WILMINGTON TRUST

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January | 2021

Capital Perspectives

Monthly investment analysis and insights from Wilmington Trust Investment Advisors

ON THE RECORD

2021: In Like a Lion, (Hopefully) Out like a Lamb

In this issue:

Tony Roth
Chief Investment Officer

It was with a distinctive mix of relief and hope that we turned the page on the calendar year, leaving behind a convulsion of health, political, economic, and market disorder that had rocked the world. Barely two weeks in and the new year hardly seems to have shepherded an abatement to the past year's chaos and uncertainty.

Nonetheless, as we look past the continuing tragedy of COVID-19, the recent violence in our nation's capital, and an unprecedented second presidential impeachment, an undoubtedly brighter path forward emerges. The arrival of effective vaccines along with a new administration likely to increase fiscal support for a badly battered economy underwrites our confidence that the second half of 2021 will feel a world apart from the past year. It is with this conviction that we positioned portfolios late in 2020 to overweight risk assets (where the return is uncertain), anticipating the healing before it arrives. Risks remain, as they always do. But now is the time to press any economic and market advantages as the nation and the world accelerates its convalescence.

Specifically, we start the year with an overweight to equities, focusing on U.S. small cap and emerging markets, and underweights to investment-grade fixed income and real assets. We have also recently eliminated gold from our portfolios and returned commodities to a neutral weight.

Politics and policy

With the inauguration, a protracted, historic, and emotional political season will finally draw to a close. Democrats in Georgia have delivered an upset victory to tie the Senate, in turn delivering to Vice President-elect Kamala Harris the tie-breaking

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Tech regulation is also likely to increase given that a broad consensus now exists among Democrats and Republicans relative to both reversing monopoly powers and enhancing consumer protections, particularly in the privacy area.

vote, and to Democrats one of the narrowest congressional majorities in history. Back in November, the stock market cheered the prospects of a divided government. Now that the government is not divided but is in fact *unified* under Democratic control, the market is, well, still cheering. In our view, the continued market momentum owes to two realities. First is the basic fact that the Democratic Senate majority is indeed razor thin and not likely to result in the type of progressive tax policy that would harm an economic recovery before it even gets going. Second, as noted earlier, we expect the new Washington power lineup to result in a material increase in fiscal support. Whether it be infrastructure spending, $2,000 checks, or state and local aid, more government dollars are good for the economy and thus good for markets.

Here is an overview of how we see events possibly shaping up around the three key investment domains of federal spending, taxes, and regulation in light of the slim Democratic Senate majority:

- **Spending**—Additional near-term fiscal stimulus beyond the $900 billion passed in December to address the pandemic would require the support of 10 Republican senators or some way of paying for it via the budget reconciliation process.
- **Taxes**—Corporate or personal tax increases can be accomplished through the budget reconciliation process and a simple majority in the Senate; the Republicans handed the Democrats that playbook back in 2017. With the economy so weak and midterm elections in 2022, we would expect this to be a late 2021 or early 2022 priority. Additionally, we anticipate increases in the marginal tax rate for top earners and the corporate tax rate to at least 25%.
- **Regulation**—Likely to escalate, this would be to the detriment of core economic sectors, including energy, health care, financials, and technology. Most of these changes will transpire within the framework of the executive branch and will not require legislative action. Standards around bank capital reserve (liquidity) buffers and consumer protections could be raised within the first year of the new administration. Tech regulation is also likely to increase given that a broad consensus now exists among Democrats and Republicans relative to both reversing monopoly powers and enhancing consumer protections, particularly in the privacy area. It is a certainty that the new administration will take a much tougher approach to energy regulation from an environmental perspective. Last, the Biden administration is likely to continue the work of the Obama era toward greater equality within the health care arena.

Resumption of the reflation trade

The equity market has been on a tear, with the S&P 500 gaining 71% since the March 23 low and 15% just since the November 3 election (through January 7, 2021). More notable in recent weeks has been the rotation occurring beneath the surface of the equity market. The change in presidential party set off a dramatic reflation trade, i.e., an expectation that additional fiscal spending would aid an economic recovery and potentially spark inflationary pressures. The reflation trade received a second

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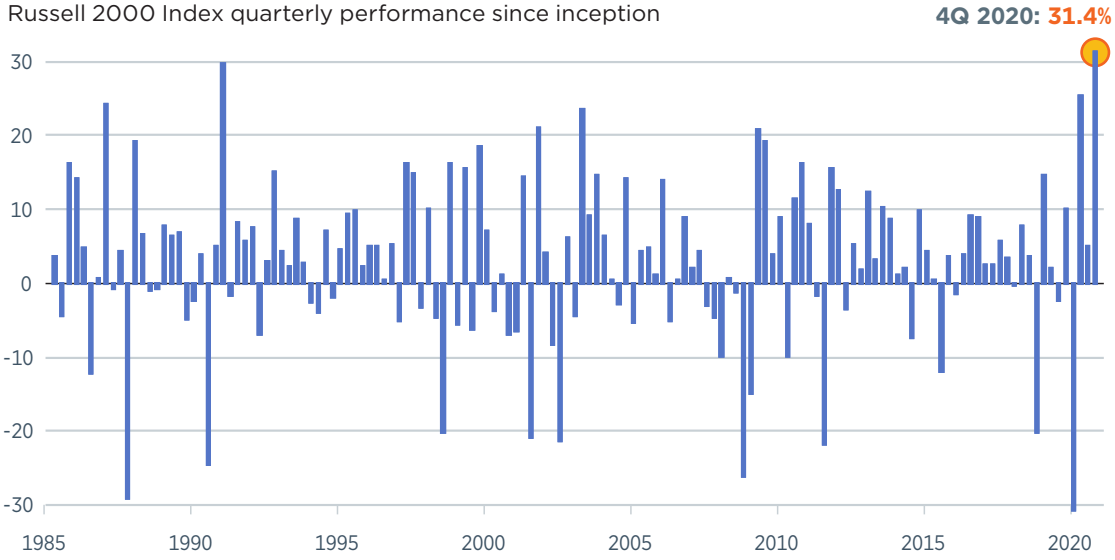
Figure 1

U.S. small-cap stocks are having their best 3-month performance since 1Q 1991

Russell 2000 Index quarterly performance since inception



Data as of December 31, 2020.

Source: Macrobond.

Past performance cannot guarantee future results. Indices are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses such as management fees and transaction costs, which will reduce returns.

The vaccine could unleash the $1.5 trillion of savings accumulated since the pandemic began and pent-up demand for services including travel, hospitality, and entertainment

wind following the Georgia election runoff, which solidified the close Democrat majority in Congress. Interest rates have shot higher, with the 10-year Treasury yield breaking well above 1% for the first time since March 2020 and the yield curve steepening to 95 basis points (0.95%), a level not seen since 2017. Cyclical stocks like those in the energy, financials, and materials sectors have outperformed mega-cap growth stocks. The U.S. small-cap Russell 2000 Index closed out 2020 with its best quarter since index inception (Figure 1).

Over the short term, we expect the leadership of cyclical assets to continue, with the 10-year Treasury moving higher into 2021 but likely taking a breather around 1.5%–1.75% (though interest rates are notorious for overshooting and undershooting expectations). We are looking through the near-term risks around the virus and the economy that are real but could be well behind us six to 12 months from now. The vaccine could unleash the $1.5 trillion of savings accumulated since the pandemic began and pent-up demand for services including travel, hospitality, and entertainment (Figure 2). The likelihood of the Fed maintaining its policy rate at the lower bound and pace of asset purchases through 2021 means the steepness of the yield curve could provide some much-needed margin relief to the banking industry. Record amounts of liquidity create a foundation for inflationary pressures and commodity prices, which are also benefiting from strength in U.S. and Chinese manufacturing.

We have positioned client accounts accordingly, with an underweight to investment-grade fixed income and overweight allocations to U.S. small-cap and emerging markets equities. As discussed in our December note, the global economic recovery is still in the early stage, and these areas of the market have some catching up to do in terms of valuations, particularly relative to U.S. large-cap equities. U.S. small cap could also benefit from an anticipated wave of merger and acquisition activity, a key component of our 2021 Capital Markets Forecast.

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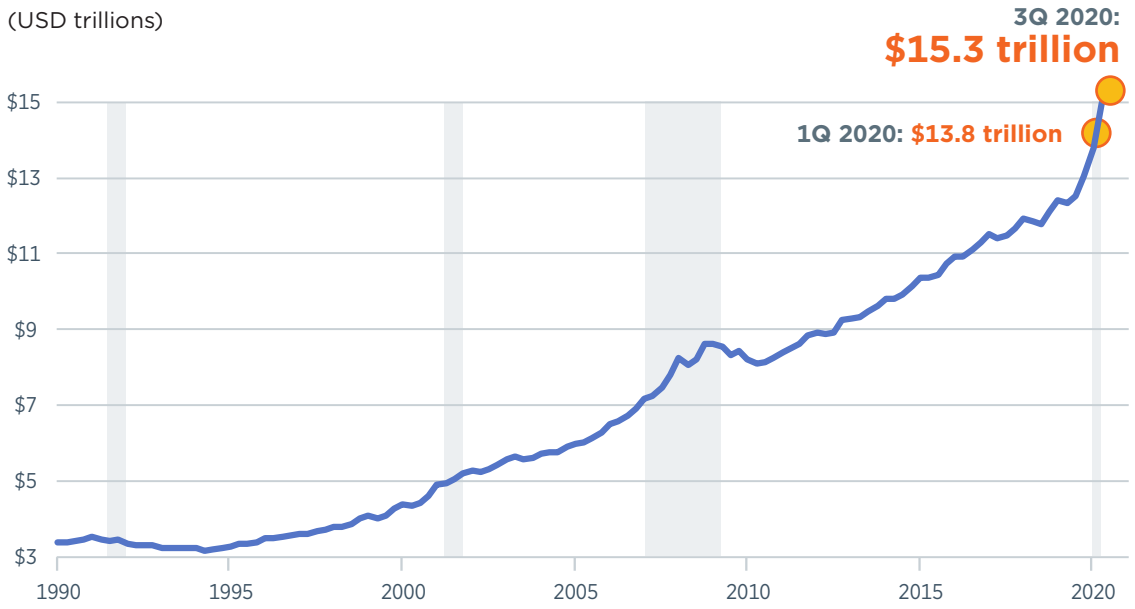
Figure 2

Household savings increased by $1.5 trillion since the pandemic began

(USD trillions)



Data as of September 30, 2020.

Source: Federal Reserve Financial Accounts.

Household savings estimated as the sum of checkable deposits and currency, other deposits including time and savings deposits, and money market fund shares.

Shaded areas represent recession periods.

We witnessed a modest but healthy pullback in U.S. large-cap equities of –9.6% peak to trough, which began as a shunning of high-flying tech stocks but morphed into skepticism about the trajectory of economic growth.

Gauging the risks

Despite our constructive outlook, we are closely monitoring several risks, which we see as manageable at this time. The most pressing and obvious risk is the spread of the virus and the associated impact on the economy. Fiscal aid is providing a lifeline to consumers and businesses to weather the storm while vaccines are distributed.

Vaccine rollout also presents its own set of risks. Bottlenecks have slowed the expected pace of inoculation around the globe, but it is early days and we believe these issues will be worked out in short order. Perhaps more of a concern is what human behavior looks like on the other side. With data as yet unclear on whether a person who has received the vaccine can still spread the virus, there are suggestions being made by medical experts that inoculation may not materially alter the social distancing and mitigation measures currently in place. If vaccinations do not permit a return to normal (or something that at least resembles the prior normal) by late 2021, our bullish view would be challenged.

Lastly, we watch with some unease as euphoria and speculation become more apparent in certain areas of the market, including some tech stocks and other less conventional assets like bitcoin. Broadly speaking, we still view equity market valuations as high but not unreasonably so. The growing importance of technology in our society, changes in the sector composition of equity indices over time, and historically low interest rates make historical valuation comparisons less reliable. We would also note that certain parts of the equity market, particularly in U.S. cyclicals and overseas equities, do not appear as frothy.

Looking ahead

Now could be a time to be invested with an overweight to risk versus a long-term benchmark (Figure 3). As always, we recommend diversifying across asset classes

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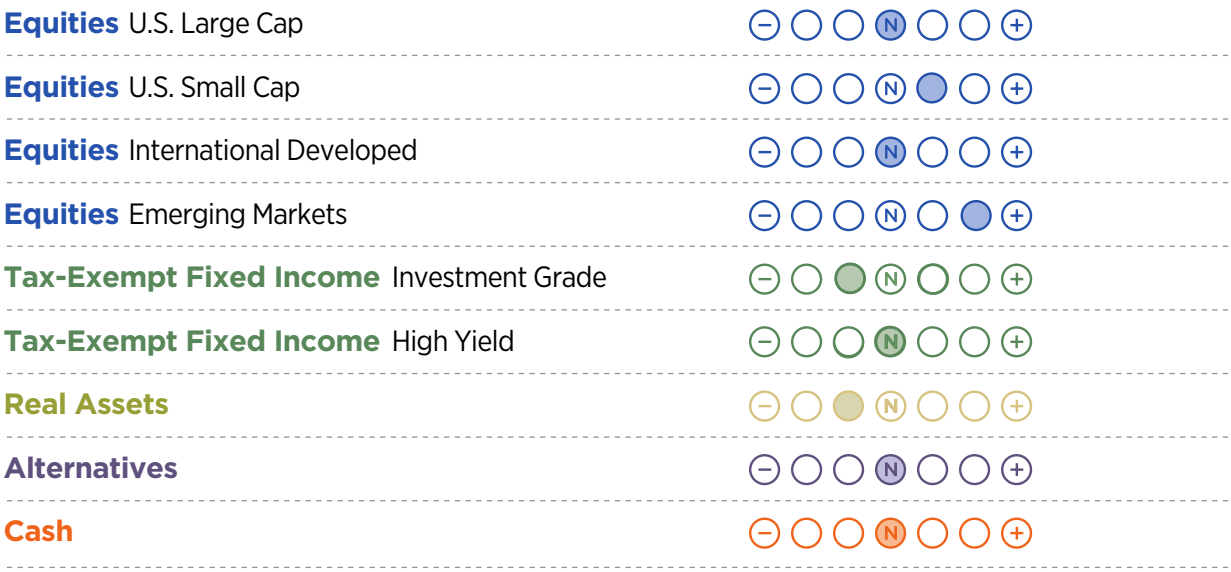
Figure 3

Current tactical asset allocation



and factors, especially when it comes to metrics like quality, value, growth, and momentum. It is also a good time to revisit your long-term objectives with your advisor. A new year and new presidential administration can be an opportune time to reflect on changes to priorities and investment objectives. Unanticipated volatility over the coming months would not surprise us, and having the proper investment plan in place is an important tool to help enhance the likelihood of emerging unscathed on the other side.

Until next month,

Tony

IN FOCUS

What's your 2021 Capital Markets Forecast IQ?

Our 2021 Capital Markets Forecast explores the trends that are unfolding at an accelerated pace and how they will affect the way we live, work, and invest. To see how much you know about what we believe you can expect, take our quiz. Once you're armed with this investment intelligence, talk to your financial advisor to see if your portfolio is appropriately positioned to try and capitalize on opportunities and sidestep challenges in the year ahead and beyond.

1. Increases in productivity are the lifeblood of long-term economic growth as well as profitability for firms. What is Wilmington Trust's outlook on productivity in 2021 and beyond in the wake of the COVID-19 pandemic?

A. Weaker productivity as firms grapple with reopening and the "new normal"

B. Stronger productivity from innovation over the course of 2020

C. No discernible change in productivity as life returns to normal

2. After registering a sharp decline in the first half of 2020, we believe that M&A activity will ultimately accelerate in the years ahead. Which of the following do we cite as factors that could contribute to higher levels of industry consolidation coming out of the pandemic?

A. High interest rates

B. Decreasing technology needs

C. Elevated cash balances

D. Relaxed antitrust enforcement

3. The pandemic has prompted companies to rethink supply chain decisions as resilience to unexpected shocks becomes an increasingly important factor to consider in addition to cost. We expect that most companies are likely to reshore operations (bring supply chains home from China and other countries) as a result. True or false?

A. True

B. False

4. Governments around the world responded to the pandemic with varying levels of fiscal support, issuing fresh new debt to pay for the spending. The U.S. had the highest level of permanent direct support (spending and tax cuts) as a share of gross domestic product (GDP) while other countries had higher total support with more indirect, less permanent measures (loans and guarantees). What is our view of the impact on markets?

A. Risk of higher inflation and interest rates than in the previous cycle

B. Little risk of long-term effects as the debt was already extremely high

C. Risk of low inflation and U.S. interest rates going negative as in Europe

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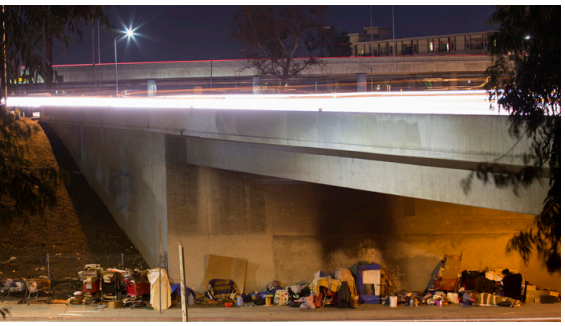


5. The share of income held by the top 1% of earners has nearly doubled since 1980, while the share held by the bottom 50% has declined by a third as of 2019. Which of the below are potential economic outcomes related to the pandemic's further acceleration of income inequality?

A) Dampened consumer spending and economic growth as a result of the slow return of low-income service sector jobs

B) Lower labor force participation and lower long-term potential growth as a result of structural economic changes weighing on job opportunities for low-income workers

C) Potential enactment of populist economic policies

D) All of the above

6. The U.S. is leading the world in adoption of next generation contactless payments, including via app-based digital wallets, hand-print scanners, and facial recognition technology. True or false?

A. True

B. False

7. In many ways 2020 was a breakthrough year for ESG (investments focused on companies with sound environmental, social, and governance qualities). Which of the following are reasons we expect the ESG trend to be a structural shift in the market environment, rather than a passing investment fad?

A. We identify a close link between ESG-focused companies and the quality factor, meaning that a portfolio rated highly in both ESG criteria and quality (defined as high profitability, low leverage, and lower volatility) could offer better risk-adjusted returns over time. This also coincides with reduced frequency of negative tail-risk events.

B. Companies across the business landscape are shifting from a focus on delivering shareholder returns to a focus on delivering returns to all stakeholders, a concept referred to as "stakeholder capitalism."

C. Data availability, data standards, and mass adoption of ESG-related disclosures by public companies are making it easier for investors to make fully informed investment decisions.

D. All of the above

Continued

8. Approximately what percentage of daily trading in the U.S. equity market is done by quantitative trading strategies, including high-frequency or algorithmic trading?

A. 5%

B. 10%

C. 25%

D. >50%

9. Headed into 2021, our client portfolios are overweight the following asset class[es]:

A. U.S. small-cap and emerging markets equities

B. Tax-exempt investment-grade fixed income and real assets

C. U.S. large-cap and international developed equities

D. Tax-exempt high-yield fixed income

10. Which of the following do we view as the most pressing key near-term risks for the equity market? (Select all that apply.)

A. Equity market valuations

B. Washington policy

C. Slower economic recovery

D. Delay of vaccine rollout

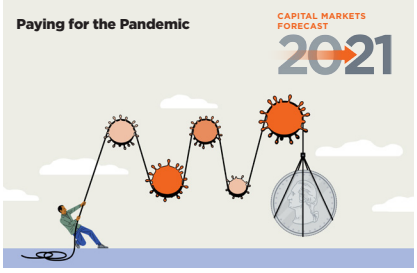
Continued

ANSWER KEY

1. B

Both history and economic theory show productivity accelerates after recessions. We believe firms have reacted to the pandemic by investing in new technologies, systems, and software to enhance the productivity of their workers and will drive overall productivity and profitability higher in the coming years, a boon for equities. However, these actions lead to elimination of jobs at the firm level and if the dynamic is widespread there is a risk of persistent high unemployment. Learn more about our views on the topic here.

2. C



U.S. corporations accumulated over $2.4 trillion of cash in the first half of 2020, the highest amount in at least several decades, as they looked to shore up liquidity in the face of a highly uncertain path ahead due to the pandemic. We expect that better capitalized companies may choose to deploy excess cash toward strategic acquisitions. Private investors have also built up a record amount of dry powder that we anticipate could be allocated toward growth equity investments or sponsor-driven leveraged buyouts.

3. False

While reshoring is one option, particularly in industries deemed critical for national interest, it is just one of a few alternatives that are likely to be considered by companies. Regionalization—maintaining operations in China while adding production locations (or shifting operations to alternate locations) is also an option that is likely to be in play, depending on company- and industry-specific dynamics. Some technology supply chains in Asia, for example, may be sticky, given deep, long-standing supply networks that are difficult to easily replicate elsewhere. On the whole, however, we expect a trend toward diversification in supply chains to reduce heavy concentration in China. Learn more about how the pandemic is impacting corporate supply chain decisions here.

4. A

Though we are not calling for rapid inflation and skyrocketing interest rates, the risk is to the upside. The U.S. and many other countries have now pushed debt-to-GDP levels above thresholds that are believed to have deleterious effects on longer-term rates. If inflation surprises to the upside, then longer-term rates would likely be pushed higher again, requiring sharp focus on positioning in fixed income markets. Read more of our views on debt and inflation and also view videos on our website that focus on our fixed income positioning.

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5. D

Low-wage service industry jobs with high levels of personal contact (such as restaurant and hotel workers) were hardest hit at the outset of the pandemic. These jobs will remain vulnerable until virus concerns diminish, potentially weighing on consumer spending and growth once fiscal stimulus fades. Structural changes such as reduced business travel, de-urbanization, and increased automation, could lead to fewer job opportunities for low-income workers in the future, weighing on labor force participation and long-term growth. An unequal distribution of income may also lead to populist economic policies (such as increased taxes or tariffs) that seek to correct for this inequality, which in turn could impact economic and market outlooks. Learn more about the pandemic's impact on income inequality and the economy here.

6: False

The U.S. is lagging other countries like China as well as the UK and other areas of Europe. As of the middle of 2020, 78% of European payment transactions were "contactless" (made without a traditional physical card scanning). Growth of the contactless payments market could be more than 20% per year for the next six years, representing opportunity for the U.S.—specifically for companies in the payment services, software, and internet retail industries—to catch up to other countries. Read more here.

7: D

The factors above will not necessarily result in outperformance of ESG investments in any given year, but we do believe over time they will allow ESG to deliver competitive risk-adjusted returns and will result in ESG continuing to grow as a fixture in the investment landscape. Read more here.

8: D

While quantitative trading can provide a useful function in providing liquidity, the technical triggers that result in buying or selling of securities can often result in positive feedback loops. For example, when a security dips below a certain level, technical or quant-driven strategies may automatically sell that security, thereby exacerbating the selloff and leading the security price lower, sometimes dramatically so. This differs from the trading behavior of long-term, fundamental investors. Read more here.

9. A

Small caps stand to advance the most from a faster economic recovery, but near-term economic risks remain. We believe M&A activity could result in disruption and selective investment opportunities over the next 12 months. In our view, emerging markets equities stand to prosper from the structural acceleration of tech adoption around the world, and local firms are likely to adopt new productive technologies. China, in particular, should profit from a more benign trade backdrop under a Biden administration and expectations for a weaker dollar. Additionally, we believe

Continued

valuations of emerging markets growth equities still look attractive relative to the U.S. Learn more here.

10. A and C

Equity market valuations by many metrics and across many asset classes are near all-time highs. A significant amount of good news is priced into stocks, particularly those that are tech-related in U.S. large cap. We find valuations to be more reasonable for U.S. large-cap value, U.S. small cap, and international equities.

Washington policy is a risk longer term, but in the short term the focus is likely to remain on the Democrat-controlled government resulting in more stimulative fiscal policy—a support for cyclical equities, interest rates, and other reflation-type assets. Longer term, the very narrow Democrat majority still makes broad, sweeping policy change unlikely. However, we could see modest increases to corporate or personal tax rates, as well as regulatory changes.

We do remain concerned about a slower economic recovery resulting from deeper scars on the labor market. If businesses are no longer there to rehire workers, or if the new jobs are in fields that require retraining, the recovery in the labor market could take longer than expected.

The early delays in vaccine distribution bear monitoring, but we believe the global logistical system will ultimately rise to the challenge and smooth out the early wrinkles. This is a daunting task involving distribution, supply chains, and vaccine education, but we still believe the spread of the virus can be greatly curbed by the middle of 2021.


ASSET CLASS OVERVIEW

Real Assets

Jordan Strauss, CFA, Senior Portfolio Manager
Jessica Blitz, Research Analyst

	AS OF DECEMBER 31, 2020		
	Month	QTD	YTD
S&P Developed Property TR USD	3.68%	13.03%	-6.20%
Bloomberg Barclays US Treasury US TIPS TR USD	1.15%	1.62%	10.99%
Bloomberg Commodity TR USD	4.97%	10.19%	-3.12%

Sources: FactSet, Bloomberg. Investing involves risks and you may incur a profit or a loss. Past performance cannot guarantee future results. Indices are not available for direct investment.

What we are seeing now

Real assets saw positive performance in 4Q 2020 as markets were driven higher by vaccine optimism and further government economic support.

Real estate, which sold off dramatically in March amid unprecedented disruption, rallied along with broader risk assets from 2Q 2020, but failed to recover fully from losses in the first quarter. Sectors viewed as more tied to "economic reopening"—hotels, retail, and office—rallied alongside the broader equity market during the year, but ultimately were a drag on the asset class given their initial steep price declines. Sectors that were considered more resilient, such as cell towers and industrial properties, had much shallower drawdowns during the March selloff and while they trailed in the rally, ended the year in positive territory. While dividends were cut across the REIT sector as rent collections dropped and net operating income fell, they were not as widespread and pronounced as feared.

Inflation-linked bonds (ILBs) performed well in the quarter, and were positive for the year overall, though this was primarily due to yield compression across the curve rather than inflation expectations. Positive year-to-date and quarter-to-date returns hid volatility, particularly in 1Q 2020, prior to the announcement of market-calming measures by the Fed. A new "flexible average inflation targeting" policy announced by the Fed—allowing inflation to move above the 2% target for some time—remains low as the pandemic continues to affect economic performance.

Commodities returns were generally positive after a challenging first quarter. West Texas Intermediate Crude, which dropped over 60% earlier in the year, recovered as the global economy—driven largely by China—reopened. Gold, which performed well during the broad market downturn, remains elevated relative to the historical average, but fell slightly as risk-on sentiment returned after positive vaccine news.

What's changing

Market participants appear to be largely positive on continued economic recovery, as investors look past surging COVID-19 caseloads and new lockdowns. The passage of additional fiscal stimulus in the U.S. and the prospect of future packages sponsored by the incoming Biden administration only add to market optimism. The development and deployment of several COVID vaccines led to strong market rallies, which benefited risk assets, including cyclical holdings such as oil and retail as well as office REITs. Inflation has picked up considerably from 1Q 2020 levels, but remains low, and the Fed has repeatedly promised to hold interest rates at or near zero for the foreseeable future.

What we expect

While vaccine rollouts inch us closer to normalization, we believe economic conditions will remain somewhat uncertain as we start the new year. There has been some speculation that fiscal and monetary stimulus may put upward pressure on inflation. We anticipate inflation will indeed rise from current levels later in the year as the economy improves and a vaccinated public can return to spending on services, but that it will remain contained. This would slow the pace of interest rate hikes relative to past market cycles.

Our long-term outlook for REITs remains constructive. Though certain asset types may be more affected long term, including urban office and shopping malls, more resilient assets like data centers and logistics spaces may provide protection through continued volatility. Some may even benefit from shifts in macro trends, such as the strong consumer preference for online shopping. Ongoing dividend payments from REITs will also provide investors with income in a low-rate environment.

Investment Positioning

Portfolio targets effective January 1, 2020, for high-net-worth clients with Hedge Funds

Growth & Income

	Strategic Asset Allocation (long term)	Tactical Asset Allocation (short term)
Equities		
U.S. Large-Cap	31.5%	Neutral
U.S. Small-Cap	5.5%	Overweight
International Developed	16.0%	Neutral
Emerging Markets	5.5%	Overweight
Fixed Income		
U.S. Investment Grade–Tax-Exempt	28.5%	Underweight
High-Yield–Tax-Exempt	2.0%	Neutral
Real Assets		
U.S. Inflation-Linked Bonds	1.0%	Underweight
Global REITs	1.5%	Neutral
Other	1.5%	Neutral
Nontraditional Hedge	5.0%	Neutral
Cash & Equivalents	2.0%	Neutral
Total	100.0%	

Note: Totals may differ slightly from the allocation building blocks due to rounding.

TAA, or Tactical Asset Allocation, represents our *current recommendation* for each model strategy.

SAA, or Strategic Asset Allocation, represents our *current benchmark* allocation for each model strategy.

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For an overview of our asset allocation strategies, please see the disclosures.

Source: WTIA.

Investment Positioning

Portfolio targets effective January 1, 2020, for high-net-worth clients with Private Markets*

Growth & Income

	Strategic Asset Allocation (long term)	Tactical Asset Allocation (short term)
Equities		
U.S. Large-Cap	24.3%	Neutral
U.S. Small-Cap	4.3%	Overweight
International Developed	11.6%	Neutral
Emerging Markets	4.1%	Overweight
Fixed Income		
U.S. Investment Grade–Tax-Exempt	24.7%	Underweight
High-Yield–Tax-Exempt	2.0%	Neutral
Real Assets		
U.S. Inflation-Linked Bonds	0.9%	Underweight
Global REITs	1.3%	Neutral
Other	1.3%	Neutral
Nontraditional Hedge	6.0%	Neutral
Private Markets	17.5%	Neutral
Cash & Equivalents	2.0%	Underweight
Total	100.0%	

Note: Totals may differ slightly from the allocation building blocks due to rounding.

TAA, or Tactical Asset Allocation, represents our *current recommendation* for each model strategy.

SAA, or Strategic Asset Allocation, represents our *current benchmark* allocation for each model strategy.

* Private markets are only available to investors that meet Securities and Exchange Commission standards and are qualified and accredited.

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Source: WTIA.

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Alternative assets, such as strategies that invest in hedge funds, can present greater risk and are not suitable for all investors.

Any positioning information provided does not include all positions that were taken in client accounts and may not be representative of current positioning. It should not be assumed that the positions described are or will be profitable or that positions taken in the future will be profitable or will equal the performance of those described.

Indices are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses, such as management fees and transaction costs that will reduce returns.

An overview of our asset allocation strategies:
Wilmington Trust offers seven asset allocation models for taxable (high-net-worth) and tax-exempt (institutional) investors across five strategies reflecting a range of investment objectives and risk tolerances: Aggressive, Growth, Growth & Income, Income & Growth, and Conservative. The seven models are High-Net-Worth (HNW), HNW with Liquid Alternatives, HNW with Private Markets, HNW Tax Advantaged, Institutional, Institutional with Hedge LP, and Institutional with Private Markets. As the names imply, the strategies vary with the type and degree of exposure to hedge strategies and private market exposure, as well as with the focus on taxable or tax-exempt income.

Model Strategies may include exposure to the following asset classes: U.S. large-capitalization stocks, U.S. small-cap stocks, developed international stocks, emerging market stocks, U.S. and international real asset securities (including inflation-linked bonds and commodity-related and real estate-related securities), U.S. and international investment-grade bonds (corporate for Institutional or Tax Advantaged, municipal for other HNW), U.S. and international speculative grade (high-yield) corporate bonds and floating-rate notes, emerging markets debt, and cash equivalents. Model Strategies employing nontraditional hedge and private market investments will, naturally, carry those exposures as well. **Each asset class carries a distinct set of risks, which should be reviewed and understood prior to investing.**

Allocations:
Each strategy is constructed with target weights for each asset class. Wilmington Trust periodically adjusts the target allocations and may shift away from the target allocations within certain ranges. Such tactical adjustments to allocations typically are considered on a monthly basis in response to market conditions. The asset classes and their current proxies are: large–cap U.S. stocks: Russell 1000® Index; small–cap U.S. stocks: Russell 2000® Index; developed international stocks: MSCI EAFE® (Net) Index; emerging market stocks: MSCI Emerging Markets Index; U.S. inflation-linked bonds: Bloomberg/Barclays US Government ILB Index; international inflation-linked bonds: Bloomberg/Barclays World exUS ILB (Hedged) Index; commodity-related securities: Bloomberg Commodity Index; U.S. REITs: S&P US REIT Index; international REITs: Dow Jones Global exUS Select RESI Index; private markets: S&P Listed Private Equity Index; hedge funds: HFRI Fund of Funds Composite Index; U.S. taxable, investment-grade bonds: Bloomberg/Barclays U.S. Aggregate Index; U.S. high-yield corporate bonds: Bloomberg/Barclays U.S. Corporate High Yield Index; U.S. municipal, investment-grade bonds: S&P Municipal Bond Index; U.S. municipal high-yield bonds: Bloomberg/Barclays 60% High Yield Municipal Bond Index / 40% Municipal Bond Index; international taxable, investment-grade bonds: Bloomberg/Barclays Global Aggregate exUS; emerging bond markets: Bloomberg/Barclays EM USD Aggregate; and cash equivalents: 30-day U.S. Treasury bill rate.

Continued

Disclosures Continued

All investments carry some degree of risk. Return volatility, as measured by standard deviation, of asset classes is often used as a proxy for illustrating risk. Volatility serves as a collective, quantitative estimate of risks present to varying degrees in the respective asset classes (e.g., liquidity, credit, and default risks). Certain types of risk may be underrepresented by this measure. **Investors should develop a thorough understanding of the risks of any investment prior to committing funds.**

Quality ratings are used to evaluate the likelihood of default by a bond issuer. Independent rating agencies, such as Moody's Investors Service and Standard & Poors, analyze the financial strength of each bond's issuer. Ratings range from Aaa or AAA (highest quality) to C or D (lowest quality). Bonds rated Baa3 or BBB and better are considered **Investment Grade.** Bonds rated Ba1 or BB and below are **Speculative Grade** (also **High Yield**.)

Definitions:

Alpha is a measure of performance on a risk-adjusted basis. The excess return of the fund relative to the return of the benchmark index is a fund's alpha.

Equity risk premium is the extra return that's available to equity investors above the return they could get by investing in a riskless investment like T-Bills or T-Bonds or cash.

Event-driven hedge fund strategies attempt to take advantage of temporary stock mispricing before or after a corporate event takes place. An event-driven strategy exploits the tendency of a company's stock price to suffer during a period of change.

HFR® (HedgeFundResearch) Indices are the established global leader in the indexation, analysis and research of the hedge fund industry.

LIBOR is the average interbank interest rate at which a selection of banks on the London money market are prepared to lend to one another.

Macro hedge fund strategies generally focus on financial instruments that are broad in scope and move based on systemic or market risk (not security specific). In general, portfolio managers who trade within the context of macro strategies focus on currency strategies, interest rates strategies, and stock index strategies.

Relative value hedge fund strategies cover a variety of low-volatility trading strategies with the consistent theme of attempting to reduce market risk, i.e., the manager seeks to generate a profit regardless of which direction the markets are moving. All relative value strategies minimize market risk by taking offsetting long and short positions in related stocks, bonds, and other types of securities.

S&P 500 index measures the stock performance of 500 large companies listed on stock exchanges in the U.S. and is one of the most commonly followed equity indices.

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