

## Equities in Review

The second quarter of 2020 saw US stocks post their best quarterly return in more than 20 years, significantly trimming the YTD losses resulting from the massive first quarter sell-off. The recovery in US stocks reflected investors' hopeful expectations that reopening businesses worldwide would provide a strong economy by year-end or early 2021. However, with so much uncertainty surrounding the healthcare situation domestically and abroad, equity market volatility is likely to remain high. As you know, our core philosophy is that short-term market movements are frequently driven by non-fundamental factors (e.g. psychology and momentum), while the long-term is based much more on fundamentals. This has been glaringly evident thus far in 2020, as fear and greed have taken turns gripping the markets, underscoring the importance of maintaining patience and discipline.

The Fed and central banks from around the globe continue to take steps to backstop the economy and provide liquidity. In the short-term, their actions have provided confidence to the markets.

Following are the quarterly, year-to-date and 5-year average returns for the six equity indexes that we track:

INDEX	DESCRIPTION	Quarter	Year-to-Date	5-Year Avg.
DJ Industrial Average	Large cap stocks	+18.5%	- 8.4%	+10.6%
MSCI EAFE	Foreign stocks of developed nations	+14.9%	-11.3%	+2.1%
MSCI Emerging Markets	Foreign stocks of emerging nations	+12.5%	- 1.1%	+3.7%
NASDAQ Composite	Growth-oriented large cap stocks	+31.0%	+12.7%	+16.4%
Russell 2000	Small cap stocks	+25.4%	-13.0%	+4.3%
S&P 500	Large cap stocks	+20.5%	-3.1%	+10.7%
Weighted Index Benchmark*	Diversified Equities	+21.8%	-3.6%	+9.0%

*\*The Index weighting is 20% each: DJ Industrial Average, NASDAQ Composite, S&P 500, and Russell 2000; and 10% each: MSCI EAFE and MSCI Emerging Markets.*

## Other Important Data

For the twelve months ending June 30, 2020, inflation as measured by the CPI increased 0.6%, a notably smaller increase than the 1.6% increase for the twelve months ending March 31. June saw the CPI tick up following three months of deflation. The sharp increase in the gasoline index was the primary driver for this increase following five months of significant price declines, as demand for fuel plummeted during shutdowns related to the COVID-19 pandemic.

The spread on the yield curve (the difference in yield between the 1-Year and 30-Year Treasury bond) has often been a reliable leading indicator of the likelihood of recession. During the second quarter, the spread widened to 1.25%. This spread, which is high by recent standards, is primarily driven by the Fed cutting short term rates to near zero as one of the several steps they took to provide liquidity to the market. While the current spread itself does not necessarily indicate we are in recession, the slowdown of the global economy and the uncertainty surrounding the re-opening of the domestic and global economies it is likely we are in the midst or will be in the midst of a recession.

- June 30, 2020 1.25%
- March 31, 2020 1.18%
- December 31, 2019 0.80%
- September 30, 2019 0.37%
- June 30, 2019 0.60%

## Equities Looking Forward

Under normal circumstances, financial market action is often violent and unpredictable in the short-term. In the current situation, the moves have been even more volatile than usual. As the COVID-19 situation plays out, we assume the Fed and the world's central banks will attempt to continue fighting the economic impact of the pandemic with whatever resources and strategies they deem necessary. While this may help provide a short-term floor under stock prices, eventually stocks will trade based on the prevailing economic conditions.

From a longer-term view in a hopefully post-virus world, stock valuations seem to be wide ranging, as some high-flying names seem overvalued, while others in traditionally more value-oriented sectors seem undervalued. In the short-term, the recent action may continue and overvalued stocks may remain in favor at the expense of businesses which look cheap, but we prefer to take a longer-term view to what our clients own in their equity portfolios.

## Hybrid and Hedging Assets

We believe that the Morningstar Moderate Risk Target Index offers the best benchmarks for hybrid and hedging assets. Returns are as follows:

INDEX	DESCRIPTION	<u>Quarter</u>	<u>Year-to-Date</u>	<u>5-Year Avg.</u>
Morningstar Moderate Risk	Hybrid (bonds and stocks)	+12.7%	-2.4%	+6.04%

Since the hybrid assets we own in our portfolios invest in a combination of securities including, but not limited to, bonds and stocks, the hybrid assets typically produce returns close to the average of the bond and stock index returns. This is the case for the quarter and for the annualized returns of the past five years.

Hedging assets like commodities or alternative strategies generally move with little, zero, or negative correlation to the bond and stock markets. We believe hedging assets should play a role in diversified portfolios because over the long-term, their limited or inverse correlation to bonds and stocks should reduce the volatility of overall portfolio returns.

## Bonds

Bond prices rose significantly in the second quarter as investors sold stocks and the safety of cash and bonds. Since bond prices and bond yields move in opposite directions, the 10-Year US Treasury yield dropping from 1.92% at the end of 2019 to 0.66% on June 30 is strong evidence of the impact of the shift into bonds. The yield reached a high for the quarter of 0.91% on June 5 before falling back down, as concerns mounted about going back to shutting down segments of the economy. It seems reasonable to expect somewhat muted returns from bonds going forward given the current low yields as compared to recent history.

The quarterly and historical results for the bond indexes that we track are as follows:

INDEX	DESCRIPTION	Quarter	Year-to-Date	5-Year Avg.
Barclays Municipal Bond	I-T US Municipality Issues	+2.9%	+2.2%	+4.3%
Barclays US Aggregate Bond	I-T US Gov't and Corporate Issues	+2.9%	+6.1%	+4.3%
Morningstar TIPS	Inflation Protected Gov't Issues	+4.0%	+5.7%	+3.7%
Average of the Indexes	Diversified Fixed Income	+3.2%	+4.7%	+4.1%

The recent moves higher in bond prices seem to have the asset class overvalued in the short-term. However, it is important to remember the following, even when we feel bonds are overvalued:

- The prices of overvalued investments often go higher. This is especially true of bonds if the move is in response to a flight to safety amidst equity selling.
- Bonds always have a place in diversified portfolios to reduce volatility, preserve principal, and provide income.

## Our Asset Allocation Philosophy

It is our philosophy that investors with long-term time horizons are best served by using a disciplined, diversified asset allocation approach (investing in bonds, hybrid and other hedging assets and stocks) rather than trying to time the markets. It is important to periodically review your asset allocation and your target allocation and to rebalance your assets among the classes to keep the allocation close to the target. We will address the issues specific to you when we review your situation in the coming months. In the interim, if you would like to discuss these issues, please contact us at [howard@kadescheifetz.com](mailto:howard@kadescheifetz.com) or [steve@kadescheifetz.com](mailto:steve@kadescheifetz.com).

## Reminders

Please contact Kades & Cheifetz LLC if there are any changes in your financial situation or investment objectives, or if you wish to impose, add or modify any reasonable restrictions to the management of your account. Our current disclosure statement is set forth on Parts 2A and 2B of Form ADV and is available for your review upon request.

Kades & Cheifetz LLC has provided this overview for internal use and for use by our clients. We have prepared it using sources believed to be reliable. We do not guarantee the accuracy of the sources. We reserve the right to change our opinions (expressed above) without notice.

You should be receiving statements at least quarterly from your custodian. If you are not receiving these statements, or you need another copy of a statement, please call us and we will provide one to you. Clients are encouraged to review the information on the statements, especially the amount of fees deducted, and compare that information with any information provided by Kades & Cheifetz LLC. If there are any questions or discrepancies, please contact us as soon as possible.

#### Important Disclosure Information

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*Additionally, please remember to contact Kades & Cheifetz, **in writing**, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing or evaluating or revising our previous recommendations and/or services, or if you want to impose, add, to modify any reasonable restrictions to our investment advisory services. Kades & Cheifetz shall continue to rely on the accuracy of information that you have provided. **Please Note:** unless you advise, in writing, to the contrary, we will assume that there are no restrictions on our services, other than to manage the account in accordance with your designated investment objective.*

*Historical performance results for investment indices, benchmarks, and/or categories have been provided for general informational/comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your Kades & Cheifetz account holdings correspond directly to any comparative indices or categories. **Please Also Note:** (1) performance results do not reflect the impact of taxes; (2) comparative benchmarks/indices may be more or less volatile than your Kades & Cheifetz accounts; and, (3) a description of each comparative benchmark is available upon request.*

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