INVESTMENT REPORT

LYNCH FINANCIAL GROUP LLC
Retirement Wealth Management

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Investment Review and Outlook

Equity investors have been on quite a roller-coaster ride this year.

For the second quarter, larger-cap U.S. stocks gained 21% and smaller-cap stocks climbed 25% .

The U.S. market is down just 3% year to date and is only 8% below its all-time high on February 19.

The Russell 1000 Growth Index is up 10% on the year, but its Value sibling is down 16%.

Developed international stocks rose 17% and emerging markets (EM) stocks gained 19% in the second quarter.

Core bonds gained almost 3% for the quarter.

We welcome questions or comments regarding this newsletter at dlynch@lynchfinancialgroup.com. Lynch Financial Group provides Retirement Wealth Management Services to individuals within 15 years of retirement, retirees, and surviving spouses. We also provide specialized assistance to professionals, fiduciaries and heirs in wealth transfer situations.

Second Quarter 2020 Key Takeaways

For most of the second quarter, financial markets seemed to defy grim economic news, the continued spread of COVID-19, and worldwide protests against racial inequality. Global equities performed strongly for the quarter. The S&P 500 Index gained an incredible 21% and, as of June 30, is now down only 3% for the year, despite the huge drawdown in March. Developed international and emerging-market (EM) stocks gained 17% and 19%, respectively, and outperformed U.S. stocks in late May and June.

Enormous levels of money printing and government spending certainly helped the investor mood. Central banks around the world provided unprecedented support to markets and economies. On the fiscal side in the United States, trillions in direct payments and loans have been or are going to be delivered to impacted citizens and businesses. The level of stimulus globally already surpasses by far what was issued during the 2008 financial crisis.

Short-term interest rates are now near zero or negative in most of the developed world. The 10-year Treasury yield fell slightly this quarter but has revolved around 0.7% for some time. Also, investment-grade corporate bond spreads narrowed. Accordingly, core bonds gained another 3%.

Overall, we are comfortable with our current portfolio positioning, which balances a variety of shorter-term risks against attractive medium- to longer-term return opportunities.

The Economy

COVID-19 is the Most Important Near-Term Variable

As always, we see a range of potential economic and financial market outcomes looking ahead over the next six to 12 months and beyond. What's unique about the current environment is how dependent the outcomes are on the course of COVID-19.

Significant uncertainty remains as to the virus's progression, even as economies around the globe start to reopen and relax social distancing standards.

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Benchmark Returns (Periods Ended 6/30/2020)

	Quarter	12 Months
Large-Cap Benchmarks		
Vanguard 500 Index	20.5%	7.4%
Russell 1000 Growth iShares	27.8%	23.0%
Russell 1000 Value iShares	14.3%	-9.0%
Mid-Cap Benchmarks		
Russell Midcap iShares	24.6%	-2.4%
Russell Midcap Growth iShares	30.2%	11.6%
Russell Midcap Value iShares	19.9%	-12.0%
Small-Cap Benchmarks		
Russell 2000 iShares	25.4%	-6.7%
Russell 2000 Growth iShares	30.6%	3.5%
Russell 2000 Value iShares	18.9%	-17.6%
Other Benchmarks		
Vanguard Developed Mkts Idx	17.5%	-4.4%
Vanguard Emerging Markets	19.8%	-3.1%
Vanguard REIT Index	13.5%	-7.0%
Vanguard Total Bond Mkt Index	3.0%	8.9%
Credit Suisse High Yield Index	10.0%	-1.8%

Second Quarter Market Recap

In the second quarter, larger-cap U.S. stocks gained 21% and smaller-cap stocks climbed 25%. Despite the medical, economic, and social turmoil all around, the U.S. market is down just 3% year to date (as of June 30) and only 8% below its all-time high on February 19.

However, there is a distinct style (or factor) bifurcation beneath the surface: The Russell 1000 Growth Index is up 10% on the year, while its Value sibling is down 16%. That is a stunning 26-percentage-point difference. Or, from another angle, the S&P 500 technology sector is up 12% on the year, while the financials, industrials, and energy sectors are down 24%, 14%, and 35%, respectively.

Looking overseas, developed international stocks rose 17% and EM stocks gained 19% in the second quarter. For the year, they are down 11% and 10%, respectively. As in the United States, growth indexes are meaningfully outperforming value indexes overseas. The U.S. dollar depreciated slightly during the quarter, providing a modest tailwind to foreign market returns for dollar-based (unhedged) investors such as ourselves.

Finally, in the fixed-income markets, core bonds gained almost 3% for the quarter, as Treasury yields dropped slightly (falling bond yields imply rising bond prices) and investment-grade corporate bond spreads narrowed, rallying along with the equity markets. Riskier credit-sensitive sectors within the fixed-income universe posted very strong gains, making up ground from their first quarter losses. Floating-rate loans and high-yield bonds gained nearly 10%, leaving them around 5% underwater for the year.

Second Quarter Portfolio Performance & Key Performance Drivers

The incredible rebound in risk-asset markets—stocks, corporate bonds, and other credit markets—in the second quarter provided a strong tailwind for our portfolios.

As a reminder, in mid-March, as the S&P 500 plunged 25%, we added an increment back to U.S. stocks in balanced portfolios, funded from lower-risk assets. As the market continued to drop, we were prepared to add another increment to U.S. stocks. But thanks to the Federal Reserve's massive "whatever it takes" monetary interventions, we did not get the chance; the market reversed course above our trigger point. We do not rule out the possibility U.S. stocks will revisit their March lows (2,237 on the S&P 500) and are ready to act again if a compelling opportunity arises.

In the meantime, we are comfortable with current portfolio positioning, which balances a variety of shorter-term risks against attractive medium- to longer-term return opportunities, across a range of macroeconomic scenarios and potential market outcomes. As of quarter-end, our balanced portfolios are slightly underweight to equities overall—comprising an underweight to U.S. stocks, a neutral allocation to developed international stocks, and an overweight to EM stocks.

As highlighted above, global equities performed strongly for the quarter. While the U.S. market was the best performer, foreign markets gained momentum, outperforming the S&P 500 from late May to quarter-end.

We continue to expect superior returns from international and EM stocks over our five-year tactical time horizon. First, overseas stocks are more reasonably priced. For example, EM stocks' cyclically adjusted P/E ratio is near its lowest point in 35 years of data. Second, foreign economies and their markets are generally more sensitive to global growth, so as the world recovers from the pandemic, foreign stock prices should outperform U.S. stocks. Finally, in a sustainable recovery, we would expect the U.S. dollar to decline, as it is generally a safe-haven currency that depreciates in the face of strong global growth. A falling dollar would further enhance foreign stock returns for U.S.-dollar-based investors (as foreign earnings are translated into more dollars).

Our portfolios' fixed-income exposure remains well-diversified, including core investment-grade bond funds (providing recessionary/bear-market ballast to the portfolio) and flexible, actively managed credit- and income-oriented funds, including a tactical position in floating-rate loans in some portfolios. All these non-core fixed-income sectors meaningfully outperformed the core bond index, enhancing our portfolios' absolute and relative performance for the quarter.

Special report - The Economy (continued from Page 1)

The timing, availability and effectiveness of treatments and vaccines are also highly uncertain but crucial variables for the economic outlook.

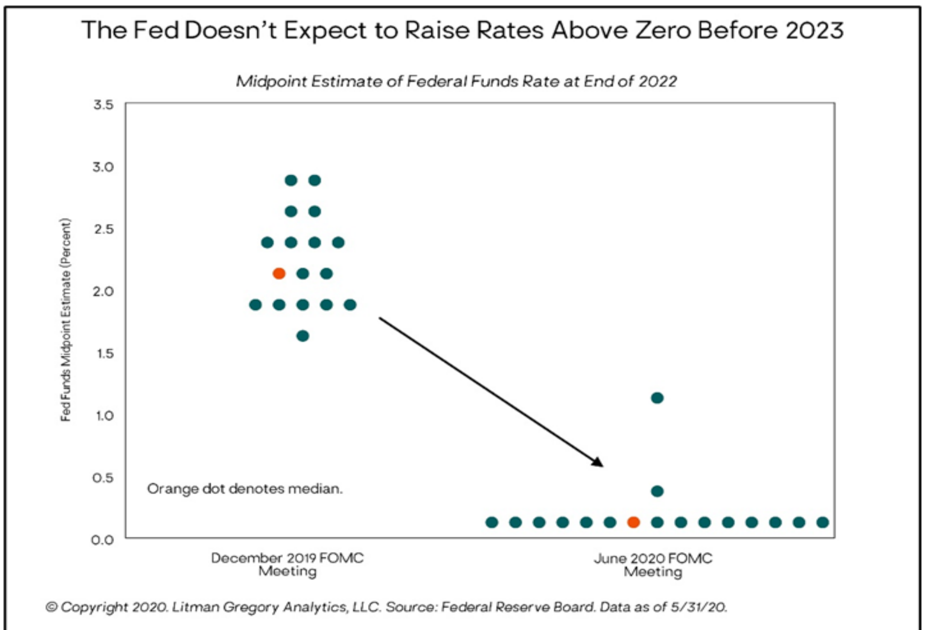
In our view, the key risk to the economy and financial markets is the potential for a widespread second wave of COVID-19 infections, hospitalizations, and deaths that force another large-scale economic shut-down. In that event, stocks could re-test their March lows. We are prepared for that dire scenario with our portfolio holdings in core bonds and alternative strategies. But absent a severe second wave (or some other major exogenous shock), and even assuming there are smaller localized outbreaks, we think an uneven but steadfast economic recovery is the most likely scenario looking out over the next six to 12 months at least.

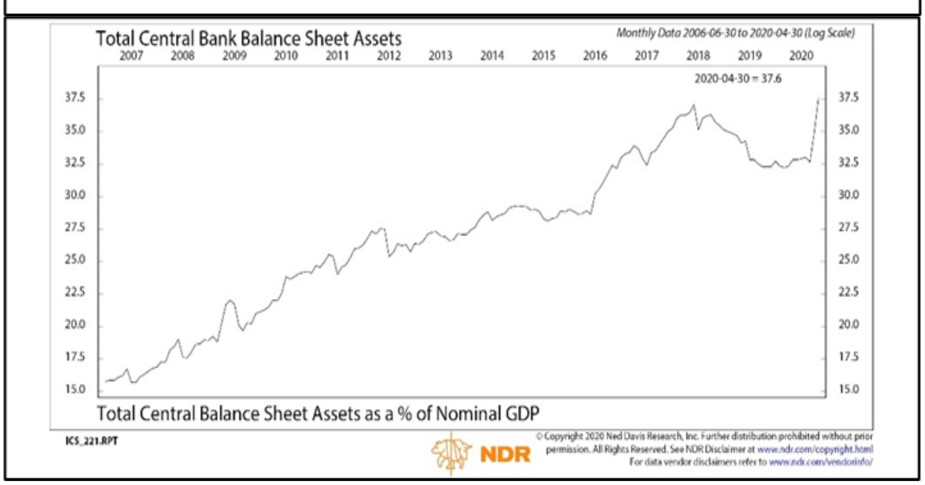
Monetary and Fiscal Policy Are Also Key

While we view the progression of COVID-19 as the most important driver of the near-term economic and market outlook, monetary and fiscal policy are second-most in importance. And, in the policy sphere, the Fed is key.

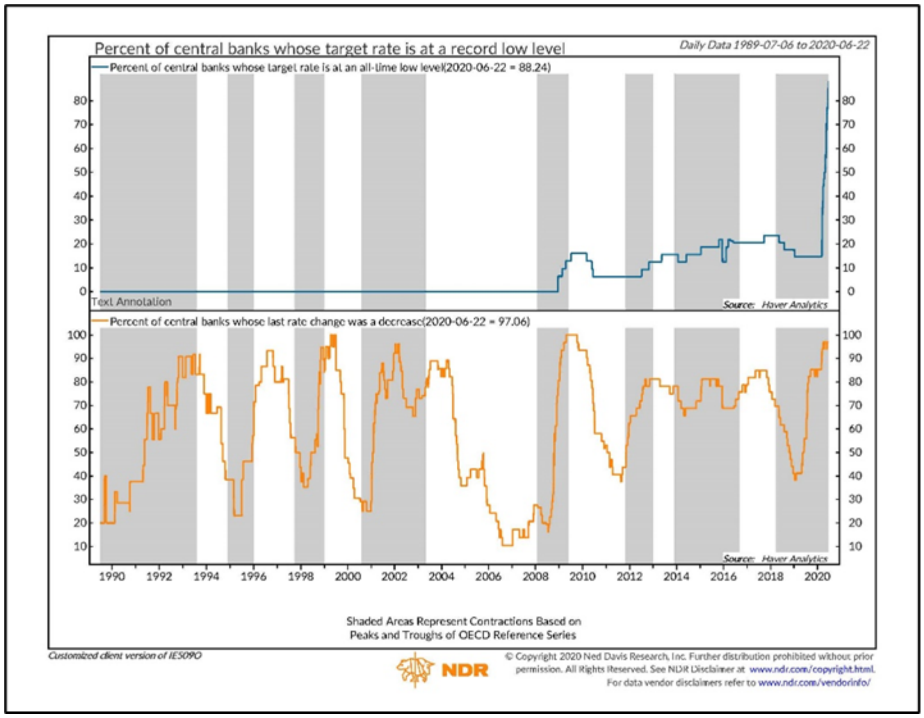
After the Federal Open Market Committee (FOMC) meeting in June, Fed chair Jerome Powell made it very clear the Fed intends to keep monetary policy extremely accommodative for the foreseeable future. Powell said, "We are strongly committed to use our tools to do whatever we can, and for as long as it takes, to provide some relief and stability, to ensure the recovery will be as strong as possible and to limit lasting damage to the economy. … We are not thinking about raising rates. We are not even thinking about thinking about raising rates."

To this end, 15 of 17 FOMC participants expect the federal funds poli-



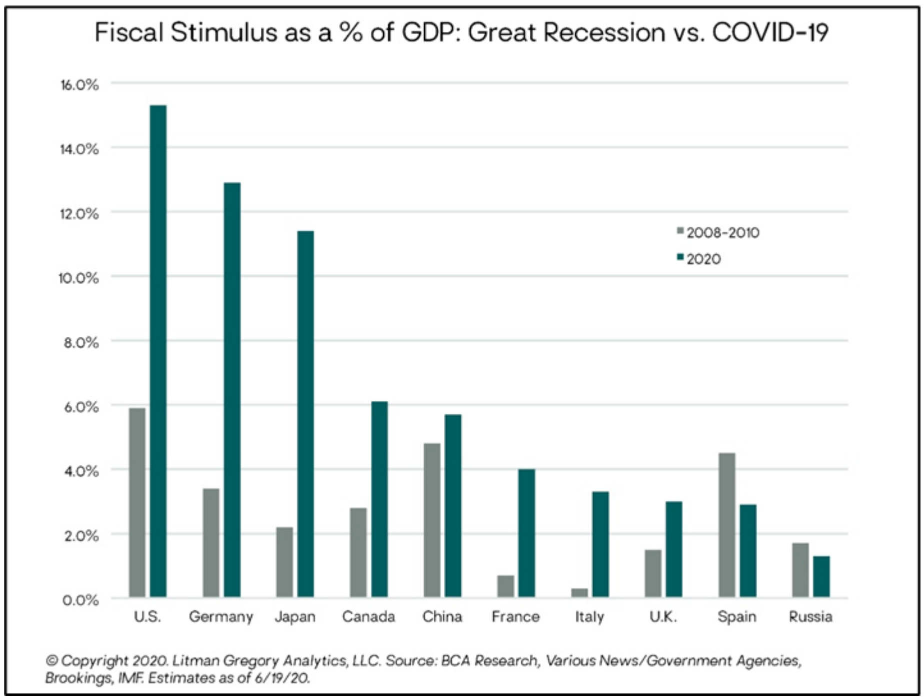


The Fed is leading the way for other global central banks to enact their own extremely loose monetary policies. According to Ned Davis Research, 97% of all central banks are now in an easing cycle (cutting rates), and 87% of central banks have their current target interest rate at a record low level.



On the QE front, global central bank balance sheets, in aggregate, have increased to a record 38% of global GDP. The Fed's balance sheet stands at a record 33% of U.S. GDP and climbing. Similarly, for the European Central Bank at 44% of GDP and the Bank of Japan's balance sheet at a whopping 118% of Japan's GDP.

On the fiscal policy side, global fiscal stimulus and support programs have also been unprecedented, much larger than during the financial crisis of 2008–09 for most countries. Another trillion-ish dollar fiscal stimulus package in the U.S. seems likely later this summer as both the White House and Democrats (if not yet congressional Republicans) favor additional government spending to support households and business get through the medical crisis.



This monetary and fiscal support helped prevent a depressionary spiral from taking hold as the pandemic crisis peaked in March/April. It now looks like the U.S. and global economies may have bottomed in April and are on the upswing, albeit from severe recessionary levels. Recent U.S. economic data have been much better than expected—most notably the surprisingly strong May payrolls (2.5 million jobs added) and retail sales reports.

But as Guggenheim Investments recently wrote (and we agree): "Ultimately, monetary and fiscal policy will take a backseat to public health policy. Progress in testing, treatment, non-pharmaceutical intervention and vaccine development will be the biggest determinants in the shape of the [economic] recovery."

Closing Thoughts

So where does this leave us? The successful containment of COVID-19 is not a foregone conclusion. The resurgence of cases in the southern and western United States, not to mention in several EM countries like Brazil and India, is concerning. Local U.S. authorities have so far refrained from large-scale rollbacks of their reopening efforts. But if strict, widespread lockdowns return, the global economic recovery will be more drawn out, which would be a negative surprise for markets. There are also other uncertainties around the November election or the ongoing U.S.-China dispute that could disrupt financial markets.

But we also hold a cautiously optimistic view that with the recent uptick in COVID-19 cases, the overall social policy response won't need to be as draconian. Therefore, the economic impact should be less extreme than during the first wave. If a more benign public health scenario plays out against a backdrop of extremely loose fiscal and monetary policy, there is a good chance we'll get a sustainable, albeit uneven, global economic recovery. It's unlikely to be a sharp V-shaped recovery, but something more gradual, with fits and starts along the way and with some sectors and industries doing much better than others. If so, corporate earnings are likely to rebound as well.

Measured against very low interest rates—and with fears of severe recession (or worse) off the table for now thanks to the policy response—this would support the view that equities and fixed-income credit sectors are relatively attractive compared to core bonds. Our meaningful portfolio exposures to non-core, flexible, and actively managed bond funds should do quite well in this event.

Furthermore, within the equity universe, a global economic recovery, likely accompanied by a declining dollar, would be a tailwind for international and EM stock markets relative to U.S. stock markets, for the reasons discussed earlier. Our globally diversified equity exposure and overweight to EM stocks should boost portfolio returns.

In sum, we see several ways for our portfolios to outperform over the next five to 10 years. But we should also steel ourselves for a potential double-dip back down to the late-March market lows, most likely caused by disappointing developments on the virus/medical front.

As always, it is paramount that our investment management be guided by a strategy that meets the risk/return profile of the clients we serve. And we need to keep a long-term perspective with an eye on near-term risks so that we remain disciplined through the inevitable downdrafts when fear in the markets is palpable.