SilverOak

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Second Quarter 2020 Market Summary

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Second Quarter 2020 Market Summary

The quarter began with the shutdown of the U.S. economy, tens of millions of people suddenly unemployed, and plunging asset prices. The world had turned upside down. The first quarter was one of the worst quarters for equity markets in history. However, the swift and significant actions from the Federal Reserve and Congress stemmed the economic damage, turning the second quarter into one of the best quarters in history. The economic impact of COVID-19 and the governmental reaction were both of historic proportions. The seemingly limitless buying power of the Fed and their positive influence on risk-taking has sparked a recovery of asset prices. The NASDAQ finished the quarter at all-time highs, while the S&P 500 is not far behind. Although, a full market cycle typically transpires over the course of years, this one has occurred over a few months!

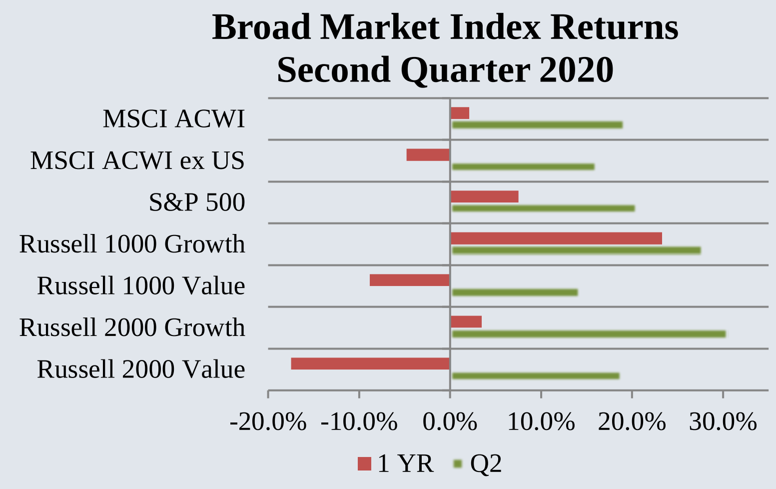
We frequently talk with our clients about a Venn diagram that lays a foundation for thinking of the interplay between the economy, markets, and politics. These spheres can influence each other, but they can also exist independently. Although the markets have been very strong the past few months and economic metrics have improved from shockingly poor levels, overall economic conditions still could be considered tepid, at best. Unemployment remains high but unemployment benefits and fiscal stimulus payments have helped to offset lost income. The personal savings rate hit an all-time high in April of 32%; however, that figure has already started to decline. There are some bright spots in the economy that are seeing more pent-up consumer demand. Spending trends have shifted from travel and leisure to home improvement and on-line shopping. Lastly, politics are as polarized as ever and U.S. elections are approaching later in the fall.

In this environment, it is reasonable to question how markets can be near all-time highs while there is still great uncertainty and a large percentage of the population is struggling. Have the markets gotten ahead of themselves? The economic and social implications of COVID-19 are real, but for many the strong market returns seem to suspend reality. This may be due to many market participants underestimating the Fed's influence on liquidity and asset prices thus far. Nonetheless, there is no sure way to know if the market advance has been justified or fueled by speculation. Time will tell.

U.S. large company stocks, represented by the S&P 500 Index, were up 20.5% during the second quarter of 2020. U.S. small company stocks, represented by the Russell 2000 Index, were up 25.4% during the quarter but are down 6.6% over the past year. The market breadth of the recovery has been shallow and dominated by large technology growth companies as investors seek companies they feel will benefit in a post COVID world.

Financials and Energy have lagged YTD; however, the latter had a solid quarter with the rebound in oil prices. International stocks, represented by the MSCI ACWI ex US Index, were up 16.1% during the quarter.

The Bloomberg Barclays U.S. Aggregate Bond Index, which represents a broad basket of bonds, was up 2.9%. Fixed income returns benefitted from the narrowing of credit spreads as the result of the Fed's bond purchases and liquidity programs. The Fed indicated that the Fed funds rate will likely remain low for many years and are committed to the bond purchase programs to support the fixed income markets.



Based on the recovery of asset prices, investors seem to feel the economic recovery is well underway and their worst fears have not been realized. This recession may turn out to be the shortest, but sharpest ever. Many states have opened up with limited restrictions. However, it hasn't been smooth sailing as over the past few weeks certain states have seen a dramatic increase in COVID-19 cases and thus have had to reinstate some restrictions. Research and our understanding of the virus increases daily while vaccine trials are ongoing and have shown promise for 2021 production. While we don't know how this pandemic will play out, it seems inevitable that certain aspects of daily life may have changed indefinitely and citizens will have to learn to live with COVID-19.

Second Quarter 2020 Market Summary (continued)

Even if COVID-19 concerns ease, there will be continued uncertainty with the U.S. elections approaching in the fall and potentially deteriorating U.S./China relations. We can paint scenarios in which the market could move significantly in either direction. Currently, investors seem to be weighing the positive outcomes more heavily as the massive amount of current and expected fiscal and monetary stimulus may have put a floor in risk assets.

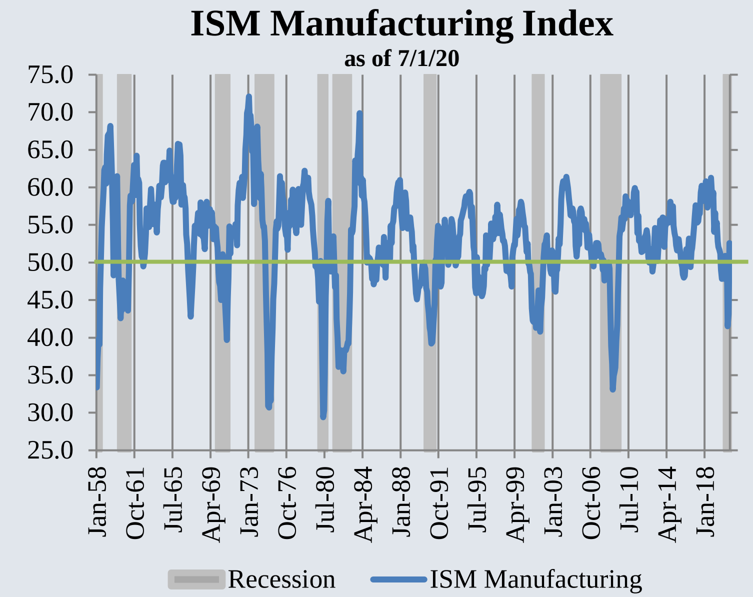
Considering the extreme negative and subsequent positive market volatility over the past two quarters, now is a great time to self-reflect and determine if your asset allocation is truly consistent with your risk tolerance and aligns with your long-term goals. Some investors may have felt like they were riding an emotional roller-coaster and were not comfortable seeing significant declines in their portfolio. While others may have held tight, knowing their portfolio and financial situation meets their long-term objectives. Lastly, other investors may have felt they could tolerate even more risk in their portfolio than previously thought. Over the remainder of the year, a key topic that we will continue to discuss with our clients is their reflection on the past two quarters and how that may affect their ability and willingness to take risk.

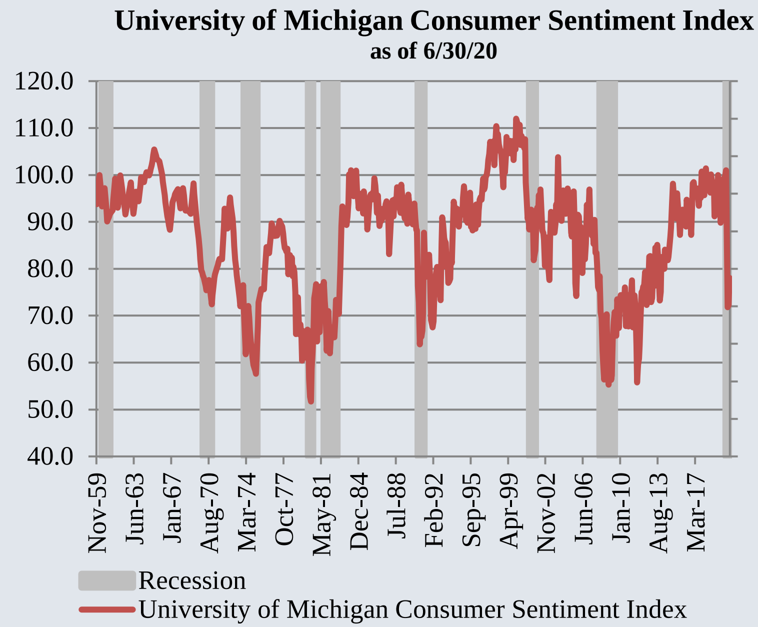
MACROECONOMICS

- The Bureau of Economic Analysis released the advanced estimate of second quarter 2020 real GDP, an annual rate decrease of 32.9% from the preceding quarter. The dramatic decline in GDP was due to the “stay-at-home” orders across the U.S. in April and May. Third quarter estimates expect a large positive GDP growth rate as economic activity rebounds.
- The U.S. government is looking to pass another round of stimulus to support businesses, individuals and state and local governments.
- The ISM Manufacturing Index remained weak to start the quarter, but picked up in June, finishing at 52.6, versus 49.1 in March. Typically, when the ISM Index is above 55 it is bullish and when it is below 45 it is bearish. The ISM Non-Manufacturing Index was also very weak in April and May but rebounded to 57.1 in June.
- In June, the Conference Board Leading Economic Index increased 2.0% month-over-month to 102.0. The index, which is a composite of leading employment, housing, manufacturing, and market indicators, has increased in the past two months after falling significantly from January highs.
- The price of WTI Crude Oil was $39.27 at the end of June, which is 91.5% higher than $20.51 at the end of March. The price of Brent Crude Oil ended the quarter at $41.64, which is 180.4% higher than at the end of March. The price of oil has been extremely volatile over the past few months due to a supply and demand imbalance; however, the price has been more stable in the past month.
- Inflation had remained stable over the past few years around 2.0%; however, in the past few months CPI has fallen considerably. In June, headline CPI increased only 0.6% year-over-year. Core CPI, which does not include food and energy, had a 1.2% increase.

CONFIDENCE METRICS

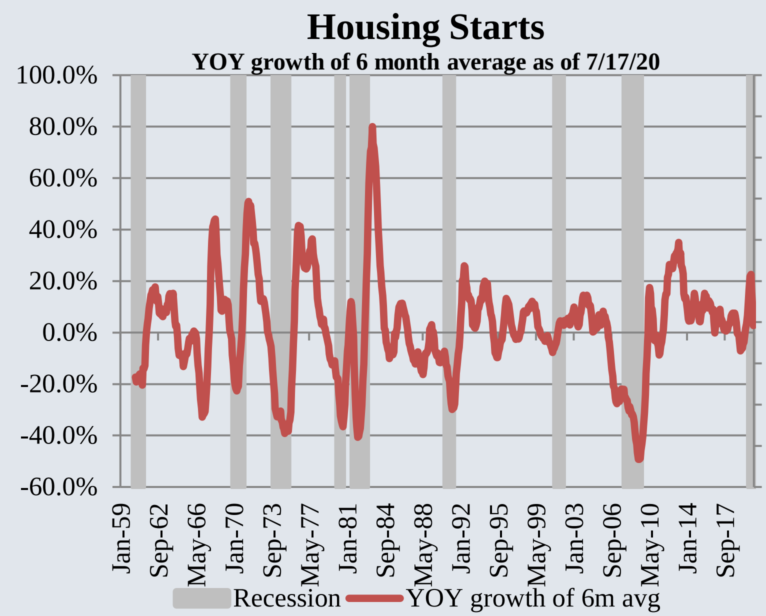
- Consumer confidence weakened due to the impact of COVID-19 and the shutdown of the economy in April and May. With the partial re-opening of the economy and month-over-month improvement in employment, consumer confidence marginally increased in June.
- The University of Michigan Consumer Sentiment Index final reading for June was 78.1, which is a significant decline from its high of 101.0 in February.
- The Conference Board’s Consumer Confidence Index June reading was 98.3, down from 118.8 in March.





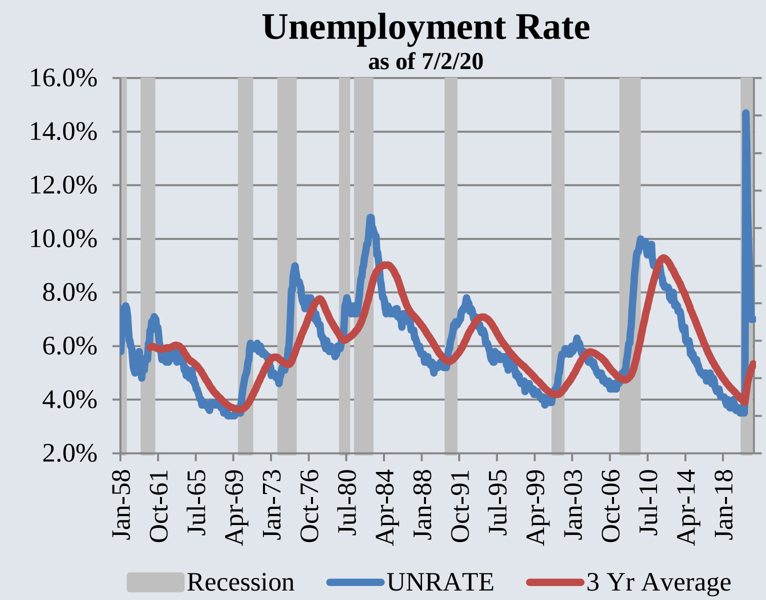
HOUSING

- The housing sector stalled during the COVID-19 shutdown. However, housing data appears to be recovering as states and businesses have "re-opened". In addition, lower mortgage rates will continue to support the sector.
- Preliminary existing home sales decreased in the quarter, with a monthly average annualized rate of 4.32 million units from 5.48 million units in the first quarter. Unsold home supply remains at low levels.
- The preliminary existing home sale prices for June were 3.5% higher than the levels of one year ago. Prices have been trending up since the beginning of 2012 and are currently at all-time highs.
- New home sales and prices were lower during the quarter but remain healthy.
- S&P Case-Shiller 20-City Home Price Index (seasonally adjusted) showed home prices rose over 3.7% year-over-year in May. Of the locations in the Index, home prices in San Francisco, Seattle, Phoenix, Las Vegas, and Denver have risen the most since 2011, while New York, Chicago and Washington D.C. have seen the least price growth.
- Housing starts were down significantly during the quarter, bottoming in April. However, in May and June, housing starts have started to rebound.



EMPLOYMENT

- The labor market has weakened significantly due to the impact of COVID-19, and will likely take many years to return to pre-COVID-19 levels. Fiscal stimulus has aided to offset some of the damage to household incomes.
- During the quarter, nonfarm payrolls averaged 4,429,000 jobs subtracted per month due to an April report that saw a historic decline in payrolls. In May and June, there were positive jobs added to payrolls.
- The unemployment rate increased during the quarter to 11.1% and peaking at 14.7% in April. The unemployment rate is the highest it has been since WWII.
- Initial Jobless Claims surged to an all-time record in April. Many of the jobless claims are in the restaurant, leisure, retail and education sectors.

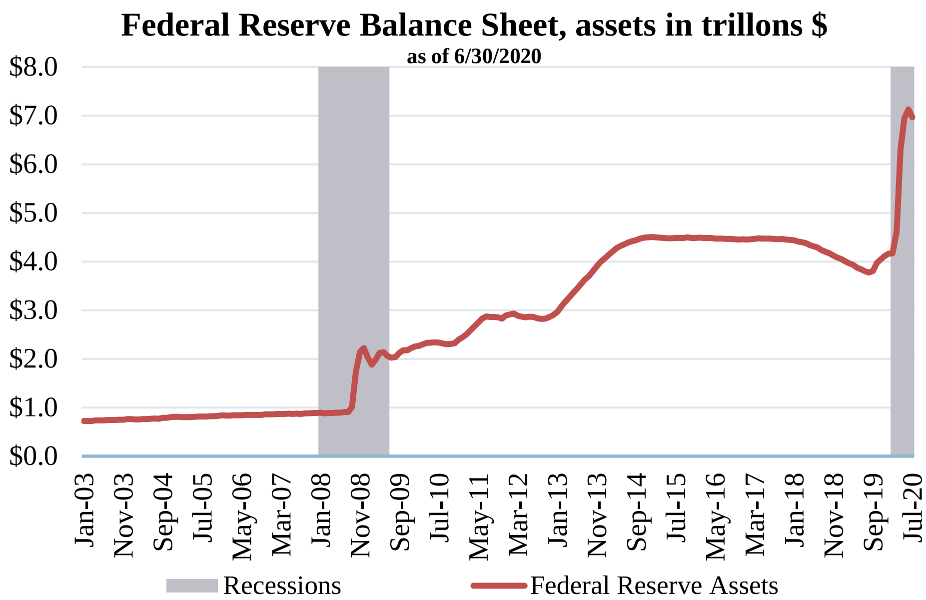


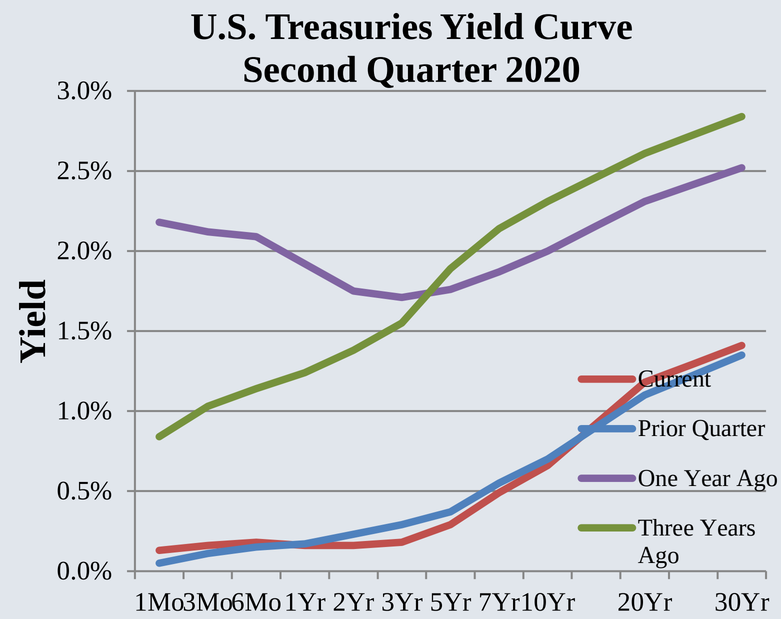
FED POLICY

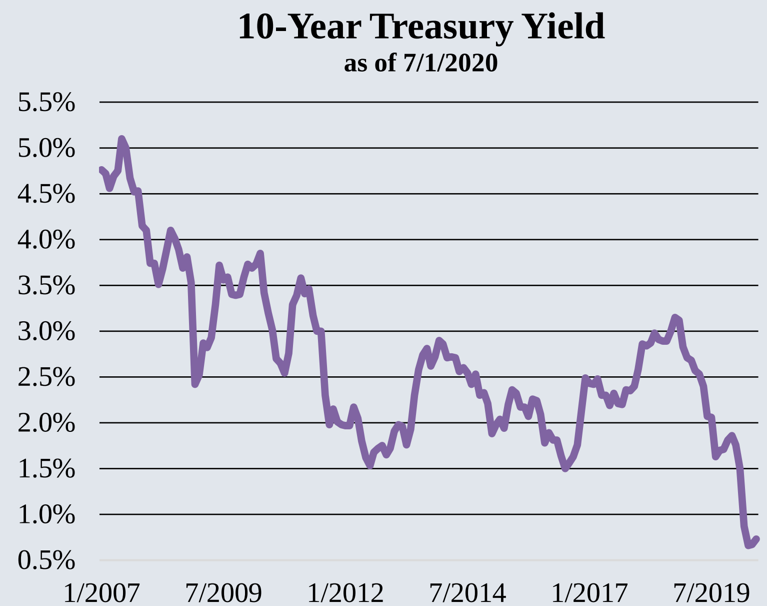
- The Federal Open Market Committee (FOMC) kept the federal funds rate at a target range of 0.00% - 0.25% in June. The Fed will keep the fed funds rate low for an extended period of time.
- The Fed's economic projections for GDP, unemployment rate and inflation appear to be more subdued than consensus market expectations. The projections show a more prolonged recovery. Continued monetary stimulus may be required in that scenario, thus the Fed reiterated that they have more tools they could use to combat economic weakness.
- Monetary stimulus by the Federal Reserve has pushed its balance sheet above $7T from $4T in February. If the Fed were to continue its asset purchase programs and use all of the announced capacity in their credit facilities, their balance sheet would grow to $10T.

FIXED INCOME

- During the second quarter, U.S. Treasury yields did not change much across the curve as the Fed remains committed to their bond buying programs.
- Short-term interest rates are controlled or heavily influenced by central banks, whereas long term interest rates are controlled by market forces and economic growth.



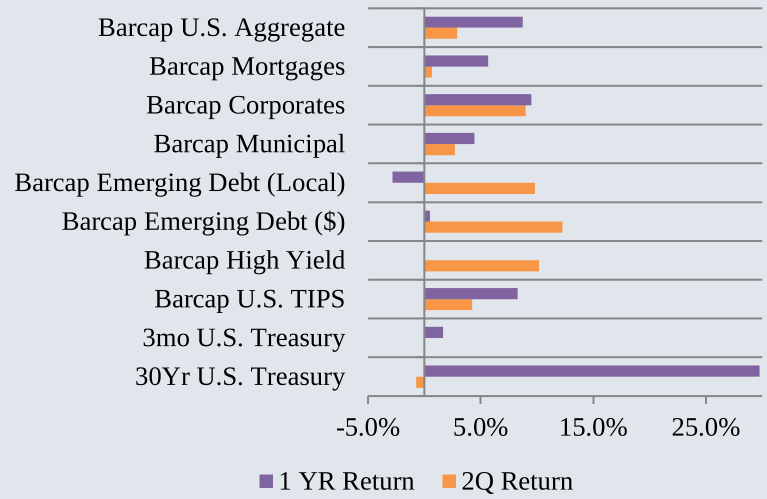




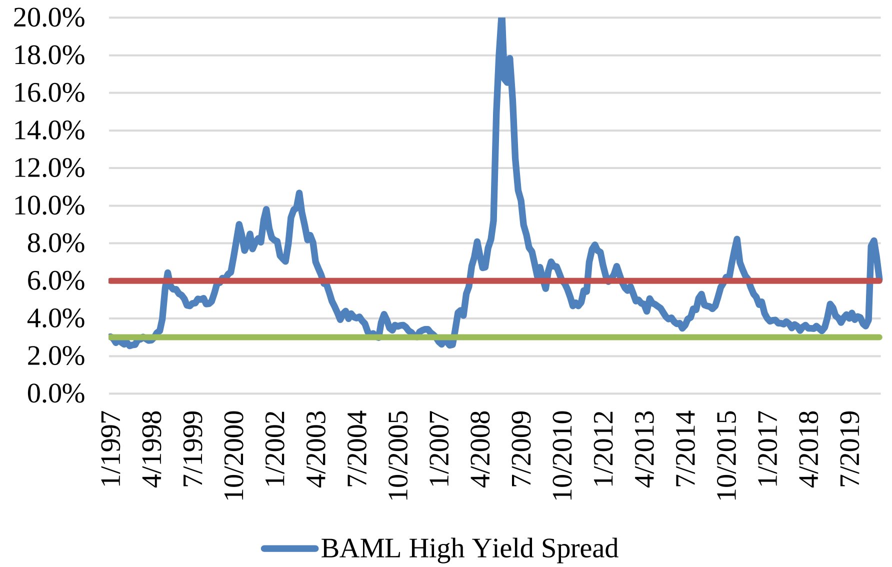
FIXED INCOME (continued)

- During the quarter, the Bloomberg Barclays U.S. Aggregate Index returned 2.9%. Credit sectors outperformed Treasuries during the second quarter. Emerging market debt, high yield and investment grade corporates had the strongest performance.
- Defaults and downgrades have increased; however, credit spreads have continued to contract.
- The Fed's impact on the fixed income market with their monetary stimulus, including bond purchasing programs, has been significant. It has reduced volatility and encouraged investors to take risk, which has led to strong returns in the credit sectors since April.
- U.S. and foreign developed government yields are the lowest they have been in history. The compensation for the interest rate risk is not compelling. That being said, Treasuries remain one of the only asset classes negatively correlated to equities.

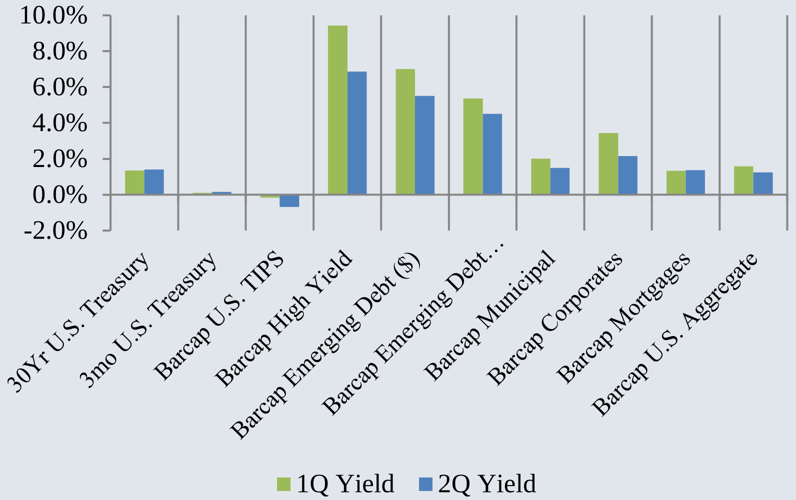
Fixed Income Returns Second Quarter 2020



Credit Spreads - High Yield
as of 7/1/2020



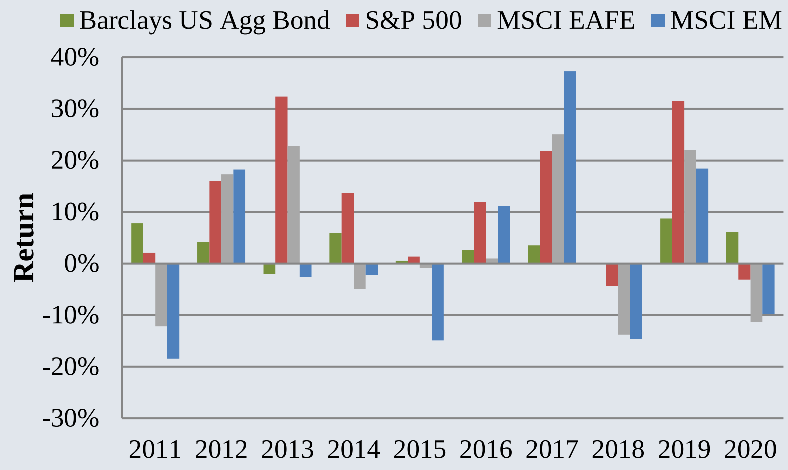
Fixed Income Yields Second Quarter 2020



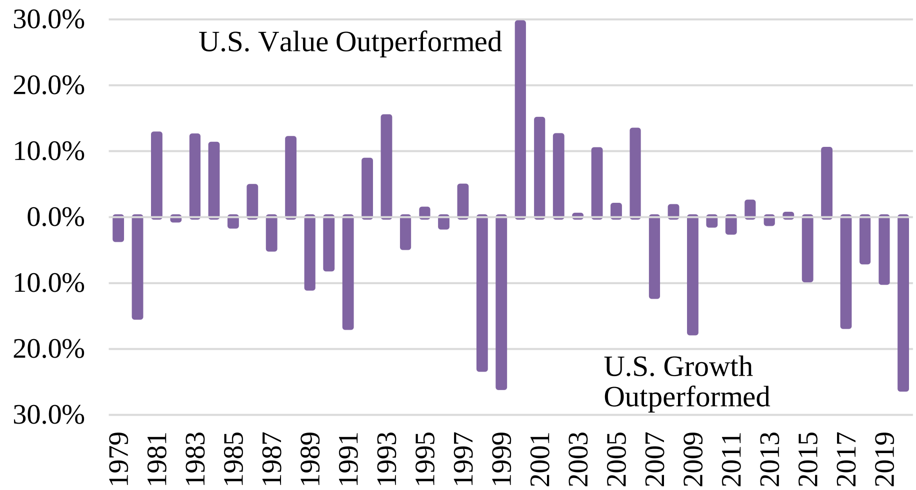
EQUITIES

- Risk assets have been supported by monetary and fiscal policy, leading to a strong rebound in prices in the second quarter. Equities advanced seemingly every time there was a COVID-19 vaccine announcement or the potential for more stimulus.
- As a style, growth continued to outperform versus value. The NASDAQ Composite Index, which is concentrated by growth sectors, is at all-time highs.
- The top 5 names by market cap (Apple, Microsoft, Amazon, Google and Facebook) in the S&P 500 Index make up over 23% of the index. The concentration of market cap in the top names in the index is at historical levels.
- Upcoming risks that the market will need to navigate include the U.S. elections in the fall and geopolitical events, such as the U.S./China rivalry, that continually seem to flare up. In addition, the economy may continue to be hampered by additional waves of COVID-19 infections. Policy response will be a key determinant as the population learns to live with the virus.

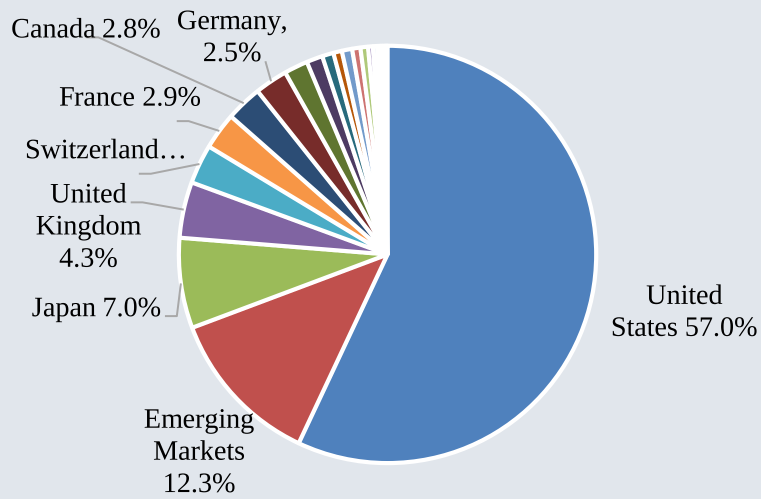
Equity & Fixed Income Market Annual Returns
(as of 6/30/2020)



U.S. Value vs. Growth Relative Equity Performance (as of 6/30/20)



Country Weighting in MSCI ACWI
(as of 7/28/2020)



DOMESTIC EQUITIES

- The Russell 1000 Index, comprised of large and mid-capitalization stocks, posted a total return of 21.8% during the second quarter. All sectors were up during the quarter led by Technology and Energy. On a year-over-year basis, the Russell 1000 Index has increased 7.5%.
- Small capitalization stocks, as represented by the Russell 2000 Index, increased 25.4% during the second quarter. On a year-over-year basis, the index has decreased 6.6%.
- Corporate operating earnings have declined significantly and are expected to bottom-out over the next few quarters. Industries such as energy, retail, leisure and financials will be impacted more by the current environment than many technology and health care companies. However, the market has already started to price in the rebound of earnings in 2021.
- Valuations based on P/E have risen to highs last seen in the late 1990s, as markets have rebounded despite falling earnings. Valuations relative to fixed income provide a more compelling view. Over the short-term, valuations tend to have little influence on returns but over longer periods they tend to be more correlated.

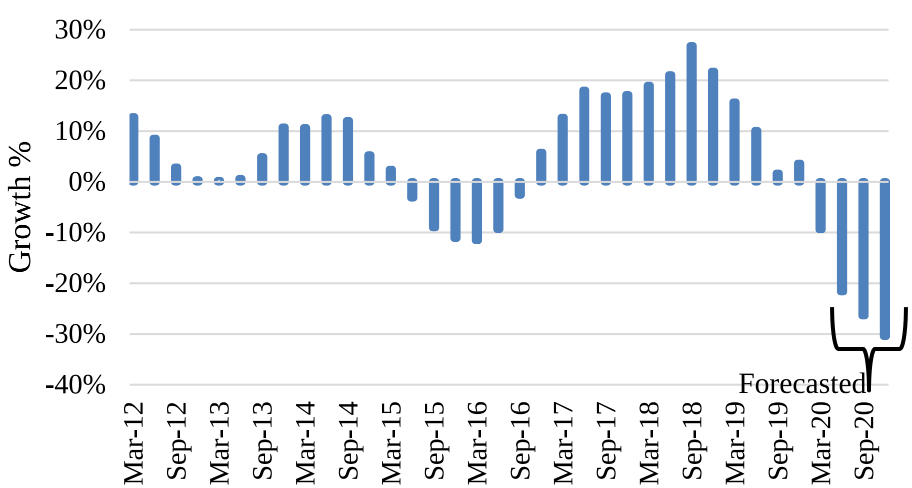
Second Quarter 2020 Returns

	Value	Core	Growth
Mega Cap		22.1%	
Large Cap	14.3%	21.8%	27.8%
Mid Cap	20.0%	24.6%	30.3%
Small Cap	18.9%	25.4%	30.6%
Micro Cap	22.9%	30.5%	38.8%

S&P 500 Earnings Growth

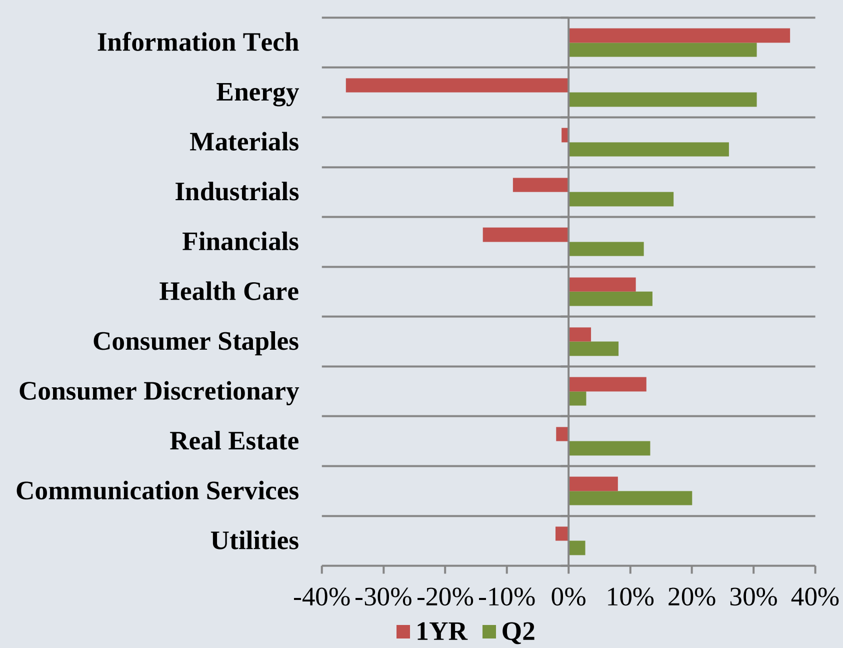
Trailing 12-Month Operating Earnings Growth YOY

(as of 7/23/2020)



U.S. Equity Market Returns by Major Sector

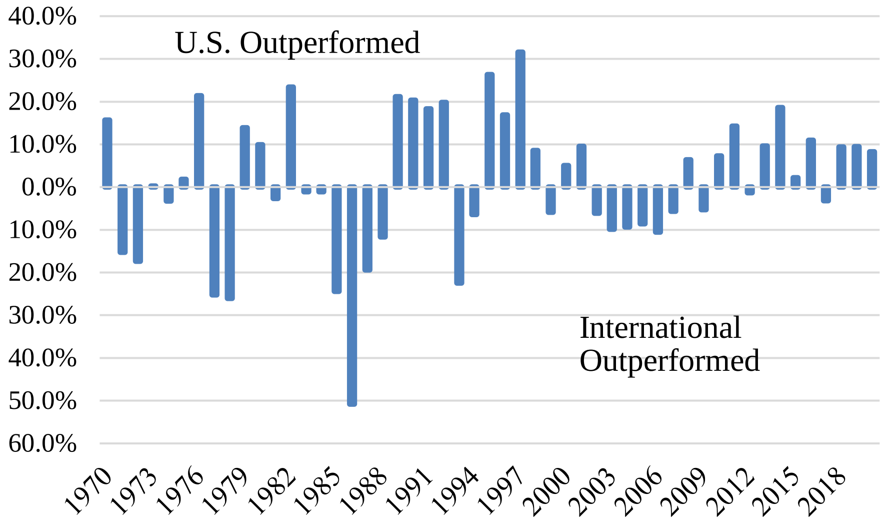
(Securities in S&P 500, Second Quarter 2020)



INTERNATIONAL EQUITIES

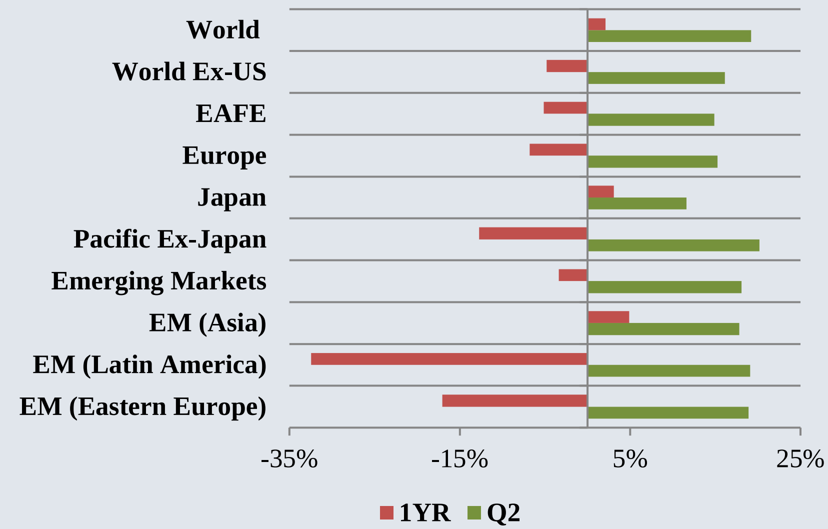
- Developed international stocks, as represented by the MSCI EAFE, were up 14.9% during the quarter. On a year-over-year basis, the EAFE is down 5.1%, performing worse than U.S. domestic equities.
- Emerging market stocks outperformed developed markets during the second quarter as the MSCI Emerging Markets Index rose 18.1%. On a year-over-year basis, emerging market stocks have a slight edge versus developed markets with a return of -3.4%.
- Most international markets have seen a partial rebound in economic data in the past two months. In addition, monetary and fiscal stimulus have helped support markets.
- The U.S. dollar depreciated during the quarter, benefitting international equity performance.
- The past few years have seen the rise of populism and de-globalization pressures. Going forward, global asset diversification may provide more benefit than it has over the previous decade.

U.S. vs. International Equity Performance
(as of 6/30/20)

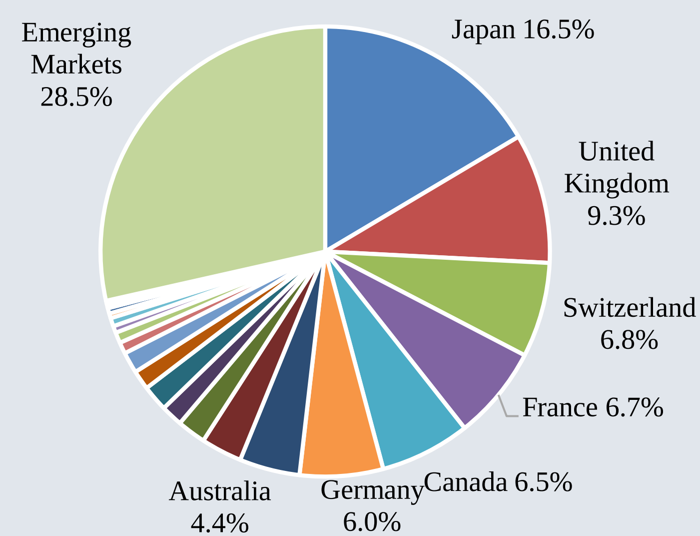


S&P 500 TR vs. MSCI EAFE NR

Non-U.S. Equity Market Returns
Second Quarter 2020



Country Weighting in MSCI ACWI ex US
(as of 7/28/2020)



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