FROM THE DESK OF BOB CENTRELLA, CFA **October 7, 2020**

Q3-2020 REVIEW AND OUTLOOK LETTER

First, I hope you and your loved ones have been safe and healthy. It continues to be an upside-down world although we all seem to be adapting. Henry Kissinger once said, "There cannot be a crisis next week. My schedule is already full." I don't know but that seems to be what we've lived with these past 8 months. And as we move into month 8 since Covid-19 took hold, there are still many unknowns including who the next President will be. I don't think there is any way to say this other than, Covid sucks. It has completely changed our lives, taken lives and ruined businesses. On the positive side professional sports has stopped the replays and I don't have to relive any more games from the past. But as teams play to mostly empty arenas, I say it is strange but still good to see live action. I continue to thank the good lord for golf courses and the normalcy that it offers!

As we all know the President tested positive for Covid but has already come back to work. That uncertainty perhaps has been removed and although markets have been volatile since September, there is still hope some type of stimulus package can help near-term if today is any indication (Stocks up big.) Meanwhile, US stocks recorded a great quarter and are coming off the best 2 quarter performance since 2009. For the quarter the S&P rose 8.47% and traded near all-time highs again as September began. But you wouldn't think so after recording their worst September since 2011 with the S&P 500 dropping 3.92% in the month. Below is a list of asset classes and indexes and their price change for the quarter. Large caps outperformed mid and small as investors rode large cap tech stocks. As such, Growth outperformed Value again although the selloff in September was driven by profit-taking in these same tech stocks. Interestingly, YTD large Growth has outperformed large Value +20.66% to -11.50%! That's an incredible spread due largely to the weakness in Energy (YTD -19.25%) and Financial stocks (YTD -22.47%), while technology stocks (+29.85%) have zoomed. And how bout them Hogs!

Asset class	% Return Quarter	Asset Class	% Return Quarter
Lean Hogs	61.15%	DAX Germany	3.65
Nymex Nat Gas	44.32	High Yield Corp	2.79
Comex Silver	26.38	Nymex Crude Oil	2.42
Nasdaq 100	12.42	Yen Japan	2.37
SP500 Growth	11.80	Euro Stoxx	0.28
S&P 500	8.47	*Total Bond Index*	-.14
Shanghai Comp - China	7.82	MIB Italy	-1.86
Dow Jones	7.63	CAC-40 France	-2.69
Comex Gold	5.27	US Dollar Index	-3.15
SP500 Value	4.86	Hang Seng - Hong Kong	-3.96
Russell 2000	4.60	FTSE 100 UK	-4.92
S&P Midcap 400	4.38	IBEX 35 Spain	-7.12
Nikkei 225	4.02	SP 500 Energy	-20.86

ECONOMY

Final GDP for the 2nd quarter came in at -31.4% easily the worst quarter since the Great Depression. To put this in perspective, previously the worst quarter was in Q1-1958 following WW2 when GDP fell at a -10% rate.

Corporate profits fell -10.3% in Q2 and are down -19% in the past year. They are expected to be off -18% in 2020. Unemployment is improving but still a major problem. The unemployment rate just decreased to 7.9%, which is still an exceedingly high level but well below the peak of 14.7% in April. As a reminder, we were at 3.5% in February. After peaking in February, nonfarm payrolls plummeted by 22.2 million in March and April. In the past five months, payrolls have grown 11.4 million, making up 52% of the jobs lost earlier in the year.

This is all rear-view mirror stuff and GDP is anticipated to grow around 25-30% in Q3 which would then be the fastest rate since WW2. Still, a full economic recovery is a long way off and can't occur without a vaccine for all Americans. Many sectors remain shut down or only partially open. Any more robust recovery involves reopening. Another fiscal stimulus can help for a short while but is not a solution in itself. So, states must consider pushing through to reopen in a responsible manner. Per a well-known economist: "Recently, Florida (7.4% unemployment) and Indiana (6.4%) have fully opened their economies. These states, among many others, had lower unemployment than the national average, mainly because their shutdowns were less draconian. The competition between states that open and those that don't – at the political, business, sports, school, and even family level – will lead to even more opening of the economy in the months ahead. For a self-sustaining recovery to fully catch hold, it is reopening, not additional stimulus, that is the key". And of course, a vaccine is the real key but that may be a 2021 solution.

STOCKS, BONDS AND OTHER ASSETS

October brings 3rd quarter earnings reporting over the next month. Last quarter stocks rallied through earnings in July as companies widely beat expectations. Q3 earnings are expected to decline 21% on a 3.6% drop in revenues, the biggest eps decline since Q2-2009. It's likely we will see better earnings than that but still a decline in the high teens is probable. Last quarter earnings dropped 18%, yet we still rallied. Better than expected earnings could again bring an increase in stock prices but that little thing called the presidential election looms in the background and companies may be cautious in their guidance given Covid uncertainty.

As we move closer to the election it is interesting to look at how assets have performed since the prior election. Below is a an asset class performance matrix highlighting the total return of key ETFs over three time frames: (1) since Election Day 2016 (11/8/16), (2) since Trump took office on 1/20/17, and (3) since the first US case of Covid was confirmed (1/20/20). Large growth has dominated in all 3 categories as has the US market in general due to technology and consumer stocks. The Nasdaq 100 has been by far the best performing US index this Presidential Election Cycle. Since Election Day 2016, QQQ is up 146%, while the S&P 500 is up 70.7% and the Russell 2,000 is up 38.5%. Looking at US sectors, Technology and Consumer Discretionary are both up 100%+ since Election Day 2016, while the Energy sector is down 48%. The Financial sector has been the second worst performer under Trump with a gain of 33.9%.

International equity market returns (on a dollar adjusted basis) have been much weaker than the US since Trump's victory. Country returns since Election Day 2016 range from double-digit percentage declines for Brazil and Mexico to a 45.4% gain for China . China's gain, however, is still 25 percentage points worse than the S&P 500.

What may be more notable are equity market returns since COVID began. Since the first US case of COVID was confirmed on January 20th, the S&P 500 has still managed to post a 3.4% gain. This after going through a bear market decline (over -20%) which occurred in only 23 days in Feb. and March. The Nasdaq 100 is up a remarkable 25.3% during the pandemic, while the small-cap Russell 2,000 is down 6.8%. Value stocks have gotten hit hard during COVID, while growth has outperformed. The commodities of Oil and Natural Gas have been the biggest losers as energy companies, airlines, and cruise ships have come to a halt due to Covid. Meanwhile Gold and Silver along with longer dated Treasury Bonds have been solid performers since Covid as safe harbor assets for investors.

Bespoke's Asset Class Performance Matrix: Key ETF Total Returns (%)

US Related

ETF	Description	Since 1st US Covid Case	Since Trump Inaug.	Since '16 Election Day
SPY	S&P 500	3.43	60.28	70.74
DIA	Dow 30	-2.73	53.78	67.01
QQQ	Nasdaq 100	25.31	133.06	146.00
IJH	S&P Midcap 400	-6.65	22.37	35.92
IJR	S&P Smallcap 600	-13.22	13.68	30.09
IWB	Russell 1000	4.28	60.57	71.55
IWM	Russell 2000	-6.75	21.92	38.45
IWV	Russell 3000	3.54	57.36	68.88
IVW	S&P 500 Growth	15.63	96.43	105.44
IJK	Midcap 400 Growth	2.30	39.29	52.34
IJT	Smallcap 600 Growth	-7.85	27.19	45.06
IVE	S&P 500 Value	-11.30	23.38	33.66
IJJ	Midcap 400 Value	-16.62	3.67	16.59
IJS	Smallcap 600 Value	-19.27	-0.88	13.62
DVY	DJ Dividend	-18.82	8.52	15.75
RSP	S&P 500 Equalweight	-4.88	34.97	44.88
FXB	British Pound	-0.55	4.05	3.91
FXE	Euro	5.55	6.82	3.59
FXY	Yen	3.77	6.27	-2.51
XLY	Cons Disc	17.91	86.96	100.26
XLP	Cons Stap	2.89	35.70	36.39
XLE	Energy	-46.57	-51.85	-47.95
XLF	Financials	-18.74	15.10	33.90
XLV	Health Care	2.88	62.39	66.61
XLI	Industrials	-5.21	33.73	46.64
XLB	Materials	7.26	36.10	48.10
XLK	Technology	21.32	146.95	160.55
XLC	Comm Services	6.19	-	-
XLU	Utilities	-5.54	42.86	42.67

Global

ETF	Description	Since 1st US Covid Case	Since Trump Inaug.	Since '16 Election Day
EWA	Australia	-12.93	11.02	17.35
EWZ	Brazil	-39.81	-17.08	-17.95
EWC	Canada	-7.78	12.48	19.95
ASHR	China	14.21	46.17	45.39
EWQ	France	-13.00	22.39	28.93
EWG	Germany	0.25	17.83	25.55
EWH	Hong Kong	-11.64	20.59	18.51
PIN	India	-0.27	33.34	32.40
EWI	Italy	-16.41	12.74	25.86
EWJ	Japan	-0.18	24.10	27.27
EWW	Mexico	-29.12	-14.16	-30.35
EWP	Spain	-21.85	-8.30	-5.87
RSX	Russia	-21.23	15.09	34.46
EWU	UK	-22.72	-3.87	1.22
EFA	EAFE	-6.93	20.64	25.88
EEM	Emerging Mkts	-3.45	31.40	29.19
IOO	Global 100	2.81	57.86	66.25
BKF	BRIC	-0.56	47.57	46.81
DBC	Commodities	-17.09	-15.20	-8.69
USO	Oil	-71.55	-69.20	-65.27
UNG	Nat. Gas	-22.12	-62.41	-56.84
GLD	Gold	22.64	56.25	47.78
SLV	Silver	34.78	40.03	30.29
SHY	1-3 Yr Treasuries	2.81	8.29	7.90
IEF	7-10 Yr Treasuries	9.82	24.08	18.96
TLT	20+ Yr Treasuries	17.39	45.62	34.88
AGG	Aggregate Bond	5.86	19.70	17.12
BND	Total Bond Market	6.00	20.01	17.49
TIP	T.I.P.S.	8.40	19.13	17.41

As you look at the S&P 500 performance this year it continues to be driven by the FAANG-M stocks I mentioned last quarter (Facebook, Apple, Amazon, Netflix, Google & Microsoft). These stocks drive the Nasdaq which has had a great year, and comprise almost one quarter (23%) of the S&P 500. To explain – the total return of the S&P 500 YTD is 5.54%. The returns of this group (+45% on average) have accounted for 10.4% of the returns in the S&P 500. <u>That means that the other 494 stocks in the S&P 500 have decreased -4.86% YTD</u>. In comparison, following are returns YTD of common asset classes used in building a diversified portfolio.

<u>**YTD %**</u>
5.54%   S&P 500
-8.59% Russell 2000 Small Cap
-8.75& S&P 400 Midcap
-5.26% MSCI Rest of World
6.70% Barclays Bond Agg

So aside from the FAANG-M stocks, many asset categories are underwater and still working their way back to just breakeven for the year. <u>A typical allocated combination of these assets this year would provide about a 2% to 4% return YTD depending on the allocations for a 65%Equity/35% Bond portfolio. This is more in line with a moderate diversified investment portfolio return.</u> The market this year has bifurcated due to Covid to the *haves* and *have-nots*. The FAANG-M stocks, many technology companies and others actually *have* benefitted from the pandemic as their services are much in need. But more companies have not and are hurting and still trying to claw back. As states and the economy continue onto the path to reopen, the have-nots are likely to be the bigger beneficiary. Therefore, in constructing portfolios I still believe you need to have both and should continue to build the exposure to cyclical companies that are in the *have-not* category while continuing to own the *haves* to balance things out.

On the bond front, bond yields have remained in a trading range and the yield curve is positively sloping, although in a tight band. The Fed has indicated it has no intention of raising rates and will continue to provide as much liquidity as it can. So, with rates likely remaining flat finding yield is at a premium. I favor using a combination of medium-term bonds, ETF funds, convertible bonds and preferred stock to generate yield.

CONCLUSION
With the election looming and no vaccine likely for the near-term, market volatility is bound to occur based on the news flow. Markets are starting to adapt to a possible Biden presidency and what that means as he has a big lead in polls. If a possible Biden presidency means higher taxes, more government and regulation, and more government spending, then it will have different repercussions than what we've experienced the last 4 years. We won't know until it happens, but it seems on the face the initial reaction of stocks is likely to be down as the policies are digested and debated. In time, the market will adjust as it always does and there will lie opportunity. For now, I still prefer US Stocks and fixed income securities. On a sector basis I prefer technology, consumer, services, healthcare, industrials and some basic materials. For equities, exposure to both the *haves* and *have-nots* is a good approach. I do want limited exposure to international stocks and like gold as a hedge and store of value.

Stay safe and healthy and let's touch base in the coming months.

Bob