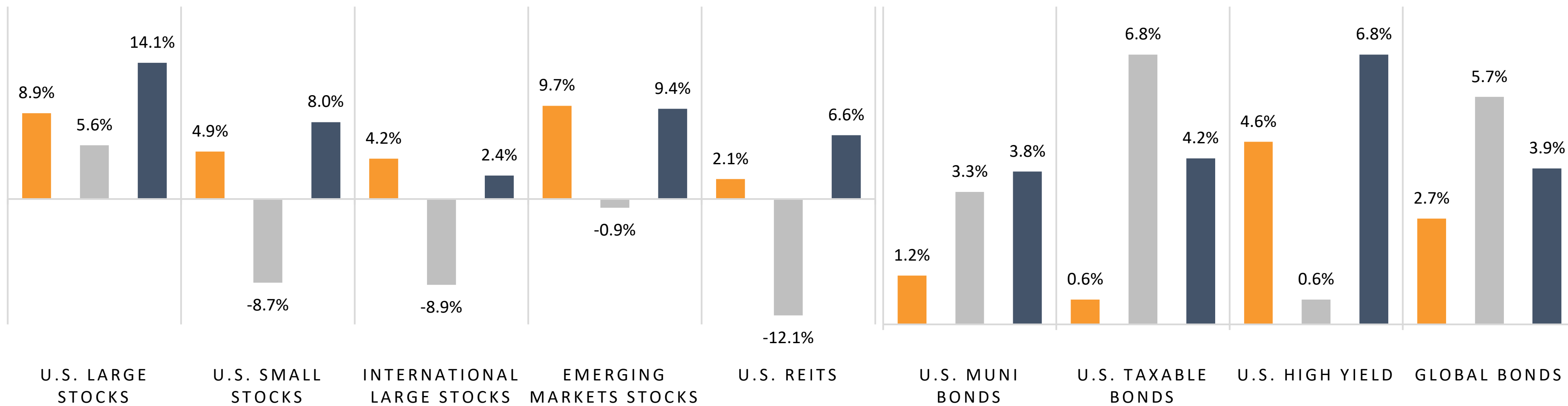
Q3 2020 Market Review

EQUITY MARKETS 3Q'20 YTD 5 Year Annualized* **FIXED INCOME MARKETS**



- Despite the COVID-19 Pandemic retaining its grasp on the global economy, equity markets around the world continued to rebound off the March lows. Part of the gains were driven from strong forecasted Q3'2020 US GDP of 30% quarter-over-quarter growth, which was a swift rebound following the Q2 collapse of nearly 30%. The strength of the market's recovery did show signs of slowing in September, with continued uncertainty about the strength of the economic recovery, no clear end in sight for the pandemic, and the election in November.
- **U.S. Large Stocks** rallied +8.9% in Q3 again driven by gains in technology. As seen on the *Q3'2020 Asset Class, Sector and Style Returns* page, the energy sector was the sole sector to finish in the red as a lack of demand compounded the sector's pain. The consumer cyclical sector was the top performing sector as increased retail sales helped companies recover after the Q2 lockdowns.
  - The P/E for the S&P 500 ended Q3 at 21.5x, significantly higher than the 25-year average of 16.5x and the highest reading since 2001. Also noteworthy is that the valuation gap between perceived "winners" and "losers" is the widest it has ever been.
- **U.S. Small Stocks** reverted to a long-term trend of underperforming their larger peers in Q3 as they were up +4.9% for the quarter but remain negative for the year.
- U.S. dollar weakness helped push **Emerging Markets Stocks** to be the top performing equity class in Q3, up +9.7%, while **International Large Stocks** lagged their developing and U.S. counterparts, up +4.9%.
- **U.S. REITs** continued to lag other equity classes in Q3, up +2.1% but still down -12.1% YTD due to uncertainty around the future of commercial real estate from COVID-19.

- For the first time in quite some time, we finished Q3 with a normal shaped yield curve with the short-end of the curve finally flattening. While this is a good long-term sign, rates remain at historic lows across the globe. Rates are so low that for the first time since 2008, the dividend yield on the S&P 500 (1.75%) was higher than the rate paid on a 30-year treasury bond (1.52%).
- In an historical move, the Fed introduced a new term called "average inflation target" to its mandate. This new philosophy is partially why the Fed is aiming to keep rates low through 2022 and push inflation above 2% to make up for periods where inflation was significantly below 2%. The Fed also communicated it would remain accommodative to corporations and municipalities. "Lower for longer" resulted in continued gains in **U.S. Taxable Bonds** in Q3, up +0.6%, while concerns about higher future taxes increased demand for tax-free bonds. This helped see **U.S. Muni Bonds** outperform their taxable counterparts in Q3, up +1.2%.
- **U.S. High Yield** and **Global Bonds** saw the strongest returns in the fixed income markets in Q3, up +4.6% and +2.7%, respectively, as investors sought yield, pushing demand for higher yielding and higher risk assets up. Interestingly, the large Q1 drawdown in the high yield market has been completely reversed now as the rally in Q2 and Q3 pushed the asset class to positive territory YTD.

**Annualized daily returns as of 9/30/2020*

Source: YCharts; underlying indices are S&P 500® TR Index, Russell 2000® TR Index, MSCI EAFE TR, MSCI Emerging Markets Index TR, Dow Jones US Real Estate Index TR, Barclays Municipal Bond Index, Barclays U.S. Aggregate Bond Index, Barclays U.S. Corporate High Yield Bond Index and the Barclays Global Aggregate Bond Index. Market conditions and trends will vary. Past performance is no guarantee of future results. Investments cannot be made in an index.

Integrated Q3 2020 TOI: Modern Monetary Theory

Modern Monetary Theory (MMT) is a relatively new school of thought in macroeconomics that has become more relevant in 2020 after the fiscal and monetary response to the economic impacts of the COVID-19 pandemic. MMT describes the theory that countries with control over their own currency can create more of that currency (or print more money) as a tool to spur economic growth and fight off economic woes, so long as that creation of new money does not generate significant inflation. It is a drastic and abrupt departure from traditional macroeconomic thought that printing money to solve problems leads to currency debasement and inflation. Below we have reviewed what both proponents and critics of this new school of economic thought believe.

Proponents

- ❑ Keynesian economics set the foundation for MMT with the "paradox of thrift," which contends that the economy of a country is different from the financial situation of a single household that can cut spending when income falls. The idea of an economy as a household limits the lack of investment back into the economy.
- ❑ MMT believes banks are creating deposits from loans, not loans from deposits, because loans made today are based on the demand for borrowing.
- ❑ The goal of MMT is full employment, at which point the economy's resources are used, and further spending is not necessary. The additional jobs created by this view are jobs the private sector has historically had no interest in creating.
- ❑ While historical examples of the Weimar Republic, Venezuela and Zimbabwe are concerning, money creation on its own did not cause hyperinflation in those examples. Inflation was spurred by a combination of money creation and lack of goods, labor, or capacity.

Critics

- ❑ If the government is "buying" all unemployed labor, productive, efficient, market-driven companies that create jobs will diminish, and those jobs are redeployed into inefficient government jobs.
- ❑ If the economy were to reach full employment under MMT and inflation picked up, fiscal policy as a deflationary measure would take too long to implement, especially in countries where tax hikes are unpopular, like the US.
- ❑ Political bias would creep into the picture, as can be seen from historical collapses in Venezuela and Zimbabwe, where central banks caved to political pressure to print money.
- ❑ MMT has no answer for supply-side shocks that could both reduce and prolong an economic downturn, and spur rising prices, if the only policy response is tax hikes.
- ❑ While Paul Krugman favors more government spending, he stated MMT would lead banks to refuse to lend at market rates, which would create hyperinflation as the price of credit rose and investors fled. He believes the government's inability to sell bonds would destroy the currency.

Sources: Cato Institute, the Levy Economic Institute, Bloomberg

Q3 2020 Asset Class, Sector and Style Returns

Sector Snapshot	9/30/20
Sector	**QTD Return**
Consumer Cyclical	15.09%
Materials	12.94%
Industrials	12.05%
Technology	11.69%
Comm. Services	9.92%
Consumer Defensive	9.31%
Health Care	5.41%
Utilities	5.23%
Financials	4.02%
Real Estate	1.32%
Energy	-20.87%

Equity Style Snapshot			9/30/20
QTD	Value	Blend	Growth
Large	5.62%	9.73%	13.02%
Mid	6.57%	7.95%	9.27%
Small	4.00%	5.78%	7.77%

Asset Class Summary						9/30/20
Asset Class	**1 Month**	**QTD**	**YTD**	**1 Year**	**3 Year**	**5 Year**
U.S. Large Stocks	-4.00%	8.93%	5.57%	15.15%	12.28%	14.15%
U.S. Small Stocks	-4.33%	4.93%	-8.69%	0.39%	1.77%	8.00%
International Large Stocks	-2.90%	4.20%	-8.92%	-1.80%	-2.04%	2.44%
International Small Stocks	-0.97%	10.61%	-3.34%	7.36%	1.32%	7.20%
Emerging Markets Stocks	-3.34%	9.70%	-0.91%	10.91%	2.79%	9.37%
U.S. REITs	-3.21%	2.07%	-12.08%	-11.39%	3.72%	6.62%
U.S. Taxable Bonds	0.18%	0.62%	6.79%	6.98%	5.24%	4.18%
U.S. Muni Bonds	0.03%	1.23%	3.33%	4.09%	4.28%	3.84%
U.S. High Yield	-0.97%	4.60%	0.62%	3.25%	4.21%	6.79%
Global Bonds	-0.17%	2.66%	5.72%	6.24%	4.10%	3.92%

Equity Style Summary						9/30/20
Region	**1 Month**	**QTD**	**YTD**	**1 Year**	**3 Year**	**5 Year**
Large Growth	-4.21%	13.02%	25.85%	38.32%	21.06%	19.28%
Large Blend	-3.72%	9.73%	7.36%	17.10%	12.87%	14.45%
Large Value	-2.95%	5.62%	-10.71%	-3.34%	4.38%	9.27%
Mid Growth	-1.23%	9.27%	14.11%	22.65%	14.88%	14.09%
Mid Blend	-1.98%	7.95%	0.18%	7.07%	7.99%	10.36%
Mid Value	-2.71%	6.57%	-13.24%	-7.79%	1.09%	6.43%
Small Growth	-1.66%	7.77%	8.58%	18.73%	12.87%	13.67%
Small Blend	-3.47%	5.78%	-6.32%	1.29%	4.37%	8.92%
Small Value	-5.09%	4.00%	-18.22%	-12.39%	-2.71%	4.79%

Source: YCharts, Inc.

Q3 2020 Market Indicators

Market Indicators as of 09/30/20						
Name	**Last Quarter**	**1 Month Ago**	**1 Mo. % Change**	**1 Year Ago**	**1 Year % Change**	**Freq.**
Key Interest Rates						
1 Month Treasury	0.08%	0.09%	-11.1%	1.91%	-95.8%	Daily
2 Year Treasury	0.13%	0.14%	-7.1%	1.63%	-92.0%	Daily
10 Year Treasury	0.69%	0.74%	-6.8%	1.68%	-58.9%	Daily
30 Year Mortgage	2.90%	2.99%	-3.0%	3.73%	-22.3%	Weekly
US Corporate AAA	1.62%	1.60%	1.3%	2.49%	-34.9%	Daily
US Corporate BBB	2.44%	2.41%	1.2%	3.30%	-26.1%	Daily
US Corporate CCC	11.80%	12.09%	-2.4%	12.20%	-3.3%	Daily
Effective Federal Funds	0.09%	0.09%	0.0%	1.90%	-95.3%	Daily
U.S. Economy						
Consumer Sentiment	80.40	72.50	10.9%	93.20	-13.7%	Monthly
Unemployment Rate	7.90%	10.20%	-22.5%	3.50%	125.7%	Monthly
Inflation Rate	1.37%	0.99%	39.1%	1.71%	-19.9%	Monthly
Manufacturing PMI	55.40	54.20	2.2%	47.80	15.9%	Monthly
Non Manufacturing PMI	57.80	58.10	-0.5%	52.60	9.9%	Monthly
Retail Sales	493,661	483,699	2.1%	456,351	8.2%	Monthly
Building Permits	1,553	1,483	4.7%	1,437	8.1%	Monthly

Source: YCharts, Inc.