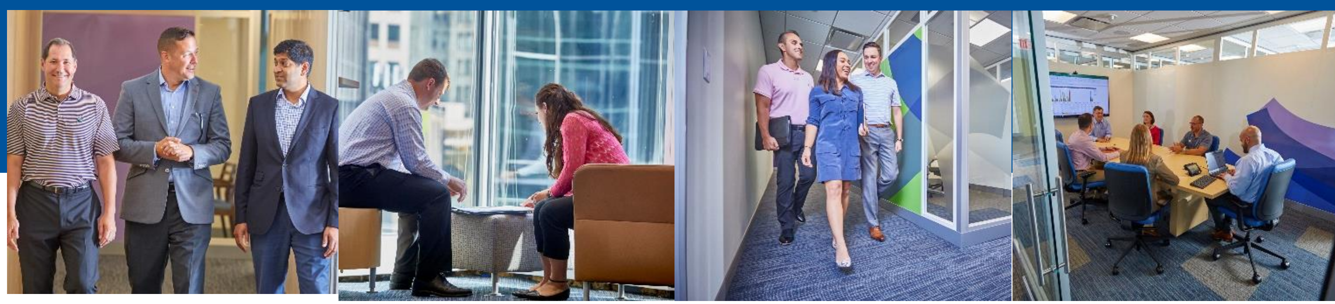
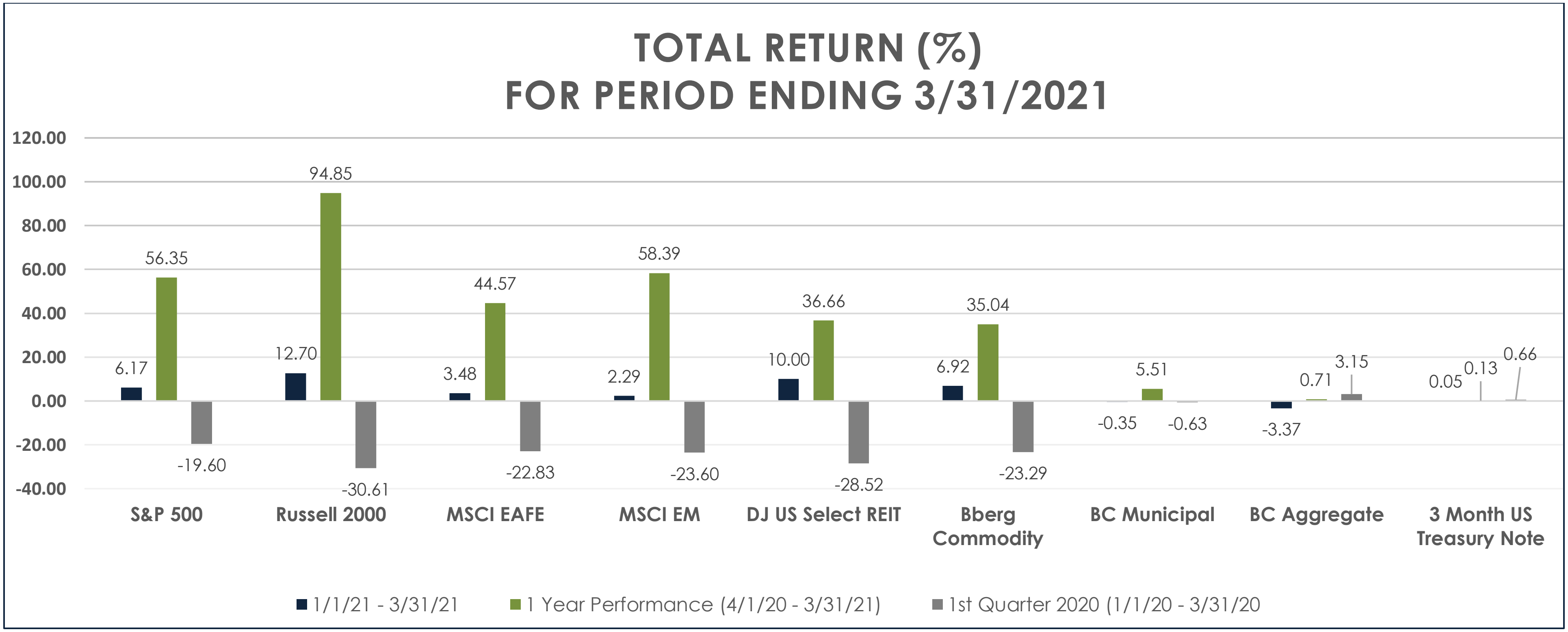
SCHNEIDER DOWNS
Wealth Management

Time + Vaccines =
A Return To Normalcy Within Sight



Schneider Downs Wealth Management Advisors, LP
Q1 2021 Market Commentary

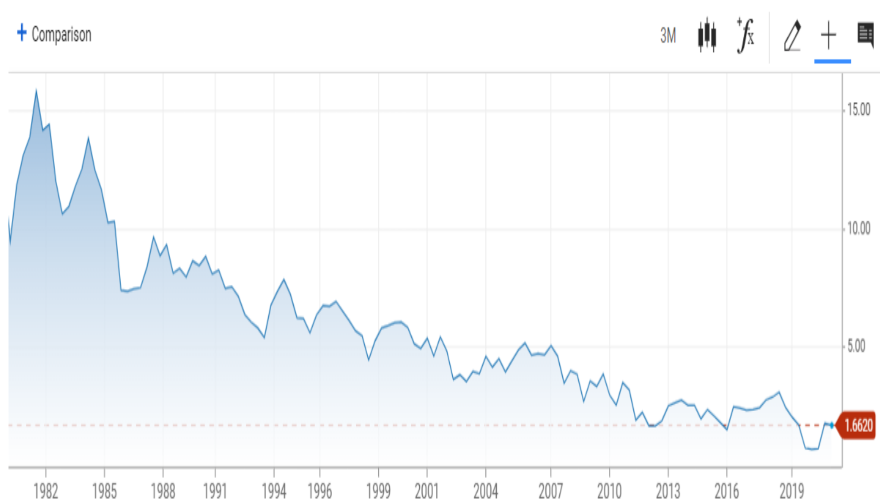
Big Thinking. Personal Focus.



The saying goes "time heals all wounds," and while we can debate the overall wisdom of the statement, it certainly applies to the last 365 days in capital markets. At this time last year, in less than 21 trading days, we experienced the quickest market drawdown on record, from an all-time high to a 33% decline on the S&P 500. The magnitude and swiftness of the S&P 500 STILL wasn't the top worry among investors. The top worry was a nascent, but ascending, global pandemic that caused government-mandated lockdowns, and caused our economy to bleed millions of jobs every week. Mile-long food lines, gut-wrenching stories of doctors and nurses desperately trying to save COVID patients, as well as barren office towers and lifeless downtown city centers dominated newspapers and evening news programs. Fast forward just 365 days and not only have capital markets healed (very much a secondary concern), but most importantly, the COVID pandemic is beginning to recede. A medical miracle born from the amazing power of modern science, human ingenuity, and government support, has blessed the world with multiple, powerful vaccines truly with astounding efficacy. While we need to remain vigilant as vaccine distribution grows and shots go into arms, it is hard to not sit back and be truly amazed by how far we have come in one year. The economy still needs to heal, with unemployment still at unacceptable levels, but there is truly light at the end of the tunnel, and that is a cause for rejoicing, thankfulness, and relief. In the first quarter, most equity markets, sensing that light at the end of the tunnel, were generally buoyant and positive in setting up an interesting second quarter scenario with high expectations for economic activity and growth. Whether those high economic growth expectations are met, only time will tell. We are on the cusp of putting a one-in-one-hundred-year pandemic in the rear-view mirror, and that is cause for celebration… indeed, we have come quite a long way in one year.

In trying to explain what set of values we as humans place significance on from one society to another (and how this has evolved over time), Sebastian Junger, in his book Tribe, writes "bluntly put, modern society seems to emphasize extrinsic values over intrinsic ones."[1] It is also a near perfect corollary to the last few years of stock markets, which have seen investors place an emphasis on the expectation of future growth above all else. Mostly concentrated in technology or technology-adjacent sub-sectors, companies are trading at record high multiples with the prospect of turning a profit a decade or more in the future. Market participants and investors have justified this run up in stocks as the natural evolution in the "internet and digitization of things," another industrial revolution of sorts. This turning of the guard, plus record-low interest rates and record high fiscal and monetary policy support efforts, led growth stocks to outperform value stocks for over a decade, with the gap widening at the heights of the COVID lockdowns. However, it was not always this way, and investors didn't always place an emphasis on growth over qualities like high free cash flow yields, durable and expanding profit margins, and the ability to turn a profit on the top and bottom line (e.g. Warren Buffet's Berkshire Hathaway). The battle for growth and value was deemed mostly won by growth after "work from home" stocks like Amazon, Peloton, Zoom, and others became integral, and seemingly permanent, parts of our life. The narrative began to change in September as growth stocks that had appreciated over 100%+ in less than three months retreated, and then began to underperform value stocks in the fourth quarter as news of promising vaccines turned into the reality of vaccines with greater than 90% efficacy. Dubbed "the reopening" or "reflation" trade, value stocks continued their outperformance in both domestic and international markets in the first quarter of 2021, stringing together back-to-back quarters of outperformance for the first time in over five years. Growth stocks continued to be tied, in part, to the level of the 10-year U.S. Treasury yield; as the yield has gone from 0.93% to as high as 1.75% in the first quarter, growth stocks have experienced significant volatility, including a near 10% correction in the NASDAQ index in February. The team at SDWMA continues to favor a balanced approach to equity investing with exposures to both growth and value, with a modest overweight to growth strategies internationally due to regional and local factor dynamics. The tug of war between growth and value is far from over, but for the first time in years, value is putting up a fight.

Fixed income, after two banner years in 2019 and 2020, took a breather in the first quarter as the yield on the benchmark U.S. 10-year Treasury went up 88% intra quarter (0.93% to a high of 1.75%[2]). As a refresher, bond price and bond yield are like a seesaw; as bond prices go up bond yields go down (and vice versa). For most of the past 30+ years, bonds yields have been on a steady decline pushing bonds prices upward, which has been a wonderful thing for fixed income investors. Bond math, however, works the same way when yields go up as they do when yields go down, and yet most investors have never had to deal with a steady and prolonged climb in interest rates. As the chart to the right shows, the ten-year Treasury yield hit a high of around 16% in 1982 and dropped as low as 0.32% in 2020 during the COVID lockdowns. The sharp rise in fixed income yields has led to questions about the possibility of sustained, rather than transient, inflation, and how that might affect the fixed income markets. In addition, as yields have fallen, the duration of most fixed income has meaningfully extended, meaning that investors are being compensated the least amount (in terms of yield), while taking on the most interest rate risk in a generation.



[1] Tribe, On Homecoming and Belonging: page 22. Tribe was written by Sebastian Junger and published in 2016 by Hachette Book Group.
[2] https://www.cnbc.com/quotes/US10Y

The investment team has been less sanguine on longer term bonds for the past several years, preferring to parcel out the core fixed income allocation to intermediate as well as short-term bonds. To complement the core fixed income allocation, SDWMA portfolios incorporate a mixture of multi-strategy and income-oriented strategies that have lower interest rate sensitivity while providing above-average yield. The combination approach of core fixed income blended with multi-strategy and income strategies positions our portfolio well to navigate what will likely be a volatile fixed income market in 2021. A conversation between Investment Relationship Manager, David Brinkman, and Director of Research and Due Diligence, Jason Staley, has recently been filmed and expands on the yield curve and our approach to fixed income investing. We encourage you to watch the lively conversation when it hits your email inbox later this week.

In his most recent letter to Berkshire Hathaway shareholders, Warren Buffet remarked, "productive assets such as farm, real estate, and yes business ownership produces wealth – lots of it. Most owners of such will be rewarded. All that is required is the passage of time, an inner calm, and ample diversification."[3] Mr. Buffet always offers sage advice, but this quote in particular caught our attention as it can be applied to the lessons of the past year. The passage of time and ample diversification parts of the quote are something that we have expounded on in previous quarterly commentaries, but we have found that these need to be reinforced over and over again as integral parts of successful investing. In recent years we have added real asset (farmland, timberland, and infrastructure) and real estate (high quality commercial real estate) exposures to portfolios as they align well with long-term accumulation of wealth and provide highly-attractive and accretive diversification properties to portfolios. Perhaps the most important part of Mr. Buffet's quote is the insight that investors need "an inner calm" to produce and compound wealth. We hope, as advisors, that we were able to be a steadying force over the past twelve months, reinforcing and at times being the "inner calm" that Mr. Buffet spoke of. Together we were able to navigate the uncertainty, and at times scary, market volatility to get to where we are now: a world with the COVID pandemic receding and powerful vaccines offering the miracle of "normalcy." Whatever the market gives us, the SDWMA team will continue to keep Mr. Buffet's quote top of mind, and work to reinforce and be that inner calm that allows for the passage from turbulent waters to calmer seas.

Thank you again for placing your trust and faith in the SDWMA team with your financial assets; we know they are much more than a number, they are your life's work, and we approach that responsibility with a humble and determined focus to help you achieve your goals and objectives. Please continue to stay safe and healthy – we look forward to seeing you all in person very soon!

[3] https://www.berkshirehathaway.com/letters/2020ltr.pdf