

November 2, 2020

Quarterly Commentary; Virus Market

2020 continues to be a rollercoaster for financial markets. After a tumultuous drawdown brought on by the COVID pandemic, risk assets have recovered sharply. In the 3rd quarter, the dramatic rebound continued, leaving most major stock indices at or near pre-COVID highs. Economic conditions continued to improve sequentially from extremely low levels, but progress has slowed and will largely depend on COVID-19's trajectory and on more policy support.

This is Not Your Normal Recession

A pandemic, the resulting sharpest growth downturn in modern times and soaring government debt all occurring in a normally volatile US Presidential election year make this one for the books. Meanwhile, the fastest equity bear market in history was followed by the quickest recovery to new highs. Growth has rebounded (albeit unevenly) as economic lockdowns have ended, but most forecasts (including our own) suggest the level of activity will not return to its pre-crisis levels before the end of next year. The only valuation metric the market looks attractive is comparing earnings yields with

the returns on available cash and bonds. This is the so-called TINA (there is no alternative) argument. The sharp decline in interest rates certainly supports higher equity valuations, but it also reflects a very bleak long-run outlook for economic growth and thus earnings and stock prices. But a bull market that depends largely on stimulative policy is problematic... therefore, we clearly see a disconnect between future economic prospects and risky asset prices. (See Chart 1)

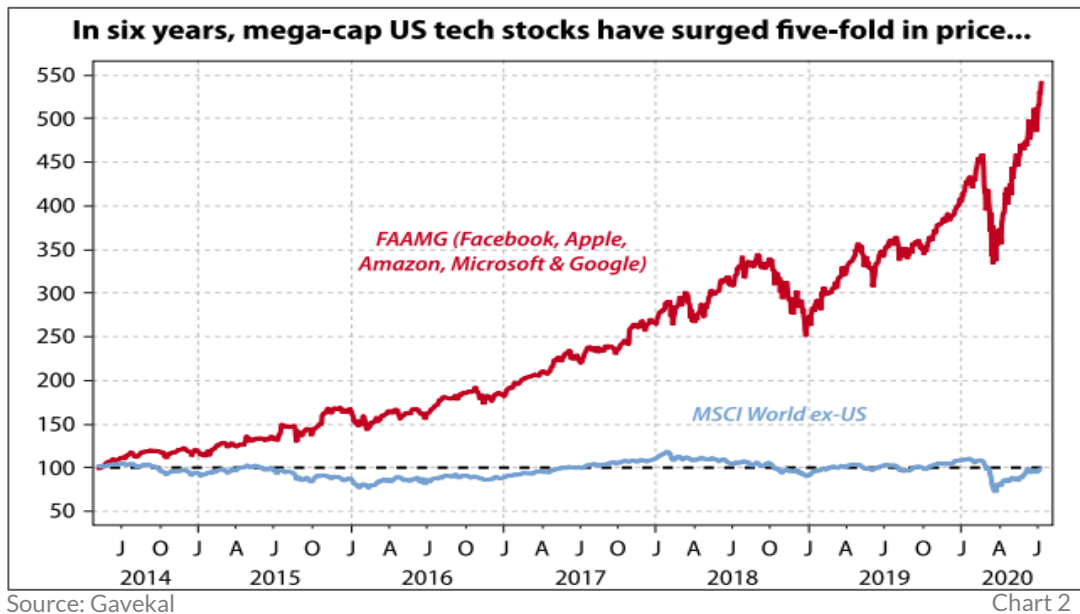


Source: Bloomberg

Chart 1

Market Breadth is Narrow

History tells us that the fundamental performance of companies cannot sustainably diverge from that of the underlying economy—see the “Tech Wreck” of 2000-2002 as the most recent example. How bad was it? Tech-centric funds had up to 90% peak-to-trough drawdowns and Nasdaq-centric funds fell from 60%-75%. In the short term, share prices can reflect large swings in valuations driven by investor sentiment. This irrational exuberance has been concentrated squarely in “big tech”. The top 5 companies in the world by market cap (Facebook, Apple, Amazon, Microsoft, Google) have risen five-fold over the past six years, while over the same period the MSCI World ex-US index has flat-lined. In fact, with the median stock price still down on the year, manager performance can largely be explained by their exposure to these stocks. (See Chart 2)



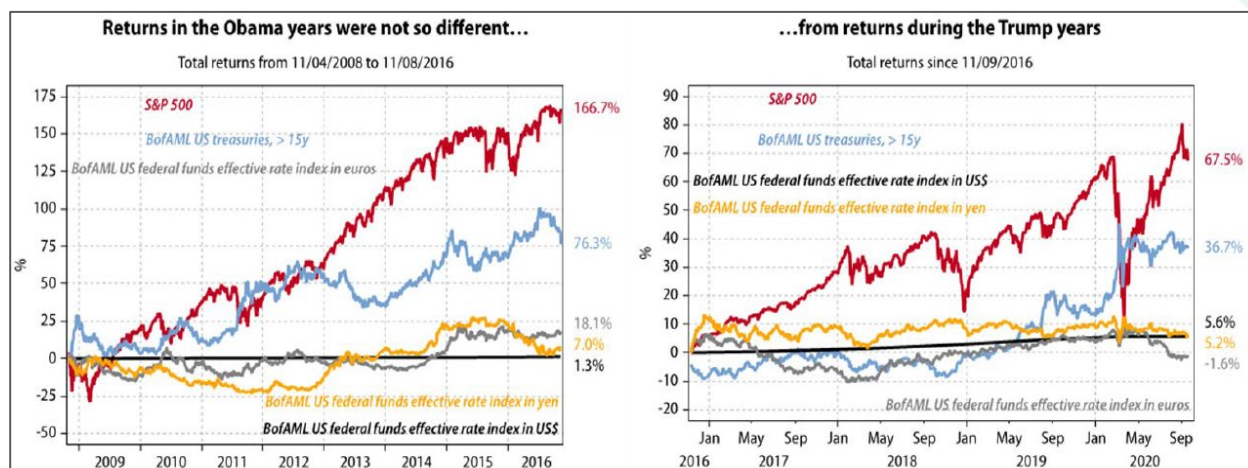
Indeed, if the bull case rests simply on the TINA argument, then it implies the current high valuations could persist over the medium term. We are reminded of the late 1990's when the bull market lasted much longer and moved far higher than many others expected. However, with no cheap assets, tactical and unconstrained management is now more important than ever.

2020 Election Risks are Overstated and Overanalyzed

With historic interest, big partisan differences, social unrest and a pandemic, we acknowledge this election "feels" different.

But the more things change, the more they stay the same...

There are profound differences in both style and substance between Donald Trump and Joe Biden—just as there were between Donald Trump and Barack Obama. The curious thing is that financial markets do not seem to agree with this uncontroversial assessment. If we look at the returns of the major US asset classes, we find that: Equities delivered roughly the same return during the Obama years as under Trump; Long-dated bonds delivered positive returns in the Obama years as well as in the Trump years. (see chart 3).



Source: Gavikal

Chart 3

And both equity bull markets had the same secular drivers (tech, consumer discretionary, and healthcare). One might have expected healthcare to do poorly under Obama (it didn't) or energy do well under Trump (it didn't). Conventional wisdom and narratives don't usually pan out! And while we use this anecdote between Trump and Obama to get the point across ... it is also historically true that stocks have performed well (and poorly at times!) under both parties and there are more important factors that drive asset performance. Therefore, despite all the attention, the impact the President has on the market is overrated.

We continue to focus on the need in a financial crisis (whatever the origin) to help craft easy-to-understand, longer-term narratives for Advisors and their Clients. Panicking and abandoning diversified investment strategies during volatility and market crashes/surges is a time-tested losing proposition.

Donoghue Forlines solutions are designed to be client-centric and deliver strong risk-adjusted return streams through both our rules-based, tactical strategies as well as our global macro, fundamentally driven tactical solutions. We aim to capture the majority of the upside but more importantly to avoid the majority of the downside.

We have continued to carefully assess exposure across all our portfolios over the past quarter, as per our risk management process. Certain portfolios reflect defensive/conservative positioning amid historic volatility in asset markets, while others are more aggressively positioned. In our fundamental strategies, we have deployed cash in high quality credit and equities. Our positioning is outlined in more depth below. We remain cautiously optimistic to the continuation of the recovery but recognize the possibility of some pain ahead in the near-term due to several risks outlined above.

We will stay vigilant with our goal of seeking strong risk-adjusted returns. Please visit our website at www.donoghueforlines.com. Thank you for your confidence in Donoghue Forlines. Please let us know if you have any questions.

Regards,



A handwritten signature in black ink that reads "Jeffrey R. Thompson". The signature is fluid and cursive.

Jeffrey R. Thompson
Chief Executive Officer
Portfolio Manager

The following reflects Donoghue Forlines' rules-based and blended portfolios' positioning as of September 30, 2020.

Donoghue Forlines Dividend Portfolio

Positioning: 100% allocated to large and mid-sized high yielding companies with a diversified sector exposure and quality orientation.

The principal goal of our strategy is to capture most of the upside and limit participation on the downside following our belief that "It's not what you make, it's what you keep." As you know, the Donoghue Forlines Dividend Portfolio uses a set of technical and fundamental indicators to determine if it should be invested in equities or be in a defensive position. The Portfolio began the third quarter fully defensive, 100% allocated to short-term Treasury ETFs. However, on August 17, the Portfolio received a bullish buy signal, where it completely sold out of short-term Treasury ETFs in favor of high dividend Large/Mid-Cap stocks. Additionally, the Portfolio performed its quarterly reconstitution/rebalance on September 18th. Our focus continues to be risk-adjusted returns over a full market cycle. We believe that the Donoghue

Forlines Dividend strategy is well positioned as the market demographics are shifting from a position of accumulation to seeking income-producing investments.

Donoghue Forlines Momentum Portfolio

Positioning: 90% invested in high Sharpe Ratio Large/Mid-Cap Stocks; 10% invested in Short-Term Treasuries via ETF exposure.

The Portfolio began the third quarter 80% invested in high Sharpe Ratio Large/Mid-Cap stocks and 20% allocated toward short-term Treasury ETFs. Since, the Donoghue Forlines Momentum Portfolio has received multiple signals, the first of which came through on July 6, when we bought back into Financials. Another bullish buy signal came through on July 21, where the Portfolio bought into the Utilities sector. In early September, we received a signal to sell out of Energy. Additionally, the Portfolio performed its quarterly reconstitution/rebalance on September 18th. We would suggest considering diversifying into this strategy to complement the Donoghue Forlines Dividend Portfolio as the Momentum strategy has ten tactical overlay trigger points and is less binary.

Donoghue Forlines Dividend Mid-Cap Portfolio

Positioning: 100% allocated to Short-Term Treasuries via ETF exposure.

The Donoghue Forlines Dividend Mid-Cap Portfolio began the second quarter fully defensive. The Portfolio remained fully defensive for the entirety of the quarter. Our focus continues to be on risk-adjusted returns over a full market cycle.

Donoghue Forlines Dividend International Portfolio

Positioning: 100% invested in Short-term Treasuries via ETF exposure.

The Donoghue Forlines Dividend International Portfolio began the quarter in a fully defensive posture. The Portfolio remained fully defensive for the entirety of the quarter. Our focus continues to be risk-adjusted returns over a full market cycle. We believe that the Dividend International strategy is well positioned as the market demographics are shifting from a position of accumulation to seeking income-producing investments.

Donoghue Forlines Treasury Portfolio

Positioning: 100% invested in long-term U.S. Treasury bonds via ETF exposure.

The Donoghue Forlines Treasury Portfolio began the quarter bullishly invested in intermediate-term US Treasuries. In late-September, the Portfolio's technical signals triggered a shift into long-term US Treasuries. Year to date, the Donoghue Forlines Treasury Portfolio has been our best performing strategy, as the rally in bonds has been nothing short of incredible. We continue to suggest that this strategy should not be utilized as a standalone solution, but rather should be blended with other solutions to provide a potential hedge in risk-off market environments, like the one we saw in March.

BLENDED SOLUTIONS

The blended solutions combine the best ideas from our rules-based and global macro solutions into long-term investment solutions.

Donoghue Forlines Income Portfolio

The Donoghue Forlines Income Portfolio's allocations at quarter end are as follows: 4.27% in cash, 86.91% in fixed income, 5.51% in equities, and 3.31% in alternatives.

Being that we are likely at or near a secular turning point in the bond market, the overall portfolio, and particularly the Power Income Fund, shifted towards a more diversified global, multi-asset income approach to seek opportunities in the fixed income and yield-oriented equity markets. We believe that future potential returns will predominantly come from coupon and dividend yield performance moving forward. The Power Floating Rate fund spent the quarter 100% invested in Floating Rates and High Yield.

Target Allocations: 56.25% in Power Income Fund, 31.25% in Power Floating Rate Index Fund, and 12.50% in a short-term treasury bond fund.

Donoghue Forlines Dividend & Yield Portfolio

The Donoghue Forlines Dividend and Yield Portfolio's allocations at quarter end are as follows: 4.30% in cash, 65.46% in fixed income, 26.47% in equities, and 3.77% in alternatives.

Target Allocations: Power Income Fund (35%); Power Tactical Allocation/JAForlines Fund (35%); Power Floating Rate Index Fund (15%); Power Dividend Index Fund (7%); Power Dividend Mid-Cap Index Fund (5%); Power Momentum Index Fund (3%).

Donoghue Forlines Growth & Income Portfolio

The Donoghue Forlines Growth and Income Portfolio's allocations at quarter end are as follows: 4.06% in cash, 51.16% in fixed income, 41.80% in equities, and 2.99% in alternatives.

Target Allocations: Power Tactical Allocation/JAForlines Fund (49%); Power Momentum Index Fund (15%); Power Dividend Mid-Cap Index Fund (12%); Power Floating Rate Index Fund (5%); Power Income Fund (10%); Power Dividend Index Fund (9%).

IMPORTANT RISK INFORMATION

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There can be no assurance that the purchase of the securities in this portfolio will be profitable, either individually or in the aggregate, or that such purchases will be more profitable than alternative investments. Investment in any Portfolio, or any other investment or investment strategy involves risk, including the loss of principal; and there is no guarantee that investment in Donoghue Forlines' Portfolios or any other investment strategy will be profitable for a client's or prospective client's portfolio. Investments in Donoghue Forlines' Portfolios, or any other investment or investment strategy, are not deposits of a bank, savings, and loan or credit union; are not issued by, guaranteed by, or obligations of a bank, savings, and loan, or credit union; and are not insured or guaranteed by the FDIC, SIPC, NCUSIF or any other agency. The composite strategy provides diversified exposure to various asset classes such as equities, fixed income, and alternatives utilizing liquid exchange-traded products. Diversification does not guarantee a profit or protect against a loss.

The S&P 500 Index is a market capitalization weighted index of 500 widely held stocks often used as a proxy for the stock market. Standard and Poor's chooses the member companies based on market size, liquidity, and industry group representation. Included are stocks of industrial, financial, utility, and transportation companies.

The S&P 500 Value Index measures the performance of value stocks drawn from the S&P 500 index. The complete market capitalization of S&P 500 index is divided into growth and value segments by using three factors: sales growth, the ratio of earnings change to price, and momentum. The index is market capitalization weighted.

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