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Nauset Market Commentary
Second Quarter 2020

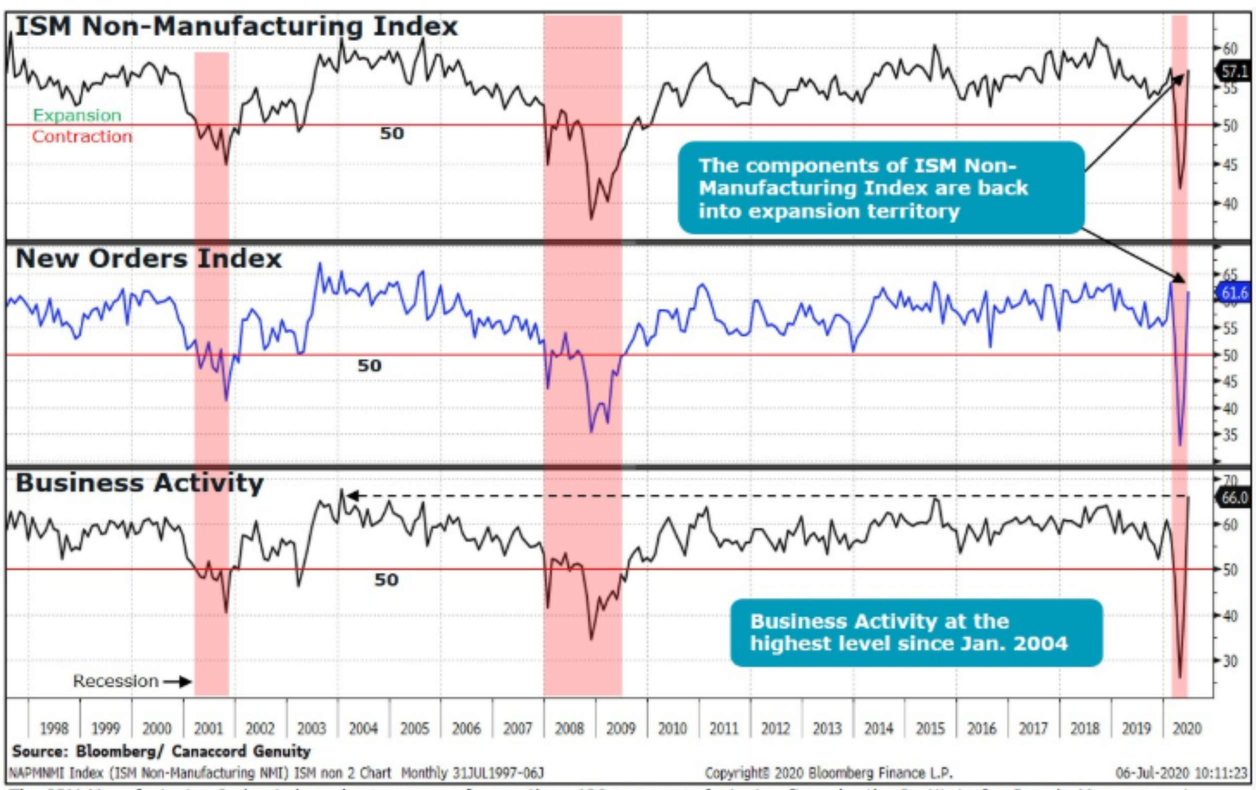
Market Performance Recap: **Historic Stock Bounce Back**

The Russell 1000 notched its best quarterly performance in 21 years, rising +21.8% in a strong bounce back from the pandemic-induced market decline in the first quarter of the year. While the Covid-19 pandemic continues to hinder economies across the globe, the strong rally puts the US large cap Russell 1000 index down only -2.8% for 2020. The surprising Q2 rally was led by technology, consumer discretionary and communications stock sectors. US small cap stocks posted an even stronger rally of +25.4%, but remain off -12.8% year-to-date. For international stocks, the MSCI EAFE developed country index gained +14.9% for Q2, now down -11.3% for 2020, while the emerging market index rebounded +18.1% in the quarter and is -9.8% year-to-date. Barclays Intermediate Gov't/Credit bond index posted another solid quarter with a +2.8% increase.

Economic & Market Discussion: **Making Sense of the Market Rally**

As US equity markets posted their best quarter in over 20 years, the US economy has struggled through its worst quarter on record. How and why did this happen? And what does it mean for markets going forward?

- Economic Rebound – Broadly speaking, the market is reacting to better-than-expected economic data as shown in the graphs below and a reversal in unemployment data in May and June. Despite the current surge in Covid-19 cases in many states, the market is supported by the likelihood that there will not be a second nationwide economic shutdown. Also aiding the market upswing is investor optimism regarding vaccine development. While the market may have reacted too strongly and quickly to the positive economic trends, the rebound is underway. Given the strong Q2 stock gains, the market's reaction to future good economic news may be muted, while any setbacks in the economic rebound would be negative.



The ISM Manufacturing Index is based on surveys of more than 400 non-manufacturing firms by the Institute for Supply Management (ISM). The ISM Non-Manufacturing Index monitors employment trends, prices and new orders in non-manufacturing, within 60 sectors.

- Don't Fight the Fed – The Fed has stepped up in a huge way to support the economy by ensuring the mechanics of the credit market and purchasing bonds across several markets. The Fed has also committed to low interest rates for several years. As with positive economic data, the markets have reacted very strongly to the Fed's easy money policies. In the short term, we expect the Fed to continue to act as a backstop to the bond markets and lessen the negative effects of the pandemic on the economy.
- Winner, Winner – Another key to understanding the exceptional stock market gains in Q2 is that the largest US public companies, especially tech firms, have been hurt less by the effects of the pandemic than smaller and private businesses. Thus, the earnings of many US large cap public companies should outperform GDP despite the impact of lower aggregate demand. Additionally, accelerating structural changes in the economy caused by the virus are also likely to benefit the mega-cap US public companies.

While the rationale for a stock market rebound is understandable, the speed and strength of the rally may have anticipated a faster economic recovery than what is unfolding. For that reason, we are cautious with respect to further gains in 2020, and markets are likely to experience more volatility as small businesses and schools reopen this quarter. There are plenty of factors to monitor in the coming months. In addition to the usual economic and market data, we are also watching Covid-19 vaccine progress, the Presidential race and social injustice protests. Any of these elements could have positive or negative market impact over the next quarter as the recovery continues.

Portfolio Strategy: **Maintaining Balance**

Anticipating a V-shaped economic recovery, the US stock market is now fully or slightly overvalued. Keeping with our usual long-term perspective, here is how we managing portfolios entering the second half of 2020.

- Near Neutral – The market rally and recent rebalancing have placed most portfolios at or near neutral allocations for equities. We expect to maintain that stance unless market conditions drive market levels significantly in either direction, in which case we would likely rebalance back to neutral.
- Stay with Strength – As a form of defense, we will continue to focus on quality in both stocks and income-producing securities during this period of market uncertainty. We will favor investments with a margin of safety, such as investment grade bond funds, and large cap US tech and health care stocks.
- Open to New Opportunities– As the economy continues its recovery amid the uncertainty, we will search for attractive opportunities in credit as well as international and smaller cap stock areas based on valuation.

Market Performance **% Change for Periods Ended 6/30/2020**

Market Index	Second Quarter	2020 YTD	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	21.82	-2.81	7.48	10.64	10.47
MSCI EAFE – Non-US	14.88	-11.34	-5.13	0.81	2.05
Russell 2000	25.42	-12.98	-6.62	2.01	4.29
MSCI Emerging Markets Equity	18.08	-9.78	-3.39	1.90	2.86
DJ US Real Estate	13.91	-13.87	-6.85	3.40	6.28
NASDAQ 100	30.95	12.67	26.94	19.14	16.36
Barclays Gov't/Credit Interm. Bond	2.81	5.28	7.12	4.43	3.46
Wilshire Liquid Alternative	5.56	-3.39	-1.47	0.52	0.50
3-Month T-Bill	0.13	0.52	1.55	1.72	1.15