Weekly 3

WHAT YOU NEED TO KNOW ABOUT THE MARKETS

November 2, 2020

ORION

Week in Review

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Market Performance

as of 11/2/2020

FIXED INCOME	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	THIS WEEK
Cash Equivalent[1]	0.58	1.13	1.55	0.74	0.47	0.01	0.01
U.S. Investment Grade Bonds[2]	3.55	4.08	5.06	6.19	6.32	-0.45	-0.45
EQUITIES	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**THIS WEEK**
Global Equity Market[3]	7.98	8.08	5.43	4.60	-1.31	-2.40	-2.40
Total U.S. Market[4]	12.94	11.65	10.32	10.45	3.50	-2.21	-2.21
Domestic Large-Cap Equity[5]	13.47	12.60	11.78	12.97	5.55	-3.40	-3.40
Domestic Small-Cap Equity[6]	9.65	6.70	2.03	-1.72	-7.43	2.82	2.82
International Equity[7]	3.72	4.49	0.16	-2.33	-7.20	-2.13	-2.13
Developed International Equity[8]	3.88	3.32	-0.81	-5.93	-10.06	-3.93	-3.93
Emerging Market Equity[9]	2.88	8.08	2.61	7.55	0.36	2.33	2.33
DIVERSIFIERS	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**THIS WEEK**
Diversified Alternatives[10]	1.43	0.50	-1.06	-5.10	-7.03	0.64	0.64
Commodity[11]	-6.36	-2.73	-4.41	-8.75	-10.85	1.41	1.41
Global Real Estate[12]	4.72	2.22	-0.79	-16.36	-17.28	-3.21	-3.21

Source: Morningstar

[1]Morningstar Cash Index [2]Bloomberg Barclay's Capital U.S. Aggregate Bond Index [3]Morningstar Global Market Large-Mid Index [4]Morningstar U.S. Market Index [5]Morningstar U.S. Large Cap Index [6]Morningstar U.S. Small Cap Index [7]Morningstar Global ex U.S. Large-Mid Index [8]Morningstar Developed Markets ex U.S. Large-Mid Index [9]Morningstar Emerging Markets Large-Mid Index [10]Morningstar Diversified Alternatives Index [11]Bloomberg Commodity Index [12]Morningstar Global Real Estate.

1 *Don't Panic*

2 *Inflection Points*

3 *Don't Give Up on Bonds*

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

Stock Market Outlook: Don't Panic

1

"A real optimist is someone who knows that the short run and the medium run are going to constantly be filled with setbacks and delays and crises and tragedies but that those things do not prevent long-term growth and long-term optimism." — Morgan Housel

RUSTY VANNEMAN

CFA, CMT

Chief Investment Officer

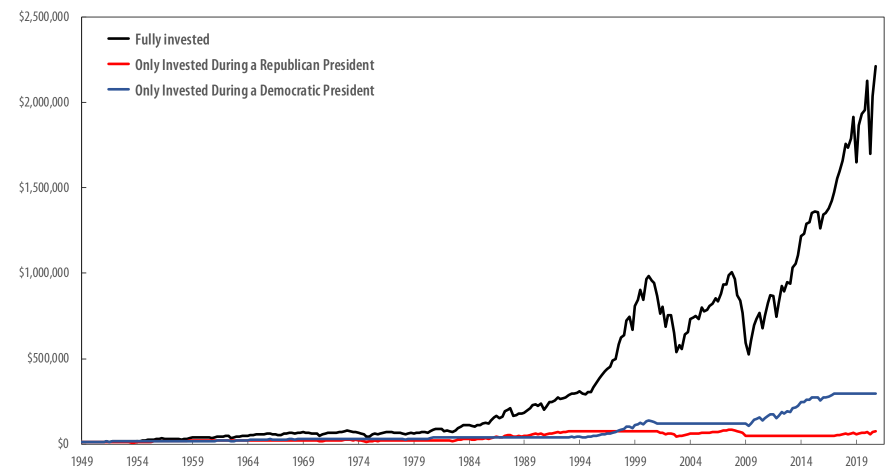
This commentary is being written a few days before the national election. Regardless of the outcome, here is some time-tested counsel: Don't panic.

If your preferred candidates didn't win, don't run to the sidelines. In my 30 years working with investors, I've seen investors bail on the market when their candidates lost, and it hurt their long-term returns. I witnessed it when President Bill Clinton was elected, when President George W. Bush was elected, when President Barack Obama was elected, and when President Donald Trump was elected. Historically, investing based upon political bias has not been a winning strategy.

Yes, you can make money if you only invest when a Democrat is president or only when a Republican is president. But as the below chart from the investment firm First Trust attests, you may potentially make a lot more money if you just stay invested and let the magic of compounding do its work.

GROWTH OF $10,000 IN THE S&P 500 INDEX SINCE 1949

First Trust



Source: Standard & Poor's, FT Advisors. Data is quarterly from 1949 – Q3 2020.

Past performance is no guarantee of future results. For illustrative purposes only and not indicative of any actual investment. The S&P 500 Index is an unmanaged index of 500 stocks used to measure large-cap U.S. stock market performance. Investors cannot invest directly in an index. Index returns do not reflect any fees, expenses, or sales charges. These returns were the result of certain market factors and events which may not be repeated in the future.

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Source: First Trust https://www.ftportfolios.com/ 10/30/20

There are many more factors that drive market performance than who sits in the White House or controls Congress. In the short-term, numerous narratives may drive investors' moods and actions. But over the long run valuations and fundamentals have always won out.

Inflection Points

2

The market may be experiencing two notable inflection points that could continue irrespective of election results.

1. We may be in the slack tide period where value, such as financial stocks, starts to outperform growth, such as technology stocks.

2. Inflation may finally be on the rise.

RUSTY VANNEMAN
CFA, CMT
Chief Investment Officer

The End of Growth Stock Outperformance?

Value is being supported by many factors, including the potential passage of significant anti-trust regulation[1] against many of the most successful companies and stocks of recent years, including Google and Amazon. The proposal appears to have bipartisan support, but a Biden presidency may be tougher on big tech. The skeptic in me knows these big, powerful companies have well-paid and well-connected lobbyists, but I also recognize that past monopolies did, too. Some may consider our country the United States of Google, but other companies once considered "invincible" have faltered. Top dogs don't always stay top dogs[2], either in terms of economic or market performance.

As a 2018 study noted, the average lifespan of S&P 500 companies went from 33 years in 1964 to 24 years by 2016 and is forecasted to shrink to just 12 years by 2027[3]. At the current churn rate, about half of S&P 500 companies will be replaced over the next 10 years.

While technology prices have held up relatively well recently, small-cap value stocks have outperformed large growth for more than three months. That's a technical (price action) signal that will surely prompt more rotations toward value.

This is also taking place against the backdrop of high valuations and skyrocketing expectations for leading names in the market. Ned Davis Research in late October published a report on the "Elite Eight" stocks (Facebook, Amazon, Netflix, Alphabet (Google), Apple, Microsoft, Tesla, and Nvidia) that have driven market performance and investor attention this year. As of that publication, the Elite Eight saw revenue and earnings growth of 10-12% year over year, but stock prices increased more than 70%.[4] The companies were being rewarded far and above what they actually accomplished. Will they be able to reward investors' expectations for more above-average growth? The massive shift to working from home was a significant push for big tech, but will that growth persist?

Here are some quick stats that illustrate how expensive U.S. large growth stocks currently are:

- U.S. growth stocks are typically 20% pricier than the benchmark, but they are now 50% more expensive.[4]

- The 10 largest S&P 500 constituents tend to trade at the same multiple as the rest of the index. Currently, the big companies are valued nearly 60% higher.[4]

If the capital gains tax is increased in 2021 (I'm betting that is unlikely even if Biden wins), some investors may harvest gains to preserve a lower rate. That would also impact the market's recent winners, suggesting further pressure on big tech.

Since only five companies make up 25% of the U.S. market, if big tech underperforms or even declines, the overall stock market could fall. However, many if not most stocks could

1 New York Times 10/30/20
2 ETF.com 10/30/20
3 Innosight 10/30/20
4 NDR 10/30/20

still rise in that environment. That was the case the last time the bubble of high-flying tech stocks popped 20 years ago.

Bottom line: The overall stock market indices will likely fall on big tech price weakness, but the average stock price could actually move higher.

2

Inflation to Finally Return?

Yet another reason which may cause value stocks to reassert themselves is that long-term interest rates may finally begin to rise. This may happen for many reasons, but primarily because inflation expectations are climbing.[5] This is because federal spending and deficits are projected to continue to expand to their highest levels since WWII, nearly 80 years ago.[6]

Federal spending, for example, has comprised about 20% of GDP since WWII. By the end of June this year, that percentage had expanded to nearly 50%.[7] The approximately $2 trillion stimulus package, which will most likely be passed after the election, will only push that figure higher.

Intuitively, higher federal spending and larger deficits should correlate to higher nominal economic growth (at least in the short-term) and inflation. Higher inflation typically means higher interest rates.

Rates could move higher not only because of higher inflation, but because higher deficits also mean the government needs to issue more bonds. More bonds mean lower prices are needed to sell those bonds. Lower bond prices mean higher interest rates. It's an ankle bone connected to the shin bone kind of thing.

Of course, federal spending is not the only inflationary factor. Monetary policy is inflationary, too. The U.S. Federal Reserve has put a lot of liquidity into the system. Money supply growth has skyrocketed.[8] The Fed is also consistently and clearly communicating that it will pin short-term interest rates at zero for years (IMO, this may change, especially if inflation significantly perks up in 2021).[9] That, in turn, means real (after-inflation) interest rates may be negative.

The Fed has also changed its approach to managing inflation. Instead of responding to inflation reaching a certain level, it will now let inflation run above target, potentially for years, before reacting. Intuitively, these are all inflationary factors.

Inflation pressures are already percolating. Supply chains are being remapped in response to COVID-19 and trade conflicts, and globalization appears to have peaked for the time being.

The economic and market data appears to be confirming that inflation and inflation expectations have bottomed and are rising. Markets that would be expected to perform better, on a relative basis, in an inflationary environment (such as gold and other commodities), are doing so, and international markets are also performing better since the U.S. dollar is weakening.

What does this mean for investors? The key takeaway: remain globally diversified. Higher inflation likely means a weaker dollar and the potential for better performance from international stocks. It also likely means higher interest rates, which indicates value investing should perform relatively well and real assets, such as commodities, should improve.

Bottom line: Global diversification makes as much sense as ever, in our view.

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5 Bloomberg Bloomberg terminal 10/30/20
6 CNN 10/29/20
7 Ned Davis Research 10/30/20
8 US Federal Reserve 10/29/20
9 CNBC 10/29/20

Despite Low Rates, Don't Give Up on Bonds

3

RUSTY VANNEMAN
CFA, CMT
Chief Investment Officer

Some advisors and investors have been wondering lately why they should own bonds, or at least why they should own so many. It's a good question in today's low-rate environment.

Yet, despite the low interest rates and likelihood that rates may move higher (and bond prices lower), long-term investors who use bonds to help stabilize portfolios and potentially enhance risk-adjusted performance shouldn't give up on them, at least not high-quality bonds.

There are two useful studies that might surprise some investors, which help to show the true value of bonds. The first was produced by CLS Investments' quantitative portfolio manager, Jackson Lee. In Jackson's study, he examined how portfolio risk changed for multi-asset portfolios (those that contain stocks and bonds), during this year's massive market turbulence. (By some statistical measures, 2020's volatility was the highest in decades and possibly ever.)[1]

Jackson reviewed conservative portfolios that owned more bonds than stocks, and which therefore had less than half the price volatility as compared to the overall global stock market. He then zeroed in on two types of bond allocations: those that included corporate bonds (both investment grade and high yield), and the other consisting only of high-quality U.S. Treasury bonds. Each allocation had roughly the same duration, which means each had approximately the same sensitivity to interest rates. He then reviewed relative risk, both in terms of relative volatility and beta.

The study's results were fascinating and confirmed the classic advice from some of the great asset allocators over the years (such as David Swensen[2]) who strongly recommend to individual investors against owning corporate bonds in fixed-income allocations, since credit risk positively correlates to equity risk and fixed income's primary role is in fact to hedge stock market risk, not to add to it.

The multi-asset portfolios with corporate bonds saw a sharp spike in risk, which makes sense given the historic market stress and the typical overreaction to stress from corporate bonds. Our research indicates that investing in corporate bonds is typically a way to outperform fixed-income benchmarks. It's one reason active management has historically worked better in fixed-income markets. But it's also like picking up nickels in front of a steamroller. Well, COVID-19 was driving a big steamroller in the first quarter of 2020 and was able to catch and squash corporate bond investors.

The really interesting point in the study is that bond portfolios which only held Treasury bonds, saw relative risk remain essentially the same! Absolute risk moved higher, and portfolios with equity exposure still temporarily lost ground, but relative risk remained constant. High-quality bonds are known as excellent diversifiers against stock market risk, and 2020 proved that yet again.

The second study[3] is a white paper produced by CLS Investments, which showed that the bond market still overwhelmingly provides positive nominal returns to investors over one-, three-, and five-year time frames, even in rising rate environments.

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1 *MarketWatch Chart of Wall Street's 'fear' index 3/10/20*
2 *David F. Swensen 11/2/20*
3 *CLS Investments: Bonds in a Rising-Rate Environment 9/09/19*

The study, which is similar to others conducted by peer firms, reviewed rising rates using two definitions: short-term rates and long-term rates. Long-term rates were defined by intermediate-maturity Treasuries increasing by 100 basis points without being interrupted by a consecutive 25 basis point decline.

In the current environment, long-term rates are more likely to rise than short-term rates. Historically, the bond market has generated positive returns 85% of the time in one-year time frames during periods of rising rates.[3] Even in three-month time frames when the initial shock was happening, it was more likely than not to generate positive returns. Fascinating.

3

INTERMEDIATE-TERM TREASURY BOND ROLLING RETURNS (RISING RATE ENVIRONMENT)

	3MO. ROLLING RETURN	6MO. ROLLING RETURN	1YR. ROLLING RETURN	3YR. ROLLING RETURN (ANNUALIZED)	5YR. ROLLING RETURN (ANNUALIZED)	10YR. ROLLING RETURN (ANNUALIZED)
Period Count	260	260	260	260	247	242
Average Return	0.2%	1.6%	5.0%	6.6%	7.3%	7.5%
Positive Return Frequency	60.0%	68.8%	85.4%	100.0%	100.0%	100.0%

Returns based on IA SBBI Intermediate-Term Treasury Bond Index from 1/1/1962 - 12/31/2016
Yields are based on the yield-to-maturity of the on-the-run 5-Year Treasury Bond Index from 1/1/1962 - 12/31/2016

How can this happen in a rising-rate environment? I'll quote the executive summary of the white paper, which highlights how the **bond market is self-healing** since bonds reinvest their interest payments into higher-yielding bonds.[3]

Executive Summary's Key Findings:

1. An evaluation of historical returns in the bond market provides evidence that performance for the asset class is generally positive.

2. Evaluating performance only during adverse environments provides similar results using multiple definitions for a rising-rate environment. Forward returns during these periods have historically been positive but slightly lower in near-term horizons and higher in long-term horizons.

3. Bonds can be described as self-healing assets. Short-term losses are often outweighed in the long run by the reinvestment of principal and interest at more attractive rates. Investors should therefore desire rates to move upward.

4. Volatility is low in the bond market relative to the equity market. Equity market drawdowns are more frequent and substantially more severe. Earning more than half the return on average with a third of the volatility, bonds earn superior risk-adjusted returns.

5. Bonds are excellent diversifiers for a stock portfolio as evidenced by their low historical average correlation. An evaluation of bond performance during equity market drawdowns provides a clear example of why investors should not abandon this asset class.

In sum, given the current market, economic, and social environment, investors should not give up bonds. Or stocks. They should also consider investing more in real assets. I'll say it again — don't give up on globally diversified portfolios!

3 *CLS Investments: Bonds in a Rising-Rate Environment* *9/09/19*

Thank You

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Over the years, I have been called an optimist, but I've also been called a contrarian. It's probably a bit nature and a bit nurture. It's partly how I'm wired, but I'm sure it's also because of my training, which includes looking up to and learning from past great investors such as Sir John Templeton.

I also recognize that from an investment management standpoint believing in the power of the markets, diversifying, and not buying expensive stuff are key to long-term success. However, I know from an investment counselor standpoint, the biggest obstacle for individual investor success often boils down to the relationship between greed and fear.

I'd like to close with another quote from the great contemporary financial writer Morgan Housel, who came out with a book earlier this fall that I'm sure will find its way into the Christmas stockings of many investors.

> "If someone says that they think everything is always going to be okay, that's not an optimist. That's a complacent, whereas a real optimist is someone who understands that the short run is always going to be a mess, always going to be a disaster, both for you and other people, constantly running into problems, running into setbacks, but those things do not preclude long-term growth. And that, to me, is the real optimist."

As always, a sincere thank you for your time and trust. If you have any questions or feedback on this material, or anything else, please let me know.

Stay balanced and be well.

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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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