Investment Strategy Update

ASCENTIAL WEALTH ADVISORS
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Market Report — Quarter 3 · 2020

Markets Look Beyond Recession

Following the most rapid bear market decline in history due to the COVID-19 pandemic, global equities made a rapid recovery in the second quarter of 2020 as investors shifted focus beyond the current economic crisis. Unprecedented stimulus from central banks and plummeting yields on bonds played an important role in supporting stocks, giving investors the confidence to remain invested. Although US GDP is expected to contract by more than 30% for the second quarter of 2020, and unemployment hovered at levels not seen since the Great Depression, markets were surprisingly resilient. The S&P 500 surged almost 20% for the quarter and 39% from its March low.

Across the board, equities made a strong rebound from their lows, however, technology dominated. Heightened demand created a significant tailwind for tech, and the tech-heavy NASDAQ actually reached new all-time highs, closing up +12.1% year-to-date. This is a stunning outperformance in comparison to less technology weighted indices, such as the Russell 2000 which was down -12.9%, a 25.0% performance disparity. Foreign stock indices, which also generally carry a lesser weighting to technology, were also negative for the period but relatively in line with most US equities.

What happens next is largely dependent on the trajectory of the pandemic and whether measures to contain it cause additional economic suppression. The rally in equity markets was curtailed a bit in June as cases began rising in some places, stoking fears of a second wave of lockdowns. Developments with regard to COVID-19 treatments or a vaccine would likely be perceived positively by markets, but current prices may reflect some of this. Given the high degree of uncertainty, we expect that markets could pause and remain volatile until the economic outlook becomes more clear.

The bond market also saw its share of instability in the first half of 2020. In the US, the Federal Reserve lowered rates and embarked on a new phase of bond buying to calm financial markets and cushion the recession's blow. With the backing of the Fed, bonds were able to post strong returns for the period, while yields fell significantly. The yield on the benchmark 10-year US treasury started the year at 1.92% and ended June 30 at 0.66%, well below the core inflation rate of 1.24% (CPI).

Index	*2020 (through 6/30)*
S&P 500	-3.1
DJIA	-8.4
EAFE (Int'l)	-11.3
BC Ttl Bond	6.1

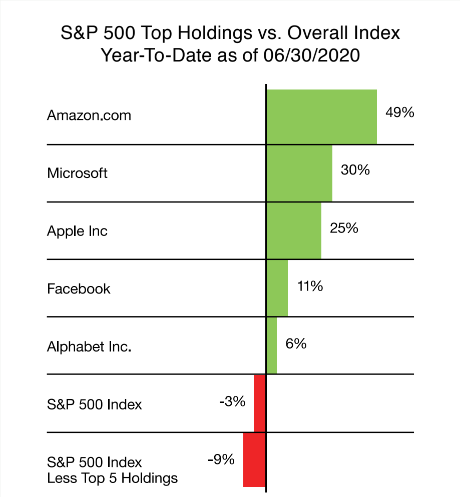
Dow Jones Relative Risk Benchmarks	
Conservative	1.6
Moderate	-3.7
Aggressive	-8.3

Technology Triumphs in COVID Crisis

It is hard to imagine what this year would have looked like without technology. The world shifted rapidly to working, learning, shopping, and socializing via technology when in-person interactions halted under stay-at-home orders. This period has been very painful economically, however, there is no question it would have been much worse had we not had technology allowing some areas of the economy to continue to function. It is no surprise that tech stocks are the golden ones so far this year.

A true standout as of June 30, the NASDAQ index was positive 12.1% for the year, while other US and foreign stock indices remained negative. The S&P 500 is 27% technology, and it too received a boost from the technology component. The chart here shows how dramatically just the top 5 tech companies in the S&P 500 impacted performance.

Is heightened technology use here to stay? If so, are tech companies including these giants positioned to skyrocket even further? Only time will tell if we are in the midst of a new technological revolution, and we are proponents of maintaining a diversified exposure across sectors. It is also not unusual for markets to become overly optimistic with trends like this, as it did in the late 1990s. Some days, however, it does feel a bit like the Jetsons cartoon may not be too far-fetched.



Source: S&P Dow Jones Indices (spdj.com), Morningstar

2020 OUTLOOK

FIXED INCOME — Bonds had a strong but uneven first half of the year. When the economic shutdown began in the first quarter, fear drove investors to buy US Treasury bonds as a safe haven, sending Treasury prices higher. The same fear led to the selling of corporate bonds as investors fretted over which companies would be most affected by the crisis. When the Federal Reserve intervened and stabilized the market, a strong rally in corporate debt ensued. Many bonds now look expensive with yields low and expected to remain low for the foreseeable future. We continue to recommend active bond managers to help in determining the most advantageous positioning for this low rate, high uncertainty environment. We also remain in favor of utilizing alternative strategies to supplement traditional fixed income. We believe fixed income and alternatives are a critical risk management component, providing diversification and some offset to equity volatility.

Our View — Maintain allocation, use active management to adjust for changing conditions

US EQUITIES — The second quarter rally has left the S&P 500 index looking somewhat expensive, trading at almost 22 times forward earnings. The most difficult question is, exactly when earnings will normalize? Most analysts do not expect earnings to fully recover until the latter part of 2021, however, it would appear that investors are more focused on the long-term recovery than near-term results. The stimulus provided by the US government, $2.4 trillion thus far with more expected, coupled with a lack of other attractive investment choices are supportive of US stocks. We believe selectivity will be key going forward, and are recommending a shift from small and mid-sized to larger companies. Growth continues to outperform value and we feel this trend could continue. As such, we will not be recommending rebalancing out of growth at this time for most diversified inverstors.

Our View —Overweight large US companies, reduce small & mid-sized company exposure

INTERNATIONAL EQUITIES — Foreign equity markets have had much the same experience as the US — a precipitous drop in the first quarter followed by a rebound in Q2. With less exposure to technology, foreign indices are slightly behind the S&P 500 year-to-date. Hit hard early on, by the end of the second quarter Europe seemed to have gotten some control on the virus spread, and stimulus from the European Central Bank and European governments will aid in an economic recovery. We are recommending a reduction to developed international as there are some structural economic issues that Europe still needs to address. The virus took longer to get into many emerging countries, and depending on policy response, some have been hit harder than others. We remain convicted in the long-term opportunity in emerging markets, but feel selectivity and active management in this space are even more important under current circumstances.

Our View — Reduce developed international, use active managers to navigate potential uneven recovery

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DISCLOSURES