BlackDiamond Financial

INVESTMENT INSIGHTS

SECOND QUARTER 2020

Key Topics

- Stocks Post Biggest Quarterly Gain Since 1998
- United States Now at 50,000 New Coronavirus Cases per Day
- Will Economic Conditions Impact the Upcoming November Election?
- 2021 Corporate Earnings Now Projected to Equal 2019
- Uneven Market Rebound as Large Capitalization Tech Stocks Outperform

Stocks Post Biggest Quarterly Gain Since 1998

Many businesses around the world reopened and economic activity increased as consumers picked up spending and lockdown restrictions eased in the second quarter. The key question on investors' minds remains whether the shape of the recovery will continue to look like a "V" or ultimately be a "W" or "L" shape. More likely than not, economic trends will be uneven as the pandemic's impact will be unpredictable until a vaccine is developed and widely distributed. Massive government stimulus was the critical element driving the stock market to its biggest quarterly gain since 1998.

Large company stocks rose substantially this quarter as evidenced by the S&P 500 gaining 20.5%. Small company and international stocks also bounced back with gains of 25.4% and 16.1%, respectively. Real estate stocks lagged other asset classes, in part due to the changing nature and location of work, while still gaining 11.7%. The Fed's open market purchases of both individual bonds and bond ETFs helped stabilize bond market volatility and buoyed prices to a 2.9% return.

The stock market's rebound has been swift and surprising to some. However, the U.S. has faced obstacles far greater than COVID-19 in the past and prevailed every time. Once an effective vaccine is formulated, economic growth will continue, and stocks will inevitably achieve new highs.

Comparative Returns

			Annualized Performance			
	Q2 2020	YTD	1 Year	3 Years	5 Years	10 Years
Large Cap U.S. Stocks[1]	20.5%	(3.1%)	7.5%	10.7%	10.7%	14.0%
Small Cap U.S. Stocks[2]	25.4%	(13.0%)	(6.6%)	2.0%	4.3%	10.5%
International Stocks[3]	16.1%	(11.0%)	(4.8%)	1.1%	2.3%	5.0%
Real Estate[4]	11.7%	(18.5%)	(12.9%)	0.1%	4.1%	9.1%
U.S. Bonds[5]	2.9%	6.1%	8.7%	5.3%	4.3%	3.8%

1 S&P 500 index, which includes 500 of the largest U.S. companies in all sectors of the economy.
2 Russell 2000, which includes the 2000 smaller stocks of the Russell 3000 index.
3 MSCI ACWI ex-U.S. index, which includes large and mid-capitalization stocks from developed and emerging international markets.
4 MSCI U.S. REIT index, which includes domestic publicly traded real estate stocks.
5 Bloomberg Barclays Aggregate Bond index, which includes a representation of the performance of the entire U.S. investment grade bond market.

United States Now at 50,000 New Coronavirus Cases per Day

More than 2.5 million Americans have tested positive for COVID-19 and the CDC estimates that over 20 million Americans (6% of the nation) have contracted the virus. These figures are surging in many states, including several that were among the first to reopen.

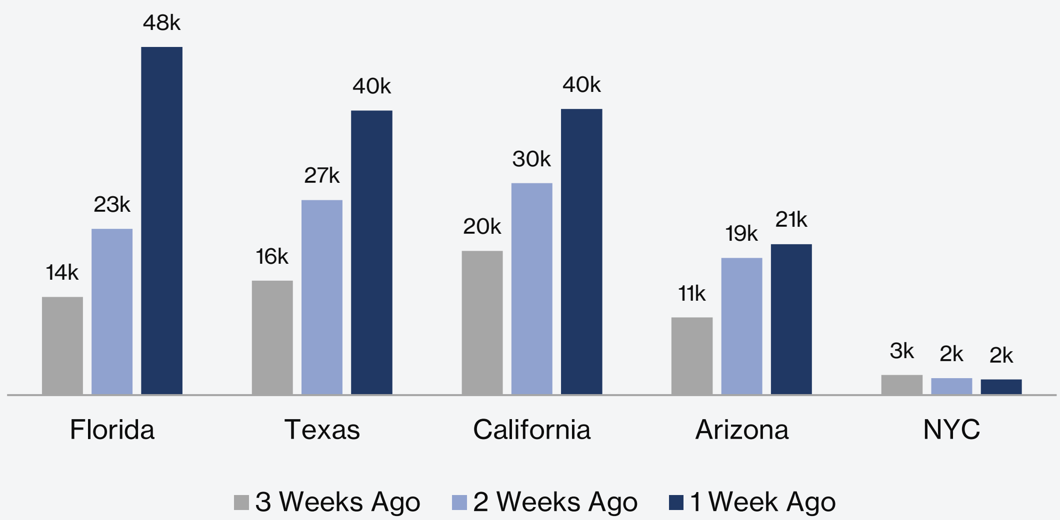
For example, Florida and Texas have been forced to impose new restrictions on gatherings as infections in those states have ballooned in recent weeks. Florida's total cases increased by 48% over the last week while Texas has experienced a 33% increase. Recent data also shows new cases tend to be concentrated in younger people who may be less inclined to practice social distancing and take protective precautions.

Both the number of people hospitalized and the percentage of people testing positive are rising, suggesting the case spike is not entirely explained by increased testing. Fortunately, COVID-19 death rates remain well below their peak levels and healthy individuals that contract the virus typically make a full recovery.

The median age of those dying is 80 years of age and 43% of deaths are associated with nursing homes and long-term care facilities. That said, more data is coming in from China and Europe regarding persistent and even permanent effects of the virus in people who have recovered. The bottom line is that we still have much to learn about the virus.

Further actions across the country to contain a resurgence in cases will send a cautionary signal to Wall Street similar to the first lockdown in late March. The VIX, a popular measure of market volatility, surpassed its 2008 peak to 82.7 on March 16th following news of a nationwide lockdown. Shortly after, on March 23rd, the S&P 500 reached its recent bottom. Should cases continue to rise this summer, we can expect markets will respond with increased volatility.

Weekly Cases Climb in Hot Spot States



Source: CDC as of June 30, 2020.

Will Economic Conditions Impact the Upcoming November Election?

As November approaches, investors will shift some of their focus from COVID-19 to the election. Economic conditions can influence the results and may provide insight into a likely victor. As seen below, only three of 11 presidential incumbents since WWII have lost, and two of those coincided with rising unemployment. Furthermore, when the S&P 500 rises during the three months prior to an election, the incumbent has won 87% of the time since 1928. Inversely, if the S&P 500 falls during the three months prior to an election, the incumbent usually lost.

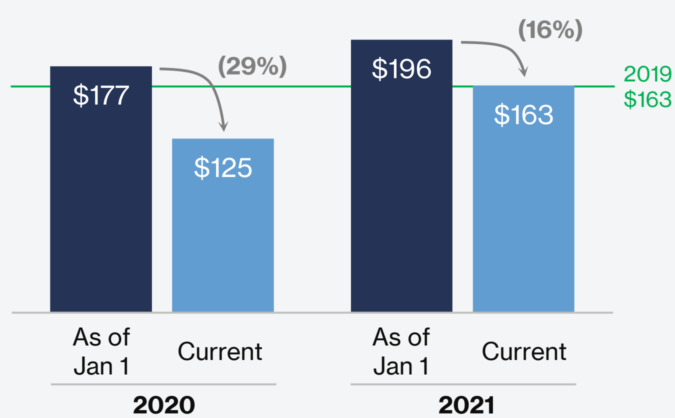
Only 3 Incumbent Presidents Have Lost Reelection Since WWII

Source: Morgan Stanley

2021 Corporate Earnings Now Projected to Equal 2019

Corporate earnings have declined severely in light of the pandemic. Wall Street forecasts for 2020 S&P 500 earnings-per-share (EPS) were $177 in January, but have declined to just $125 today. Expectations are for EPS to bounce back to $163 in 2021, which would equal that of 2019. Wall Street has placed a lot of confidence in the Fed and Treasury's strong response to COVID-19 and is optimistic that the virus will be contained. Thus, investors today are generally looking beyond 2020 (and in some cases even 2021) earnings and value stocks as if the pandemic will pass.

S&P 500 EPS Estimates Decline



Source: Refinitiv consensus data as of January and June.

Uneven Market Rebound as Large Tech Stocks Outperform

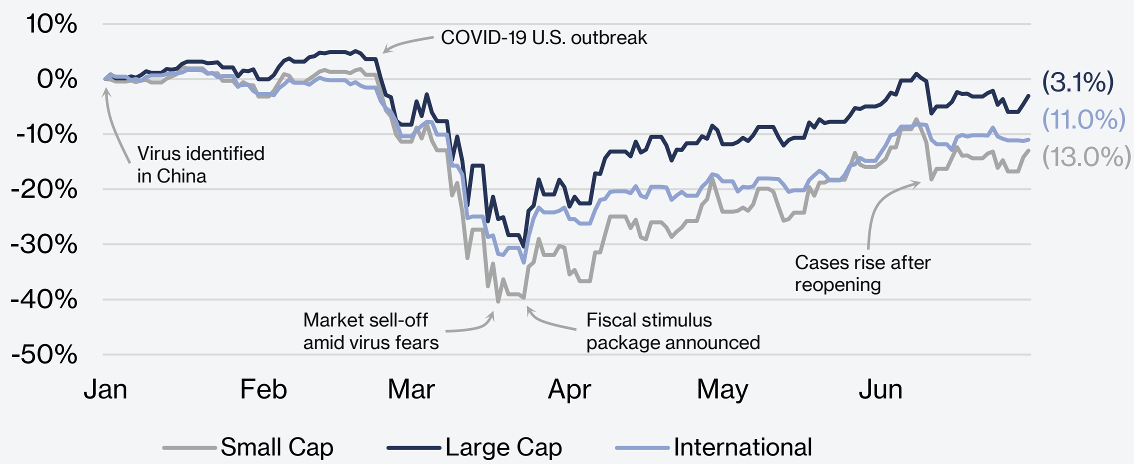
When people refer to the stock market, they often think of the S&P 500 or Dow Jones Industrials that track the performance of the largest public companies in the U.S. However, thousands of other public companies are bought and sold each day within the small-cap, mid-cap and international market segments. While the S&P 500 has nearly rebounded to where it started the year, most other indices are significantly lower year-to-date. For example, small company and international stocks remain down 13.0% and 11.0%, respectively this year.

The S&P 500 is a market capitalization weighted index, meaning larger companies have a proportionately larger weighting within the index. For example, Microsoft has a market value of $1.5 trillion and therefore has the biggest weighting in the S&P 500 of 5.5%. Due to this weighting methodology, the five largest companies (Microsoft, Apple, Amazon, Alphabet/Google, and Facebook) make up 20.1% of the index. While significant, this level of concentration is not unusual for the S&P 500, as the five largest companies often comprise 20% or more of the index. By comparison, the five biggest companies in the Russell 2000 (small companies) and MSCI ACWI (international companies) indexes only account for 2.2% and 7.8% of the indexes, respectively.

Within the S&P 500 index, results have been bifurcated this year between winners and losers. In fact, over 71% of the index's components have lost value in 2020. The primary reason the S&P 500 has outperformed other market segments this year, and over the last five years, is its heavy concentration in technology companies (more than twice the exposure of the international index) and specifically, its five largest constituents. These five companies alone have accounted for a 4.2% increase in the S&P 500 this year. In other words, the S&P 500 is down 3.1% year-to-date and if these five companies were removed, it would be down 7.3%.

Diversified index investors likely own shares in all five of these companies and have participated in their significant gains over the last five years. Ownership in these top performing stocks is one of the many reasons that index investors have consistently outperformed the majority of stock pickers trying to beat the market.

Year-to-Date Stock Market Performance



Sources: Morningstar as of June 30, 2020. Large Cap is represented by the S&P 500, Small Cap by the Russell 2000, and International by the MSCI ACWI Ex-US index.

BlackDiamond Financial

ABOUT US

Black Diamond Financial, LLC is a fee-only registered investment advisor with a unique and holistic focus on preserving and enhancing wealth. Our mission is to help you achieve your financial goals through the use of low cost, tax efficient investment strategies. We create individualized investment portfolios for each client that are risk-appropriate, returns optimized, and tax-efficient. Furthermore, we believe cost is a critical factor in any successful investment strategy and therefore offer fully transparent pricing that is well-below industry standard. As an employee-owned firm focused on our fiduciary duty, we make our clients' interests our highest priority.

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