US against Chinese aggression. From lack of respect for intellectual property rights to involvement in global criminal drug trafficking to financial crimes and human rights abuses bordering on genocide, the country is finding it harder to get the global community to look the other way. We view this as a risk to investment in China and investment in companies reliant on a Chinese supply chain, but likely bullish for other parts of the Asia Pacific interested in usurping China's role as the manufacturing floor for the world.

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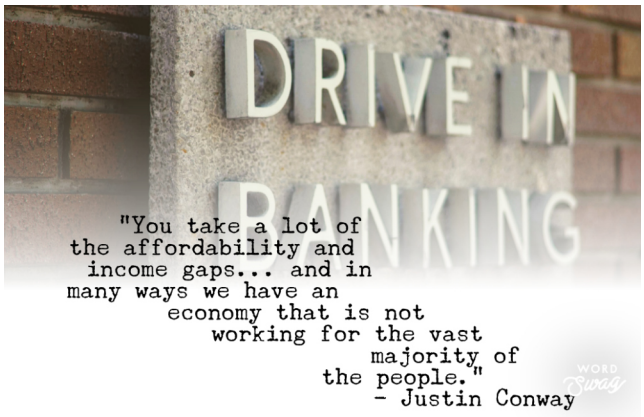
ESG Considerations

June 14 – 18, 2021 is WCM ESG Week. Five days, five topics, each looking ahead to challenges and opportunities to improve communities, society and the planet using the tools of capitalism. The state-of-the-art in ESG investment strategies, whether in public or private markets, begins to address these themes, but they are works in progress. Affecting the flow of capital is an important and necessary step toward improvement in each area, but is not enough on its own — even with massive mobilization the scale is global and the challenges daunting.

Regenerative Agriculture

Extractive industry is not working for us. Sooner or later, whatever resource is being extracted becomes depleted. Mine claims play out, oceans, lakes and rivers are fished empty, forests are leveled, and soil becomes exhausted. The natural systems from which we benefit are fundamentally regenerative when allowed to function normally, something indigenous cultures have understood for thousands of years. Regenerative agriculture is proven to address the global challenges of sufficiency with better yields of more diverse and nutrient-rich foods. It also addresses challenges to what we think of as "normal" agricultural processes including soil exhaustion, pests, and water retention, therefore making the business of agriculture more efficient, more productive and more profitable. As a much-needed bonus, regenerative agriculture helps restore and support climate and water systems.

In this interview with Marc Ian Barasch, author and filmmaker, we discuss the ideas behind applying regenerative principles to the business of agriculture, providing for greater abundance for a population of nearly 8 billion people, and caring for climate, water and other systems that are failing as we speak.



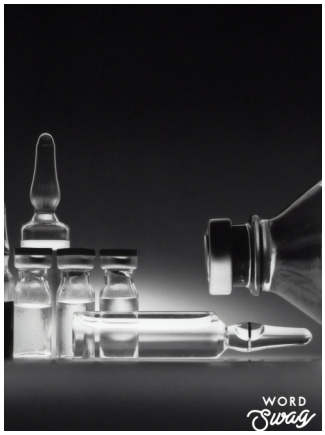
Banking the Un(der)banked

Access to basic financial services is one of those things it is easy for those who live in and with relative comfort and privilege to take for granted. In a typical city or suburb it is difficult to throw a stone and not hit a bank, or a brokerage, or an insurance agency. But across the United States, in many economically disadvantaged urban and rural settings, traditional financial services are scarce or entirely absent. There might be pay-day lenders, or pawn shops, or money transfer stores. In other countries, the postal service might bridge some portion of that gap, but few alternatives exist here. This means that basic economic activities like depositing a paycheck, borrowing for a consumer, auto or home purchase, or obtaining financing to start, maintain or grow a small business go from being simple, almost mindless tasks, to ordeals that stand in the way of household and business formation, growth and prosperity.

This interview is with Justin Conway of Calvert Impact Capital. We discuss what it means to be under- or un-banked, what alternative resources are or could be available to facilitate economic activity, and how investing in servicing these communities is good business, good risk-taking, and a good opportunity to create shared value for all stakeholders.

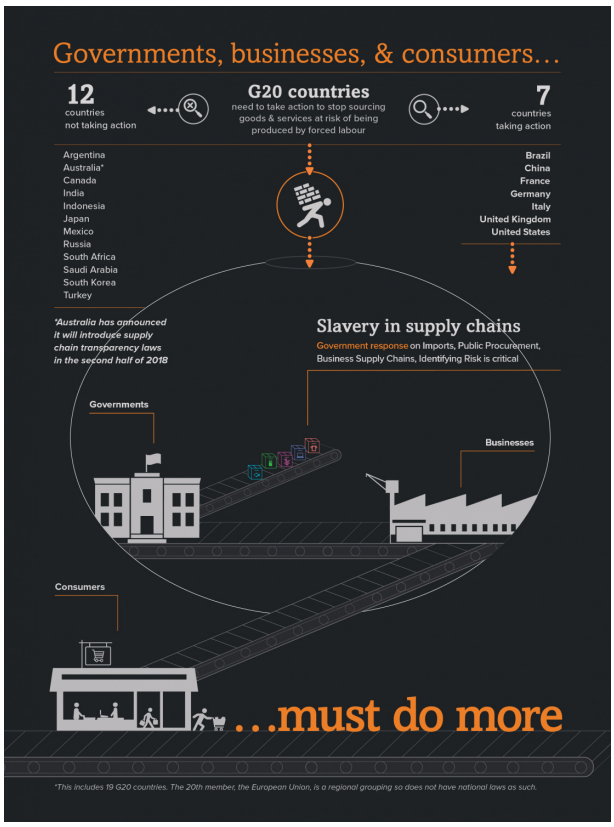
ESG Considerations [cont'd]

"At the end of the day its not just about extending your life, it's improved quality of life. Those businesses or solutions that address access, affordability, and innovation will ultimately be the winners in the marketplace." – Ingrid Dyott



Medical Justice and Access to Healthcare

Good health is driven by numerous factors, starting with well understood fundamentals like access to quality nutrition, clean water, bathroom facilities and basic medical services. COVID-19 has also brought into plain view what was known but not as well understood — there are many other aspects of life and commerce that are material contributors to good personal and community health outcomes, including workplace safety, product safety, and managing environmental hazards. Incentives can be misaligned, where on one side of the ledger healthcare is a business where more and sicker people can equate to more profit opportunity, and on the other where not investing in the welfare and safety of communities and workforces saves public and private dollars (in the near term). Focusing on what is just in terms of access to basic needs but also access to a clean, safe environment and workplace improves overall wellness and with it productivity and prosperity while reducing the social and economic burdens that come with unwell communities. This interview is with Ingrid Dyott, Managing Director and Portfolio Manager at Neuberger Berman, where we discuss the structural challenges to achieving a global basic level of wellness, and how companies both in and out of the broad medical industrial complex can contribute to achieving greater global health and what the economic and other incentives are for doing so.

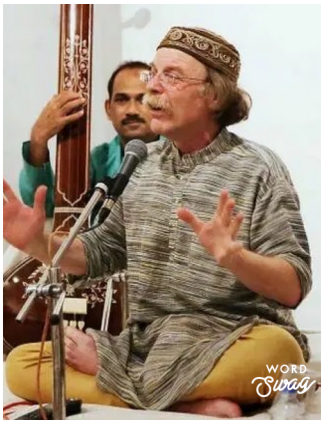


The Business of Human Trafficking

There are few absolutes to be found in the discipline of ESG investing. Most issues and controversies are matters of degree or perspective. However, there are a few issues that rise to a level where there is no shading, no equivalency, no tradeoff that makes them acceptable to any investor or any reasoning human for that matter. Weapons of mass destruction, genocide, and human trafficking contravene all measures of decency, justice, and law and profiting from these atrocities crosses a bright line. In discussing human trafficking in this interview with Michele Bongiovanni of HealRWorld and Distributed Data Network, we begin with the baseline that trafficking is fundamentally objectionable, but we must examine how widespread it is, how deeply it is woven into commerce, and how easy it is to unknowingly benefit or profit from it in the Developed West. 40 million people, the equivalent of the population of California, are exploited for sexual servitude, forced labor or financial gain in any given year, and the Global Slavery Index estimates that $354 billion worth of products imported annually by the G20 are estimated to be 'at risk of being produced by modern slavery'.

ESG Considerations [cont'd]

"We've been running up charges on our Bank of Earth credit card for many hundreds of years and our responsibilities are no longer avoidable." - Warren Senders



Climate Justice

Climate change is now on nearly everyone's tongue, but climate change is the language of systems and science. That is not to suggest in any way that it is invalid, but it does not take us all the way to the end of the narrative, which is that vast swaths of the human population are not materially contributing to the climate crisis, but they are disproportionately affected by the consequences of it. This is where the language of climate justice comes into play. From farmers in Africa dealing with failing crops from heat and drought to the loss of ice fishing and related cultural traditions of the Inuit to populations vulnerable to saltwater inundation and the effects of ocean acidification in the Seychelles, communities around the world do not have the resources, access or opportunity to pursue the adaptation and resiliency strategies that are much discussed in wealthier and more prosperous parts of the world. Individuals and families are at risk, international stability is at risk, and our shared cultural heritage is at risk.

Climate justice gives us the words and concepts to frame and then address these and countless other intertwined challenges that affect access to nutrition, access to clean water, access to education, access to economic opportunity, an expectation of peace and prosperity, and the ability and in fact the right to care for our collective legacy and culture and gift it to the generations that come after. Our final discussion for ESG Week is with Professor Warren Senders of the New England Conservatory of Music. We explore the interconnectedness of climate science, indigenous wisdom, and world art and culture, and our collective responsibility to care for the planet we have, and to care equitably and justly for the people on it.

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Please go to https://wildecapitalmgmt.net/sustainability/wcm-esg-week-2021/ to find the recordings of each interview as well as a curated collection of papers and other links to learn more about each topic.

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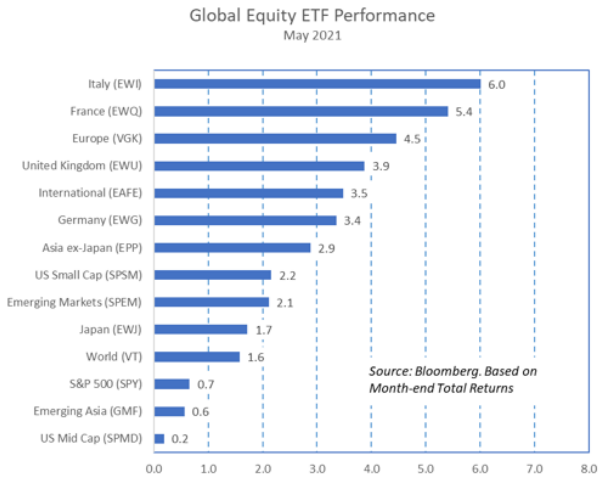
May 2021 Capital Market Review

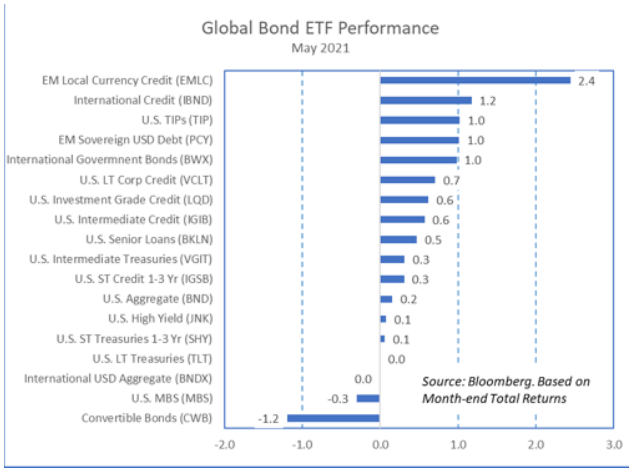
Global equities rallied in May with key international markets leading the way. Conditions in fixed income markets were generally positive, aided by relatively stable US Treasury rates.

Equity Markets

In May, global equities were led by key European equity bourses, notably Italy (+6.0%), France (+5.4%), and the UK (+3.9%). It is encouraging to see that these markets are rebounding despite COVID resurgences and lockdown responses.

US Large, Mid and Small Caps posted positive returns in May but lagged the rest of the world. Emerging Markets outperformed, bolstered by a rebound in China as the Shanghai Shenzhen CSI 300 rallied 5.7% for the month.





Bond Markets

The benchmark US 10-year Treasury Bond yield was relatively stable in May (falling a modest 3-basis points from 1.63% to 1.60% by month-end). Stable and benign interest rate conditions coupled with US Dollar weakness propelled international fixed income markets higher for the month.

Convertible bonds did fall 1.2% in May, consolidating strong gains made earlier in the year.

The returns cited reflect total return performance of exchange traded funds listed in the corresponding bar charts

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Diversification and strategic asset allocation do not guarantee a profit nor protect against a loss in declining markets. All investments are subject to risk, including the loss of principal.

The information contained herein is based upon the data available as of the date of this document and is subject to change at any time without notice.

Portfolios that invest in fixed income securities are subject to several general risks, including interest rate risk, credit risk, the risk of issuer default, liquidity risk and market risk. These risks can affect a security's price and yield to varying degrees, depending upon the nature of the instrument, and may occur from fluctuations in interest rates, a change to an issuer's individual situation or industry, or events in the financial markets. In general, a bond's yield is inversely related to its price. Bonds can lose their value as interest rates rise and an investor can lose principal. If sold prior to maturity, fixed income securities are subject to gains/losses based on the level of interest rates, market conditions and the credit quality of the issuer.

Foreign investments are subject to risks not ordinarily associated with domestic investments, such as currency, economic and political risks, and may follow different accounting standards than domestic investments. Investments in emerging or developing markets involve exposure to economic structures that are generally less diverse and mature, and to political systems that can be expected to have less stability than those of more developed countries. These securities may be less liquid and more volatile than investments in U.S. and longer-established non-U.S. markets.

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Portfolios that invest in real estate investment trusts (REITs) are subject to many of the risks associated with direct real estate ownership and, as such, may be adversely affected by declines in real estate values and general and local economic conditions. Portfolios that invest a significant portion of assets in one sector, issuer, geographical area or industry, or in related industries, may involve greater risks, including greater potential for volatility, than more diversified portfolios.

Important Disclosures: Exchange-Traded Funds

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ETFs included in portfolios may charge additional fees and expenses in addition to the advisory fee charged for the Selected Portfolio. These additional fees and expenses are disclosed in the respective fund/note prospectus. For complete details, please refer to the prospectus.

For additional information regarding advisory fees, please refer to the Fee Summary and/or Fee Detail pages (if included with this report) and the program sponsor's/each co-sponsor's Form ADV Part 2, Wrap Fee Brochure or other disclosure documents, which may be obtained through your advisor.

Certain ETFs have elected to be treated as partnerships for federal, state and local income tax purposes. Accordingly, investors in such ETFs will be taxed as a beneficial owner of an interest in a partnership. Tax information for such ETFs will be reported to investors on an IRS schedule K-1. Investors should consult with their tax advisors in determining the tax consequences of any investment, including the application of state, local or other tax laws and the possible effects of changes in federal or other tax laws.

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