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CHARTWELL REVIEW

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Don't Fight the Fed!

- When the global pandemic took hold in March, stock markets simply plunged. The S&P500 fell -35% in just 22 days. Conversely, the quarter ending 6/30/20 was the 9th best since 1925, and the 4th best since the 1930's. Most of the top 20 best quarters in market history occurred closely after a large downturn or recession, with an average return of 14.7% in the following one-year period (the market's overall 1-year average return is 10%).

- Assets in money market funds at the end of June were the highest they have ever been ($4.8T). The previous two records followed the Dot Com Bubble (Jan-03, $2.3T) and the Global Financial Crisis (Jan-09, $3.8T). With returns on money funds virtually zero, these balances are highly incented to be invested elsewhere.

- Starting in late March, under terms of the very broad and powerful Section 13(3) of the Federal Reserve Act, the Fed began creating an array of commercial and municipal loan facilities and funding backstops. Today, these total $4.3T, and are in addition to its "regular" program purchases of US Treasuries, residential MBS and agency MBS. The latter asset purchase programs average $120bn per month of purposely injected liquidity ($3.6T/year).

- When combined, the Fed's programs of liquidity and credit support will total close to $8T this year. In comparison, the real GDP of the US is only $19.0T. There has never been this degree of monetary policy support.

- As a result of the Fed's unprecedented support for the economy, interest rates have been driven to near historic lows. Key yields at quarter's end were 0.15% for the 2-year Treasury, and 0.65% for the 10-year Treasury (down from 1.91% on December 31st). Globally, the 10-year German and Swissie yielded -0.40%. With the Federal Reserve resistant to negative interest rates, there is more room for rates to increase than to decrease in the future.

Figure 1: Index Benchmarks

Market Index	**Trailing Returns *** 2Q 20	1 Yr	3 Yr	5 Yr	10 Yr
S&P 500	20.5	7.5	10.7	10.7	14.0
U.S. Top-cap Stocks	20.9	11.2	12.5	11.9	14.6
U.S. Mid-cap Stocks	24.6	(2.2)	5.8	6.8	12.4
U.S. Small-cap Stocks	25.4	(6.6)	2.0	4.3	10.5
Non-US Stocks (**EAFE**)	14.9	(5.1)	0.8	2.1	5.7
Non-US Stocks (**Emerg**)	18.1	(3.4)	1.9	2.9	3.3
3 mo. T-Bills	0.1	1.6	1.7	1.2	0.6
U.S. Aggregate Bonds	2.9	8.7	5.3	4.3	3.8
High Yield Bonds	9.6	(1.1)	2.9	4.6	6.5
Global Bonds ($Hdgd)	2.4	6.1	5.1	4.4	4.1
Consumer Prices, p.a.	*(0.1)*	*0.7*	*1.7*	*1.6*	*1.7*
Blmbrg Commodities	5.1	(17.4)	(6.1)	(7.7)	(5.8)
MSCI World REIT's	12.0	(10.6)	0.0	2.0	5.5
Chartwell 65/35 Global	13.4	(0.4)	5.0	5.9	7.9

Figure 2: Average Mutual Fund Returns

Fund Category	**Trailing Returns *** 2Q 20	1 Yr	3 Yr	5 Yr	10 Yr
U.S. Large-cap	20.0	4.5	8.5	8.7	12.5
U.S. Mid-cap	22.9	(5.8)	2.9	4.2	10.3
U.S. Small-cap	23.6	(10.7)	(0.2)	2.9	9.7
International Lg. Cap	18.0	(2.1)	1.7	2.7	6.1
International Sm. Cap	27.9	3.2	3.5	5.1	9.4
Emerg. Mkt. Equity	20.8	(2.4)	1.8	3.1	3.6
Balanced/Hybrid	12.7	3.7	5.4	5.5	7.7
General Bond	7.3	10.8	6.8	6.2	6.3
High Yield Bond	9.3	(1.3)	2.5	3.7	5.8
Hedge Funds, Equity	13.6	1.1	3.1	3.2	4.6

*Annualized trailing returns for periods ending 6/30/20

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Economies, Economics, Prices, and Policy

	6.30.20	6.30.19
CPI - headline, y-o-y	0.7%	1.7%
CPI - core, y-o-y	1.2 %	2.1%
Unemployment Rate	11.1%	3.7%
Labor Force (millions)	159.9	163.1
Employed (millions)	142.2	157.1
Employment/Population	54.6%	60.7%
Growth in Real GDP, (y-o-y)	2.1%	2.9%

At 1.2%, *core* inflation (ex-food & energy) has collapsed on a year-over-year basis. Sharply falling energy prices in April (-10%) pushed year-over-year *headline* inflation down to only 0.7%.

The unemployment rate jumped to 11% at the end of June, despite a 4.8 million increase in non-farm payrolls that month. Gains were driven by leisure and hospitality, retail, and education and health care. The labor force participation rate rose to 61.5%, but the Employment/Population ratio plummeted to 54.6% at the end of June. The lowest E/P ratio during the Great Financial Crisis was 58.2%, in November 2010. Although many returned to work with the early reopening of the economy, the sharp resurgence in COVID-19 cases (and deaths) and pauses in re-openings are expected to slow the pace of recovery in the 3rd quarter.

The labor force declined by 3mm persons in the quarter. However, employment declined by an unprecedented 15 million persons (142mm vs. 157mm).

Figure 3: Breaking Down 1st Quarter* Real GDP

% Change from Preceding Period *(seasonally adjusted at annualized rates)*				
Factor	**1Q '20**	**4Q '19**	**3Q '19**	**2Q '19**
Real GDP Growth	(5.0)%	2.1%	2.1%	2.0%
Nominal GDP Growth	(3.4)	3.5	3.8	4.7
Real Final Sales	(4.6)	3.1	2.1	3.0
Personal Spending	(6.8)	1.8	3.2	4.6
Private Investment	(10.2)	(6.0)	(1.0)	(6.3)
- Fixed, Businesses	(6.4)	(2.4)	(2.3)	(1.0)
- Fixed, Residential	18.2	6.5	4.6	(3.0)
*- Chg. In Inventories **($bn)***	*($50)*	*$18*	*$67*	*$75*
Export growth	(9.0)	2.1	1.0	(5.7)
Import growth	(15.7)	(-8.4)	1.8	0.0
Government Spending	1.1	2.5	1.7	4.8

** BEA final estimate on June 25, 2020*

1Q20 GDP fell 5% quarter/quarter, marking the start of a sharp, but hopefully short-lived, recession. Data continues to rebound off of April lows, with the Institute of Supply Management's non-manufacturing index for June reentering expansionary territory at a healthy 57.1 (50.1 is expansionary).

The Atlanta Fed's GDP model estimate for real GDP growth (seasonally adjusted annual rate) in the second quarter of 2020 is **-35%.** JP Morgan also forecasts that Q2 real GDP plunged 35% (annualized), but is on pace to bounce +20% in Q3. The latter figure has been put into serious question, as the rate of infections and deaths have rebounded rather sharply in various southern and western "hot spot" states.

The U.S budget deficit reached $3 trillion in the 12 months through June, as stimulus spending soared and tax revenue plunged. As a share of GDP, the 12-month deficit came to 14% last month, compared with 10.1% in February 2010. The Congressional Budget Office projects the annual deficit will total $3.7 trillion for the fiscal year that ends in September.

And that gap could widen further. Congress has returned from their summer campaign break and appears poised to augment the $2.3T CARES Act. One of that spending bill's main (and most controversial) provisions is an estimated $260Bn of unemployment benefits in the form of a $600/week addition to each state's unemployment benefits. The aid is scheduled to expire on July 31st, thereby reducing disposal income considerably. Not to be outdone in an election year, the House and Senate are said to be contemplating another $1-1.5T of additional aid.

During Q2, the yield on the 10-year Treasury inflation protected (TIPS) security dropped sharply even as the nominal 10-yr yield stayed unchanged - a combination that suggests investors are both dialing up their inflation expectations and not worrying about any increase in short-term interest rates. The nominal inflation protected Treasury yield, known as the breakeven inflation rate, jumped to 1.46% from 1.05% on May 1st. At the same time, the nominal 10-yr yield was unchanged at 0.65%. That means the inflation adjusted 10 year Treasury yield, a proxy for the so called real yield, has slid from (-0.4)% to (-0.8%), a level not reached since late 2012 when the Fed was still responding to the 2008-09 Great Financial Crisis.

Consensus is that the economy won't get healthier while America is getting sicker. The fierce resurgence of COVID-19 cases and related shutdowns are dashing hopes of a quick economic recovery prompting businesses to shift their strategies this time. With a focus on the long-term, companies are turning furloughs into permanent layoffs, deemphasizing their core businesses, and downsizing production indefinitely. Executives who were bracing for months-long disruptions are now thinking in terms of years. The economic uncertainty associated with the pandemic is monumental. Primary economic risks at this point are –

- The recession and recovery are at a slower pace than markets are anticipating;
- There is no apparent engine of economic growth in the current cycle. The expansion cycle will be unique;
- Political headlines could foment market volatility.

Bonds – Go Big or Go Home

Fixed income markets staged a rapid recovery since the depths of March. Optimism over the resumption of growth as states gradually reopen, along with any positive news on the vaccine, have bolstered risk assets. But the primary driver of the rally has been the Fed's liquidity backstop (both QE and various credit facilities), with markets rallying on each successive Fed announcement. While all bond sectors have seen a remediation, there's a distinct bifurcation in performance, with sectors that stand to benefit from QE and the Fed's credit programs recovering the most.

Investment grade credit spreads (140 bps) are trading close to historical averages after widening well past normal recessionary levels in late March (340 bps). In fact, the average yield of investment grade corporate bonds fell to a record low 2.23% in June, a clear sign of waning risk aversion.

Figure 4 reflects this, as we see US High Yield and Investment Grade credit indices both returning over 8% in the quarter due to yield declines (and price advances).

Casting some doubt on the durability of the recovery, the Treasury market has yet to validate the current rally. Despite investor optimism, Fed purchases, and a massive increase in Treasury supply to finance the deficit, 10-year Treasuries have remained around 0.65% since April. The 30-year's yield rose moderately in Q2, to 1.41%. Further, the TIPS market is priced for inflation to remain below 1.4% for the next five years.

Per Figures 5 and 6, developed market yield moves were broadly mixed over the quarter, though remained anchored at lower levels amid ongoing support from central banks. In the US, the Treasury curve steepened alongside the recovery in risk assets as the 30-year's yield rose 6bps and the 2-year's fell 8 bps. Rates in Germany and Japan remain similarly range bound at 0.0% or lower.

US agency mortgage-backed securities (MBS) returned 0.67%, outperforming like-duration Treasuries by 38 bps. The sector recovered meaningfully as market liquidity improved, and continued Fed-buying offset pressures from large growth issuances. Non-agency MBS spreads tightened, and Commercial MBS returned 3.8%.

US investment grade credit spreads tightened 112 bps, ending the quarter at 142 bps. The sector returned 8.2%, outperforming like-duration treasuries by 7.7%. Credit rallied over the quarter alongside improving liquidity conditions due in large part to support from the Fed's corporate purchase program, which improved access to funding markets for many companies.

High Yield credit spreads tightened meaningfully during the quarter (down 260 bps) yet remained wider than they were at the start of the year (up 166 bps). HY bonds returned 9.6% in the quarter, but were off 1.1% during the past 12 months.

Figure 4: Primary Bond Sector Returns (%)

Index	2Q '20	1 Yr	3 Yrs	5 Yrs
US Aggregate Bond index	2.9	8.7	5.3	4.3
US Gov't/Credit: (1-3yrs)	1.2	4.2	2.9	2.1
US Treasury: Long	0.3	25.4	12.0	9.3
US TIPS (1-10yrs)	3.8	5.8	3.9	3.0
Mortgage-Backed (MBS)	0.7	5.7	4.0	3.2
Commercial MBS	3.8	5.9	4.9	4.1
Asset-Backed (ABS)	3.5	4.7	3.3	2.7
Inv. Grade US Credit	8.2	9.1	6.1	3.3
Leveraged Loans	4.5	(5.1)	1.2	2.4
US High Yield Credit	9.6	(1.1)	2.9	4.6
Municipal Bonds, broad	2.7	4.5	4.2	3.9
Global Agg., ($ hdgd)	2.4	6.1	5.1	4.4
Global Credit, ($ hdgd)	6.9	6.9	5.6	5.2
Emerg. Mkts Bonds (US$)	12.3	0.5	3.6	5.3

Figure 5: Fixed Income Yields – 2nd Quarter 2020

(YTM, % p.a.)	Jun-20	Mar-20	Dec-19	Jun-19	*1-Year Change*
US Treasuries					
3-month	0.14	0.08	1.55	2.12	*(1.98)*
2-year	0.15	0.23	1.56	1.74	*(1.59)*
5-year	0.29	0.38	1.68	1.76	*(1.47)*
10-year	0.65	0.70	1.91	2.00	*(1.35)*
30-year	1.41	1.35	2.38	2.53	*(1.12)*
BarCap Aggregate	1.27	1.59	2.31	2.49	*(1.22)*
BBB Credit	2.59	4.32	3.17	3.53	*(0.94)*
AA Credit	1.52	2.12	2.35	2.54	*(1.02)*
Agency MBS	1.36	2.18	2.54	2.7	*(1.34)*
Emerging Mkts ($)	5.51	7.00	4.91	5.54	*(0.03)*
US High Yield	6.85	9.44	5.19	6.06	*0.79*
UST 10yr - 3Mo	0.51	0.62	0.36	(0.12)	*0.63*

Figure 6: Sovereign Bond Yields, selected countries

10-year yields (%)	Jun-20	Mar-20	Dec-19	Jun-19	*1-Year Change*
Germany	(0.40)	(0.47)	(0.18)	(0.30)	*(0.10)*
Switzerland	(0.39)	(0.32)	(0.48)	(0.50)	*0.11*
Japan	0.00	0.00	0.00	(0.20)	*0.20*
Britain	0.22	0.42	0.82	0.90	*(0.68)*
Spain	0.48	0.50	0.44	0.30	*0.18*
United States	0.65	0.70	1.91	2.00	*(1.35)*
Australia	0.88	0.73	1.43	1.30	*(0.42)*
Italy	1.40	1.62	1.41	2.10	*(0.70)*
Poland	1.42	1.69	2.12	2.40	*(0.98)*
Greece (new bonds)	1.25	1.80	1.49	2.50	*(1.25)*
China (5 year)	2.61	2.31	2.83	3.10	*(0.49)*
Brazil	2.06	3.42	4.58	6.00	*(3.94)*
India	5.85	6.12	6.52	6.90	*(1.05)*
Russia	5.90	6.81	6.40	7.50	*(1.60)*

US Stocks – Melting Up

Following the worst quarter since the 2008 financial crisis, domestic equities rallied to close out the best quarterly gain since 1998. Unprecedented actions in monetary policy by the Fed encouraged investors to price a robust economic recovery into the stock market despite negative GDP growth, record high unemployment levels, and weak corporate earnings. A spike of COVID-19 cases in June reminded us the pandemic will remain a source of headline risk and volatility until a vaccine is developed. With a presidential election set to take place later this year, politics might also provide a source of uncertainty and volatility.

The size premium in equities revealed itself over the quarter, as small- and mid-cap companies outperformed large-caps. The Russell 2000 (small-cap) rose 25.4%, followed by the Russell Midcap rising 24.6%, and the Russell 1000 (large-cap) gaining 21.8%. The Russell 1000 large-cap differential was 13.5%, and the Russell 2000 small-cap differential was 11.7%.

For growth stocks, we observe that large-caps have outperformed small-caps over trailing 1-, 3-, 5-, and 10-year periods at a differential we have not seen in the 25 years we have been writing this review.

Figure 7: U.S. Equity Market - Size/Style Returns

		Trailing			
	2Q '20	**1-year**	**3-yrs**	**5-yrs**	**10-yrs**
Growth					
Large Cap	27.8	23.3	19.0	15.9	17.2
Mid Cap	30.3	11.9	14.8	11.6	15.1
Small Cap	30.6	3.5	7.9	6.9	12.9
Value					
Large Cap	14.3	(8.8)	1.8	4.6	10.4
Mid Cap	20.0	(11.8)	(0.5)	3.3	10.3
Small Cap	18.9	(17.5)	(4.4)	1.3	7.8

In terms of style, the second quarter maintained a risk-on market, favoring growth stocks over value. The 1-year positive differentials for growth are 32% and 21%, respectively. Since June of 2007, the S&P 500 Growth index has a cumulative total return of 376%, doubling the S&P 500 Value return of 187%. The underperformance of value has been a consistent downward spiral since 2007, but widened materially in Q2.

From a factor standpoint, Growth and Momentum outperformed in both the first and second quarters, finishing the first half of the year in positive territory (7.9% and 5%, respectively). As spring turned to summer, however, every factor was overtaken by the extraordinary recovery in High Beta stocks, which jumped +38% in the quarter.

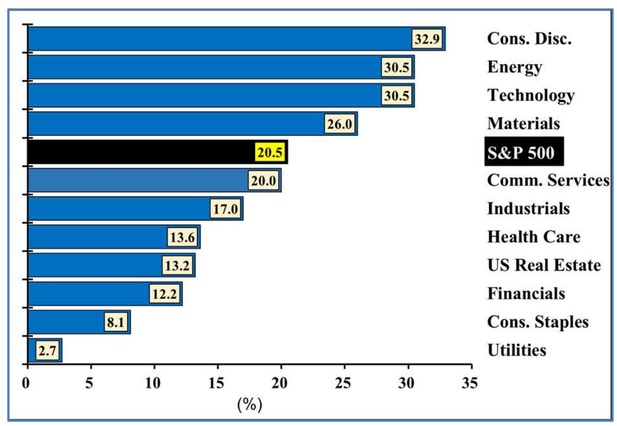
Conversely, Value and Dividend factors/strategies are among the weakest performers, rising "only" 13% and 11% in Q2 and falling -15% and -27% year to date, respectively.

All eleven sectors of the S&P 500 posted positive returns in Q2, with four outpacing the broad index return:

- **Consumer discretionary** – e-commerce giant Amazon outperformed as did essential retailers that were able to stay open throughout the lockdown;
- **Energy –** the sector returned 31%, bouncing back after a 50% decline in Q1. WTI crude oil soared 92%;
- **Technology –** several large technology stocks hit all-time highs. Markets are placing a premium on companies that benefit from online services for work-at-home, communication, and entertainment;
- **Materials –** This sector rebounded as economies and industries began re-opening.

Defensive sectors which were top performers in the first quarter lagged the broader market in Q2, including utilities and consumer staples. Financials remain pressured by low interest rates and a tenuous economic outlook.

Figure 8: US Sector Returns –2nd Quarter 2020



After such a rebound, the questions equity investors need to address are – (1) the depth, length and shape of the economic recovery; (2) how this will translate into an earnings recovery, and (3) how that recovery will be valued by investors. To date, investors have been very optimistic about valuations, despite little or no clarity regarding the earnings translation. The 2nd quarter is expected to mark the low point for earnings, as margins collapsed and revenues came under significant pressure. Current estimate for 2Q20 S&P 500 operating earnings per share is only $22.30, a **45%** decline from a year prior. Annualized earnings look set to contract on a year-over-year basis through the end of 2020, to only $125/share. That compares with the S&P 500's valuation of 3100 at quarter's end, for a Price/Earnings ratio of nearly 25x. Long-term trailing P/E for the market is 15x. Stock market values appear to be even more than considerably "ahead" of themselves.

International Markets Re-Open

Global stocks staged a powerful rally, rebounding from a coronavirus-induced selloff in the 1st quarter. Investors looked optimistically toward a global economic recovery, despite a spike of the virus in some regions during the final weeks of the quarter. Developed markets (MSCI EAFE) rose 14.9% and emerging markets jumped 18.1%. The inclusive All Country World index rose 19.2%. All sectors in the MSCI World advanced in Q2, led by technology stocks as e-commerce, networking, and streaming companies benefited during imposed lockdowns. Defensive sectors (utilities, consumer staples) lagged the overall market. Globally, the growth style rebounded more strongly than value, and smaller capitalization stocks outpaced their larger cap peers. In currency markets, the US$ weakened versus most developed and emerging markets as "safe-haven" buying cooled.

Within developed markets, Europe (15.3%) posted its best quarterly return since 2015. The region was propelled by a €600B increase in the ECB's pandemic relief program alongside a commitment to purchase as much as €1.35T of government and corporate bonds over the next year. European Union leaders proposed issuing €750B in centrally backed bonds for the first time ever, with proceeds directed to pandemic relief efforts in Europe's hardest-hit countries.

Europe's largest economy, Germany, rallied (26.5%) as it re-opened manufacturing plants in key export industries. The euro rallied 2.4% versus the US$ as a result. The UK market lagged the overall market (7.8%) as growing COVID-19 cases and ongoing uncertainty over the terms of the UK's departure from the EU raised investor concerns. In Europe only one sector posted a negative return, energy (-3%), as some European oil majors reported massive write-downs after oil prices plummeted.

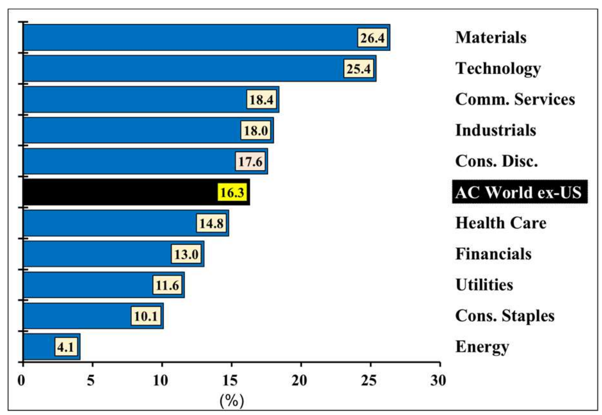
Figure 9: International Equity Markets – Returns

	U.S. Dollar Returns (%)		Local Currency Returns (%)	
thru 6/30/20	2Q '20	1-Yr	2Q '20	1-Yr
World ex-USA	**15.3**	**(5.4)**	**12.8**	**(4.2)**
- MSCI Growth	*17.9*	*4.3*	*15.2*	*5.4*
- MSCI Value	*12.4*	*(15.1)*	*10.0*	*(14.0)*
- Europe	15.3	(6.8)	13.1	(5.7)
- Pacific, ex-Japan	20.2	(12.7)	12.1	(11.6)
- Japan	11.6	3.1	11.5	3.2
- United Kingdom	7.8	(17.7)	8.2	(15.3)
Int'l Small Caps	**21.7**	**(3.2)**	**18.7**	**(1.8)**
Emerging Mkts	**18.1**	**(3.4)**	**16.7**	**(1.4)**
- EM Asia	*17.8*	*4.9*	*16.5*	*5.7*
- EM Europe	*18.6*	*(17.1)*	*11.5*	*(8.2)*
- EM Lat Amer	*19.1*	*(32.5)*	*22.1*	*(10.1)*
- EM BRIC	*16.9*	*(0.2)*	*16.8*	*5.9*

The Pacific region rose 14.2% during the quarter. Japan (11.6%), rebounded as the country appeared to contain its coronavirus outbreak. The Japanese economy fell into recession, contracting by 2.2% on an annualized basis in 1q. Exports plunged in May hurt by weak automotive shipments to the US. Industrial production and retail sales also tumbled. To combat the economic downturn, the Bank of Japan pledged to buy an unlimited amount of government bonds, quadrupled its planned purchases of corporate debt until September 2020, and increased its support for corporate lending by banks. The Japanese government launched two stimulus packages of ¥117T each in Q2. The Japanese yen ended the quarter flat against the US dollar (0.1%).

Hong Kong (9.2%) rose the least in the region as a resurgence of civil unrest deepened concerns regarding the territory's autonomy from mainland China. Australian markets jumped 29% as authorities unleashed stimulus measures to support an economy on the verge of it first recession in nearly 30 years. The Australian$ rallied 12% versus the US dollar. New Zealand stocks rose 28% and are up 7% YTD, making it one of three countries in the world in positive territory in the first half of 2020 (Belgium up 9% and China up 3%).

Figure 10: Ex-USA Sector Returns – 2nd Quarter 2020



Emerging markets (18.1%) jumped in Q2 as China's economy restarted, commodity prices rebounded, and central bankers globally cut key lending rates and rolled out massive stimulus packages to blunt the impact of the global economic slowdown. Asian (17.8%) emerging markets rose as China (15.3%) re-opened factories earlier than most. Policymakers chose not to set an economic growth target at the annual parliament meeting in May but pledged to roll out additional stimulus measures if needed. Internet-platform companies led the Chinese market. Countries that produce oil and industrial metals led the emerging markets rebound. Russian equities (18.7%) followed oil prices higher, contributing to EM Europe's 18.7% rise. Brazilian (23%) stocks soared as prices for iron ore and other raw materials rose. This led Latin American (19%) markets to top emerging market honors in Q2.

The Back Page – Gold Regaining its Luster

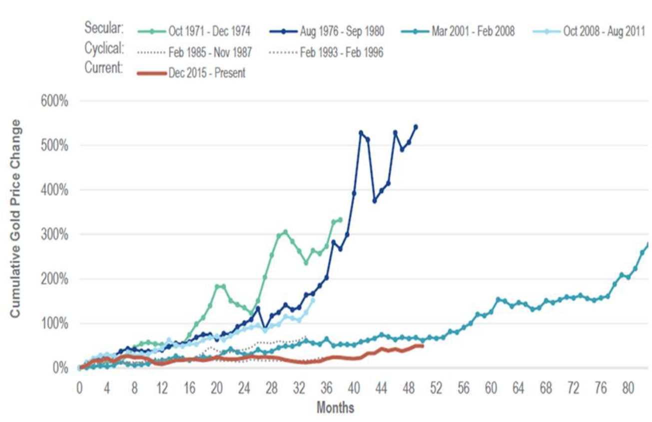
During the COVID-19 pandemic-induced market crash in 1Q20, the list of asset classes that posted positive returns was short; money market securities, government backed bonds, and gold. Historically viewed as the ultimate safe haven asset, gold did not disappoint during the recent market turmoil. The initial 2020 gold rush began in late February, on pandemic fears and weakening stock and bond prices. When the Fed slashed rates on March 2nd to provide liquidity support to frozen debt markets, panic selling across all asset classes ensued as investors sought out cash. Gold's drop during this sell-off was short-lived; sliding from a high of $1,707 an ounce on March 9th to a low of $1,453 on March 16th. Gold began rebounding March 24th and has crossed over $1900 per ounce at the end of July.

Does gold have more room to run? There are a number of technical factors and macroeconomic trends which support a sustainable longer-term rally for gold:

- A new secular bull market began with Fed rate hikes in December 2015. Gold was priced at $1,050 an ounce;
- Prices broke out and accelerated in 2019 with the Fed shifting to a policy of easing;
- Fears of the global pandemic sent gold prices to $1,700 an ounce in April 2020.

Bull markets for gold historically have been multi-year. The gold market appears to be on trend to perform as it did in the 2001 – 2008 gold rally, as shown in the following table:

Historical Gold Bull Market Rallies



**Source of Table Data: VanEck, Bloomberg. Data as of March 2020. Past performance is not indicative of future results.*

Macroeconomic trends also support a fertile environment for gold's strength:

- Short recession followed by a slow recovery – a longer recession would be even more bullish;
- A growing number of failures/bankruptcies which may prompt additional trillion-dollar rescue programs;
- Financially stressed states and municipalities;
- Sovereign and corporate debt levels expand to unsustainable levels around the globe.

Why would gold be a good addition to a portfolio?

Gold provides diversification and is a liquid asset. Should the massive monetary and fiscal stimulus programs global central banks have unleashed result in future inflation, gold also remains an effective inflation hedge. Gold is a real asset, and could be included in, or be the sole allocation of, a commodities/natural resources allocation.

Asset Class Correlations – Jan. 1990 to Dec. 2019

	US Stocks	Gold Bullion	Gold Miners	Commodities	Natural Resources Equity
US Stocks	1.00				
Gold Bullion	0.02	1.00			
Gold Miners	0.16	0.72	1.00		
Commodities	0.31	0.24	0.29	1.00	
Natural Resources Equity	0.68	0.25	0.43	0.65	1.00

Gold does correlate strongly with "real" interest rates. Also referred to as inflation-adjusted rates, when the US Treasury 10-year yield *less* CPI is negative, gold is an attractive store of value and becomes an alternative to interest bearing assets.

How can gold be added to a portfolio?

In addition to investing in gold directly, gold mining stocks are another avenue for exposure to the asset class. In the commodity complex, stock prices do not always move in concert with the underlying commodity, but current gold equity valuations are at attractive levels. Companies have improved balance sheets and can generate significant free cash flow. Investment structures are available for dedicated gold exposure through ETFs, as well as mutual funds which invest in both gold and gold equities.

We are recommending that our long-term investor clients consider an allocation to gold directly, to gold mining stocks, or to a combination thereof.

Stay Safe.

Sell high, buy low. See you next quarter!

Natalka Bukalo
Richard Shaffer, CFA

