DT INVESTMENT PARTNERS, LLC

# Q3 2020 FINANCIAL MARKETS COMMENTARY

*"When In Unchartered Territory, Be Well-Diversified"*

DT INVESTMENT PARTNERS

## RISK-BASED ASSETS PERFORMANCE SUMMARY

- After rallying strongly in July and August, global stocks took a breather in September. U.S. stocks still finished a solid quarter as monetary policy remained ultra-supportive, recent trends indicate that the world economy is getting stronger, historically low bond yields illustrate that there are very few investment alternatives to stocks, and news emerged that numerous vaccines will soon be ready.

- Stocks climbed the wall of worry and rallied higher in price, despite a resurgence of COVID-19 cases in several states, U.S. political gridlock regarding the passage of more fiscal stimulus, a U.S. unemployment rate of 8.4%, trade tensions between the U.S. and China, and a polarizing November U.S. presidential election. U.S. mega-cap growth (technology) stocks led the way. With the exception of Real Estate Investment Trusts, all risk-based assets rose during the third quarter (See page 5).

- U.S. Large Cap stocks generated relatively strong returns thanks to profits that have remained resilient during the pandemic and the belief that technology and consumer discretionary stocks will benefit as more Americans continue working from home. Gold also performed well due to its store of value appeal during challenging economic and political times. Gains in U.S. Small Cap stocks, which began the third quarter as one of the worst-performing asset classes for the first six months of the year, can best be explained by the fact that stock markets are forward-looking by nature leading to price rallies before business prospects begin to improve in any meaningful and sustainable way.

- All Large Cap stock sectors, except for Energy, rose for the quarter led by Consumer Discretionary (Target, Lowes, McDonalds & Amazon), stocks. In addition, investors willingness to look past the current economic situation helped the highly cyclical Industrial and Materials sectors post attractive gains. The Energy sector struggled as oil prices stayed relatively flat. Gasoline prices remained low as summer peak driving season demand never really materialized due to the continuation of working from home and the reluctance to travel.

## BOND PERFORMANCE SUMMARY

- All fixed income sectors moved higher in price during the quarter, led once again by Investment Grade (IG) Corporate bonds. After a punishing first quarter that pushed yield spreads much wider, corporate bonds have continued to look relatively attractive over the past two quarters. In addition, demand for IG corporate bonds has remained strong thanks to the Fed. As part of the effort to support market functioning and ease credit conditions, the Fed added functions to its Secondary Market Corporate Credit Facility allowing it to buy corporate bond ETFs and individual bonds.

- Municipal bonds continued their recovery during the third quarter from the depths of the pandemic earlier this year. Returns were driven by gains in lower rated investment grade credits as investors continued their search for yield with interest rates so low.

- Mortgage-Backed Securities (MBS) were the worst performing fixed income sector, generating marginally positive returns. Low mortgage rates continued to power a surge in refinance activity amid the pandemic, resulting in record-breaking loan volume for lenders. Low mortgage rates typically fuel a surge in refinance activity which leads to increased prepayment speeds for MBS. When interest rates are so low, the last thing a bond investor wants is to have their principal returned to them well before maturity, leaving them forced to reinvest at lower yields.

### CONTRIBUTORS & DETRACTORS TO PERFORMANCE

- Performance contributors versus the Global Stock/Intermediate Maturity U.S. Bond blended benchmark index during the quarter included our overweight allocations to U.S. Large Cap stocks, and Investment Grade Corporate bonds, and our outside-of-benchmark allocation to Gold and High Yield bonds.

- Detractors to performance versus the benchmark index included our underweight to risk-based assets for part of the quarter, our underweight allocation to Emerging Market stocks, and our outside-of-benchmark allocation to Mortgage-Backed Securities.

# GLOBAL MARKETS & ECONOMY

- During the Fed's annual Jackson Hole Symposium on August 27th, Chairman Jerome Powell announced a new approach to setting U.S. monetary policy by letting inflation and employment run higher for longer. The Fed will seek inflation that averages 2% over time, a step that implies allowing price pressures to overshoot after periods of weakness. At the September 16th FOMC (Federal Open Market Committee) meeting, Fed officials signaled they would hold interest rates near zero through at least 2023 to help the U.S. economy recover from the COVID-19 pandemic. The Fed reiterated that they expect to keep monetary policy easy until inflation averages 2% over time. Going forward, the Fed will not feel pressure to pre-emptively raise interest rates to fight future inflation.

- After reaching its ninth all-time high in price during the third quarter on September 2nd, the S&P 500 index proceeded to decline over the next four weeks, making the month of September the first down month for U.S. stocks since March. We believe the September retreat in stock prices represents a short-term, bull market correction from very overbought conditions, particularly in the mega-cap, technology stocks. Recent economic data reveal that the global economy is getting stronger.

- Investor stock market sentiment is far from exuberant, despite the powerful rally since the March 23rd lows in price. Institutional investors are still sitting on a large cash balances. This should be a positive sign for the future direction of stocks as it represents buying fuel to power a continued rise in stock prices.

- The recent spike in Covid-19 cases in New York City and other states throughout the U.S. has investors on edge over fears that the global economy recovery may stall. We believe additional fiscal stimulus is needed to provide a bridge for the economy until an effective vaccine has been created.

- U.S. lawmakers and the White House appear to be getting closer to reaching another fiscal stimulus deal that would offer financial relief to consumers, businesses, and state and local governments. Despite a great deal of skepticism from many lawmakers and political pundits about the chances of reaching a new bipartisan accord on coronavirus aid before the November elections, we believe it is very unlikely that Congress will not ultimately reach a stimulus deal.

- As we begin the fourth and final quarter of the year, we find ourselves in unchartered territory. We are still in the midst of the most severe global virus pandemic since 1918. Global Debt as a percentage of Global Gross Domestic Product has never been higher at 331%. The upcoming U.S. Presidential election in November has been highly contentious. Interest rates and nominal government bond yields are at or near historic lows. When adjusted for inflation, real bond yields are negative across the maturity spectrum.

- Stock markets are forward-looking by nature leading to price rallies before business prospects begin to improve in any meaningful and sustainable way. In recent months, signs of improving global growth have emerged while the promise of the availability of multiple virus vaccines in the next few months and the abundance of liquidity wanting and/or needing higher returns than bonds currently provide, have all contributed to increased investor risk-taking.

- We continue to believe that the unprecedented levels of monetary and fiscal policy stimulus (more than $7 trillion) combined with ultra-low rates will keep encouraging investors to look past the immediate economic situation and focus on the potential for future growth. With interest rates so low, a major risk to both bond and stock allocations is a rise in inflation. However, inflation may be a long way off. We view deflation as a much bigger risk over the next few years, despite the unprecedented amount of monetary and fiscal stimulus. Aggregate demand remains low in a heavily indebted world that has an abundance of supply in just about everything from goods and services to labor and savings.

# PORTFOLIO STRATEGY & OUTLOOK

- With key stock market averages either having broken out to new highs or very close to new highs, the potential for increased volatility has certainly risen. In terms of November election risk, we believe that with a little over a month left before the election, it is too early for us to make tactical portfolio adjustments based upon which candidate is projected to win the Presidency and which party is forecast to win the Senate. At this point, the races are simply too close to call.

- While it is true that interest rates may remain low for years to come, we believe it is prudent to stick with an allocation to high quality bonds for their diversification value. Low interest rates are supportive of stock prices. Therefore, in the near term, risk-based assets may generate most of an asset allocation portfolio's return, while high quality bonds provide coupon income and an offset to stock volatility.

- We are comfortable with our current positioning as we continue to monitor the ongoing economic recovery, vaccine development, and upcoming U.S. elections. We are equal-weight to the strategic target for risk-based assets, underweight bonds, and slightly overweight cash. In particular, we are overweight U.S. Large Cap and International Developed Market stocks, IG Corporate bonds, MBS, and Cash. We are equal-weight U.S. Small Cap stocks, High Yield bonds and Gold. We are underweight U.S. Mid Cap and Emerging Market stocks, and Government bonds.

- Once the re-escalation of documented virus cases subsides, economies around the globe will accelerate re-opening plans and the U.S. dollar may continue its weakening trend. As a defensive currency, the dollar should come under pressure as the global economy and risk-based assets recover. International and Emerging Market stocks tend to outperform U.S. stocks when the dollar is weakening.

- Economic activity in Europe is starting to recover and negative bond yields are forcing European investors into stocks. The Chinese economy is bouncing back strongly from the pandemic. The world's second largest economy claims that they have virtually eliminated COVID-19 infections and the government has begun to inoculate the population.

- In the fixed income markets, corporate bonds may continue to outperform government bonds and MBS because of better relative value. Although there may be some pressure on corporate and municipal borrowers as credit downgrades could occur, a large amount of credit defaults seems unlikely given the Fed's willingness to intervene in this unprecedented healthcare crisis with historic amounts of stimulus. The outlook for Municipal bonds for the remainder of the year looks promising as demand keeps pace with supply. The credit impact of the election is likely to be positive for municipal borrowers regardless of who wins because of the potential for increased Federal aid and/or higher taxes on the state and local level to strengthen municipal balance sheets.

- Extraordinary times like this validate the importance of being well-diversified and investing in an asset allocation that is consistent with each investor's risk tolerance and long-term investment goals. We will continue to keep you updated on our thoughts and any future portfolio adjustments.

Andrew Zimmerman, Chief Investment Strategist

# ASSET CLASS TOTAL RATE OF RETURN PERFORMANCE SUMMARY AS OF 9/30/2020

| Stock Indices | Asset Class | QTD Return | YTD Return | 1 Year Return |
|---|---|---|---|---|
| MSCI AC World Daily TR N | Global Equities | 8.13% | 1.37% | 10.44% |
| S&P 500 INDEX | U.S. Large Cap Equities | 8.93% | 5.57% | 15.14% |
| S&P 400 MIDCAP INDEX | U.S. Mid Cap Equities | 4.77% | -8.62% | -2.17% |
| RUSSELL 2000 INDEX | U.S. Small Cap Equities | 4.93% | -8.70% | 0.37% |
| MSCI EAFE | International Developed Market Equities | 4.87% | -6.69% | 0.99% |
| MSCI EM | Emerging Market Equities | 9.65% | -0.96% | 10.84% |
| FTSE E/N All Eqty ReitTR | Real Estate (REITs) | 1.19% | -12.27% | -12.15% |
| **U.S. Large Cap Sector Stock Indices** | | | | |
| S&P 500 ENERGY INDEX | U.S. Large Cap Equities - Energy Sector | -19.72% | -48.09% | -45.24% |
| S&P 500 HEALTH CARE IDX | U.S. Large Cap Equities - Health Care Sector | 5.87% | 5.01% | 20.11% |
| S&P 500 CONS DISCRET IDX | U.S. Large Cap Equities - Consumer Discretionary Sector | 15.06% | 23.38% | 28.89% |
| S&P 500 CONS STAPLES IDX | U.S. Large Cap Equities - Consumer Staples Sector | 10.38% | 4.13% | 7.79% |
| S&P 500 INFO TECH INDEX | U.S. Large Cap Equities - Information Technology Sector | 11.95% | 28.69% | 47.23% |
| S&P 500 UTILITIES INDEX | U.S. Large Cap Equities - Utilities Sector | 6.14% | -5.68% | -4.97% |
| S&P 500 INDUSTRIALS IDX | U.S. Large Cap Equities - Industrials Sector | 12.47% | -3.99% | 1.29% |
| S&P 500 COMM SVC | U.S. Large Cap Equities - Telecom Sector | 8.94% | 8.60% | 18.37% |
| S&P 500 MATERIALS INDEX | U.S. Large Cap Equities - Materials Sector | 13.31% | 5.47% | 12.19% |
| S&P 500 FINANCIALS INDEX | U.S. Large Cap Equities - Financials Sector | 4.44% | -20.25% | -11.93% |
| S&P 500 REAL ESTATE IDX | U.S. Large Cap Equities - Real Estate Sector | 1.92% | -6.77% | -7.28% |
| **Commodities Indices** | | | | |
| ISHARES GOLD TRUST | Gold | 5.89% | 24.07% | 27.59% |
| S&P GSCI Tot Return Indx | Broad Commodities | 4.61% | -33.38% | -27.84% |
| **Bond Indices** | | | | |
| U.S. Aggregate | Core Bonds | 0.62% | 6.79% | 6.98% |
| Intermediate | Intermediate Government & Corporate Bonds | 0.62% | 5.92% | 6.32% |
| US Corporate High Yield | High Yield Debt | 4.60% | 0.62% | 3.25% |
| U.S. Treasury | U.S. Treasuries | 0.17% | 8.90% | 8.04% |
| U.S. TIPS | U.S. TIPs | 3.03% | 9.22% | 10.08% |
| U.S. Agency | U.S. Government Agencies | 0.36% | 5.44% | 5.34% |
| U.S. MBS | Mortgage-Backed Securities | 0.11% | 3.62% | 4.36% |
| Corporate | Corporate Debt | 1.54% | 6.64% | 7.90% |
| Municipal Bond Index | Municipal Debt | 1.23% | 3.33% | 4.09% |

*Notes: The DT Investment Partners' Commentary and Outlook discusses general developments, financial events in the news and broad investment principles. It is provided for information purposes only. The material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. Investments in various asset classes entail different investment risks. For example, small cap stocks tend to be more volatile than large or mid-cap stocks. International and emerging markets stocks have exposure to currency fluctuations, foreign taxes, political instability and the possibility for illiquid markets. Fixed income investments involve interest rate and credit risks among others. Real estate investing includes risks such as declines in value of real estate, changing economic conditions, tax laws or property taxes. Commodities' investing is highly volatile and subject to changing economic conditions and the vagaries of speculators among other risks. One cannot invest directly in an index. Past performance does not guarantee future results.*