Goodman Financial

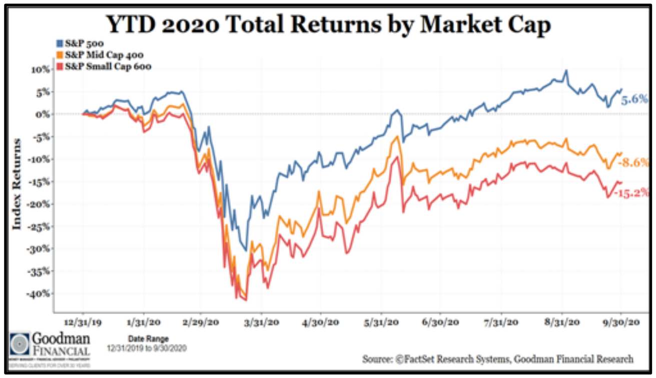
MONEY MANAGER • FINANCIAL ADVISOR • PHILANTHROPY

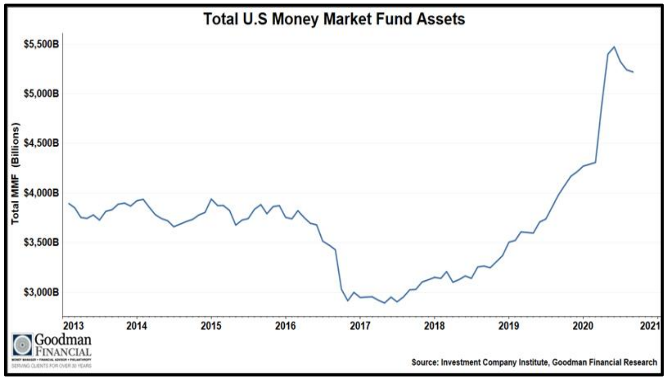
SERVING CLIENTS FOR OVER 30 YEARS

Q3 2020
MARKET & ECONOMIC REVIEW

INDEX	DESCRIPTION	6/30/20	LOW CLOSE	HIGH CLOSE	9/30/20	QTD RETURN*
S&P 500	A market-capitalization weighted index of 500 large U.S companies.	3,100	3,100	3,581	3,363	+8.5%
DJIA	Dow Jones Industrial Average or "The Dow"; A price-weighted average of 30 major U.S. companies.	25,813	25,706	29,101	27,782	+7.6%
Nasdaq Composite Index	A market-capitalization weighted index comprised of over 3,000 companies, mostly in the technology and biotech industries.	10,059	10,059	12,056	11,168	+11.0%
Russell 2000	A market-capitalization weighted index tracking U.S. small-cap stocks.	1,441	1,399	1,592	1,508	+4.6%
NIKKEI 225	A price-weighted index comprised of Japan's top 225 most established companies (in Yen).	22,288	21,710	23,559	23,185	+4.0%
MSCI Emerging Markets	An index comprised of 23 MSCI indices from emerging economies including Brazil, China, India, Mexico, Russia, South Africa, and the UAE.	995	995	1,122	1,082	+8.7%
Stoxx Europe 600	An index comprised of 600 companies based in one of 18 EU countries including Austria, Belgium, Denmark, France, Germany, Ireland, Spain, and the United Kingdom (in Euro).	360	356	377	361	+0.2%

*** Excludes effects of dividends** **Source: FactSet**





Major Equity Market Indexes & Commentary

- Stocks had solid gains in Q3, though nothing like the recovery seen in Q2. Large-cap stocks have now more than fully recovered their Q1 losses, thanks to stout performance from the very biggest "Mega-cap" stocks like Apple, Microsoft, Amazon, etc. Unfortunately, small- and mid-cap stocks are still well below their pre-COVID highs, and significantly so for small-caps. This can be seen in the bottom left chart. The smaller-sized stocks had outperformed in Q2, and we thought that was perhaps the beginning of a long overdue recovery of small stocks relative to large ones, but alas that was not the case this quarter. We discuss this in more detail in our ***Q3 Client Letter***.
- We get many calls from clients and friends asking some version of this question: "How can stocks be doing so well when the economy is a mess?", implying a high dose of skepticism about this market recovery. Their concerns and skepticism seem to be well-grounded in fact (even though the economy is indeed recovering) and stocks are certainly expensive on many traditional measures. So, what gives? There are several strong supporting factors for stocks going forward. First, as we discussed last quarter, the TINA effect is in place (**T**here **I**s **N**o **A**lternative!) given that stocks yield considerably more than bonds, a rare occurrence. Secondly, there remains a considerable amount of cash on the sidelines, thanks to the monetary infusion by the Fed. As seen in the bottom right chart, money market fund assets have swelled this year to over $5 trillion (yes, with a T!). That is a lot of pent-up buying power, and a strong support for stocks. Finally, the Federal Reserve (the Fed) has been clear that they will do whatever is necessary to support financial markets, often referred to as the "Fed Put". While we could see some down periods like that seen in September, as long as interest rates stay low and the Fed remains accommodating, it is just hard to see what could cause another major market correction anytime soon.

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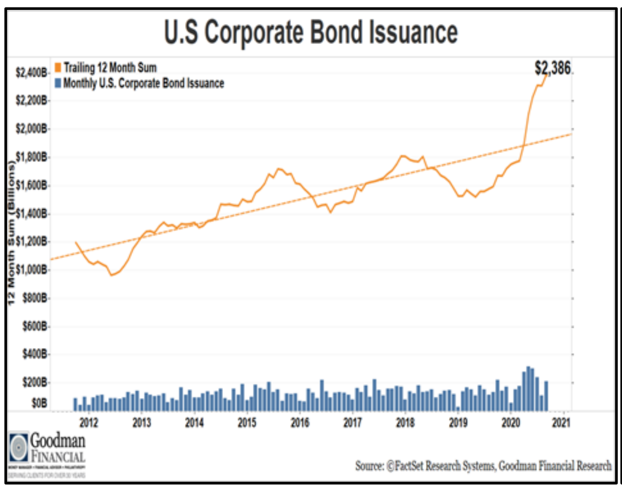
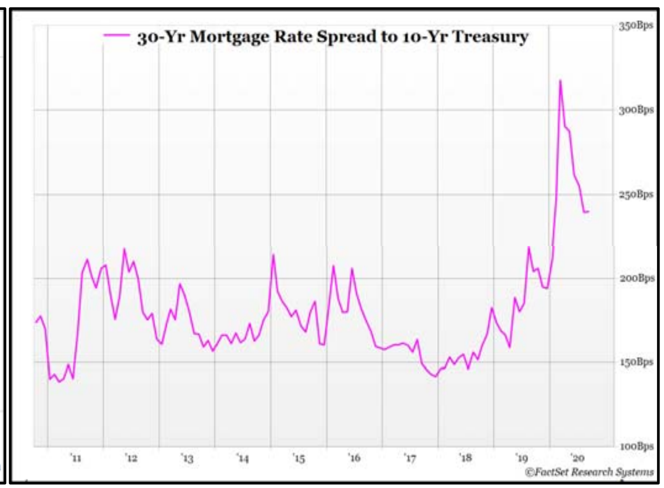
DESCRIPTION	6/30/20	9/30/20	QTD CHANGE IN BASIS POINTS*	DESCRIPTION	6/30/20	9/30/20	QTD CHANGE IN BASIS POINTS*
Federal Funds Target Rate	0.00%-0.25%	0.00%-0.25%	➡ 0	15 Yr. Mortgage Rate	2.59%	2.40%	⬇ -19
90 Day Treasury Bill	0.16%	0.10%	⬇ -6	30 Yr. Mortgage Rate	3.13%	2.90%	⬇ -23
2 Yr. Treasury Note	0.16%	0.13%	⬇ -3	Prime Rate (U.S.)	3.25%	3.25%	➡ 0
10 Yr. Treasury Note	0.66%	0.69%	⬆ +3	LIBOR (3 Month)	0.30%	0.23%	⬇ -7
30 Yr. Treasury Bond	1.41%	1.46%	⬆ +5	5-Year CD	1.28%	1.14%	⬇ -14

***One basis point is equal to 1/100th of 1% or 0.01%**

Sources: FactSet, Wall St. Journal, U.S. Treasury





Fixed Income Rates & Commentary

- U.S. Treasury bonds were relatively flat in Q3 as treasury yields of all maturities were essentially unchanged during the quarter. Unless treasury yields go to or below zero (never say never!), further gains in U.S. treasury bond prices would seem to be unlikely from here. This means we are in a very low yield/return fixed income environment for the foreseeable future.
- Corporate bonds on the other hand, posted some gains in Q3. Given that treasury yields were flat in Q3 (as discussed above), the positive returns came almost entirely from a narrowing of corporate bond yield "spreads" to Treasury yields during the quarter. This was largely thanks to the unprecedented support of the corporate bond market by the Fed, which has purchased nearly $10 billion of corporate bonds since May. More importantly, this signal gave investors renewed confidence to buy and own corporate bonds. This has also allowed corporations to issue new bonds, enabling them to refinance existing debt and in many cases eliminate any near-term liquidity concerns that investors might otherwise have had for those issuers. As seen in the bottom left chart, corporations issued record amounts of new bonds these past few months ($2.3 trillion over the past 12 months).
- Last quarter we commented that "there is reason to believe that mortgage rates still have room to fall…assuming Treasury yields don't rise". In fact, as seen in the table above, that is exactly what happened in Q3 as the 30-year mortgage rate decreased by 0.23% even while the 30-year Treasury yield ***increased*** by 0.05%. As seen in the bottom right chart, the spread of mortgage rates to the benchmark 10-year Treasury rate is approaching more normal levels and so, mortgage rates probably have less room to fall from here. Lower mortgage rates are supportive of housing, as discussed in the ***Economic Commentary*** section.

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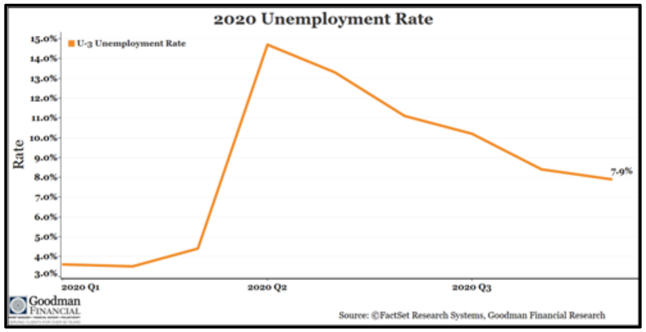
INDICATOR	DESCRIPTION	6/30/20	9/30/20	QTD CHANGE
Weekly Initial Claims for Unemployment Insurance (in Thousands)	The number of new filings for unemployment insurance benefits. Most economists believe claims below 300,000 indicate a healthy labor market environment. **While claims continue to drop, they are still well above the 200,000 weekly type number we were seeing before the pandemic hit.**	1,480	837	-43%
Unemployment Rate	The percentage of total labor force that is unemployed but actively seeking employment. The U.S. Federal Reserve targets a long-run unemployment rate of between 4.5% and 5%. **The unemployment rate continues its surprisingly swift decline.**	11.1%	7.9%	320 bps
Average Weekly Earnings	The average weekly salary earned by private, nonfarm employees. **The drop in wages seen this quarter is a result of more lower wage jobs returning to the economy than those with higher wages, bringing the average down. This is actually good news.**	$1,032	$1,023	- 0.1%
Index of Consumer Sentiment	This index is published by the University of Michigan and reflects consumer attitudes towards the state of the economy. **Given the strength of the economic recovery and lower unemployment, the increase in sentiment isn't too surprising. It is still much lower than last year's reading of 93.2.**	78.1	80.4	+2.9%
ISM Purchasing Managers Index (PMI®)	This index represents economic activity in the manufacturing sector. Any value above 42.9 represents economic expansion. **The PMI recovery continues to be good news as this is a more forward-looking indicator of economic activity.**	52.6	55.4	+5.3%
Existing Home Sales (in Millions) *	This data is provided by the National Association of Realtors®. It is a seasonally adjusted annualized rate and reflects completed transactions in houses, townhomes, and condominiums. **Home sales are skyrocketing!**	3.91	6.00	+53.5%
US Capacity Utilization: Manufacturing *	The ratio of production capacity being used to produce finished products compared to the total capacity available. **Utilization improved nicely as many factories re-opened following the Covid-19 induced closures seen in Q2.**	62.6%	70.9%	+13.3%

***These items are as of 8/28/20, the date of the most recently published statistics**

Sources: FactSet, Federal Reserve Bank of St. Louis, The University of Michigan, U.S. Census Bureau, U.S Department of Labor, Institute of Supply Management



U.S. Economic Commentary

- The numbers of green arrows in the accompanying table reflect the swiftness and strength of the economic recovery currently underway. This follows the historic economic crash seen in Q2, as U.S. real GDP fell at an almost unbelievable and historic 32% annualized rate. Per FactSet, economists now estimate that Q3 real GDP will grow at an equally surprising and incredible annualized rate of 25%, an increase from estimates just three months ago of "only" a 17% rate. Those economists currently predict a 2020 GDP decline of 4.6%, an improvement from their 5.1% decline estimates three months ago. There is certainly some permanent damage done to the economy and more recovery needs to happen, but the media doesn't give much recognition to the recovery seen so far.
- While unemployment remains at very high levels, the recovering economy continues to put many previously laid-off workers back to work. This is demonstrated by the decline of weekly new claims for unemployment insurance (as seen in the table) and in the falling unemployment rate from its highs in late March, as seen in the bottom left chart. Certainly, there is much work to be done to recover all these lost jobs, but at least we are going in the right direction.
- One surprising area of economic strength has been in the housing market. As seen in the bottom right chart, existing home sales reached an annualized rate of 6 million in August, a level not seen since 2006. Similarly, new home sales reached an annualized rate of 1 million in August, again the highest level since 2006. Low and falling mortgage rates are a big driving influence here, but another driver is the desire of buyers to own their home now since so many are working from home.