STOKES CAPITAL ADVISORS, LLC

Market Commentary
September 30, 2020

Quarterly Market Review

The rally in global equities continued during the quarter as investors looked beyond the economic carnage inflicted by the COVID-19 pandemic and measure the prospects of an economic recovery in 2021 facilitated by unprecedented accommodative monetary policy and fiscal stimulus.

The S&P 500 Index gained 8.9% for the quarter delivering investors a positive 5.6% return for the year. Equities have recorded an impressive 50% gain since the pandemic low on March 23 as measured by the S&P 500. However, it is the highflying technology sector that remains the most favored by investors with the NASDAQ Composite gaining an eye popping 25.3% year to date. By contrast, investors continue to avoid small-cap equities as the focus remains on larger companies with strong balance sheets, access to capital markets and better prospects for growth in the post-COVID economy.

Energy remains the most unloved sector as the oil patch struggles to navigate a highly uncertain outlook for global hydrocarbon demand and the possibility of increased regulation and political uncertainty. Year to date, WTI and Brent Crude are down -34% and -38% respectively. Gold on the other hand hit an all-time high passing 2,000 $/ozt as investors remain fearful of inflation and negative real bond yields provided a bid for the precious metal.

Turning to the bond market, the Federal reserve signaled during the quarter their intention to leave interest rates strapped to the zero bound for the foreseeable future and indicated in their policy statement a desire to let inflation over-shoot their long standing 2% target. During the quarter, credit spreads tightened as yield hungry investors exchange credit risk for duration and/or liquidity concerns.

Global markets remain fractured as Governments deploy stimulus and alternate methods to control the spread of the virus. European markets lag while China's draconian measures to control the virus produced a quicker recovery.

Global Economic Outlook *

United States: Economic activity appears to have recovered robustly in Q3, after GDP contracted at the fastest pace on record in Q2 due to a plunge in domestic demand amid Covid-19 containment measures. In August, the unemployment rate dropped 1.8 percentage points from the month prior while non-farm payrolls continued to rise, although they were still down 11.5 million compared to February. Moreover, retail sales continued to grow in August, albeit at the softest pace in four months as additional weekly unemployment benefits for roughly 25 million unemployed people expired at the end of July.

The economy is expected to contract notably this year due to a higher unemployment rate and anemic consumer confidence weighing on private consumption. Next year, GDP should rebound on the back of monetary and fiscal stimulus and as the impact of the pandemic fades. U.S.–China trade tensions are a key downside risk. Economists see GDP contracting -4.7% in 2020 and growing 3.8% in 2021.

Eurozone: Lockdowns struck an unprecedented blow to the economy in Q2, with domestic demand tumbling amid frozen business and household activity, and with the external sector also taking a hit. Available indicators for Q3 point to an underwhelming recovery: Industrial production and retail sales cooled, exports declined, and the unemployment rate rose again in July. Additionally, outbreaks of the virus in France and Spain threaten the regional recovery, while S&P Global Ratings warned that European banks have increased their exposure to sovereign debt, which could result in higher "doom loop" risks.

The economy will shrink at the fastest pace on record this year as lockdowns to contain the spread of Covid-19 lead to business closures, higher unemployment, income losses and elevated uncertainty. In 2021, the economy is expected to rebound and recover some of its lost output. Further waves of infections, high levels of public debt and trade tensions pose downside risks. The economy is seen contracting -8.1% in 2020. In 2021, GDP is seen increasing 5.5%.

Japan: Detailed results confirmed the heavy hit sustained by the economy in Q2, as the pandemic significantly hampered both the domestic and external sectors. Turning to Q3, recent data suggests an improving but subdued panorama. Industrial output in July declined at a softer pace than the

Q2 average. Meanwhile retail sales expanded in the same month, hinting at a rebound in economic activity for Q3. However, the unemployment rate ticked up in July, while consumer confidence dipped in August, moving deeper into pessimistic territory. Furthermore, flash PMI data for manufacturing and services indicated continued, albeit softer, contractions in operating conditions in September.

Activity is set to contract sharply this year on shrinking private consumption and an impaired external sector. Significant fiscal and monetary stimulus should temper the downturn and help to foster a recovery in 2021. However, stubbornly high Covid-19 case rates throughout August and into September cloud the outlook. Economists see the economy contracting -5.5% in 2020 and growing 2.7% in 2021.

China: The economic recovery continues to gain traction, despite a challenging external environment, mostly due to solid dynamics at home. Retail sales returned to growth in August as consumers gradually came back and cross-provincial travel increased. Investment activity improved in the same month, reflecting gains in both traditional and new infrastructure projects. The new infrastructure initiative, which was rubberstamped during May's National People's Congress, seeks to upgrade China's industries and accelerate digital transformation. Industrial production growth also picked up in August, led by gains in advanced technologies. Although the external sector continued to fare well in August, risks are looming on the horizon as some of China's main trading partners are suffering heavily from the consequences of the pandemic.

Growth prospects have been improving in recent months, reflecting a stronger-than-expected recovery. Looking forward, the economy will benefit from strong overseas demand for medical products and technological devices as well as solid new infrastructure investment. A re-escalation of trade tensions with the U.S. and a second wave of Covid-19 are the main downside risks. Analysts see the economy growing 2.0% in 2020 and accelerate to 7.6% in 2021.

Investment Strategy & Outlook

The outlook remains very uncertain as we head into the final quarter of an already tumultuous year. Most importantly, markets are grappling with the speed/shape of the recovery which is contingent upon the containment of the virus and the prospects of a vaccine. The Federal Reserve, in a recent FOMC policy statement reiterated this contingency in addition to modifying their policy on inflation and committing to no interest rate increases until 2023. These are unprecedented moves by the Central Bank and should be a warning for investors holding long dated, fixed income securities with negative real yields.

In our view, such extreme monetary policy accommodation has been a major tailwind for equities and effectively inflated financial assets while enticing corporations and sovereigns to issue trillions of low cost debt; A good deal for the borrower/issuer but a poor investment for the lender/investor. From a risk/reward perspective, equities offer a much more compelling investment thesis for long term investors.

Finally, as the election approaches investor anxiety is rising. While there is no way to accurately predict election outcomes, the historical evidence suggests that markets react more to economic trends than to political outcomes. However, that is not to say that these two are not somewhat linked. For example, policies perceived to reduce corporate profits, increase regulation and/or serve as a drag on economic growth can be quickly discounted in the markets even before they are fact. Regardless, companies will quickly adjust to any change and focus on their mandate of maximizing shareholder value. Markets are incredibly efficient, and investors should avoid making short-term bets on an election outcome. Instead, focus on the inputs that have the greatest impact on portfolio returns such as asset allocation and security selection.

Performance Scorecard

Benchmark Description	Q3	YTD	1 Year
U.S. Treasury 3 Month T-Bill	0.0%	0.6%	1.1%
Barclays Aggregate Bond Index	0.6%	6.8%	7.5%
Barclays US High Yield Corp Bond	4.6%	0.6%	3.3%
S&P 500 Index Total Return	8.9%	5.6%	15.2%
NASDAQ Composite	11.2%	25.3%	41.0%
NASDAQ Dividend Achievers Index	10.3%	4.8%	9.7%
Russell 2000 Index TR	4.9%	-8.7%	0.4%
Alerian MLP Index TR	-9.4%	-36.2%	-34.2%
U.K. FTSE 100 Index	-4.0%	-20.2%	-18.1%
German DAX Index	3.7%	-3.7%	2.7%
China SCI 300 Index	11.2%	14.2%	22.7%
Japan Nikkei 225 Index	6.3%	1.3%	10.3%
MSCI Emerging Markets	8.8%	2.9%	12.8%

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