Delos | Capital Advisors

DALLAS | NEWPORT BEACH

Wealth Management for the Modern Affluent

Quarterly Reflections

SECOND QUARTER 2021

Contents

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Chief Executive Officer

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QUARTERLY REFLECTIONS

Midyear Update

It's amazing that we are already halfway through 2021…and what a difference a year makes. 2020 is one many of us would like to forget, or at the very least, put way behind us. With that in mind, I want to spend a few minutes with you talking about the many things we learned and how we as a firm are moving forward, stronger than ever, as a more optimistic and collective unit.

Last year gave us a lot of time to reflect, learn and build on experiences we had not faced as a firm in our young existence, and nothing the world had seen since the Great Financial Crisis of 2008. We chose to seize the opportunity presented to us by continuing to build out the Delos Capital Advisors platform and suite of services for our clients and partners.

At our core, we built this firm to empower our clients to achieve their version of financial success. No two families have the same vision of this idea. This ultimately means a one size fits all model cannot work for everyone. We believe that bringing the right solutions at a competitive cost is essential in helping achieve our mission. How do we do this? By genuinely taking the friction out of wealth management. Providing our clients and partners an independent platform that offers transparency, communication, and peace of mind. If you are reading this and are not already taking advantage of the Delos360 technology, please consider doing so by reaching out or visiting our website and using the client login feature. Our updated Delos360 portal provides performance reporting, account aggregation, financial planning outcomes, and a secure vault where we will safely send and upload documents most important to you. Once set up, we would love your feedback to continue to improve on the experience we know you deserve!

As you will see throughout our Mid-Year Update, we have excellent thought leadership and ideas from our talented team of advisors. Our Chief Investment Strategist, Andrew Smith, will be reviewing many of our current investments that allowed us to outperform the broad markets this year. While discussing our thoughts for the remainder of the year and how we will be positioning our strategy for continued growth and opportunity. As an advisor and Certified Financial Planner (CFP)®, Joe Connolly is helping guide many of our firms' relationships with in-depth cash flow analysis and investment strategy. As President of Delos Risk Management, he works with our advisors to help consult and offer best-in-class insurance solutions. If you have not spoken to our team about your current insurance policies or future needs, please do so soon; we would love to help!

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Midyear Update

Thomas Keeling, Director of Wealth Management, brings invaluable insight into the Delos wealth management and financial planning process. Understanding that financial plans, like life, are always fluid and ever-changing: Our goal is to help you make the most well-educated decision possible when navigating your financial decisions.

Thank you to all our clients, partners, friends, and family for your continued trust and support. We do not take the responsibility you have given us lightly, and we will continue to work diligently with each one of you and your families in mind.

God Bless,

Cody Lummus
Chief Executive Officer

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WEALTH MANAGEMENT

Time Marches On

With well over half of 2021 behind us, we trudge on through these last few dog days of summer with that familiar feeling of uncertainty. Over the last year and a half, we have grown accustomed to chaos and confusion. The unpredictable rollercoaster ride that started with COVID-19 early last year continued throughout 2020, wrought with highs and lows and twists and turns. By year's end, we had been strapped into this ride so long that a looming cloud of ennui had settled over everyone--we just wanted the ride to be over. But when I look back at what I will remember as The Lost Year, what felt like an eternity at the time seems to have vanished as if it never existed at all. Time that sometimes appeared to stand still inevitably passed despite my perception.

Although similarities may remain, the overall landscape of our uncertainty has drastically changed. A year ago, we were anxiously awaiting an effective vaccine; sporting events were just returning; we had yet to witness the calamitous first presidential debate, and GameStop still looked like it was destined to the same fate as Blockbuster. Today, we have over 70% of the population vaccinated with concerns turned toward the new Delta variant; the 2020 Olympics are currently underway; we saw two grown men argue like kindergarteners, and meme stocks became a thing thanks to a guy named "Roaring Kitty."

The last year and a half has been full of significant events that have profoundly influenced life, and there will undoubtedly be more to come. 2020 started with the enactment of The SECURE Act, which brought many changes that substantially affected retirement planning. The CARES Act was signed into law a few months later, presenting very unexpected and important planning opportunities. Now, a newly unveiled $1 trillion bipartisan infrastructure bill is trying to work its way through congress with another $3.5 trillion package expected to follow. While the content of proposals themselves are known, the legislation that may ultimately be passed is uncertain, and the path is long and arduous. The effect of various possible outcomes from additional future indeterminate variables must be given careful consideration. From the impact of expiring COVID-19 related mortgage and student loan moratoriums and federal unemployment programs, to the impending sunset of specific provisions of the Tax Cuts and Jobs Act, every possible outcome affects change in one way or another. And though you can't precisely predict the future, you can understand and prepare for how these changes can affect your financial plan.

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Time Marches On

As we progress along the track through the second half of the year and summer turns to fall, I hope you can focus on the positives and enjoy the changing of the seasons. But if at any point you begin to feel like a clock on the wall is slowing to a crawl, I encourage you to remember the words from a favorite song of mine by Tracy Lawrence: "Time marches on, and the only thing that remains the same is everything changes."

Best,

Thomas Keeling
Director of Financial Planning

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RISK MANAGEMENT

The Nutritionist vs. The Butcher

In the early '90s, drinking Almond Milk and eating Organic foods wasn't very cool.. especially for me as a 10-year-old kid who got teased by his friends for not being allowed to drink soda. My mother was an early adopter of holistic and organic solutions that have become very popular over the last two decades. Although difficult at the time, in hindsight, I am very grateful to be the son of a Nutritionist.

Today, my mom consults with clients to help them create healthy lifestyles through proper diet, exercise, and adding vitamins and supplements – all specific to her client's nutritional needs.

She has nothing to sell, no targets to hit, no managers to "keep off her back." She has spent an enormous amount of time learning about nutrition and uses that knowledge to help her clients create healthier lives. For that knowledge, the plans she creates, and the consultation she provides, her clients pay her a fee. She has no conflict of interest!

Now, I love a good steak as much as anyone, but when I want a steak, do I ask my mom for a recommendation?

No. I go to the local butcher and ask Frank for his best cut of New York Strip. I don't anticipate Frank asking me 45 questions and then suggesting I go to the local farmers market and pick up ingredients for a fresh salad and a lean piece of North Atlantic Cod.

Frank is a butcher. His job is to sell me meat. I trust that Frank will suggest the best piece of meat that he has in his shop on that given day.

A client of Delos Wealth Management was recently presented a Long-Term Care solution from a sales rep at a large insurance provider. Our clients had recently helped place their mother in an elder care facility and took great interest in learning how to ensure against the costs associated with eldercare.

Believe it or not, the solution presented by the insurance agent was a "pretty good" recommendation. However, the agent only had one product/solution to offer that could fill the client's need. Luckily, our clients brought Delos the insurance proposal for our review and feedback.

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The Nutritionist vs. The Butcher

We took the information provided by our client, analyzed the marketplace, and constructed a solution that was considerate of our client's cash flows, retirement plans, and current insurance positions. Delos can align a client's asset management, wealth management, and risk management needs in a way that creates a customized plan based on the client's situation.

The benefit of customization is evident in how we helped our client who met with the insurance agent. Delos was able to find a solution that provided nearly TWICE (2x) the Long Term Care benefit as was being offered.

In addition, by understanding the client's entire financial picture, we could fund the LTC insurance premium with assets from an existing paid-up life insurance policy. By utilizing funds from this alternate source on the family balance sheet, this client does not have to tap into their retirement cash flow to fund the LTC premiums.
In August of last year, we created Delos Risk Management. This business unit has expanded Delos's platform to provide best-in-class insurance solutions for families and business owners. Cody and Andrew have the vision to grow a firm that caters to the needs of our clients with customized solutions that are tailored, not sold.
Unfortunately, the insurance agent is the Butcher in this story. He tried to sell the best solution he had in his store on that given day. He did the best he could possibly do with the resources he had.

By design, Delos's clients have a full-time "financial nutritionist" on retainer. Leverage us.

Sincerely,

Joe Connolly, CPF ®
President, Delos Risk Management

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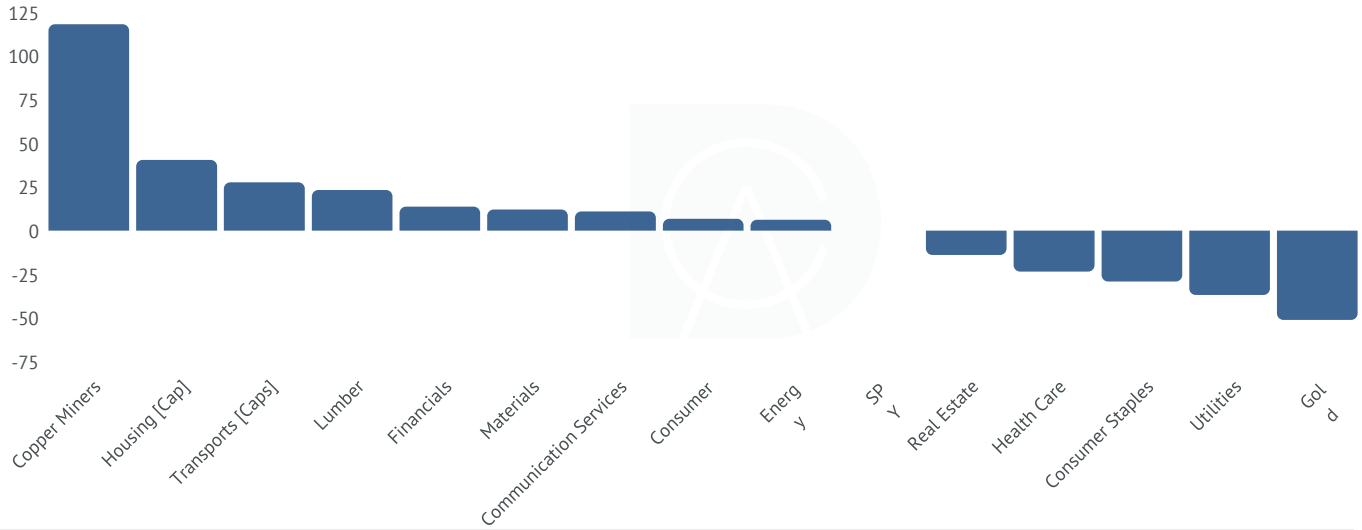
INVESTMENT STRATEGY

Sneaky Peak

It's hard to believe it's been nearly 18 months since the beginning of the global COVID pandemic that roiled everyone's lives. At the time it seemed there was little to feel happy about at the time as health and economic restrictions altered our way of living. And to make matters more complex, our economic growth via production, employment, and sales quickly disappeared as the global economy abruptly came to a grinding halt. According to the National Bureau of Economic Research, this marked the fastest recession on record. This record-breaking economic slowdown brought about one of those most volatile financial market periods since the Great Recession. And while at the time it felt as the rules of investing were thrown out the window, in hindsight, I find much comfort knowing that the recovery thus far has followed the same playbook it has in the past. Our rigorous study of the business cycle helped us not only position portfolios to sidestep the COVID-induced volatility in Q1 of 2020 but re-position clients for the cyclical surge in growth and inflation in May. For reference, please review our Q2-2020 Investment Strategy Quarterly Reflection titled ***Trust We Must*** reflect upon the cyclical upturn in the business cycle, which paved the way for cyclical outperformance (SEE EXHIBIT 1). Now, 18 months post-recovery, we conclude a quarter that has begun to see a deceleration in the V-shaped recovery. Does this mark the end of the growth boom or merely a ***Sneak Peak***?

This Quarterly Reflection will discuss the main variables driving our assumption on why consensus thinking of peak growth and inflation will prove to be a mere head fake as cyclicality makes one last push higher into year-end.

EXHIBIT 1: Excess Performance of Selected Sectors and Industries for S&P 500- May 1st, 2020 to June 30th, 2021



Source: Bloomberg, Delos Capital Advisors, As of June 30, 2021

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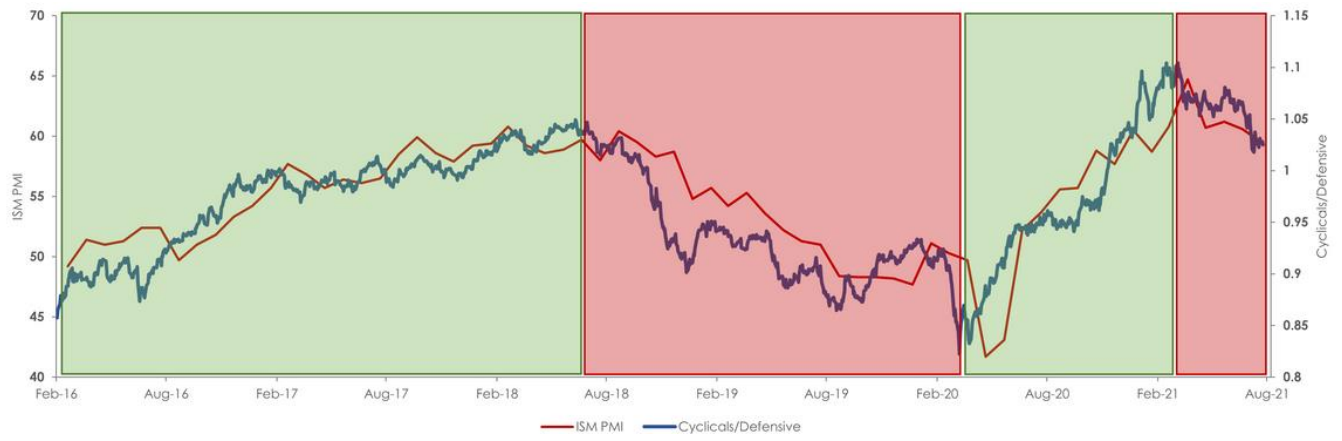
Sneaky Peak

When reflecting upon the second quarter of this year, it has undoubtedly contained a number of moving parts. We've seen inflation move higher than most anticipated; China experiences a not-so-subtle slowdown; global growth begins to move lower, and major central banks become more hawkish on the margin. Add all of this up, and you get a decent bout of cross-asset volatility and dramatic rotation into defensive segments of the financial markets. Exhibit 2 shows the deceleration in the PMI coinciding with the recent underperformance of cyclical factors.

EXHIBIT 2: Cyclicals and Defensive Relative Performance EBB and Flow with the Business Cycle



Source: Bloomberg, Russell Indices. Delos Capital Advisors

> *"We believe the recent relative underperformance from cyclicals over the second quarter has been mainly a function of multiple influences beyond the decelerating growth story."*

With defensive clearly taking the baton, as evident in the chart above, many have begun to question the viability of the growth boom and whether the once-beloved cyclical trade has run its course. While we sit firmly in the camp that economic growth will remain robust. We believe the recent relative underperformance from cyclicals over the second quarter has been mainly a function of multiple influences beyond the decelerating growth story. Now to be fair, growth is decelerating. As most know, financial assets trade-off the rate of change in macro variables (i.e., Policy, Inflation, Interest Rates, Liquidity). Still, we must keep in mind that growth is decelerating from an above-trend level. Exhibit 3 shows the deceleration in GDP growth based on Bloomberg Medium-Term Forecasts.

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Sneaky Peak

Exhibit 3: Bloomberg GDP Forecasts								
	2021				2022			
	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Quarter 1	Quarter 2	Quarter 3	Quarter 4
United States	0.40%	13.10%	7.70%	7.70%	7.10%	5.50%	4.00%	4.00%
Euro Area	-1.30%	12.90%	2.40%	4.30%	5.50%	4.80%	3.40%	2.70%
Japan	-1.50%	7.90%	3.20%	0.80%	2.20%	2.00%	1.60%	1.50%
LatAm	2.20%	19.80%	6.00%	1.00%	-1.10%	0.70%	1.20%	2.40%

Source: Bloomberg: GDP Forecasts QoQ

As stated, the above GDP forecasts show meaningful deceleration, yet the expectations remain well above growth trends post the Great Financial Crisis. Our DCA Investment Committee believes that the relative outperformance of defensive to cyclicals, although slightly attributed to a marginally slower growth outlook, has more to do with the inflation debate and interest rate environment.

Inflation has been a hot topic discussed in abundance as of late. Many debates have been stoked surrounding the structural nature of inflation and whether the Federal Reserve is correct in its "transitory" assumption. We believe the argument to be wildly misguided as inflation in itself is cyclical. Per the ECRI, we have more inflation cycles than we do business cycles. The mere fact that inflation itself has proven to be cyclical in nature refutes the transitory discussion.

While inflation is set to moderate from peak levels, it will maintain a much higher growth level than the pre-COVID inflationary backdrop.

The right question that investors need to contemplate is when inflation will inevitably slow (and it will); **how much will it slow by?** Our position at DCA is that while inflation is set to moderate from peak levels, it will maintain a much higher growth level than the pre-COVID inflationary backdrop. Our assessment for not-so-"transitory" inflation stems from several inflationary tailwinds:

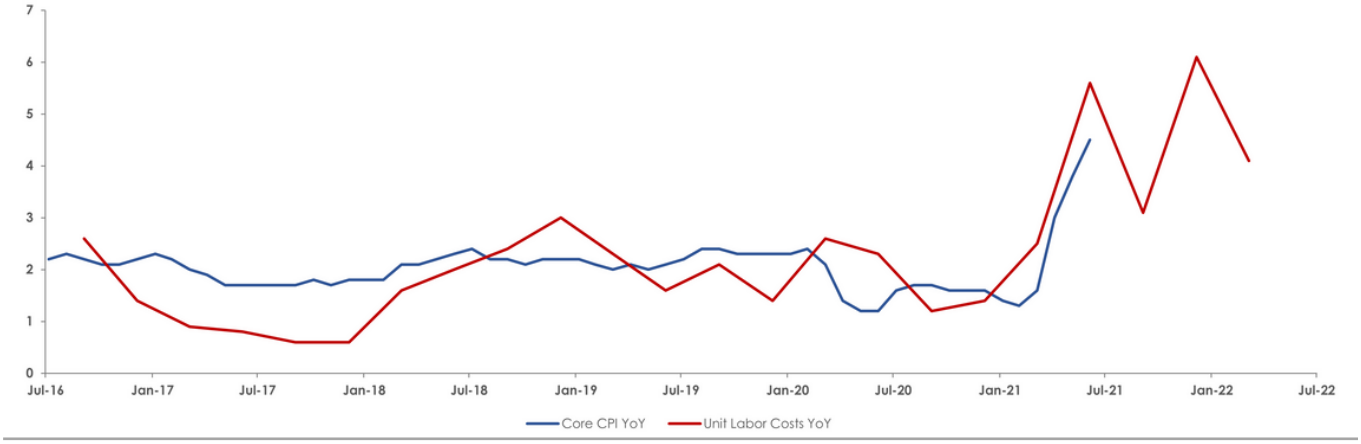
Sneaky Peak

- Household personal savings are well above trend long-term averages. Will this excess in savings be used for consumption of goods and services as the economy re-opens, and fears of the delta-variant subside? The latest GDP report showed that personal consumption expenditures drove most of the 2Q 2021 increase.

- Unemployment benefits are set to expire in the coming months. While a portion of individuals left the labor force in lieu of early retirement, millions of Americans will need jobs. As of current, there are more jobs available than there is a supply of labor. This will force companies to bid for quality work, thus driving wage inflation higher, which is one of the most significant contributors to sustained inflation. See Exhibit 4.

- Supply shocks following the economic closure have left many companies in search of input goods, particularly autos. This has led to dramatic price increases in used automobiles as parts and chips have been hard to come by. While this supply shock is well recognized and most likely to subside, we are dismissing the supply shock that has occurred in our service industry, such as restaurants and leisure. For example, many restaurants have closed doors, thus allowing remaining competition to embark on price increases (Food away from home up 4.2% Y/Y). While supply shocks tend to alleviate, we believe the structural damage to the service industry will have longer-lasting inflationary impacts than most people appreciate.

EXHIBIT 4: Elevated Labor Costs Should Keep Inflation Elevated Well into 2022



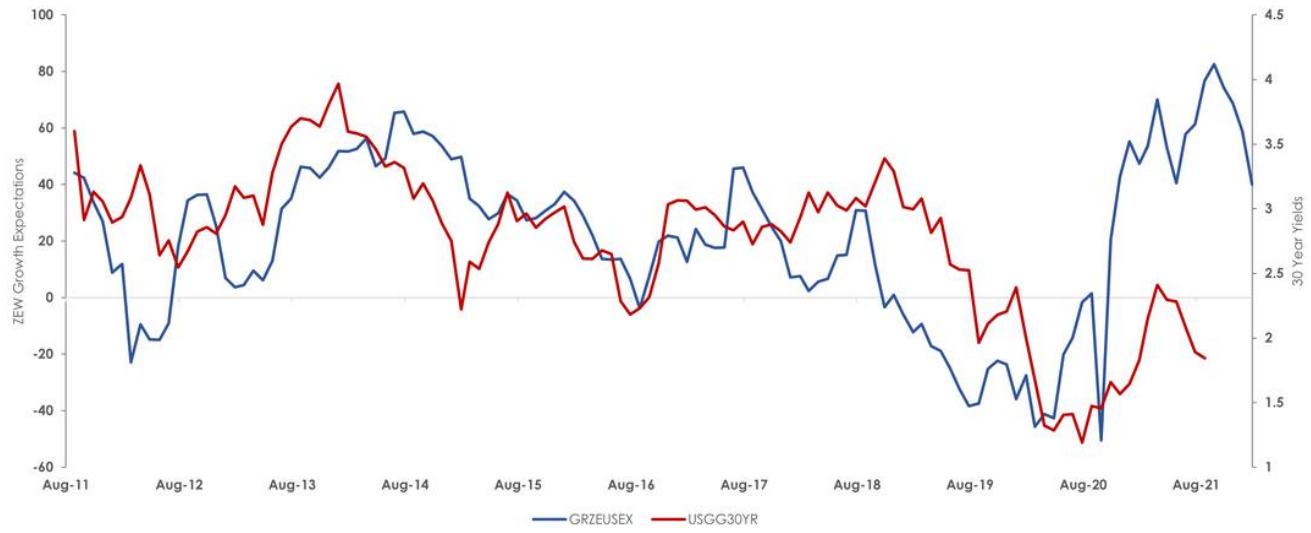
Source: Bloomberg: BLS, Delos Capital Advisors

Sneaky Peak

While it is well documented that inflation is alive and well with inflation surveys and indexes at multi-decade highs, it came as quite a shock to many economists that inflation manifested much faster and higher than they expected. The Federal Reserve continuously assuaged investors that inflation was seen as "transitory" and that monetary policy would remain accommodative given the inflation stance. Many investors were caught off guard when the Fed changed rhetoric from a dovish to a slightly hawkish stance in their June meeting. The financial market reaction was swift as interest rates quickly re-priced a Fed communication scare as monetary tightening would promptly dismiss any inflationary forces. This amplified the move lower in yields as investors worry that the Fed will be tightening policy amidst decelerating economic growth (mentioned earlier).

The abrupt decline in interest rates shocked many investors, thus causing a knee-jerk reaction by pivoting their portfolios in favor of defensive. And while we do agree that the deceleration in growth and inflation will manifest, we believe that they will remain at elevated levels, which will ultimately force yields to reprice higher. Investors should take comfort that while the current drop in yields is eye-opening, it is not uncommon. Over history, it has been found that profits go through a discounting process as the Fed begins to embark on a tightening path. We've seen yields behave similarly in 2004, 2010 (quant twist), and 2016 tightening cycles. After the yield discounting phase, the aftermath is durable moves higher as yields reprice for the higher growth and inflationary backdrop (Exhibit 5). This anticipated move higher in yields will ultimately bring about the reemergence of cyclical outperformance relative to defensive.

EXHIBIT 5: Zew Expectations Argue for Higher Long Term Rates

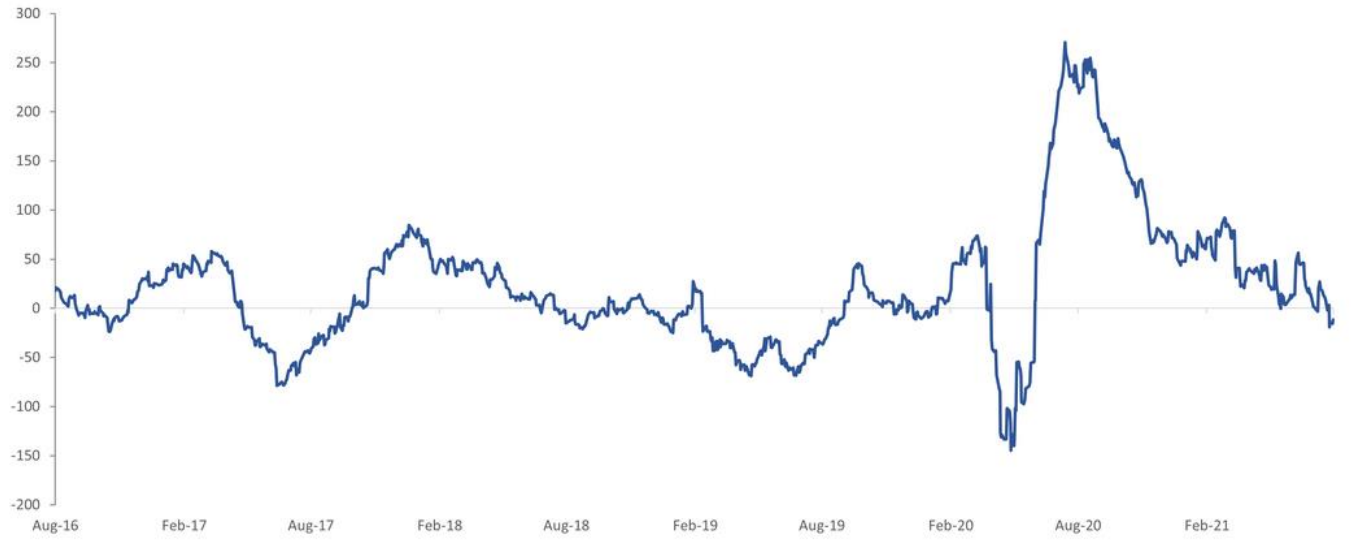


Source: Bloomberg: Zew, Delos Capital Advisors

Sneaky Peak

The second quarter brought about a Sneaky Peak in growth and inflation expectations, thus shifting asset class, sector, and factor leadership in favor of growth and defensive. While this rotation has paid off, we believe that leading economic indicators are set to re-accelerate with change surprising to the upside for the latter part of the year, all while inflation is set to remain elevated. We believe the dynamics that occurred in the second quarter were merely a burn-off of the over-invested and highly beloved reflation trade. Exhibit 6 below shows how economic surprises have collapsed, given the lofty expectations. This burn-off has allowed a much-needed reset which should ultimately be a key entry point to cyclical outperformance.

EXHIBIT 6: Dose of Reality for Expectations



Source: Bloomberg. Citigroup, Delos Capital Advisors

DCA client portfolios remain overweight cyclicality. With a marginal allocation to grow to compensate for the expected deceleration and subsequent repricing in financial assets. Our most significant move was a sizable reduction in commodity exposures given the slowdown in the Chinese credit impulse. While commodities have remained a viable inflation hedge, the slowing economic prospects in China have reduced industrial commodity tailwinds. Given the high inflationary backdrop, we hold a minimal allocation to commodities in the event real assets look through the China slowdown.

Sneaky Peak

Our DCA Investment Strategy concludes that leading economic data is set to surprise the upside following a period of expected indigestion, which will favor cyclicality. With that being said, we have begun to see signs of an inflection point commencing at the beginning of next year, which will prompt us to re-introduce our defensive allocation. But, for now, green lights for cyclicality.

" We have begun to see signs of an inflection point commencing at the beginning of next year, which will prompt us to re-introduce our defensive allocation. But, for now, green lights for cyclicality."

As always, thank you for your friendship, support, and trust. Please stay safe during these challenging times, and do not hesitate to reach out with any questions.

Sincerely,

Andrew H. Smith
Chief Investment Strategist

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