Investment Tally & Perspective

MAJOR ASSET CLASS RETURNS	2nd Qtr. 2020	1-Year	3-Year	5-Year
Equities				
S&P 500	20.5%	7.5%	10.7%	10.7%
MSCI EAFE	14.9%	-5.1%	0.8%	2.1%
MSCI Emerging Markets	18.1%	-3.4%	1.9%	2.9%
Fixed Income				
Barclays Capital US Aggregate	2.9%	8.7%	5.3%	4.3%
Barclays Capital US Corp. Inv. Grade	9.0%	9.5%	6.3%	5.8%
Barclays Capital Emerging Market	10.0%	3.0%	4.2%	5.2%
Other Assets				
MSCI US Reit Index	11.7%	-12.9%	0.1%	4.1%
S&P GSCI	10.5%	-33.9%	-8.7%	-12.5%
ICE WTI Crude Oil	92.1%	-32.7%	-5.1%	-7.9%
Comex Gold	12.8%	26.8%	13.2%	9.0%

Source: Capital IQ — All returns greater than one year are annualized

Market Activity –

Barring a few mild interruptions, trends that were in place in late March continued during the second quarter as the S&P 500 gained 20.5%, outpacing its international counterparts. Bonds also performed well, with the Barclays Aggregate up 2.9% in the quarter and 6.1% year-to-date.

Economic Activity –

As evident with recent data releases, the U.S. economy likely troughed in early April. As an example, JPMorgan Chase showed card activity declined -40% year over year in late March; spending has steadily improved since then with more recent card usage being down approximately -10% from last year. TSA checkpoints have also been rising as recent data show the number of people flying is 7 times the bottom seen in March, yet still only 25% of its usual value for this time of year.

Employment is down significantly from pre-COVID levels. After losing a net 1.3 million jobs in March and 20.7 million in April, the country added 7.5 million in the past two months. As of mid-June, 10 million of the 18 million unemployed were considered temporarily laid-off, up from 801,000 in February. According to the Job Openings and Labor Turnover Survey (JOLTS), the layoff and discharge rate in May returned to levels seen in February, while hiring is above last year's level, and job quitting is below last year levels – all signaling we are making progress in getting the unemployed back to work.

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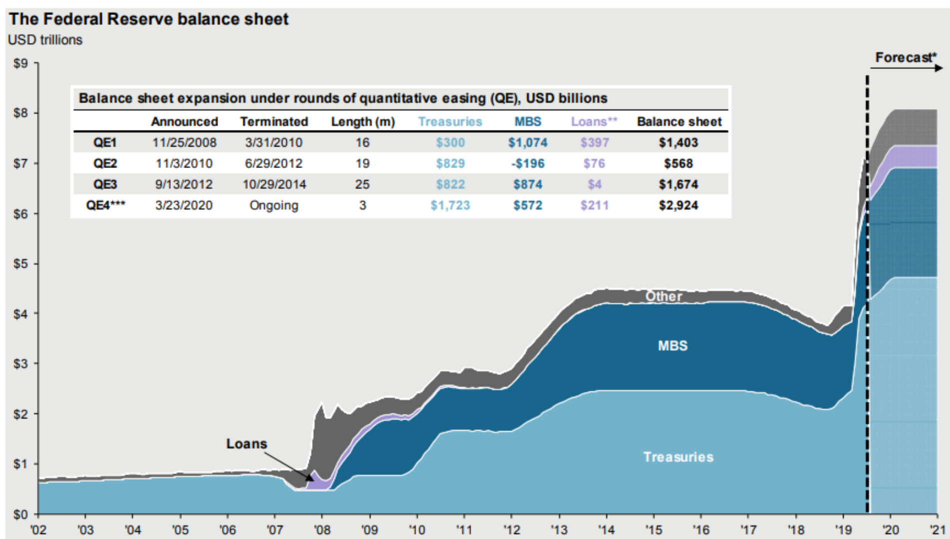
One key question mark for U.S. economic activity is how fiscal policy unfolds from here. Despite massive job loss, April and May incomes were larger than the prior year due to stimulus and unemployment benefits. While consumers have saved a historic sum, this may be quickly depleted, and the economic recovery impaired, if the unemployment number remains elevated. Our view is that another aid package will be successfully negotiated by Congress and signed by President Trump during the summer months.

Globally, while the carnage is widespread, there is a fair amount of dispersion seen in individual economies due to disparate experiences with the virus and their associated responses. Brazil and India, now the second and third largest countries by confirmed cases, did not see the virus appear in earnest until May. China, the first to be impacted, has seen a reasonably strong recovery, yet it is still impacted by the status of its major trading partners. In all, world GDP is expected to shrink by 4.9% in 2020, the worst performance since the Great Depression.

Monetary Policy –

As noted in prior communications, the Fed is going all-out to provide support to businesses and markets. The pace of the Fed's bond buying is unprecedented and is the major factor for the strong returns seen from risky assets since March (see graphic on right).



Balance sheet expansion under rounds of quantitative easing (QE), USD billions

	Announced	Terminated	Length (m)	Treasuries	MBS	Loans**	Balance sheet
QE1	11/25/2008	3/31/2010	16	$300	$1,074	$397	$1,403
QE2	11/3/2010	6/29/2012	19	$829	-$196	$76	$568
QE3	9/13/2012	10/29/2014	25	$822	$874	$4	$1,674
QE4***	3/23/2020	Ongoing	3	$1,723	$572	$211	$2,924

Source: FactSet, Federal Reserve, J.P. Morgan Investment Bank, J.P. Morgan Asset Management.

Valuation & Sentiment –

Valuations can either be called cheap or expensive depending on which data you look at, a common position for investors in recent years. Compared to bond interest rates at the lowest levels in modern history, P/E multiples and dividend yields from equities appear reasonable, or attractive. Compared to any metric other than interest rates, stocks look expensive. Both arguments have merit, though our opinion leans to the expensive side today. We believe that stocks should be compared to what is likely to be the long-run average for rates, rather than today's rates. Equity returns are driven by the price paid, dividends received, and the price received when the security is sold. The price received when sold is highly dependent on interest rates in the future, therefore, today's interest rates alone cannot be the sole rationale for purchasing equities (see Investment Strategy).

Looking at sentiment, Goldman Sachs' sentiment indicator is firmly in the neutral camp, while the American Association of Individual Investors (AAII) survey shows individuals being much more bearish than in February. We view the AAII figures and others as contrary indicators. We note that the level of individual investor participation in the market recently spiked at traditional discount brokerages, such as Schwab, TD Ameritrade, E-Trade, and a newer entrant, Robinhood, which has had some issues. We attribute this increased activity to several factors including - the large number of people stuck at home, the lack of sports and sports betting, the removal of trading commissions, more attractive stock prices following the 34% decline from February 19th to the low on March 23rd, and FOMO – the Fear of Missing Out.

Investment Strategy

We describe the current investment background as "murky", and a near term (3 to 6 months) pullback in the stock market, while not certain, would not be surprising either. Yet even given these expectations, we maintain a neutral (normal) allocation to common stock investments over longer periods of time (one year and more). An overview of the thought process behind our views and expectations follows.

<u>The Economy, Stock Prices, and COVID-19</u> –

Stock prices generally reflect corporate profits and are significantly impacted by the level and changes in economic activity. Primary factors include monetary and fiscal policies, geopolitical issues and, occasionally, developments such as the Black Swan event known as COVID-19 which has delivered a huge external shock to global economies and human well-being.

In past, normal times, interest rates were determined by the supply of funds available for lending and the demand for funds by borrowers. The Fed closely monitored money supply metrics and made its primary impact by controlling short-term interest rates, leaving longer term interest rates to the vagaries of bond market investors. Over time, and particularly in the decade since the Great Recession of 2007 to 2009, the Fed assumed additional responsibilities and expanded its array of tools. The Fed has shown it has the will to use these tools and has earned the credibility of investors. So, when Fed Chairman Jerome Powell stated that the Fed will do whatever is necessary to prop and support the economy, there are few doubters of the Fed intent and will to take appropriate actions as needed.

<u>The Elections, Taxes, and Corporate Profits</u> –

As of this writing, polls indicate Joe Biden having a considerable lead over President Trump. Mr. Biden has made it clear that he will seek higher corporate tax rates which would reduce cash flows to shareholders. Whichever septarian is elected, we view the Senate outcome as the pivotal election, as it will decide whether one party has full control of the Presidency and Congress, or whether control remains split. As we get closer to election day with campaigns becoming more intense, ramifications from political battles will likely contribute to increased market volatility.

As previously noted, stock prices follow corporate profits which, in this murky environment are very difficult to project with accuracy. Current estimates for 2021 earnings, which are around 2018 and 2019 levels, appear to be too high and subject to downward revisions.

<u>Investment Strategy –</u>

Putting it all together, global economies are in recovery mode with vital support from central banks and governments. Economic activity will not rise in a straight line. Graphically and visually, it may be more like a "W" or a series of "w's", versus a "V", and market actions will likely trade in a relatively similar manner. Though we expect earnings estimates to be adjusted lower and we have apprehensions over virus and election developments, we maintain a normal exposure to equity allocations primarily due to expectations for continued Fed support, and for Congress passing another aid package in the next few days and weeks. The valuations of common stocks, though elevated, are supported by interest rates at record low levels, and by monetary and fiscal policies that are pouring trillions of dollars into the economy. Though stocks have limited room for error, at the end of the day the flood of liquidity will likely result in stock returns exceeding those offered by alternatives in the year ahead.

<u>ESTATE PLANNING IS VITAL - "WILL" YOU USE OUR COMPLEMENTARY SERVICES?</u>

Many find estate planning complex and overwhelming (not to mention, morbid). Yet if you care about what happens to your home, your financial and other assets after you die, the process need not be cumbersome. A well-informed and structured estate plan makes a big difference in terms of the time, expense, and headaches you save your family and beneficiaries. The cornerstone of estate plans are wills, which are recommended for all, even if you are young and your estate size is modest. Below are some of the key benefits of having a sound and up to date will.

Wills allow your estate to avoid intestacy, that is, you get to choose who gets your property rather than leaving it up to state law. State intestate laws generally distribute property to your closest blood relatives in proportions according to the governing laws; this may, or may not, be what you wanted. In many states, a will is the only way for you to nominate a guardian if you have minor children. You may name both a personal guardian, who takes care of the child(ren), and a property guardian who takes care of the child's assets, if you wish to name them separate Wills allow you to name an executor who, as your legal representative after your death, is responsible for settling your estate - collecting personal assets, paying any creditors or taxes owed, and distributing remaining assets to beneficiaries. Wills may be used to create a trust, called a testamentary trust, or to fund a living trust, a "pour-over" will, as your assets pour over into a trust. For wills that create a trust, the will establishes trust terms including naming the trustee, the beneficiaries, and designating trust assets. The creation or funding of a trust is important for families with beneficiaries who are unable to manage assets and finances by themselves.

While wills are important for anyone who owns property, it is important to note that having a will alone does not allow your estate to avoid probate. Probate is the legal process which determines if a will was created, is valid and, if no will is present or it's invalid, the general administration of a deceased person's estate. Probate can be costly and time intensive, sometimes taking years to distribute assets at a cost that can be greater than 1% of the estate. There are strategies to avoid probate which include the development of trusts and proper beneficiary designations, to name a few.

While there are many do-it-yourself programs available for drafting wills, we highly recommend the engagement of an attorney that has estate planning as their primary specialty. As part of our financial planning services, we work with clients to prepare them for engaging an estate planning attorney, and we work together to complete the process and suggest periodic updates. If you want to learn more about our estate planning services and personally discuss this further, or if you need a referral to an experienced estate attorney, then please give us a call or send a brief note or email.