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Quarterly

2020 Third Quarter Investment Market Report

Despite a weak September, US stocks were up in the Third Quarter. Two powerful trends continued throughout the quarter: large cap stocks outperformed mid and small cap stocks, and technology stocks outperformed all other sectors. Given the persistent decline in the U.S. economy and the uncertainties around the economic impact of the pandemic, the investment situation could have been a lot worse. Once again, the old market adage of "Don't fight the Fed" holds true—unprecedented monetary stimulus is helping to push stock prices higher.

The S&P 500 index gained 8.93% in the third quarter and is now up 5.57% for calendar 2020. At the other side of the spectrum, the Russell Midcap Index is down 2.84% so far this year, while the Russell 2000 Small-Cap Index is down 8.69% so far this year. The technology-heavy Nasdaq Composite Index gained 12.27% in the third quarter, and stands at a remarkable 23.55% gain through the first nine months of the year.

	Quarter	YTD	1 Year	3 Years
S&P 500 Index TR	8.93	5.57	15.15	12.28
Russell 2000 TR	4.93	-8.69	0.39	1.77
Wilshire U.S. REIT TR	1.25	-16.74	-17.69	0.45

Source: Morningstar Direct; See disclosures for imporant benchmark information

Looking over the other investment categories, real estate, as measured by the Wilshire U.S. REIT index, posted a slim 1.25% gain in the third quarter, but real estate investors are still down 16.74% for the year. The S&P GSCI index, which measures commodities returns, gained 7.59% in the third quarter, but is still sitting on a 19.72% loss for the year.

International investors are generally in the red so far this year. The broad-based EAFE index of companies in developed foreign economies gained 4.80% in the third quarter, but is still down 7.09% for the year.

	Quarter	YTD	1 Year	3 Years
MSCI EAFE NR	4.80	-7.09	0.49	0.62
MSCI EM NR	9.56	-1.16	10.54	2.42

Source: Morningstar Direct; See disclosures for imporant benchmark information

In the bond markets, rates are still scraping along the bottom. Coupon rates on 10-year Treasury bonds stand at 0.69%, while 3-month, 6-month and 12-month bonds are still sporting coupon rates of roughly 0%.

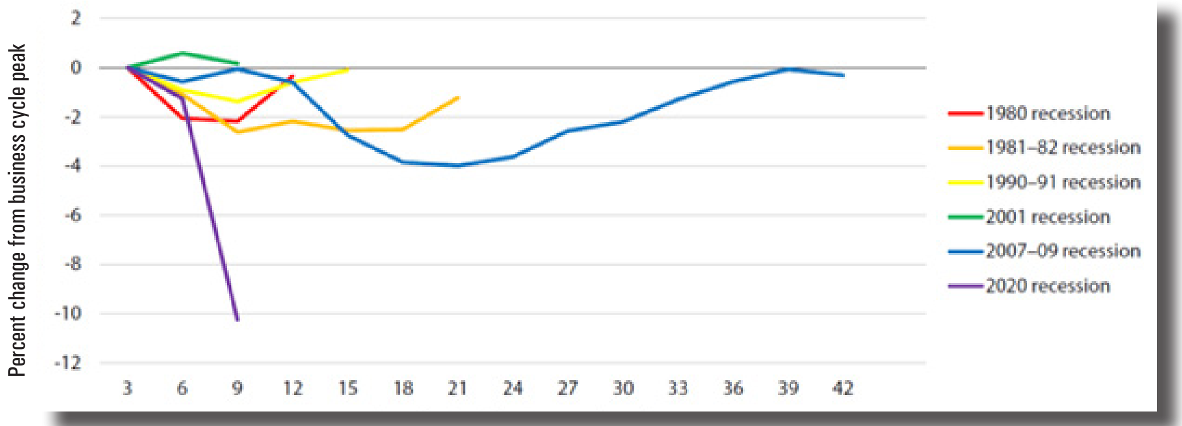
	Quarter	YTD	1 Year	3 Years
Barclays US Aggregate Bond (TR)	0.62	6.79	6.98	5.24

Source: Morningstar Direct; See disclosures for imporant benchmark information

In the early days of the pandemic, most economists and market analysts would have been surprised that the investment markets have held up as well as they have at this point in the year. They would not have been surprised that—as reported by the U.S. Commerce Department—the American economy suffered its sharpest contraction in at least 73 years during the second quarter. GDP plunged at a 31.4% annualized rate, with consumer spending down 33.2% (annualized). April alone saw the loss of 20.5 million jobs. The most optimistic pundits were touting the return of 749,000 payroll jobs in September. At that rate, a full economic recovery could take years, but we should know more when the third quarter's economic data is compiled at the end of October.

To put all this in context, consider the two charts shown here. The first chart shows the change in economic activity in the U.S. from the business cycle peak during past downturns—and the purple line heading straight down—in a way that is really unprecedented—is our current economic decline.

Percent Change in GDP Relative to Business Cycle Peak: by Business Cycle

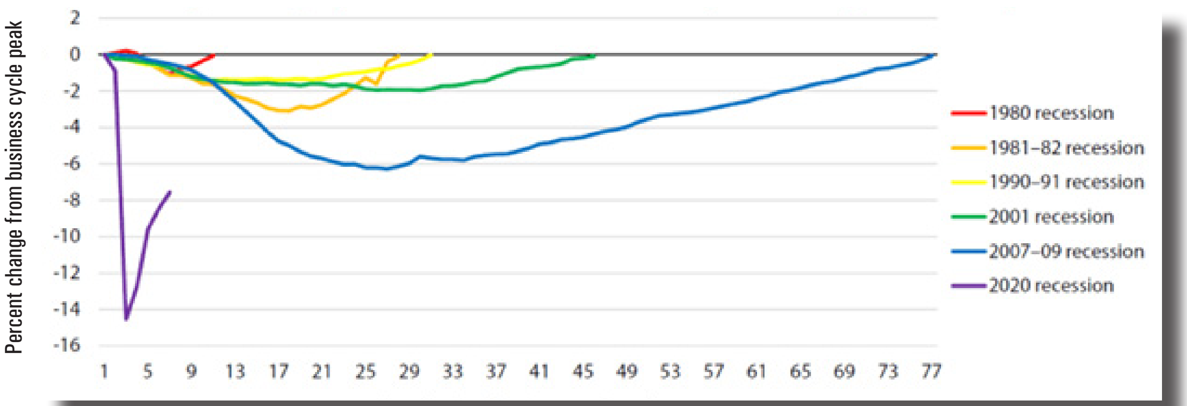


Months since business cycle peak

Source: Data from U.S. Bureau of Economic Analysis, Chart from Brookings Institution

In the second chart, you can see the change in unemployment from peak to trough during past economic recessions, and once again you see that the current situation is more dramatic than anything that has come before. We can take some comfort that the purple line is trending back upward faster than any previous cycle, but what happens from there is, of course, unknown.

Percent Change in Employment Relative to Business Cycle Peak: by Business Cycle



Months since business cycle peak

Source: Data from U.S. Bureau of Labor Statistics. Chart from Brookings Institution

Will the September declines lead to more losses as we approach the November election? Nobody can consistently accurately predict the short-term future, of course. Looking at history, the last ten times when the S&P 500 dropped at least 3.5% for the month of September, seven of those following Octobers showed gains for the month. On the other hand, from a valuation perspective, the S&P 500 is extremely expensive according to our internal valuation models. Expensive valuations do not mean that a correction is imminent, however, it does lead us to believe that longer term expected future rates of return for the index will be lower than historical norms.

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Financial Planning News:

The election on November 3, 2020 is fast approaching and there are many factors contributing toward an answer for the question: "Who are you going to vote for?"

Policies and issues vary in importance for each of us, but we believe that a short review of the tax proposals for each candidate is valuable even if it is not your primary reason to vote one candidate over the other. Keep in mind that the key for either candidate to enact his agenda will be having allies in the Senate.

With that said, here is a short summary of key differences for the candidates. By necessity, much has been left out, and it's important to remember that these are proposals, not law, which can be updated or altered at any time.

It's not yet time to implement planning strategies based on the election. The outcome is not certain, and even if you chose the correct presidential candidate, there are many competitive Senate races to watch that will be key to allowing the new President to enact any tax changes. It's not too early for high-earners to consider their options if it seems likely that a new Democrat Congress and President Biden will enact these changes.

For most high-earners, the strategy will emphasize accelerating income and as many deductions as possible into 2020 before the year ends. Typically, tax rates will dictate either accelerating income or deductions, but not both. In the Biden proposal, there are increases in tax rates and a decrease in the value of deductions, requiring a strategy that includes both approaches. For some, a ROTH conversion is an attractive option to pull income into 2020. Accelerating gifting could be another strategy for those in higher tax brackets.

For now, we (like you) will pay close attention as the last days of the election play out.

TAX ISSUE	BIDEN	TRUMP
Top Individual Tax Rate	Increase to 39.6% on taxable income above $400,000	Maintain current law — 37%
Capital Gains Tax Rate for Top Earners	Same rate as ordinary income – up to 39.6% – for those earning more than $1m	Maintain current law – top capital gains rate is 20%
Social Security Wages	To collect Social Security taxes on wages above $400,000	Maintain current law – Social Security taxes not collected on wages above $137,700
Itemized Deductions	Cap the benefit of itemized deductions to 28% for those earning more than $400,000	Maintain current law
Estate Tax	Tax capital gain assets at death and elimination of the "step-up" in basis.	Maintain current "step-up" in basis and make the provision permanent
Estate and Gift Tax Exclusion	Reduce the exclusion amount by 50% to the pre-TCJA amount of $5.79m	Maintain current law
Like-Kind Exchanges	End "like-kind" or 1031 exchanges for property investors with incomes over $400,000	Maintain current law
Corporate Income Tax Rate	Raise rate to 28%; establish 15% minimum rate on firms with book profits of $100m or higher	Maintain (or lower) current 21% rate and make it permanent
Tax on foreign profits of American corporations	21%	10.5%

Montis is Growing: Jen Cole joins Montis as Operations Specialist

Jen Cole joined Montis Financial in September and has quickly become part of the family. She is a key contributor to the day-to-day functions of our office, concentrating on trading, portfolio accounting, reporting, billing and client services.

Prior to joining Montis, Jen spent six years as a Financial Sales Assistant and Operations Specialist with an independent Financial Advisor in the Boston area.

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Important Disclosure Information

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S&P 500, Russell 2000, Wilshire U.S. REIT, and Barclays U.S. Aggregate Bond indexes are reported using Total Return. Total Return assumes the reinvestment of dividends/interest. MSCI EAFE and MSCI EM benchmark performance is reported using Net Total Return. Net total return indexes reinvest dividends after the deduction of withholding taxes, using (for international indexes) a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties.

Historical performance results for investment indexes, benchmarks, and/or categories have been provided for general informational/comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your Montis account holdings correspond directly to any comparative indices or categories. Please Also Note: (1) performance results do not reflect the impact of taxes; (2) comparative benchmarks/indices may be more or less volatile than your Montis accounts; and, (3) a description of each comparative benchmark/index is available upon request.