



# SECOR ASSET MANAGEMENT

## Q3 2023 Equity Outlook

25 July 2023

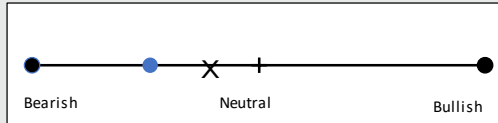
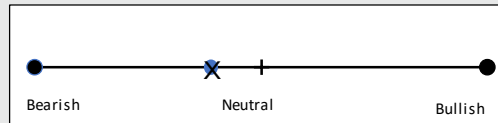
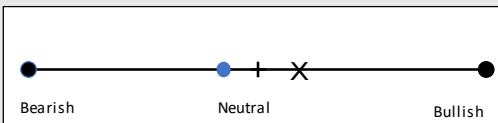
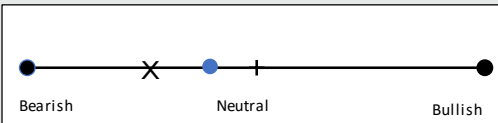
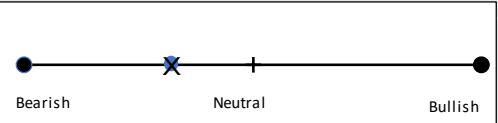
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# What Has Changed Through the Second Quarter?

	<b>31-Mar-23</b>	<b>30-Jun-23</b>	<b>Change</b>
<b>MSCI World</b>	<b>9836.12</b>	<b>10556.40</b>	<b>7%</b>
<b>S&amp;P 500 Index</b>	<b>4109.31</b>	<b>4450.38</b>	<b>8%</b>
<b>MSCI World P/E</b>	<b>16.8x</b>	<b>17.5x</b>	<b>4%</b>
<b>S&amp;P 500 2023 Est. EPS</b>	<b>0.0%</b>	<b>0.5%</b>	<b>0.5%</b>
<b>US 10 Yr Yield</b>	<b>3.47%</b>	<b>3.84%</b>	<b>+37 bps</b>
<b>High Yield Spread</b>	<b>502 bps</b>	<b>475 bps</b>	<b>-27 bps</b>
<b>US CPI YoY</b>	<b>5.0%</b>	<b>4.0%</b>	<b>-100 bps</b>

# Public Equity – Factors Driving Outlook

Factors	Comments	Historical Range
Valuation	<ul style="list-style-type: none"> <li>• Valuations remain elevated, particularly in the US, versus very long-term averages; less so over shorter horizons.</li> <li>• Valuations expanded after H1 rally despite tepid earnings growth.</li> <li>• Rising bond yields have narrowed the relative attractiveness of stocks but spreads are still better than average.</li> </ul>	
Fundamentals	<ul style="list-style-type: none"> <li>• Muted earnings expectations for 2023; high expectations for H2 2022.</li> <li>• Earnings revisions have turned positive after strong Q1 relative to expectations.</li> <li>• Companies have thus far proven resilient in passing on higher costs, maintaining profit margins in what were expected to be challenging times.</li> </ul>	
Technicals	<ul style="list-style-type: none"> <li>• Sentiment measures improved with H1 rally, now mostly neutral-to-positive, although equity outflows persist.</li> <li>• Past large drawdowns have often been followed by periods of above-average equity returns.</li> <li>• However, households still hold a relatively high percentage of their assets in stocks versus history (but off peak).</li> </ul>	
Macro Impact	<ul style="list-style-type: none"> <li>• TINA trade continues to become less attractive as equity earnings yield advantage narrows, but still above average.</li> <li>• Moderating expectations for global growth threatens equity fundamentals, but pessimistic scenarios have yet to play out. Encouraging data on inflation fight.</li> <li>• Recent banking turmoil appears to have been contained.</li> <li>• No break from geo-political tensions.</li> </ul>	
	9 – 12 Month View	

\* See Appendix 2 for more detail.

# Private Equity – Factors Driving Outlook – Summary

Factors	Comments	Historical Range
Valuation	<ul style="list-style-type: none"> <li>• Median Buyout EV/EBITDA acquisition multiple in North America &amp; Europe eased slightly in Q1 to 11.1x, share of debt in deals continues to fall.</li> <li>• Leverage levels not extreme, however.</li> </ul>	
Fundamentals	<ul style="list-style-type: none"> <li>• HY default rates remain very low and interest coverage high; distress ratio has increased slightly.</li> <li>• Rising financing costs should impact deal economics, dampen deal activity.</li> </ul>	
Technicals	<ul style="list-style-type: none"> <li>• PE deal activity maintained 2022's pace in Q1 2023.</li> <li>• Fundraising and especially exit activity fell considerably from 2022's levels.</li> <li>• IPO market showing hopeful signs of reopening after extremely slow H1 2023.</li> </ul>	
Macro Impact	<ul style="list-style-type: none"> <li>• Approaching peak rates and promising signs on inflation lessens threat to PE environment.</li> <li>• Recent quiet on the regulatory front.</li> <li>• VC industry survived the SVB failure with little collateral damage.</li> </ul>	
<div style="display: flex; align-items: center;"> <div style="margin-right: 10px;"> <span style="color: blue;">●</span> Current Quarter  <span style="font-weight: bold;">X</span> Last Quarter                 </div> </div>	<p>9 – 12 Month View</p>	

\* See Appendix 2 for more detail.

# Need to Change Inputs to Outlook Based on Drivers & Catalysts?

- The next 5 years return forecast is for below-average returns from expected slower than average earnings growth as well as multiple contraction (see Appendix 19-20 for more detail).

MSCI World	Long-Term Assumption	Last 5 Years	Next 5 Years Est.
Nominal EPS Growth	4.2%	7.4%	1.9%
<i>Real Earnings Growth</i>	2.2%	4.1%	-0.1%
<i>Inflation</i>	2.0%	3.3%	2.0%
P/E Multiple Expansion/(Contraction)	<u>0.0%</u>	<u>0.7%</u>	<u>-0.3%</u>
Annual Price Gain	4.2%	8.1%	1.6%
Dividend Yield	<u>2.8%</u>	<u>2.1%</u>	<u>2.1%</u>
<b>Total Return (Local)</b>	<b>7.0%</b>	<b>10.2%</b>	<b>3.7%</b>

Data as of 30 June 2023

# Equity Premia Performance & Valuation Summary\*

	Performance		Valuation (z-score)	
	Last 3 Mo.	TTM	Last 10 Yrs	Last 35 Yrs
Value	-3.9%	-6.9%	-0.7	-1.4
Size (Small)	-2.6%	-5.8%	-0.9	-1.1
Momentum	1.6%	-1.8%	0.3	0.3
Quality	0.4%	4.2%	0.3	1.1
Low Volatility	-3.9%	-10.5%	0.6	1.5

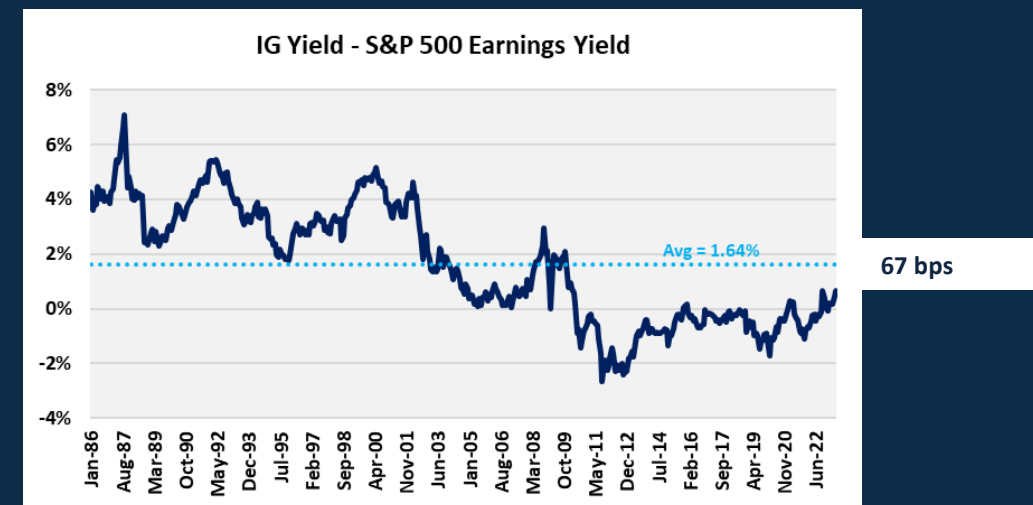
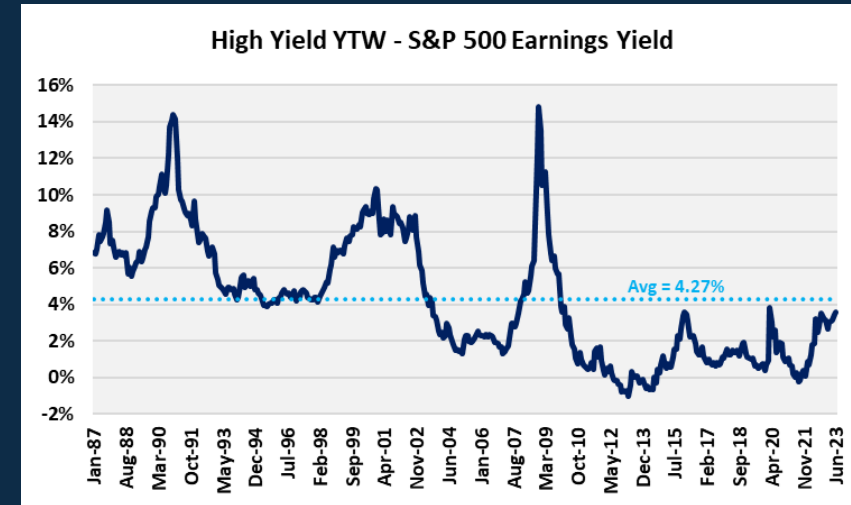
## Highlights

- The Value rally of 2022 continued to reverse in Q2, although the stocks look attractively valued versus history.
- Small caps and low volatility stocks extended their strings of negative performance; small caps appear attractively valued relative to history while low vol stocks look expensive.
- High Momentum stocks were modestly positive in Q2 but negative for the year with the change in market leadership.



# US Equity versus Credit

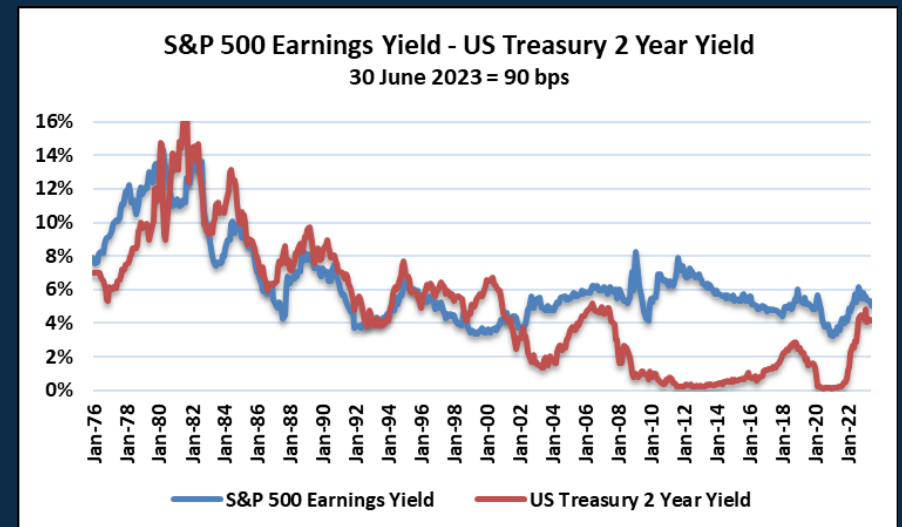
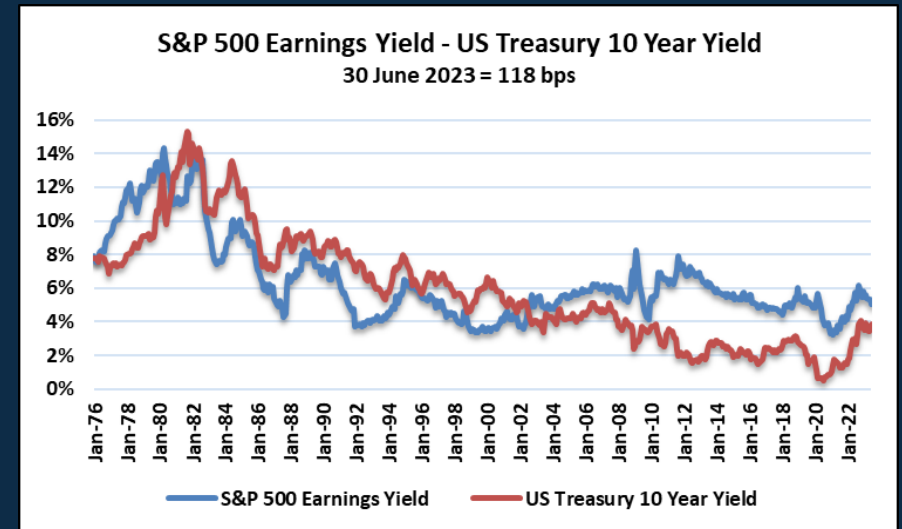
- **The spread between HY YTW and the US equity Earnings Yield expanded another 50bps during the second quarter and is now 70bps below long-term average.**
  - The spread between High Yield YTW (8.59%) and the S&P 500 Earnings Yield (5.02%) stood at 357 bps at 30-Jun-2023, slightly below the average of 427 bps since 1987 (48<sup>th</sup> percentile).
- **The spread between IG Yield and the equity Earnings Yield has also continued to normalize but is still below historical average.**
  - The spread between the IG Yield (5.69%) and the S&P 500 Earnings Yield (5.02%) stood at 67 bps at 31-Jun-2023, below the average of 164 bps since 1986 (and 43<sup>rd</sup> percentile).



Sources: CS BarCap, Federal Reserve Economic Database, Moody's, Standard & Poor's, Bloomberg.

# US Equity versus Bonds

- **The spread between the equity earnings yield and the US 10 Year yield continues to narrow.**
  - The spread of 118 bps as of 30-Jun-2023 compares to a median of 86 bps from 1976.
  - The current spread is the lowest since 2009.
- **And the spread between the equity yield and the yield on the US 2 Year Note (90 bps) also continued to narrow to GFC-era levels.**
  - TINA → TARA? (There Are Reasonable Alternatives)

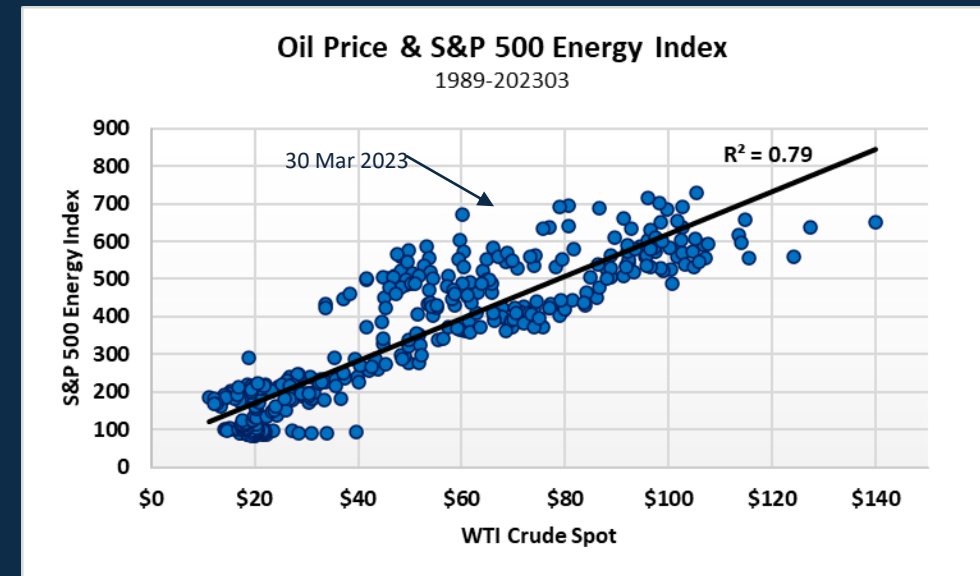
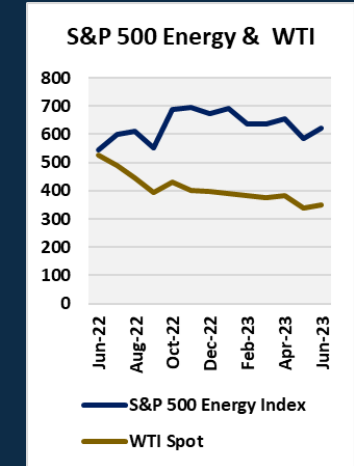
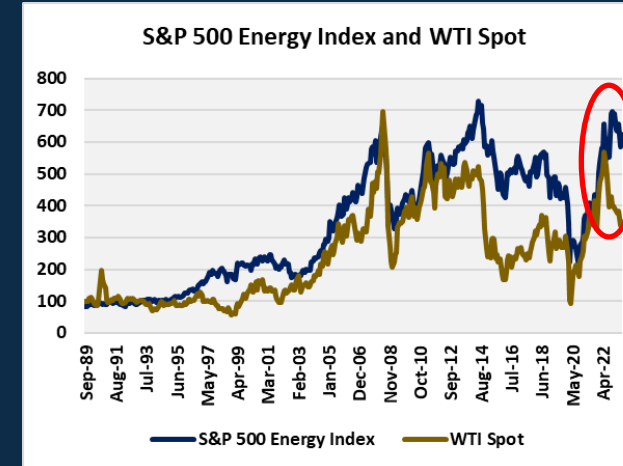




# Trade Idea #1 – Long Oil/Short Energy Stocks

- Energy stock prices decoupled from the price of oil since mid-2022.
  - The S&P 500 Energy Index is up 14% since 30 June 2022 (thru 30 June 2023) while the price of crude has fallen by 33%.
  
- There has been a very tight relationship historically between the price of oil and the price of oil stocks.
  
- *ITD Performance 23 Jan 2023 – 30 Jun 2023: -3%*

Sources: Standard & Poor's, Bloomberg, SECOR.



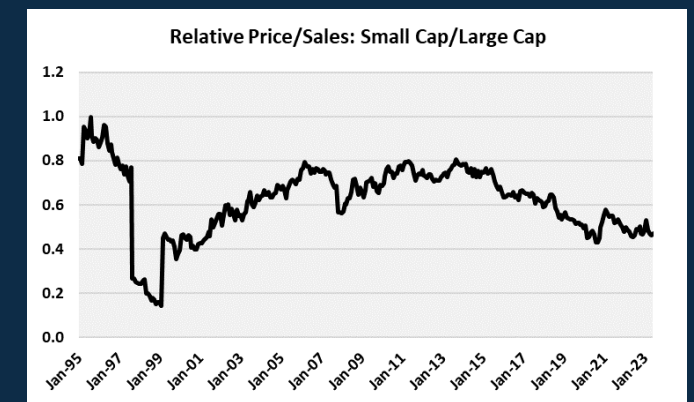
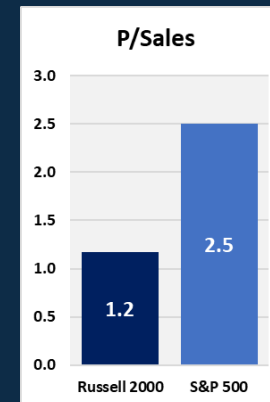
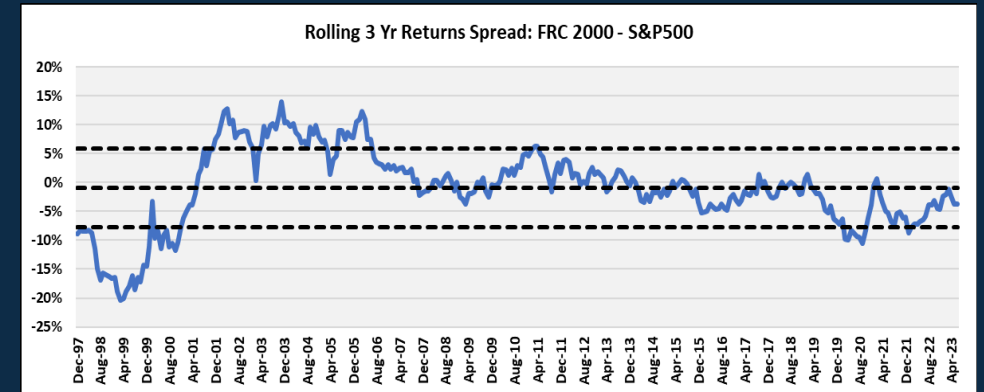
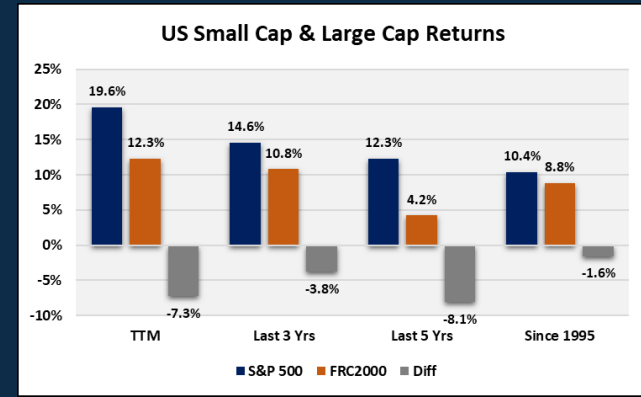
# Trade Idea #2 – Long US Large Caps/Short US Small Caps

## ■ Small Cap stocks have consistently trailed Large Caps over the last 25+ years.

- The recent underperformance, though sizable, is not extreme. Over the last 3 years, the Russell 2000 has underperformed the S&P 500 by 3.8%/yr. (73<sup>rd</sup> percentile since 1995).
- No evidence of small cap effect over this period as large caps have topped small caps by 1.6%/yr.
- Large Caps also enjoy strong momentum vs small caps, with the last one-year outperformance of 7.3% ranking in the 73<sup>rd</sup> percentile.

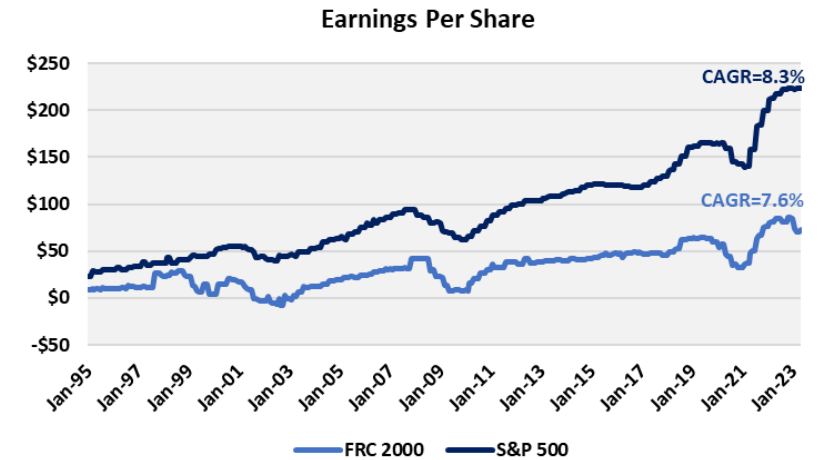
## ■ Small Caps current discount to Large Caps on a Price/Sales basis has only been exceeded during the peak of the TMT bubble.

- Large Caps do trade at a large premium to Small Caps on Price/Sales (84<sup>th</sup> percentile).

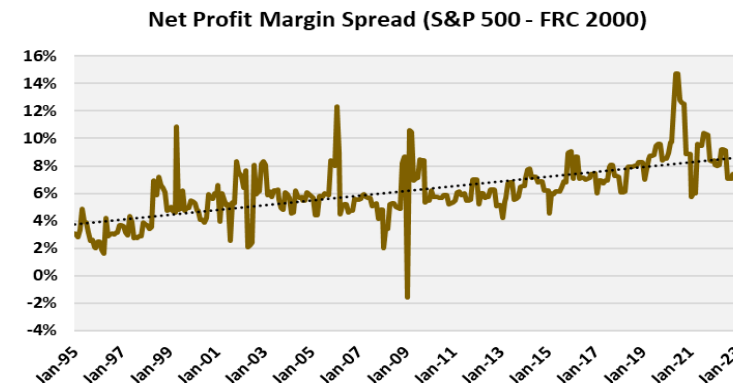
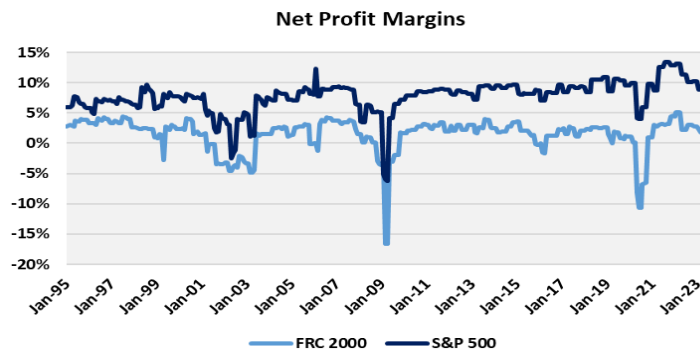


# Trade Idea #2 – Long US Large Caps/Short US Small Caps

- Small Cap earnings growth has trailed that of Large Caps.
  - The difference has widened over the last ten years with Large Caps growing earnings at 7.5%/yr. versus 6.2%/yr. for Small Caps.
  - Small Cap earnings have also been more volatile than those of Large Caps.



- Small cap earnings growth has lagged because their profit margins have remained flat at ~2%-3% while those of large caps have steadily expanded from ~6% to ~11%.
  - The spread in profit margins has nearly tripled from 3.1% in 1995 to 8.9% today (SPX=10.9%, RTY=2.0%).
  - Small cap profit margins did not exceed 5% at any time since 1995.



# Trade Ideas: Performance

## Open Trade Ideas

As of Date **30-Jun-23**

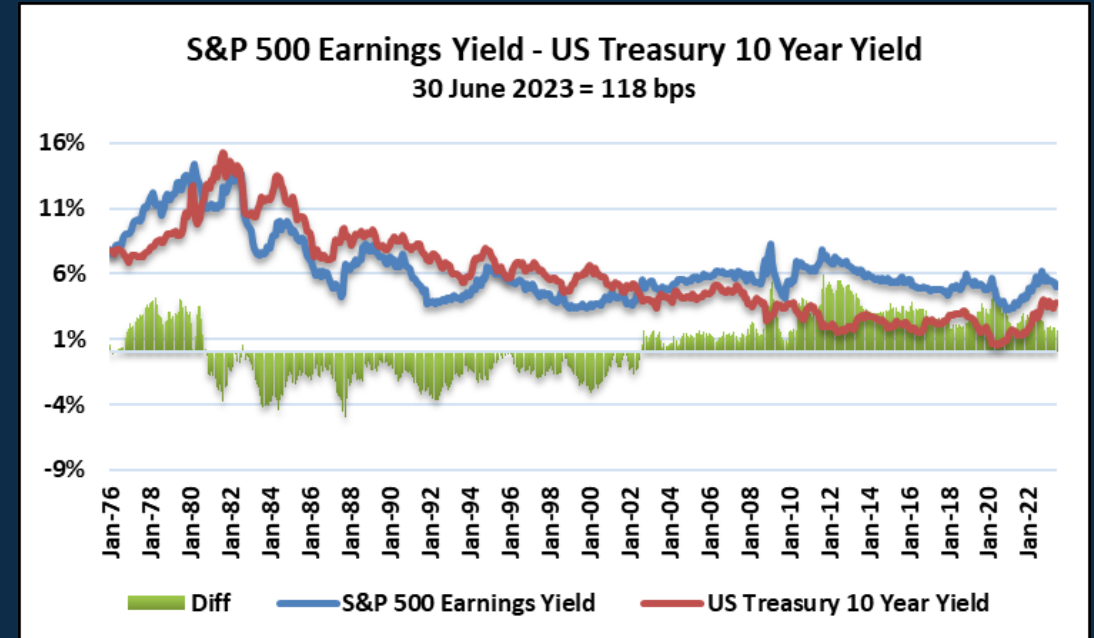
Trade Idea	Implementation	QTD	YTD	Since Inception	Inception date
Long Oil/Short S&P 500 Energy	Futures/Swaps	-5%	NA	-3%	23-Jan-23
Long US Equity/Short US HY	Futures/Swaps	7%	11%	2%	18-Aug-22
Long US Equity/Short US IG	Futures/Swaps	9%	14%	5%	18-Aug-22
Long S&P 500 2024 Dividends	Futures/Swaps	5%	9%	10%	18-Aug-22
Long US Large Cap/Short US Small Cap	Futures/Swaps	4%	9%	7%	29-Apr-22
Long ACWI ex China/Short China	Futures/Swaps	16%	20%	33%	31-Jul-21

## Closed Trade Ideas

Trade Idea	Implementation	Return	Trade Dates
Long Japan Value/Short Japan Growth	Futures/Swaps	12%	1/20/2022 - 1/23/2023
Long EM Value/Short EM Growth	Futures/Swaps	5%	1/20/2022 - 1/23/2023

# 3 Catalysts That Could Change Your View & Recommendation

- **Recommendation: Neutral Weight Equity**
- **3 Catalysts That Could Change Your View**
  1. The attractiveness of equities relative to other assets reverses.
    - Despite narrowing recently, the spread between the earnings yield and yields on bonds and credit continues to favor stocks.
  2. AI-mania grips the equity market, spills over into the rest of the market creating a bubble.
  3. Geopolitical shock: Russia resorts to nuclear weapons, China attacks Taiwan.



# Appendix

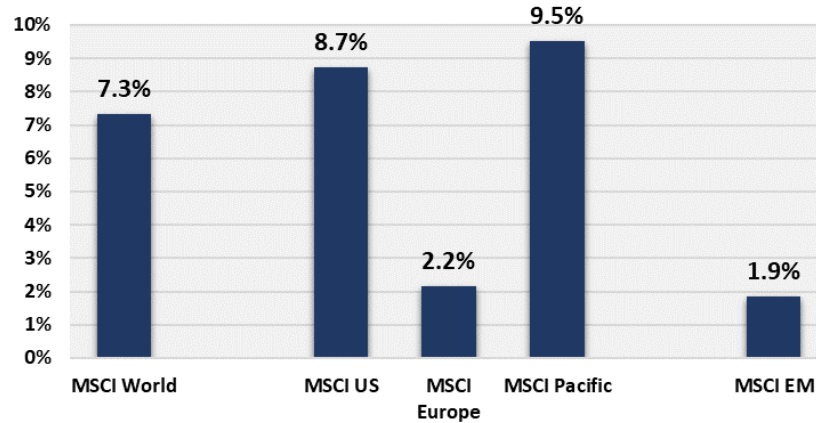
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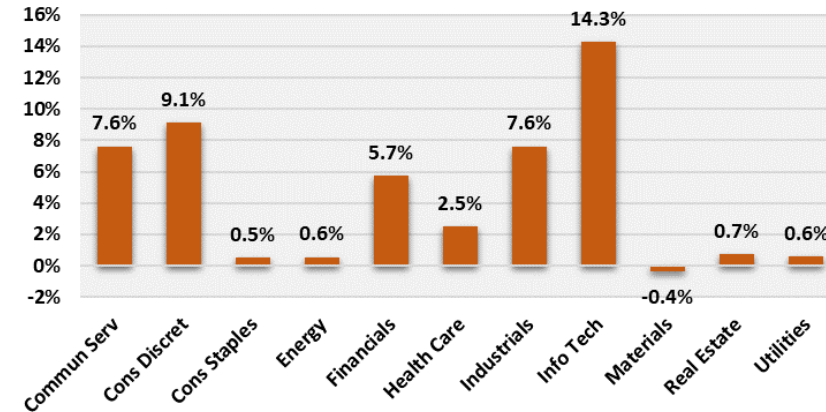


# Appendix 1 – Equity Market Returns

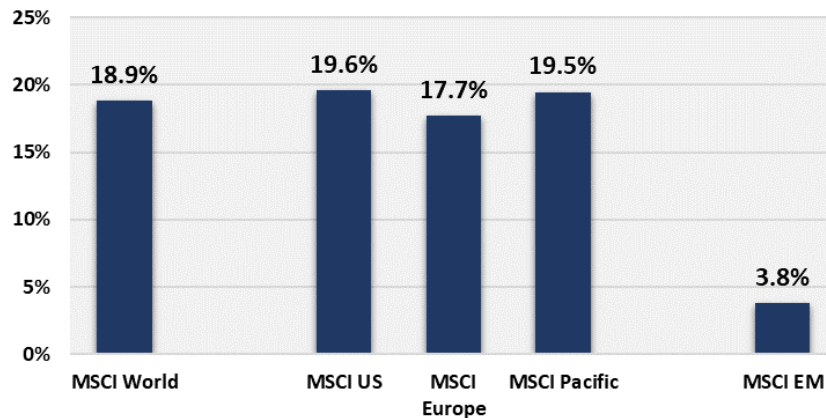
Last 3 Months Returns thru 30 June 2023 (Local)



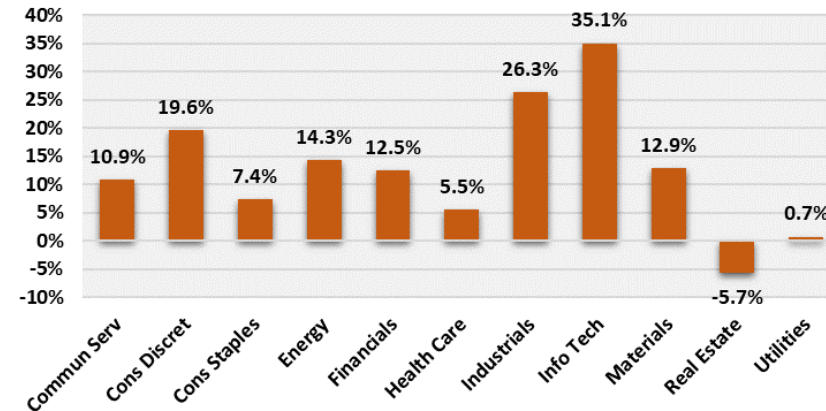
Last 3 Months Returns thru 30 June 2023 (ACWI,Local)



TTM Returns thru 30 June 2023 (Local)



TTM Returns thru 30 June 2023 (ACWI, Local)



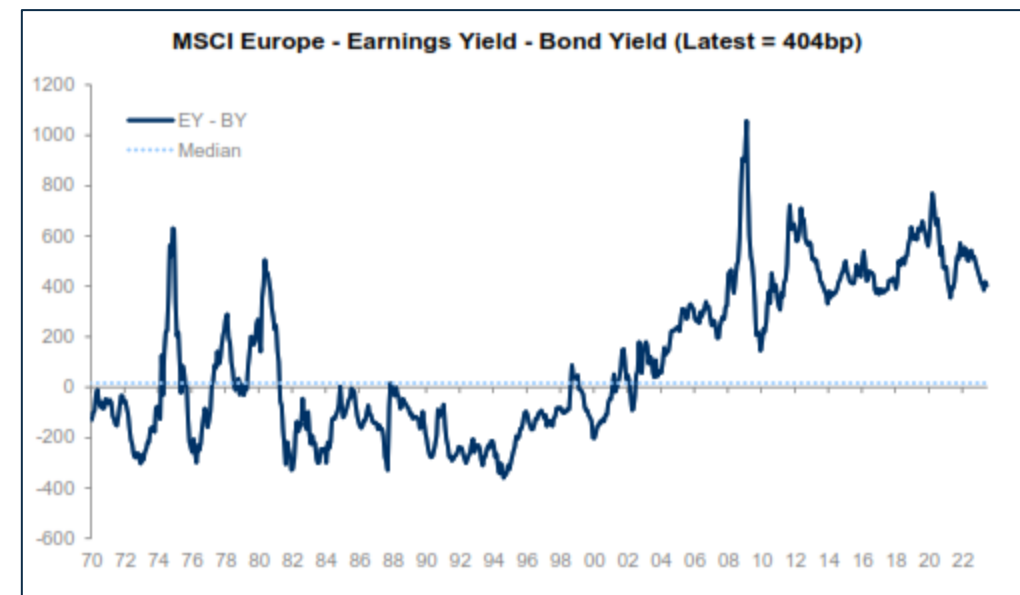
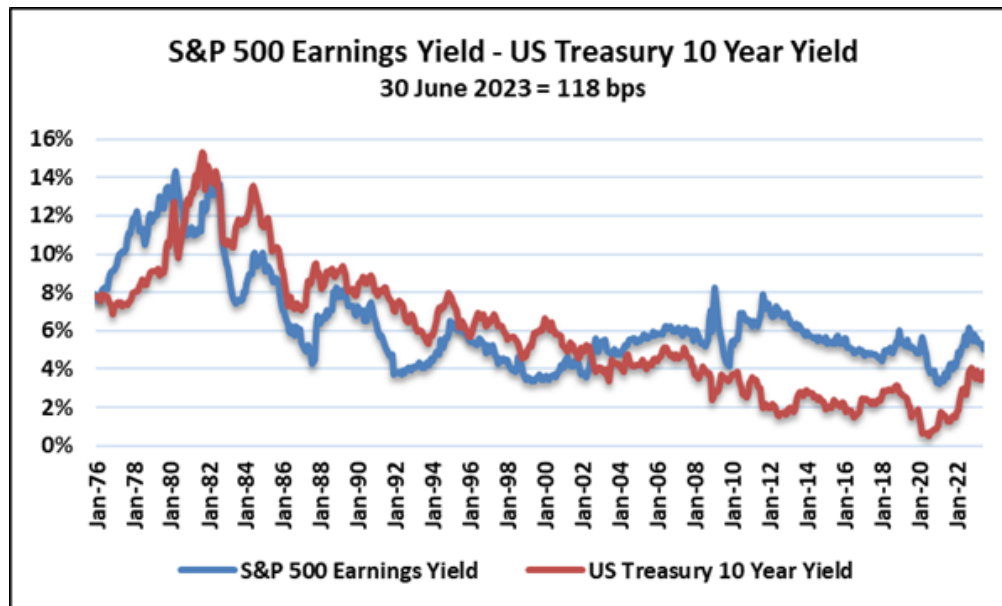


## Appendix 2a – 5 Factors Driving the Outlook for Equities

- **Valuation** – Global equity valuations remain high by historical standards, particularly in the US. (Appendix 1-8)
  - Valuation measures in the US well above long-term median.
  - US Shiller P/E at 30.8x at end of June (93<sup>rd</sup> percentile since 1926), up from 28.5x at YE2022.
  - Valuations are less extreme in Europe where the Shiller P/E is at 17.9x (59<sup>th</sup> percentile since 1980);
  - Emerging Markets relative valuation versus Developed Markets are near average levels, as are current valuations relative to their own history.
  - Median Buyout EV/EBITDA acquisition multiple in North America & Europe eased slightly in Q1 to 11.1x, share of debt in deals continues to fall.
  
- **Fundamentals** – Earnings growth continues to moderate after post-COVID spike. (App. 9-12)
  - Earnings are expected to grow 1% in US in 2023 and 11% in 2024 after growing by 4% in 2022.
  - Earnings growth in Europe and Japan expected to grow by 0% and 7% , respectively, in 2023.
  - Emerging Markets EPS expected to fall by 5% in 2023.
  - Estimate revisions have turned positive across all regions after Q1 earnings comfortably exceeded expectations.
  - Buyouts have yet to show signs of stress from higher funding costs as default rates remain low for HY borrowers; interest coverage and net margins remain high.

## Appendix 2b – 5 Factors Driving the Outlook for Equities

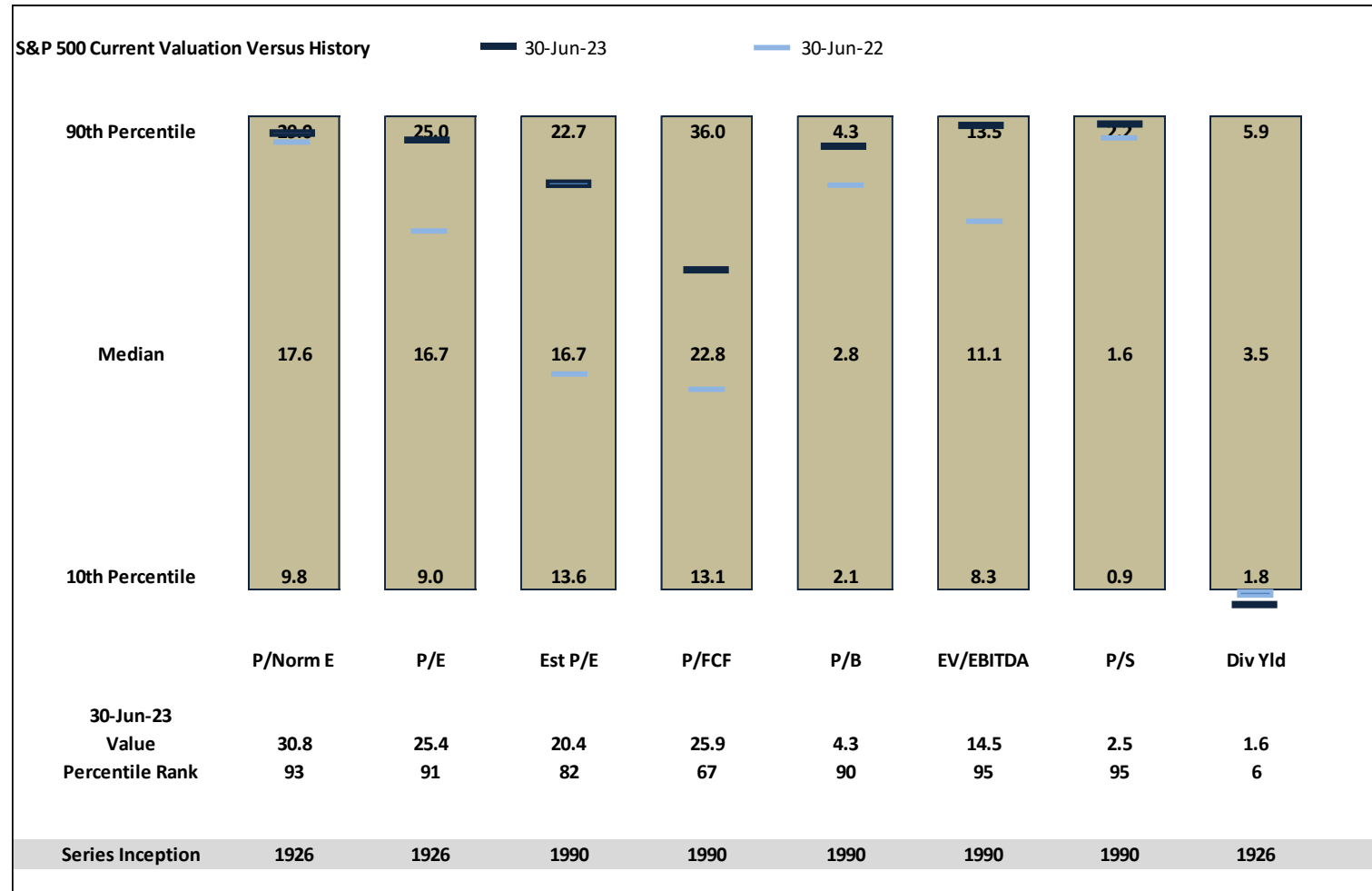
- **Macro Environment** – Macro environment continues to plod along, avoiding recession in US.
  - Global growth has proven resilient, defying pessimistic outlook, recession in US.
  - Banking turmoil in the US during the first quarter now in the rearview mirror.
  - Spread between earnings yields and bond yields in the US continue to mean-revert, stands at 118 bps in the US at the end of Q2 versus 193 bps at YE2022 and is approaching the historical median of 86 bps.
  - Earnings yield spread in Europe remains wide by historical standards at 404 bps but has also narrowed recently.



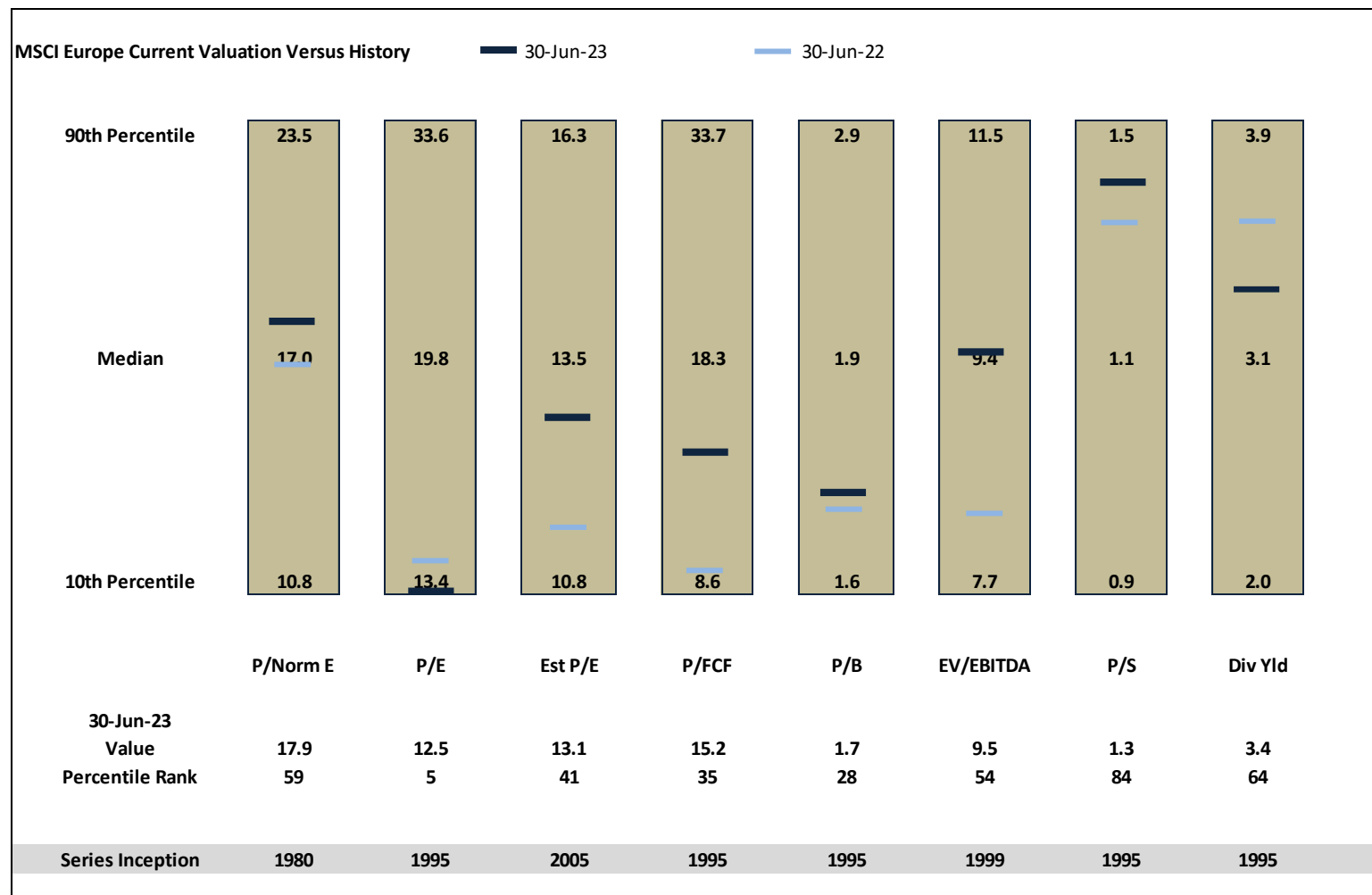
## Appendix 2c – 5 Factors Driving the Outlook for Equities

- **Technicals** – Sentiment improving after strong Q2 returns. (Appendix 13-18)
  - Outflows from equity to fixed income still occurring but have slowed. (Appendix 13)
  - Stocks have tended to rebound following big down years such as 2022. (Appendix 14)
  - Retail investor sentiment has improved from negative to neutral to optimistic in some cases. (Appendix 15,16)
  - Household Equity Assets as a percentage of Total Financial Assets has fallen sharply over the past few quarters but remains high versus history. (Appendix 17)
  - PE deal activity maintained 2022's pace in Q1 2023; however, fundraising and especially exit activity fell considerably from 2022's levels. (Appendix 18)
  
- **Politics** – Geopolitical risk remains center stage as Russia-Ukraine war, US-China tensions persist.
  - No end in sight for war in Ukraine, China-US tensions for the foreseeable future.
  - Posturing for 2024 presidential election in the US has begun.

# Appendix 3 – US Valuation

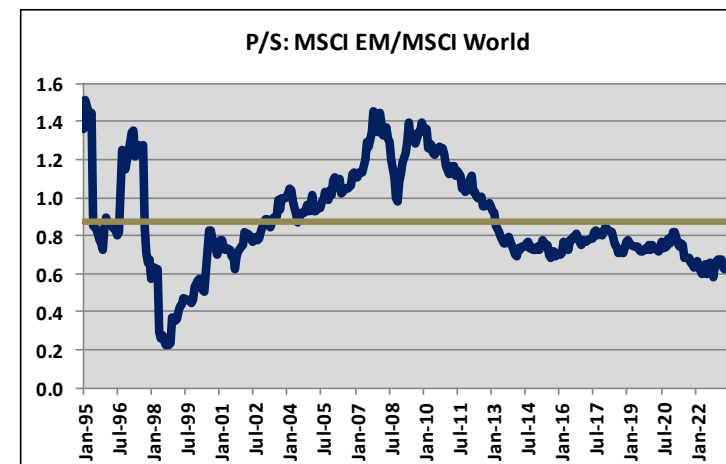
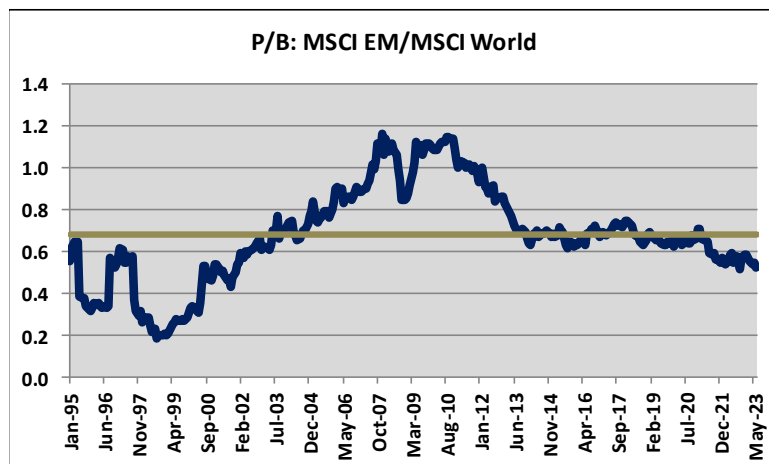
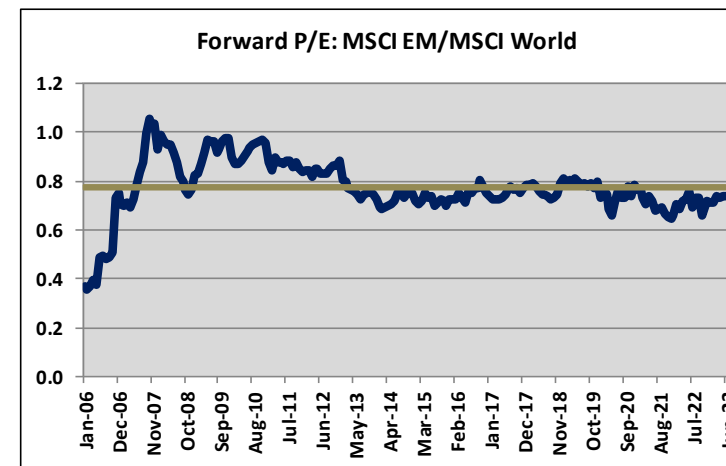
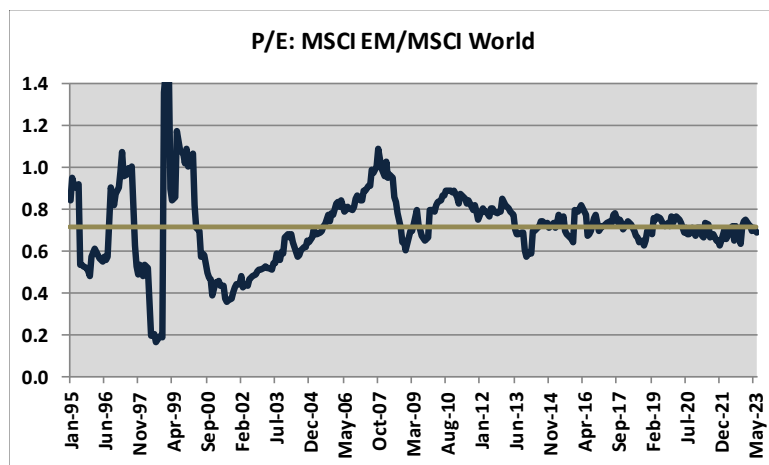


# Appendix 4 – Europe Valuation



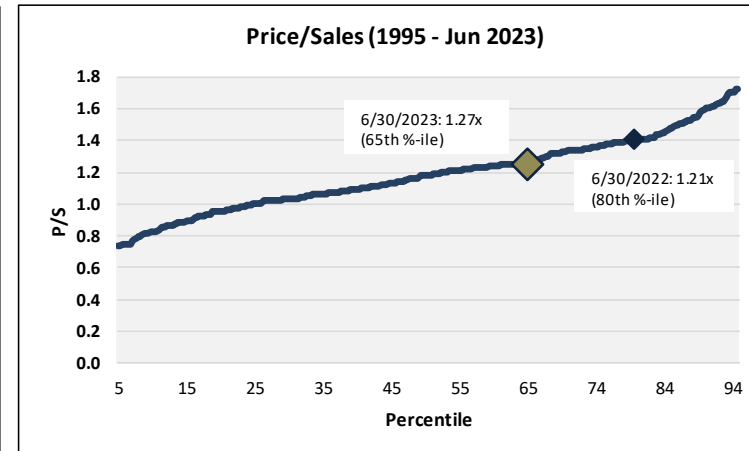
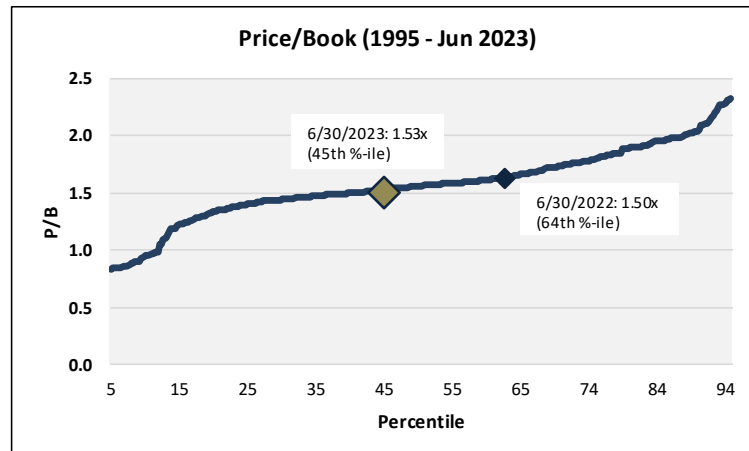
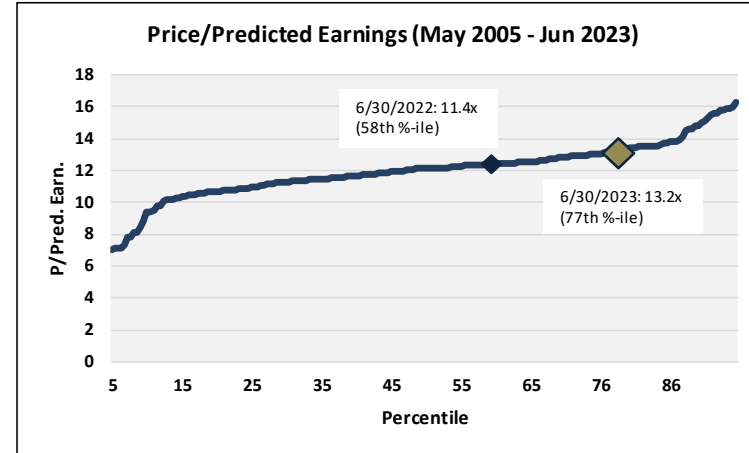
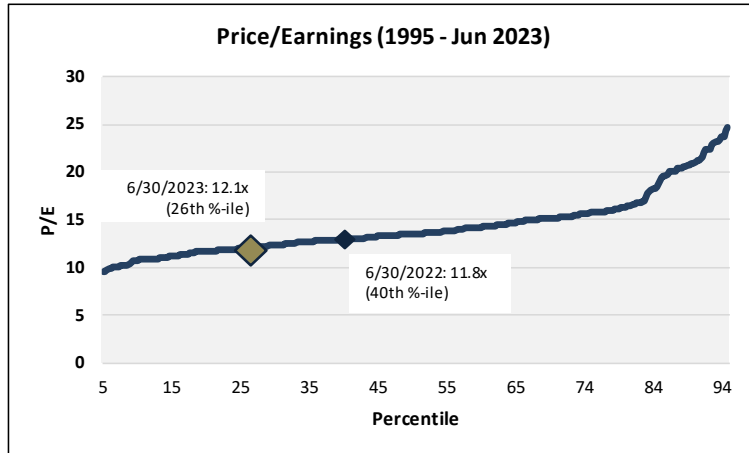
# Appendix 5 – Emerging Versus Developed Valuations

- Despite their underperformance, Emerging Markets valuations are not compelling relative to Developed Markets.



# Appendix 6 – Emerging Market Valuations

- Nor are Emerging Market equity valuations compelling relative to their long-term average.



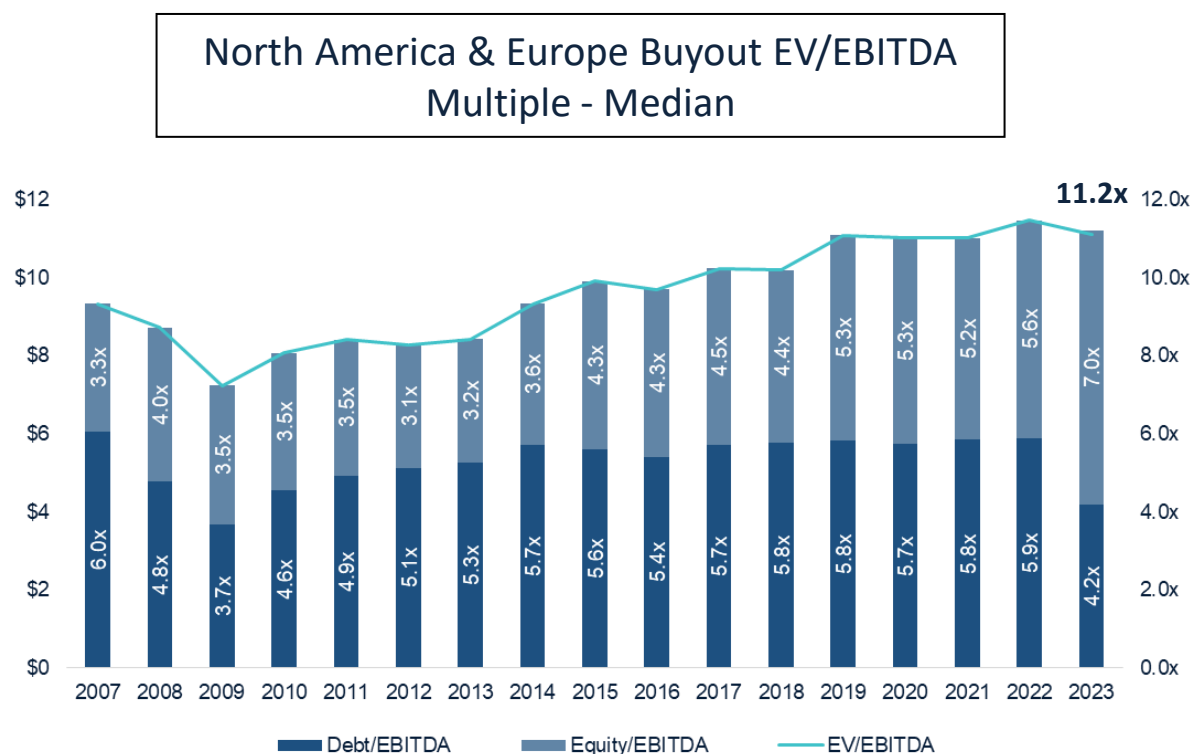


# Appendix 7 – Global Equity Valuation

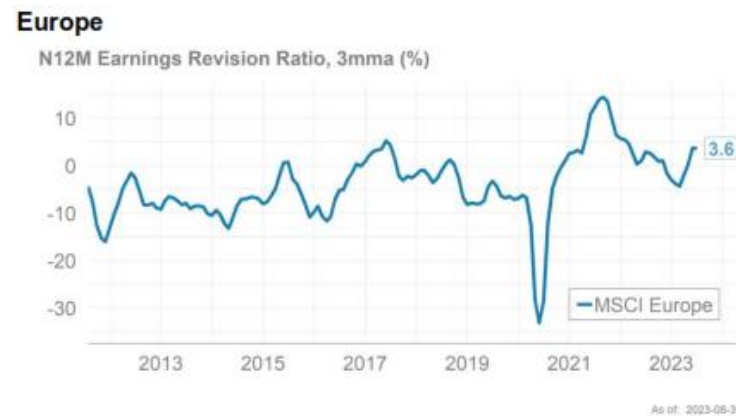
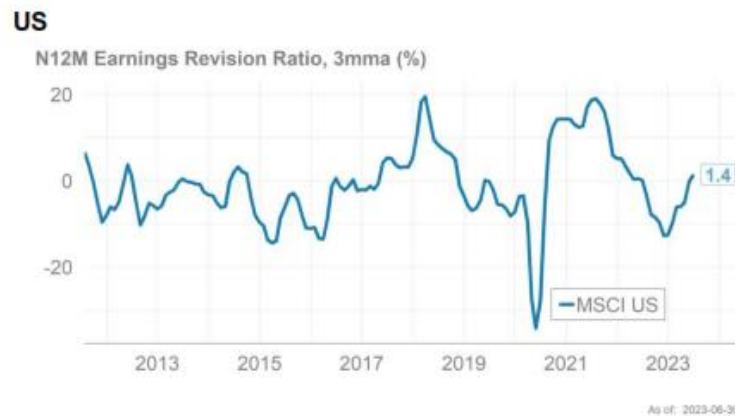
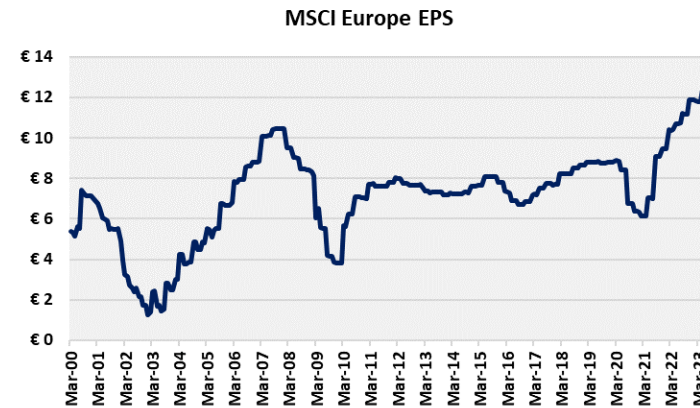
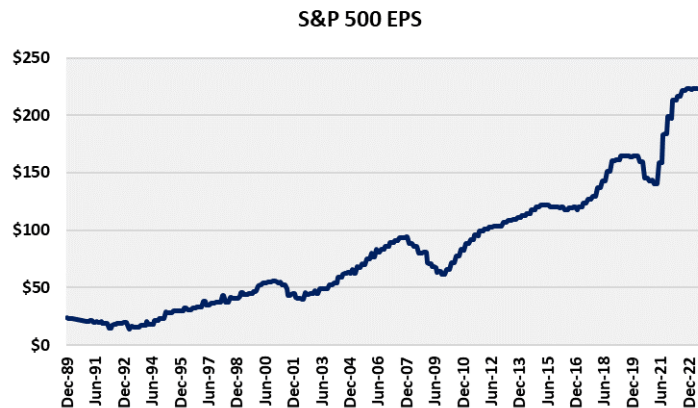
Index	Level	1yr Range	Forward		Trailing			Composite Value		
			Fwd P/E	20y Z-Score	P/B	20y Z-Score	Div Yield	20y Z-Score	vs. ACWI	20yr Range
MSCI ACWI	683		16.4		2.8		2.1		n/a	n/a
S&P 500	4,450		19.3		4.3		1.6		137%	
MSCI Europe	1,868		12.7		1.9		3.2		74%	
FTSE 100	7,532		10.5		1.7		4.2		63%	
TOPIX	2,289		14.2		1.4		2.3		69%	
Hang Seng	18,916		9.2		1.0		3.8		47%	
MSCI Australia	1,430		15.1		2.1		4.8		85%	
MSCI EM	989		12.2		1.6		3.3		67%	
Brazil	1,636		7.7		1.5		11.0		51%	
China	61		10.2		1.4		2.5		56%	
India	2,143		21.5		3.5		1.3		130%	
Korea	795		13.8		1.0		2.1		61%	
US Growth	9,658		28.5		9.6		0.5		261%	
US Value	3,227		14.6		2.7		2.6		93%	
EU Growth	190		21.1		4.5		1.8		146%	
EU Value	118		8.7		1.2		4.8		48%	
US Large Cap	2,970		20.1		4.7		1.5		147%	
US Small Cap	1,216		16.1		1.7		2.0		81%	

# Appendix 8 – Buyout Deal Multiples

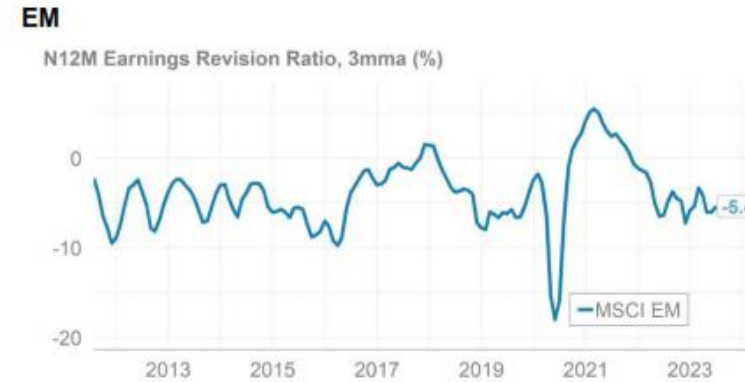
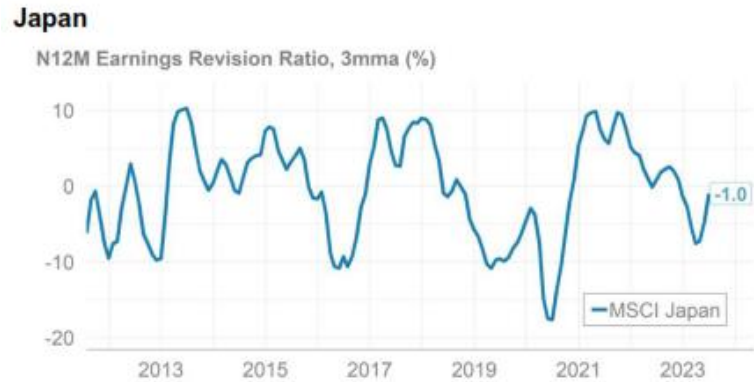
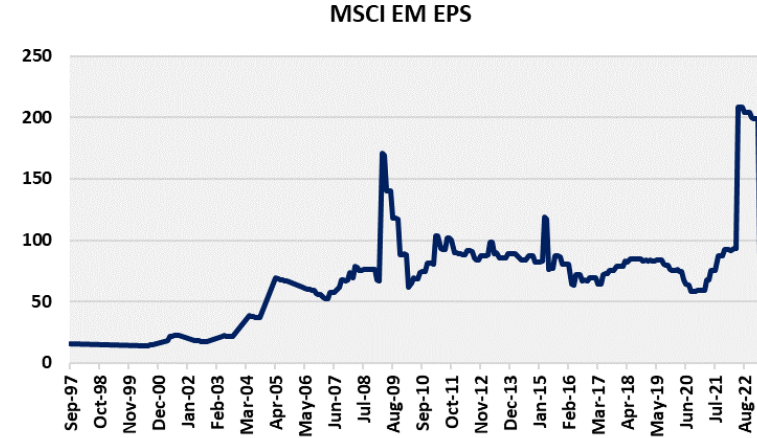
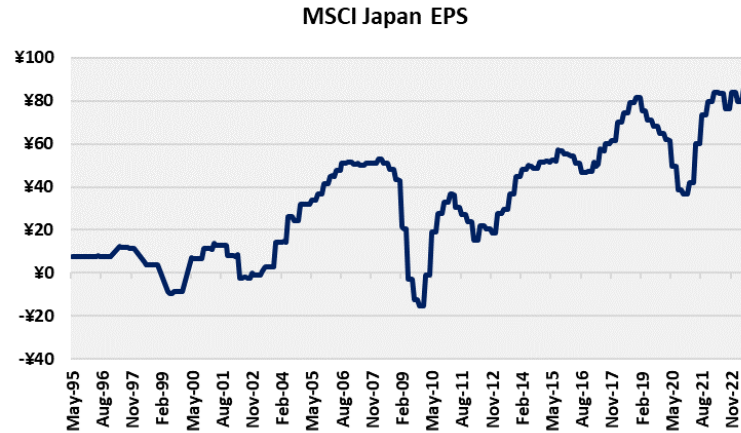
- The median Buyout EV/EBITDA multiple in North America & Europe moderated slightly in Q1 2023 to 11.2x and the median debt level has declined to a recent years' low of 38%.



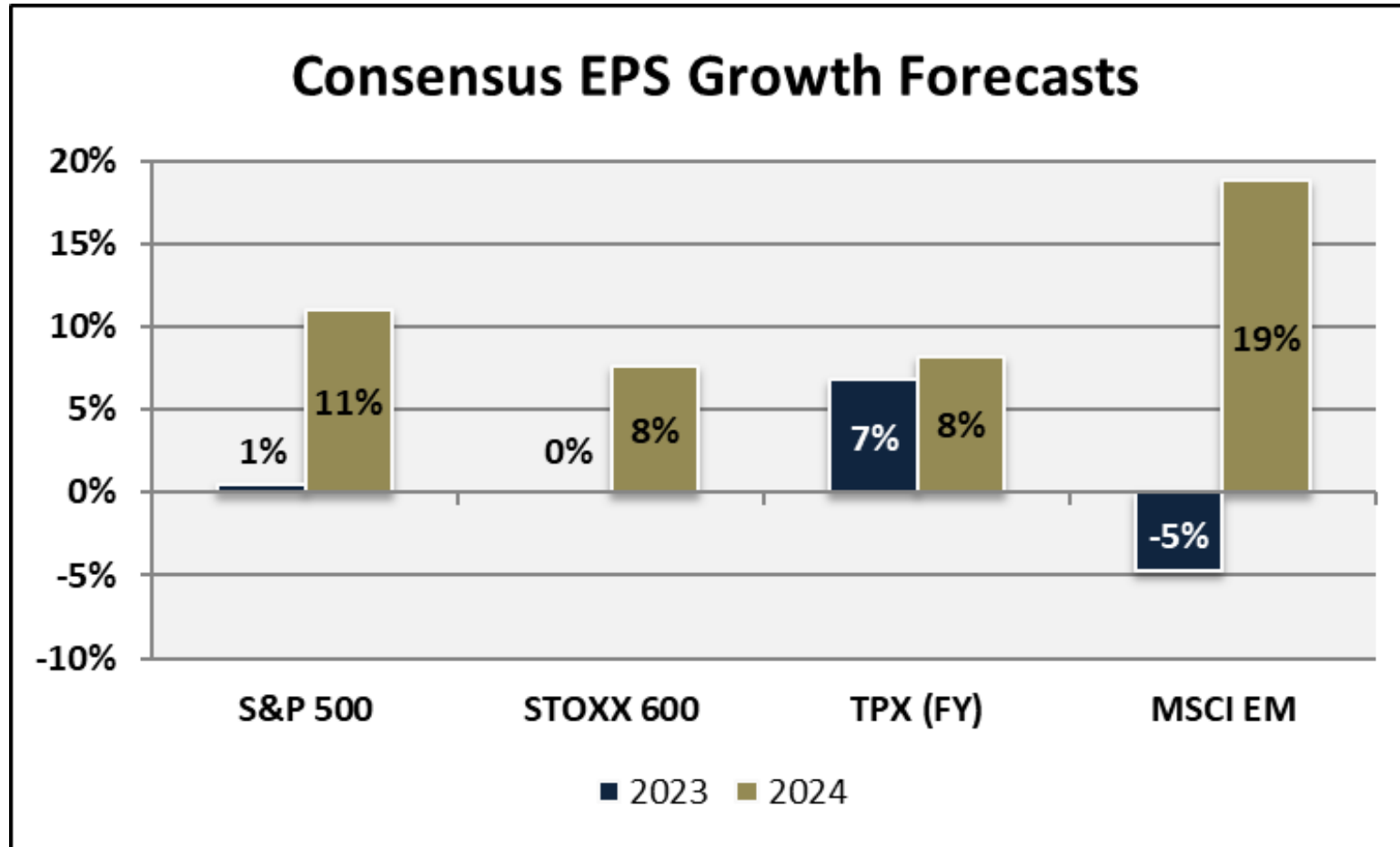
# Appendix 9 – US & Europe Earnings



# Appendix 10 – Japan & EM Earnings



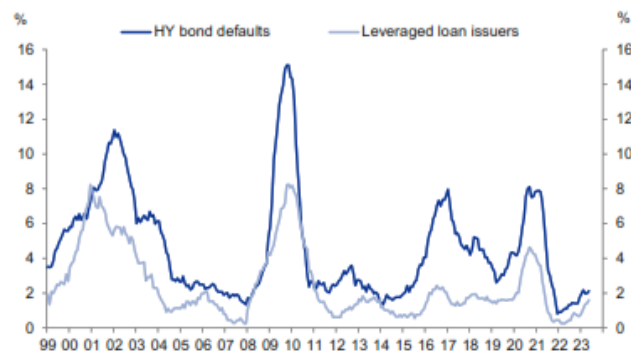
# Appendix 11 – Earnings Forecasts



# Appendix 12 – Private Equity Fundamentals

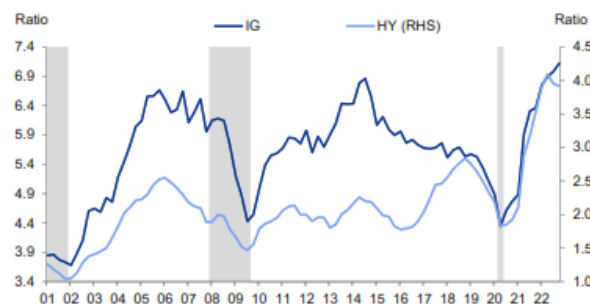
- Default rates remain very low for HY bond and leveraged loan issuers and interest coverage is near an all-time high for US high yield issuers.

12-month trailing issuer-weighted default rate in the USD HY bond and leveraged loan markets



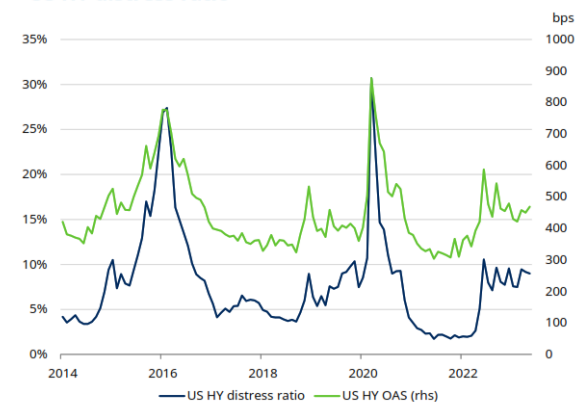
**Exhibit 37: Interest coverage ratios for the median IG-rated and HY-rated company in North America**

We show 4-quarter moving averages to account for seasonal factors; shaded areas indicate recessions

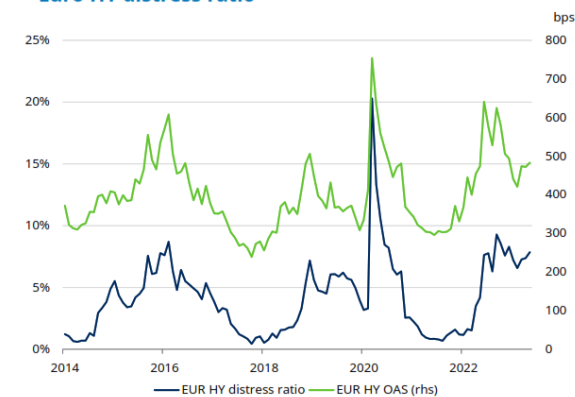


- HY distress ratios picked up in mid-2022 but have levelled off.

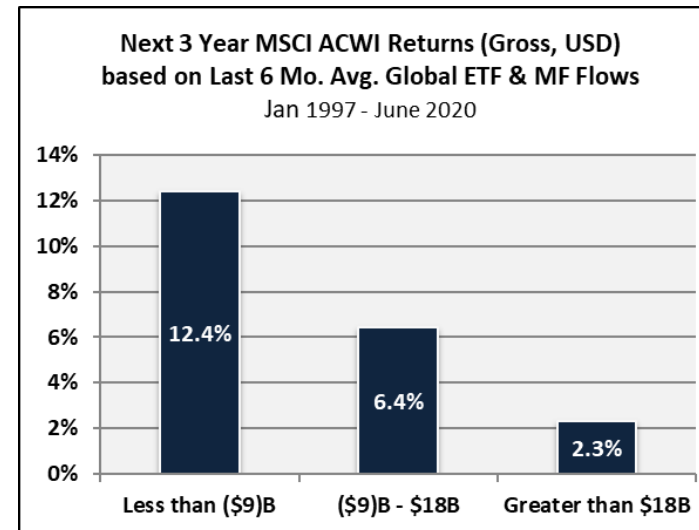
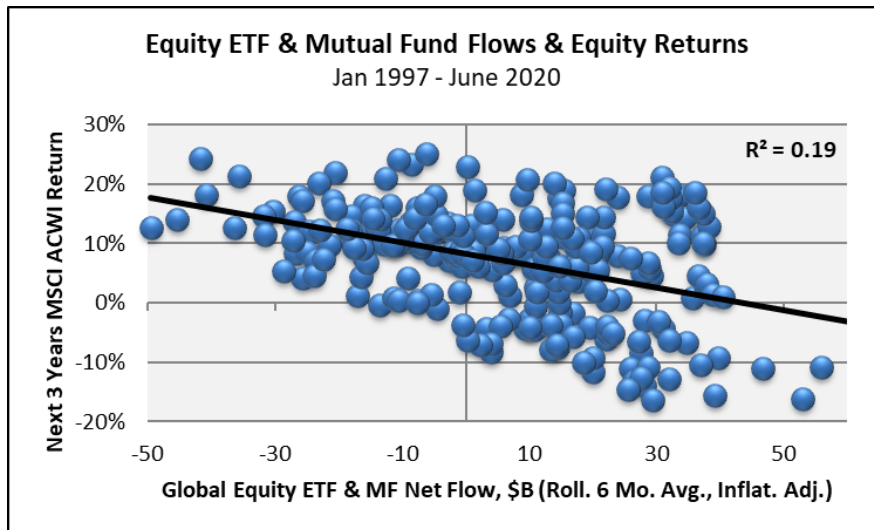
US HY distress ratio<sup>1</sup>



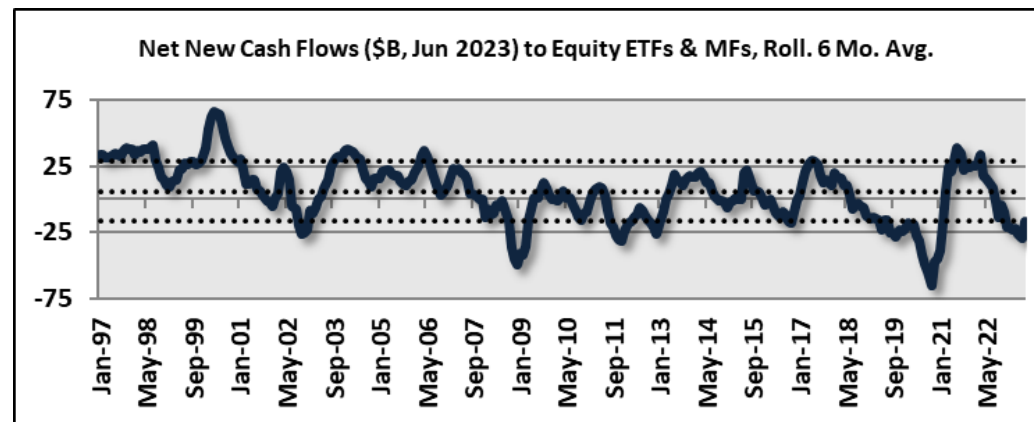
Euro HY distress ratio<sup>1</sup>



# Appendix 13 – Technicals: Flows



Est. June 2023 Avg. Flow =  $-\$16.5B$

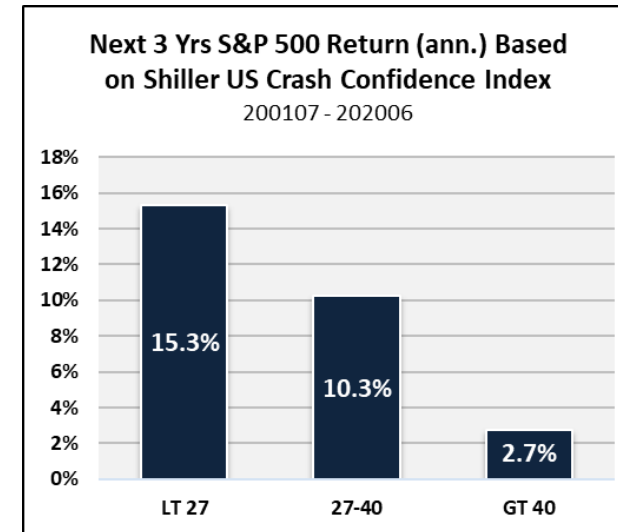
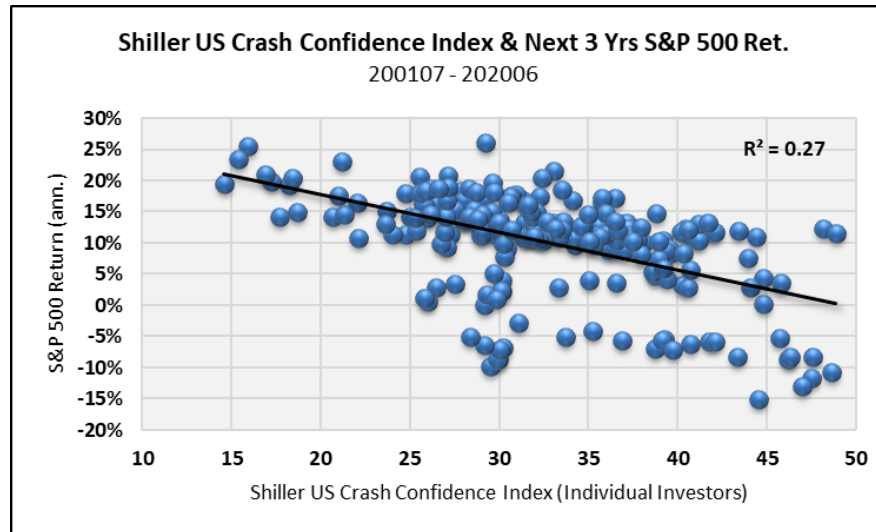




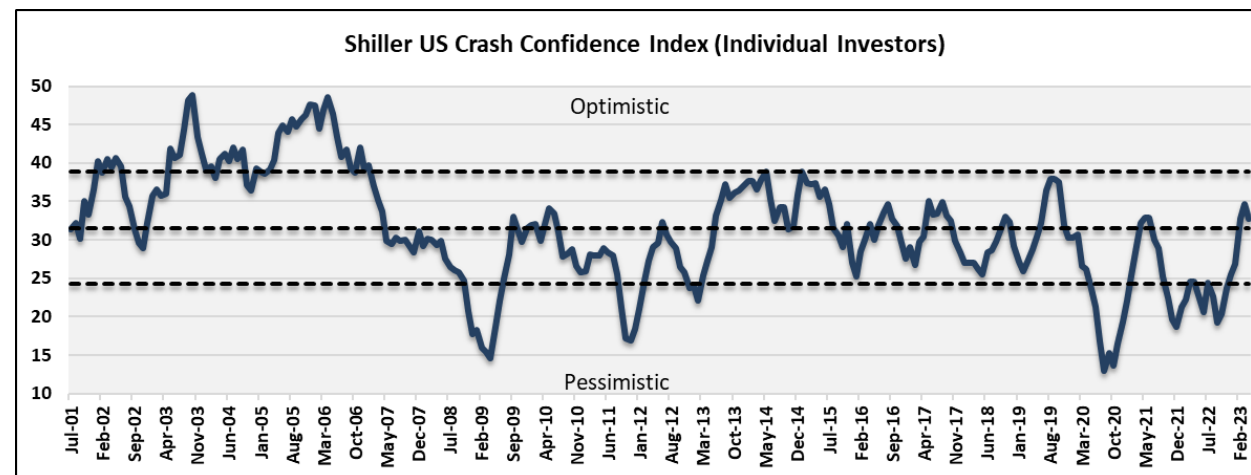
# Appendix 14 – Technicals: Post-Bear Market Performance

Peak	Trough	S&P 500	Price Return (ann.)			
		% Decline	+1 Year	+3 Years	+5 Years	+10 Years
12-Dec-61	26-Jun-62	-28.0%	32.7%	16.7%	12.0%	7.5%
29-Nov-68	26-May-70	-36.1%	43.8%	15.9%	5.5%	4.8%
11-Jan-73	03-Oct-74	-48.2%	38.0%	15.8%	12.0%	10.1%
28-Nov-80	12-Aug-82	-27.1%	58.3%	22.3%	26.5%	15.1%
25-Aug-87	04-Dec-87	-33.5%	21.5%	12.9%	14.0%	15.8%
24-Mar-00	09-Oct-02	-49.1%	33.7%	15.5%	15.0%	6.4%
09-Oct-07	09-Mar-09	-56.8%	68.6%	26.5%	22.7%	15.0%
19-Feb-20	23-Mar-20	-33.9%	74.8%	20.8%	???	???
03-Jan-22	12-Oct-22	-25.4%	???	???	???	???

# Appendix 15 – Technicals: Sentiment



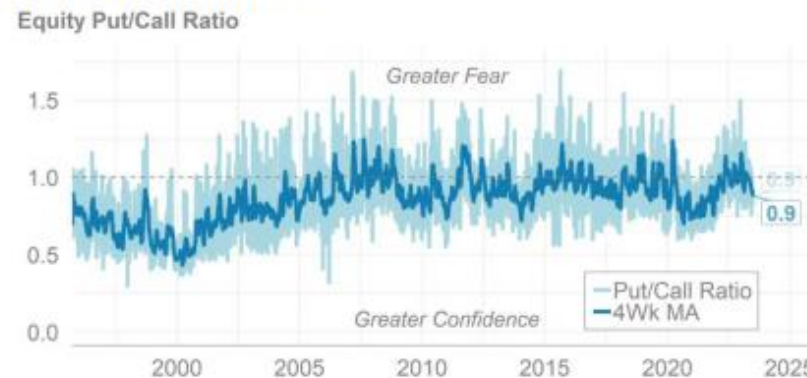
Jun 2023 = 33.9



# Appendix 16 – Technicals: Sentiment

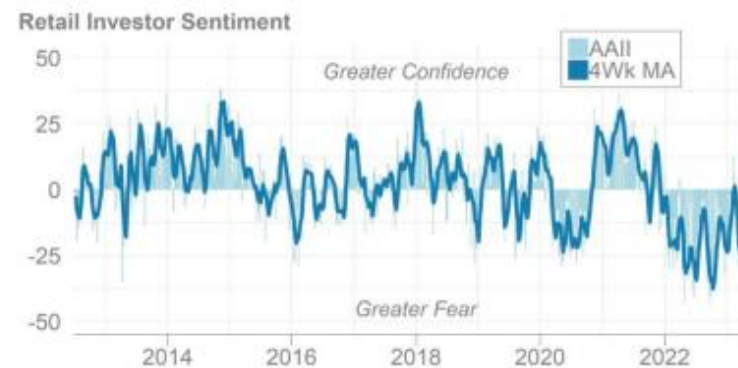
- Both the Put/Call ratio and the AAI Bull-Bears Retail Sentiment Index have bounced to optimistic levels.

## US Equity Put/Call Ratio



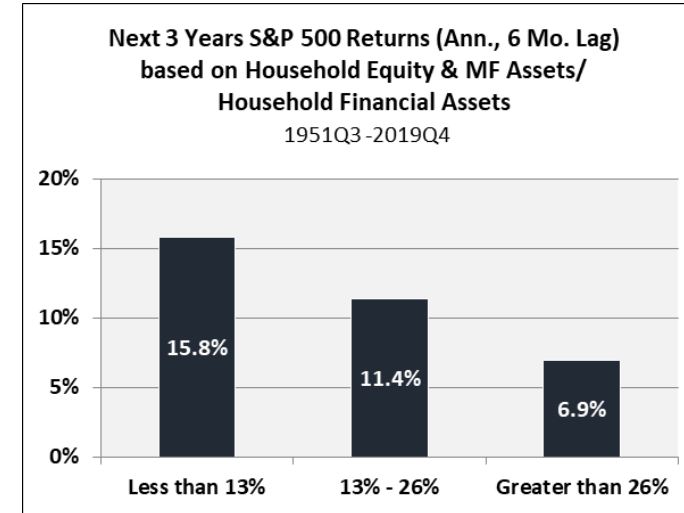
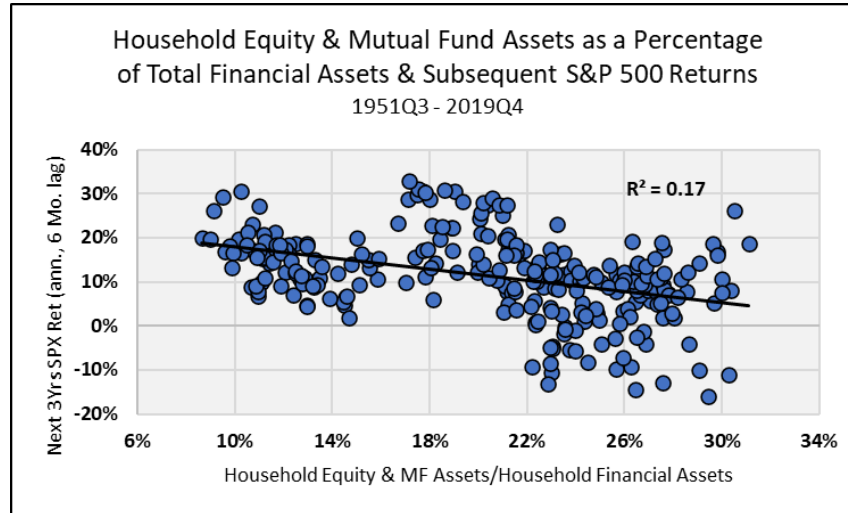
Source: CBOE, Bloomberg, Morgan Stanley Research

## AAII Bulls-Bears

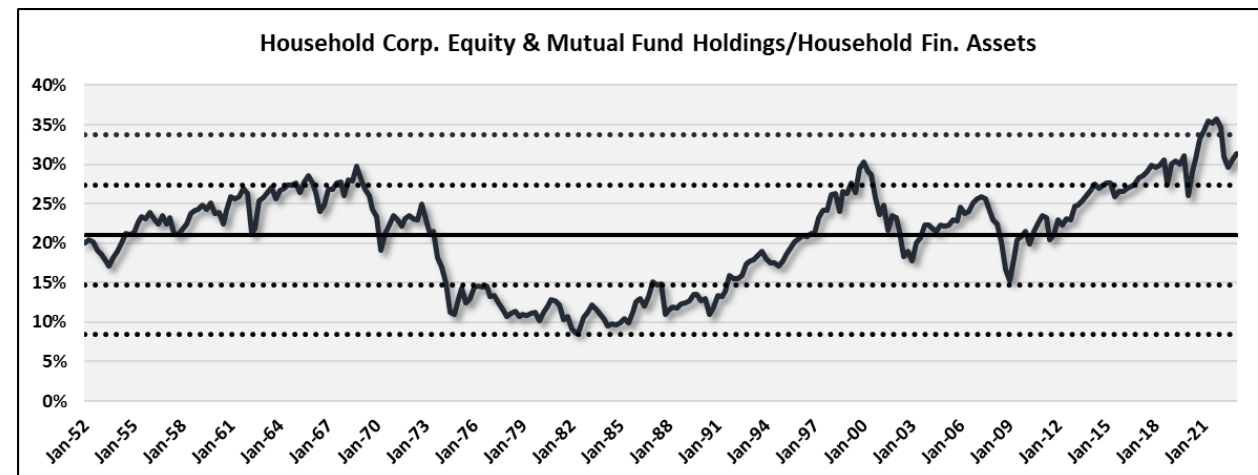


Source: AAI, Bloomberg, Morgan Stanley Research

# Appendix 17 – Technicals: Sentiment

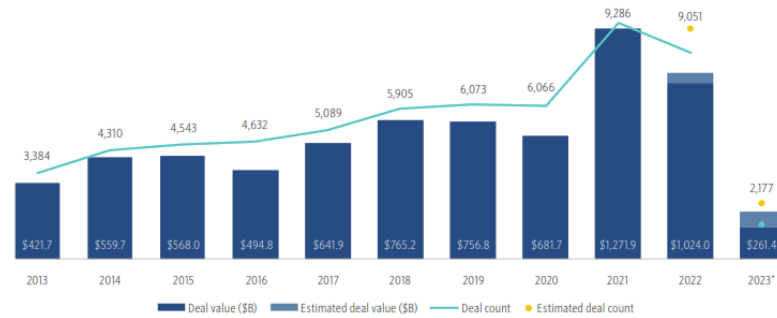


Q1 2023 = 31.3%

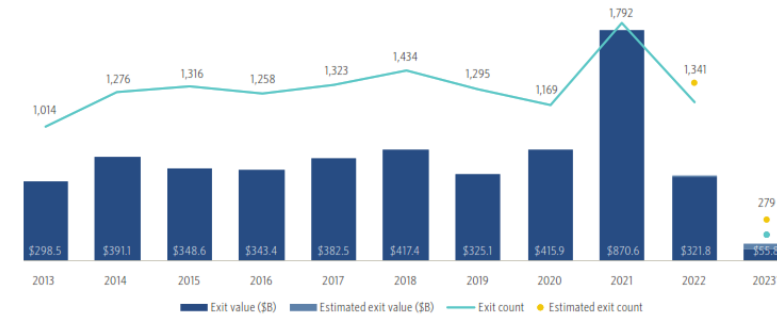


# Appendix 18 – PE Technicals: US Deals, Exits, Fundraising & Global Dry Powder

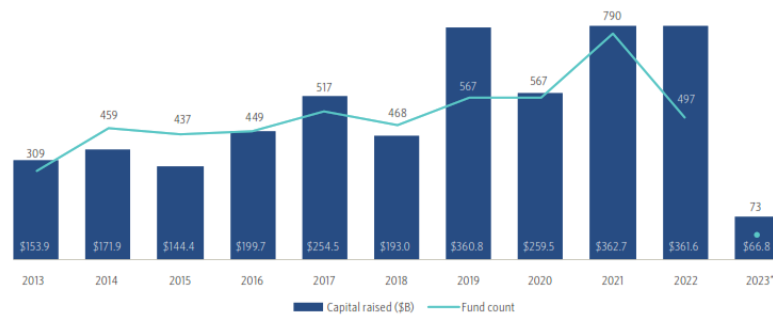
PE deal activity



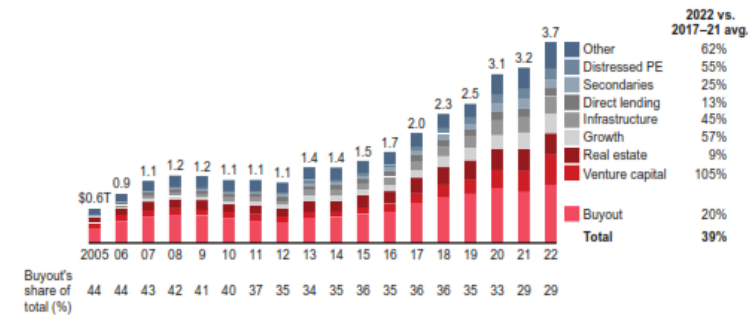
PE exit activity



PE fundraising activity

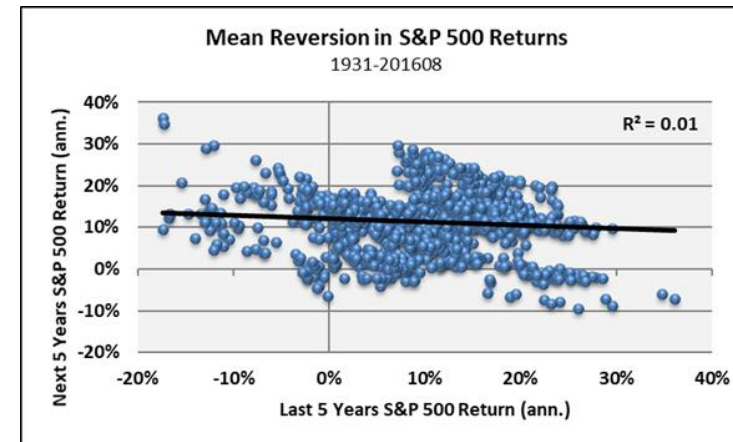
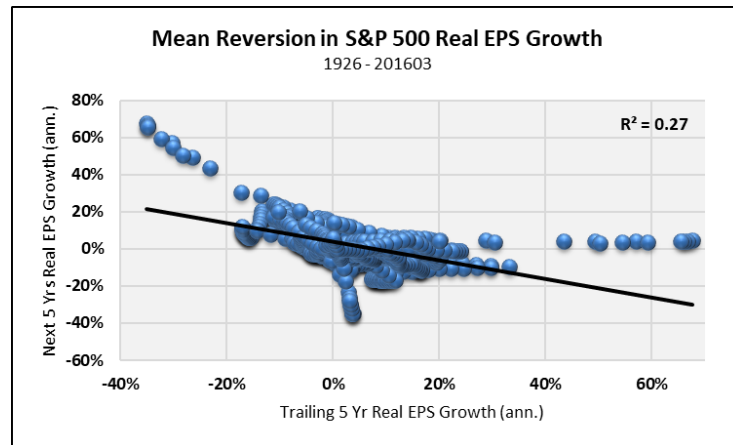


Global private capital dry powder, by fund type (\$T)

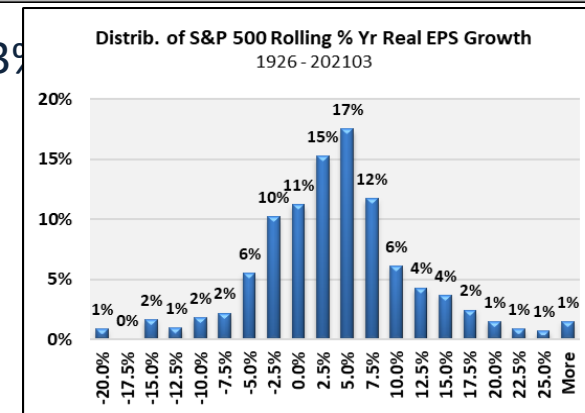


# Appendix 19a – US Equity Real Earnings Growth & Total Returns

- Real EPS Growth has shown a tendency to mean revert over 5-year periods, unlike returns.
  - Trailing 5, 10 and 20 Year MSCI World Real EPS Growth of 4.1%/yr, 4.1%/yr and 6.9%/yr through Q1 2023; implies 2.0%/yr, 0.2%/yr and -6.1% over next 5 years. (average = -1.3%/yr)

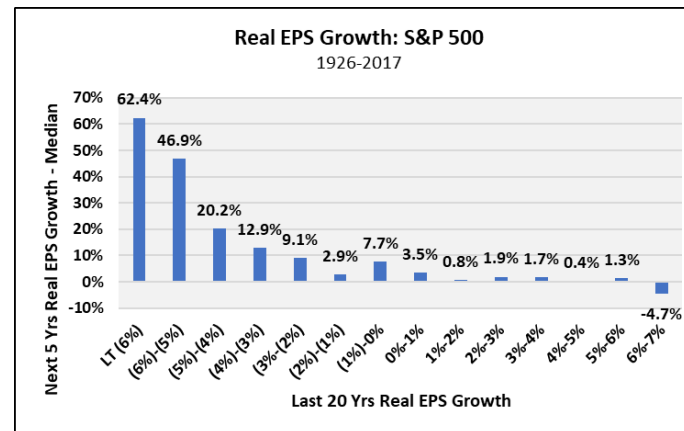
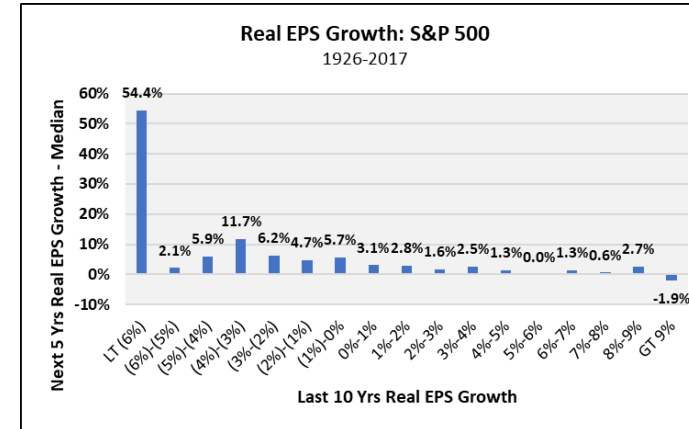
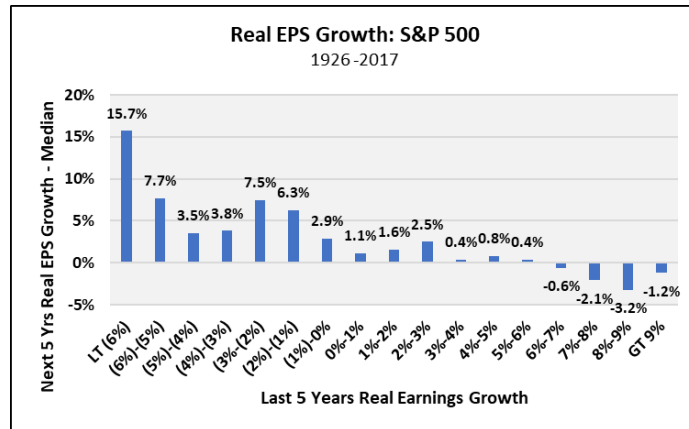


- US Real Earnings have grown at -1.3% or better over 5 years in 73% of observed periods from 1926–2016.
  - Median = 2.5%
  - Mean = 2.9%



# Appendix 19b – US Equity Real Earnings Growth & Total Returns

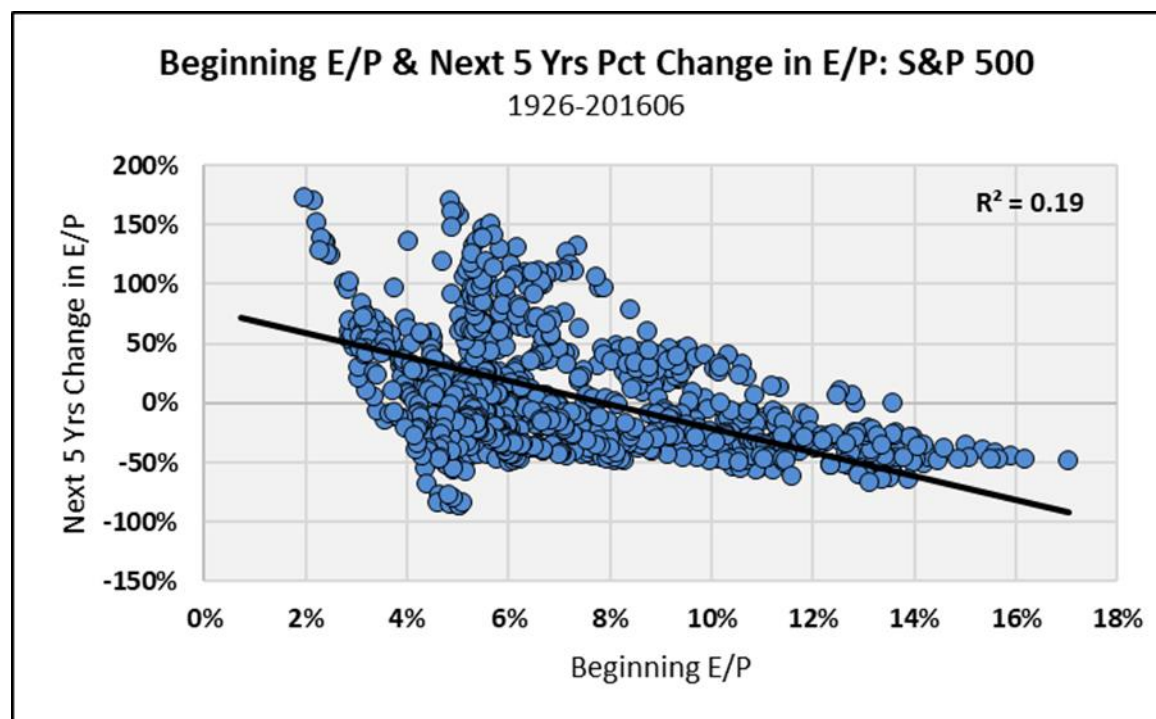
- Real EPS Growth has shown a tendency to mean revert over 5-year periods, unlike returns.
  - Trailing 5, 10 and 20 Year MSCI World Real EPS Growth of 4.1%/yr, 4.1%/yr and 6.9%/yr through Q1 2023; implies 0.8%/yr, 1.3%/yr and -4.7% over next 5 years. (average = -0.9%/yr)





## Appendix 20a – 5 Year Changes in Earnings Yield – Since 1926

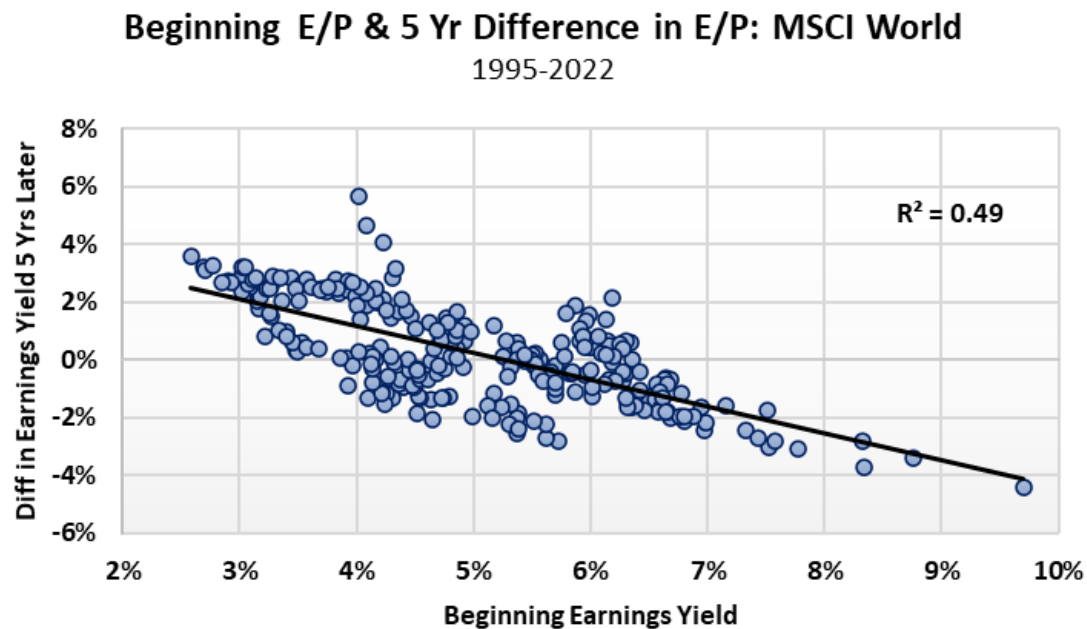
- Trailing twelve months earnings yields have tended to mean revert.



- 30 June 2023 MSCI World E/P of 5.7% (P/E of 17.5x) implies a 10.5% increase over the next 5 years to 6.3% (P/E of 15.8x).
- P/E Ratio would contract by 2.1%/yr.

## Appendix 20b – 5 Year Changes in Earnings Yield – Since 1995

- Trailing twelve months earnings yields have tended to mean revert.



- 30 June 2023 MSCI World E/P of 5.7% (P/E of 17.5x) implies a 7.0% decrease over the next 5 years to 5.3% (P/E of 18.9x).
- P/E Ratio would expand by 1.5%/yr.

# Appendix 21 – Outlook for Respective Premia

## Value

- The Value factor return was negative over both the last three- and twelve-month periods after a very strong 2022. (App. 17)
- The factor appears cheap, especially relative to its long-term history.

## Size

- Small caps were again poor performers in both the last three- and twelve-month periods, continuing a long trend. (App. 17)
- Small caps also appear cheap relative to their history.

## Momentum

- The Momentum factor was positive for the last three months but down over the trailing twelve-month period. (App. 17)
- High momentum stock valuations appear slightly expensive relative to historical average.

## Quality

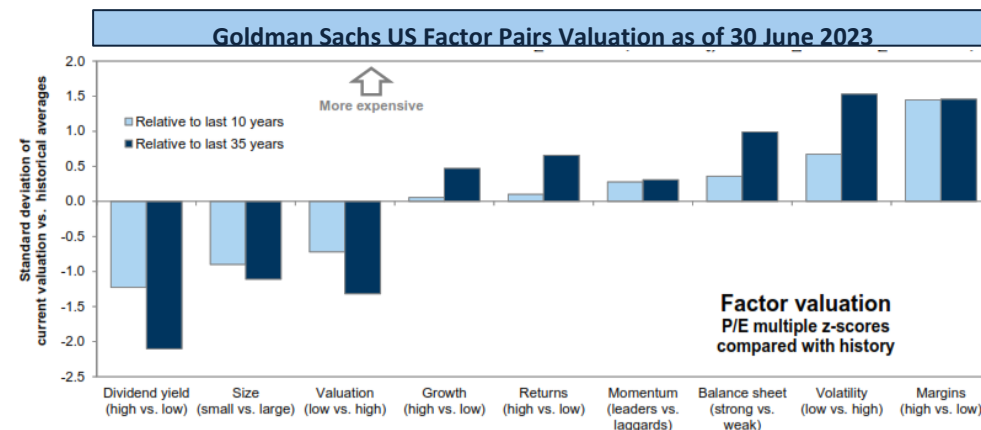
- High quality stocks outperformed modestly over the last quarter and have been positive over the last 12 months. (App. 17)
- Companies with strong balance sheets are unattractively valued relative to their history, especially over the longer term.

## Volatility

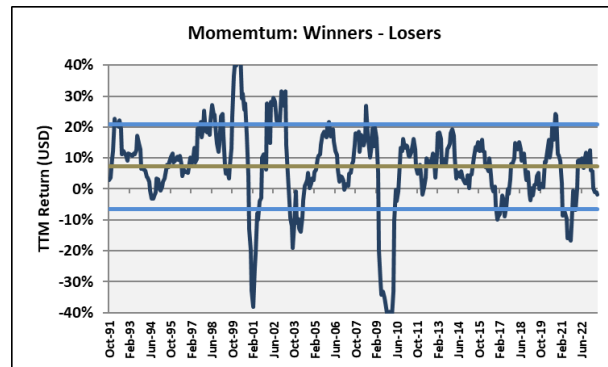
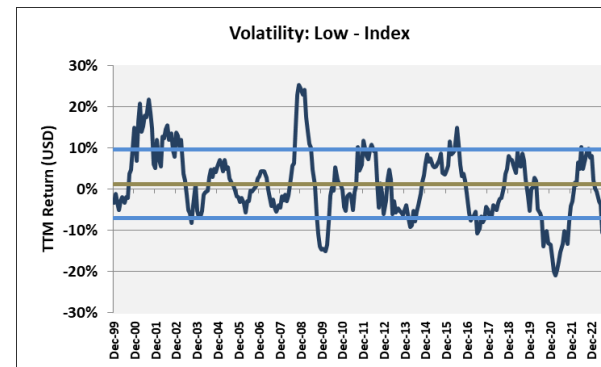
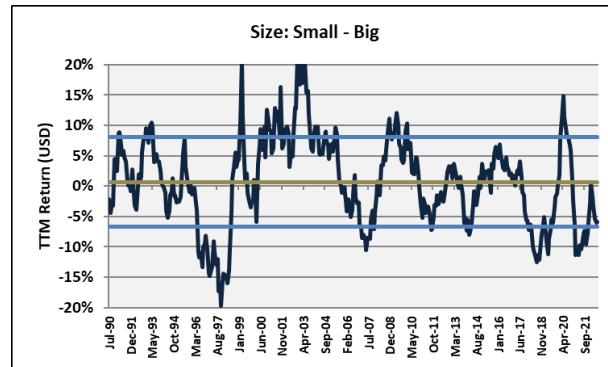
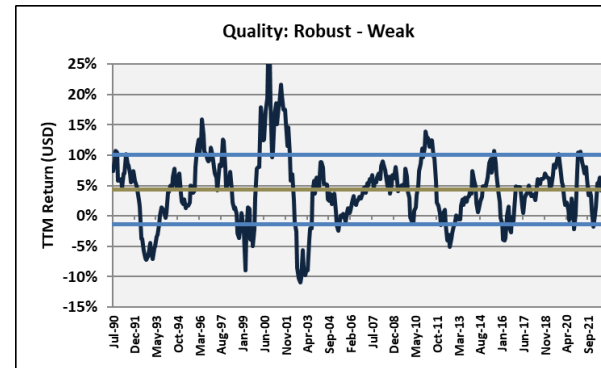
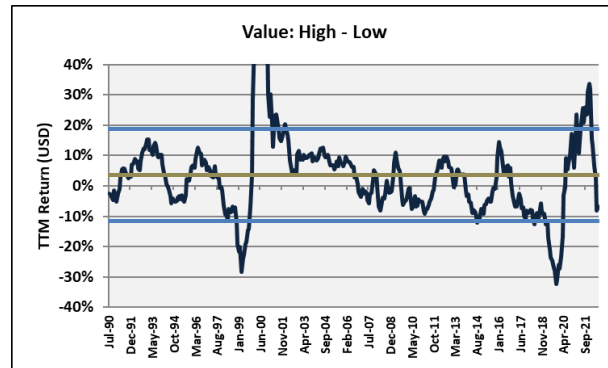
- Low volatility stocks continued to struggle in the second quarter and over the last year. (App. 17)
- Low volatility stocks also appear expensive valued relative to their longer-term history.

Global Factor Performance	TTM Return	Z-Score History		Note: Last 3 Mo. Return
		10 Year	Since Inception*	
Value (FF)	-6.9%	-0.4	-0.7	-3.9%
Size (FF)	-5.8%	-0.7	-0.9	-2.6%
Momentum (FF)	-1.8%	-0.8	-0.7	1.6%
Quality (Balance Sheet Strength, FF)	4.2%	0.1	0.0	0.4%
Volatility (MSCI ACWI Min Vol - ACWI)	-10.5%	-1.2	-1.4	-3.9%

\* July 1990 for Value, Size & Quality, Nov 1990 for Momentum, Dec 1998 for Volatility). June 2023 estimated.  
 Sources: Ken French website ([http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data\\_library.html](http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html)), MSCI, Bloomberg, SECOR.



# Appendix 22 – Global Equity Factor Performance



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