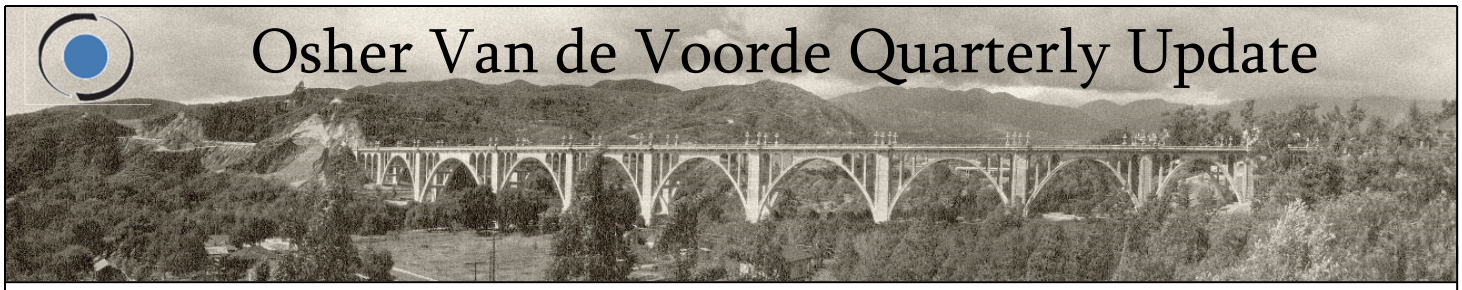


To V or Not to V

July 2020

The stock market enjoyed its best quarterly performance in more than 20 years, as the S&P 500, Dow Jones Industrial Average and NASDAQ Composite respectively surged 20%, 18% and 31% during the second quarter. For the first six months of the year, the S&P 500 and Dow Jones are down -4.04% and -9.55% respectively. Meanwhile, the NASDAQ Composite finished the quarter up a stunning 12.11% for the first half of the year.

Relentless momentum in technology shares has many market participants on bubble watch. To that regard, it is remarkable that Facebook, Apple, Amazon, Netflix, Alphabet and Microsoft (FAANGM) now collectively represent 25% of the total $25.6 trillion market capitalization of the S&P 500. While we are becoming increasingly concerned by the potential ramifications of this concentration, we also recognize that these companies are primary beneficiaries of the accelerated proliferation of digitization caused by the pandemic. Microsoft CEO Satya Nadella recently stated that "we've seen two years of digital transformation in two months." When these technology titans eventually suffer an inevitable correction, it will have a disproportionate impact on the overall market. Meanwhile, according to analyst David Rosenberg, 70% of non-technology S&P 500 companies remain below levels reached in 2018. The disparity between the performance of growth and value stocks is at a 25-year high.

In a recent survey of 190 fund managers by Bank of America, a second wave of coronavirus cases, permanently high unemployment and a Democratic sweep of the election were cited as the most prominent risks facing the market. Let us evaluate these risk factors to ascertain the extent to which the stock market recovery from the March lows may have come too far, too fast.

While coronavirus cases are indeed spiking in hotspot states such as Florida, Texas, California and Arizona, for now there remains little evidence of a commensurate increase in new deaths. While we admit that mortality rate is a lagging indicator and likely to increase in the coming weeks, the death rate nationwide has been steadily declining since mid-April and can be attributed to the availability of treatments such as remdesivir and dexamethasone, widespread access to coronavirus testing, continued social distancing and face covering as businesses have reopened and the appropriate quarantine precautions taken by those most at-risk.

The at-risk population is most noticeable in nursing homes which account for 43% of all coronavirus fatalities in the United States. To be sure, fatality risk escalates substantially for those over age 70 with pre-existing conditions. Stanford University Chair in Disease Prevention John Ioannidis references "more than 50 studies that presented results on how many people in different countries have developed antibodies to the virus" and estimates "that about 150-300 million or more people have already been infected around the world, far more than the 10 million documented cases", implying a dramatically lower mortality rate than what is presently reported, an infection fatality rate "almost 0%" for those under age 45 and a mortality rate about 0.05% to 0.3% for those age 45 to age 70. As testing continues to accelerate and treatments become more readily available, the fatality rate for COVID-19 seems destined to more closely resemble that of the seasonal flu. Interestingly, COVID-19 may soon lose its status as an "epidemic" based on CDC guidelines that require the number of weekly deaths caused by a disease outbreak to exceed a certain percentage of overall deaths. According to the CDC, the percentage of deaths attributed to pneumonia, influenza or COVID-19 (PIC) decreased from 6.9% during week 26 to 5.5% during week 27, representing the eleventh consecutive week during which a declining percentage of deaths due to PIC has been recorded and is currently below the epidemic threshold.

Especially with the odds for a potential vaccine increasing as companies are poised to start Phase III trials this month, we remain cautiously optimistic that the worst of the pandemic has already passed in the United States. Effective treatments are in place, hospitals are better prepared and local governments are more adept at handling intermittent spikes with temporary shutdown measures. Further, we believe the recent spikes serve as an important reminder that we all must remain vigilant with face coverings and social distancing. Overall, we are all learning to cope with the reality that we will be living with COVID-19 for many months to come. Whether we are still in the first wave of cases or a surging second wave, we must recognize that additional spread of the virus was inevitable once states started to relax their lockdowns.

Over the past two months, nonfarm payrolls have risen by 7.5 million as workers began returning to their jobs following the coronavirus-induced shutdown, topping expectations by a dramatic sum. While 2.5 million returned to work in May, the median forecast was for a loss of 7.5 million jobs! Consequently, the unemployment rate has fallen from a peak 14.7% in April to 11.1%. St. Louis Fed President James Bullard anticipates that the renewed health scare will make mask-wearing "ubiquitous", which will in turn reduce the virus threat and boost the economy. Bullard sees the unemployment rate falling to as low as 7% before the year is over. As the economy continues to open, re-employment will outpace job losses and continuing jobless claims are likely to recede. Indeed, the Labor Department reported that 1.8 million workers were laid off in May, down from 7.7 million in April and 11.5 million in March, and in line with layoffs reported in January and February, before the pandemic essentially shut down the U.S. economy. The upcoming July 31st expiration of enhanced unemployment benefits looms large as workers will have a much greater incentive to return to work. While employment numbers are in the midst of a v-shaped recovery, we expect the ongoing rebound to flatten out over a more prolonged period. Until there is a vaccine, social distancing and rolling shutdowns will make it extraordinarily difficult to reach previous low levels of unemployment.

Other surging economic indicators that support a more v-shaped recovery include retail sales, homebuilder sentiment, rebound in the price of oil, mortgage applications, consumer confidence and both ISM Services and ISM Manufacturing Indices. Add in a weakening dollar, improving corporate credit, seemingly endless accommodation and QE from the Federal Reserve, nearly $3 trillion of fiscal stimulus with potentially more on the way, generational low interest rates that are likely to remain so for the foreseeable future, record bearish bets by hedge funds and an unbelievable $5 trillion record cash hoard in money market funds and we have the ingredients for what many analysts believe to be a new bull market in stocks. Morningstar expects U.S. GDP to fall 5.1% in 2020, but sees a sharp GDP rebound in the second half of 2020 with 5.9% growth in the third quarter and 3.2% growth in the fourth quarter, and robust catch-up growth in the years following 2020.

This $5 trillion of cash earning next to nothing gives us increased confidence that buying the dip will continue to prevail. We fully expect additional volatility for the balance of the year, especially as the election draws closer, but this hoard of dry powder, should limit excessive downside risk. JP Morgan forecasts a $16 trillion increase in worldwide debt this year, pushing the combination of private and public sector debt to a record high $200 trillion by year end, coinciding with higher savings rates, very accommodative central bank policies and more cash in the system. JP Morgan sees total global money creation exceeding $15 trillion or more by the middle of 2021 and "most of this liquidity will eventually be deployed into equities as the need for precautionary savings subsides over time", especially given the low level of bond yields. As a case in point, Calpers (the largest defined-benefit public pension plan in the U.S.), just introduced a plan to use leverage, taking advantage of low interest rates by borrowing and using those funds to acquire assets with potentially higher returns, in order to help meet its target 7% risk-adjusted return.

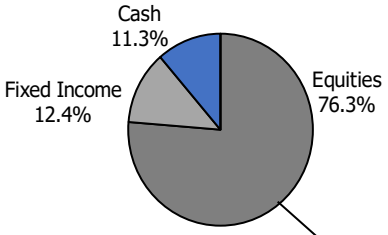
With regards to the upcoming Presidential election, we have never attempted to trade around potential outcomes. With Democratic nominee Biden soaring in recent polls, we might expect the markets to have some difficulty grappling with the increasing prospects for higher corporate and capital gains taxes. If there is a Democratic sweep of the House, Senate and White House, we would not be surprised at all by a material year-end selloff as investors lock in capital gains at today's lower rates. The odds for such a sweep seem evenly balanced at the present time. In any case, the stock market's performance in the months ahead could have a big impact on the outcome of the election. Data going back to 1928 shows that the incumbent party has won the contest 87% of the time when the S&P 500 is positive over three months ahead of the election and lost when it is negative.

With 180 companies in the S&P 500 having withdrawn their earnings forecast and only 49 companies having issued guidance for the coming second-quarter earnings season, analysts and investors are increasingly looking to 2021 and beyond. With today's consensus earnings estimate at $163.32 for 2021 and $186.30 for 2022, the S&P 500 presently trades at 19x 2021 earnings and almost 17x 2022 estimates. While these PE ratios seem relatively high by historical standards, they appear more reasonable given historically low interest rates and considering recession-induced trough earnings. Further, high PE technology companies give the overall market a disproportionately high valuation. We again expect additional volatility as the second half of the year progresses, but it appears to us that the stock market had this recovery right all along.

Investment Strategy Summary

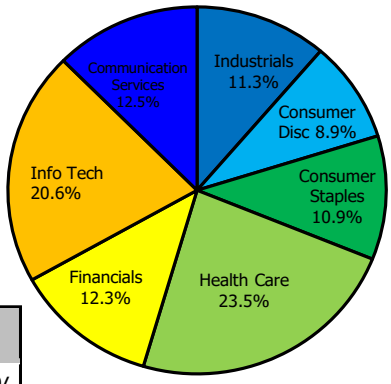
As of June 30, 2020

Firmwide Asset Allocation



OVIM Equity Composition	
International Core	14.1%
U.S. Core	85.9%

Equity Sector Allocation

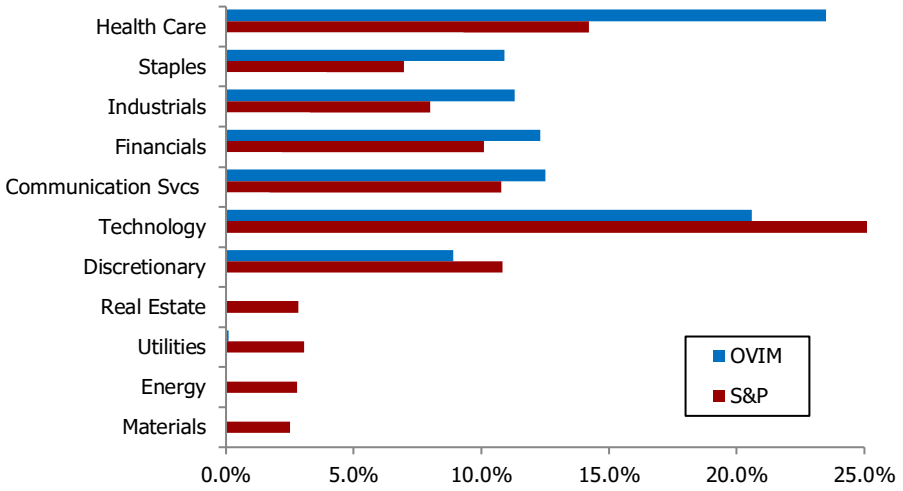


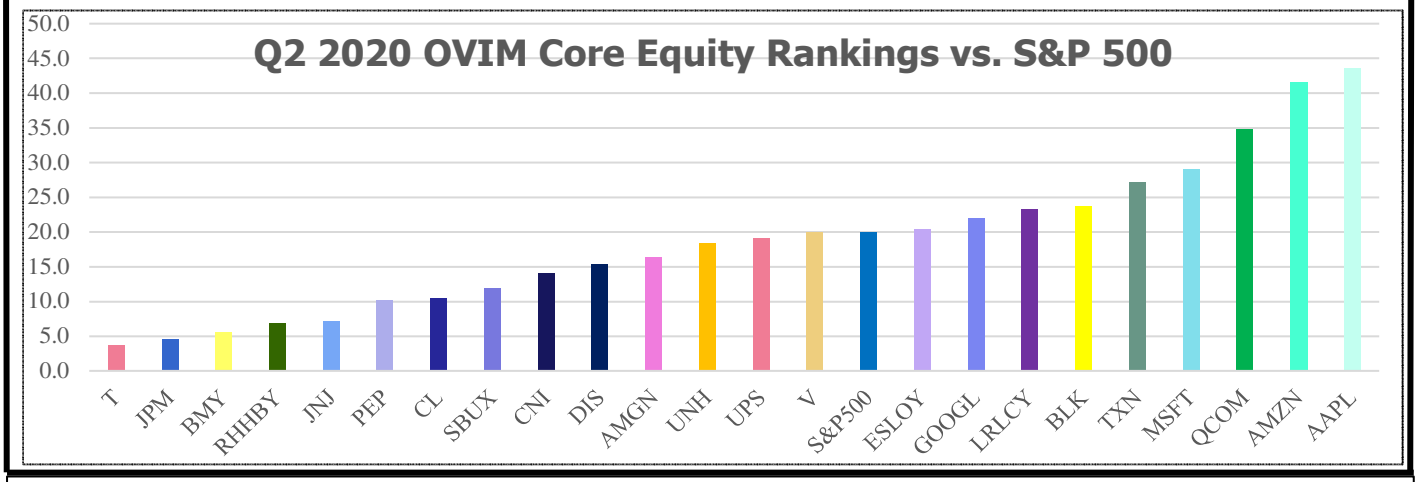
Top Core Global Equity Holdings

BlackRock Inc.	BLK
Amazon.com Inc.	AMZN
Alphabet Inc. "A"	GOOGL
Qualcomm Inc.	QCOM
United Parcel Service Inc.	UPS
Bristol-Myers Squibb Co.	BMY
Pepsico Inc.	PEP
Amgen Inc.	AMGN
Apple Inc.	AAPL
UnitedHealth Group Inc.	UNH
Microsoft Corp.	MSFT
Starbucks Corp.	SBUX
Roche Holdings AG	RHHBY
Texas Instruments Inc.	TXN
AT&T Inc.	T
Visa Inc.	V
Walt Disney Co.	DIS
Johnson & Johnson	JNJ
JPMorgan Chase & Co.	JPM
L'Oreal ADR	LRLCY
Berkshire Hathaway Inc. "B"	BRKB
Canadian National Railway	CNI
Raytheon Technologies	RTX
EssilorLuxottica SA	ESLOY
Colgate Palmolive Co.	CL

Sector Weightings Relative to S&P 500

Ranked by Largest Overweight

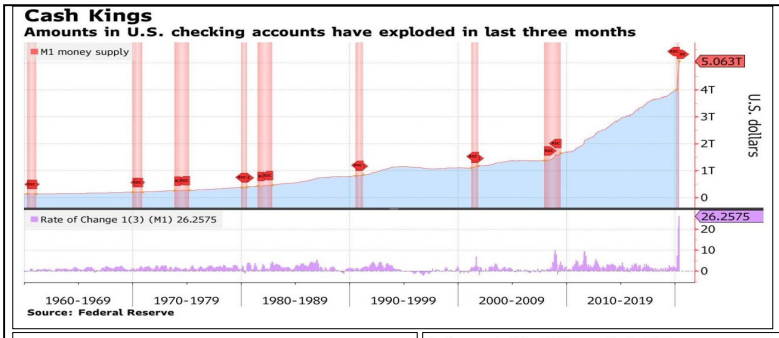


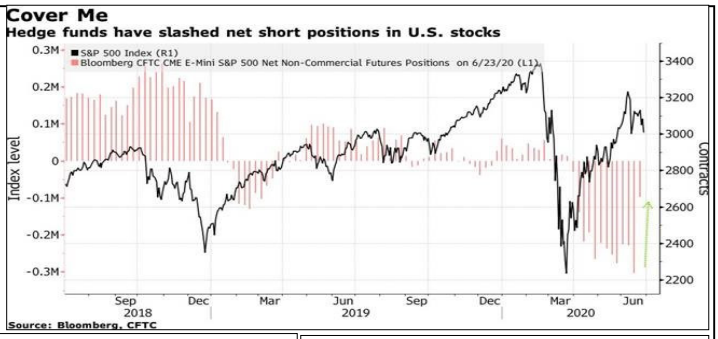


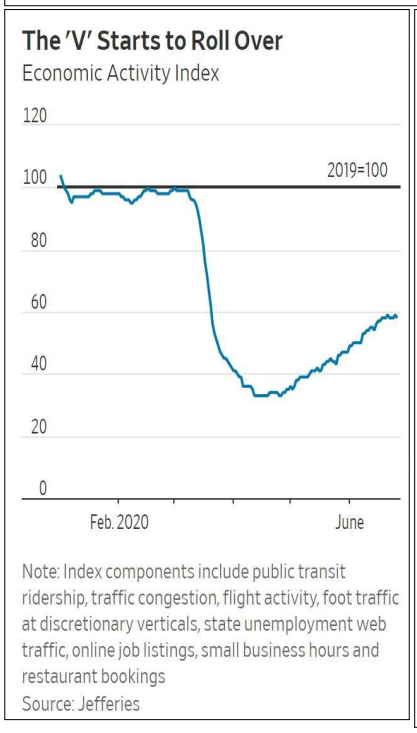
This presentation is solely for informational purposes. Data is pulled from sources believed to be reliable, but not independently verified. Past performance is no guarantee of future returns. Investing involves risk and possible loss of principal capital. No advice may be rendered by Osher Van de Voorde Investment Management unless a client service agreement is in place. Please contact us at your earliest convenience with any questions regarding the content of this presentation and how it may be the right strategy for you. This data is representative of all equity securities held across Osher Van de Voorde's client accounts, however portfolios are tailored to meet specific client objectives and actual client holdings will vary.

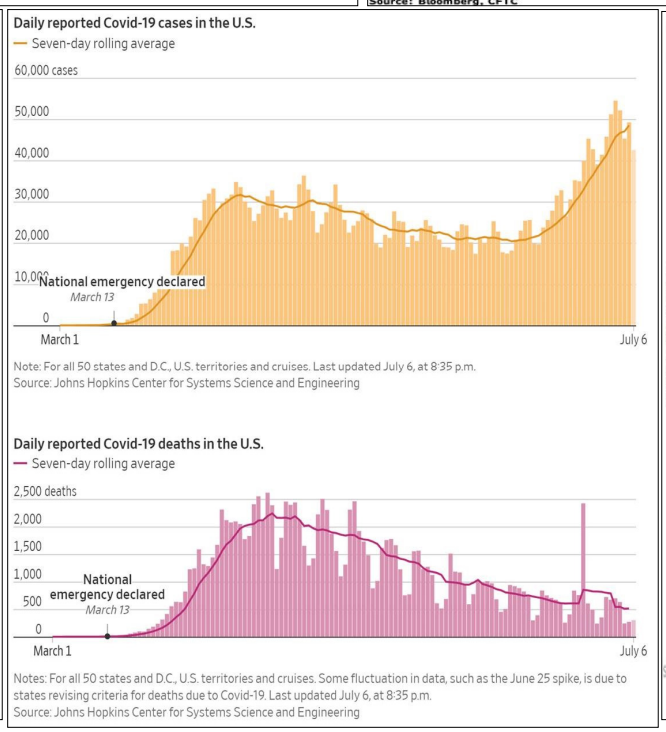
The S&P 500 Index or the Standard & Poor's 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies. The S&P 500 is a float-weighted index, meaning company market capitalizations are adjusted by the number of shares available for public trading. Investors cannot invest directly *in an* index. *Note: Investors* cannot invest directly *in an* index. *These unmanaged* indices *do not reflect management fees and transaction costs that are associated with most* investments.

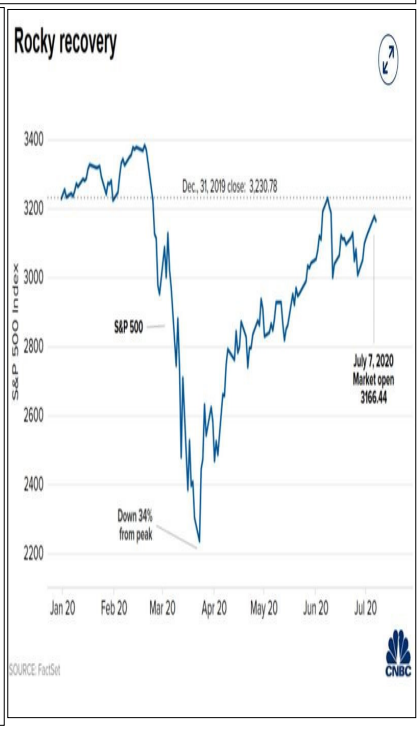
Charting the Markets

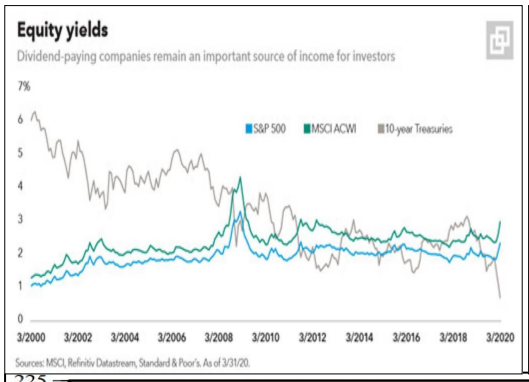


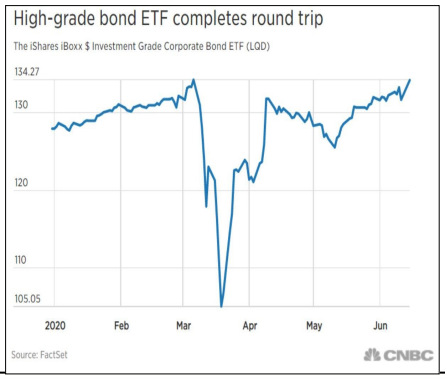


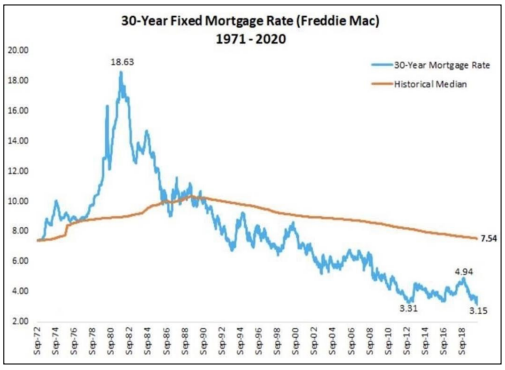


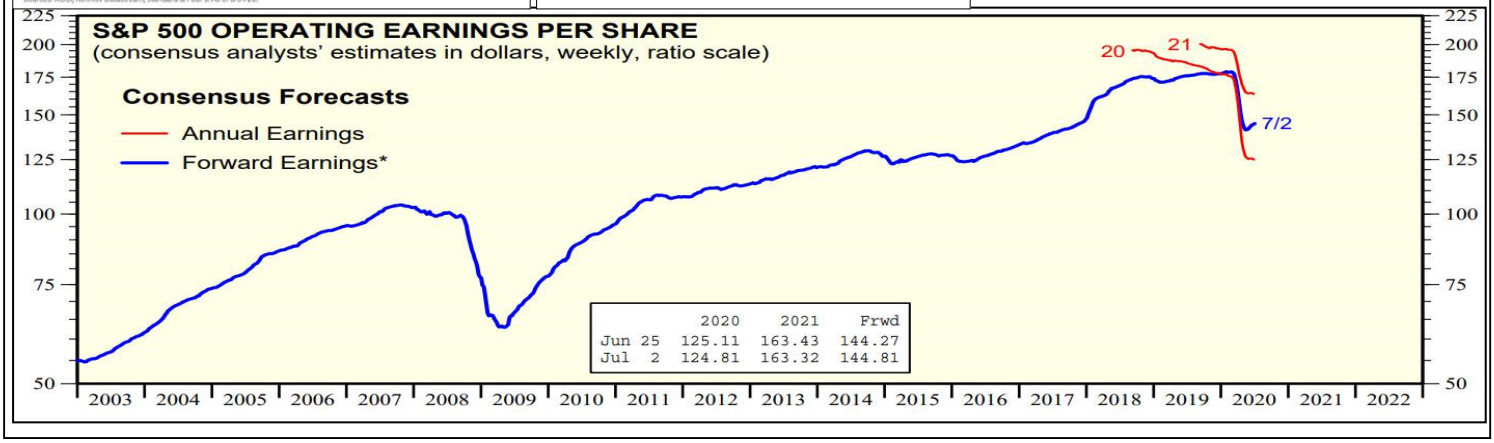












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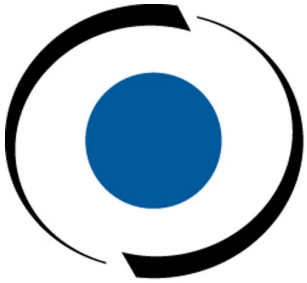

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Triple Tax Benefits of Health Savings Accounts

With the triple tax benefits of the Health Savings Account (HSA), it is no surprise that HSAs are growing in popularity as a key retirement strategy. According to a report by Devenir Research, there are now over 26 million HSA accounts, holding $61.7 billion in assets. Contributions to an HSA are deductible from current year's taxable income, can be invested to grow tax-free and feature tax-free qualified withdrawals resulting in a triple tax advantage.

Tracing its roots back to the earlier Medical Savings Accounts or MSAs, today's HSA was approved by Congress in 2003 and passed into law in January 2004. An HSA acts like a savings account, where participants can periodically set aside their own money for future healthcare needs. HSA accounts can only be established in conjunction with a qualified High Deductible Health Plan (HDHP) and one cannot be enrolled in any other non-HSA qualified health insurance plan, including Medicare or Medicaid. For 2020, the HDHP minimum deductible to qualify for participation in an HSA is $1,400 for individuals and $2,800 for families. The actual deductible will vary depending on the actual health plan purchased. In addition, to qualify for an HSA in 2020, the HDHP must have a limit on out-of-pocket medical expenses, including deductibles and copayments but excluding premiums, of $6,900 for individuals or $13,800 for families.

In owning the HDHP, one becomes eligible to open an HSA account with an approved trustee, like Charles Schwab or HSA Bank. In 2020, the tax-deductible contributions to an HSA are limited to $3,550 for individuals and $7,100 for families. If you reach age 55 by the end of the year, you may contribute an additional $1,000 in 2020. Contributions can be made from various sources including the individual, the employer, and even other family members. Regardless of the source, contributions from all sources cannot exceed these limits. There is no income limit to be eligible to contribute to an HSA.

What is most exciting is the triple-tax-free status of the HSA. Contributions made to the HSA are tax-deductible in the year of contribution. Any capital appreciation and income generated from investments within the HSA are tax-free, and withdrawals for qualified medical expenses are also tax-free. In contrast, retirement savings vehicles such as IRAs and 401(k)s offer tax-deductible contributions and tax-free growth, but the withdrawals are taxed as ordinary income. Roth IRAs offer tax-free growth and tax-free withdrawals, but the contributions are not deductible. In California, 529 Plans offer tax-free growth and tax-free withdrawals for qualified education expenses, but contributions (just like Roth IRAs) are not deductible. Yes, the HSA is the only triple-tax-free vehicle around.

HSA owners can use available funds to meet annual health care costs, thereby reducing the actual maximum out of pocket expense in any given year or save and invest these funds for the long-term. In theory, the HSA has the potential to become a self-funded long-term care policy. We realize that these plans are not for everyone, especially those already faced with high annual health care costs. However, for younger and healthier individuals, the HSA offers a wonderful investment opportunity.