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Third Quarter 2020 Commentary

Dear Clients,

Please find enclosed your September 30, 2020 Investment Reports.

Despite some considerable volatility in September, equity investors were treated to solid gains during the third quarter. The U.S. large cap stocks rose 10.1% in the quarter and has recovered all of its losses for the year. Smaller-cap U.S. stocks posted a return of 5.8% but remain negative year to date. The mega-cap growth names continue to lead the market (i.e., Facebook, Apple, Netflix, Microsoft, Amazon, and Google). The outperformance of these top index names means concentration within the index has soared to record highs. The top 10 stocks by market capitalization in the S&P 500 make up a record 28% of the total market cap of the index.

For the third quarter, developed international stocks gained 5.6%. Emerging-market stocks outperformed U.S. stocks with a return of 9.3%. Within the fixed-income markets, core bonds gained 0.6% for the third quarter. Treasury yields were basically unchanged over the last three months. Bond markets have been calm throughout the summer, thanks in large part to extremely accommodative monetary policy from the Federal Reserve. Fed officials have signaled that they do not expect to raise rates at least through the end of 2023. With a new policy of "average inflation targeting" around 2%, coupled with inflation that has rarely topped that level over the last decade, many market participants are expecting low rates and supportive monetary policy to continue for a long time to come. Keep in mind that economists and other financial market experts (including the Fed itself) are notoriously poor interest rate forecasters.

Looking out over the rest of the year, the potential for market volatility is elevated, primarily due to the upcoming U.S. election in November and the ongoing coronavirus pandemic.

Benchmark Returns

	Last Quarter	Last Twelve Months	Last Five Years
US Large Cap Stocks	10.1%	19.1%	15.3%
US Mid Cap Stocks	8.0%	7.1%	10.4%
US Small Cap Stocks	5.8%	1.3%	8.9%
International Developed Stocks	5.6%	2.0%	6.2%
Emerging Market Stocks	9.3%	9.8%	9.2%
US Bonds	0.6%	7.0%	4.2%
Global Bonds	4.1%	5.5%	3.6%
US REITs	1.3%	-18.8%	2.7%

Data source: Morningstar Direct. Past performance does not guarantee future results. It is not possible to invest directly in an index. Last five years data is annualized. Market indexes include:

US Large Cap Stocks: CRSP US Mega Cap TR USD
US Mid Cap Stocks: CRSP US Mid Cap TR USD
US Small Cap Stocks: CRSP US Small Cap TR USD
Emerging Market Stocks: FTSE Emerging TR USD
International Developed Stocks: FTSE Developed Ex US TR USD
US Bonds: Barclays US Aggregate Bond TR USD
Global Bonds: Barclays Global Aggregate Ex USD TR USD
US REITs: MSCI US REIT NR USD

As for the election, there is a significant likelihood that we may not know the final result of the presidential election for several days or weeks after election night as mail-in ballots are counted, creating some level of uncertainty. (It is worth remembering that the 2000 Bush-Gore election took 34 days for the winner to be declared. The S&P 500 lost about 4% during that time). Even absent a disputed election result, the weeks leading up to Election Day are likely to be volatile. For example, a Democratic sweep raises the likelihood of corporate and/or individual tax increases. On the other hand, the economy may get a near-term boost in a Biden administration from increased fiscal stimulus (e.g., extended unemployment benefits and infrastructure spending) as well as the potential for a reduction in trade tensions and tariffs relative to a Trump administration. Moreover, given the polling results over the past several weeks, the financial markets should already be

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incorporating some meaningful likelihood (at least 50%) of a Biden victory and a Democratic sweep of Congress. In other words, a Biden victory at this point would not be a market surprise. Nor would a Trump victory, unlike in 2016. Regardless of the outcome, history suggests that the political party in power is not a significant differentiator or driver of investment returns. There are simply too many other factors, variables, and events that impact markets and asset prices over time.

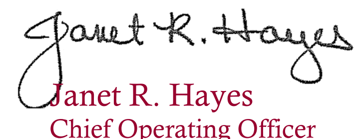
The coronavirus pandemic remains a significant risk facing societies and financial markets in the near term. While the U.S. and global infection and death curves have been generally flattening/ improving (albeit with large variance across individual countries), the potential remains for a resurgence of the coronavirus in the fall and winter months. One recent news headline read, "'Pandemic fatigue' leads to resurgence of coronavirus in Europe." The same could happen in the United States. This raises the risk of renewed shutdowns and another economic downturn. Fed chair Jerome Powell emphasized this at his September press conference saying, "The outlook for the economy is extraordinarily uncertain and will depend in large part on our success in keeping the virus in check." He also said that "additional fiscal support is likely to be needed" to help small businesses and state and local governments. Republicans and Democrats appear to be far apart in their negotiations although it now seems that some targeted fiscal stimulus package may be in the works.

It would appear that an economic recovery is underway. The Fed sharply revised up its forecast for U.S. GDP this year to a 3.7% annual decline, compared with its June forecast of a 6.5% decline. The Fed is forecasting 4% U.S. real GDP growth in 2021, which is in line with the consensus forecast. All else equal, a backdrop of rebounding U.S. and global economic growth should be supportive of equity and credit markets as increased consumer and business spending flows through to corporate sales and profits. But, equity markets—large-cap U.S. stock valuations in particular — are already implicitly assuming a continued recovery from the deep pandemic recession. So it remains to be seen how strong the actual recovery is and how much of it is already discounted in current prices. Given this macro and market backdrop, the risks and unknowns, and the wide range of potential outcomes, maintaining an appropriate asset allocation and retaining proper diversification are particularly important right now.

There is always the potential for a negative surprise or shock on the geopolitical stage. Stock markets and other "risk assets" are constantly subject to short-term volatility and drawdowns due to unexpected negative events and shocks. The coronavirus pandemic is only the most recent example, albeit an extreme one. Unfortunately, there will inevitably be other events that shock and scare the markets. For some historical perspective, since 1950, the U.S. stock market has experienced a 10% or worse decline about once a year on average; 5% market declines have occurred roughly three times a year. But it's impossible to consistently predict when such drops will happen, how deep they will go, or how long they will last. Although it can feel uncomfortable at the time, maintaining a disciplined investment approach through such periods is the best course of action. Consistency and patience will be rewarded.

Thank you for your continued trust and confidence.

Timothy S. Healey
Chief Investment Officer



Janet R. Hayes
Chief Operating Officer

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