Truist Advisory Services, Inc.

Alternative Investments State of the union and outlook

from the Investment Advisory Group

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Spencer Boggess
Managing Director
Alternative Investments

Rich Cheung
Senior Alternative
Investments Analyst

Len Lebov
Senior Alternative
Investments Analyst

Ryan Taylor, CFA, CAIA
Alternative Investments
Analyst

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Introduction

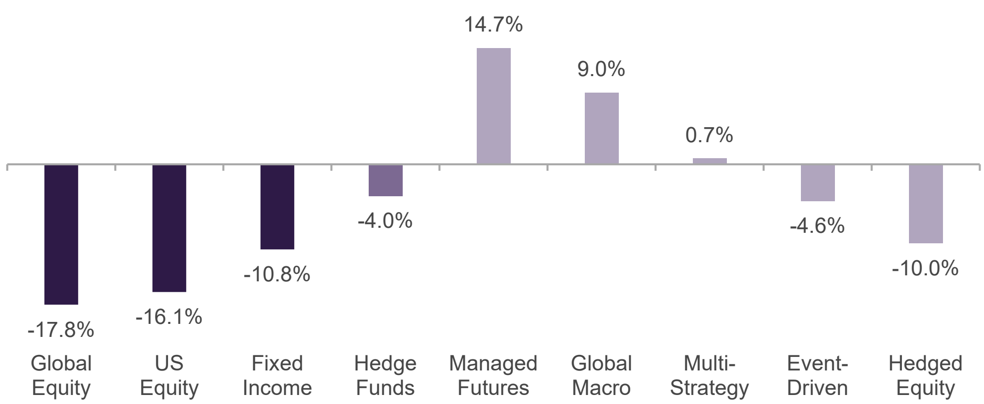
This publication provides our views on the state of the hedge fund marketplace. Going forward, we'll present our take on significant market developments and our perspective on potential opportunities for hedge fund investors on a periodic basis. As always, please contact your Truist advisor to learn more, and for guidance on how our views might inform your portfolio.

2022 performance and outlook for hedge fund investors

Hedge fund market leadership changed in the first half of 2022 as the equity and "return enhancement" oriented strategies that had dramatically outperformed for several years ceded their top status to more "diversifying" strategies that had comparatively underperformed. The previously strong performance of many directional, growth-oriented equity funds with a bias toward technology, health care and consumer discretionary sectors halted as the interest rate environment shifted and growth equities came under severe pressure. By contrast, discretionary global macro and managed futures (CTAs) provided strong absolute performance in the first half of 2022 and various multi-strategy, relative-value and low net exposure equity long/short funds also benefitted from either good capital preservation or, in a few cases, small gains.

Notably, hedge funds helped preserve capital in the worst market environment for equities and bonds since the 1970s: the HFRI Fund Weighted Composite Index was down only 4.0% through August versus the MSCI ACWI registering a 17.8% decline for the same period.

Year-to-date returns through August



Data source: eVestment. YTD returns are through August 2022.
Please see index terms and definitions at the end of this report.

TRUIST Wealth

This degree of downside risk mitigation compares favorably with other recent market stress periods including:

- March of 2020 (Covid-19)
- Sell-off in 4Q 2018
- The 2015-2016 period
- The Global Financial Crisis in 2008-2009

In the final analysis, we believe the first eight months of 2022 represent a key shift in the character of risk in global financial markets and are consequential for the positioning of hedge fund investors. The acute change in the environment has made it imperative to move away from dependence on more equity beta-driven strategies and emphasize diversifying strategies such as global macro, managed futures and select multi-strategy funds.

Third quarter so far

July marked a break from the punishingly difficult performance of most risk assets in the first half of the year. Most hedge funds also managed to produce solid absolute returns for the month. An expectation of a more dovish path for Fed monetary policy and reasonably solid corporate earnings prompted a risk-on environment in which more directional long/short equity and global macro strategies shined. August, however, saw equities and fixed income markets succumb to the hawkish Fed Chair commentary at Jackson Hole. Hedge funds as a group, led by relative value, multi-strategy and more hedged long/short equity, held up especially well in August’s return to a more risk-off mode for traditional risk assets.

AI outlook

With Federal Reserve policy focused on taming inflation elevating the risk of a (U.S.) recession and the expectation that cross-asset volatility will remain higher than normal, we generally favor defensive and “diversifying” as opposed to “return enhancement” oriented hedge fund strategies. In order of preference, we continue to favor:

- discretionary macro and managed futures
- more defensive multi-strategy funds
- relative value strategies
- lower net exposure equity long/short

Consistent with this point, we continue to be cautious on more directional hedged equity and more aggressive event-driven equities. Still, these hedge fund market views reflect our perspective on portfolio “tilts” within a balanced and diversified strategy mix. As always, we favor a diversified portfolio approach to investing in hedge funds to help navigate the market challenges ahead.

Less Attractive | More Attractive

Opportunity set based on a 6- to 12-month outlook

Global macro

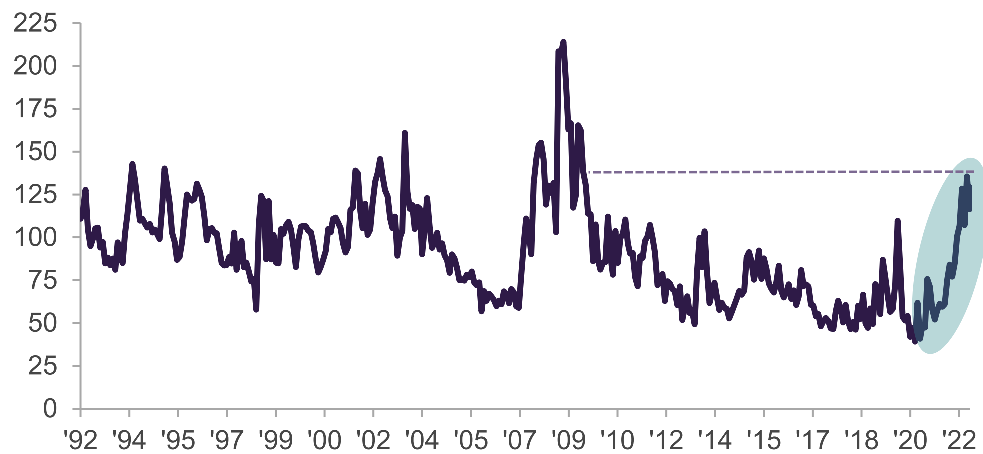
First half performance

The first half of 2022 proved to be a rich environment for discretionary global macro strategies. As global economies began to emerge from COVID-driven lockdowns in 2021, supply chain challenges collided with a surge in demand to produce sharp price increases in various agricultural and energy-related commodities. The ensuing elevated global inflation figures prompted the world's central banks in the first half of 2022 to accelerate a move from extremely accommodative policies to become much more restrictive ones. Thus, the pressures that started in commodities began to manifest themselves in financial assets all of which provided an excellent set of opportunities on which global macro managers capitalized.

Return drivers:

- Energy was the main source of returns in the commodity sector as crude oil and natural gas surged.
- Agricultural commodity returns were broad-based coming from long positions in markets such as corn, wheat and soybeans.
- Short positions at both the front and back end of a number of developed market interest rate curves as central banks raised rates and inflation expectations moved higher.
- Long US Dollar positions performed well, particularly against the Japanese Yen, which fell to more than a 24-year low.
- Volatility trading, via options and other derivative structures, across various asset classes. Fixed income volatility was the leader as the MOVE Index reached levels not seen since 2009.

Fixed income volatility at levels not seen since 2009



Data source: Bloomberg. Fixed income volatility as measured by MOVE Index.

This opportunity set and macro managers' ability to capitalize led to strong performance for the strategy as measured by the HFRI Macro (Total) Index which rose 8.5% in the first six months of 2022. The range of performance by managers in the index was quite wide, ranging from -2.7% to 18.5% for the bottom and top quartile. As in most hedge fund investing, manager selection is critical to successful outcomes when allocating to this strategy. Numerous macro funds closed in the 2010s. Along with the high barriers to entry, this makes capacity quite difficult to come by, particularly with managers who have consistently performed at the top of their peer group.

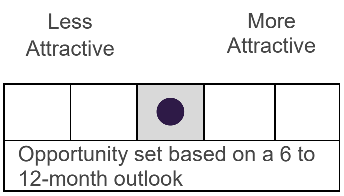
Q3 so far

More recently in July and August, macro managers gave back a small portion of their prior gains as some of the more profitable trends reversed, most notably in equities, interest rates and energy.

Outlook

The outlook for global macro appears favorable. Skilled managers should continue to benefit from the persistence of central bank policies, inflation, geopolitical tensions and their downstream effects that will keep volatility and directional market movements elevated. Through their investor communications, our managers have expressed optimism and remain sanguine about the opportunity set in a variety of markets. Furthermore, the possibility of a recession and the related “risk-off” environment have proven to be fertile ground for the strategy historically

Relative value & multi-strategy



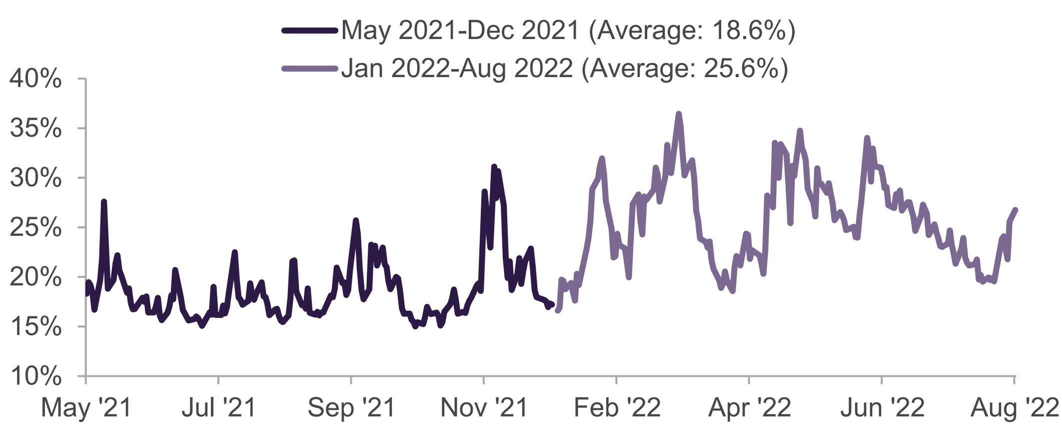
First half performance

Market neutral

Relative Value strategies have demonstrated resilience this year in a volatile environment where significant drawdowns were seen across markets. The index declined 1.0% through June as managers were generally able to mitigate severe capital losses.

Relative value equities, which incorporate shorting stocks to achieve a level of market neutrality, were generally able to protect on the downside as stocks broadly sold off. The HFRI EH: Equity Market Neutral Index declined only 0.3% in the first half of 2022. This strategy is typically governed by stricter risk management processes, especially as it relates to limiting factor exposures. Thus, the negative effects of the dramatic ‘growth to value’ factor rotation seen were diminished.

Volatility is higher than the prior eight months



Data Source: Bloomberg. Volatility is measured by the VIX Index.

Convertible arbitrage

Convertible arbitrage faced a challenging environment due to rising interest rates and widening credit spreads. The relevant HFRI RV: Fixed Income-Convertible Arbitrage Index was essentially flat in Q1 returning -0.63% before ultimately losing 5% by the end of June. At the start of the year, many convertible arbitrage managers took advantage of the opportunity to purchase convertible bonds that were deep in-the-money. This allowed managers to implement substantial amounts of stock shorts which profited as stocks sold off in Q1, thereby offsetting losses against their convertible positions. Increasing losses materialized in Q2 with the HFRI index losing 4.4% as recession fears drove credit spreads meaningfully wider.

SPACs have been a tumultuous market segment so far this year. While regulatory uncertainty around proposed SEC rule changes to SPAC IPOs has chilled the SPAC market and halted new issuance, hedge funds see SPAC investing as a compelling opportunity. Relative value managers have focused on pre-announcement SPACs for their yield potential by targeting SPACs trading below their trust value. These discounts to trust value increased meaningfully, reaching as much as 5.5% on average according to recent manager discussions. These managers also rely on SPACs' more limited downside as investors can eventually redeem their holdings for cash proceeds.

Multi-strategy

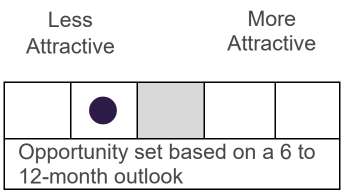
Multi-strategy funds, which often incorporate relative value strategies among others, were able to navigate the choppy market environment in H1 due to their diverse strategy mix and risk management focus. Several sub-strategies, including systematic macro, global macro and CTAs, benefited from prominent market moves driven by consequential economic and policy pivots, such as rising inflation, rising interest rates, and a stronger dollar.

Q3 so far

In the first two months of Q3, the portfolios of relative value managers and multi-strategy managers held up soundly in the face of further market uncertainties. Manager performances through August were generally flat to positive as broader markets swung up and down. Notably, convertible arbitrage rebounded from Q2 lows with the HFRI RV: Fixed Income-Convertible Arbitrage Index up 2.5% in the first two months of Q3.

Outlook

With heightened market volatility likely to persist in the near term, investment approaches of relative value and multi-strategy funds have distinct advantages. Therefore, we maintain a neutral view of relative value, balancing against elevated market risks. We are incrementally more constructive on multi-strategy as this approach benefits from a more diverse set of sub-strategies and with active risk management measures to stem potential losses.



Event-driven & credit

First half performance

Event-driven and credit strategies encountered difficulty in the first half of 2022 as the more acute equity and fixed income volatility in the second quarter impacted strategies dependent upon more directional equity special situations, credit and, to a lesser degree, merger arbitrage.

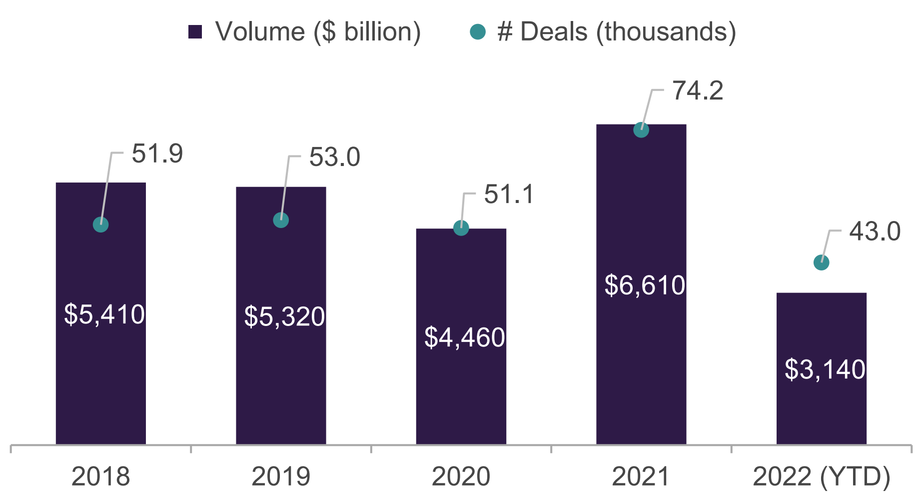
Merger arbitrage

Merger arbitrage generally helped mitigate the level of losses for event driven strategies in the first two quarters of 2022. Indeed, the environment for merger arbitrage proved reasonably constructive during the first quarter as several larger, more profitable deals were consummated and overall spread tightening helped buoy returns for the segment. In specific terms, the HFRI Merger Arbitrage index registered a gain of 1.3% for the first three months of the year.

However, during the second quarter, equity market declines and fixed income volatility assumed prominence as a combination of higher inflation readings, rate increases, and the war in Ukraine roiled global markets. Merger arbitrage performance declined by 3.1% in this three-month period. Although deal volume declined in the second half, merger activity kept reasonably close to historic averages. In general, strategic deals fell but the slack was taken up by financial buyers: private equity activity buyers grew to account for approximately half of all deals done in the second quarter of 2022. Technology deals predominated, amounting to more than two times the dollar volume of financials, industrials and real estate combined.

However, spread volatility was a notable aspect of the second quarter environment. According to one merger arbitrage focused manager, the average merger spread for domestic deals had widened from around 10% annualized at the beginning of 2022 to 15% in the May and June period.

Global M&A volumes healthy despite headwinds



Data source: Bloomberg. YTD through August 16, 2022.

Credit arbitrage

Credit arbitrage strategies unsurprisingly fared better in one of the more difficult half year periods for credit markets in recent history. Credit spreads widened significantly in the second quarter relative to the first. While the HFRI Credit Arbitrage Index fell a comparatively modest 5.0% for the 1H 2022, the BofAML global high yield and corporate investment grade indices declined 16.7% and 14.4% respectively. In terms of issuance, it is notable that high yield bonds had their lowest single quarter since the Global Financial Crisis. By contrast, the percentage of defaults increased during the first half of 2022. More specifically, the number of distressed high yield issuers with bond spreads greater than a thousand basis points has grown from below 100 in January to approximately 260 currently. However, the overall default rate for global high yield issuers was at 1.4% on a trailing 12 month basis through June of 2022 and is expected to rise to 3.8% (on a trailing basis) through June of 2023 according to S&P Global. Several hedge fund managers observed that the distressed companies poised for restructuring tended to represent lower-quality corporate assets and remained broadly unattractive from a "value" perspective.

Assuming continued higher than average equity and fixed income volatility, the anticipated opportunity set and return profile for event-driven strategies is likely less promising than relative value and global macro strategies. However, the outlook for event-driven strategies is defined by, in historical terms, a still reasonably constructive deal environment and a growing and more encouraging medium- to longer-term opportunity in credit. The more volatile market environment and greater regulatory deal scrutiny has marginally dampened the pace for mergers. But the significant volume of "dry powder" possessed by the Private Equity industry (approximately $2.4 trillion according to Citigroup) continues to provide an important offset and has helped maintain deal volume at a lower but still historically meaningful level.

Most managers continue to be more constructive about the growing opportunity in credit. The increase in spreads points to greater discrimination in the pricing of credit risk and the recently higher trajectory for high yield defaults creates the underpinnings of a more pronounced distressed cycle. In the meantime, several managers have highlighted a more promising near-term profit potential provided by, for example, a higher number of rescue financings for distressed borrowers.

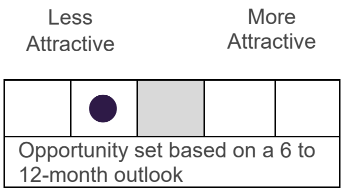
Q3 so far

Merger arbitrage performance since the start of Q3 has retraced losses experienced through June. The HFRI Merger Arbitrage index gained 2.3% and 0.9% in July and August, respectively. As for credit, markets got a temporary reprieve in July as Fed rhetoric was perceived as being less hawkish. However, this was short-lived as inflation dynamics surrounding the pace of interest rate increases drove spreads wider and markets lower once again. After failing to capture meaningful upside in July, credit arbitrage strategies generated strong alpha in August, up 0.4% and 1.8%, respectively.

Outlook

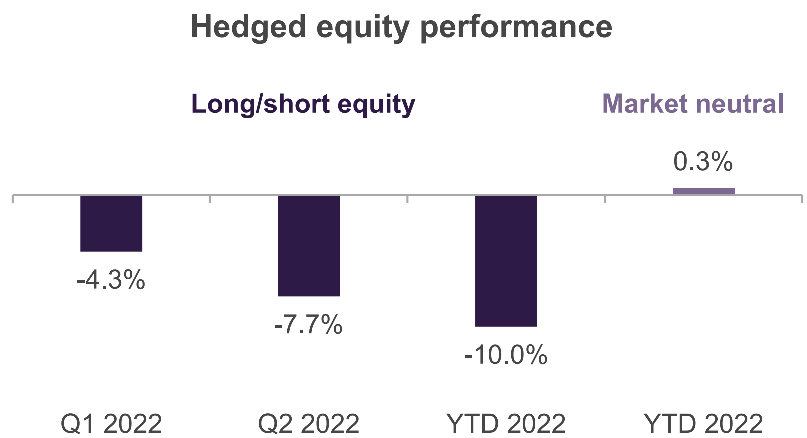
The opportunities for event-driven and credit strategies should continue to be robust. The fundamentals supporting deal activity remain in place, and so long as deals continue to close, unrealized losses should ultimately turn into realized gains for the strategy. Also, many managers have become more constructive about the growing opportunity in credit. The increase in spreads points to greater discrimination in the pricing of credit risk and the recently higher trajectory for high yield defaults creates the underpinnings of a more pronounced distressed cycle. In the meantime, several managers have recently highlighted a more promising near-term profit potential provided by, for example, a higher number of rescue financings for distressed borrowers.

Equity long/short



First half performance

The first half of 2022 has produced some of the more difficult performances for long/short in the past decade and an unusually wide dispersion in the overall character of the long/short equity results relative to prior periods.



Data source: eVestment. YTD data through August 2022.

The environment shifted significantly. The sharp increase in interest rates—illustrated by the 10-Year treasury climbing from 2.34% at the start of the second quarter to 3.48% yield in the middle of June—negatively impacted equity multiples. More speculative and smaller capitalization growth stocks were especially impacted. In broad terms, factor exposure and net market positioning were more important than stock picking for the majority of long/short manager results.

The overall effect on this large segment of the hedge fund universe was conspicuously negative performance on the long side (i.e. “negative long alpha”) and insufficient short profits to offset these declines. The impact proved more severe for dedicated long exposure to high growth, long duration and smaller cap tech and biotech issues.

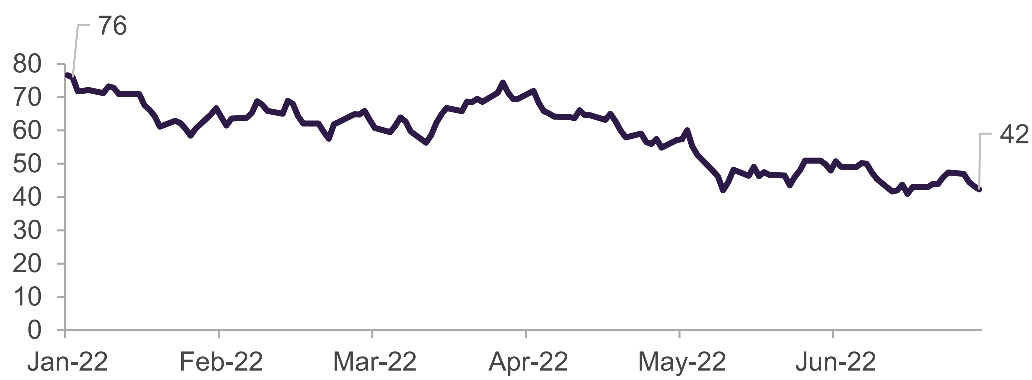
The growth/value performance differential proved significant: The gap between S&P 500 Value and Growth indices was approximately 16% in the first half of the year. Consequently, factor rotations and abrupt market reversals made the environment especially treacherous for long/short equity managers carrying growth equities, higher leverage and net market exposure more generally.

The magnitude of the market dynamics is more sharply illustrated by results of more speculative issues: The GS Profitless Tech index fell a precipitous 68% from its high in 4Q of 2021 to its low in 2Q 2022.

In reviewing industry results and after many anecdotal manager discussions, it is hard not to conclude that many managers who had profited substantially in 2020 with heavily growth-oriented books tended to “overstay” and kept, in hindsight, longer net exposure than warranted.

In the second quarter, short selling helped alleviate the consequences of losses due to long exposure. Moreover, according to many of our long/short practitioners, the environment for shorting stocks continues to be attractive. As one unusually experienced manager on our platform noted, the opportunity was shaping up as: “the best opportunity for short selling since the Global Financial Crisis”. Despite the dramatic valuation collapse in many more speculative tech and biotech names, our managers have tended to recycle their short capital into a broad number of still overvalued companies with inflation-induced margin pressure and thinning earnings prospects. In addition, although higher rates have altered the outlook for many companies and business models, higher rates (i.e. 2.25-2.50) have improved short rebates (i.e. interest paid by prime brokers to short-sellers) for hedge fund managers and are starting to add an important source of incremental return in a manner not seen since the ‘90s.

GS Liquid Most Short Index declined precipitously



Source: Goldman Sachs. Data through June 2022.

Q3 so far

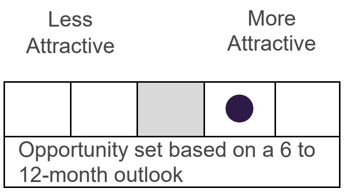
After a sharp decline in performance in Q2, long short rebounded some in the first two months of the third quarter. Oversold conditions and a slightly more positive sentiment toward recessionary conditions led to a lift in equities at the start of the quarter, which subsequently reversed course. Long short managers with more balanced portfolios were able to manage through the volatility while more direction portfolios experienced the swings coming from market beta.

Outlook

We remain more cautious on the prospects for long/short equity relative to the opportunity set for more trading- and tactically-oriented global macro and relative value strategies. Part of this is also based on an understanding of most long/short managers current positioning. In general terms, this group is showing a more cautious tone in its positioning: According to Morgan Stanley’s prime brokerage unit, overall gross and net exposure for the group is at lows not seen since the group began recording such data formally in 2015.

With a view toward this point, we favor long/short managers with the capacity to be nimble in positioning, diverse in their positions and comfortable managing more modest net market exposure overall. However, given the more limited number of hedged equity funds with this profile, we are less constructive on the broader category of long/short managers overall.

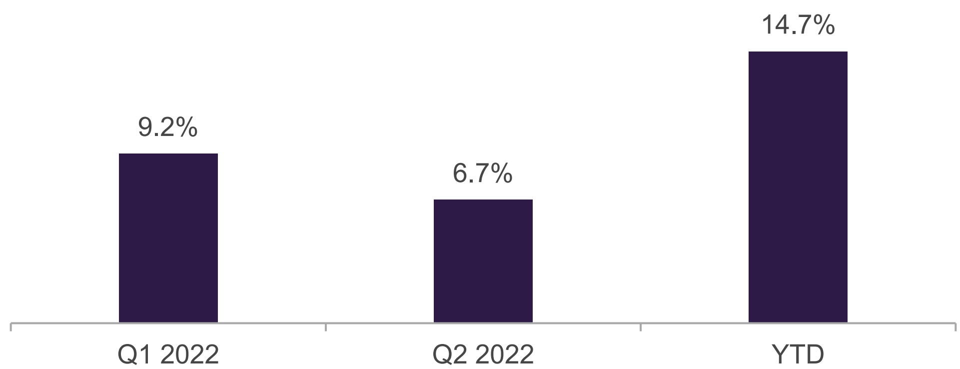
Managed futures



First half performance

Managed futures have performed well historically when global markets offer a broad number of sustainable trends in sufficient strength. Accordingly, the first half of 2022 proved an unusually fertile setting for the strategy with medium- and long-term trend followers posting almost exclusively strong gains—May was a modest exception—for the sixth month period. Systematic trading strategies generated material profits across many of the most liquid markets in commodities (e.g. energy), fixed income and currencies.

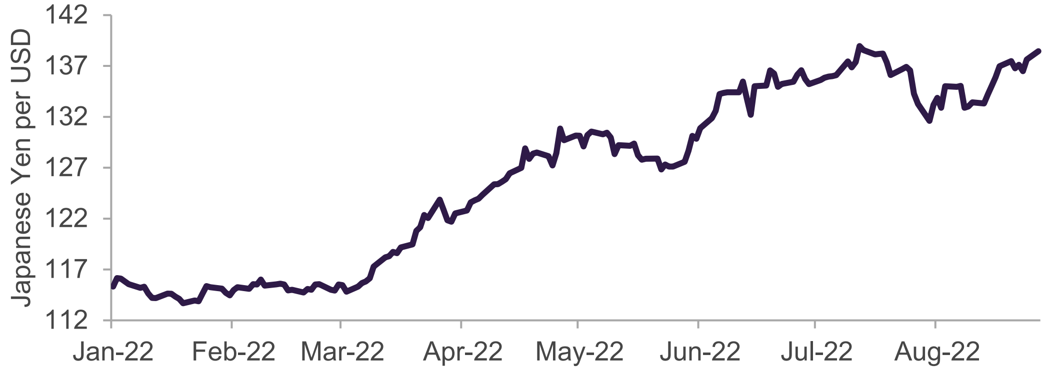
Managed futures performance in 2022



Data source: eVestment. Data through August 2022.

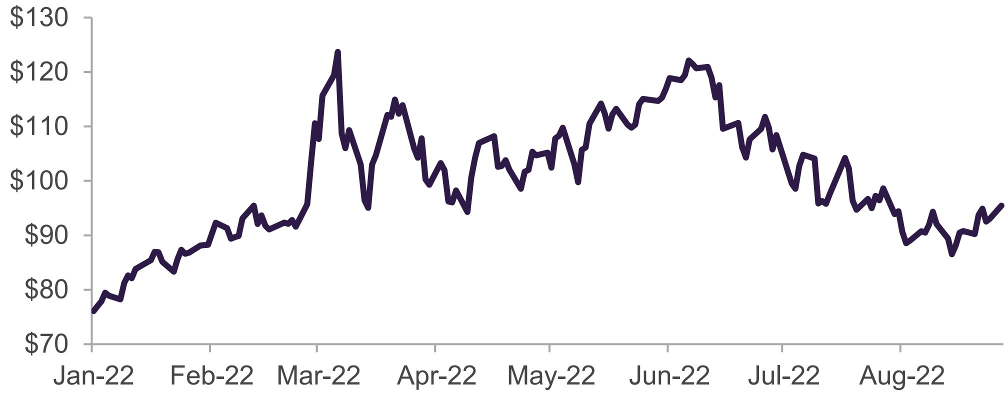
In the first quarter, energy (e.g. crude oil), bonds and major currencies generally produced the largest gains while whipsawing equities proved a somewhat isolated and limited source of loss. In the second quarter the largest gains derived from bonds, major currencies and energy while “soft” commodities (e.g. sugar, cotton, soybeans) detracted slightly. Overall, according to one managed futures fund manager, market trends began in “softs” and energy, and then slowly rotated to all markets and asset classes. The last of these were foreign currencies (FX) and the U.S. Dollar.

USD/JPY upward trend has been strong all year



Data Source: Bloomberg. Data through August 2022.

Crude oil also exhibits strong directionality



Sources: Bloomberg. Data through August 2022.

Q3 so far

More recently in July and August, CTA managers gave back a small portion of their prior gains, particularly in July. Losses were concentrated in fixed-income (i.e., European, Canadian and UK government bonds), energy markets such as gasoline and heating oil and, to a lesser extent, the "soft" commodities including wheat and coffee.

Outlook

In the context of a market environment in which volatility appears likely to persist, central bank activity remains heightened and larger liquid market trends are profuse, we maintain a constructive view on the medium term (i.e. 6-12 months) return potential for managed futures/systematic hedge fund strategies.

Index and term definitions

Indexes used in the benchmark returns chart on page 2 are as follows:

CTA/Managed Futures is represented by the BTOP50 Index.

Macro is represented by the HFRI Macro (Total) Index.

Event-driven is represented by the HFRI Event-Driven Index

Fixed Income is represented by the Bloomberg US Aggregate Index.

Hedge Equity is represented by the HFRI Equity Hedge (Total) Index.

Hedge Funds are represented by the HFRI Fund Weighted Composite Index.

Relative Value is represented by the HFRI RV: Multi-Strategy Index.

US IG Credit is represented by the Bloomberg US Corporate Investment Grade Index.

Global equities are represented by the MSCI All Country World Index.

US Equities represented by the S&P 500

Bloomberg US Aggregate Bond Index is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. In addition to investment grade corporate debt, the index tracks government debt, mortgage-backed securities (MBS) and asset-backed securities (ABS) to simulate the universe of investable bonds that meet certain criteria. In order to be included in the index, bonds must be of investment grade or higher, have an outstanding par value of at least $100 million and have at least one year until maturity.

Equity long/short strategies involve identifying stocks with the potential to perform well (the long portfolio) and those expected to do poorly (the short portfolio). These funds tend to actively manage market exposure by shifting the allocation between long and short investments over time, depending on stock selection opportunities and the manager's outlook for the specific equity or overall market. Sub-strategies in this sector tend to focus on use of net market exposure (low net, long-biased net or somewhere in between) or have a geographic focus such as U.S, Europe, Asia, or Emerging Markets.

Event-driven strategies involve investing in opportunities created by significant transactional events, such as spin-offs, mergers and acquisitions, bankruptcies, recapitalizations and share buybacks. Because there is substantial uncertainty concerning the outcome of transactions involving financially troubled companies or situations in which the managers may invest, there is a potential risk of loss by the managers of their entire investment in such companies. Sub-strategies include credit, merger arbitrage, and special situations and distressed.

GS Liquid Most Short Index a liquidity optimized index consisting of names in the Russell 3000 with over $1 billion market cap that have the highest percentage of short interest as measured by float. The basket is liquidity optimized and can trade $250mm per day with no name exceeding 10% of volume. Biotech as an industry is capped at 10% at the time of re-balance.

HFRI Fund Weighted Composite Index is a global, equal-weighted index of over 1,400 single-manager funds that report to HFR Database. Constituent funds report monthly net of all fees performance in US Dollar and have a minimum of $50 Million under management or a 12-month track record of active performance. The HFRI Fund Weighted Composite Index does not include Funds of Hedge Funds.

MSCI All Country World Index (ACWI) is a free-float adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 45 country indices comprising 24 developed and 21 emerging market country indices.

Relative value/multi-strategy funds tend to look for specific relative pricing anomalies while also maintaining minimal exposure to systematic market risk. This may be achieved by purchasing one security perceived to be undervalued, while selling short another security perceived to be overvalued. Sub-strategies include equity market neutral, convertible arbitrage, statistical arbitrage, and fixed income arbitrage. Some managers in this space are classified as multi-strategy as they tend to dynamically invest in various sub-strategies.

S&P 500 is a float-adjusted market-cap weighted index that's calculated by taking the sum of the adjusted market capitalization of all S&P 500 stocks (the 500 largest corporations by market capitalization listed on the New York Stock Exchange or Nasdaq Composite) and then dividing by an index divisor, which is a proprietary figure developed by Standard & Poor's.

Trading strategies are typically classified in the global macro sector of hedge fund strategies. These strategies require well-developed risk management procedures due to the frequent use of leverage. Managers using such strategies may include Commodity Trading Advisors that trade primarily futures, options on futures contracts, and foreign exchange contracts. This broad category also includes discretionary macro and systematic macro strategies. Discretionary strategies look to dynamically allocate capital to relatively short-term trading opportunities globally based on the portfolio management team's view of the market/asset class opportunities. Systematic macro strategies generally rely on quantitative trading systems or models to identify and capitalize on trends in financial and commodity markets. The trading models may be focused on technical or fundamental factors or a combination of both.

Disclosures

Hedge fund investing involves substantial risks and may not be suitable for all clients. Hedge funds are intended for sophisticated investors who can bear the economic risks involved. Hedge funds may engage in leveraging and speculative investment practices that may increase the risk of investment loss, can be illiquid, and are not required to provide periodic pricing or valuation information to investors. Hedge funds may involve complex tax structures, have delays in distributing tax information, are not subject to the same regulatory requirements as mutual funds and often charge higher fees. Past performance is not indicative of future returns. Any investment entails some, and often a significant, risk of loss. Any performance comparisons to any benchmark or index may not be a meaningful comparison. This is not a recommendation to buy or sell investments (including in any particular security or asset class) or to use any particular strategy

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An investment cannot be made directly into an index.

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