Q2 Update: A Tale of Two Quarters

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Section I: Market Update Report

The second quarter of 2020 was a dramatic comeback from the first quarter. If you click on this link you will be able to download our graphical review of the second quarter. In this, you will notice that in Quarter 2 of 2020 each equity market was up more than 10%, with the US and Emerging Markets being the top performers at 22% and 18%.

Section II: MWA Quarterly Commentary

What a difference a quarter makes. The markets have roared back from last quarters COVID scare and government-imposed lockdowns, even though relapses that are now popping up from the COVID virus around the world.

As was the plan, when markets fell and valuations reached pessimistic price assumptions, we sold defensive assets that held their value or increased in value and used the funds to buy into oversold areas of the market. The trades we placed near the March lows all added value, some more than others. Our portfolios strategic weighting away from Large Growth detracted from value, as the biggest and most expensive tech stocks led the recovery, and our partial rebalance into the riskiest of assets has been neutral with those markets still down double digits and represent an area for more growth once confidence returns and a vaccine is deployed.

Q: We have heard from investors, “How can the market be at these levels with COVID Spreading again?”

Sometimes I feel I say the same things from quarter to quarter, so I hope I don’t sound like a broken record player. If the overwhelming consensus in research suggests markets work to price assets correctly, and we believe they do, that means that markets always look into the future. Sometimes they move on short term noise, and sometimes on longer-term policy. Initially, when the COVID crisis rocked markets, prices fell to assume a very pessimistic outcome, faster than any other decline in modern history, and fortunately, these values did not persist.

Governments around the world took and expanded on lessons learned fighting the Financial Crisis and primed the pump by creating unprecedented amounts of stimulus in the form of direct checks to taxpayers, PPP forgivable loans to businesses, and other relief mechanisms through the CARES Act. US government policy, along with many other developed nations, appears to be **socializing losses** by printing money and utilizing quantitative easing which takes the printed money and buys higher-quality assets driving interest rates toward 0.

The confluence of these policy changes has created a unique dilemma for the investor in the marketplace, whereas the prices of “risk assets” (i.e. higher-yielding stocks) have been driven up due to the drought that exists among “safe assets” (i.e. bonds). For example, if an investor’s “safe assets” have traditionally returned 2-4% on an annualized basis, but due to recent interest rate changes, that same portion of their portfolio is returning 0-2%, where do they turn to make up for that difference? The answer is in international equities, where companies are currently yielding much higher dividends than domestic companies. Fortunately, this lesson is one that repeats itself over time, and our portfolios are positioned to capitalize on this by investing in globally diversified sets of companies.

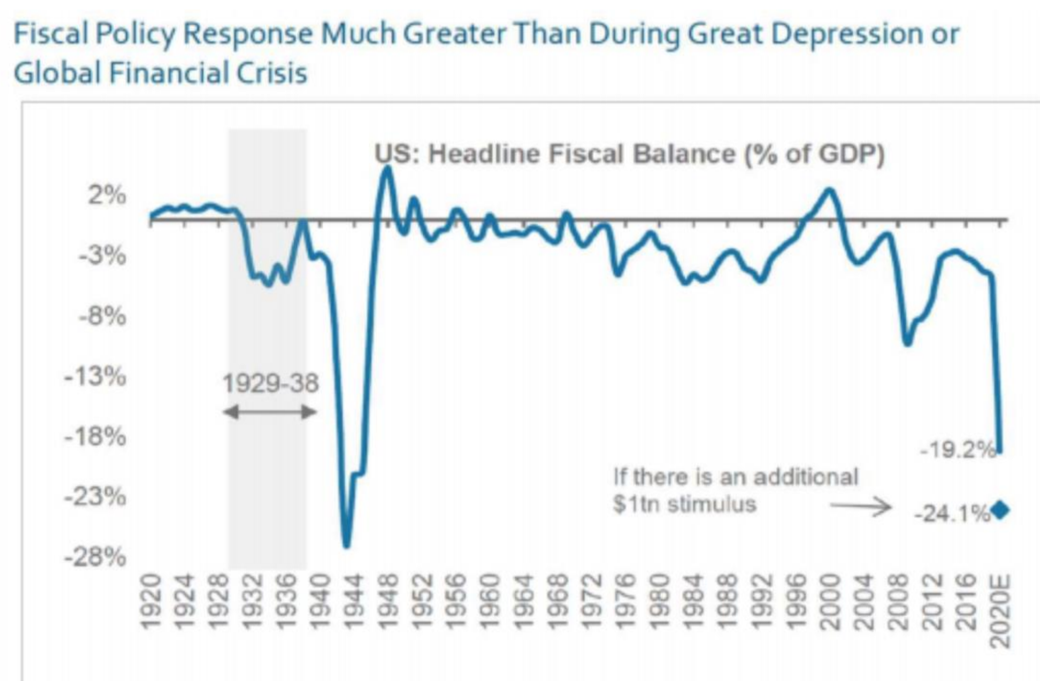

Figure 1: Fed Policy Response

The following reasons illustrate why we don’t want to fight the FED and believe the best course of action is to stay invested at least at your targeted risk levels:

- The COVID disease is becoming less deadly as healthcare professionals develop more promising methods of treatment
- A vaccine is around the corner

- When rates decline and are estimated to stay at or near those levels, riskier assets, like stocks, are worth more over time
- When stocks rise on bad news, we believe it is better to be invested (i.e. on June 25th when Texas COVID spiked and markets rose)

I'm sure most of my clients get tired of me saying that "markets work" and that prices, while sometimes hard to figure out, are mostly right with a buyer for every seller. As you all know, there is certainly a risk associated with investing in the marketplace. Some seasons you will make money, and some seasons you will lose money, but historically, research suggests that buy-and-hold, long-term investors will be rewarded over time. We are in a season right now where international equities have not performed as well as domestic equities, but to change course now would be similar to jumping off the ride before it reaches your destination with a much greater chance of loss being out of markets when they rise than remaining in them during a decline.

Index Returns

	STOCKS				BONDS	
	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
2Q 2020	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%
1 Year	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%

Figure 2: Comparison of Short and Long Term returns:

If you look at the index returns above in **Figure 2** you will see short term returns compared to 10-year returns. Notice the massive outperformance of the US during this period. (As you know, we own all the stocks in the US so we have participated in these gains with over 50% of our money allocated to the US, however, our average weighting is greater in the small and middle parts of the market especially on the value side of the equation because over time these areas have and should continue to pay investors more. When investing in broadly diversified asset classes funds or index funds that are constructed of thousands of securities, **permanent loss of capital is NOT a long-term risk**. The broad diversification protects investors from long-term loss of capital; however, by changing investment strategies or losing faith in a strategy before the return can materialize can create short-term losses. As evidence-based investors, we place a lot of weight on historical returns, academic research, and our past experience. Investors have historically overpaid for growth, so don't give up on value.

One of the hardest Investment Rules of Thumb to follow is: Sell Winners and Buy Losers: Adding money to the underperformers in your portfolio with proceeds from your winners may seem counter-intuitive, but is a crucial step in winning over the long haul. The US makes up over 50% of our investment portfolios and is our single largest asset class, but I want to point out how much the US has recently outperformed other areas of the world (see the returns above). The dividend yield in non-US markets is 50% more than in the US depending on the area of the market and will eventually reward investors that maintain global exposure. Global markets are all linked and when too much capital flows to one area other areas get cheaper and then the capital flows back. We think a year from today's markets are higher than where we sit today, so it pays to stay invested.

We as a firm will be the first to tell you that in the short-term, we cannot predict what will happen in the marketplace. Any individual or professional who promises otherwise is lying. What we can tell you with confidence is that we are actively monitoring your portfolios and regularly meeting with you all to ensure your savings are well-positioned to adapt to the changes you are seeing in the world today, and you will be rewarded over time. Ultimately, the goal of our team is not to simply make you all money but to grow (or sustain) your wealth in alignment with the goals and aspirations you have for yourselves and your loved ones. We acknowledge these have been trying times for everyone, but we cannot be more proud of how you all have responded to this crisis and have remained steadfast in your long-term plans.

Section II-A: The Election

The only major negative on the horizon for the market prices could be the election. When Trump was elected you saw a large jump on anticipated policy changes. If Biden wins I think it is possible we see a selloff based on an increase in tax reform (esp. regarding capital gains and toward wealthier Americans), especially if the Democrats win both the House and Senate. We believe political events are usually overemphasized when it comes to the stock market. When viewed historically, both the economy and stock markets show similar rates of growth no matter which party controls the White House.

To conclude, If history repeats itself, you will eventually be rewarded for maintaining diversification. Research suggests that having a plan is one of the most important tools in helping accomplish your goals, next is sticking to it. Investments are like raindrops such that we don't know which one will get there first, but by extending your umbrella wide enough, you will surely catch a little of each. As always if you have questions concerns or just want to talk we are here and always available. Please don't hesitate to call.

Section III: Around the MWA Office

Over the next 90-120 days, we will be reaching out to do update your plan, check-in, make sure you know how to use our new technology platform, and to introduce everyone to a dedicated CFP's in addition to just me so that we can continue to provide more in-depth planning, investment ideas, and all-around service. Our team is the best it has ever been. Stephen, Jim, Matt all have over a decade serving clients I look forward to you getting to know them better if you have not spent much time with them.

Section IV: Articles of Value

If you would like more in-depth reading from authors we think do a good job illustrating prudent long-term evidence-based investment principals, here are a few preselected articles and papers that we think make some interesting points that will help lead to investment success:

The Forgotten History of Value Investing, Larry Swedroe:
https://www.advisorperspectives.com/articles/2020/06/01/the-forgotten-history-of-value-investing

Knightsbridge Asset Management Quarterly Market Commentary by John Prichard, Miles Yourman 7/14/20 https://www.advisorperspectives.com/commentaries/2020/07/14/quarterly-market-commentary

Is Value Investing Dead, Again? Mike Minter (My friend at Financial Synergies)

https://www.finsyn.com/is-value-investing-dead-again/