OCEAN PARK
ASSET MANAGEMENT

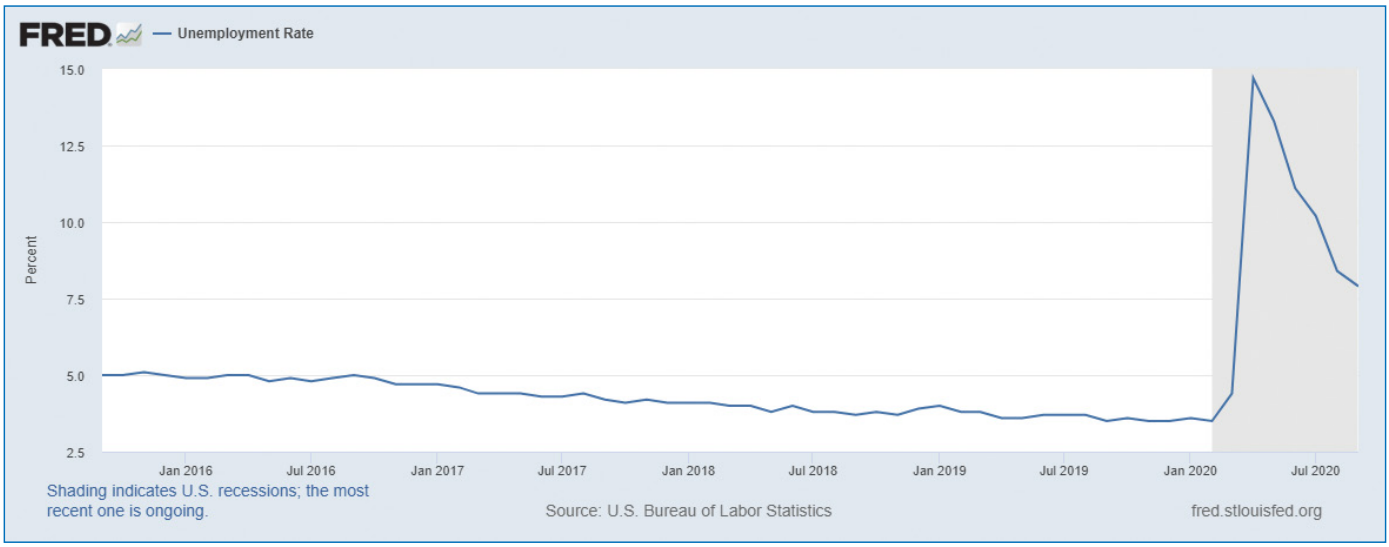
Q3 2020

Risk Matters. Defense Matters. Discipline Matters.

WHAT HAPPENED:
THIRD QUARTER 2020

Liquidity supporting the economy and markets. Earlier this year, the U.S. pivoted from its lowest unemployment rate in 40 years to its highest level in 90 years. While the worst appears behind us, unemployment is still high, businesses are struggling, and concerns about a COVID-19 winter wave are on the rise. During the third quarter, the Federal Reserve adjusted its approach to interest rates and inflation. The Fed's new stance is now more focused on jobs than inflation. In his policy speech, Federal Reserve Chair Jerome Powell talked extensively about employment and the importance of the Fed doing all it can to support job growth. A part of the Fed's review of its policy was a "listening tour" during which it engaged in discussions about the economy with communities across the country. The overwhelming message was that a strong labor market is important for improving the lives of individuals and the overall economy.

With that message, the Fed has abandoned its old framework and will not pre-emptively raise interest rates just because the unemployment rate falls below a predetermined level. The chart below shows that unemployment rate (and underemployment rate) for the past 5 years. While unemployment has come back down from 10%, it is still well above levels of the past 5 years which suggests that the Fed will not be raising interest rates for a long time.



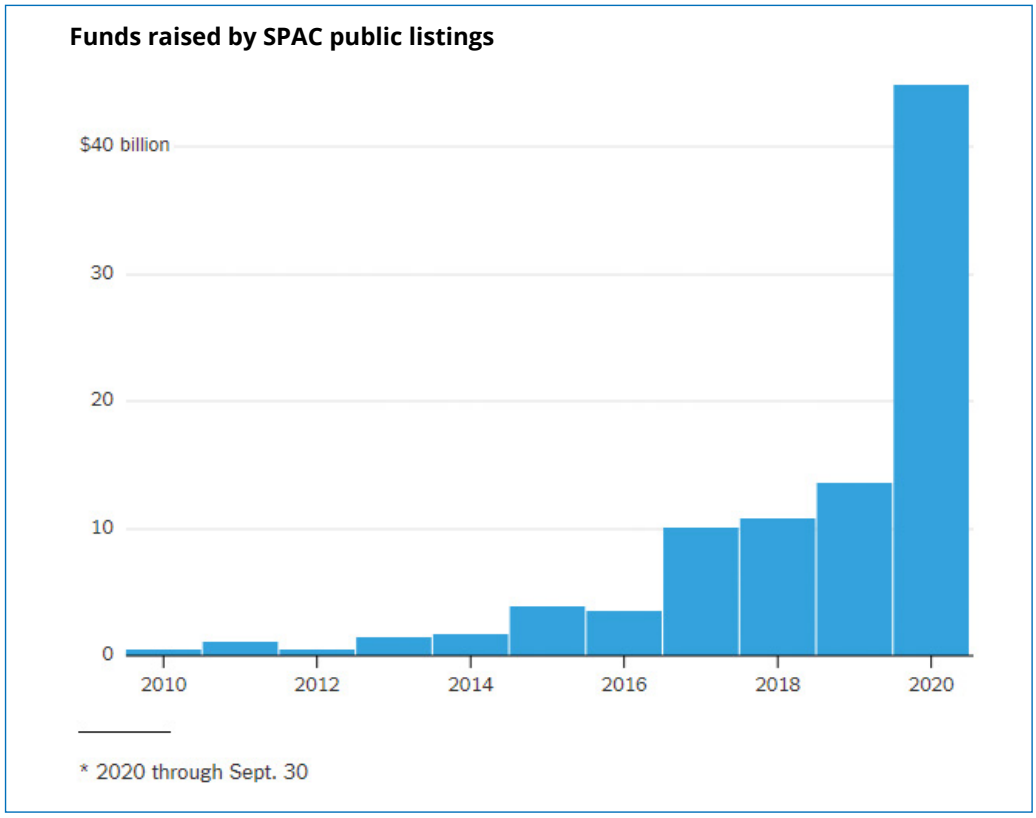
The Federal Reserve's massive liquidity provisions were in large part the driver of a continued dramatic recovery in riskier assets, erasing most losses suffered earlier in 2020. During the quarter, U.S. stocks rose, credit spreads tightened, but commodity prices overall continued to lag.

After a strong July and August, the stock market had its worst month since March in September. The S&P 500 was down about 4 percent in September, and at times it flirted with "correction" territory as investors felt increasingly jittery about the November elections.

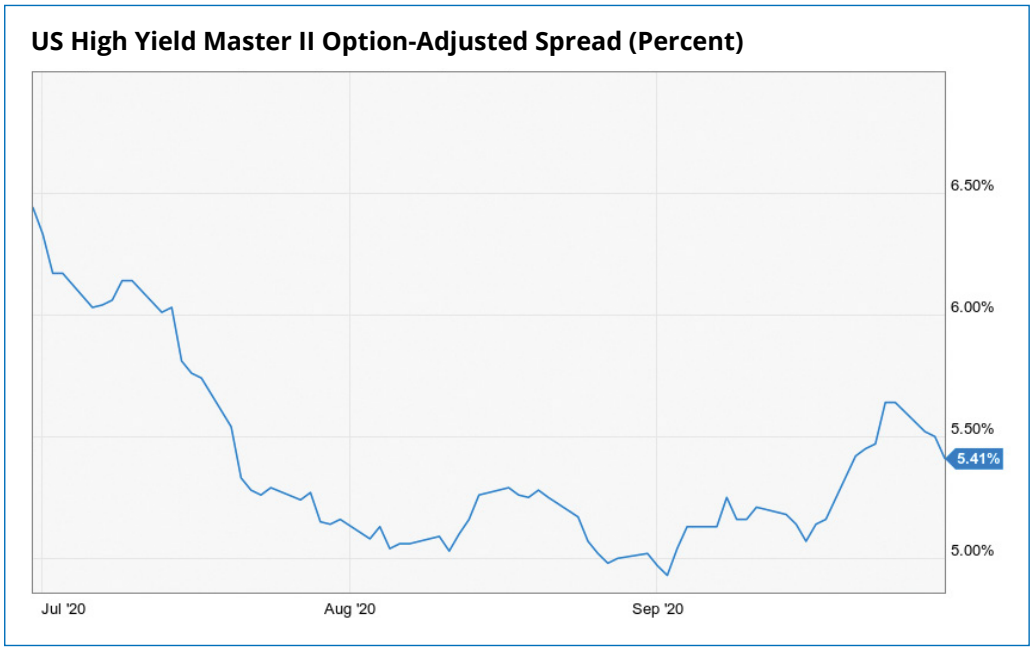
Elections are notoriously peppered with angst, anticipation and speculation. At the same time, markets don't always behave as conventionally expected.

Regardless, of the September bumps, investors still seem in a buying mode and initial public offerings are poised to set records. The amount raised in U.S. listings so far this year is ahead of even the dot-com days, with the busiest deal count for a third quarter since 2000 (Source: Renaissance Capital).

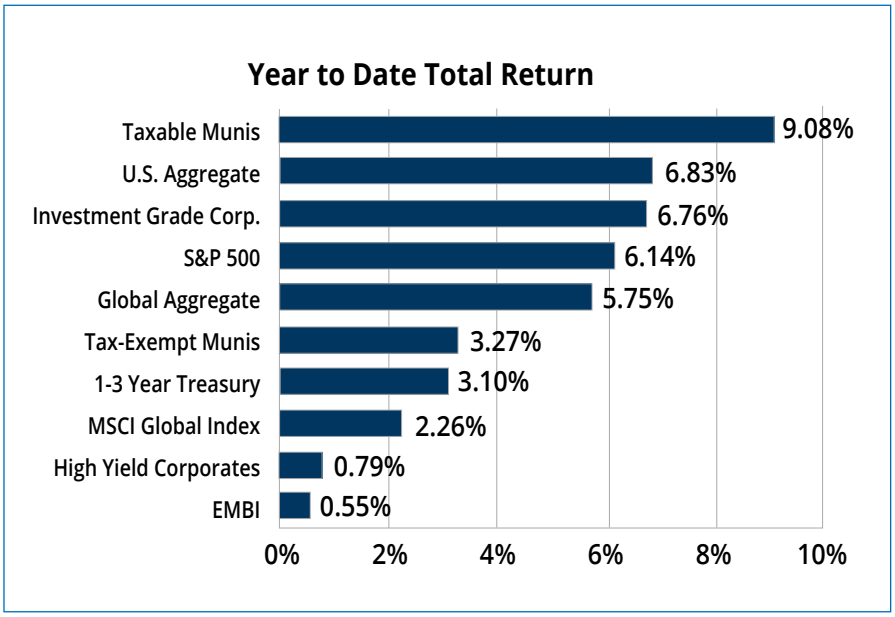
Here is what is fueling the boom: More than 100 SPACs have gone public so far this year, raising more than $44 billion. The chart below shows the record raises in 2020 already. (Sources: New York Times, SPAC Analytics).



Other risk-on assets also registered a strong 3 months. The chart below graphs spreads on high yield corporate bonds over comparable Treasuries during the third quarter. The decline in spreads totaled +103 bps closing the quarter at +541 bps, showing that investors are willing to hold high yield corporate bonds with less compensation. The drop in the rate equates to higher prices for high yield corporate bonds and supports the thesis of an improving investor appetite for risk.



In a similar vein, preferred stocks, which are quasi-bond (for the coupon) and quasi-equity (for their placement in the capital structure) were some of our most productive holdings during the third quarter. Tax-free rates were little changed in September but fell for the quarter. Despite ongoing uncertainty over additional fiscal stimulus and the looming November elections, demand for municipal bonds was strong and consistent. Flows into municipal funds across the market were positive in all but the final week in Q3 bringing total YTD flows to $20B. Emerging markets bonds posted gains during the quarter, although lagged other asset classes.



The benchmark 10yr Treasury ended the quarter at 0.68%, increasing 3 bps for the quarter. The slope of the yield curve was virtually unchanged in September and only modestly steeper for the quarter even as economic data recovered strongly in Q3.

WHAT WE DID:

A RULES-BASED APPROACH TO NAVIGATING MARKETS

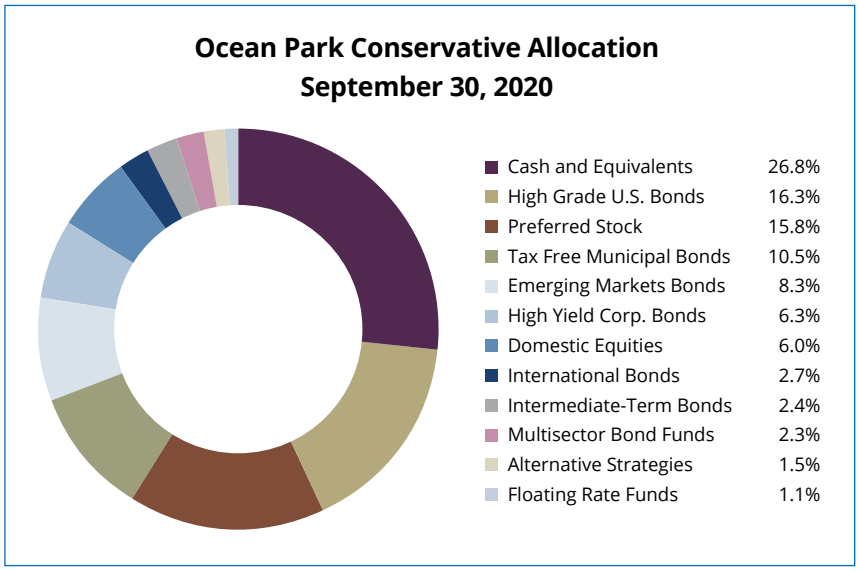
As mentioned above, the stock market had a sharp fall in September. High yield corporate bonds trend in the same direction and we observed and acted on Sell signals in most high yield corporate bond fund holdings as well as global equities fund holdings.

As a result, we ended the quarter with cash and havens in nearly all Ocean Park Strategies. For instance, the Conservative Allocation ended the quarter with 27% in cash and havens while Strategic Income owned approximately 25%. As a reminder, we never "allocate" to cash, but hold cash when we have Sell signals in asset classes and have not observed and acted on Buy signals.

The High Yield Corporate Bond Strategy rose to almost 90% cash and havens.

The Tactical Bond Strategy held approximately 13% in high yield corporate bonds after sell signals and reinvested some of those proceeds into long-term government bond funds, in keeping with our process. This Strategy closed the quarter with over 60% in cash and havens. And lastly, the Ocean Park Municipal Bond Strategy was fully invested in municipal bond funds at the end of the third quarter.

As an example of the broad diversification of asset classes that are used tactically to moderate drawdown, the pie chart shows the asset allocation of the Ocean Park Conservative Allocation Strategy at the end of the third quarter:



WHAT WE ARE DOING NOW:
DISCIPLINE MATTERS.

As noted above, the great enigma is why do global investors continue to apparently believe that corporate America is more valuable than it was in February, before the global crash in oil prices (which by the way have not recovered) and the human and economic devastation caused by COVID-19? We are not mind readers, so we are glad that our long-proven defensive disciplines simply have us watch for actual trend reversals rather than predict the markets. You can rest assured that we are highly attentive every day to protect your accounts in the event the Bear Market resumes.

Elections are notoriously peppered with angst, anticipation and speculation. As investors, we believe they should be approached with humility, a grain of salt and, most importantly, a process. We adhere to strict rules-based disciplines that first and foremost serve our goal of limiting drawdowns, while also generating satisfactory returns. We want to assure you that, despite these challenging times of our public health crisis with its significant impact on the economy and the investment markets, Ocean Park will continue to manage your accounts to mitigate risk, just as we have done throughout our 33-year history.

HIGHLIGHTED STRATEGY:
OCEAN PARK TACTICAL BOND

We would like to again highlight the Ocean Park Tactical Bond Strategy. In a roller coaster year, the Strategy has gained 9.65% (before fees) in the first nine months of 2020. As importantly, the Strategy ***gained 6.67%*** during the month ended March 20, a several week period that wiped out most managers.

The Tactical Bond Strategy uses a rules-based approach to shift between high yield corporate bond funds and long-maturity Treasury bonds, depending on the trends in the HYCB funds. We encourage you to consider diversifying some of your allocations into this newest Strategy at Ocean Park.

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