Market Commentary

As of September 30, 2020

Economy & Market Review

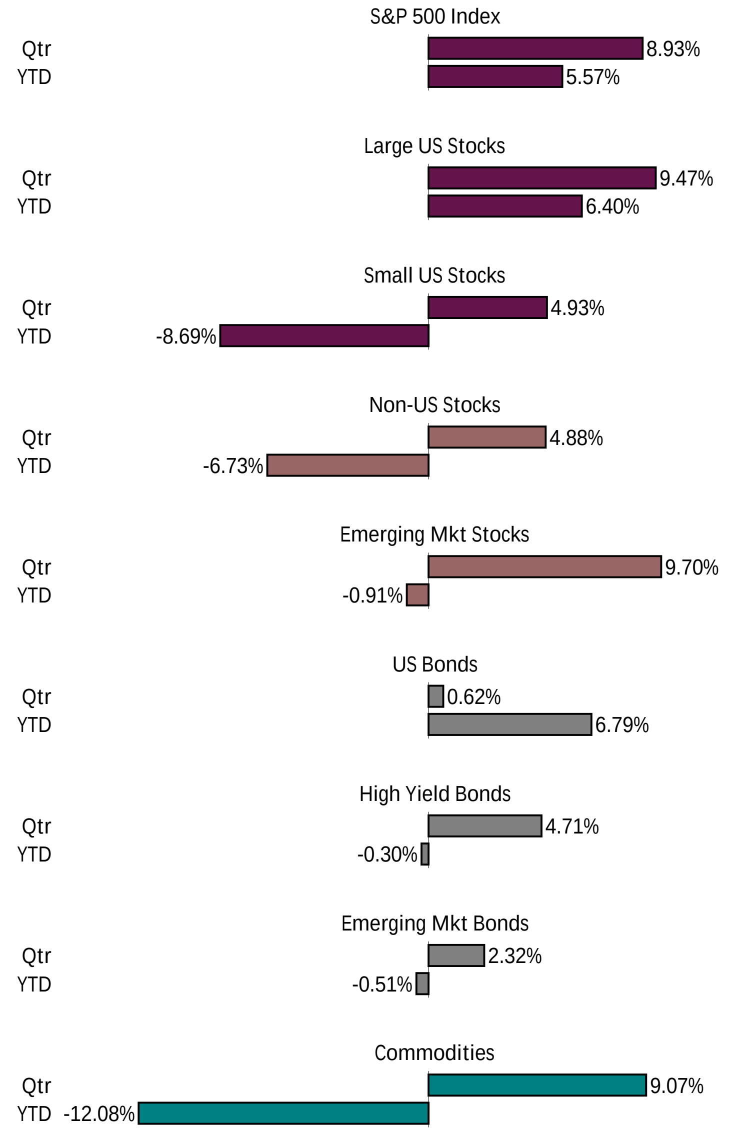
Third Quarter 2020

A favorite movie for many, “The Princess Bride”, has a scene that fittingly sums up 2020. The movie's narrator (the boy's grandfather) asks the young boy being told the story, “Let's see … where were we? Oh yes, in the Pit of Despair”. A global pandemic may leave some with a feeling of despair. As many continue to be isolated to some degree or another, socioeconomic improvements continue to vary, and political and social unrest rises, it impacts people both physically and emotionally. From an economic perspective, the economy and financial markets have diverged. The economic situation certainly is a struggle for the 11.7 million people with continuing jobless claims, but unemployment has dropped from 14.7% in April to 7.9% recently. Businesses, many small businesses in particular, continue to lack the wherewithal to weather the continued limited consumer demand and outright city/state government shutdown decrees. As a result, banks are reserving more for loan losses and tightening lending standards. On the financial market side, the metrics and sentiment are much different seemingly disconnected from the real economy. The Federal Reserve (Fed) continues to be extra supportive monetarily, but recently asked for additional fiscal stimulus from Congress. As the battle heats up between the Fed's ability to keep markets afloat and the economy's challenge of running at less than full capacity, increased investment returns now may mean lowered returns in the future.

During the second quarter, the US economy plunged 31.4%. With uncertainty remaining elevated, regional Federal Reserve Banks' third quarter estimates vary widely at an annualized increase of between 14-35%. Global growth estimates are very similar to the US, hopeful but uncertain. Recently, the Fed laid out a very long runway for rates to be anchored near zero through 2023 and allow average inflation to “overshoot” the 2% target.

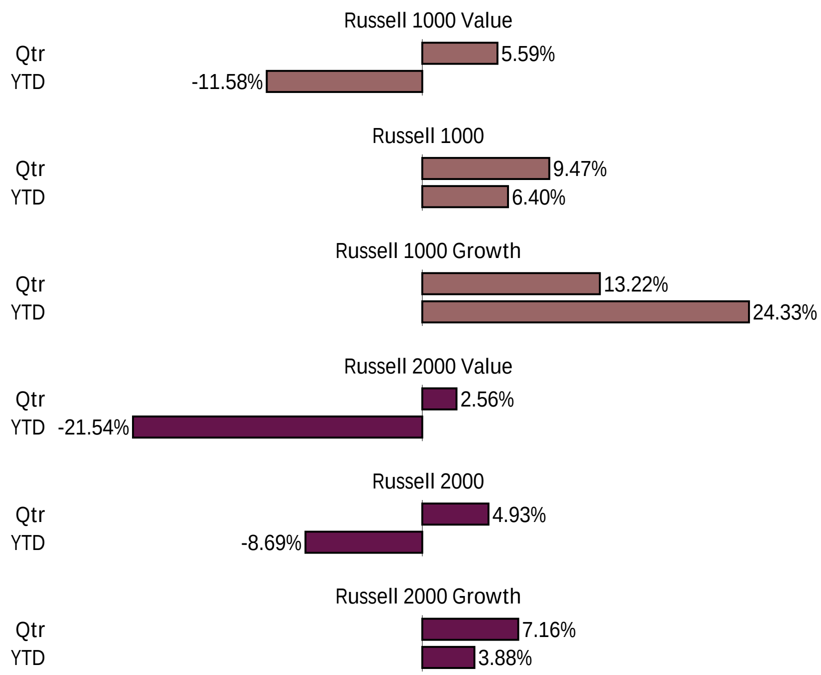
Back to the Pit of Despair, the villain's henchman uses The Machine (a torture device) to suck peoples life away and asks “I've just sucked one year of your life away…tell me, how do you feel?” Even though the quarantine and life changes may make some feel this way, we as Americans are resilient. As we get additional Covid-19 information, therapeutics, and a possible vaccine, life will become more “normal”. Patience in life, as in investing, can pay off handsomely over time.

Global Market Performance



U.S. Equity Markets

U.S. Equity Style Performance

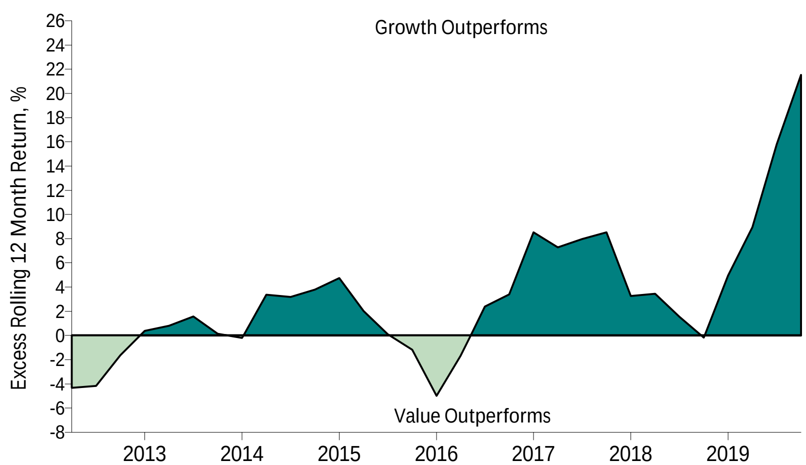


Equity valuations in the US seem less than compelling at 21.5x forward price-to-earnings multiple. The 25 year average is 16.5x. Historically at these valuation levels, the subsequent 1-year return has been less than 5% and the ensuing 5-year return has been around zero. Just another reminder that future returns may be lower, but with interest rates so low alternatives to produce above inflation returns are scarce.

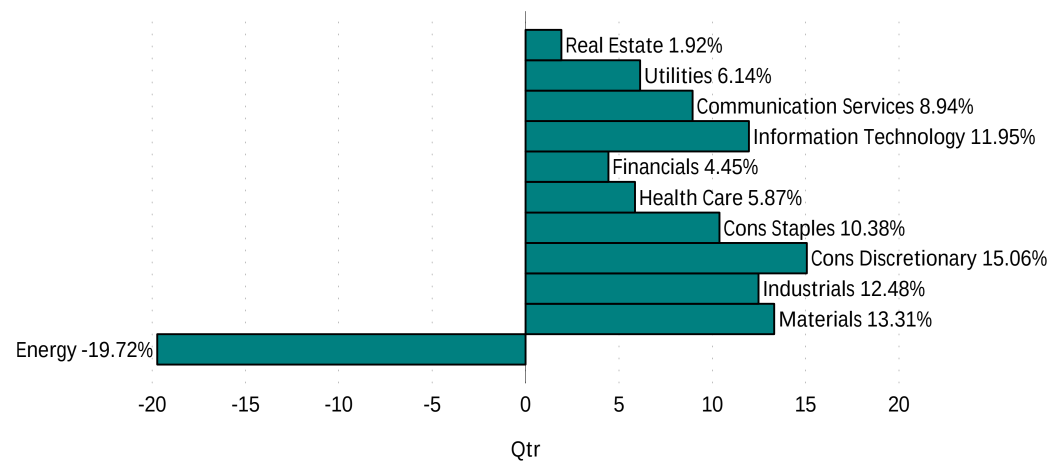
The Russell 1000 Index of large cap stocks increased nearly 9.5% during the quarter pushing its YTD performance positive at 6.4%. During the third quarter, the Russell 2000 Index of small cap stocks produced a return of a little over half their large cap brethren at 4.9%. Growth stocks again outperformed value during the quarter and brought the YTD dispersion between large growth and large value to a jaw-dropping 35.9%. Contrarians might be intrigued by this large of a chasm.

All Sectors except Energy provided positive performance during the quarter. Consumer Discretionary, Materials, Industrials, and Information Technology were the best performers. Materials performance was a slight shock as it usually performs best in inflationary not deflationary situations as we have currently. Energy performance has been abysmal for two of the three quarters this year. As Energy is usually a larger component of value portfolios, the continued Energy underperformance has also impacted the aforementioned value/growth performance gap.

Growth Relative to Value (Russell 1000)

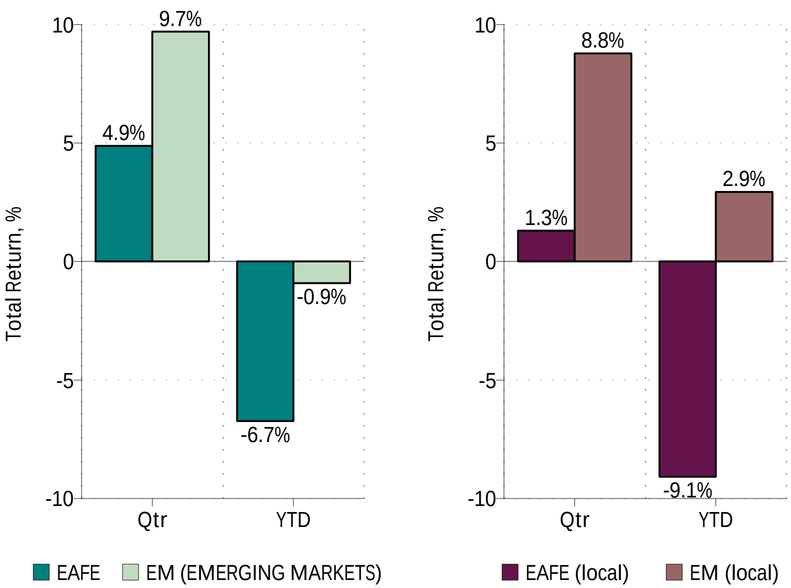


U.S. Equity Sector Performance (S&P 500)



International Equity Markets

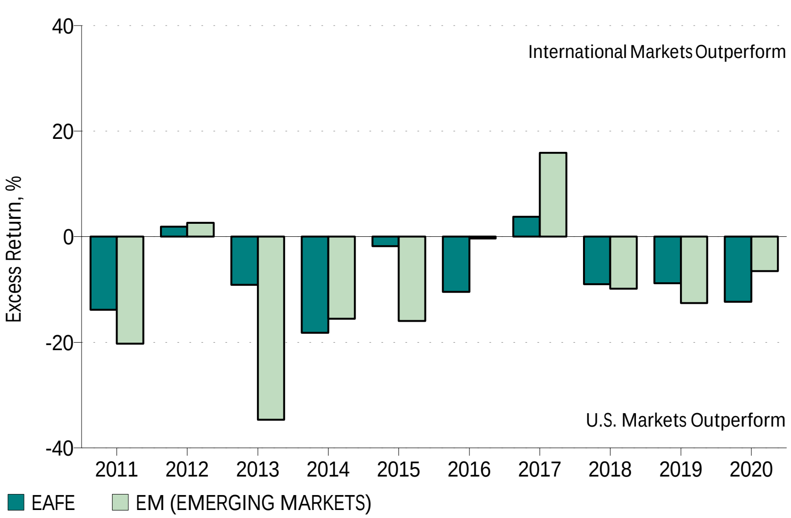
Non-U.S. Equity Performance



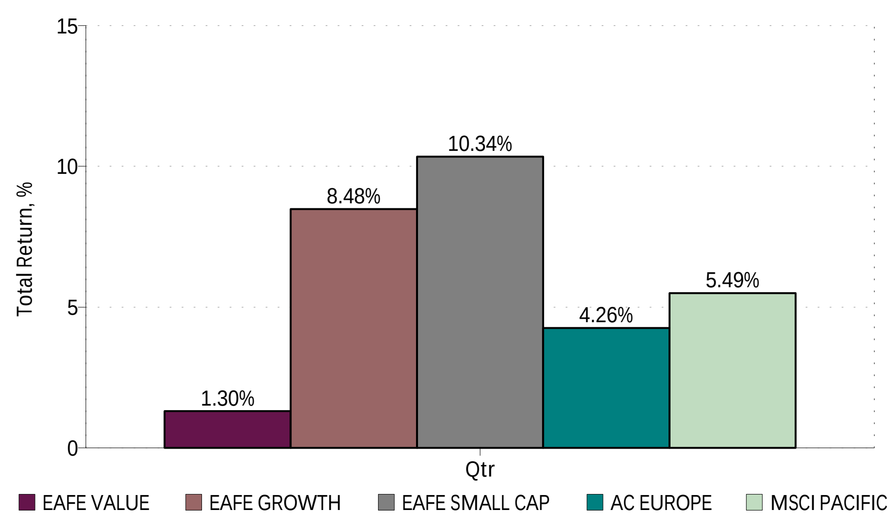
Although the US equity market produced strong returns for the quarter, emerging market stocks outperformed US equities during the quarter, but continue to trail significantly YTD. The MSCI Emerging Markets Index was up a robust 9.7% for the quarter. One of the main reasons emerging markets outperformed was China's strong performance. The MSCI China Index was up 12.6% during the quarter, mostly due to improved economic metrics. From a valuation standpoint, emerging markets equal their 25-year historical valuation, which is much cheaper than either US or developed markets.

During both the quarter and YTD, developed countries continue to underperform emerging markets. High quality, fast growing, and expensive stocks performed the best in Q3. In the quarter, developed markets based on the MSCI EAFE Index increased 4.9% for the quarter and only 1.3% in local currency. The dollar's weakness was a benefit to foreign markets during the quarter. The weaker dollar has likely been precipitated by the tremendous amount of government spending to lessen the financial impacts of the Covid-19 outbreak. The US has stimulated its economy much more than other central banks and governments around the world. Investors are concerned the increase in money supply and debt will have a negative effect on the dollar's ongoing purchasing power.

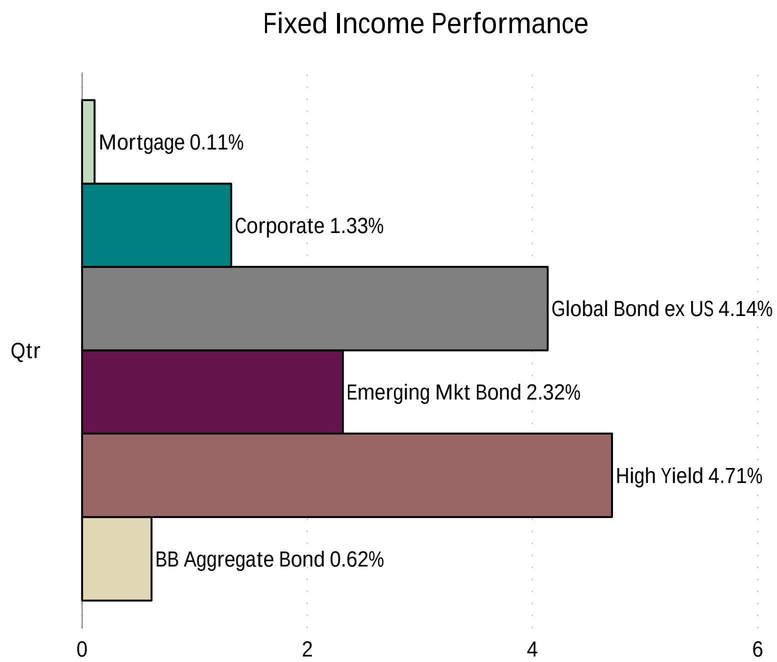
Non-U.S. Equity Returns Relative to U.S. (S&P 500)



Style and Regional Non-U.S. Equity Performance

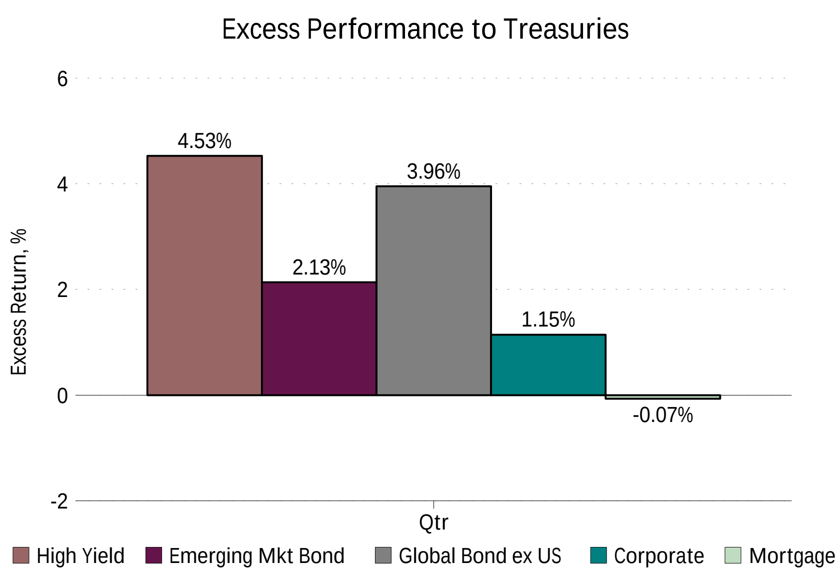


Fixed-Income Markets



Bond markets experienced fairly strong returns in the third quarter with the Bloomberg Barclays Aggregate Bond Index up 0.62% for the quarter. All fixed-income categories ended the quarter in positive territory. The best bond returns were found in risk/spread products. For instance, high yield bonds were up 4.7% as corporate defaults have still been limited so far. The Fed and many other major central banks continue with policy rates near zero or below and show no inclination for that to change anytime soon. Although negative yielding sovereign debt has once again eclipsed $16 Trillion in value, the US likely can't take rates negative as it would completely destroy the commercial banking system. As the US is more dependent on banking infrastructure, this would likely be a very negative sign domestically.

The US yield curve remains range bound. As inflation targets have been difficult to attain, the Fed continues to signal low rates. Hence, since April the 10-year treasury yield has bounced around a narrow range of 0.60% - 0.75%. With low treasury rates, investors continue to reach for yield. Likely, the most vulnerable investors those in or near retirement are the one's trying to get more yield out of their fixed income portfolios. We still believe in the current low rate and narrow spread environment that return-of-principal is just as important as return-on-principal.



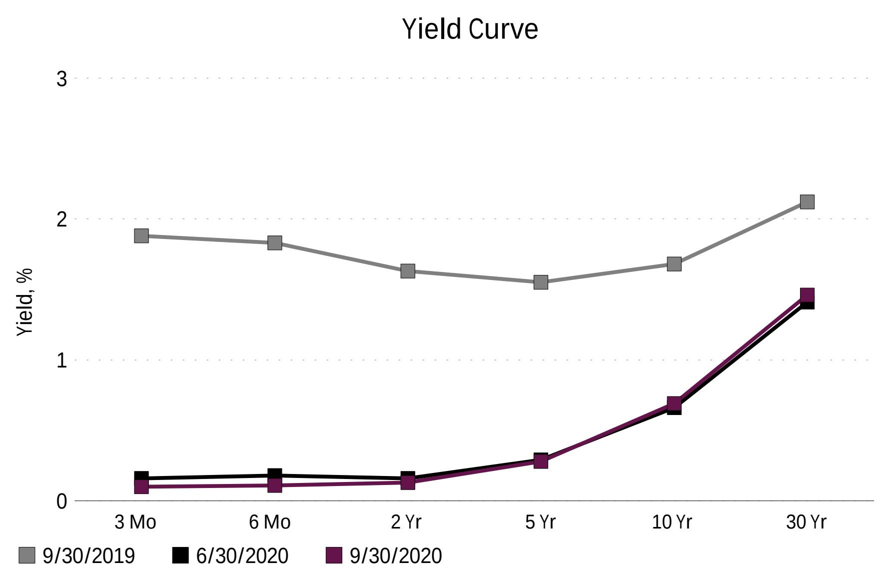
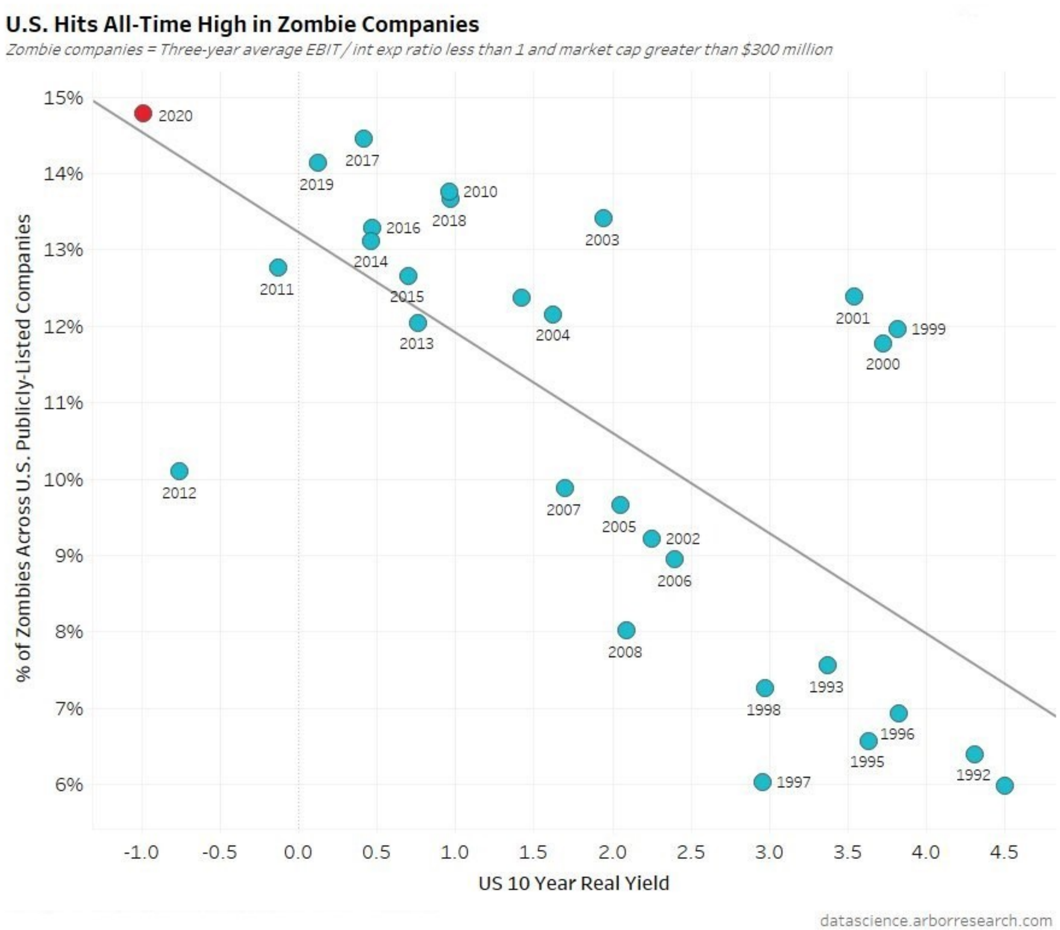


Chart of the Quarter



No, this isn't an episode of AMC's The Walking Dead, but it is close. As markets continue to be manipulated by governmental entities, the percentage of companies that earn just enough money to continue operating and servicing debt but are unable to pay off their debt grows. This has become more prevalent with low rates and corporate bailouts. Historically, investors would deem them too risky and force insolvency which eliminates inefficient corporations and allows others to prosper – not so currently.

Periodic Table of Investment Returns

Axia Advisory

Gold 29.24%						Small Cap Stocks 21.31%	Emerging Mkt Stocks 37.75%		Large Cap Stocks 31.43%		
Small Cap Stocks 26.85%		Emerging Mkt Stocks 18.63%				High Yield 17.49%	International Stocks 27.77%		Small Cap Stocks 25.52%		
Emerging Mkt Stocks 19.20%		International Stocks 17.39%				Large Cap Stocks 12.05%	Large Cap Stocks 21.69%		International Stocks 22.13%		
Commodities 16.83%		Large Cap Stocks 16.42%		Large Cap Stocks 13.24%		Commodities 11.77%	Small Cap Stocks 14.65%		Emerging Mkt Stocks 18.90%		
Real Estate 16.36%	Real Estate 15.99%	Small Cap Stocks 16.35%		Real Estate 12.49%		Emerging Mkt Stocks 11.60%	Gold 12.66%		Gold 18.43%		
Large Cap Stocks 16.10%	Gold 8.93%	High Yield 15.58%	Small Cap Stocks 38.82%	US Bonds 5.97%		Real Estate 8.76%	60/40 Blended Index 12.07%		60/40 Blended Index 16.50%		Annualized Return
High Yield 15.19%	US Bonds 7.84%	60/40 Blended Index 11.09%	Large Cap Stocks 33.11%	60/40 Blended Index 5.51%		Gold 8.10%	Intl/EM Bonds 10.41%		High Yield 14.41%	Gold 24.57%	5.26
60/40 Blended Index 12.84%	Intl/EM Bonds 5.88%	Real Estate 10.94%	International Stocks 15.78%	Small Cap Stocks 4.89%	Real Estate 15.01%	60/40 Blended Index 7.85%	Real Estate 7.62%		Intl/EM Bonds 9.98%	US Bonds 6.79%	4.11
International Stocks 11.60%	High Yield 4.38%	Intl/EM Bonds 10.60%	60/40 Blended Index 14.85%	High Yield 2.50%	Large Cap Stocks 0.92%	Intl/EM Bonds 5.77%	High Yield 7.48%		US Bonds 8.72%	Large Cap Stocks 6.4%	13.19
Intl/EM Bonds 8.60%	Large Cap Stocks 1.5%	Gold 8.26%	Real Estate 13.94%	Intl/EM Bonds 2.08%	US Bonds 0.55%	International Stocks 5.01%	US Bonds 3.54%	Real Estate 8.35%	Commodities 7.69%	Intl/EM Bonds 2.32%	4.13
US Bonds 6.54%	60/40 Blended Index 0.49%	US Bonds 4.22%	High Yield 7.42%	Gold 0.12%	60/40 Blended Index 0.11%	US Bonds 2.65%	Commodities 1.70%	3-month T-Bills 1.87%	Real Estate 5.35%	60/40 Blended Index 2.32%	7.24
3-month T-Bills 0.13%	3-month T-Bills 0.1%	3-month T-Bills 0.11%	3-month T-Bills 0.07%	3-month T-Bills 0.03%	3-month T-Bills 0.05%	3-month T-Bills 0.33%	3-month T-Bills 0.86%	US Bonds 0.01%	3-month T-Bills 2.28%	3-month T-Bills 0.64%	0.60
2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	
	Small Cap Stocks (4.18)%	Commodities (1.06)%	US Bonds (2.02)%	Emerging Mkt Stocks (1.82)%	Intl/EM Bonds (2.42)%			Gold (0.93)%		Real Estate (0.12)%	10.57
	Commodities (13.32)%		Emerging Mkt Stocks (2.27)%	International Stocks (3.44)%	Small Cap Stocks (4.41)%			High Yield (2.26)%		High Yield (0.30)%	6.93
	International Stocks (13.33)%		Intl/EM Bonds (4.13)%	Commodities (17.01)%	High Yield (4.64)%			Intl/EM Bonds (3.17)%		Emerging Mkt Stocks (0.91)%	3.67
	Emerging Mkt Stocks (18.17)%		Commodities (9.52)%		International Stocks (5.25)%			60/40 Blended Index (3.71)%		International Stocks (5.08)%	4.55
			Gold (27.33)%		Gold (12.11)%			Large Cap Stocks (4.78)%		Small Cap Stocks (8.69)%	10.02
					Emerging Mkt Stocks (14.60)%			Small Cap Stocks (11.01)%		Commodities (12.08)%	-5.55
					Commodities (24.66)%			Commodities (11.25)%			
								International Stocks (13.78)%			
								Emerging Mkt Stocks (14.25)%			

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