

# Weekly 3

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WHAT YOU NEED TO KNOW  
ABOUT THE MARKETS

October 26, 2020



# Week in Review

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## Market Performance

as of 10/24/2020

FIXED INCOME	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	THIS WEEK
Cash Equivalent <sup>1</sup>	0.58	1.12	1.57	0.79	0.47	0.01	0.00
U.S. Investment Grade Bonds <sup>2</sup>	3.55	4.02	5.11	6.72	6.36	-0.41	-0.42
EQUITIES	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	THIS WEEK
Global Equity Market <sup>3</sup>	8.57	9.20	7.48	11.68	4.16	3.02	-0.15
Total U.S. Market <sup>4</sup>	13.62	13.02	12.66	18.46	9.76	3.70	-0.47
Domestic Large-Cap Equity <sup>5</sup>	14.14	13.97	14.17	21.35	11.87	2.38	-0.86
Domestic Small-Cap Equity <sup>6</sup>	10.31	7.95	4.16	4.96	-1.81	9.06	0.67
International Equity <sup>7</sup>	4.20	5.34	1.87	3.65	-2.63	2.68	0.39
Developed International Equity <sup>8</sup>	4.44	4.41	1.17	0.69	-4.85	1.64	0.06
Emerging Market Equity <sup>9</sup>	3.17	8.21	3.68	11.87	3.25	5.28	1.20
DIVERSIFIERS	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	THIS WEEK
Diversified Alternatives <sup>10</sup>	1.55	0.28	-0.72	-4.10	-6.11	1.63	0.43
Commodity <sup>11</sup>	-5.98	-2.27	-3.43	-6.26	-8.71	3.84	0.25
Global Real Estate <sup>12</sup>	5.07	3.02	0.42	-12.68	-13.56	1.14	-0.20

Source: Morningstar

<sup>1</sup>Morningstar Cash Index <sup>2</sup>Bloomberg Barclay's Capital U.S. Aggregate Bond Index <sup>3</sup>Morningstar Global Market Large-Mid

Index <sup>4</sup>Morningstar U.S. Market Index <sup>5</sup>Morningstar U.S. Large Cap Index <sup>6</sup>Morningstar U.S. Small Cap Index

<sup>7</sup>Morningstar Global ex U.S. Large-Mid Index <sup>8</sup>Morningstar Developed Markets ex U.S. Large-Mid Index <sup>9</sup>Morningstar

Emerging Markets Large-Mid Index <sup>10</sup>Morningstar Diversified Alternatives Index <sup>11</sup>Bloomberg Commodity Index

<sup>12</sup>Morningstar Global Real Estate.

### 1 CIO Weekly Viewpoint

### 2 The Forgotten

### 3 2020 In One Word: Innovation



The Weighing Machine podcast is available on [iTunes](#).

On Orion Portfolio Solutions' The Weighing Machine podcast, Rusty Vanneman and Robyn Murray cut through the market clamor and focus on time-tested, proven principles that help financial advisors and investors reach their long-term financial goals.



Market Update Video

# CIO Weekly Viewpoint

# 1

- Last week, U.S. stocks ended the week lower after getting whipsawed back and forth over the stimulus uncertainty. Market moves were also driven by increasing COVID-19 cases and earnings reports.
- For the week the S&P 500 declined 0.5% and the DJIA dropped by 1% along with tech stocks<sup>1</sup>. Value stocks<sup>2</sup> significantly outperformed growth stocks<sup>3</sup>.
- European stocks<sup>4</sup> managed to claim a small gain. Emerging Market<sup>5</sup> stocks were up more than 1%.
- Commodities<sup>6</sup> rose in spite of oil dropping more than 3%.
- Domestic bond yields rose as the 10-year Treasury yield climbed to the highest level in four months, signaling that the market may be suggesting a more positive outlook to economic growth next year regardless of the election outcome.
- The third-quarter earnings season has almost 40% of the S&P 500 companies reporting earnings throughout this week. Important economic data being released include consumer confidence on Tuesday, third-quarter GDP growth on Wednesday, and personal income and spending on Friday.

Source: Bloomberg 10/25/20

1 Morningstar U.S. Technology Index

2 Morningstar U.S. Value Index

3 Morningstar U.S. Growth Index

4 Morningstar DM xUS Large-Mid NR USD

5 Morningstar EM Large-Mid NR USD

6 Bloomberg Commodity TR USD



**MARC PFEFFER**  
Chief Investment Officer

Marc Pfeffer serves as CLS's Chief Investment Officer. In his role, Marc is responsible for leading CLS's Portfolio Management Team and overseeing all investment operations at CLS, including investment philosophy, process, positioning, and performance.

Prior to taking on the role of CIO, Marc was CLS's Chief Investment Strategist. He was also previously a Portfolio Manager on the CLS Flexible Income Fund team, and managed the CLS Active Income X Strategy and CLS's ETF strategies. He also managed individual municipal bond portfolios for the CLS Master Manager Strategy and continues to serve as a senior member of the CLS Investment Committee.

Marc has more than 30 years of investment management experience, including time spent as the Chief Investment Officer at Milestone Treasury Obligations Fund. He also worked previously at Goldman Sachs and Bear Stearns.

Marc graduated from the State University of New York at Buffalo with a Bachelor of Science degree in finance. He received his Master of Business Administration degree, with a focus on finance, from Fordham University. Mr. Pfeffer holds the Series 65 license.

# The Forgotten

## 2

As global investors, we often look at a portfolio's geographical exposures and attempt to gain access to what we believe are the most attractive countries and regions around the world. Expanding our investment universe outside the U.S. potentially allows for more opportunities and broader risk diversification. Many investment firms appear to spend a great deal of time evaluating opportunities in U.S. markets, developed international markets (such as Europe), and emerging market countries (such as China). But it seems that one country is often ignored: Japan!

Japan makes up 6% of global GDP and nearly 7% of the MSCI All Country World Index (ACWI). It stands out as the largest country exposure in the MSCI EAFE Index — constituting more than 25%. This index is commonly used to gain exposure to developed economies outside the U.S.

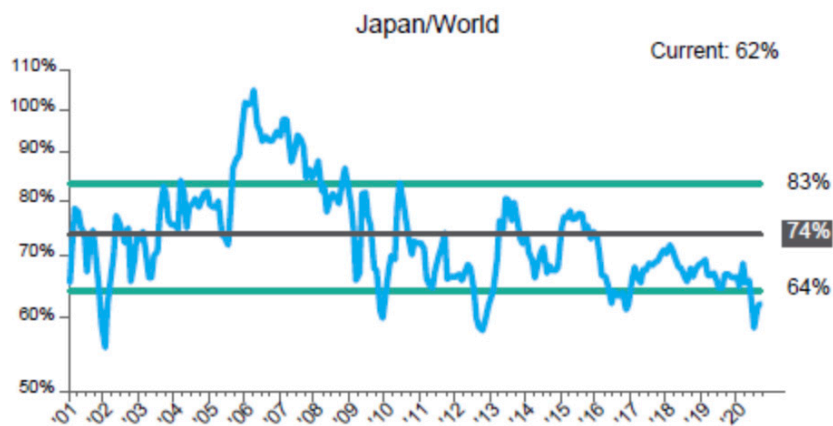
Japan may be somewhat forgotten due to its negative interest rates, aging demographics, and persistently low economic growth. Not exactly a wish list in an attractive market. But given its impact on the global benchmark, it is important to not neglect Japan. In fact, there are some attractive opportunities to add exposure to the country, and there are several reasons Japan could potentially outperform moving forward.



**MICHAEL HADDEN**  
CFA, CLS Portfolio  
Manager

## 1. Valuations

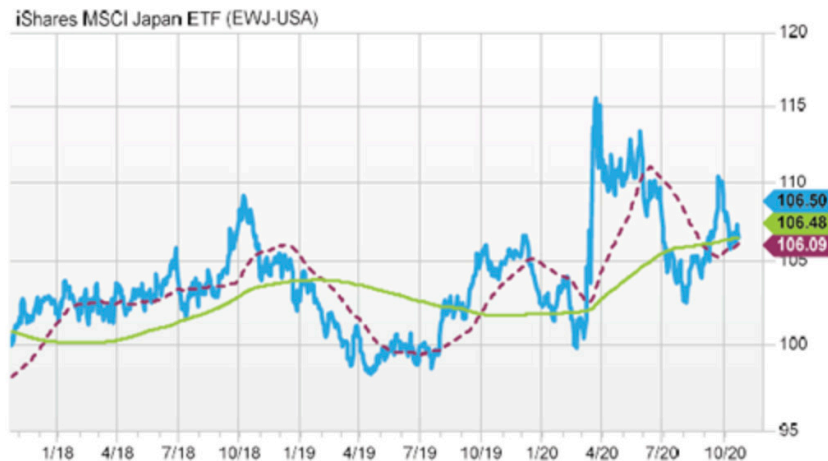
Japan has traded at a discount to global markets since 2000, but that discount is now much wider than average. The chart below shows the relative valuations of the MSCI Japan Index compared with the MSCI All Cap World Index, since 2001. Currently trading at 62% of the valuation level of the global markets, Japanese markets are now more than one standard deviation below their long-term average, an attractive indicator for forward returns.



Source: Factset 10/7/2020

## 2. Technicals

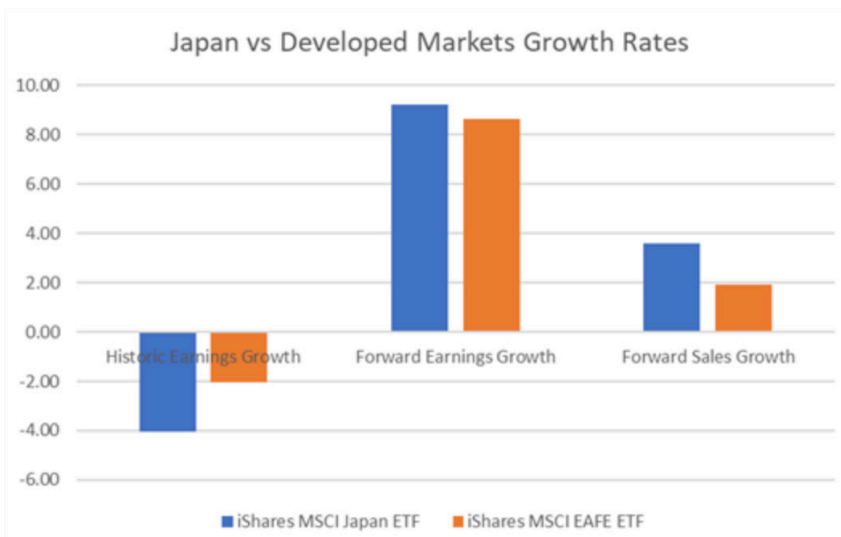
While Japan has trailed global markets, especially U.S. markets over the past few years, the country had great performance in the third quarter. We believe the technical chart below shows promise as relative performance has perked up and is nearing a golden cross (63-day moving average crossing over 252-day moving average). The chart below shows the relative performance of the iShares MSCI Japan ETF compared with the MSCI All Cap World Index, since 2018.



Source: Factset 10/24/2020

## 3. Forward growth

Japan has experienced lower growth than other developed markets in the past five years. However, forward expectations show higher earnings growth and nearly double sales growth.



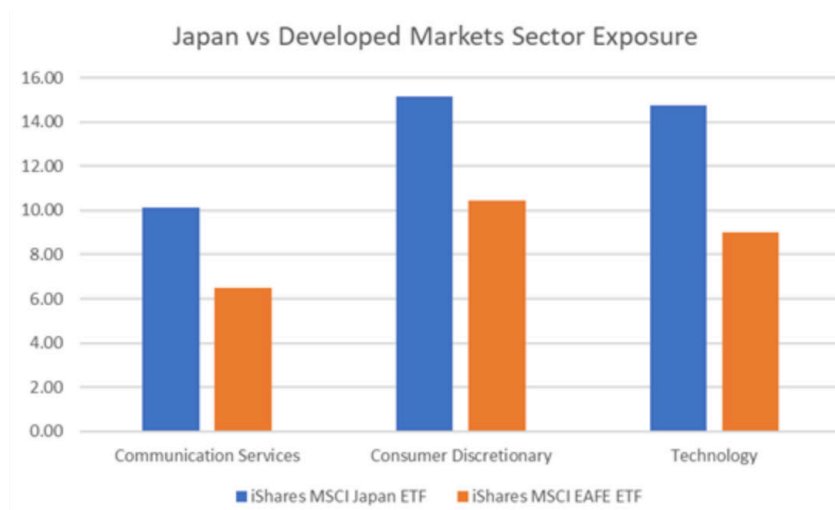
Source: Morningstar Direct 10/25/2020

Historic Earnings Growth from 9/30/2016 to 9/30/2020

5 year projected Forward Estimates as of 9/30/2020.

## 4. Sector exposures

The difference in sector exposures between U.S. and international markets may possibly explain recent U.S. dominance, as I wrote about here. As noted, international markets typically do not have as much exposure to some of the more growth oriented areas of the market. Japan actually flips this narrative, as EWJ (MSCI Japan ETF) has larger exposures to the communication services, consumer discretionary, and technology sectors, which have been leaders recently.



Source: Morningstar Direct 10/25/2020

Although the story has been bleak and often nonexistent for Japan in recent years, the country is still a significant part of global exposures. Don't neglect the possibility of a bright future for Japanese stocks!

# 2020 In One Word: Innovation

# 3

Okay so maybe you can't wrap up this wild year in just one word. But one thing is for certain, the pandemic and ongoing circumstances that have resulted have led to innovation around the world. If nothing else, shifts that were already taking place have been greatly accelerated, due to the pressing need to adapt. We have seen companies embrace working from home, stores of all types have adopted an online presence, and it is expected that a vaccine will be developed and made available to the general public in record time.

Although life has been greatly altered, in the long-run we may see meaningful improvements to general quality of life, given the progress that has been made this year in various areas. The financial markets have taken notice of the innovation happening across the global economy and have greatly rewarded those companies that have been at the forefront. Rusty touched on thematic ETFs, and more specifically "Megatrends" in his [latest monthly update](#). While many of these trends are based upon long-term investment theses, the disruptive nature of the year has provided an opportunity for many of the funds he mentioned to achieve strong performance.

When looking at the top performers in the ETF marketplace YTD (after removing leveraged funds), innovative ETFs appear to dominate the top spots. The top performing ETF is the Grayscale Ethereum Trust (ETHE), a trust which holds the crypto currency Ethereum, which is now up over 200% YTD. Obviously crypto currencies have been in and out of the news as a potential disruptive technology spanning the fintech market.



**MICHAEL HADDEN**  
CFA, CLS Portfolio  
Manager

Name	Ticker	Total Return YTD
Grayscale Ethereum Trust (ETH)	ETHE	211%
Invesco Solar ETF	TAN	131%
ARK Genomic Revolution ETF	ARKG	109%
iPath® S&P 500 Dynamic VIX ETN	XVZ	108%
ARK Next Generation Internet ETF	ARKW	106%
Invesco WilderHill Clean Energy ETF	PBW	100%
First Trust NASDAQ® Cln Edge® GrnEngyETF	QCLN	98%
ARK Innovation ETF	ARKK	98%
Amplify Online Retail ETF	IBUY	88%
ProShares Online Retail ETF	ONLN	87%

Source: Morningstar Direct 10/25/2020

Looking at the top ten performers, I'd argue that nine of the ten are products which directly benefit from innovation in some manner. Several clean energy funds are included, which benefit from the transition we have begun to see in energy production from the traditional oil and gas industries to alternative energy sources. ARK places two funds in the top ten, which target innovation in various areas of the marketplace, including healthcare (ARKG), the internet (ARKW), and multi-industry broad-based innovation (ARKK). Online retail rounds out the top ten with a couple of products. This is the trend the average person has probably witnessed most directly, as staying home and ordering online has become the safest and most convenient way to shop in 2020. In fact, according to the Census Bureau, in the second quarter of 2020 E-commerce made up 16.1% of all US Retail sales, up from only 10.8% in the second quarter of 2019.

The market continues to reward companies and ETFs that target the changing dynamic of life as we know it. While no one knows what 2020 will throw at us next, it is clear that the companies which are able to adjust most quickly, will likely thrive in the fast paced environment that is the world we live in today.

The Morningstar Global Market Large-Mid Index is an index that measures the performance of the global market's equity markets targeting the top 90% of stocks by market capitalization. The Morningstar U.S. Market Index is an index that measures the performance of U.S. securities and targets 97% market capitalization coverage of the investable universe. It is a diversified broad market index. The Morningstar U.S. Large Cap Index is an index that measures the performance of U.S. large-cap stocks. These stocks represent the largest 70% capitalization of the investable universe. The Morningstar U.S. Small Cap Index is an index that measures the performance of U.S. small-cap stocks. These stocks fall between the 90th and 97th percentile in market capitalization of the investable universe. In aggregate, the Small Cap Index represents 7% of the investable universe. Morningstar Global ex U.S. Large-Mid Index is an index that measures the performance of Global Markets (ex-U.S.) equity markets targeting the top 90% of stocks by market capitalization. The Morningstar DM ex U.S. Large-Mid Index is an index that measures the performance of developed markets ex-U.S. equity markets targeting the top 90% of stocks by market capitalization. The Morningstar EM Large-Mid Index is an index that measures the performance of emerging markets targeting the top 90% of stocks by market capitalization. The Barclay's Capital U.S. Aggregate Bond® Index measures the performance of the total United States investment-grade bond market. The Morningstar Cash Index is an index that measures the performance of a Treasury Bill with six to eight weeks until maturity in the U.S. market. The Morningstar Diversified Alternatives Index allocates among a comprehensive set of alternative underlying ETFs that employ alternative and non-traditional strategies such as long/short, market neutral, managed futures, hedge fund replication, private equity, infrastructure or inflation-related investments. The Bloomberg Commodity Index is made up of exchange-traded futures on physical commodities and represents commodities that are weighted to account for economic significant and market liquidity. This index provides investors with a means of understanding the performance of commodity futures markets and serves as a benchmark for investment performance of commodities as an asset class. The S&P 500 Index is an unmanaged index of 500 large-capitalization companies. This index is widely used by professional investors as a performance benchmark for large-cap stocks. Morningstar Gbl Real Estate NR USA Index: measures the performance of mortgage companies, property management companies and REITs. The Russell 2000 is an index comprised of the 2,000 smallest companies on the Russell 3000 Index and offers investors a benchmark for small-cap stocks. The S&P MidCap 400® provides investors with a benchmark for mid-sized companies. The index, which is distinct from the large-cap S&P 500®, is designed to measure the performance of 400 mid-sized companies, reflecting the distinctive risk and return characteristics of this market segment. The volatility of the indexes may be materially different from the individual performance attained by a specific investor. In addition, portfolio holdings of investors may differ significantly from the securities that comprise the indexes. You cannot invest directly in an index.

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