Market Review and Outlook
September 30, 2020

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Market Environment
September 30, 2020

- **Economic**
  - As it turns out, the economic recovery letter is a capital K, with some economic sectors growth accelerating and some deteriorating.
    - Economic growth was driven by companies and sectors that support work from home, E commerce and housing while new lines of business were created out of the pandemic. Companies that executed an E commerce strategy succeeded.
    - Those sectors and companies that were not prepared to deliver goods and services via an electronic platform continue to falter, as well as sectors that continue to be locked out of resuming business due to the nature of the pandemic keeping people away.
  - Excessive monetary and fiscal stimulus provided cashflow to those who needed it to survive and those who did not, providing support for credit and boosting consumption including technology, homes, and autos.
  - The equity market is reflecting the K recovery with those companies in the strong sectors performing well while the sectors still operating at a low level of activity still suffering.
  - The initial recovery period may have passed as economic activity, such as employment, has moderated and stimulus expired.
- **Policy**
  - The Fed will hold interest rates near zero for the foreseeable future. Low rates have spurred home and auto purchases and significant debt refinancing by individuals and corporations. Record corporate debt has been issued.
  - Checks cut to individuals, extra unemployment payments being made, PPP rolled out–completed and expired..
  - Additional stimulus unlikely until after election, at least, given current standoff between house bill at 3.5 trillion, Senate at 500 billion, and administration at 1.5 Trillion – Market hopes and expectations are for significant additional stimulus.
  - US Treasury issuing over $3 trillion in new debt this year, $314 billion notes and bonds in August alone.
  - Tensions with China continue to escalate as status of trade agreement is evaluated.
  - Election talk, and concern, heating up but market seems unconcerned.
- **Markets**
  - Equity market indices, led by growth (Tech) and large cap reached new records. Valuations are at extreme levels, NASDAQ saw 10% correction from highs in September as stimulus hopes faded along with moderating economic data.
  - FAANG + Microsoft, made up more than 25% of S&P 500 driving index gains. Current index composition different than February.
  - Banks, Energy, Utilities, Industrials recovering but still down significantly year to date while Technology accelerated.
  - Interest rates steady, yield curve steepening incrementally with significant supply on the horizon. TIPS break even inflation rate is rising.
  - Corporate bonds recovered significantly amid investor quest for yield despite record supply.

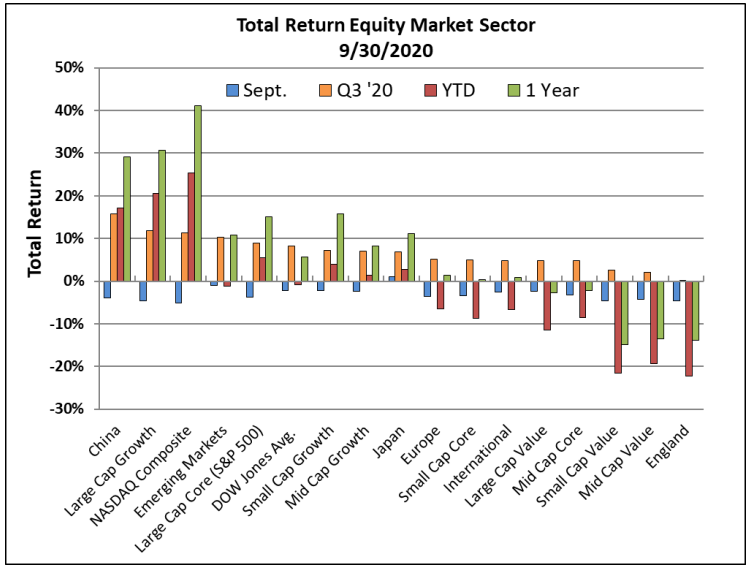
Market Outlook for 2020
September 30

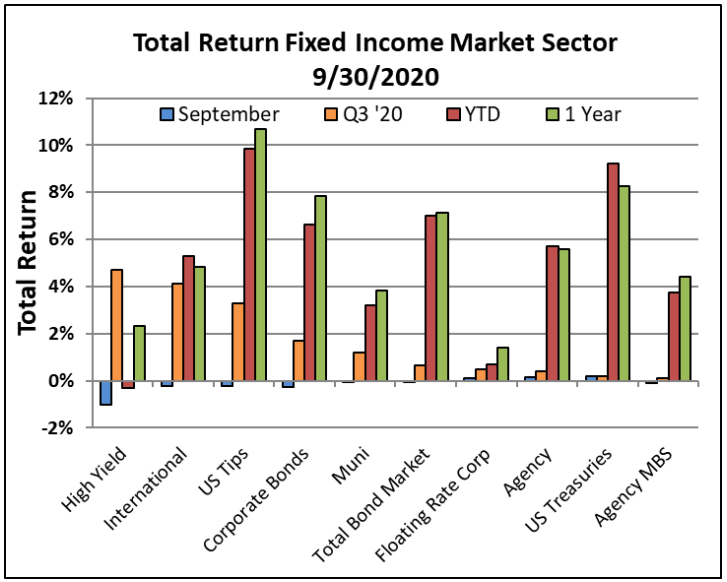
- The COVID 19 pandemic has accelerated some previously evolving social, economic, and market themes in the technology and e-commerce sectors. New opportunities are in the industrial sector as supply chains shift onshore, and manufacturing and infrastructure investment increase. Other sectors such as travel, hospitality and entertainment remain challenged.
- FAANG+Microsoft valuations continue to soar as beneficiaries of the environment, and make up significant representation in major market indices. We will need the rest of the economy to pick up in order to support these extended valuations, or these valuations will need to contract to come inline with the rest of the equity markets.
- New Infrastructure firms have potential to continue to outperform as a new corporate landscape develops. This includes: Technology equipment and remote communications, medical devices and diagnostics, Consumer staples, Industrial services for onshoring US manufacturing, Cashless transactions, movement and storage of data, hardware, software, cloud.
- Within equity markets, these "Growth" sectors should continue to provide strong returns, while many underperforming sectors such as Banking and industrials should recover, while Utilities should remain steady and provide income.
- Given unprecedented Fed action bringing rates to 0% and unlimited asset purchases, short term interest rates will remain low, near zero, and the yield curve will steepen due to massive new debt issuance.
- Within Fixed Income, additional price gains will be limited and may be at risk of a rise in longer term rates. Despite record new issuance, corporate bonds are an attractive sector given higher yields and still strong corporate balance sheets in some sectors, while significant risks remain in others. Mortgages are subject to significant prepayment risk.
- A Growth and Income strategy will focus on income as a driving source of return via bond income and equity dividends, and continue its allocation toward the technology sector, and the evolution of technology as it applies to consumer behavior, industry, health care, and the economy as a whole.

Market Review

September 30, 2020

- As Q3 2020 ended, markets slumped, including a 10% correction in the Nasdaq, as hopes of additional stimulus faded coming into the election, and COVID-19 flared up globally, bringing back shutdowns.
- Equity markets rose for the quarter led by "growth" stocks and still dominated by the FAANG + Microsoft, but included China and emerging markets as China leads in economic recovery.
- Interest rates remained stable at extremely low levels, providing flat returns in treasuries. Risk premiums on Corporate bonds tightened for the quarter, providing for strong returns, but gave back some of that in September as riskier assets faded. TIPS performed well for the quarter as inflations expectations continue to increase. MBS suffered from prepayment risk.





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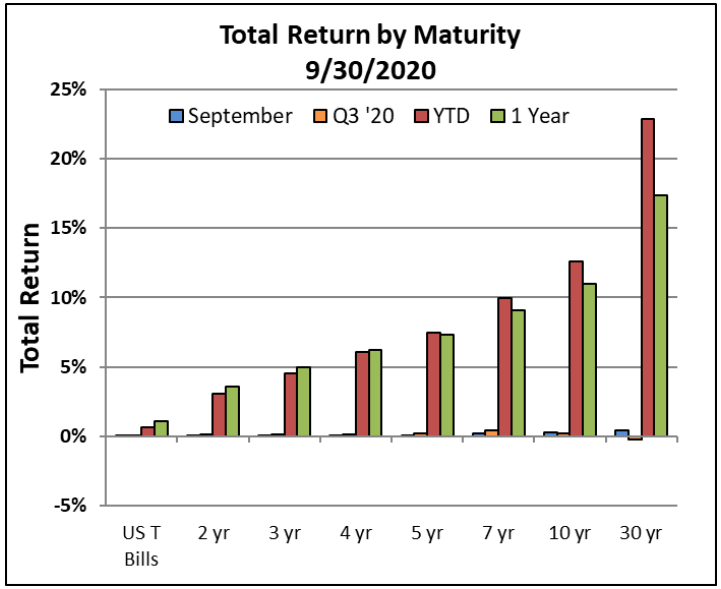
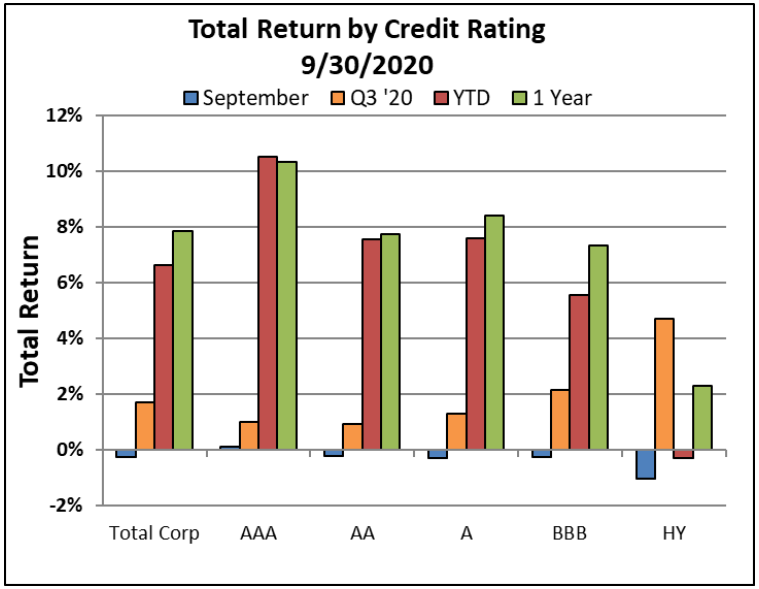
Market Review

Yield Curve and Credit Rating Returns – September 30, 2020

- Total returns on Treasuries in Q3 was close to zero as interest rates remained at extremely low levels due to Fed holding short rates at zero while buying Treasury, Mortgage, and Corporate bonds.
- For the quarter, lower rated credit securities lead the way as the quest for income dominated capital flows. This trend slightly reversed in September amid a selloff in risk assets coming into Q-end.
- Longer duration and maturity securities have retained their significant performance for the year given the drop in rates in the first half, including higher quality credits that tend to be longer term.
- Longer term securities may be vulnerable if rates rise amid massive issuance and rising inflation.





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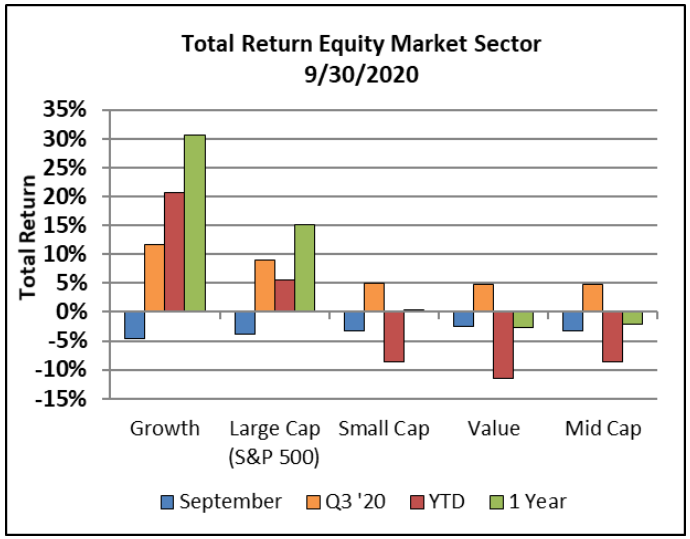
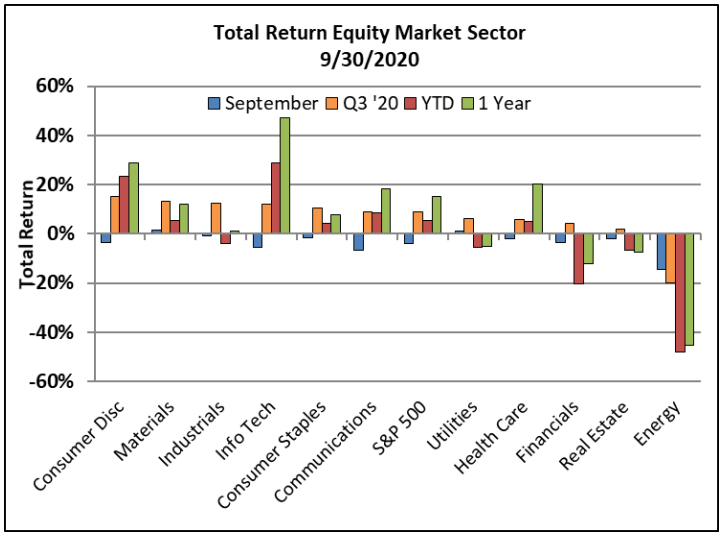
Market Review

Equity Market Returns – September 30, 2020

- Ultra easy monetary policy and extreme fiscal stimulus helped propel US stocks to record highs. During September stocks fell amid moderating economic activity and expiration of stimulus.
- Growth stocks continue to lead 2020, however gave back some of these gains in September as defensive sectors out preformed.
- The economic recovery in a number of sectors such technology and e-commerce type consumption has helped drive returns in those sectors in Q3, particularly in larger companies.
- Economic uncertainties surrounding future use of oil continued to weigh on the sector
- Industrials and Materials put in a relatively good performance during Q3 after dragging most of the year.





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Market Scoreboard
September 30th, 2020

Market Summary - September 30th, 2020					
Bond Market	**Sept.**	**Q3 '20**	**YTD**	**1 Year**	**Yield**
High Yield Corporates	-1.0%	4.7%	-0.3%	2.3%	5.8%
International Bonds	-0.2%	4.1%	5.3%	4.8%	0.1%
US TIPS (Inflation Prot.)	-0.2%	3.3%	9.8%	10.7%	1.0%
Corporate Bonds	-0.3%	1.7%	6.6%	7.8%	2.1%
Merrill Muni Index	-0.1%	1.2%	3.2%	3.8%	1.7%
Total Bond Market	0.0%	0.7%	7.0%	7.1%	1.2%
Floating Rate Corp	0.1%	0.5%	0.7%	1.4%	0.5%
US Treasuries	0.2%	0.2%	9.2%	8.2%	0.5%
US MBS Index	-0.1%	0.1%	3.7%	4.4%	1.5%

Market Summary - September 30th, 2020					
Stock Market Indices	**Sept.**	**Q3 '20**	**YTD**	**1 Year**	**End Value**
NASDAQ Composite	-5.1%	11.2%	25.4%	41.1%	11,168
DOW Jones Avg.	-2.2%	8.2%	-0.9%	5.7%	27,782
Large Cap Core (S&P 500)	-3.8%	8.9%	5.6%	15.1%	3,363
Large Cap Growth	-4.7%	11.8%	20.6%	30.6%	2,334
Large Cap Value	-2.4%	4.8%	-11.5%	-2.7%	1,114
Mid Cap Core	-3.2%	4.8%	-8.6%	-2.2%	1,861
Mid Cap Growth	-2.4%	7.0%	1.4%	8.2%	972
Mid Cap Value	-4.3%	2.0%	-19.4%	-13.4%	541
Small Cap Core	-3.3%	4.9%	-8.7%	0.4%	1,508
Small Cap Growth	-2.1%	7.2%	3.9%	15.7%	8,043
Small Cap Value	-4.7%	2.6%	-21.5%	-14.9%	9,695
Europe	-3.6%	5.1%	-6.6%	1.4%	354
England	-4.6%	0.1%	-22.2%	-13.8%	5,866
Japan	1.0%	6.9%	2.8%	11.2%	23,185
China	-3.9%	15.7%	17.1%	29.2%	4,587
International	-2.6%	4.8%	-6.8%	0.9%	1,855
Emerging Markets	-1.0%	10.3%	-1.2%	10.8%	44
Commodities/Other	**Sept.**	**Q3 '20**	**YTD**	**1 Year**	**End Value**
Oil (WTI)	-6.2%	1.6%	-29.3%	-20.6%	40.2
Gold	-4.2%	5.9%	24.3%	28.1%	1,885.8
Dollar Index	1.9%	-3.6%	-2.6%	-5.5%	93.9

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Market Review

S&P 500 – September 30, 2020

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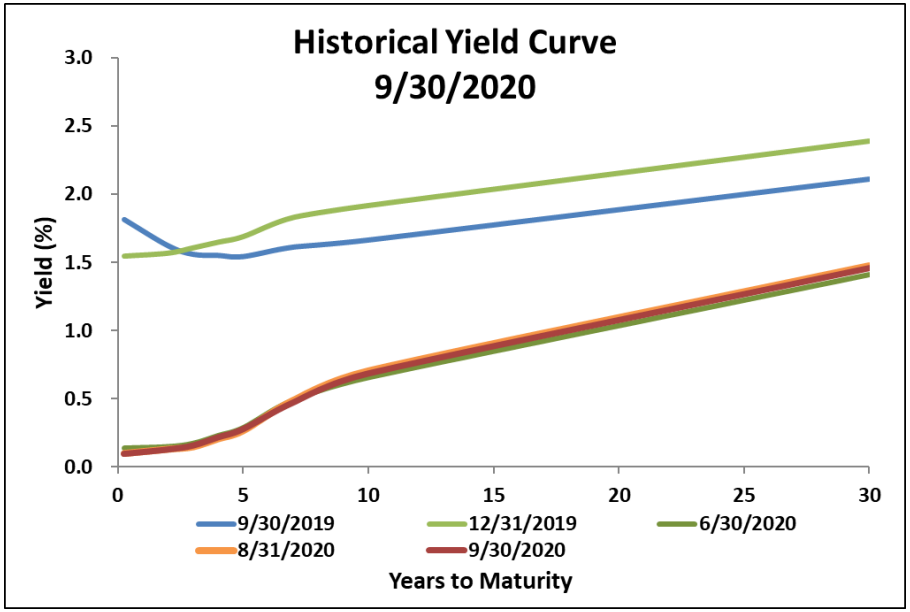
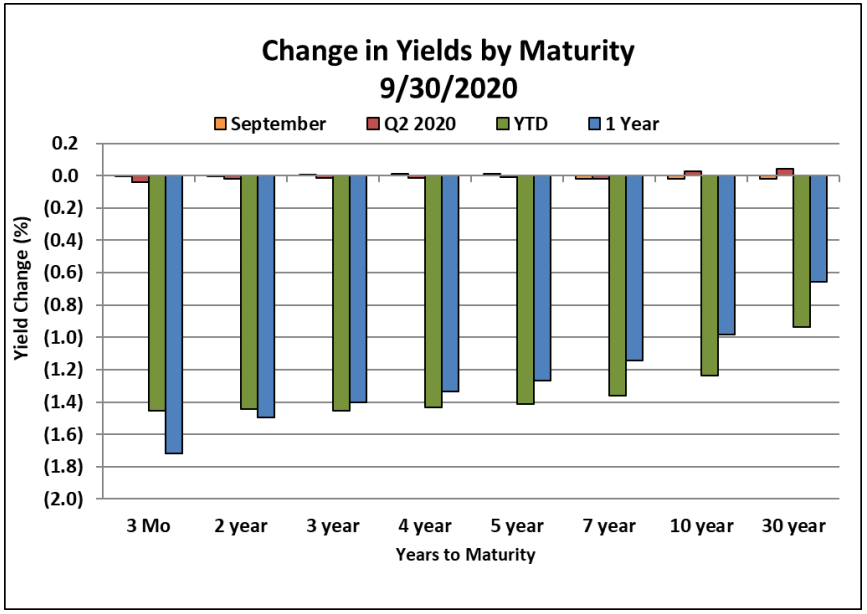
Market Review

Yield Curve – September 30, 2020

- Interest rates stabilized near their lowest levels in years as the Fed declared an accommodative policy stance including holding rates at zero for the foreseeable future and maintaining bond purchases.
- The yield curve steepened slightly with longer term rates rising more than short term rates, returning to a positive overall yield curve slope as bond issuance weighted on longer term maturities.





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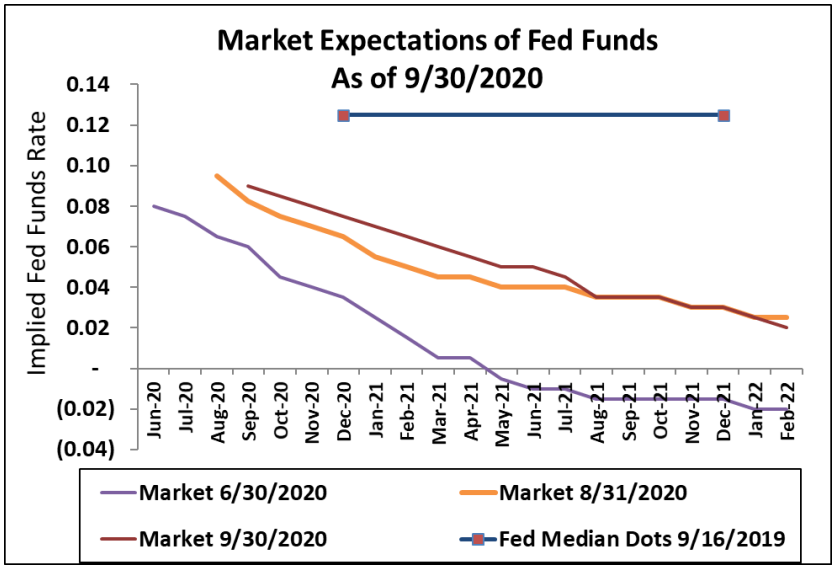
Market Review

Monetary Policy – September 2020

- The Fed brought rates to their "lower bound", continued purchases of Treasuries, Mortgages & Corporates (Both Investment Grade & High Yield)
- The Fed has suggested it will keep rates low for the foreseeable future in order to help the economy get past Covid-19 and eventually move back to their longer-term goals.
- Monetary policy will explicitly seek to let inflation run above targeted levels to achieve an average 2% over time.
- The Fed is chasing reality as they updated their economic projections.



Federal Reserve Median Economic Projections
As of 9/16/2020

	Actual	2020	2021	2022	2023	Longer Run
Change in GDP						
Sept. 2020 Projection		-3.7	4.0	3.0	2.5	1.9
June 2020 Projection		-6.5	5.0	3.5		1.8
Actual Q2 2020 yoy/qoq	**-31.4/-9.0**					
Unemployment Rate						
Sept. 2020 Projection		7.6	5.5	4.6	4.0	4.1
June 2020 Projection		9.3	6.5	5.5		4.1
Actual Q3 2020	**8.4%**					
PCE Inflation						
Sept. 2020 Projection		1.2	1.7	1.8	2.0	2.0
June 2020 Projection		0.8	1.6	1.7		2.0
Actual May 2020	**1.4%**					
Core PCE Inflation						
Sept. 2020 Projection		1.5	1.7	1.8	2.0	
June 2020 Projection		1.0	1.5	1.7		
Actual March 2019	**1.6%**					
Projected Policy Path- Fed Funds						
Sept. 2020 Projection	0.09	0.1	0.1	0.1	0.1	2.5
June 2020 Projection	0.08	0.1	0.1	0.1		2.5

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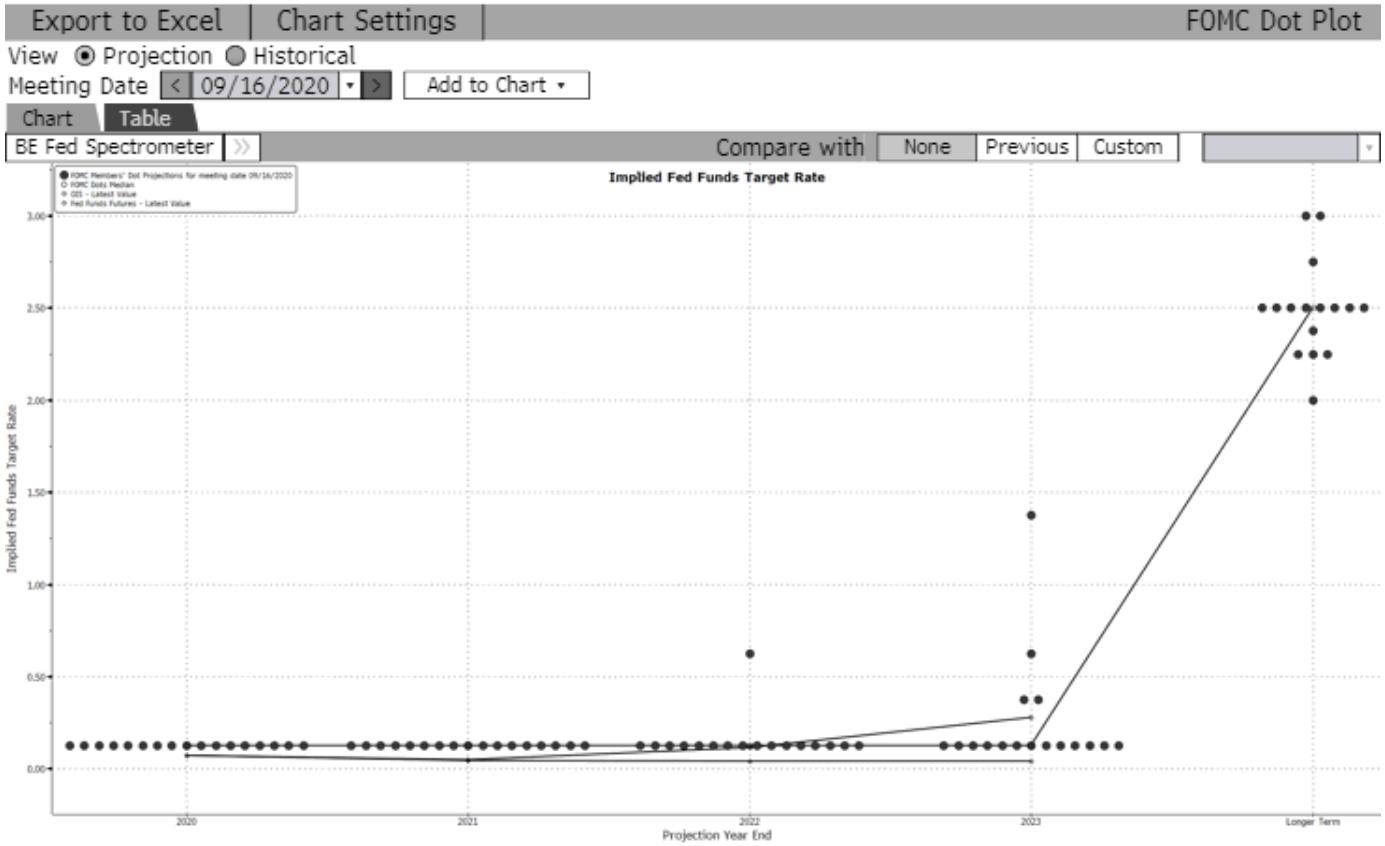
Market Review

Monetary Policy – September 2020

- The Fed Board has united in their decision to hold rates low, with only 1 dissenter out to 2022, but more varied longer term. It is likely this will change as economic conditions also change.



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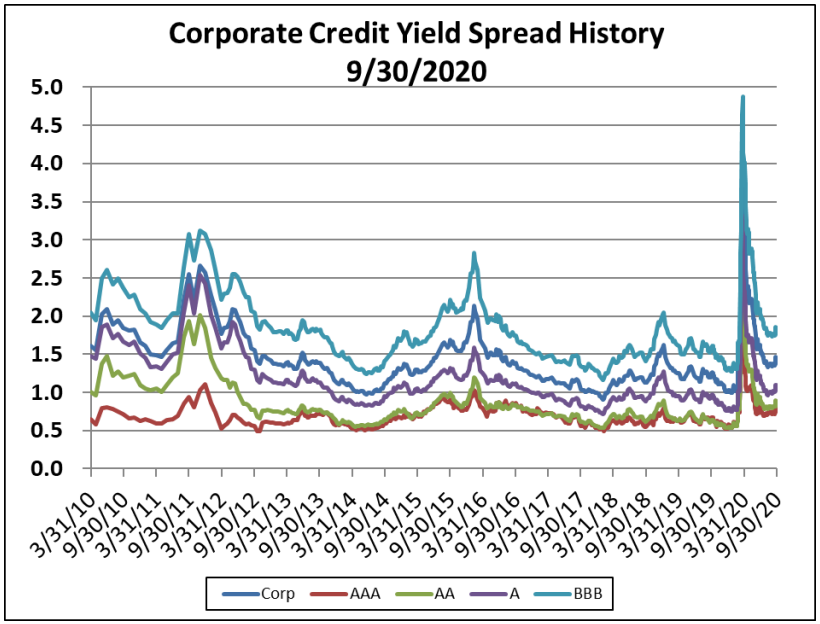
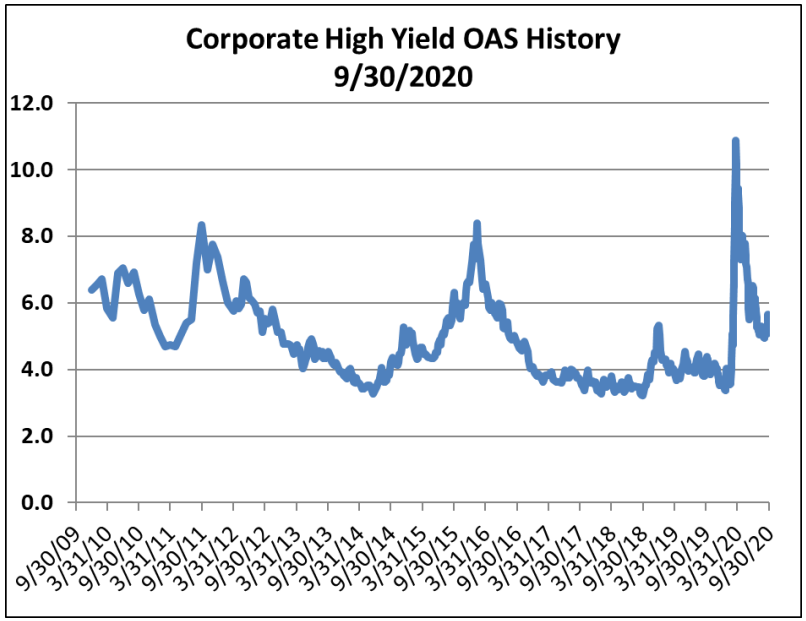
Market Review

Corporate Yield Spreads – September 2020

- Corporate yield spreads widened slightly during September as a broad market reduction in risk rattled the markets.
- Corporate credit conditions remain strong and risk of default has not risen to the degree that would continue push credit spreads wider. Spreads may continue to grind lower into 2021.
- Some stressed sectors such as energy, airlines, and hotels risk premiums remain wide.





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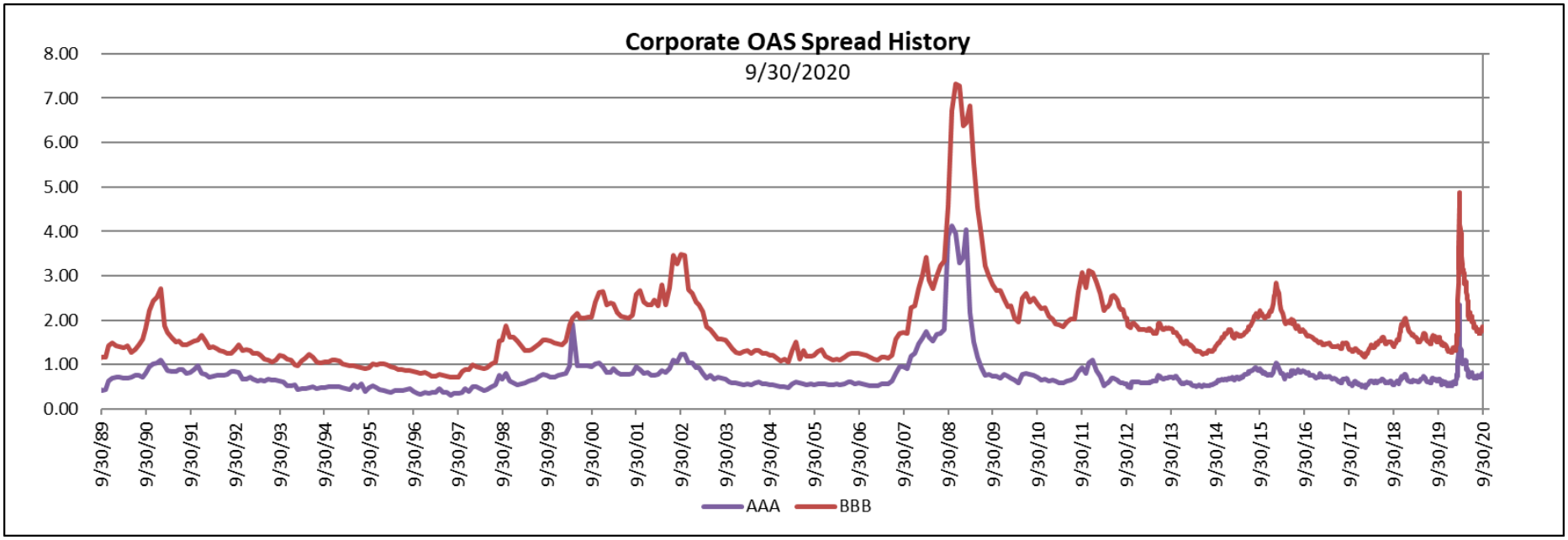
Market Review

Corporate Yield Spreads – September 2020

- When looking at corporate credit risk premiums on a longer term basis, spreads did not blow out as wide as the financial crisis, nor stay wide for as long as the '01 recession. Spreads still have room to tighten.



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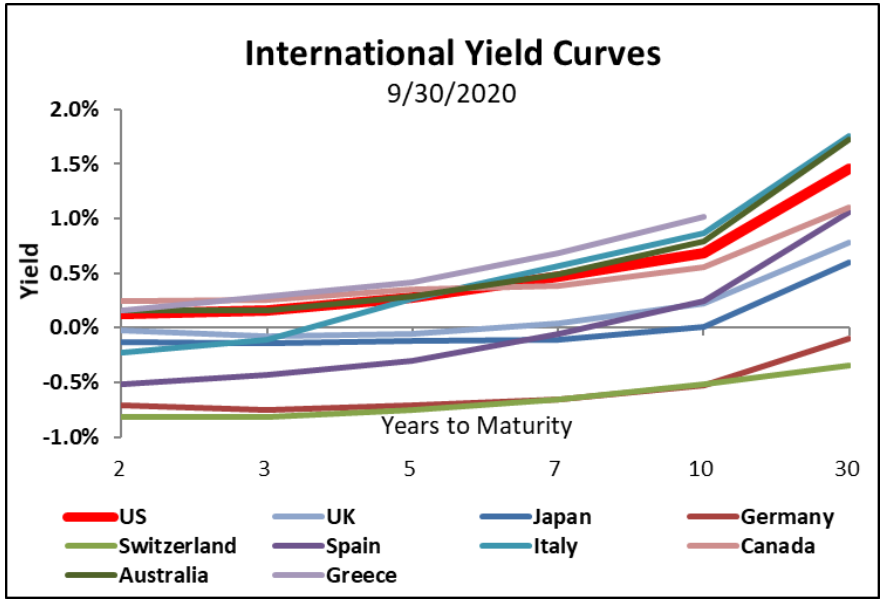
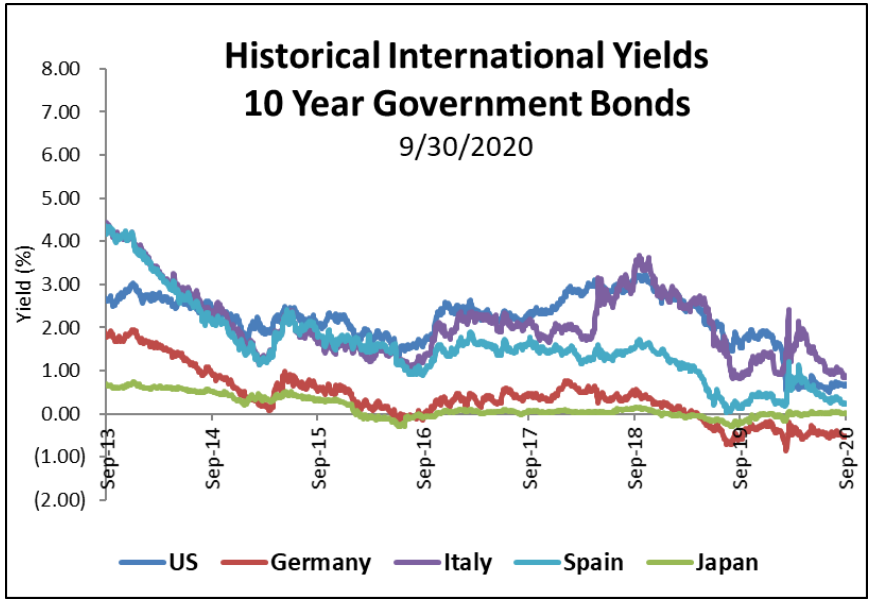
Market Review

International Yield Curves– September 2020

- Global central banks have begun to back off the notion of further push into negative rates territory, evidenced by comments by the new leader of the European Central Bank.
- The US continues as one of the highest yielding developed countries.





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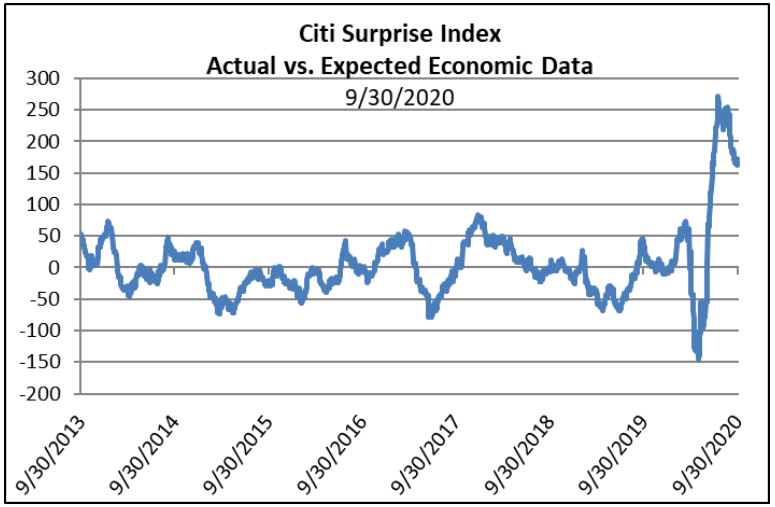
Economic Environment
September 2020

- Global GDP has fallen given the beginning of a contractionary period brought on by the pandemic.
- Inflation has migrated lower however expectations of future inflation have risen due to significant stimulus and the increased cost of doing business associated with new safety precautions as a result of the coronavirus.
- The Citi surprise index has come down from its highs as economic results begin to show actual market conditions have moderated after a faster recovery that expected.



GDP YoY % Change			
	Q2 2020	One Year Ago	Change
US	(9.00)	2.00	(11.00)
Eurozone	(14.70)	1.20	(15.90)
Germany	(11.30)	0.10	(11.40)
France	(18.90)	1.80	(20.70)
Italy	(17.98)	0.40	(18.38)
UK	(21.50)	1.30	(22.80)
Canada	(5.00)	1.60	(6.60)
Mexico	(18.68)	(1.15)	(17.53)
Australia	(6.30)	1.60	(7.90)
Japan	(9.90)	0.90	(10.80)
China	3.20	6.20	(3.00)
Russia	(8.00)	1.10	(9.10)
Brazil	(11.40)	1.08	(12.48)

*Canada GDP as of 7/31/2020

Inflation YoY % Change			
	Aug-20	One Year Ago	Change
US	1.30	1.70	(0.40)
Eurozone	(0.30)	0.80	(1.10)
Germany	(0.20)	1.20	(1.40)
France	0.10	0.90	(0.80)
Italy	(0.50)	0.30	(0.80)
UK	0.20	1.70	(1.50)
Canada	0.10	1.90	(1.80)
Mexico	4.05	3.16	0.89
Australia	(6.30)	1.60	(7.90)
Japan	0.20	0.30	(0.10)
China	2.40	2.80	(0.40)
Russia	3.70	4.00	(0.30)
Brazil	2.44	3.43	(0.99)

*Eurozone, & Russia CPI as of 9/30/2020
*Australia CPI as of 6/30/2020

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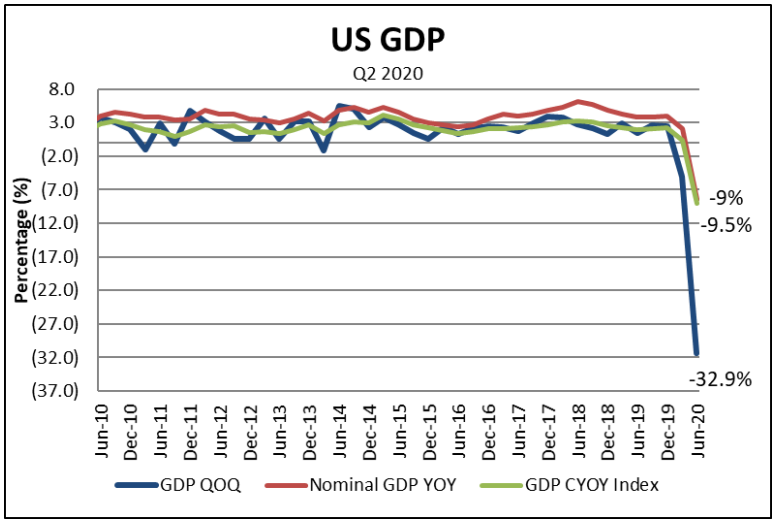
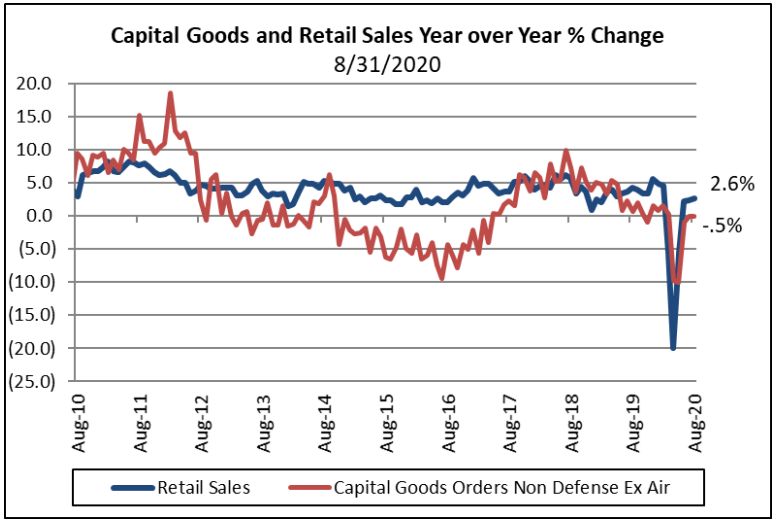
Economic Environment
September 2020

- Economic activity has contracted. It will be interesting to see how GDP results for Q3 are as we continue to deal with economic restrictions. Expectations are for a near full recovery.
- Consumption rebounded significantly due to excessive stimulus and purchasing necessary goods during the pandemic, but has since moderated as stimulus has expired and job gains have moderated.
- Investment has been industry dependent, with significant growth in remote communications technology, while oil production has been reduced dramatically. Manufacturing remains uneven due to extended uncertainties.





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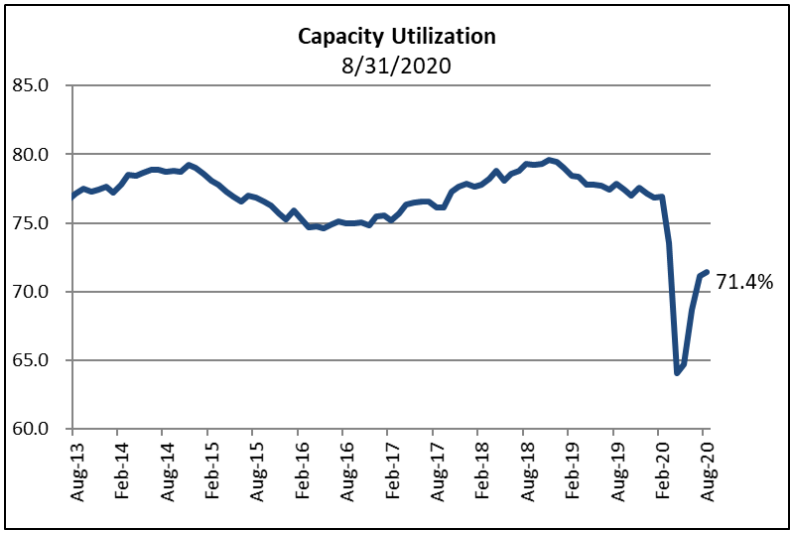
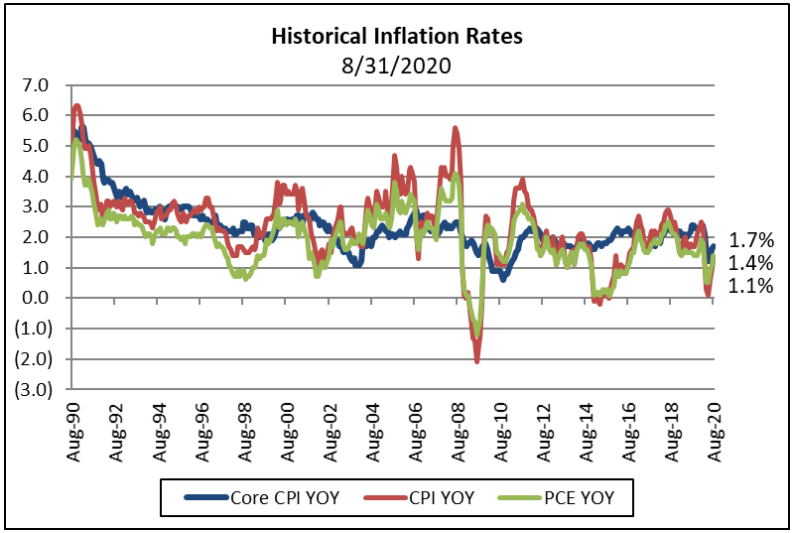
Economic Environment

Employment and Inflation – September 2020

- Inflation has rebounded amid the recovery and as the cost to produce goods and services continues to move higher.
- Future expectations of inflation have continued to increase as the realization of the increased costs associated with working, living, and operating in a post-pandemic world with increases health and safety measures.
- Employment has started to rebound as economies open, however this could remain volatile as many states and countries use different tactics to fight Covid-19.





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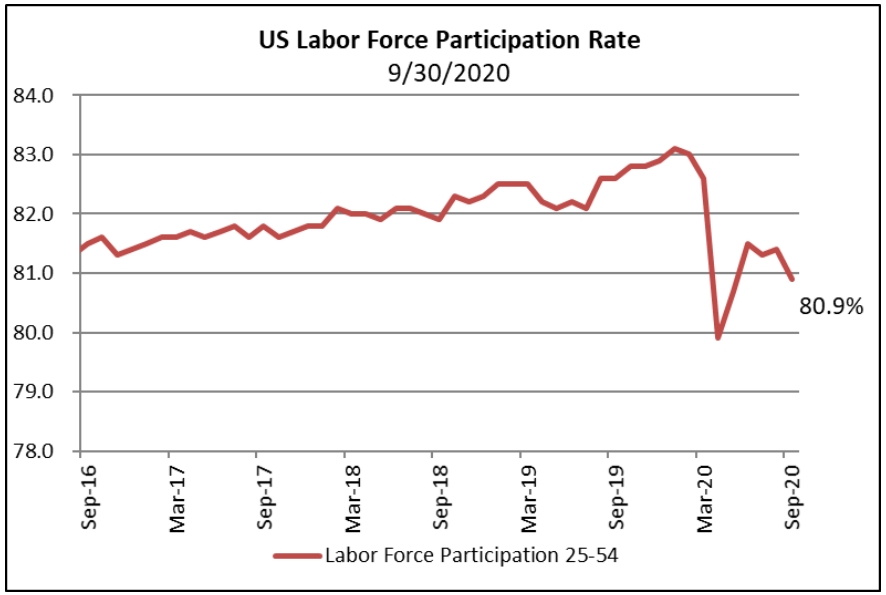
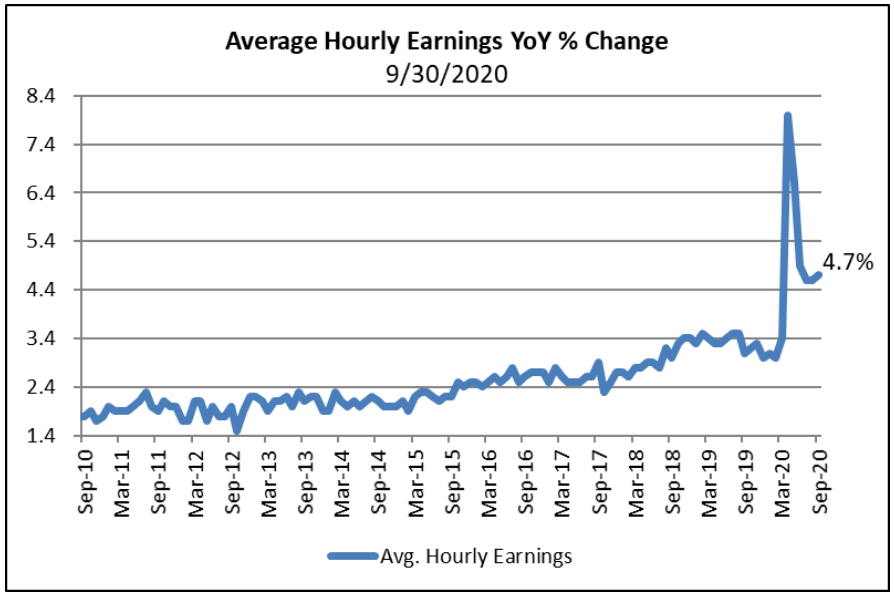
Economic Environment

Employment and Inflation – September 2020

- The prime working age participation rate has softened as corporate layoffs have begun to rattle the working landscape, and positions have been eliminated.
- Workers in a number of industries have left the work force as jobs have disappeared.
- Average hourly earnings have moved higher as some lower paying industries remain shut down.





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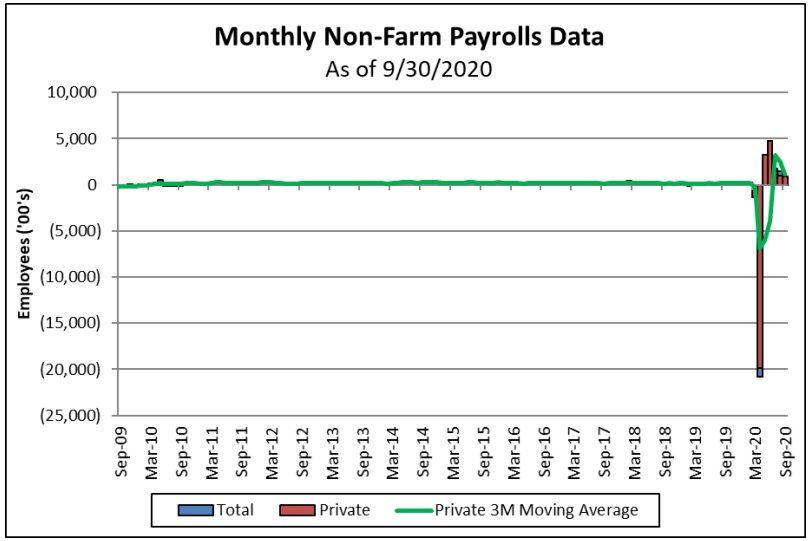
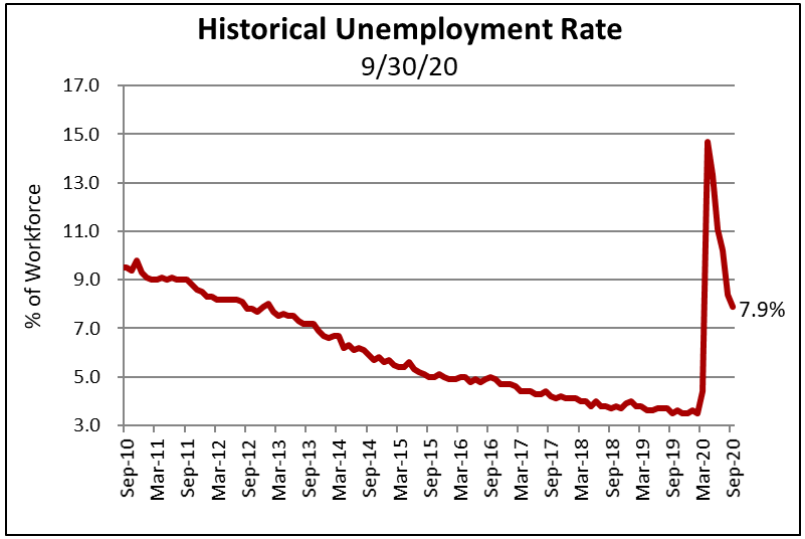
Economic Environment

Employment – Monthly Payrolls – September 2020

- About half of the initial 22 million jobs lost have come back, however as government rescue measures expire, rounds of layoffs have begun in still depressed industries.
- Monthly Payrolls are stabilizing after the initial rehiring period with gains decelerating.
- The unemployment rate has fallen to 7.9% partly due to rehiring, but also due to the participation rate (denominator) has fallen.





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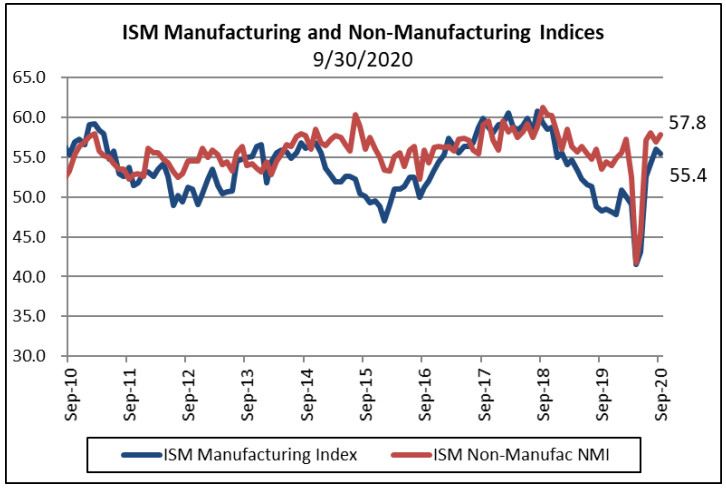
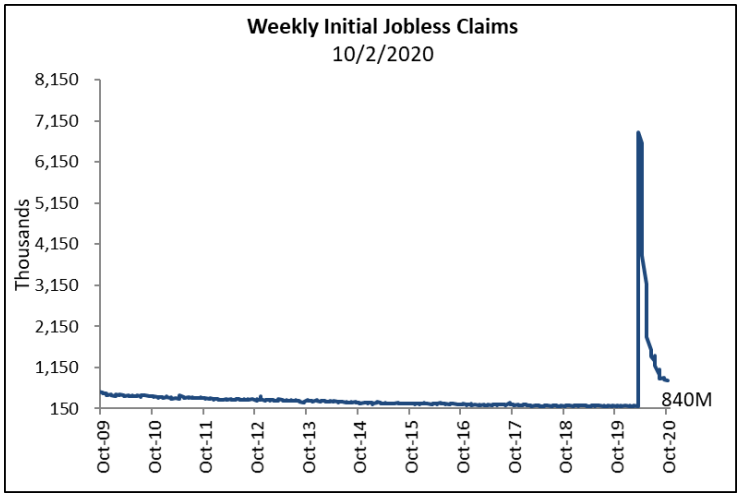
Economic Environment

Employment – Monthly Payrolls – September 2020

- The manufacturing sector, as measured by the manufacturing purchasing manager index has rebounded recently as factories bring people back in and restart production.
- The Non-Manufacturing index has stabilized above 50 as restaurants and hotels have reopened at limited capacity.
- These indices may be misleading as the measure shows month over month rather than absolute levels.
- Initial claims for unemployment spiked due to COVID-19 layoffs, migrated back towards lower levels, but remain at extraordinarily high levels at over 800 thousand new claims per month, and around 11 million continuing unemployment claims.





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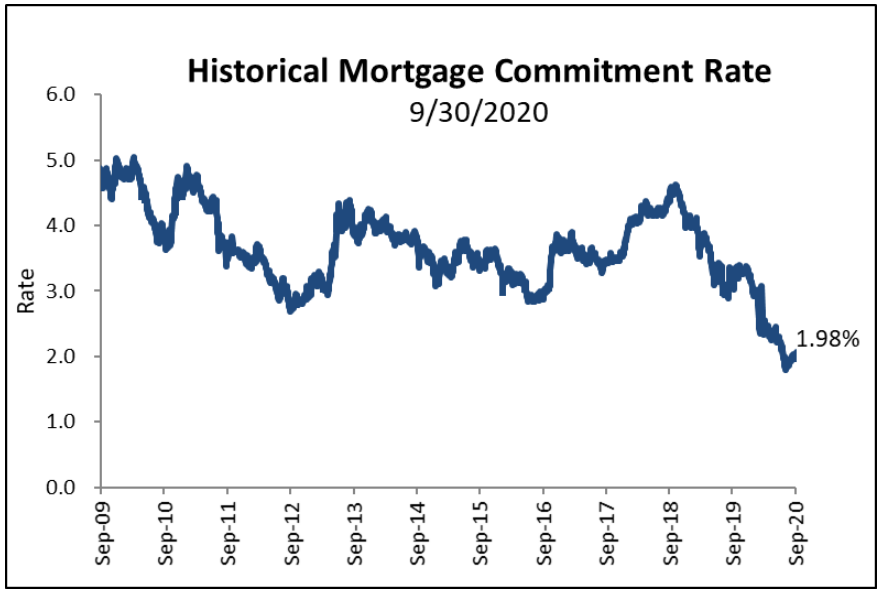
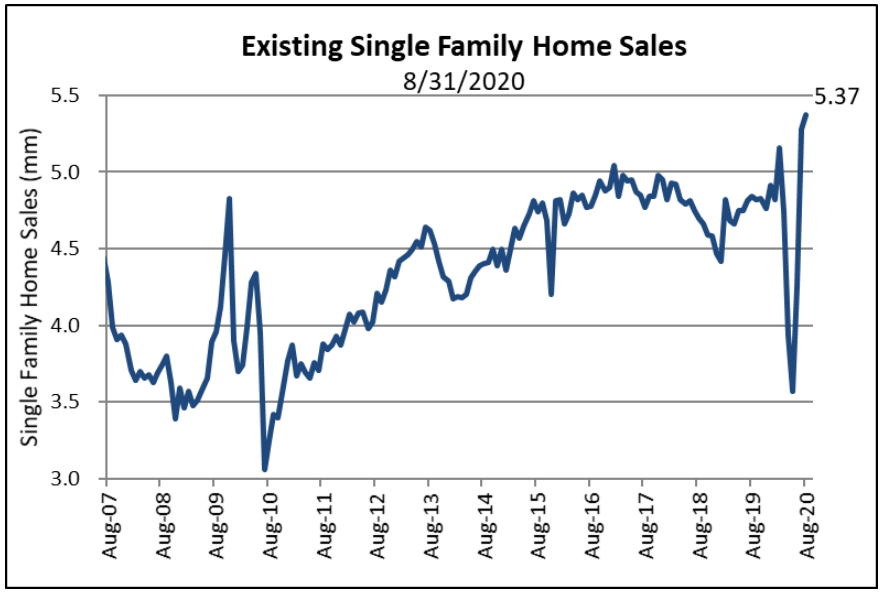
Economic Environment

Mortgage Rates and Housing – September 2020

- The recent drop in interest rates has brought mortgage rates down with it, more than 1% from their highs of last year and 2% lower than 2018.
- Lower mortgage rates have supported home sales to some degree, but the significant migration to suburbs from cities has been a driving factor, which has also pushed housing prices higher.
- Robust home sales is also supporting the housing related retail sectors.





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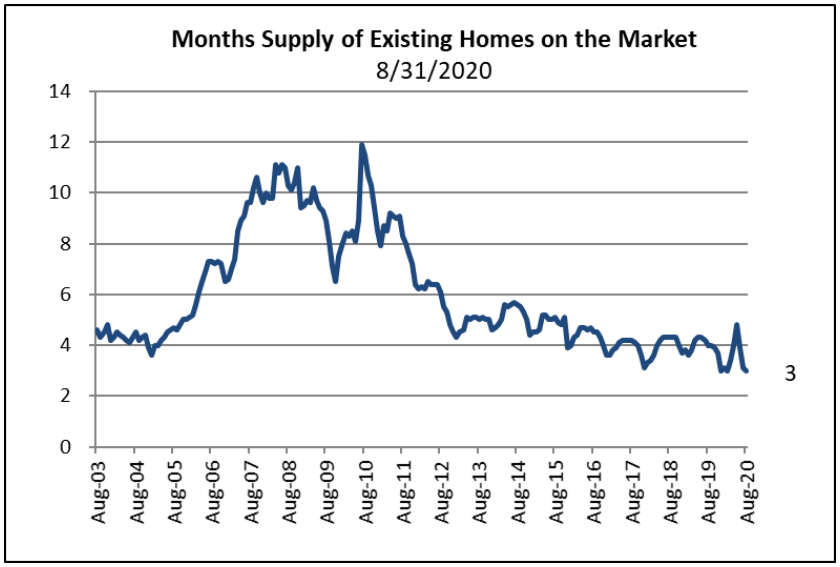
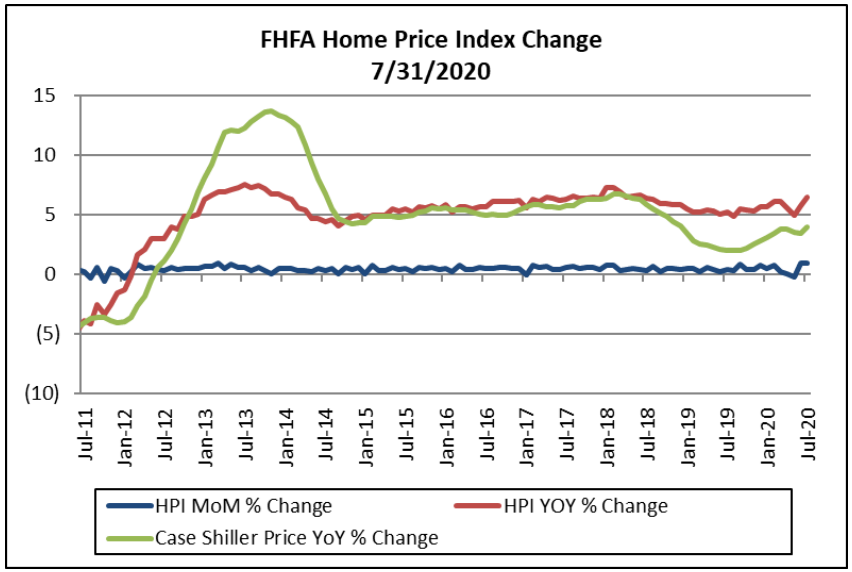
Economic Environment

Mortgage Rates and Housing – September 2020

- The recent drop in interest rates has brought mortgage commitment rates down with it to record levels.
- After a near stoppage of housing activity on the initial shutdown, lower mortgage rates have supported home sales to some degree, and recent moderation in home prices has generated renewed activity in the housing market. Demand for suburban homes has pushed home prices back up.
- There has been a spike in mortgage prepayment activity.





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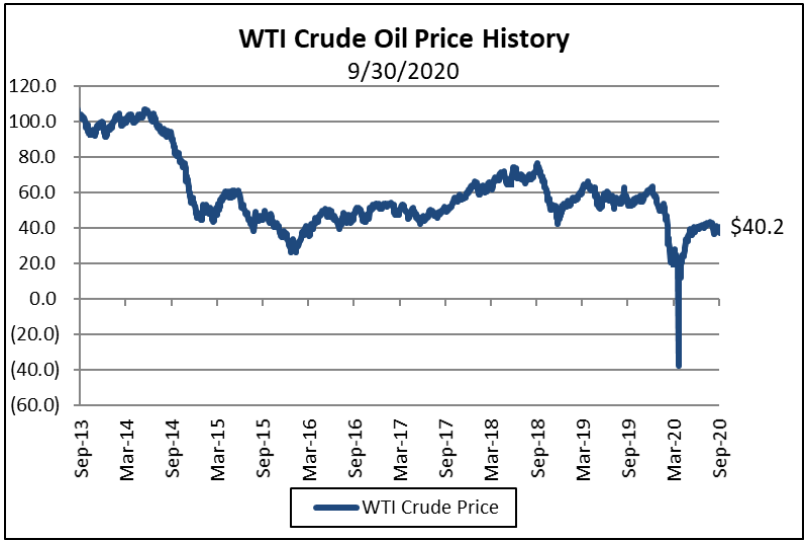
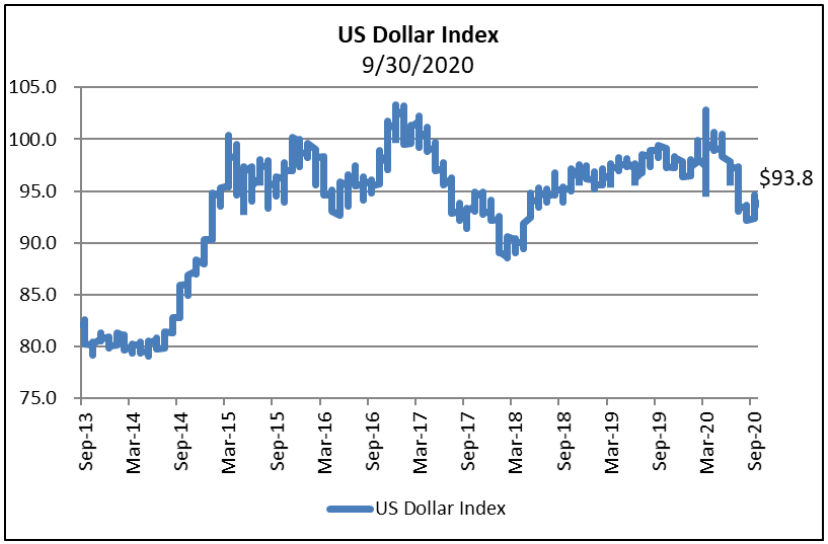
Economic Environment
September 2020

- The COVID-19 economic halt caused extreme volatility in the oil markets with demand falling originally due to stoppage of airline travel and closures of manufacturing and business.
- Supply buildup has eased somewhat as much production has been halted and some activity has resumed.
- Moving forward the energy markets should remain volatile as we open/close economies to fight the spread of the coronavirus, and the election results may or may not shift energy policy.
- The Dollar remained volatile and fell, due mostly to uncertainties around government stimulus packages the long-term impacts of the COVID-19 outbreak, and the upcoming election.





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