WAYPOINT ADVISORS

A CARY STREET PARTNERS COMPANY

Market Perspectives **Third Quarter 2020**

Large Cap Growth Stocks are Expensive

U.S. equity performance started the quarter strong with large cap growth stocks returning 21% for the quarter before giving up 8 percentage points during the month of September as positive news on the unemployment, earnings and vaccine development fronts buoyed markets. International equity markets also participated in the rally though to a much smaller degree.[1] Year to date, U.S. growth stocks have significantly outperformed value-oriented stocks and large cap equities outperformed mid and small cap equities (as depicted in the tables below).

QTD	VALUE	CORE	GROWTH
LARGE	5.59	9.47	13.22
MID	6.40	7.46	9.37
SMALL	2.56	4.93	7.16

YTD	VALUE	CORE	GROWTH
LARGE	-11.58	6.40	24.33
MID	-12.84	-2.35	13.92
SMALL	-21.54	8.69	3.88

Source: John Hancock; 3Q 2020 Capital Markets Performance Report.

This degree of divergence between growth and value has only happened a few times in the U.S. stock market's history. The growth rally elevated the price of many growth stocks to historically extreme highs relative to earnings. When this has happened in the past (Nifty Fifty and Tech Bubble), the darlings of Wall Street suffered significant losses in the subsequent 5- and 10-year periods (see below).

Top Stock	P/E at Peak	Return 5 Yrs Later	Return 10 Yrs Later	Top Stock	P/E at Peak	Return 5 Yrs Later	Return 10 Yrs Later	Top Stock	P/E at Peak	Return 5 Yrs Later	Return 10 Yrs Later
Nifty-Fifty (1975)				**Tech Bubble (2000)**				**Post Financial Crisis and COVID Rally (2020)**			
								Facebook	37x	?	?
Avon Prod.	63x	-58%	-66%	Cisco	230x	-78%	-67%	Apple	40x	?	?
Xerox	254x	-70%	-83%	Intel	50x	-66%	-76%	Amazon	152x	?	?
Polaroid	26x	-79%	-87%	Microsoft	79x	-55%	-48%	Netflix	111x	?	?
Eastman Kodak	24x	-66%	-42%	Oracle	60x	-71%	-41%	Google	38x	?	?

Source: Schafer Cullen Capital Management, Wall Street Journal, Waypoint Advisors, a Cary Street Partners Company, 2020. For illustrative purposes only. This is not a recommendation to buy or sell the stocks shown.

[1] Morningstar, Waypoint Advisors, a Cary Street Partners company.

The Federal Reserve is Propping Up Markets

While some parts of the markets have been strong, much of the economy has struggled as a result of COVID lockdowns.

To try to keep the economy and markets operating smoothly the Fed has provided enormous liquidity and stimulus by lowering the Fed funds target range to 0 - .25% and by buying corporate and U.S. Treasury bonds, a strategy referred to as quantitative easing (Q.E.). This has resulted in historically low interest rates for treasuries and other bonds.[2]

While Fed actions have mitigated the effects of COVID on the economy it has made holding bonds for the future much less attractive. Bonds have boosted portfolio returns since 1981 when the yield on the 10-year Treasury declined from a high of 15.84% to 0.68% as of 9/30/20.[3] When yields go down the price of bonds goes up, so portfolios have benefited from price appreciation, as well as significant interest income all the while demonstrating low correlation to equities which helped buffer portfolios when equities went down.

Bonds are Less Effective as Portfolio Diversifiers

The Fed has signaled that it intends to keep Q.E. (low rates and bond purchases) in place for as long as it takes to boost the economy.[4] Unless the Fed plans to set negative rate targets, which it has not indicated it would do, the benefits of holding bonds will be minimal for the foreseeable future. Fed intervention in the bond market has also limited the opportunities to take advantage of price dislocations as the Fed has become the buyer of last resort for investment grade corporate bonds and is propping up the junk bond market though purchases of High Yield Exchange Traded Funds (ETF).

Because interest rates are low, bonds are not providing the income we would normally see. In fact, after factoring in the effects of inflation, real yields on Treasuries are negative.[5] There is also the potential for interest rates to go up in the future which will cause the price of bonds to decline. Stocks whose dividends are considerably higher than the interest rates on bonds, have also become relatively more attractive.

International Investments are Relatively Inexpensive

While monetary stimulus has made bonds less attractive and inflated U.S. equity prices, international equities have become more attractive for several reasons. International stock valuations are nowhere near as high as U.S. valuations and as the U.S. Treasury has increased the money supply (M2) 21% since February[6] many economists expect the dollar to weaken,[7] adding to the attractiveness of international investing.

U.S. and international equities have traded leadership over the years as can be seen in the relative performance chart below. The gray areas show times when the U.S. outperformed while the purple areas shows periods of international outperformance.

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[2] Source: St. Louis Federal Reserve Economic Data: https://fred.stlouisfed.org/

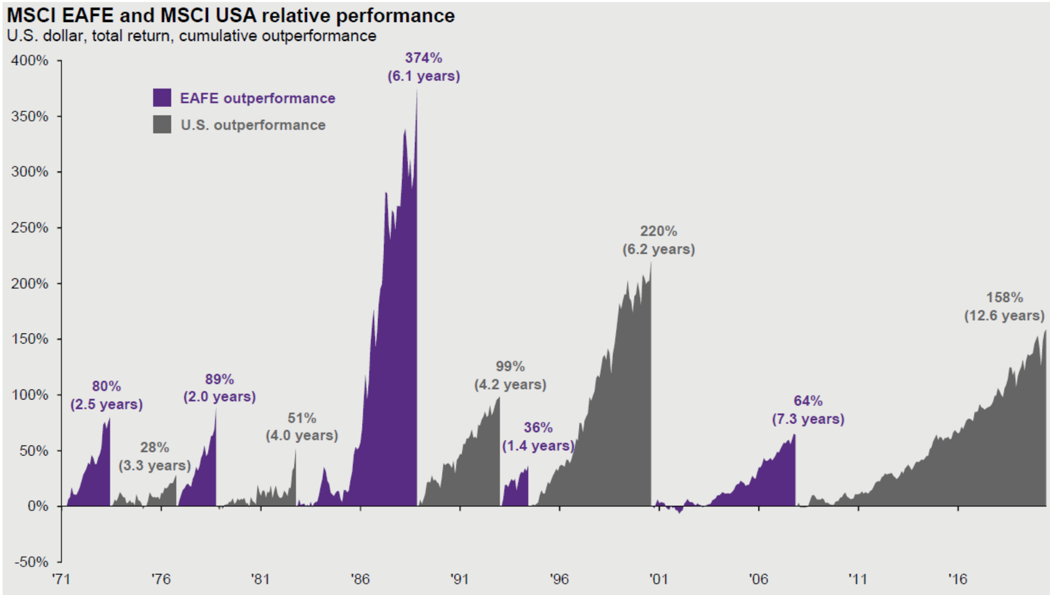
[3] Source: Commodity Systems, Inc via Yahoo Finance.

[4] Recent Economic Developments and the Challenges Ahead, Chair of the Federal Reserve Board Jerome H. Powell: https://www.federalreserve.gov/newsevents/speech/powell20201006a.htm

[5] JP Morgan Guide to the Markets, 4Q 2020 as of 9/30/2020, page 41

[6] Source: Federal Reserve Bank of St. Louis: https://fred.stlouisfed.org/series/M2

[7] Reuters: https://www.reuters.com/article/usa-markets-dollar-analysis-idUSKBN25S3KN, Fox Business News: https://www.foxbusiness.com/markets/us-dollar-to-weaken-as-coronavirus-recovery-forges-ahead, Business Insider: https://www.businessinsider.com/us-dollar-will-weaken-against-other-major-currencies-ubs-says-2020-4, Barron's: https://www.barrons.com/articles/how-to-prepare-your-portfolio-for-a-weaker-dollar-51598009400



*Source: MSCI, FactSet, J.P. Morgan Asset Management. *Cycles of outperformance include a qualitative component to determine turning points in leadership. Guide to the Markets – U.S. Data are as of June 30, 2020.*

Emerging market economies continue to grow at a much faster pace than the U.S. economy. China's economy is expected to be the largest economy by 2024 with India and Indonesia entering the ranks of the top economies as well.[8]

With cheaper prices, strong economic growth in China and more relaxed trade restrictions, conditions appear to favor international outperformance in future years.

Long-Term U.S. Economic Growth Faces Headwinds

A growing stock market is typically driven by a growing economy, which is reflected in GDP growth that is positive during expansions but can go negative during contractions. GDP growth depends upon both a growing workforce and increasing productivity of said workforce. It is a measure of the increase or decrease of economic output. In the U.S., declining births, increasing deaths, and immigration restrictions all point to a significant decline in the growth in number of workers in the future. This is a headwind for future U.S. GDP growth.

The widening disparity of income and wealth is also a headwind that deserves further exploration, but cannot be well explicated here given space limitations. Despite the Fed's actions and the initial fiscal stimulus package, parts of our economy, notably small businesses and lower income workers, are still hurting. Many are returning to work, but some job losses are permanent.[9]

The Federal Reserve's actions and fiscal stimulus from Congress have helped prop up the economy, but that improvement is slowing at the same time COVID cases appear to be increasing in a number of places.[10]

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[8]Source: World Economic Forum: https://www.weforum.org/agenda/2020/07/largest-global-economies-1992-2008-2024

[9] Recent Economic Developments and the Challenges Ahead, Chair of the Federal Reserve Board Jerome H. Powell: https://www.federalreserve.gov/newsevents/speech/powell20201006a.htm, NY Times: https://www.nytimes.com/2020/10/03/business/economy/coronavirus-permanent-job-losses.html, Fox Business News: https://www.foxbusiness.com/economy/more-coronavirus-job-losses-are-becoming-permanent, The Washington Post: https://www.washingtonpost.com/business/2020/08/25/permanent-economic-damage-piles-up-covid-crisis-is-looking-more-like-great-recession/

[10] Johns Hopkins University & Medicine: https://coronavirus.jhu.edu/data

The encouraging news is that, just as we have learned better ways to treat COVID, we have also learned how to target the stimulus to help those companies and individuals that are most impacted. The Fed is urging the President and Congress to pass another round of stimulus better targeted to those businesses and individuals who are stressed the most.[11]

[11] Advisory Board: https://www.advisory.com/daily-briefing/2020/07/15/covid-treatments, AP News: https://apnews.com/article/virus-outbreak-archive-76133a0e0258f43751b16b031f3a1684, CNN Business: https://www.cnn.com/2020/03/19/business/fed-2008-playbook-coronavirus/index.html, Bloomberg: https://www.bloomberg.com/news/articles/2020-03-18/fed-tears-through-2008-playbook-to-counter-economic-hit-of-virus