

## A VIEW FROM THE SUMMIT



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### SGI Equity Strategies 3<sup>rd</sup> Quarter Summary

In the third quarter of 2020, gradual reopening of the economy brought new all-time highs in the major equity indices. Absolute returns were positive for most equity markets. All three of the equity strategies posted positive returns but somewhat underperformed their respective benchmarks. Here are some highlights:

- The U.S. Large Cap equity strategy returned 8.24% for the quarter, slightly underperforming the S&P 500 Index on a gross basis by 0.69%, while maintaining significantly lower overall portfolio risk.
- The U.S. Small Cap equity strategy returned 2.66% for the quarter, underperforming the Russell 2000 Index on a gross basis by 2.27%, while maintaining lower overall portfolio risk.
- The Global equity strategy returned 7.00% for the quarter, underperforming the MSCI ACWI Index on a gross basis by 1.24%, while maintaining lower overall portfolio risk.

SGI Performance	3Q20	1 Yr	3 Yrs	5 Yrs
US Large Cap Gross	8.24%	7.13%	12.88%	12.75%
US Large Cap Net	8.03%	6.28%	12.01%	11.93%
S&P 500 Total Return	8.93%	15.14%	12.27%	14.14%
US Small Cap Gross	2.66%	-17.14%	-3.71%	5.96%
US Small Cap Net	2.45%	-17.84%	-4.43%	5.32%
Russell 2000 Total Return	4.93%	0.37%	1.75%	7.98%
Global Large Cap Gross	7.00%	1.19%	7.70%	10.74%
Global Large Cap Net	6.79%	0.30%	6.94%	10.16%
MSCI ACWI Total Return	8.24%	11.01%	7.70%	10.92%

*Please review our separate one-page commentaries covering each strategy for additional details about portfolio positioning and attribution.*

All SGI equity strategies implement a managed risk approach to equity investing. This managed risk focus has historically allowed investors to enjoy **competitive equity returns** while taking **meaningfully less overall portfolio risk**. For example, historically, our large cap equity

strategy averaged 10-20% less return volatility than the S&P 500 Index (trailing 5 years weekly as of 9/30/2020).

### MARKET COMMENTARY

#### Pandemic Impact

Worldwide Covid-19 cases now exceed 38 million with the U.S. representing 7.8 million. Since no vaccine is currently available the number cases continue to rise. The economic contraction during the second quarter was devastating. The Commerce Department posted that the second quarter was the worst quarter on record. GDP declined at a 31.7% annualized rate which followed a 5% decline in the first quarter. In Europe, the economy contracted even more severely. Initial unemployment claims continue to average over 800,000 per week and the unemployment rate remained high at 8.4%. Some sectors of the economy such as hospitality, travel, concerts, movies, sporting events remained 50-70% below levels a year ago. Trailing 12-month defaults in the high-yield bond market are running at a 10-year high of 5.7%. So, while the economy struggled globally, investors pushed the stock markets to new highs.

In September, stocks fell back a bit from their peaks amid worries over increasing coronavirus cases in the U.S. and Europe and unease over the upcoming U.S. election. Volatility dropped from the historic highs in the first quarter. For example, the S&P 500 Index experienced only three days of more than -2% returns compared with eight days in the second quarter and thirteen days in the first quarter. Earnings are expected to fall 20% like the average level of the past five recessions. Full recovery of earnings to previous high levels is not expected until after 2021.

#### The Fed and Government Response

The Federal Reserve primarily caused this disconnect between the stock market and the economy. The central bank's balance sheet now stands at over \$7 trillion, up over 80% from a year ago. Then came additional stimulus measures from the government with the passage of the \$2 Trillion CARES Act. The yield curve has collapsed across all maturities with the 10-year Treasury Note yielding 0.69% down from 1.90% at the beginning of 2020. When using a 12-month moving average of inflation, adjusted or real yields, the entire U.S. Treasury yield curve is negative.

## A VIEW FROM THE SUMMIT



Europe and Japan also exhibit negative real interest rates. The Fed also signaled that it was willing to accept a higher level of inflation before raising interest rates and that it would keep interest rates low for an extended period. These actions pushed gold prices to a new high of \$2,063 per ounce and caused a decline in the U.S. dollar. Growth stocks, particularly large cap technology stocks continued their dominance. The tech heavy NASDAQ Index was up over 20% through early September, but a slight correction still ended the quarter up 11.20%. In fact, the performance difference between growth stocks and value stocks is now the widest in history.

Levels	2Q20	3Q20	Change
Russell 1000 Index	1717	1873	9.04%
Russell 2000 Index	1441	1508	4.60%
MSCI EAFE Index	1781	1855	4.20%
MSCI Emerging Markets	995	1082	8.73%
U.S. Aggregate*	1.25%	1.18%	-6.16%
U.S. High Yield 2% Cap*	6.89%	5.78%	-16.09%
U.S. Federal Funds Rate**	0.08%	0.09%	12.50%
U.S. 10 Year Treasury**	0.66%	0.68%	4.25%
U.S. Dollar Index	97.39	93.89	-3.60%
WTI Crude Oil Spot	39.27	40.22	2.42%

\*Yield to Worst \*\*Interest Rate

## Economy

However, not all is bleak. The housing market continues to do well. Supply is still limited relative to demand, combined with low mortgage rates, these conditions have pushed up home prices. Schools have partially reopened across the country with many observing a hybrid of both online and in school instruction. Major sports leagues, the NBA, NFL, MLB, NHL, and PGA all restarted their seasons although often with limited fan attendance. Work from home related companies and products continue to do well as does ecommerce. Hope does exist as a vaccine or

effective treatment should boost economic activity to beyond previous high levels.

## SGI Outlook

- The U.S. economic recovery will likely be lengthy and dependent on the development of a vaccine and effective treatments.
- We think corporate bond defaults and bankruptcies will continue to increase for at least several more quarters.
- More social unrest is predicted, especially because of a contentious election in the U.S.
- The Federal Reserve has stated it will do “whatever it takes” to support the economy.
- Additional government stimulus is likely on the way during the next few months.

We continue to adhere to our disciplined, managed-risk, multi-factor investment process and find attractive investment opportunities. Over a full market cycle, this approach has historically limited downside risks and allowed for participation in market rallies. We are grateful for the opportunity to help steward your investments.

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