MARKET COMMENTARY: SECOND QUARTER 2020

EXECUTIVE SUMMARY

Markets experienced a historic recovery during the second quarter, with U.S. stocks posting their best quarterly results in two decades according to the Wall Street Journal.[1] While the economic climate continues to improve from first quarter lows, further recovery is likely contingent upon our ability to contain COVID-19. Faced with the current public health crisis, the Fed stated it will likely keep rates at zero for the foreseeable future. During the recent period of market volatility, many active managers failed to generate alpha and underperformed passive index strategies, potentially due in part to poor market timing. We believe both recent and long-term results reinforce The Mather Group's long-held belief that index-based investing best serves the needs of our client families, especially in times of increased uncertainty.

MARKET SPOTLIGHT: ACTIVE MANAGEMENT DURING CORONAVIRUS

At The Mather Group, we have been vocal in our belief that passive index-based investing outperforms active management over the long run. This belief is based upon long-term research, by S&P Dow Jones Indices LLC in the form of the SPIVA (S&P Indices Versus Active) Scorecard.[2]

Looking at the long-term track records (10 – 15 years) in the report, we can see that active management generally has underperformed an equivalent index. For example, over a 15-year period, 88.4% of all domestic U.S. equity funds have failed to exceed their equivalent index according to SPIVA. International markets, excluding small company stock, show the same, where over 82% of managers have underperformed over the long-term. Not surprisingly, fixed income has underperformed as well.

MARKET SPOTLIGHT KEY TAKEAWAYS

- An update to the SPIVA Scorecard through 4/30 was published, and illustrates the continued struggles for active management
- Active management did not fare well during the downturn, outside a few pockets of strength, as shown in the SPIVA Scorecard
- We believe underperformance relative to a comparable index for active management, both over long- and short-term periods, continues to support our index-based philosophy

Some active managers may claim that they can justify higher fees in times of stress, where they ideally can hold up better due to security selection and market timing.[3] The SPIVA Scorecard provides an update from January to April 2020 so we can see how active management held up to scrutiny in the recent period of stress based on evidence-based metrics.

The SPIVA Scorecard finds that over this short near-term period, large-cap growth, mid-cap, and small-cap active managers held up well relative to their benchmarks, but still underperformed over longer periods of time. International stock performance was close to a coin-flip whether active funds outperformed, and fixed income managers did not fare well in this environment.

Echoing the conclusion of S&P Dow Jones Indices LLC arrived at, these early 2020 results do not support the view that active funds navigate market turmoil better than index-based funds and did not change the active funds' tendency to underperform indices over the long term. And, of course, picking in advance those small number of active managers who might outperform has proven to be extremely difficult.

Sources:
1. 'U.S. Stocks Finish Best Quarter in More Than 20 Years', The Wall Street Journal, 30 June 2020
2. Berlinda Liu, 'Active Managers: No Place to Hide', S&P Dow Jones Indices, 10 June 2020
3. 'Four Reasons in Favour of Active Management', Infinity Financial Solutions

DOMESTIC ECONOMY AND MARKET

In a rapid reversal of the losses seen in the first quarter, large cap stocks (measured by the S&P 500) returned 20.54% in Q2. Growth and Technology stocks, measured by Nasdaq, led the way at 30.21%, while small-cap stocks were up 25.42%, measured by the Russell 2000. Much like we have seen over the past decade, growth companies continue to outperform value companies.

The coronavirus pandemic caused economic readings across the board to plummet to a degree that is hard to fathom. However, through June, the reopening of some businesses and an improving economy in some states has helped current economic readings.

For instance, in June, the Purchasing Manager's Index Manufacturing (PMI)[4] report improved to a 49.8 reading from a prior 39.8, with orders stabilizing, though exports are still weak due to rising US infections overall. The Institute for Supply Management (ISM) reading[5] was also strong, rising to 52.6 from a prior 43.1 reading. Taking a deeper look at both reports shows that while there has been substantial improvement, there is a lack of demand from overseas and employment remains weak. Service sector readings in June were improved from a prior 37.5 reading, but still in contraction with the PMI Service report at 47.9, even with more business reopenings.[6] ISM non-manufacturing was stronger than expected at 57.1 and near-pre-COVID levels, driven by increased business activity, though employment continues to lag.[7] The labor market saw an improvement in jobless claims to 1.27 million, down from a peak of 6.648 million,[8] bringing the unemployment rate down to 11.1% (peak 14.7%). The participation rate at 61.5% is improved, but lower than the 63.4% rate before the crisis, implying that the shutdown may have caused some workers to stop looking for work. While many are still out of work, wage growth was down -1.2% M/M but still up 5% Y/Y, illustrating that the shutdowns have not impacted all workers equally.[9]

The FOMC[10] minutes show that improvement in the economy is modest, inflation is lower, and market sentiment is a bit improved, despite expecting a -6.5% contraction in GDP in 2020. Most importantly for the markets, the FOMC remains committed to using all tools available to stimulate the economy and attempt to prop up markets.

DOMESTIC EQUITY MARKET KEY TAKEAWAYS

- Stock returns were strong in 2Q20, regaining significant lost ground
- Economic data referenced in this report indicates the economy is recovering, though still off previous highs
- The Federal Open Market Committee (FOMC) expects a significant contraction in Gross Domestic Product (GDP) and is committed to using all tools at their disposal

DOMESTIC MARKET RETURNS

Equity Index	2Q20 Return %	2020 YTD %
S&P 500	20.54%	-3.08%
Dow Jones Industrial	21.78%	-3.13%
NASDAQ	30.21%	16.71%
Russell 2000	25.42%	-12.98%

Source: BlackRock Benchmark Returns Comparison as of June 30, 2020

Sources:
4. '2020 U.S. Economic Events & Analysis – PMI Manufacturing Index', Econoday, 1 July 2020
5. '2020 U.S. Economic Events & Analysis – ISM Mfg Index', Econoday, 1 July 2020
6. '2020 U.S. Economic Events & Analysis – PMI Services Index', Econoday, 6 July 2020
7. '2020 U.S. Economic Events & Analysis – ISM Non -Mfg Index, Econoday, 6 July 2020
8. '2020 U.S. Economic Events & Analysis – Jobless Claims, Econoday, 2 July 2020
9. '2020 U.S. Economic Events & Analysis – Employment Situation, Econoday, 2 July 2020
10. '2020 U.S. Economic Events & Analysis – FOMC Minutes, Econoday, 26 June 2020

Consumer sentiment was weaker at 78.1, but improved from the lows of 71, though well off the February 2020 high of 101.[11] Consumer confidence[12] is up to 98.1 despite the continuing crisis and social unrest. In the readings, it seems survey respondents are more optimistic about the ability to find a job, and buying plans have been especially favorable for homes, partially due to low mortgage rates. Although a continuation of the crisis is a distinct possibility and not all participants are equally affected by the crisis, it seems that U.S. consumers also are slightly more optimistic about the future as of the end of June.

INTERNATIONAL ECONOMY AND EQUITY MARKET

As coronavirus continues to impact the entire world, some countries have done a better job than others in reducing the spread of disease. Foreign stock markets in general have lagged the U.S., with the Morgan Stanley Capital International (MSCI) World ex-USA index at -11.49% YTD through June 30. Developed markets, measured by MSCI EAFE (Europe, Australasia, & the Far East), have declined -11.34% in 2020, while the MSCI Emerging Market Index was only down -9.78% through June 30.

INTERNATIONAL EQUITY MARKET KEY TAKEAWAYS

- World markets are working though the effects of coronavirus
- China had one of the best stock market returns in the world, as they recover from COVID-19

Just like in the U.S., Global Purchasing Managers Index readings (an index summarizing whether market conditions, as viewed by purchasing managers, are expanding, staying the same, or contracting) were improved. In the Eurozone, Manufacturing is still in contraction, but greatly improved at 48.5 compared to May's 31.9 level, and the service sector which saw similar improvement at 48.3. This illustrates swift improvement in Europe where France has recently seen the best growth, while Germany continues to struggle. Looking at less developed countries we see greater manufacturing growth out of Columbia, Turkey, Kazakhstan, Brazil, China, Vietnam, and Malaysia which all had the manufacturing sector growing.[13]

INTERNATIONAL MARKET RETURNS

Index	2Q20 Return %	2020 YTD %
World, ex-USA	15.34%	-11.49%
Europe, Australasia and Far East (EAFE)	15.57%	-11.60%
Europe	15.26%	-12.78%
Japan	11.64%	-6.92%
Emerging Markets	18.93%	-10.09%
China	15.37%	3.58%

Source: BlackRock Benchmark Returns Comparison as of June 30, 2020

All foreign countries stock markets were not impacted by COVID-19 equally and have not recovered equally. Of all major countries in the world tracked by MSCI,[14] China has seen one of the best stock market returns year to date at +3.58%. While China was the first country with a major outbreak, they seemingly have taken drastic measures and gotten the pandemic under control, leading to higher rates of economic growth in their country.

European countries have been more united in the response to COVID-19 and the European Central Bank (ECB) has pursued asset purchases, work subsidies to keep unemployment low, passed a historic $2 trillion deal to rebuild Europe's economy, showing a rare degree of unity.[15]

Sources:

11. '2020 U.S. Economic Events & Analysis – Consumer Sentiment, Econoday, 26 June 2020
12. '2020 U.S. Economic Events & Analysis – Consumer Confidence, Econoday, 26 June 2020
13. Purchasing Managers' Index ®, IHS Markit, 3 July 2020 & J.P.Morgan Global Manufacturing PMI, J.P.Morgan, 1 July 2020
14. MSCI Index, MSCI Inc., 30 June 2020
15. James Frater & Michelle Toh, ' EU leaders strike historic $2 trillion deal to rebuild Europe's Economy', CNN, 21 July 2020

During the crisis there have been some changes to equity valuations. According to J.P. Morgan, developed international markets are priced slightly higher than their 25-year averages from a forward Price-to-Earnings standpoint, while the U.S. is even more expensive than the historical average at 21.8x, primarily driven by a recovery in growth stocks. Japan still stands out at a low P/E of 16.47, compared to Japan's average of 21.1, and Emerging markets arerelatively attractive with recovering growth and some improvement in the COVID-19 crisis.[16]

From a historical valuation perspective, current levels point to potentially greater headwinds for the U.S. stock market, while implying continued opportunity overseas. However, it remains important to remind investors that valuation levels are not guaranteed to be useful from a timing perspective. As always, we continue to believe that international exposure is an important part of a diversified portfolio.

FIXED INCOME MARKET

Bonds posted strong second quarter results, with all but one segment well into positive territory during the quarter. These solid returns can be attributed to the Fed's landmark stimulus program, improving economic conditions, and modest inflation. The Bloomberg Barclays US Aggregate Bond Index, an index used to track overall U.S. bond market performance, returned 2.91% for the second quarter and is up 6.06% YTD.[17]

This year, the U.S. and global economy faced an unprecedented economic shock due to the coronavirus pandemic. Given the ongoing public health crisis, the Fed plans to keep the Federal Funds rate at 0% through 2021. In June, Fed Chairman, Jerome Powell, stated "In light of these developments, the Committee decided to maintain the target range for the federal funds rate at 0% to 0.25%. The Committee expects to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals." [18]

Bonds continue to recover from their mid-March lows, with High Yield, Corporate and Municipal interest rates falling across the board as prices stabilize. During the second quarter, High Yield, Corporate, and Municipal yields fell by 2.72%, 0.96%, and 0.70%, respectively.[19,20] The recovery in bond price levels can be attributed, in part, to recent Fed actions through the creation of bond buying programs and liquidity facilities. Thus, the Fed's actions and statements have helped to stabilize markets in recent months.

FIXED INCOME MARKET KEY TAKEAWAYS

- Solid bond returns across the board
- Fed plans to hold rates at zero
- High Yield, Corporate, and Municipal bond price levels continue to recover from mid-March lows

Sources:
16. 'Guide to the Markets ®', J.P. Morgan Asset Management, 30 June 2020
17. Morningstar
18. 'Monetary Policy', Federal Reserve
19. 'ICE BofA US High Yield Index Effective Yield', Federal Reserve Bank of St. Louis
20. 'Fixed Income, Bonds & CDS', Fidelity

During Q2, Emerging Markets led the way, posting a 12.64% return, with YTD returns at -2.79%. Corporate Long, Intermediate, and High Yield posted strong returns of 11.27%, 9.25%, 8.36%, respectively. The strong returns demonstrate the resiliency of this asset class. U.S. government backed bonds were the Q2 laggards, with Treasury Long, Treasury Short, Mortgage-Backed Securities, and Treasury Intermediate posting -0.75%, 0.11%, 0.17%, and 0.70%, respectively. Even so, treasuries are still leading all other bond segments for YTD returns, with Treasury Long posting an impressive 21.50% total return. YTD Laggards are High Yield Muni and High Yield Corporate, posting -6.15% and -5.46% returns, respectively.

The Mather Group has and will continue to leverage our sophisticated technology and trading systems to add value during this pullback by conducting tax loss harvesting and rebalancing portfolios, when appropriate. Our Investment Committee continues to closely monitor the situation to help client portfolios maintain proper exposures. It is important to stay focused on your goals and stick with your long-term financial plan. Investing is not easy, and it is periods such as these that can test the true grit of all investors. Most importantly, we at The Mather Group hope you and your loved ones are staying healthy during these trying times. As always, please do not hesitate to contact us with any questions or concerns you may have.

Adam Recker, CFA, CFP®
Michael Furla, CFA, CFP®
Research Contributor - Steven Zaguli

Fixed Income Performance

	2Q20	YTD	2019	2018	2017	2016
Broad Market Index						
Bloomberg Barclays US Aggregate Bond	2.91%	6.06%	8.72%	-0.01%	3.54%	2.65%
US Corporate Index						
Corporate Short	5.57%	3.06%	6.85%	0.91%	2.45%	2.63%
Corporate Intermediate	9.25%	5.31%	14.46%	-2.71%	6.38%	6.16%
Corporate Long	11.27%	6.51%	23.20%	-6.91%	12.40%	10.59%
Corporate High Yield	8.36%	-5.46%	14.97%	-3.18%	6.48%	14.75%
US Government Index						
Treasury Short	0.11%	2.91%	3.42%	1.45%	0.27%	0.75%
Treasury Intermediate	0.70%	11.05%	8.38%	0.82%	2.47%	1.00%
Treasury Long	-0.75%	21.50%	14.93%	-2.07%	8.92%	1.36%
Mortgage-Backed Securities	0.17%	3.38%	6.17%	0.87%	2.37%	1.43%
Inflation-Protected Securities	4.32%	6.06%	8.28%	-1.43%	2.92%	4.56%
US Municipal Index						
Muni National Short	2.27%	2.11%	3.53%	1.39%	1.26%	-0.44%
Muni National Intermediate	2.46%	2.04%	7.50%	0.94%	4.96%	0.31%
Muni National Long	2.86%	3.05%	7.53%	0.43%	5.59%	-0.18%
Muni High Yield	1.87%	-6.15%	9.11%	2.14%	10.50%	0.40%
Non-US Index						
Emerging Markets Bond	12.64%	-2.79%	15.57%	-5.67%	9.98%	9.41%
International Bond	2.17%	2.35%	7.88%	2.94%	2.40%	4.67%

Source: Morningstar, Inc. Data as of 6/30/2020

INDEXES

S&P (Standard & Poor's) 500 - is a stock market index that measures the stock performance of 500 large companies listed on stock exchanges in the United States.
Dow Jones Industrial - is a stock market index that measures the stock performance of 30 large companies listed on stock exchanges in the United States.
NASDAQ - a stock market index of the common stocks and similar securities listed on the Nasdaq stock market, which has more of a growth focus.
Russell 2000 – is small-cap stock market index of the smallest 2,000 stocks in the Russell 3000 Index. MSCI World ex-USA – index of large and mid-cap companies of 22 Developed Market countries excluding the United States.
MSCI EAFE - index of large and mid-cap companies of 21 Developed Market countries in Europe, Australasia, & the Far East .
MSCI Europe - index of large and mid-cap companies of 15 Developed Market countries in Europe. MSCI Japan - index of large and mid-cap companies in Japan
MSCI Emerging - index of large and mid-cap companies of 26 Emerging Market countries in Europe. MSCI China - index of large and mid-cap companies in China
MSCI China - index of large and mid-cap companies in China.

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