# Weekly 3

## WHAT YOU NEED TO KNOW ABOUT THE MARKETS

November 23, 2020

ORION

# Week in Review


**Rusty Vanneman, CFA, CMT –** Chief Investment Officer: rusty@orion.com; 402-896-7641

**Marc Pfeffer:** marc.pfeffer@clsinvest.com; 402-896-7225

**Case Eichenberger, CIMA:** case.eichenberger@clsinvest.com; 402-896-7004


# Market Performance

*as of 11/23/2020*

| FIXED INCOME | 10-YEAR | 5-YEAR | 3-YEAR | 1-YEAR | YTD | QTD | THIS WEEK |
|---|---|---|---|---|---|---|---|
| Cash Equivalent[1] | 0.58 | 1.13 | 1.54 | 0.66 | 0.48 | 0.01 | 0.00 |
| U.S. Investment Grade Bonds[2] | 3.73 | 4.37 | 5.41 | 7.26 | 7.31 | 0.49 | 0.59 |
| **EQUITIES** | **10-YEAR** | **5-YEAR** | **3-YEAR** | **1-YEAR** | **YTD** | **QTD** | **THIS WEEK** |
| Global Equity Market[3] | 8.96 | 10.33 | 9.01 | 13.77 | 9.31 | 8.10 | 0.66 |
| Total U.S. Market[4] | 13.78 | 13.59 | 13.59 | 18.06 | 13.52 | 7.25 | -0.09 |
| Domestic Large-Cap Equity[5] | 14.24 | 14.31 | 14.81 | 19.62 | 14.69 | 4.96 | -0.74 |
| Domestic Small-Cap Equity[6] | 10.80 | 9.39 | 6.56 | 9.94 | 5.91 | 17.64 | 2.40 |
| International Equity[7] | 4.87 | 7.17 | 4.23 | 8.95 | 4.53 | 10.23 | 1.86 |
| Developed International Equity[8] | 5.15 | 6.23 | 3.76 | 6.16 | 2.50 | 9.48 | 2.00 |
| Emerging Market Equity[9] | 3.74 | 10.19 | 5.34 | 16.77 | 9.94 | 12.10 | 1.53 |
| **DIVERSIFIERS** | **10-YEAR** | **5-YEAR** | **3-YEAR** | **1-YEAR** | **YTD** | **QTD** | **THIS WEEK** |
| Diversified Alternatives[10] | 1.63 | 0.60 | -0.16 | -2.77 | -4.90 | 2.94 | 0.22 |
| Commodity[11] | -5.93 | -0.72 | -3.42 | -4.77 | -8.00 | 4.65 | 0.56 |
| Global Real Estate[12] | 5.95 | 4.65 | 2.32 | -6.35 | -8.12 | 7.50 | 0.12 |

*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** *CIO Weekly Viewpoint*

**2** *Taking a Bite Out of FANG*

**3** *Rising Rates, Rising Concerns?*


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

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- U.S. stocks were mixed last week, as equity markets performed a balancing act between incoming positive vaccine news and increasing economic restrictions aimed at curbing the recent spike in COVID-19 cases.
- For the week the S&P 500 and Dow Jones Industrial Index both declined less than 1%, while the NASDAQ index eked out a positive gain. Small caps[1] again led the way – rising more than 2% – and value[2] stocks outperformed growth[3] stocks in spite of falling interest rates.
- Last week was good for international stocks however, with both European[4] stocks and emerging market[5] stocks climbing nearly 2%.
- After a huge week prior, REITs[6] gave back about 0.5% and commodities[7] rose by 0.5%.
- October employment data released last week showed worse-than-expected initial jobless claims, suggesting that economic recovery will likely be choppy before returning to pre-pandemic levels.
- Treasury Secretary Steven Mnuchin said he will not extend the Federal Reserve's COVID-19 emergency lending programs set to expire at the end of this year. This triggered a rare public statement of disagreement from the central bank[8].
- Important economic data being released this week include Personal Income and Outlays, Federal Open Market Committee minutes and Residential Building Permits.

*Source: Bloomberg as of 11/23/2020*
*1 Morningstar U.S. Small Cap Index*
*2 Morningstar U.S. Value Index*
*3 Morningstar U.S. Growth Index*
*4 Morningstar DM xU.S. Large-Mid NR USD*
*5 Morningstar EM Large-Mid NR USD*
*6 Morningstar Global Real Estate Index*
*7 Bloomberg Commodity Index*
*8 CNBC as of 11/19/20*

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.*

# Taking a Bite Out of FANG

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FANG, FAANG or FANMAG, – whichever acronym you prefer – refers to the high-flying Big Tech stocks dominating the U.S. stock market. Facebook, Apple, Amazon, Netflix, Microsoft and Google are some of the top market capitalization-weighted companies, which have recently generated higher returns than the overall market. The acronym fails to account for Tesla, so throw in a "T" somewhere to round out the group.

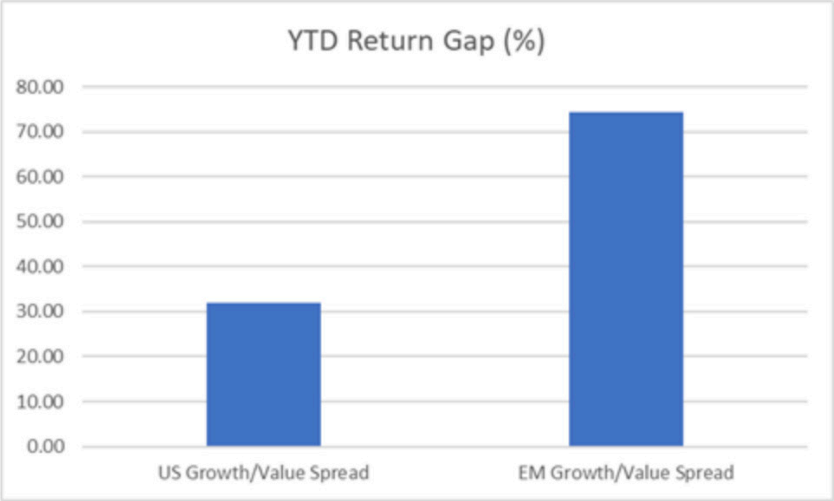
MICHAEL HADDEN

*CFA, CLS Portfolio Manager*

It's undeniable these companies have had tremendous stock performance, coupled with rich valuations. That combination, as well as the general trend of the market, has led to extreme spreads between value and growth. If you read CLS commentary, you're likely familiar with that spread and know it continues to widen.

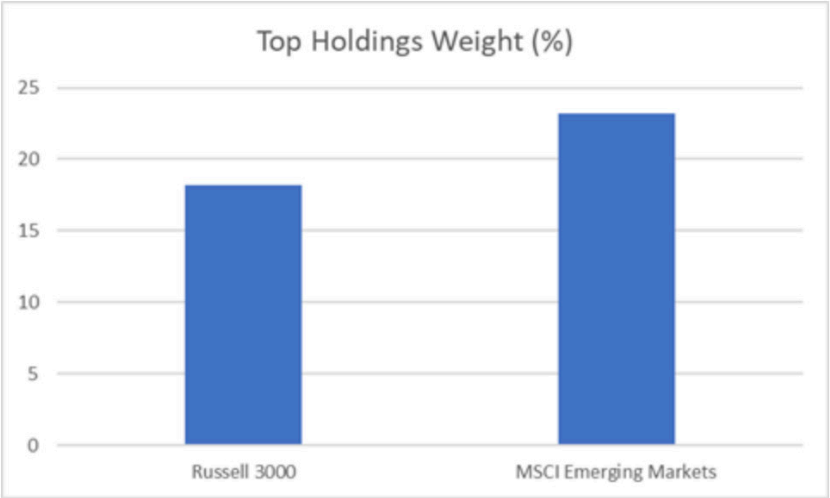
Just how wide is the value-growth spread? As of November 19, the Russell 1000 Growth Index has outperformed the Russell 1000 Value Index by 32% in 2020. This is a pretty incredible statistic, especially on the back of a period when growth has dramatically outperformed value, and FANG stocks have largely contributed to this phenomenon. Even more staggering, this spread is nothing compared to what is happening in emerging market economies.

In emerging markets, the value-growth spread is far more dramatic. Using a fundamentally weighted ETF that favors value (PXH), and an internet and ecommerce ETF (EMQQ) to represent growth, the spread of value and growth in emerging markets is 74% so far this year! That is more than double the spread we're seeing domestically.




*Source: Bloomberg. 11/23/20*

What impact do the high-flying stocks mentioned above have on the broader index for each region? For the Russell 3000 (3,000 largest domestic stocks) the top six holdings (AAPL, MSFT, AMZN, FB, GOOGL, GOOG) make up 18.18% of the index. This is a significant amount, and it's commonly understood these stocks are causing a concentration risk in market-weighted indices. In the broad emerging market index (MSCI Emerging Markets), the top six holdings make up more than 23% of the index!




*Source: Morningstar Direct 11/23/20*

So while the U.S. market gets a lot of attention for its high valuations and concentration risk, other pockets of the market are exhibiting similar characteristics. Much like how value stocks in the U.S. are far more attractively priced for forward returns, a similar story plays out in emerging markets.

The average stock in the MSCI Emerging Market Index is dramatically cheaper than the average U.S. stock in the Russell 3000 Index. Many of these more attractively valued stocks are based in emerging market Asian countries and are found in commodity producing economies.

While commodities have been a loss leader for portfolios over the past five years, the future appears to be potentially bright. As the world recovers from the COVID-19 crisis and economic activity continues to pick up, demand will likely increase for these products. The U.S. dollar continues to weaken, providing a tailwind for emerging markets and their severely undervalued currencies. The combination of both factors could lead to outperformance from the value portion of emerging markets moving forward.

*1 Morningstar 11/19/2020*

# Rising Rates, Rising Concerns?

3

**MICHAEL HADDEN**
*CFA, CLS Portfolio Manager*

Over the summer the yield curve quietly began to steepen, and over the past few weeks that trend has accelerated. First, the expectation of a blue wave and mass fiscal stimulus prior to the election caused rates to rise. While neither happened, the combination of some level of further fiscal stimulus, the potential for inflation given explosive economic growth off the COVID recession lows, and overall high levels of liquidity throughout financial markets, is leading to higher U.S. Treasury yields.

This may be concerning to investors in fixed-income vehicles, as higher rates generally lead to losses in bond prices due to their inverse relationship. It's a reasonable concern, but historical data shows long-term investors should likely not be too concerned. The CLS white paper "Bonds in a Rising-Rate Environment" explains that bond performance may trail in the short term, but in the long term it is similar, if not better, than historical performance as rates rise.

How can this be? Price losses can be offset by reinvesting coupons at the higher rate and garnering higher returns over the long term.

**INTERMEDIATE-TERM TREASURY BOND ROLLING RETURNS (BASELINE)**

| | 3MO. ROLLING RETURN | 6MO. ROLLING RETURN | 1YR. ROLLING RETURN | 3YR. ROLLING RETURN (ANNUALIZED) | 5YR. ROLLING RETURN (ANNUALIZED) | 10YR. ROLLING RETURN (ANNUALIZED) |
|---|---|---|---|---|---|---|
| Period Count | 657 | 654 | 648 | 624 | 600 | 540 |
| Average Return | 1.7% | 3.4% | 6.9% | 6.9% | 7.1% | 7.4% |
| Positive Return Frequency | 76.1% | 82.0% | 91.4% | 100.0% | 100.0% | 100.0% |

*Returns based on IA SBBI Intermediate Term Treasury Bond Index from 1/1/1962 - 12/31/2016*

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

Higher rates, and specifically a steeper curve, can be a tailwind for financial stocks. The 10-2 year Treasury curve spread has broken out to multi-year highs, as shown in the chart below, giving some much-needed support to financial stocks that have lagged the broad market for several years. Since the most recent low at the start of July, financials have outperformed the S&P 500 by 5%, supporting the theory that an increase in curve steepness may lead to financial outperformance.


*Source: Bloomberg 11/23/20*

Higher bond yields may help support their investment case, not only for the prospect of better income and higher expected returns, but as effective diversifiers to high-risk assets. As proponents of Risk Budgeting, we believe having multi-asset portfolios is essential to properly targeting risk. Having several quality tools in our arsenal to accomplish this goal only enhances portfolios.

We believe the current environment remains favorable for businesses and consumers alike. Although rates may be rising, it still remains a historically low interest rate environment, which allows creditors to borrow at low rates and service existing debt. This helps to facilitate business investment and consumer spending without threatening the overall credit environment.

In summary, although higher rates may hurt fixed-income returns in the short term, the long-term impacts may be mostly positive for several areas of the market. The near term may be volatile, so stay the course and trust the investment principles put in place to achieve your long-term investment goals.

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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Contact Us Today

17605 Wright Street | Omaha, NE 68130

402.895.1600 | orion.com

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