

Q2

Quarterly Market Review

Second Quarter 2020

WEALTHSTONE
ADVISORS

Quarterly Market Review

Second Quarter 2020

This report features world capital market performance and a timeline of events for the past quarter. It begins with a global overview, then features the returns of stock and bond asset classes in the US and international markets.

The report also illustrates the impact of globally diversified portfolios and features a quarterly topic.

Overview:

WEALTHSTONE Client Letter

Quarterly Topic: Long-Term Investors, Don't Let a Recession Faze You

Market Summary

World Stock Market Performance

World Asset Classes

US Stocks

International Developed Stocks

Emerging Markets Stocks

Select Market Performance

Select Currency Performance vs. US Dollar

Real Estate Investment Trusts (REITs)

Commodities

Fixed Income

Global Fixed Income

Impact of Diversification

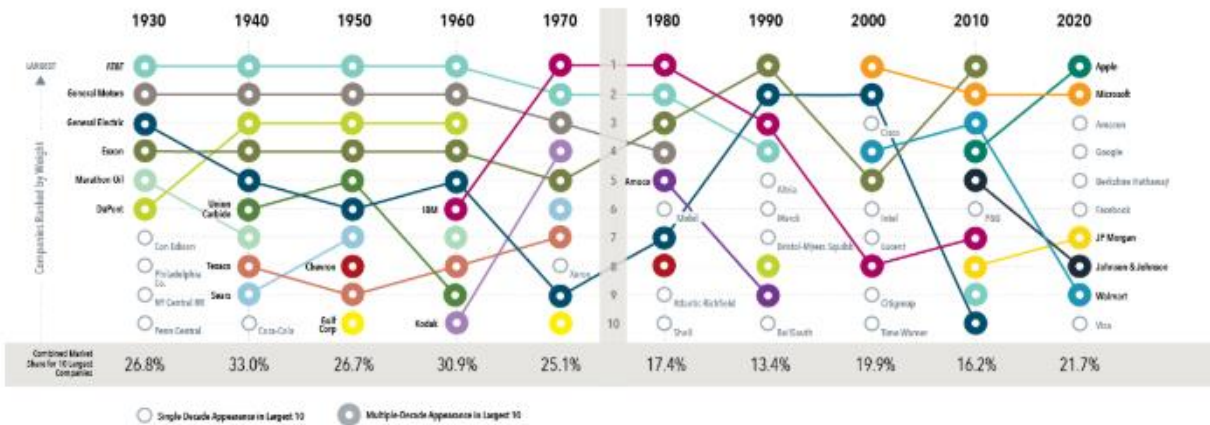
Market Extremes and the Fate of Value Investing

The variety of options for an appropriate title for the 2020 Q2 WEALTHSTONE Asset Management Investment Review would appear to be a nearly endless list. After all, 2020 has delivered a string of extremes we won't soon forget: a record unemployment spike, a massive hit to GDP, record volatility, the fastest 35% rout from a previous high since 1929 followed by the best quarter for the S&P 500 in over 20 years just for starters. Unprecedented Central Bank support on a global basis, social turmoil due to continued racial unrest, election year dynamics add heavily to the mix, while the word "pandemic" has just now made it into this quarterly reflection. One could clearly assert that the nature of the COVID-19 pandemic and our collective response to it has caused the extreme market behavior we have witnessed through the first half of this year. So, titles like "A Balanced Approach to an Imbalanced World" or taking a "A Rational View during an Irrational Timeframe" just didn't make the cut.

The second quarter of 2020 was one of the best witnessed in decades but it did not favor all in the same manner. A handful of tech companies are seeing all-time highs while many stocks and industries have yet to feel significant improvement. At the end of long cycles, it is not uncommon to witness extreme behavior in financial markets. We appear to be living through one of these phases at the moment, much as we did twenty years ago. In times of stress and economic turmoil, equity performance becomes very *narrow*. Only a "few, select" companies exhibiting superior fundamentals and with near certain positive future outcomes carry the day for market averages, while almost anything else becomes relegated to "buggy-whip" status. Robert DeLucia, an economist from Prudential, highlighted the following in his second quarter review: "A mere five mega-cap technology stocks comprise nearly 25% of the S&P 500 Index and nearly 50 % of NASDAQ and were responsible for a staggering one-third of total index gains in the quarter."

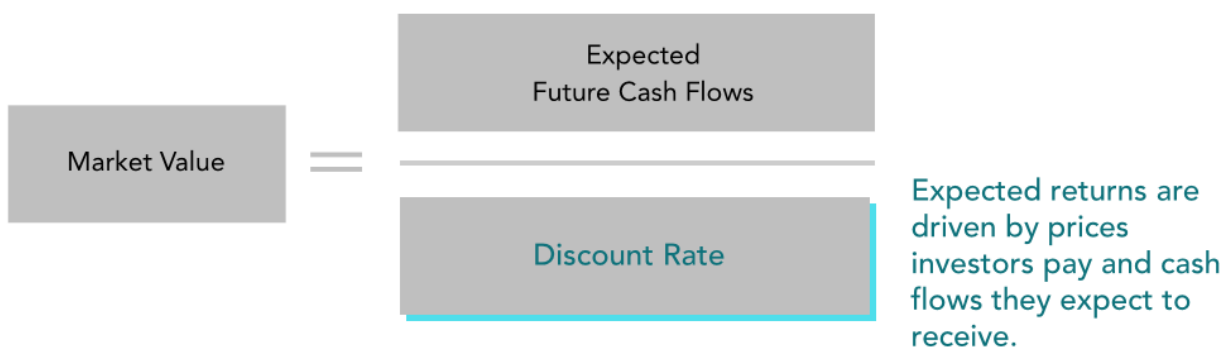
Periods like this tend to challenge conventional beliefs and historical relationships often look completely broken. The reality is that markets are constantly changing and evolving. Throughout time, we can observe dramatic changes in the make-up and construction of equity market indices like the Dow and the S&P 500. From the 1930's into the 70's and even the 80's, companies like AT&T, General Motors, Exxon and General Electric proved to be fantastic innovators and were actually considered "high-tech" leaders of their day and they represented large weightings of the market averages. The "new dynamics" of the equity market can be seen in the attached slide from Dimensional Funds depicting the Top 10 US stocks at the start of each decade.

Largest 10 US stocks at the start of each decade



As can be seen in this exhibit, five new entrants have made their way into the Top 10 as of the beginning of this decade; three of them are tech stocks (Facebook, Amazon and Google) and the others are Berkshire Hathaway and Visa. The five new entrants are shown in gray. The five incumbents this year are Apple, Microsoft, JP Morgan, Johnson and Johnson and Wal-Mart. Incidentally, there were six new entrants 20 years ago and they all underperformed the market in the subsequent decade. The new entrants 20 years ago were Cisco Systems, Intel, Lucent, Citigroup, Time Warner/AOL and Microsoft. Microsoft is the only one of the six to retain its status. However, the company was an equity market laggard for almost 15 years before finding its way back into “favored” territory with new management and an aggressive push into “cloud computing” during the last 5 years. It should be noted that the Dimensional research that accompanied this slide showed that the annualized excess return for these stocks *after* joining the Top 10 list was negative after 5 and 10 years. In all periods from 1927-2019. This is the effect of market discounting in action.

Market discounting is the very essence of value investing. The original work on value investing by Fama and French centered on results of decades of observations reviewing the performance of low price to book stocks. Much of this was conducted before the development of modern software companies and the modern understanding of the value of “brand” equity. Consultants still differentiate value and growth using somewhat outdated notions based on accounting and simple price/book (P/B) measures; but the market’s understanding of value is evolving as can be seen by the following equation from Dimensional Fund Advisors:



While P/B is still worth reviewing, market value should represent the quotient of expected future cash flows divided by the discount rate. This simple equation is also the best expression why “value” will always be a present factor governing markets. In certain environments, its success may appear to go into hibernation, but it will always be relevant as a long term principal. In the current market environment, we can see that Microsoft’s expected cash flows have turned out to be much better than *previously* expected and that the company’s specific discount rate has been lowered due to low interest rates and increased confidence in the outcome for the company. The numerator rising and the denominator falling is a recipe for fantastic success in the stock market.

For a small cap energy company, expectations of cash flows have diminished and the discount rate has risen due to lower confidence of shareholders (even though interest rates have fallen – as creditors would demand a higher return for their increased risk). In this case, the numerator has declined and confidence is shaken leading to a challenging environment for the stock.

In an abrupt event like that brought upon by COVID, the well positioned tech stock will experience a positive jolt even if it is already an expensive stock and the poorly positioned energy stock will simply become ever more cheap. Once the environment changes, so will the outcomes. If and when confidence returns to the energy markets (higher oil price supported by an improving economy), cash flow expectations will most certainly rise and the discount rate will shrink, giving rise to market value. The relative value of all tech stocks will likely be somewhat diminished when this happens because the market won’t appear to be so *narrow* anymore. Proper diversification should once again make sense and concentration among the few would most likely be considered unsustainable.

Sincerely,

WEALTHSTONE ADVISORS Investment Committee

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Long-Term Investors, Don't Let a Recession Faze You

Second Quarter 2020

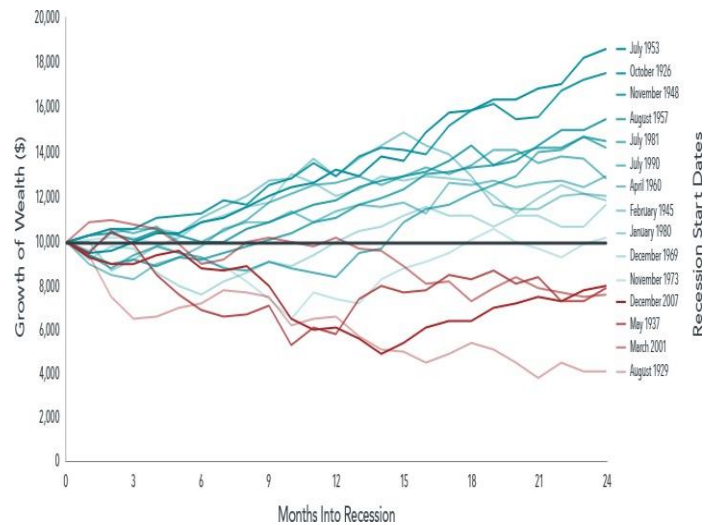
With activity in many industries sharply curtailed in an effort to reduce the chances of spreading the coronavirus, some economists say a recession is inevitable, if one hasn't already begun.¹ From a markets perspective, we have already experienced a drop in stocks, as prices have likely incorporated the growing chance of recession. Investors may be tempted to abandon equities and go to cash because of perceptions of recessions and their impact. But across the two years that follow a recession's onset, equities have a history of positive performance.

Data covering the past century's 15 US recessions show that investors tended to be rewarded for sticking with stocks. **Exhibit 1** shows that in 11 of the 15 instances, or 73% of the time, returns on stocks were positive two years after a recession began. The annualized market return for the two years following a recession's start averaged 7.8%.

Recessions understandably trigger worries over how markets might perform. But history can be a comfort for investors wondering whether now may be the time to move out of stocks.

Exhibit 1. Downturns, Then Upturns

Growth of wealth for the Fama/French Total US Market Research Index



Past performance, including hypothetical performance, is not a guarantee of future results.

In USD. Performance includes reinvestment of dividends and capital gains. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.

Growth of wealth shows the growth of a hypothetical investment of \$10,000 in the securities in the Fama/French US Total Market Research Index over the 24 months starting the month after the relevant Recession Start Date. Sample includes 15 recessions as identified by the National Bureau of Economic Research (NBER) from October 1926 to December 2007. NBER defines recessions as starting at the peak of a business cycle.

GLOSSARY







Fama/French Total US Market Research Index: The value-weighted US market index is constructed every month, using all issues listed on the NYSE, AMEX, or Nasdaq with available outstanding shares and valid prices for that month and

the month before. Exclusions: American Depository Receipts. Sources: CRSP for value-weighted US market return. Rebalancing: Monthly. Dividends: Reinvested in the paying company until the portfolio is rebalanced.

1. Nelson D. Schwartz, "Coronavirus Recession Looms, Its Course 'Unrecognizable,'" New York Times, March 21, 2020; Peter Coy, "The U.S. May Already Be in a Recession," Bloomberg Businessweek, March 6, 2020.

Quarterly Market Summary



















Index Returns

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
2Q 2020	STOCKS				BONDS	
	22.03%	15.34%	18.08%	11.17%	2.90%	1.76%
						
Since Jan. 2001						
Avg. Quarterly Return	2.1%	1.4%	2.7%	2.3%	1.2%	1.1%
Best Quarter	22.0%	25.9%	34.7%	32.3%	4.6%	4.6%
	2020 Q2	2009 Q2	2009 Q2	2009 Q3	2001 Q3	2008 Q4
Worst Quarter	-22.8%	-23.3%	-27.6%	-36.1%	-3.0%	-2.7%
	2008 Q4	2020 Q1	2008 Q4	2008 Q4	2016 Q4	2015 Q2

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]). S&P data © 2020 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2020, all rights reserved. Bloomberg Barclays data provided by Bloomberg.

Long-Term Market Summary

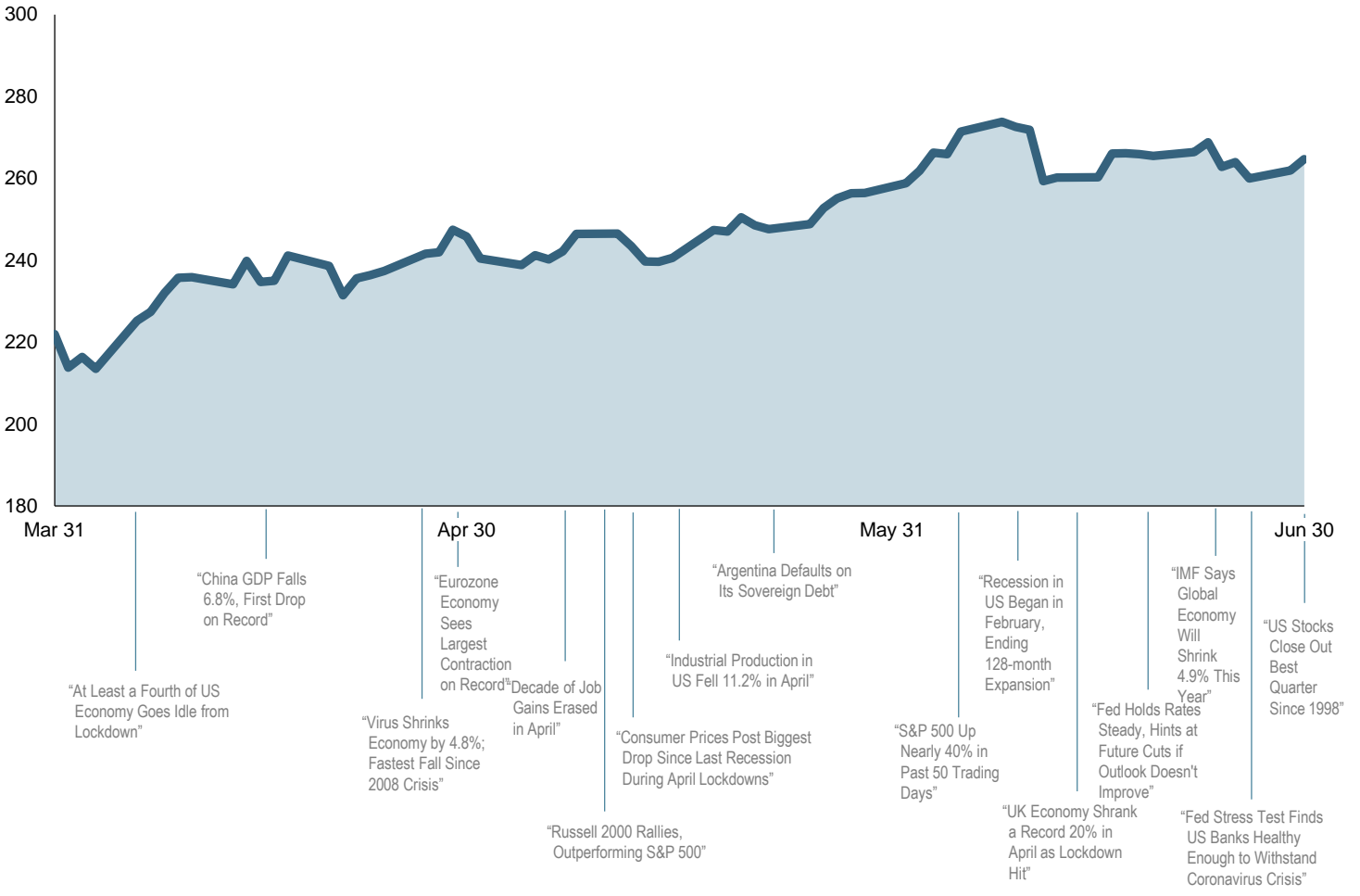
Index Returns

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate		US Bond Market	Global Bond Market ex US
1 Year	STOCKS					BONDS	
	6.53%	-5.42%	-3.39%	-15.91%		8.74%	4.00%
							
5 Years							
	10.03%	2.01%	2.86%	1.62%		4.30%	4.49%
							
10 Years							
	13.72%	5.43%	3.27%	6.97%		3.82%	4.20%
							

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World Stock Market Performance

MSCI All Country World Index with selected headlines from Q2 2020

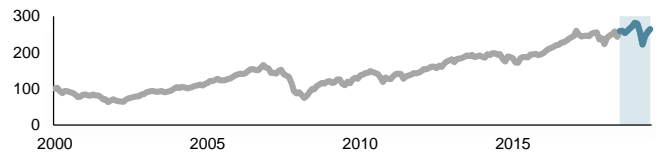


These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

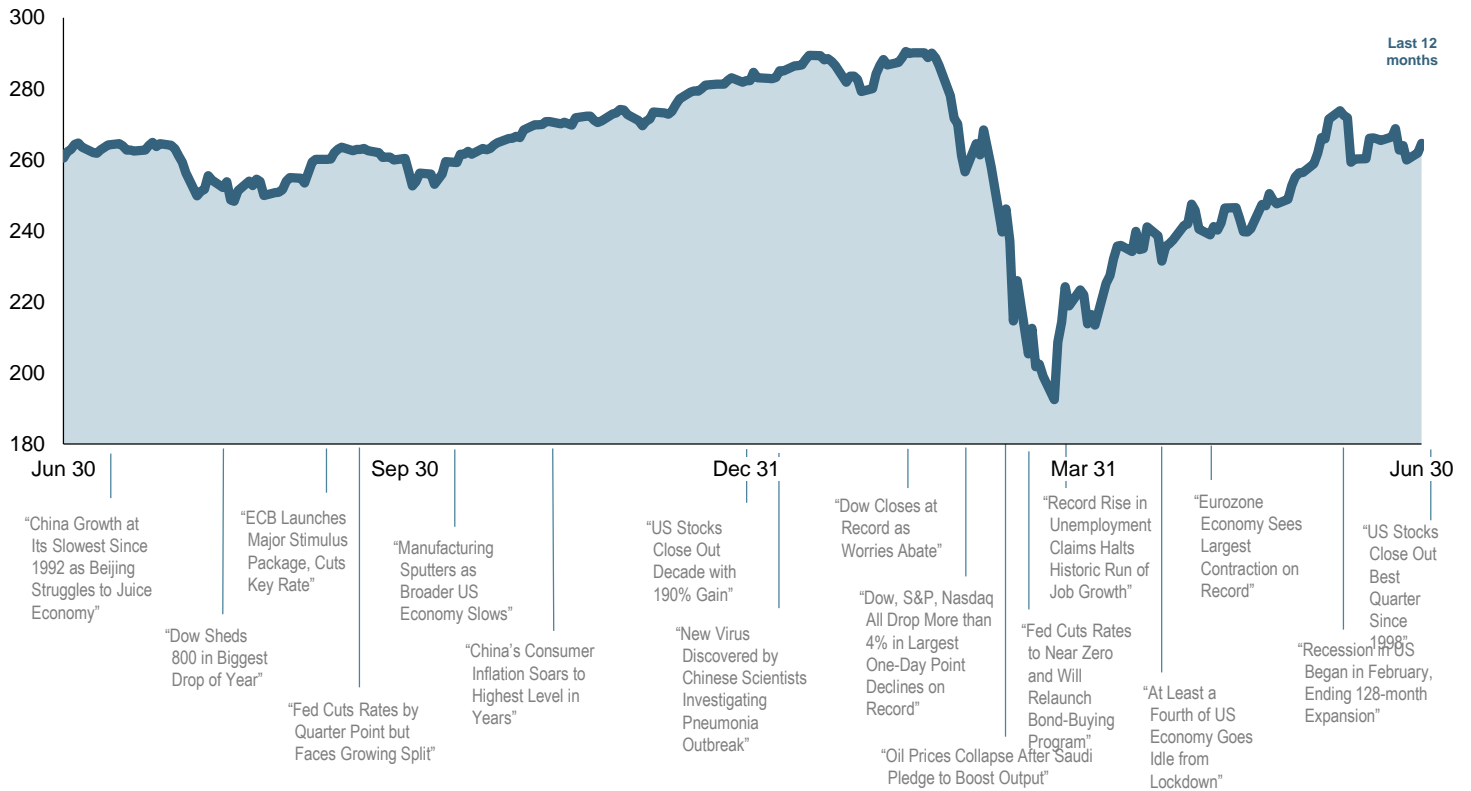
World Stock Market Performance

MSCI All Country World Index with selected headlines from past 12 months

LONG TERM (2000–Q2 2020)



SHORT TERM (Q3 2019–Q2 2020)



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

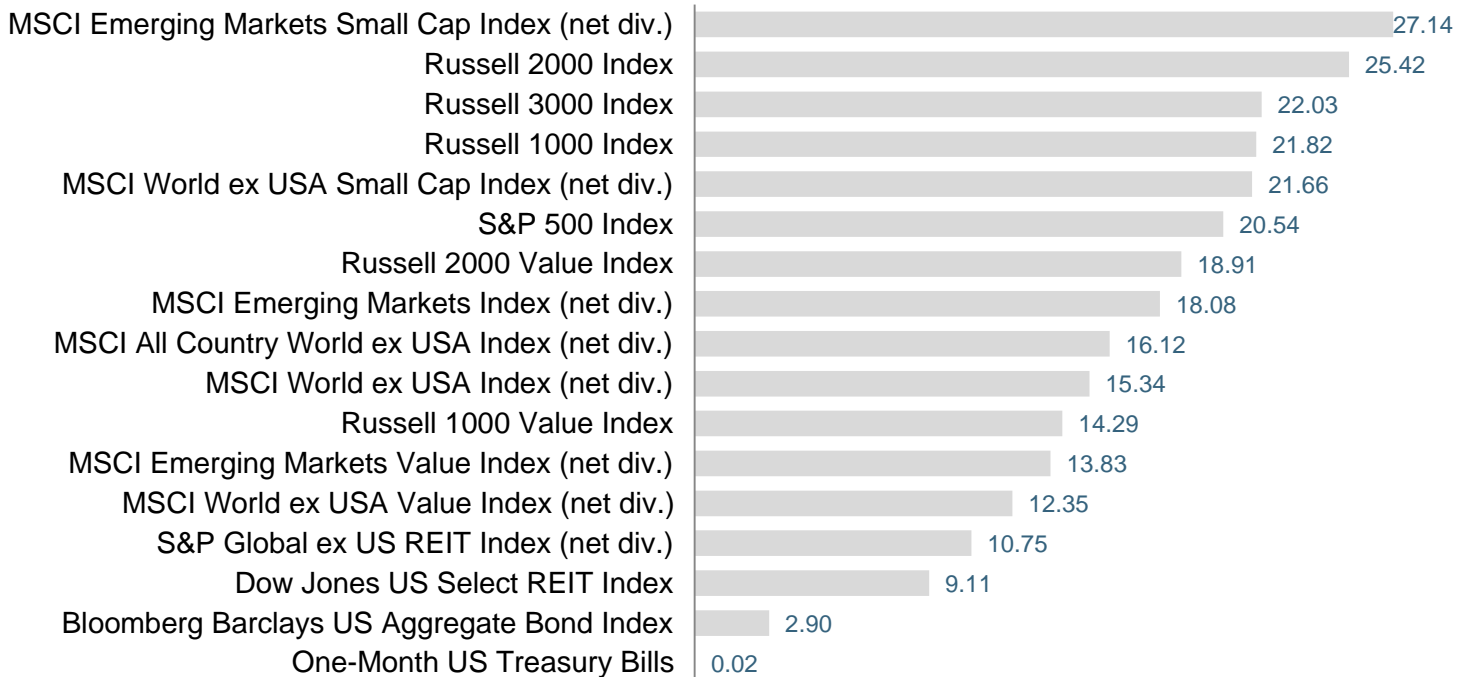
World Asset Classes

Second Quarter 2020 Index Returns (%)

Equity markets around the globe posted positive returns in the second quarter. Looking at broad market indices, US equities outperformed non-US developed markets and emerging markets.

Value stocks underperformed growth stocks, and small caps outperformed large caps.

REIT indices underperformed equity market indices in both the US and non-US developed markets.



US Stocks

Second Quarter 2020 Index Returns

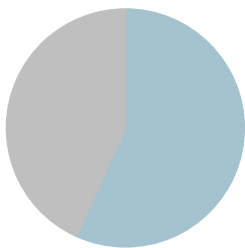
The US equity market posted positive returns for the quarter, outperforming non-US developed markets and emerging markets.

Value underperformed growth in the US across large and small cap stocks.

Small caps outperformed large caps in the US.

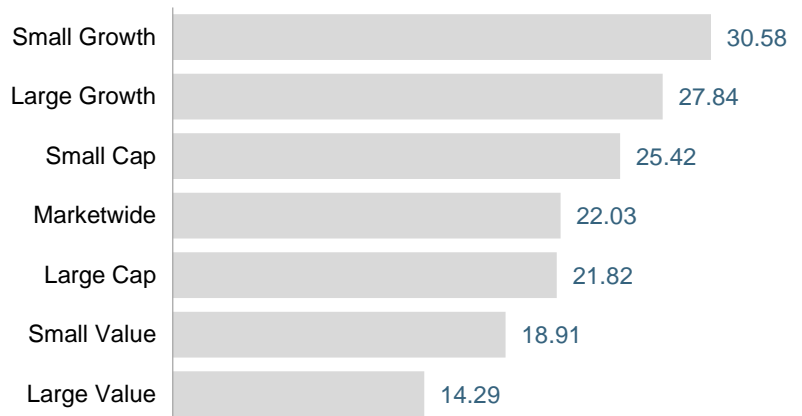
REIT indices underperformed equity market indices.

World Market Capitalization—US



57%
US Market...

Ranked Returns (%)



Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Large Growth	9.81	23.28	18.99	15.89	17.23
Large Cap	-2.81	7.48	10.64	10.47	13.97
Small Growth	-3.06	3.48	7.86	6.86	12.92
Marketwide	-3.48	6.53	10.04	10.03	13.72
Small Cap	-12.98	-6.63	2.01	4.29	10.50
Large Value	-16.26	-8.84	1.82	4.64	10.41
Small Value	-23.50	-17.48	-4.35	1.26	7.82

* Annualized

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International Developed Stocks

Second Quarter 2020 Index Returns

Developed markets outside the US underperformed both the US equity market and emerging markets equities for the quarter.

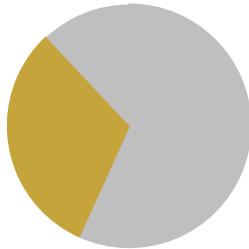
Small caps outperformed large caps in non-US developed markets.

Value underperformed growth across large and small cap stocks.

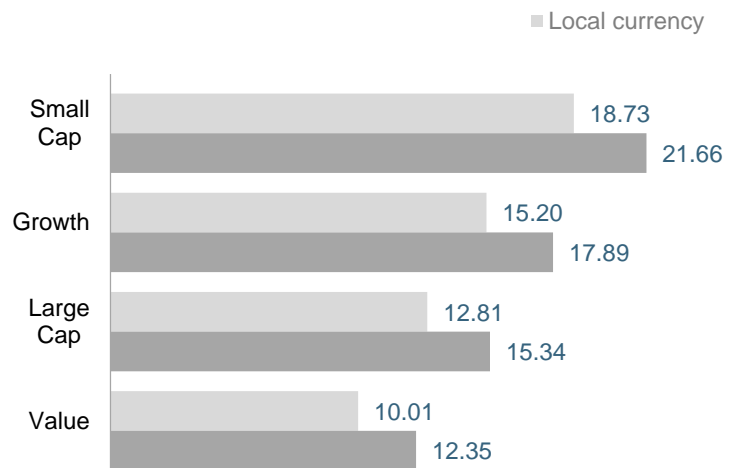
World Market Capitalization—International Developed

31%

International
Developed...



Ranked Returns (%)



Period Returns (%)

* Annualized

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Growth	-3.11	4.25	5.93	5.29	7.36
Large Cap	-11.49	-5.42	0.84	2.01	5.43
Small Cap	-12.87	-3.20	0.53	3.56	7.26
Value	-19.96	-15.14	-4.42	-1.46	3.36

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Emerging Markets Stocks

Second Quarter 2020 Index Returns

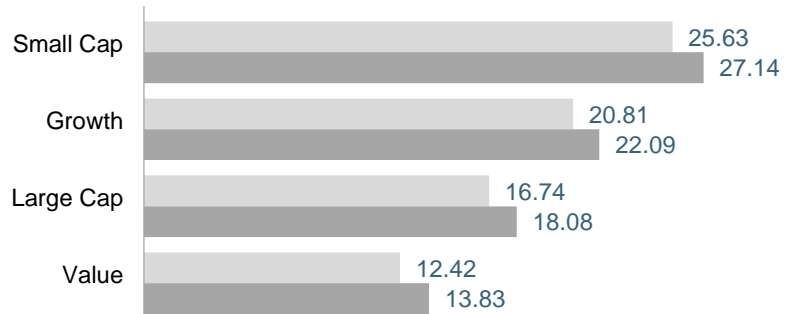
Emerging markets underperformed the US equity market but outperformed developed ex US equities for the quarter.

Value stocks underperformed growth stocks.

Small caps outperformed large caps.

Ranked Returns (%)

■ Local currency



World Market Capitalization—Emerging Markets

12%

Emerging Markets
\$6.4 trillion



Period Returns (%)

* Annualized

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Growth	-1.52	9.67	6.19	6.35	5.76
Large Cap	-9.78	-3.39	1.90	2.86	3.27
Small Cap	-12.74	-8.82	-2.95	-1.38	1.78
Value	-18.05	-15.74	-2.64	-0.80	0.66

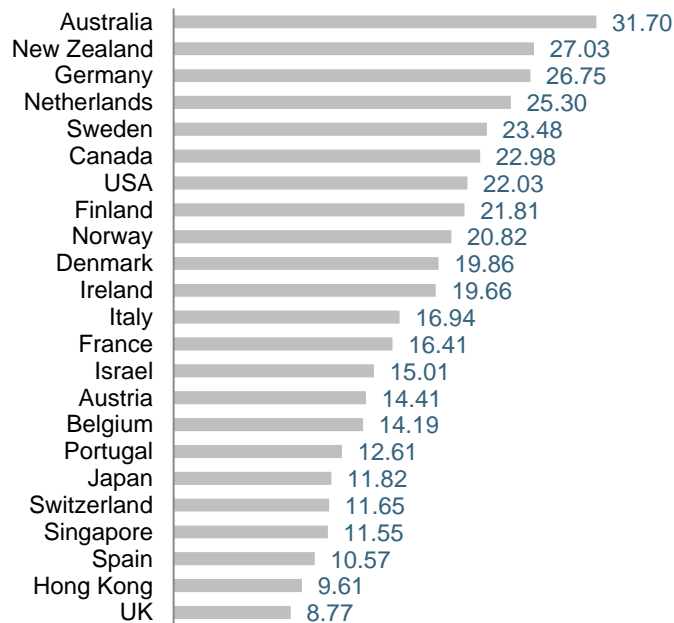
Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: Large Cap (MSCI Emerging Markets Index), Small Cap (MSCI Emerging Markets Small Cap Index), Value (MSCI Emerging Markets Value Index), and Growth (MSCI Emerging Markets Growth Index). All index returns are net of withholding tax on dividends. World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. MSCI Emerging Markets IMI Index used as the proxy for the emerging market portion of the market. MSCI data © MSCI 2020, all rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes.

Select Market Performance

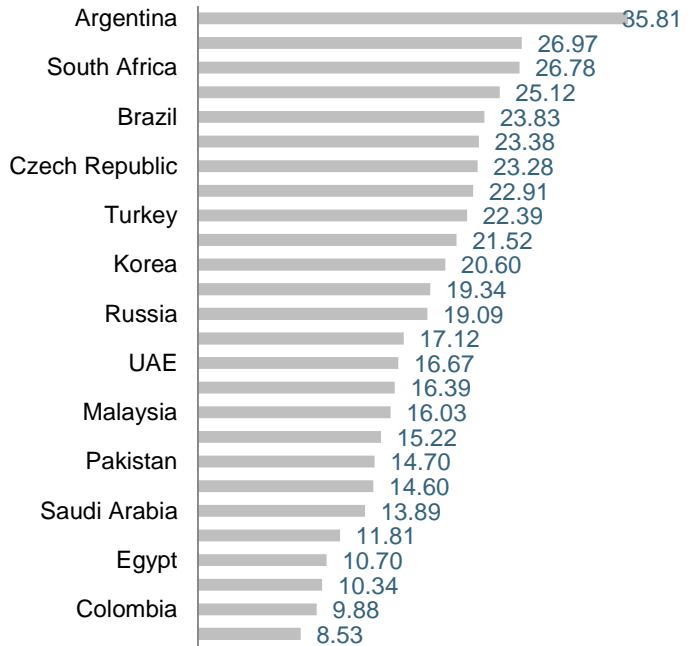
Second Quarter 2020 Index Returns

In US dollar terms, Australia and New Zealand recorded the highest country performance in developed markets, while the UK and Hong Kong posted the lowest returns for the quarter. In emerging markets, Argentina and Thailand recorded the highest country performance, while Qatar and Colombia posted the lowest performance.

Ranked Developed Markets Returns (%)



Ranked Emerging Markets Returns (%)

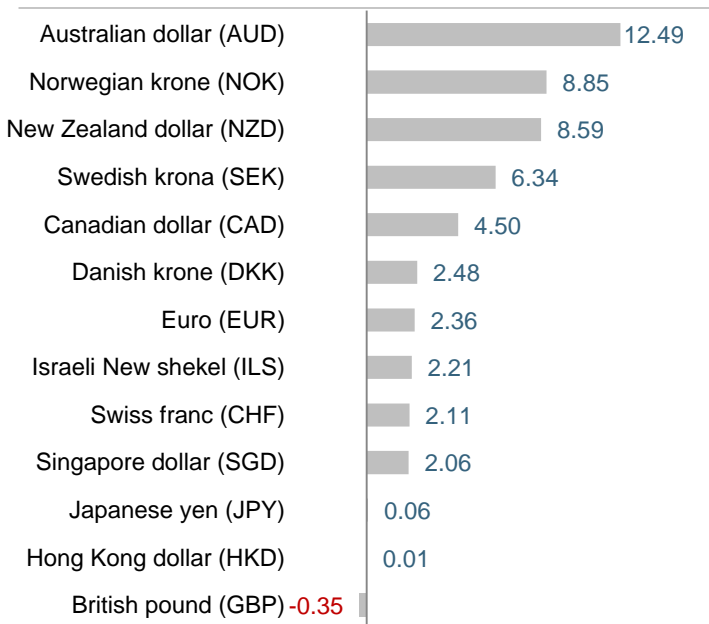


Select Currency Performance vs. US Dollar

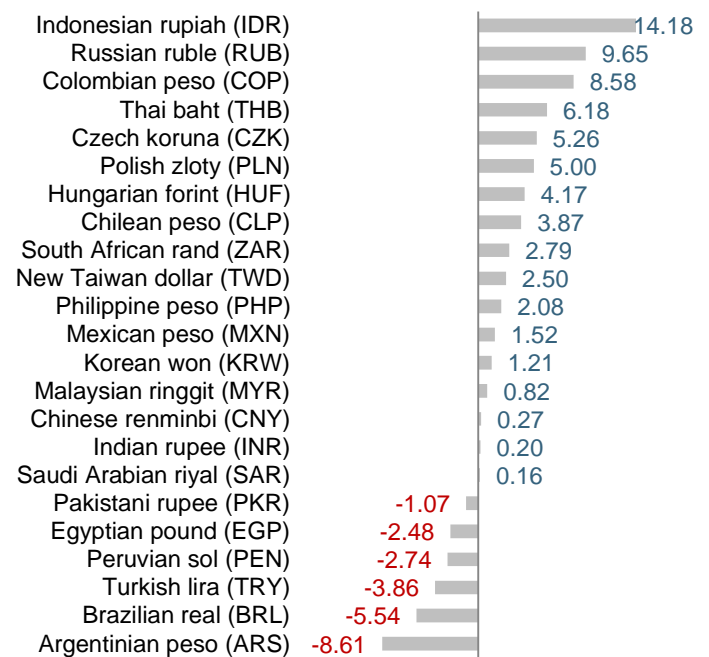
Second Quarter 2020

In developed markets, most currencies appreciated vs. the US dollar except for the British pound. In emerging markets, currency performance vs. the US dollar was mixed. Most currencies generally appreciated vs. the US dollar, but others, notably the Argentinian peso and Brazilian real, depreciated.

Ranked Developed Markets (%)



Ranked Emerging Markets (%)

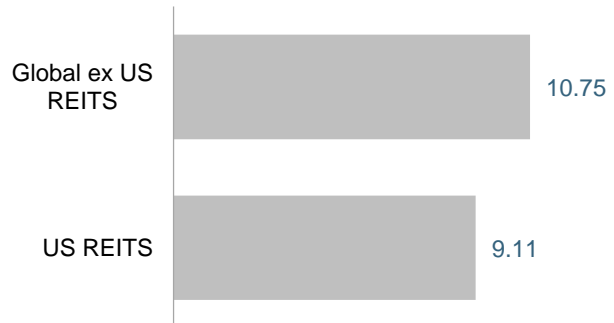


Real Estate Investment Trusts (REITs)

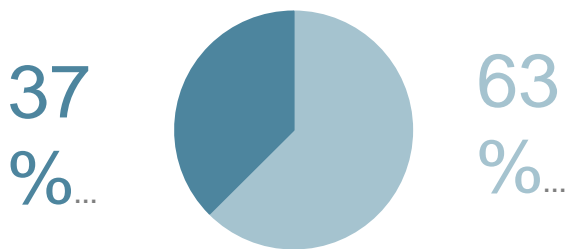
Second Quarter 2020 Index Returns

US real estate investment trusts underperformed non-US REITs in US dollar terms during the quarter.

Ranked Returns (%)



Total Value of REIT Stocks



Period Returns (%)

Asset Class	* Annualized				
	YTD	1 Year	3 Years*	5 Years*	10 Years*
US REITs	-22.01	-17.71	-1.99	2.45	8.27
Global ex US REITs	-25.25	-19.44	-2.37	-0.11	5.73

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Total value of REIT stocks represented by Dow Jones US Select REIT Index and the S&P Global ex US REIT Index. Dow Jones US Select REIT Index used as proxy for the US market, and S&P Global ex US REIT Index used as proxy for the World ex US market. Dow Jones and S&P data © 2020 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

Commodities

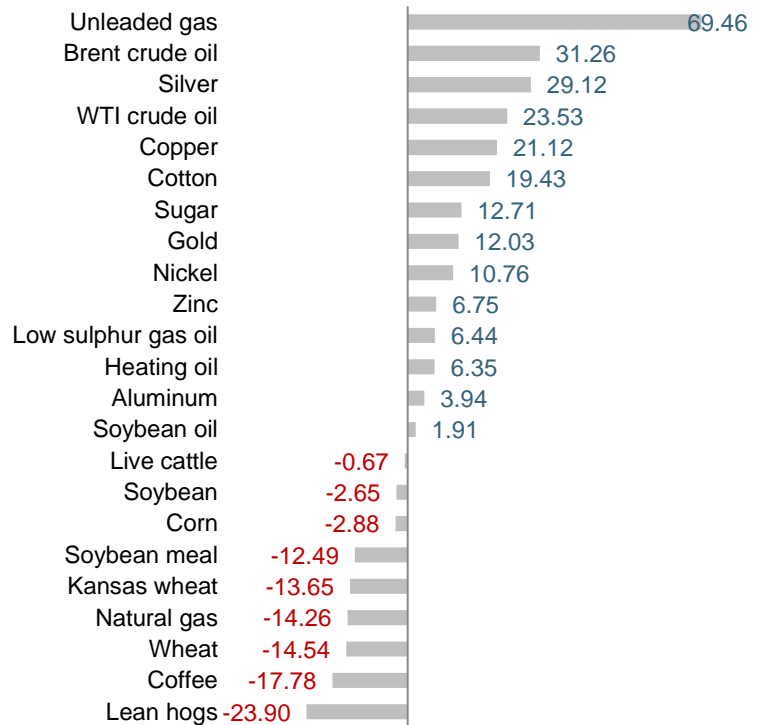
Second Quarter 2020 Index Returns

The Bloomberg Commodity Index Total Return returned 5.08% for the second quarter.

Unleaded gas and Brent crude oil were the best performers, returning 69.46% and 31.26%, respectively.

Lean hogs and coffee were the worst performers, declining 23.90% and 17.78%, respectively.

Ranked Returns (%)



Period Returns (%) * Annualized

Asset Class	QTR	YTD	1 Year	3 Years*	5 Years*	10 Years*
Commodities	5.08	-19.40	-17.38	-6.14	-7.69	-5.82

Fixed Income

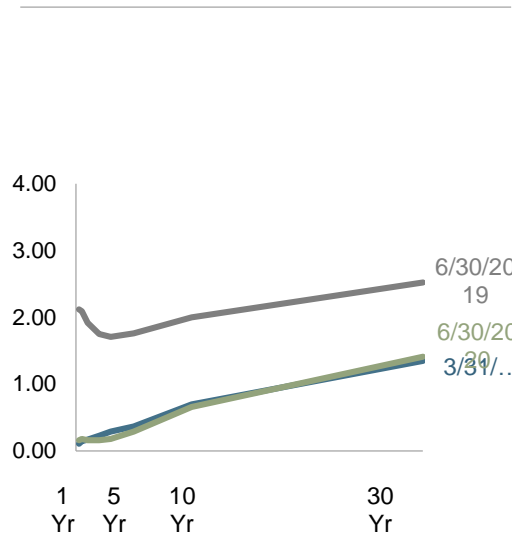
Second Quarter 2020 Index Returns

Interest rate changes were mixed in the US Treasury fixed income market in the second quarter. The yield on the 5-Year US Treasury Note decreased by 8 basis points (bps), ending at 0.29%. The yield on the 10-year note decreased by 4 bps to 0.66%. The 30-Year US Treasury Bond yield increased by 6 bps to 1.41%.

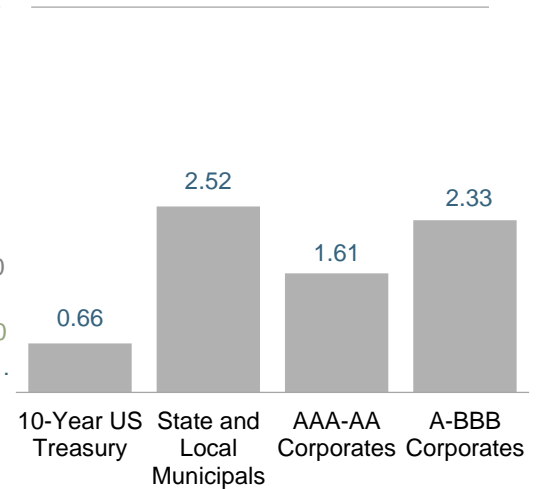
On the short end of the curve, the 1-Month T-bill yield rose by 8 bps to 0.13%, while the 1-year T-bill yield fell by 1 bp to 0.16%. The 2-year note finished at 0.16% after a yield decrease of 7 bps.

In terms of total returns, short-term corporate bonds returned 5.59% for the quarter. Intermediate corporates returned 7.63%. The total return for short-term municipal bonds was 2.38%, while intermediate-term muni bonds returned 3.19%. General obligation bonds outperformed revenue bonds.

US Treasury Yield Curve (%)



Bond Yield across Issuers (%)



Period Returns (%)

Asset Class	QTR	YTD	1 Year	3 Years*	5 Years*	10 Years*
Bloomberg Barclays US High Yield Corporate Bond Index	10.18	-3.80	0.03	3.33	4.79	6.68
Bloomberg Barclays US TIPS Index	4.24	6.01	8.28	5.05	3.75	3.52
Bloomberg Barclays US Aggregate Bond Index	2.90	6.14	8.74	5.32	4.30	3.82
Bloomberg Barclays Municipal Bond Index	2.72	2.08	4.45	4.22	3.93	4.22
FTSE World Government Bond Index 1-5 Years	1.41	2.11	2.27	1.86	1.68	0.62
FTSE World Government Bond Index 1-5 Years (hedged to USD)	0.53	2.79	3.96	3.09	2.38	1.96
Bloomberg Barclays US Government Bond Index Long	0.28	20.97	25.14	11.96	9.21	7.71
ICE BofA US 3-Month Treasury Bill Index	0.02	0.60	1.63	1.77	1.19	0.64
ICE BofA 1-Year US Treasury Note Index	-0.03	1.69	2.86	2.25	1.54	0.95

One basis point (bps) equals 0.01%. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Yield curve data from Federal Reserve. State and local bonds are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the ICE BofA Corporates, BBB-A rated. Bloomberg Barclays data provided by Bloomberg. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld). FTSE fixed income indices © 2020 FTSE Fixed Income LLC, all rights reserved. ICE BofA index data © 2020 ICE Data Indices, LLC. S&P data © 2020 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

Global Fixed Income

Second Quarter 2020 Yield Curves

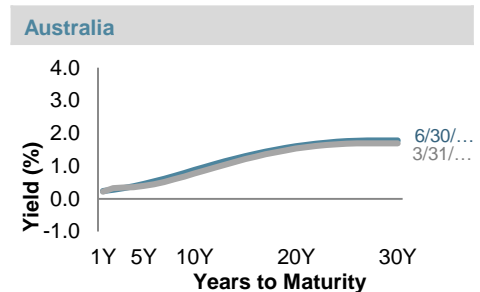
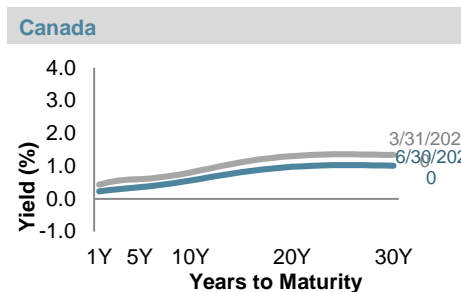
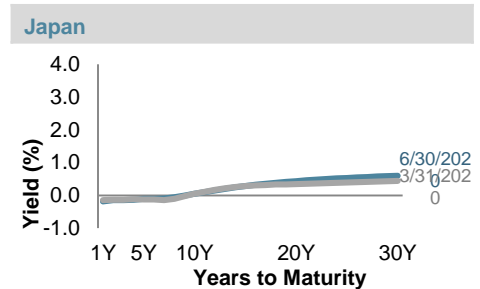
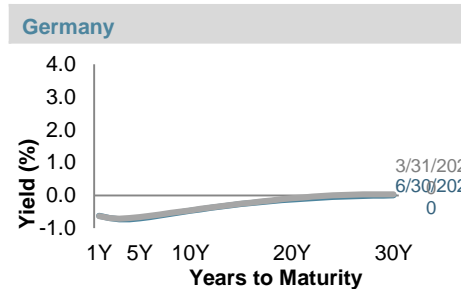
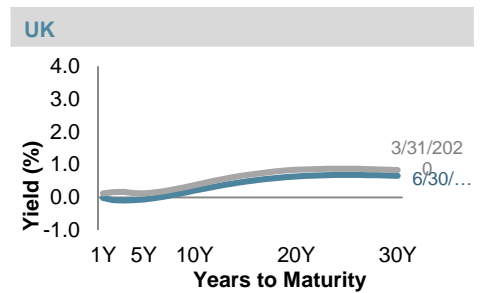
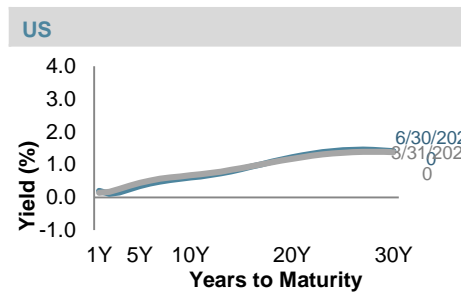
Changes in government bond interest rates in the global developed markets were mixed for the quarter.

Longer-term bonds generally outperformed shorter-term bonds in global developed markets.

Short- and intermediate-term nominal interest rates were negative in Japan, while all maturities finished the quarter negative in Germany.

Changes in Yields (bps) since 3/31/2020

	1Y	5Y	10Y	20Y	30Y
US	5.7	-9.9	-6.9	4.6	3.1
UK	-13.5	-18.9	-17.1	-20.2	-16.9
Germany	1.2	-4.0	-1.5	-3.2	-3.3
Japan	-3.0	2.2	0.0	8.9	16.1
Canada	-21.0	-24.6	-24.5	-33.1	-32.6
Australia	1.4	6.1	10.7	7.0	8.9



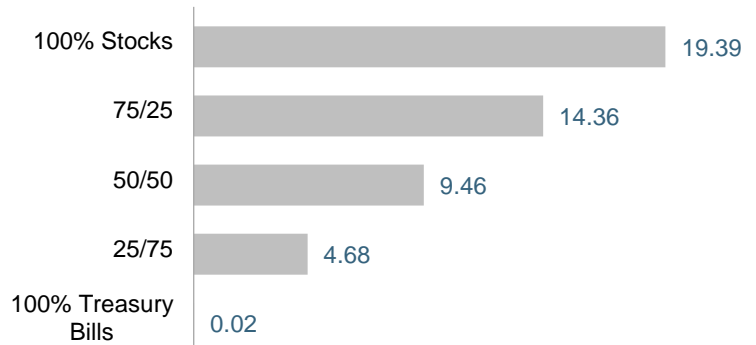
Impact of Diversification

Second Quarter 2020

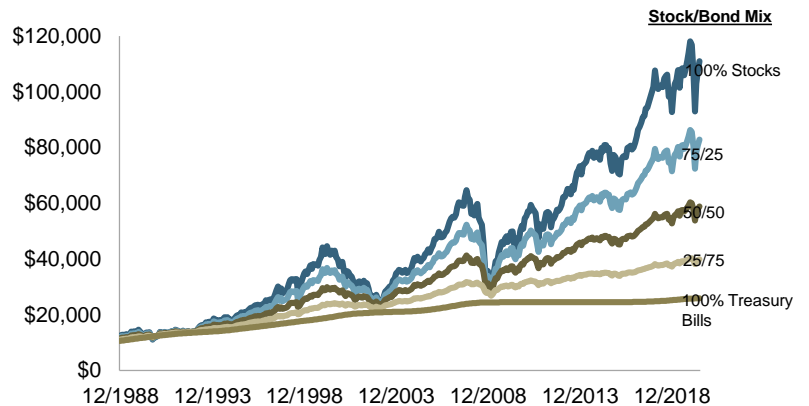
These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but have higher expected returns over time.

Period Returns (%)		* Annualized				
Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*	10-Year STDEV ¹
100% Treasury Bills	0.39	1.35	1.62	1.07	0.55	0.23
25/75	-0.86	2.10	3.12	2.73	2.97	3.49
50/50	-2.34	2.57	4.48	4.29	5.31	7.00
75/25	-4.05	2.75	5.67	5.72	7.57	10.51
100% Stocks	-5.99	2.64	6.70	7.03	9.74	14.02

Ranked Returns (%)



Growth of Wealth: The Relationship between Risk and Return



1. STDEV (standard deviation) is a measure of the variation or dispersion of a set of data points. Standard deviations are often used to quantify the historical return volatility of a security or portfolio. Diversification does not eliminate the risk of market loss. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio. Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals. Data © MSCI 2020, all rights reserved. Treasury bills © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld).

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