A YEAR WHOSE DAYS ARE LONG

Summer has come and gone, and virtually everybody's normal lives remain upended relative to pre-COVID times. Three-quarters of a year most foul (medically, economically, environmentally, societally, and politically) is thankfully now behind us. But there is a sense of foreboding that "we cannot escape history" that is still to be written across the balance of this year.[i] One thing we can all probably agree on: it is time to fast-forward and put 2020 behind.

Economies and Capital Markets on the Mend

Coming on the heels of four months of tumult – most notably, surging US and worldwide COVID-19 cases and deaths, rapidly rising unemployment, global central bankers' and government policymakers' quick actions to inject liquidity into economies and capital markets – the just completed Third Quarter produced comparatively less angst-provoking drama within investors' portfolios. Despite COVID-19's continued spread (and the near-certainty that a vaccine will not reach a broad enough swath of US and worldwide populations to help restore some semblance of normalcy until well into 2021), financial markets continued to look past the current crisis.

Developments and outcomes of note across the three-month period ended September 30, 2020 included:

- The US economy shrank at a quarterly annualized rate of -30.7%, worse than had been projected earlier in the crisis. Inclusive of the first quarter's -5.0% shrinkage, the US economy is now approximately -9% smaller than it was in June 2019.

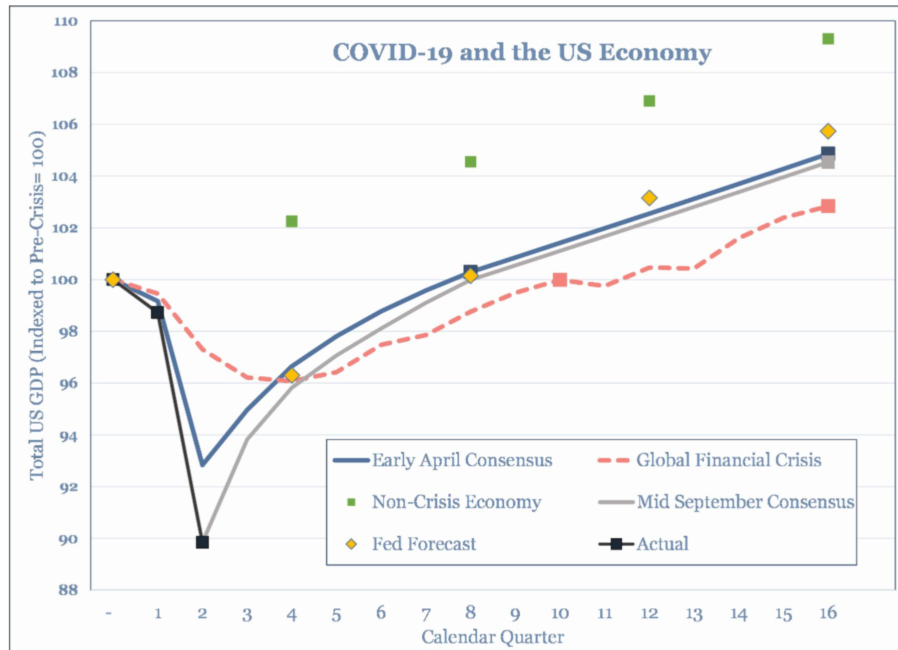
- US initial jobless claims and the unemployment rate (which peaked at nearly 7 million and 14.7%, respectively, in April) declined during the quarter as more businesses were reopened across the country. Worst-case fears of 20%+ unemployment were, fortunately, not realized; by September, the rate had declined to "only" 7.9%.

- A sharp rebound in consumer spending, fueled in part by expanded US government unemployment insurance programs, boosted consensus views that a V-shaped economic recovery could already be underway. Projected growth across the just-completed quarter (the first government read on which will be released on October 29) is estimated to come in at a +25% annualized rate; growth in the Fourth Quarter is now projected to be +5.1%. Net of these bounce-backs, full-year 2020 GDP would come in at a post war record-setting decline of -4.4%.

- Many world economies have been affected equally badly or worse by the pandemic. Year-over-year, GDPs in the Eurozone (-15%), the United Kingdom (-22%) and Japan (-10%) are also faring poorly even as their per capita rates of infection and death have mostly been

lower than those in the US. China (whose reported GDP growth rate of +3% may not be wholly accurate) and South Korea (-3%) have seemingly benefited from achieving control over the coronavirus more quickly than elsewhere.

- The US Federal Reserve made comparatively less news – and injected much smaller amounts of liquidity into the economy – last quarter. The Fed's balance sheet, which had grown from $3.7 trillion in December to $6.5 trillion by June, was roughly unchanged. It announced that its benchmark Fed Funds rate (reduced to 0.25% in March) would likely remain unchanged through 2023 in the face of expected low inflation and high joblessness relative to targets.



- A less active Federal Reserve and, on balance, less fearful investors, produced a comparatively quiet quarter for the US Treasury bond market. Yields on most maturities varied within narrow (15-20 basis points) bands and were roughly unchanged on balance; the benchmark 10-Year Treasury finished the period yielding a near-record low of 0.69%.

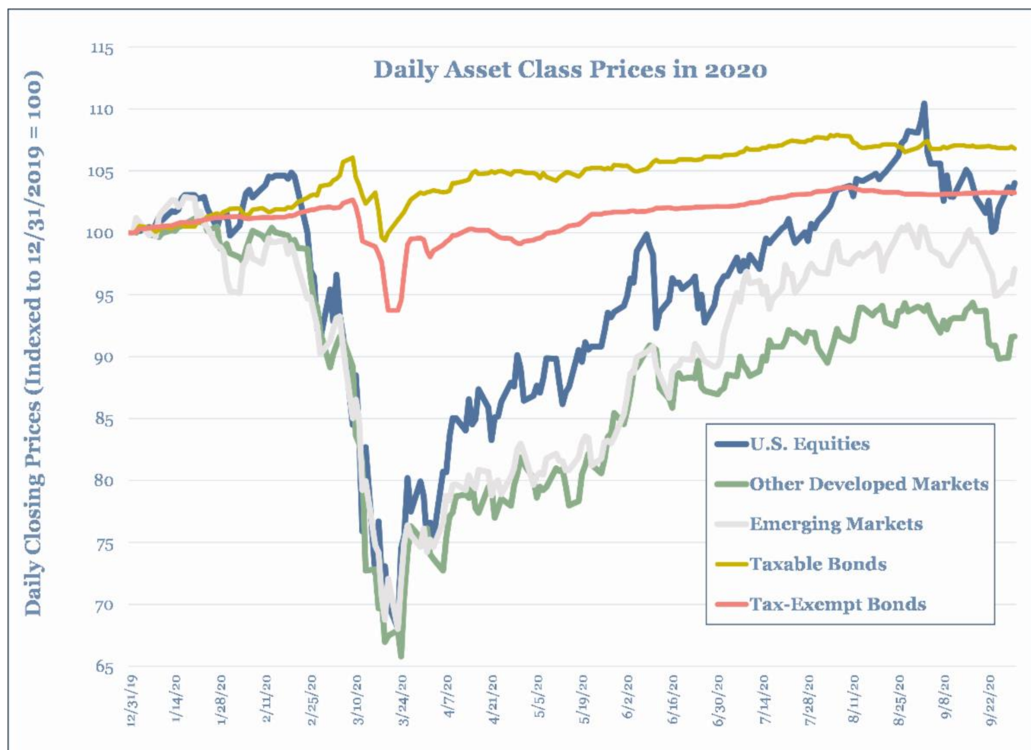
- Credit markets continued to improve, with spreads (the incremental yield earned on bonds issued by corporations and other riskier borrowers) declining to +136 basis points and +517 basis points, respectively, on investment grade and high yield bonds. Previously elevated yield spreads in both markets are currently not far-removed from their average levels of the prior 5 years.

- The aggregate earnings of companies comprising major US stock market indices were down sharply across the most recent quarterly reporting period. S&P 500 Index earnings, for example, were roughly -44% lower than in the comparable 2019 quarter. Improving prospects for a V-shaped recovery, however, led to firming estimates of future earnings growth. Estimated full-year 2020 S&P 500 earnings per share, which had been reduced -28% from late-February through June 30, are now less bearish (-23%); earnings forecasts for 2021 are predicting a strong +26% rebound over 2020.

Investment Returns

The strong price gains that had propelled returns higher after markets bottomed in late March continued for much of the year's Third Quarter. Across the asset classes and sub-asset classes in which most investors' portfolios are principally distributed, recent results include:

- Taxable bond prices were little changed for the quarter, and low yields added little to periodic total returns. The broad market *(Bloomberg Barclays Aggregate Index)* tacked +0.6% onto already strong returns; this Treasury-heavy market proxy has now returned +6.8% YTD. Overall taxable bond market yields reached an all-time low of 1.02% in early August.



- Tax-Exempt bonds enjoyed a strong quarter, with strong returns relative to taxable bonds and a total return of +1.1%. The asset class continues to claw its way back from an abrupt sell-off in March, supported by the low net issuance of such bonds and lower investor credit concerns, and is now +3.2% YTD *(Bloomberg Barclays 1-12 Year Muni Index).* Overall yields in this market, however, also touched an historic low (0.67%) in August.

Current Bond Market Metrics and Recent Total Returns

Market Segment	Yield to Maturity	Total Returns, Periods Ended 9/30/20 3 Months	Since 3/31	YTD
Taxable Bonds	1.18%	0.6%	3.5%	6.8%
Tax-Exempt Bonds	0.77%	1.1%	3.8%	3.2%

source: Bloomberg

- Global stocks, led by US equities generally and by US technology-related stocks in particular, continued their strong rebound. Several indices (e.g., the S&P 500, the NASDAQ Composite) achieved all-time highs in early September, in the process fully retracing their large February-March losses. Outside the US, investors were again well-rewarded for owning Chinese stocks (+13.5%) within the emerging market sub-asset class. Among major developed markets, stocks in Germany (+8.3%) and Japan (+5.8%) kept pace; equities in economically- and COVID-challenged Spain (-7%) and Italy (-3%) slid in Euro terms. US investors in Eurozone and Japanese stocks got a modest boost from currency appreciation (i.e., the Euro's +4.3% appreciation versus the USD; the Yen's +2.3% gain).

Current Global Equity Market Returns and Yields

Equity Market	Total Returns, Periods Ended 9/30/20 3 Months	YTD	12 Months	Dividend Yield
United States	9.2%	5.4%	15.0%	1.64%
Developed Markets	4.2%	-7.1%	0.2%	2.88%
Emerging Markets	9.6%	-1.2%	10.5%	2.28%

source: Bloomberg

- Performance within US equity markets continued to diverge broadly. Those sectors which have benefited the most from ongoing stay-at-home and work-from-home challenges (e.g., companies comprising the Information Technology and Consumer Discretionary sub-sectors) logged double-digit quarterly returns. They remain well-ahead of the market overall YTD. Conversely, stocks in sectors bearing the brunt of the pandemic and, relatedly, low interest rates and lower oil prices (e.g., Real Estate, Financials, and Energy) continued to struggle and remain extremely far-behind the top performing market sectors YTD.

S&P 500 Index Total Returns by Market Sector

	Quarter	Since 3/31	YTD
Information Technology	12.0%	46.4%	28.7%
Consumer Discretionary	15.0%	52.8%	23.3%
Communications	8.9%	30.8%	8.6%
All Other	8.3%	22.5%	-3.9%
Real Estate	1.9%	15.4%	-6.8%
Financials	4.4%	17.1%	-20.3%
Energy	-19.8%	-19.8%	-48.1%
Overall	**8.9%**	**31.3%**	**5.6%**

source: Bloomberg

- US stocks' strong advance since March has, in the face of falling earnings, created valuations that have become increasingly stretched. This outcome has been more pronounced for "growth stocks": issues comprising the benchmark Russell 1000 Growth Index, for example, were selling at a Price/Estimated 2020 earnings of 34x at quarter-end, their highest such valuation since September 2000. It will take some combination of continued strong earnings growth and lower-to-modestly higher prices to eventually return US stock market valuations to their fair value.

- Non-US equity markets continue to offer better value: aggregate valuations are -20% lower and dividend yields are +125 basis points higher in other developed markets in comparison to the US stock market. In emerging markets, valuations are -30% lower and dividend yields are +65 basis points higher.

- Dividend yields on US stocks, although they have been driven lower by rising prices, remain generous relative to bonds. And the comparatively good (versus outcomes during the Global Financial Crisis of 2008-2009) news: few companies have cut their dividends amid the pandemic. Overall dividend payouts have risen +8% (S&P 500) across the last six months. During the global financial crisis, dividend payments fell -17% across the second half of 2009.

History in the Making

Events and eventualities across the current quarter will inevitably add to the already sensational history of 2020. To state the obvious, there are two inter-related variables that will probably most affect societal and economic trends beyond the last three months of 2020 and exert a significant short-run influence on capital markets and investor portfolios: the COVID-19 pandemic and the US Presidential election.

Beyond its immediate implications for the election, COVID-19's global course from here will have a direct impact on the US and worldwide economies. It seems particularly unlikely that the

number of cases and deaths decline meaningfully in the short-run. A resurgence – fueled by less time outdoors and not yet abated by an efficacious and widely available and used vaccine – would further delay a return to social and business normalcy. The pace with which US payrolls were on the rise peaked in June, and recently announced layoffs by several large employers (i.e., Disney, American and United Airlines), together with expiring/no new government fiscal policies to protect consumers (and consumption) against losses of earnings are putting the V-shaped recovery at peril. These trends would put comparatively good earnings estimates for the Fourth Quarter (S&P 500 earnings per share -10% versus 4Q 2019) and 2020 projections (+26%) at risk. A loss of confidence in the economy and broad-based uncertainty would, in turn, put some large portion of market's post-March gains at risk.

President Trump's positive test for the virus has – at this early juncture – unknown ramifications for an election period that was already anticipated to be unlike any other in US history. The elevated levels of market volatility that we were otherwise anticipating in the days preceding and immediately following the election could now characterize the 32 days between now and November 3. And political strife and social unrest could persist for a period thereafter. The best counsel we can offer in the face of such dramatic and truly unprecedented developments: "stay the course". Neither step into additional portfolio risk nor react to it by altering an otherwise well-constructed investment portfolio amid what is an extremely precarious political, social, and economic environment.

Investment Strategy Team

Mill Creek Capital Advisors

October 2, 2020

[1] See text of Abraham Lincoln's Second Annual Message to Congress, December 1, 1862

Disclosures

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