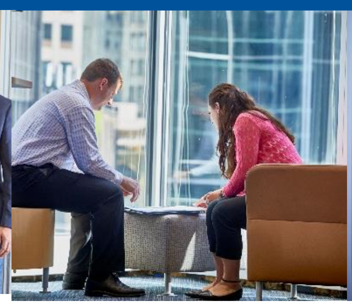
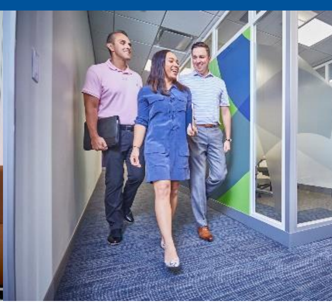
SCHNEIDER DOWNS
Wealth Management

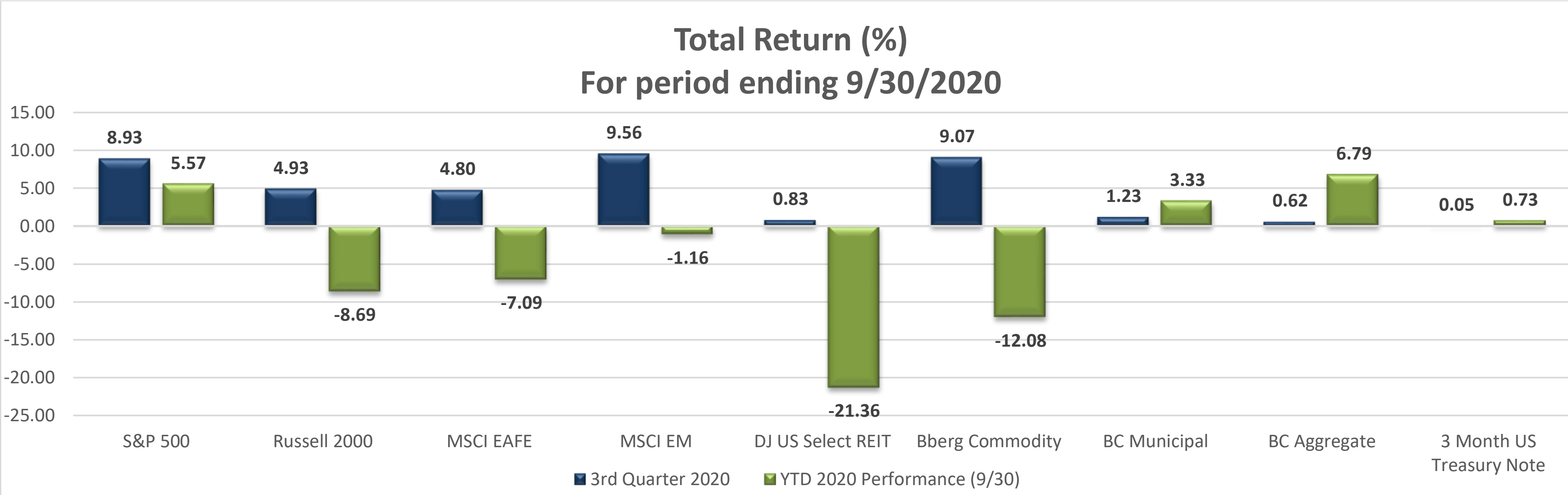
Come for the Top Gun Analogy, Stay for the Recap



Prepared by Schneider Downs Wealth Management Advisors, LP

Q3 2020 Market Commentary

Big Thinking. Personal Focus.



Despite a volatile September that saw markets teetering on a 10% correction, markets rallied to close out the quarter strong. While the continuation of the strong performance in risk assets was a welcome development, it generated a distinctly different feeling than previous strong quarters in 2017 and 2019, almost melancholy in nature. Those quarters in 2017 and 2019 were widely celebrated, whereas this one felt more like a relief that the year 2020 was almost over. Therein lies the paradox of the strong recovery in capital markets that we have seen since March; strong performance normally elicits feelings of happiness and excitement, whereas the recovery in 2020 is more of a combination of relief and trepidation. Eight to nine months of rolling lockdowns and isolation to combat the coronavirus and yet, at the time of this letter, 7,587,000 of our fellow Americans have contracted COVID-19 and 212,000 have ultimately succumbed to the virus.[1]

Even though the pace of hiring slowed in September, the U.S. economy continues to add jobs pushing the headline unemployment rate to 8% (down from a peak of 20%), which is a trend to be cautiously optimistic about.[2] In addition to the good news on the job front, the Federal Reserve Bank of Atlanta has estimated third quarter GDP growth (seasonally adjusted annual rate) to be 35.3%.[3] The strong rebound in demand and spending is a welcome sight, as it shows the economy has generated momentum and has begun, in strong fashion, its climb out of the hole from the second quarter drop of 32% in GDP. There are still three months left in 2020. With a hotly contested U.S. presidential election in early November, the beginning of flu season, and an expected uptick in COVID-19 infections, there remains significant uncertainty in the trajectory of markets. In spite of the aforementioned uncertainties, the U.S. economy continues to add jobs. Our economy is poised for another solid/positive GDP print in the fourth quarter, and most importantly, Operation Warp Speed[4] has five COVID-19 vaccines in FDA Phase III testing. Additionally, the ability to use therapeutics to treat COVID-19 gets better every day. In a year that has delivered a great deal of sadness and death from an invisible enemy, these

[1] https://coronavirus.jhu.edu/map.html
[2] https://www.bls.gov/news.release/pdf/empsit.pdf
[3] https://www.frbatlanta.org/cqer/research/gdpnow
[4] https://www.hhs.gov/coronavirus/explaining-operation-warp-speed/index.html

green shoots of optimism give us confidence that a return to normal is much closer than we ever thought possible in March…. and that is something to celebrate.

One would normally expect, with equity markets continuing their upward rise from their March lows, for us to begin our letter extolling their remarkable rise. However, as we reviewed the broad capital market performance, a scene from the movie *Top Gun*[5] kept coming to mind. In the scene, Maverick (Lt. Pete Mitchell) and Goose (Lt. Nick Bradshaw), a pilot and his radar intercept officer, are receiving a review of their performance from simulated combat by one of their commanding officers, Jester (Lt. Cmdr. Rick Heatherly). Jester remarked to Maverick and Goose, "that was some of the best flying I've seen yet - right up to the part where you got killed… you never, never leave your wingman."[6] Core fixed income has been maligned for years, with many asset allocators and financial personalities of distinction arguing, in some cases persuasively, to significantly reduce exposure to the asset class or in some cases, abandon it entirely. A combination of low yields brought on by a persistent and pervasive low interest rate environment, incrementally greater interest rate sensitivity (duration risk) and outsized equity returns led many to sour on the fixed income asset class. In essence, they were arguing for investors to leave their wingman (bonds) in favor of more exciting pursuits (equities or more equity-like investments). SDWMA made a deliberate decision to maintain a healthy allocation to fixed income across risk profiles. Bonds, in turn, have delivered strong performance (absolute and relative) in addition to their main role as portfolio stabilizers. In a year marked by extreme equity and risk asset volatility, bonds have been the only reliable calm in the proverbial storm. Despite an interest rate environment that is likely to stay low for several years, bonds will continue to offer valuable diversification properties that go beyond their mostly meager yields, and will continue to be an integral part of our client's asset allocations…. because you never, never leave your wingman.

Equities, both U.S. and International, saw strong performance in the third quarter. Domestically, the S&P 500 and NASDAQ hit all-time highs early in September, and while they declined shortly thereafter, they managed to stage a strong closing into September 30th. U.S. large cap outperformed its medium and small sized counterparts once again, pushing the S&P 500 to be the only broad market index in positive territory for 2020 at ~+5.6% for the year. That outperformance was mostly generated in July and August; in late September, not only did we start to see some relative strength across medium and small cap stocks in the U.S. (compared to U.S. large cap stocks), we also observed a modest rotation into more cyclical/value stocks (industrials, materials, financials). The modest move away from the "Work From Home/Mega Cap Tech" themed stocks that have been carrying this market for most of the year, largely centered around questions about whether they had reached "peak demand" as the COVID-19 lockdowns had begun receding, and the U.S. economy *was* pivoting to a more "reflation/recovery" environment. While still very early, we would expect this rotation to continue as the economy transitions from "surviving" to "recovery," bolstered by continued monetary and fiscal measures.

Internationally, emerging market equities rallied through the quarter, finishing with a terrific +9.6% for the quarter. Within emerging markets, Asian countries like Taiwan, China, and South Korea were stalwarts as their ability to effectively combat COVID-19 allowed them to open their economies in a more significant way. This more robust reopening allowed businesses and consumers to rebound more quickly than their developed market peers. From an International Developed equity standpoint, our decision to tilt our portfolio toward the Far East (Japan, Singapore, and Australia) and move underweight domestic Europe continued to pay benefits. In a similar vein, these countries were able to control COVID-19 more quickly than their European peers and in turn, open up for business more quickly. With the U.S. Federal Reserve looking to weaken the U.S. dollar through

---

[5] According to our Director of Research and Due Diligence, Jason Staley, Top Gun is the greatest movie ever made… and yet this isn't his worst movie opinion, as he believes Die Hard is a Christmas Movie.
[6] https://www.youtube.com/watch?v=kFBxx2tVTLE

continued monetary easing measures, we believe this will serve as another tailwind (relatively more attractive valuations being the other) for International equities closing out 2020 and into 2021.

We have been fielding many questions from clients about the upcoming U.S. Presidential election, and our view on how it will affect capital markets. As we learned in 2016, polling errors happen, and taking poll numbers as gospel can sometimes be a fool's errand. As the old adage goes, "a week is an eternity in politics," so there is plenty of time for the status quo in the race to change. While the parlor intrigue of handicapping the election can lead to spirited and exciting conversations, we won't have a definitive idea on the trajectory of markets on November 4th, and positioning our portfolios as such would be foolhardy. The investment and advisor teams have been pouring over commentary from investment managers, economists, and large financial institutions in an effort to plan for a variety of scenarios. Consistent with other times of significant uncertainty, we remain nimble in our views, with an explicit focus on aligning portfolios to match our clients specific risk tolerance and goals and objectives.

We believe that maintaining diversification in the equity complex across market cap (large to small), style (growth, core, and value), domicile (domestic and international), with fixed income continuing to serve as the ballast and exposure to real assets (infrastructure, timberland, and farmland), our portfolios are positioned well for the variety of outcomes that could potentially play out in the last three months of 2020. While 2020 has been a trying year for everyone, one thing the SDWMA team has been able to focus on is the trust you have placed in us as stewards of your capital. Where we do our work has changed during the time of COVID-19, but "why" we go to work has not changed… and that is yet another thing to celebrate. The team at SDWMA wishes continued health and safety to you and your families!