CHARTWELL INVESTMENT PARTNERS

Chartwell Strategies Current Outlook and Investment Strategy

"Inspiration comes to us slowly and quietly"

-Brenda Ueland

Summary

- *A major decline in new COVID-19 cases since last January has led to a growing economy and a robust bull market rally through the first half of 2021.*
- *Above average economic growth is expected to continue for the next several quarters.*
- *Many high technology stocks are selling at historically high valuations, but areas of value remain in the financial and industrial sectors of the market.*
- *After a relatively uninterrupted rise since the March 2020 low, the market is likely to experience more volatility in the months to come, in our opinion.*

Background

During the second quarter of 2021, the number of new COVID-19 cases plummeted as the vaccines became widely distributed throughout the United States. From a pandemic high of 305,000 new daily cases reported for January 8th of this year, the number of daily new cases fell to approximately 17,000 at the end of June*. As the effects of the pandemic receded, the economy has gained momentum and the unemployment rate has fallen, as shown in Figure 1. Prior to the pandemic, the unemployment rate had reached a low level, 3.50 percent, then soared to 14.8 percent at the end of April 2020 when businesses were forced to close. Now, over a year later, the unemployment rate has dropped to 5.90 percent but has shown signs of becoming resistant to further declines. For example, initial weekly unemployment claims, shown in Figure 2 on the next page, have become "stuck" in the 400,000 range.

U.S. UNEMPLOYMENT RATE
Bureau of Labor Statistics
08/05/2015-06/30/2021

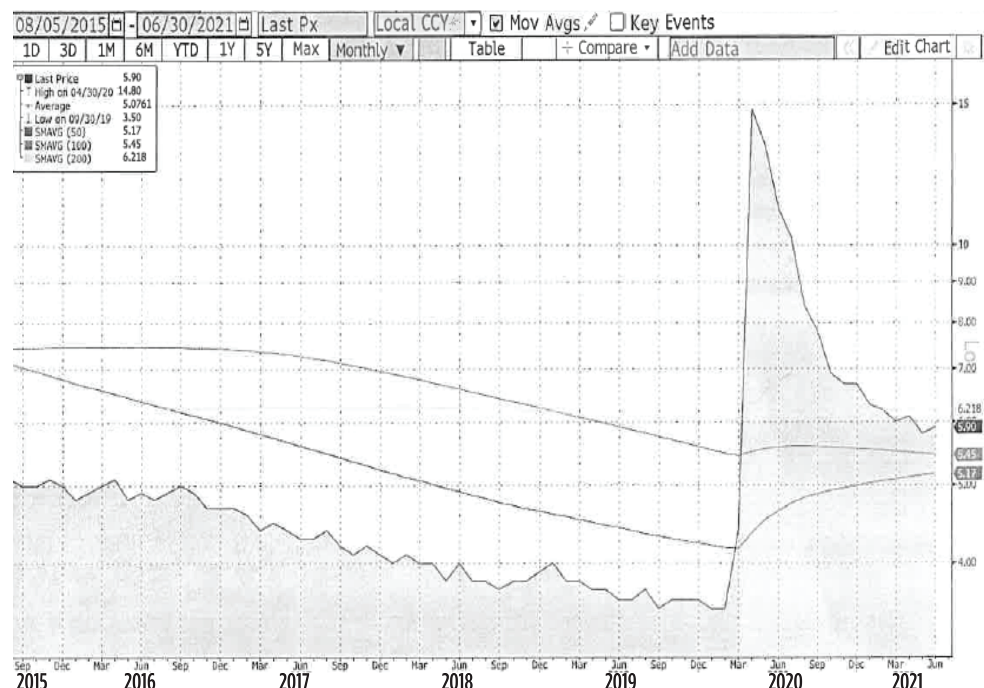

Figure 1. AFTER PEAKING AT 15% IN APRIL 2020 THE UNEMPLOYMENT RATE IS HAS DECLINED TOWARDS A MORE NORMAL RANGE.
Source: Bloomberg

*Source of daily cases: www.worldometers.info

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INITIAL WEEKLY UNEMPLOYMENT CLAIMS
Bureau of Labor Statistics
08/05/2020-07/30/2021

Figure 2. AFTER FALLING FOR THE FIRST FIVE MONTHS OF THE YEAR, CLAIMS HAVE BECOME LOCKED IN THE 400,000 PER WEEK RANGE
Source: Bloomberg

In the first quarter of this year, the United States' real Gross Domestic Product (GDP) grew 6.3 percent over that of the prior year and the second quarter is estimated to have grown 6.5 percent over the prior year. These large increases are expected to be sustained for at least a few more quarters and have not gone unnoticed by investors. Indeed, the equity markets have been rising to all-time high levels as companies report earnings improvements, sometimes dramatic, over the last year.

Nevertheless, investors have reasons to be wary of the equity markets. Most notable is valuation. The NASDAQ contains 3,385 member companies. If all members are included, the price-to -earnings (p/e) ratio of this index is a jaw-dropping 114; however, if only profitable companies are included, the index's p/e falls to 34.1 – more palatable, but certainly not inexpensive. Standard & Poor's 500 Index (S&P 500) is also priced at generous valuations with total member and profitable member valuations of 29.3 and 26.9, respectively. Reflecting these high valuations, the dividend yields on the NASDAQ and S&P 500 are a modest 0.64 percent and 1.32 percent, respectively.

In our view, controversy regarding stock market valuation and the trajectory of the economy are likely to continue and now, with alarming, but perhaps premature reports of the COVID-19 Delta variant, edicts from Washington are being interpreted, by some, as political in nature. In the face of such uncertainties, it would not be surprising if investors began to lose confidence in the bull market and the economic recovery process.

Meanwhile, the Federal Reserve Board (FRB) may be on a collision course with the expansive fiscal policies being promoted by the current Administration. With escalating government expenditures, rising inflation, low interest rates and potentially adverse tax policies, the investment outlook is unclear. Will the rise in the inflation rate continue and if it does, can the FRB keep interest rates at a constructive level? If the multi-trillion-dollar spending bills, now being considered by Congress are passed, will they be accompanied by tax legislation that makes investment in equities and other traditional financial instruments less attractive?

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In the past year, we have witnessed major price increases in commodities such as copper, lumber, oil and steel. The effects of the pandemic have created supply shortages that impact many retail products including the cost of restaurant dining. Over the past twelve-months energy costs have increased 24.5 percent, while the cost of all items, excluding food and energy, has risen about 3.5 percent. Nevertheless, the FRB maintains that this inflationary period is temporary, and they are committed to keeping interest rates low until the economy reaches full employment.

However, the Nation's fiscal policy is unprecedented. In an effort to mitigate the economic effects of the pandemic, major spending bills, amounting to five trillion dollars have been passed over the last fifteen months. At the time of this writing, a much-needed trillion-dollar infrastructure bill has been passed by the Senate, however, its passage in the House of Representatives is purported to be contingent upon the passage of a 3.5 trillion-dollar budget reconciliation bill that some project will cost taxpayers 5.5 trillion dollars.

Should these enormous expenditures occur, there is no realistic way for the country to pay for them. So far, the Administration has advanced the idea of increasing tax rates on corporate, marginal income, dividend, capital gains and estate taxes. History has repeatedly demonstrated that the negative effects on the economy from raising taxes results in far less revenue raised than originally projected. In the eight years under President Obama, economic growth, while in the process of recovering from the "Great Recession," averaged only 1.8 percent annually due to the twin burdens of over-regulation and high taxes. Another source of concern comes from a recent interview with Janet Yellen, Secretary of the Treasury, who astonishingly stated that economic growth is not the number one priority of the Administration; rather, the redistribution of income and wealth is the primary goal.

Since the pandemic began, the FRB has said that it would keep interest rates low, in part, by buying bonds in the marketplace. So far, this strategy has been remarkably successful. Despite the rise in inflation, interest rates have remained low with the 10-year Treasury bond trading at a yield of only 1.2 percent as of June 30, 2021. In the absence of competition from the bond market, investors are being encouraged to invest in equities despite their high valuations. With additional fiscal stimulus, should it occur, the FRB's job to control inflation and obtain full employment becomes even more difficult. In our view, the expansion of the FRB's balance sheet is clearly an experiment, the outcome of which remains to be seen. Admittedly, the present reality is that we are experiencing a substantial increase in inflation with interest rates that remain near historical lows. It will be fascinating to observe whether the transformational changes promised by President Biden can surmount the hurdles presented by the realities of the financial marketplace.

In summary, how the factors described in the previous paragraphs develop into either a coherent force, or muddled miasma, we believe are likely to determine the trajectory of the economy and financial markets in the months ahead. The equity markets have been in a strong bull market for the past sixteen-months, but in our opinion, are likely to become more volatile and subject to external surprises as consequences from these issues become evident.

Current Strategy

In the second quarter, small-cap value stocks narrowly outperformed small-cap growth, giving them a three-consecutive-quarter win streak. This was a good result in a quarter where interest rates retreated and some concerns about the Delta variant of Covid surfaced. The Chartwell Growth Composite (+4.52%) essentially matched that of our primary benchmark, the Russell 2000 Value (+4.56%) and was within reasonable range of the Russell Midcap Value Index (another good proxy for our style), which rose 5.66%. The Chartwell Balanced Composite rose 3.65%, as compared to +3.59% for its blended benchmark. Finally, our Dividend Equity accounts rose 4.20%, modestly below the benchmark Russell 1000 Value's gain of 5.21%.

The three best performers in the Growth and Balanced accounts were: Valvoline (VVV, 2.4%)*, up 25%, Hess (HES, 2.6%), up 24%, and QTR Realty Trust (QTS, 0.0%), up 22%. We were very pleased to get this return from Valvoline after purchasing it just last quarter; the stock's rise resulted from their (fiscal) Q2 earnings report, which was highlighted by market-share gains, international strength, and management's raised outlook for fiscal 2021. Hess's gain surpassed that of the Energy sector -- which was the best-performing sector in the quarter – on the heels of higher oil-production forecasts for both Guyana and the Bakken (N. Dakota). QTS jumped on the announcement of their being taken private by Blackstone, and we sold the stock on this move. The three worst performers in the Growth and Balanced accounts were: Dollar Tree (DLTR, 2.7%), down 13%, Hologic (HOLX, 3.4%), down 11%, and Winnebago (WGO, 1.7%), down 11%. Dollar Tree had a good quarter, but the company's 2021 EPS guidance came in below Wall Street consensus (only due to higher freight costs, though, not due to demand or sales). Hologic's weakness came after they lowered revenue assumptions for their Covid-testing business (and we took this opportunity to add to the position). For Winnebago, despite strong demand and backlog metrics in the quarter, the market grew concerned about upcoming growth deceleration from a very strong period during the worst of the pandemic.

**The numbers in parentheses following each company mentioned reflect the percentage of the portfolio's net assets comprised of such securities as of 06/30/2021. Holdings are subject to change. A full listing of portfolio holdings is available upon request.*

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In our Dividend Equity accounts, the three best performers were: United Parcel Service (UPS, 3.0%), up 23%, Methode Electronics (MEI, 2.0%), up 18%, and Seagate Technology (STX, 2.7%), up 15%. UPS had a very large earnings per share beat in the quarter, leading analysts to raise full-year estimates by 22%. Methode is gaining recognition for their exposure to the growth market of hybrid and EV (electric vehicle)-related sales, now expected to represent a mid-teens percentage of fiscal 2022 sales. Seagate preannounced a positive upside to its June quarter; they saw increased demand for their hard drives from "crypto-mining," data center/cloud, and enterprise. The three worst-performing stocks in the Dividend Equity accounts were: Las Vegas Sands (LVS, 2.4%), down 13%, Intel (INTC, 3.3%), down 12%, and Pioneer Natural Resources (PXD, 0.0%), down 9%. Casino/resort operator LVS was part of a group of "re-open" stocks that did poorly as Covid-variant (especially "Delta") concerns have grown, particularly internationally. Intel had a mixed earnings report in April – good PC/notebook results, but datacenter revenues fell 20% and raised issues of competition, pricing, and margins for that segment. Pioneer significantly lagged the Energy sector; the market signaled a dislike of their acquisition of DoublePoint Energy for $6.4 billion to gain more "acreage." We sold this position in April.

After an active quarter of trading during Q1 in the Growth Composite, this one was more subdued. The most notable trade was the purchase and sale of the same stock- data center QTS. We bought it in mid-April, and in early May it was announced that private-equity investor Blackstone was taking them private. The stock reached the "deal" price, so we sold – at about a 22% gain. NCR Corp. was a new purchase (NCR, 1.9%); they make point-of-sale terminals and bank ATMs (automated teller machines). We are intrigued by the strong EPS-growth expectations for the company in combination with an attractive PE of only 12.5x 2022 estimates (the S&P500 is about 20x on the same basis). Huntington Bancshares (HBAN, 2.5%) was purchased in conjunction with the sale of Flagstar Bancorp (FBC), which is being acquired in an all-stock deal by New York Community Bancorp. Unlike with QTS, the buyout of FBC is not at a premium, and the stock did not react positively. Other adds to existing holdings included Crown Holdings (CCK, 2.5%) and Hologic (HOLX, noted above). We sold utility PPL Corp. (PPL) after a period of weak relative performance (they are selling their troubled UK business); we feel comfortable just owning Exelon (EXC, 2.3%) in that sector for now. Other trims of portfolio positions were Foot Locker (FL, 3.1%) and Arbor Realty (ABR, 1.7%) – both after strong runs.

Trades in the Dividend Equity accounts were light. We initiated a position in Exxon Mobil (XOM, 2.5%), a premier integrated oil company, which we see as a more conservative way to play ongoing energy demand than with Pioneer Natural Resources (PXD), which was sold. We added to Las Vegas Sands (LVS) on the weakness noted above and similarly added to Citigroup (C, 2.6%) after it pulled back late in the quarter. Arbor Realty Trust (ABR, 1.4%) was trimmed on strength, and PPL Corp. was sold as described above. Finally, after receiving a very small allocation in Organon (OGN) – a spin-off from Merck – we sold that position.

While we have outlined several potential impediments to continued upside in the overall market, there is not "a market" these days, but rather several heterogeneous sub-groups. We believe that smaller to midsized, value-oriented stocks still have significant upside potential, as they could be beneficiaries of the ongoing strength in the economy, and their valuations are meaningfully discounted relative to their large-cap, growth-oriented brethren.

Chartwell News

Since June 14, 2021, we are pleased to report that all our staff are now back in the office. With over 90% of the staff vaccinated, we are getting back to normal and during the pandemic and office re-opening, there have been no firm operational, trading, or client servicing issues to report. We are proud of the effort from all our Chartwell colleagues over the past 18 months. We hope everyone is doing well, enjoying the summer, and maintaining an optimistic outlook. As reflected in the letter, the economy continues to recover, and near-term stock market gains are probable. We will continue to work hard looking for great companies and servicing our clients. Thank you for the continued trust you place with Chartwell Investments. We wish everyone a safe and healthy remainder of summer! As always, if you have any questions regarding your account performance, or want to discuss changes in your investment objective, please do not hesitate to call Mike Magee (610.407.4867) or Pete Schofield (610.407.4858).

Past performance is no guarantee of future performance. Investment involves a risk of loss.

This commentary is for informational purposes only. It is not an offer to buy or sell any security and should not be construed as investment advice. The views in this report were those of the Adviser at the time of writing this report and may not reflect our views on the date this report is first published or anytime thereafter.

*The Chartwell Growth Strategy Composite includes all fully discretionary, fee-paying equity accounts with a growth objective whose asset size is $300,000 or greater at the beginning of the measurement period. For individual

bond holdings the fee is 5/8 of 1% and for bond mutual funds, including exchange traded funds, the fee is 3/8 of 1%. The fee for these accounts is negotiable.

*The Chartwell Balanced Strategy Composite includes all fully discretionary, fee-paying accounts with a balance between growth and income as a principal objective whose asset size is $300,000 or greater at the beginning of the measurement period. For individual

bond holdings the fee is 5/8 of 1% and for bond mutual funds, including exchange traded funds, the fee is 3/8 of 1%. The fee for these accounts is negotiable.

The composites do not include accounts where total cash flows exceed 10% of the account's value during any quarterly period or accounts holding securities purchased by anyone other than the Advisor. No accounts using leverage or short positions are included in the composites. An individual client's account may have performed better or worse than the composites' returns presented above. The composites contain taxable and non-taxable accounts. The returns are before taxes and net of all advisory fees and commission charges. The net performance results for each composite are presented after deducting the actual fee charged to each account in the composite based on the management fee schedule in the Firm's Brochure or the fee negotiated between the account holder and Chartwell. Returns include the reinvestment of dividends and interest (total return). Returns for other Chartwell composites are available upon request.

As of 06/30/2021 Chartwell managed $11.5 billion in assets, $10.3 billion as advisor and $1.2 billion as sub-advisor. During the most recent quarter, the Chartwell Growth Strategy Composite consisted of 4 accounts which represented 5.3% of total Chartwell Strategy Individually Managed Accounts and 0.1% of total Chartwell assets. During the most recent quarter, the Chartwell Balanced Strategy Composite consisted of 17 accounts which represented 35.5% of total Chartwell Strategy Individually Managed Accounts and 0.4% of total Chartwell assets. The Chartwell Growth Dividend Strategy Composite consisted of 5 accounts which represent 3.1% of total Chartwell Strategy Individually Managed Accounts and less than 0.0% of total Chartwell assets.

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