NEWSLETTER – JULY 2020

MARKET TRENDS 6.30.20

Asset Class	QTD	YTD
US Stocks		
Large Cap	20.34%	-3.20%
Mid Cap	24.06%	-12.79%
Small Cap	25.50%	-12.96%
International Stocks		
Developed Markets	15.47%	-11.10%
Emerging Markets	17.86%	-10.35%
Fixed Income		
Taxable Bonds	3.08%	6.27%
International Bonds	2.87%	2.45%
Municipal Bonds	2.71%	2.29%
Alternatives		
Emerging Markets Bonds	14.25%	-2.88%
Floating Rate	4.34%	0.22%
Preferred	10.50%	-5.59%
Gold	13.05%	17.12%
Real Estate	14.03%	-14.00%

Source: Factset

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V-SHAPED RALLY

What a difference three months can make! We experienced the fastest drop in equity markets in history during the first quarter of 2020. The selling was relentless, pervasive and did not stop with stocks. Liquidations ran across many asset classes-equities, bonds, and REITs-as the country faced its first pandemic in modern times. As if schizophrenic, the stock market reversed and kept pushing higher seemingly unabated throughout the second quarter. After dropping almost 40% by mid-March, the S&P 500 has surged and closed the second quarter down only 3% for the year.

While this type of volatility is unpredictable and extremely unsettling, we at Shorepoint perform stress tests on client financial plans for bear market situations using data from the "Great Financial Crisis" of 2008 as the barometer. The result is a financial plan that provides you with realistic scenarios and probabilities based on your goals, in both extreme and normal market conditions.

WHAT ABOUT AN ECONOMIC RECOVERY?

As we all know by now, a stock market rally off the March bottom does not necessarily mean that the economy has recovered. The market is a leading indicator and attempts to predict economic conditions usually six to twelve months in the future. How else could we have experienced the stock rally of late? The second quarter economy wasn't stalled; it was stopped! Unlike the stock market, economic indicators are backward looking. The March 23rd market low was a precursor to the worst drop in U.S. gross domestic product ("GDP") in history and an increase in the unemployment rate to almost 15%, the worst since the Great Depression. Global economic conditions mirrored those in the U.S.

Though the market seems to be predicting a smooth reopening of the global economy and a return to pre-pandemic prosperity, there remain many risks heading into summer:

1. Potential resurgences in coronavirus cases could cast a cloud over reopening efforts and slow down the economic recovery
2. Increased unemployment benefits expire at the end of July
3. Higher consumer spending is dependent on workers regaining their jobs
4. Protective trade measures under this administration could dampen the recovery
5. Let's not forget this is a Presidential election year and there are potential policy impacts/changes should a new administration take office

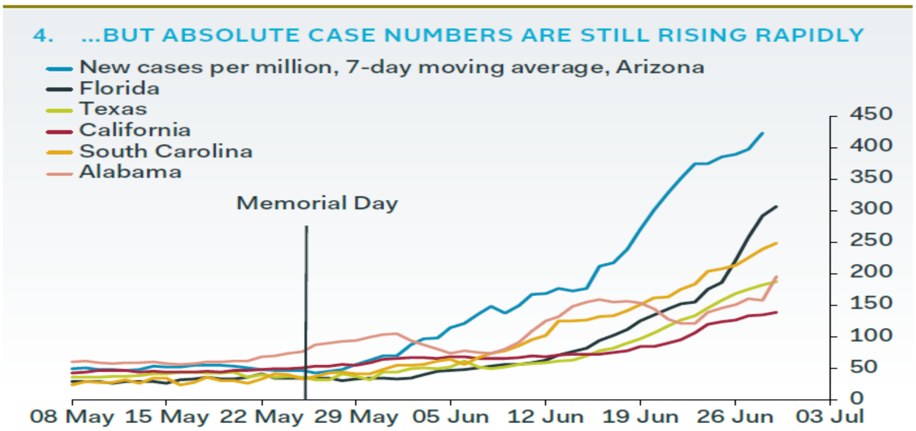
EXPERIMENTAL TREATMENTS BY FED, TREASURY, CONGRESS

The Federal Reserve ("Fed") has been responding to the pandemic with a mountain of accommodation at multiples of what it did in the 2008 financial crisis. The Fed has done so with lightning speed. They cut interest rates to near zero in mid-March, enacted a range of emergency lending programs, and are purchasing $2.5B in corporate and municipal debt. In addition, Congress authorized about $3 trillion of aid to Americans. Combined, the stimulus from the Fed and Congress represents close to 30% of domestic GDP. We would expect this level of stimulus to increase both inflation and interest rates at some point in the future, but the question is when? This is why we have kept our preference for dividend paying stocks to generate income and provide inflation protection, with our Dividend Growth Portfolio now yielding 3.5%. We also continue to allocate to higher yielding, non-traditional bond sectors such as leveraged loans, preferred stocks, and asset-backed-securities in the face of historically low Treasury yields that are linked to massive, domestic budget deficits.

PANDEMIC/COVID-19

Despite the temporary short term memory loss of the markets, the COVID-19 pandemic presents the entire world with continued volatility and enormous risks, medical and financial. However, Shorepoint has taken advantage of market sell-offs to add to stocks in order to reach your target equity allocation. This approach was beneficial for clients because their equity holdings participated in the frenetic rebound. The indiscriminate sell off in equities allowed us to upgrade the portfolios with stock in higher quality companies with more durable businesses and stronger balance sheets at much lower prices than normal.

New COVID-19 infections have declined in most countries and governments are starting to lift lockdown restrictions to revive their economies. In the U.S., death rates are generally down, but we are experiencing a resurgence in the South and West that is worrisome and must be monitored.

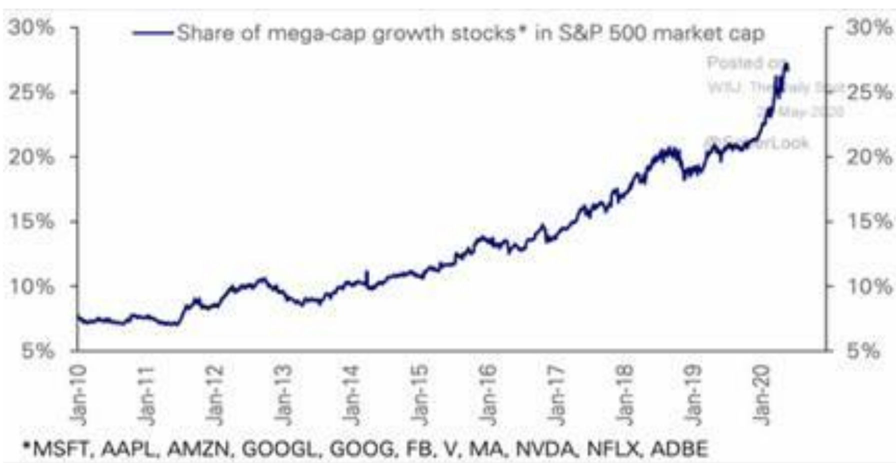


Along with the unprecedented fiscal and monetary stimulus, markets are optimistic about successful early stage trials for potential COVID-19 vaccines from the 130 global research projects.

We know COVID-19 won't simply disappear. Effective medicines and vaccines are key, but until we have them, our best course of action is to follow the health officials' and government's practical measures to reduce the spread. We will continue to follow the data and adjust allocations/investments accordingly.

MEGA CAP GROWTH DOMINANCE!

Mega-cap growth stocks have massively outperformed the S&P 500 for several years and they now represent more than a quarter of the S&P 500 index. This group is driven by the technology sector in areas such as cloud computing, internet search, internet advertising, video streaming, and social networking.



The recent equity rally continues to be led by just a handful of companies. While company size and valuation are concerns, these current market leaders are better positioned, more profitable and much cheaper than 20 years ago during the dot.com bubble period. That period's mania led to ridiculous valuations even for established companies such as Cisco Systems which traded at 300x its trailing earnings before the bubble burst versus 32x for the technology-laden NASDAQ Index today. Overall, the future is bright for these companies, although false information, fact checking, hate posts, and antitrust risks are wildcards.

The surge in big technology stocks has helped the Nasdaq Composite rally 12.5% in 2020, while the Dow Jones Industrial Average of blue-chip stocks is down 8.5%. The broader S&P 500 Index is hovering in between them, down 3.2%, while the ***median stock in the S&P 500 Index is down about 20% with Energy, Finance, Industrials, Utilities, and Materials all down double digits***. Shorepoint's equity philosophy is to manage diversified stock portfolios invested across different economic sectors with each stock generally being 2% to 4% of your equity exposure. This diversification, our focus on dividend paying stocks, and not owning enough of these five mega-cap growth stocks (see following chart) have been a drag on performance relative to the S&P 500 Index recently, but our approach remains prudent from a risk perspective and a long term view.

The bifurcation in performance between growth and value is nothing new; it has been taking place for a decade. The Growth benchmark is overweight faster-growing sectors like technology and healthcare whereas the value benchmark has much higher weights to sectors like financial services, industrials, utilities, and energy.

OUTLOOK

We feel confident about the repositioning we were able to do during the pandemic and ensuing market volatility. While we are not aggressive buyers of stocks at current levels, we will likely add to high quality equities on any meaningful weakness. However, the bond market, particularly government bonds, is worrisome, with interest rates at record lows and over $15 trillion in international bonds trading at negative interest rates. Low interest rates are a negative for savers, and at these levels, Treasury bond yields cannot keep up with current and future inflation levels.

We continue to invest the fixed income portion of your portfolio in non-traditional bond sectors such as leveraged loans, preferred stocks, asset-backed bonds and mortgages. Although these investments produced higher volatility in the recent downturn, they have rewarded our clients over the last decade with higher income and higher overall returns. When appropriate, we will make allocation adjustments as we did recently, eliminating emerging market bonds from client portfolios when they rallied, as we think the risks of the pandemic to the emerging world are even greater than they are here in the U.S. Recent Fed and Treasury actions to support the bond market make these investments more attractive, as we are getting 4%+ yields to compensate us for the added risk.

It's trite but true that with risks come opportunities. And this pandemic, which has already hastened many nascent trends like home working, schooling, entertaining, and retailing, will likely bring about new businesses and new growth-oriented trends. And we are in a world that will be increasingly driven by companies and consumers demanding cost savings and tremendous value for a dollar spent. We also believe that companies with strong balance sheets, cash flow generators, and durable business models will be better able to navigate our current environment. As mentioned in our last update, Shorepoint's process remains thoughtful, disciplined and flexible. Know that the Shorepoint team is working diligently to manage risk and returns as well as position your portfolio for the long-term.