Q2
20

WEALTH MANAGEMENT QUARTERLY INVESTMENT LETTER

Opus CAPITAL MANAGEMENT

Discussing The Disconnect

Quick Look

- Despite record setting job losses and economic contraction, stocks posted one of their best quarters in history.
- U.S. stocks have closely tracked the developments of the pandemic, and generally speaking, stocks have climbed higher on days of improving health statistics.
- Economic data, which lags the stock market, hit rock-bottom as expected during April and May, but early signs of a recovery began to appear.
- The amount of fiscal and monetary stimulus over the past four months has been unprecedented.
- Market confidence has been restored, fueled by the conviction that any market weakness will be remedied by additional stimulus measures.
- With short-term rates cut to zero and long-term rates hovering at all-time lows, investors have felt no alternative but to reach for yield by stretching their allocations to risk assets.
- Despite COVID hitting the U.S. particularly hard, U.S. stocks continued their leadership over global stock markets thanks in part to its tech-centric composition.
- New brokerage accounts spiked higher during the quarter across all discount brokers, as the recent rally has attracted new investors during the lockdown.

Contacts

KEVIN P. WHELAN, CFA
Principal and Portfolio Manager
kwhelan@opusinc.com

NATHAN A. BISHOP, CFA
Principal and Portfolio Manager
nbishop@opusinc.com

NATHAN M. BAILEY, CFA, CFP®
Principal and Portfolio Manager
nbailey@opusinc.com

221 East Fourth Street, Suite 2850
Cincinnati, Ohio 45202

P (513) 621-6787
F (513) 639-3072

www.opusinc.com

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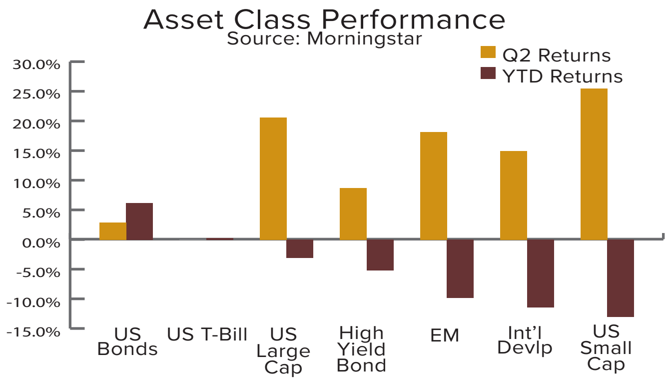
Opus Capital is an evidenced-based investment advisory firm driven by our overriding mission to help people. We believe the marriage of comprehensive financial planning + statistically proven investment principles creates the clearest roadmap to long-term success.

We are independent and transparent in all aspects of investment management decision making and financial planning. We selectively partner with like-minded individuals and families, endowments, foundations, and 401(k) plans in 28 states.

Quarterly Investment Letter, Q2 2020

The unemployment rate stands at its highest level of the post-World War II era and 2nd quarter GDP is expected to decline by its largest amount since the Great Depression. The country is witnessing its greatest period of civil unrest since 1968. Yet stocks just posted one of their best quarters in history.

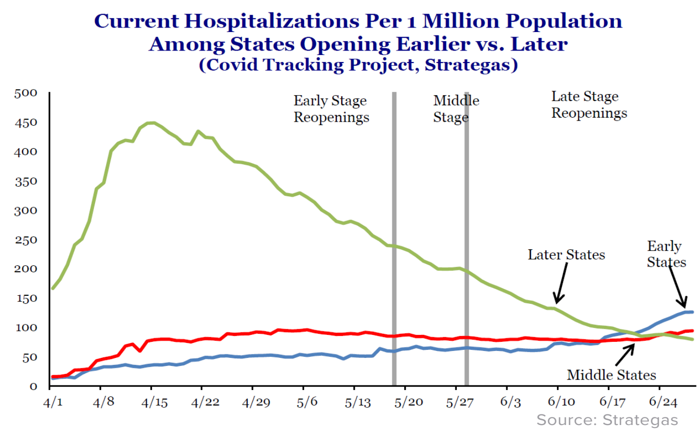


Why does the stock market seem so detached from our current reality? This is the question we have been asked repeatedly, and if you have been wondering the same, you are not alone. Throughout the quarter, this same question has befuddled investing titans such as Warren Buffett, Howard Marks, Stanley Druckenmiller, David Tepper and other luminaries that made their mark during other severe drawdowns. Buffett sold all his airline stocks in April, only to watch the entire airline industry (as measured by the U.S. Global Jets ETF, aka JETS) nearly double in price just weeks later.

To review, U.S. stocks fell 34% (as measured by the S&P 500 Index) from its February 19th high as the first known cases of COVID-19 began to pop up beyond China's borders. U.S. stocks bottomed on March 23, and rebounded as high as 45% by early June, even turning positive for the year. In mid-May, Druckenmiller told the Economic Club of New York "the risk-reward for equity is maybe as bad as I've seen it in my career." Three weeks later, he acknowledged he was up just 3% from the market bottom. "I've been humbled many times in my career, and I'm sure I'll be many times in the future," he stated. "And the last three weeks certainly fits that category." The 50 trading days after March 23 were the strongest in market history.

So, how best to explain the stock market rally? Well, its… complicated. 2020 has brought to light a number of questions that are not accompanied by a simple answer. Our preference as humans is for simple and orderly. However, answers are often complex and require multiple explanations, with threads that can be pulled and often leads to more questions. Let's pull on a couple of those threads.

Improving COVID-19 Pandemic: It is probably best to start with the source of the drawdown itself. U.S. stocks have closely tracked the developments of the pandemic, and generally speaking, stocks have climbed higher on days of improving health statistics. COVID-19 hospitalizations and deaths in the U.S. peaked in April and improved throughout the quarter. The situation in New York, which became the epicenter of the pandemic in the U.S., saw its hospitalizations drop from nearly 20,000 in mid-April to under 1,000 by the end of June. For most of the quarter, there was a general sense of optimism that the worst of the pandemic was behind us, and social distancing helped to flatten the curve to avoid the worst fears of earlier predictive models. For much of the U.S., hospitals avoided being overwhelmed, and initial shortages in PPE supplies and testing capabilities have improved. Investors are betting a vaccine can be successfully developed within the next year, and the virus can be contained. The situation in Europe and Asia looks even more controlled.



With this being said, the pandemic is far from over, and by quarter-end cases in the U.S. spiked to an all-time high, while hospitalizations began to increase as well. Whether a second

U.S. EQUITY RETURNS (%)

As of 06/30/20	Q2 2020	1-Year	3-Year	5-Year	10-Year
S&P 500	20.5	7.5	10.7	10.7	14.0
Russell 1000 (Large Cap) Growth	27.8	23.3	19.0	15.9	17.2
Russell 1000 (Large Cap) Value	14.3	-8.8	1.8	4.6	10.4
Russell 2000	25.4	-6.6	2.0	4.3	10.5
Russell 2000 (Small Cap) Growth	30.6	3.5	7.9	6.9	12.9
Russell 2000 (Small Cap) Value	18.9	-17.5	-4.4	1.3	7.8

Source: Morningstar

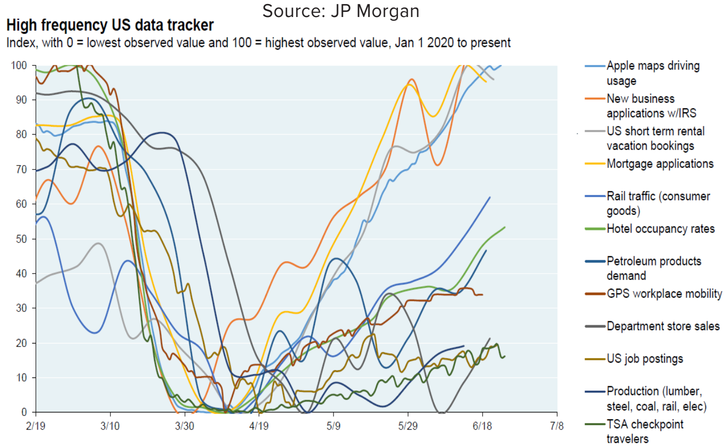
Continued from page 2 . . .

wave or the continued embers of the first wave, the virus remains as confounding as ever.

Economic Green-Shoots: The quarter opened with most of the nation in lockdown, and ended with most of the nation reopened. Economic data, which lags the stock market, hit rock-bottom as expected during April and May, but early signs of a recovery began to appear. After 21 million jobs were lost in March and April, the May jobs report incredibly showed a gain of 2.5 million jobs, widely exceeding economists' estimates, who were expecting another 7.5 million of job losses. Retail sales saw the largest decline on record in April but increased 18% in May. To be sure, these reports have miles to go before reclaiming their previous highs, but the latest reports were a step in the right direction. Per JP Morgan, high frequency data such as Apple Maps driving usage, new business applications, short-term rental vacation bookings, and mortgage applications have all climbed back to their Pre-COVID levels. While the road back seems too bumpy for the widely discussed "V-shaped recovery" to materialize, the economic data points towards improvement.

Reopening the Nation

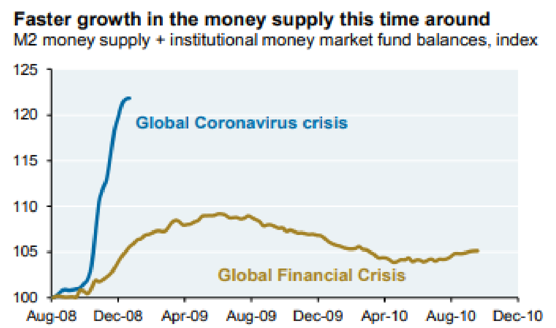
Source: JP Morgan



Fiscal and Monetary Stimulus: The lesson learned from the Financial Crisis a decade ago was the bigger the better regarding policy response, and the response from Treasury Secretary Steve Mnuchin and Fed Chair Jay Powell was swift and historic. Led by Mnuchin, the CARES Act did its best to offset spiraling unemployment with income replacement. The more than $2 trillion spending bill included $300 billion in one-time stimulus checks, $300 billion in boosted unemployment benefits, and nearly $800 billion in forgivable loans for small businesses, known as the Payment Protection Program. The CARES Act propelled personal income in April to 10%, and the savings rate to 33%, which was more than double the previous record. The stock market is betting on another $1 trillion in fiscal stimulus to arrive in July.

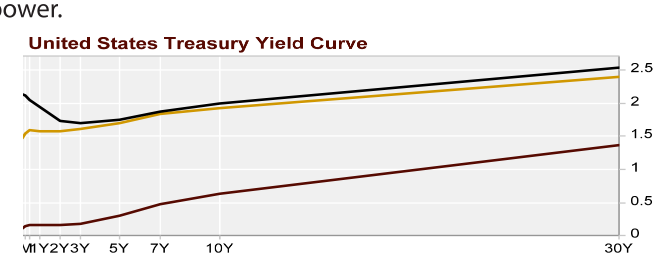
Not to be outdone, the Fed, among other things, slashed rates to zero and promised quantitative purchases of Treasurys and mortgage-backed securities for however long it takes on March 23, not coincidentally the day U.S. stocks bottomed. Markets immediately began to improve as spreads on credit started to narrow. The Fed took the further step of purchasing corporate bonds for the first time in history. The result has been a record in corporate issuance, which is a marked improvement from the temporary freezing of credit witnessed in mid-March. M2, the money supply measure of cash and highly liquid securities, is growing at 20% year over year. This is a much faster clip than what we saw after the Financial Crisis.

There is a long-standing mantra to "Don't Fight the Fed". Market confidence has been restored, fueled by the conviction that any market weakness will be remedied by additional stimulus measures. The Fed's balance sheet has doubled since February, as has Federal deficit spending. This will likely become an issue in future years, but in 2020 the consensus is getting the economy on proper footing outweighs the future costs.



Source: JP Morgan

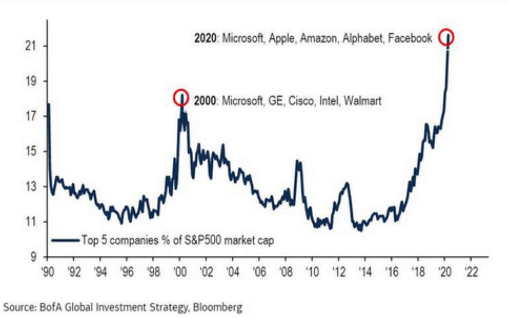
TINA *"There is No Alternative"*: With short-term rates cut to zero and long-term bond yields hovering at all-time lows, investors have felt no other alternative but to invest in risky assets. For pensions needing to match liabilities or endowments with a required return target of 7-to-8%, 10-year Treasurys at 0.65% inhibit their ability to reach their desired targets. The same can be said for individual investors, who see higher yields in stocks than available in fixed income. Risk-averse investors find themselves back in the same quandary as the first half of last decade, in which money market rates are well below inflation. As an example, in 2019, $100,000 deposited into a money market account would have generated around $2,000 in income. This year, the same deposit will be lucky to generate $200 in income. Regardless of their willingness to take risk, current rates require investors to have some exposure to the equity market for any shot at maintaining future purchasing power.



Source: FactSet

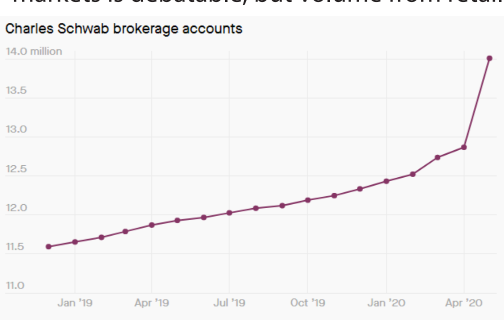
Index Composition: Despite COVID hitting the U.S. particularly hard, U.S. stocks continued their leadership over global stock markets thanks in part to its tech-centric composition. The five largest stocks in the S&P 500, which are Microsoft, Apple, Amazon, Alphabet, and Facebook, now make up more than 21% of the overall index, which marks the highest concentration in over 40 years. All five stocks are higher on the year, and their high growth reputation has gained added strength by being perceived as safe stocks during the pandemic. These five stocks all trade on the NASDAQ, which has reached 23 all-time highs this year and is up a head-scratching 26% over the past 12 months. The S&P 500 Index and NASDAQ trade at 22x and 32x forward earnings, respectively, both of which are 20-year highs. While U.S. small cap, developed international, and emerging markets also bounced strongly during the quarter, they all continue to trail U.S. large cap dominance. U.S. large growth stocks have outpaced U.S. small value stocks by an astounding 34% year-to-date. Value stocks are currently in the 100th percentile of underperformance by almost any time period (i.e. 1-Year, 3-Years, 10-Years) over the last 50 years of rolling returns as measured by the return spread of cheap stocks minus expensive stocks.

Chart 2: S&P500 now more concentrated in the 5 largest stocks than ever



Source: BofA Global Investment Strategy, Bloomberg

Good Old-fashioned Speculation: One of the more interesting developments this year has been the rise in retail trading, which was largely dormant over the past decade. It's actual impact on markets is debatable, but volume from retail brokers has tripled compared to the 2nd quarter of last year. New brokerage accounts spiked higher during the lockdown across all discount brokers, led by the brokerage app RobinHood, which added more than 3 million new customer accounts in the first quarter. Many of their new customers appear to be first-time investors, as the average RobinHood account age is 31 and the account balance is less than $2,000. Anecdotally, the market appears to have a confluence of new entrants from working-from-home employees and sports bettors, with major U.S. sports on hiatus. Stocks had more of a day-trading feel to them this quarter than at any moment since the dot-com era. Examples include 100% intraday surges in the price of a bankrupt Hertz Rental Car, the 165% year-to-date gain in Tesla, and the aforementioned JETS ETF.



In our last investment letter, we mentioned drawdowns of the magnitude we saw in March are typically accompanied by above-average forward returns, as stocks benefit from the early stages of recovery. The speed of this recovery however has been unprecedented. Historically speaking, the shortest recovery from a drawdown of more than 30% was the 1987 Black Monday Crash, which took 20 months to recover all drawdown losses. Comparatively, this current rally is 95% of the way there in only three months.

Given this, our portfolio focus has changed a bit since last quarter. For retirees, spending needs can be once again sourced partially from equities, given their quick recovery. For balanced portfolios, most of which rebalanced into equities within days of the March bottom, we are diligently monitoring equity levels, and will reduce equities should they breach the top range of their policy targets. For risk-taking, longer-term investors, forward performance historically has been good for equities 1-Year and 3-Years after large drawdowns. We would critically stress the importance of diversification of equity asset classes over the singular focus of U.S. large stocks (particularly Growth-style investing). Many of the diversifying asset classes are still well below prior highs. We also reiterate the importance of maintaining a healthy cash reserve, despite the paucity of interest in money-market and savings accounts.

On a final note, we wish all of the best to our clients, a number of whom have been sheltered at home since March. Though we still have an election to get through (heaven help us), here's hoping for a less stressful and health-related improvement during the second half of 2020. Now more than ever, please contact us if we can be of service.

INTERNATIONAL RETURNS (%)

As of 06/30/20	Q2 2020	1-Year	3-Year	5-Year	10-Year
Int'l Developed ex US	14.9	-5.1	0.8	2.1	5.7
Emerging Markets	18.1	-3.4	1.9	2.9	3.3

Source: Morningstar

FIXED INCOME RETURNS (%)

As of 06/30/20	Q2 2020	1-Year	3-Year	5-Year	10-Year
Aggregate Bond	2.9	8.7	5.3	4.3	3.8
Muni	2.7	3.1	3.4	3.1	3.5
Int'l Bonds	6.0	1.6	2.3	2.6	2.3
High-Yield	8.7	-1.9	2.0	3.4	5.5
Short-Term	3.9	3.1	2.6	2.2	2.1
90-Day T-Bill	0.1	1.4	1.7	1.2	0.6

Source: Morningstar

Opus CAPITAL MANAGEMENT
Opus Capital Management
221 East Fourth Street, Suite 2850
Cincinnati, OH 45202
(513) 621-6787 • www.opusinc.com