STATERA
ASSET MANAGEMENT

Second Quarter 2020

QUARTER IN REVIEW

After the leap came the run. Stocks furthered a surge from the March trough, at one point gaining enough ground (in the States, at least), to turn green for the year. But the recovery in stocks was hobbled by the reality of a virus that very quickly took advantage of loosening restrictions on public gatherings. With cases spiking anew, reversals of efforts to open up the economy tempered investor enthusiasm for risk. Only somewhat, though. Though the stock recovery has stalled as a fuller macroeconomic revival seems more distant, the world seems mostly to have moved away from denial toward acceptance of the facts related to the pandemic. Those barriers to more effective strategies for addressing the outbreak now more limited, we continue to believe that the world will further progress toward overcoming the crisis, with investable markets likely responding positively to the incremental improvements.

Stocks Surge—Cases, Too

Stocks continued a rally from March depths through the early part of June, completing a 46% bounce off the bottom to a post-plunge peak on June 8. As if on cue, given the fact that the day brought with it a year-to-date gain for domestic equities, stocks sank anew. As the U.S. and other countries began to reopen, those areas that more rapidly removed earlier restrictions saw infections soar.

Data Show We Are Learning

What's interesting about the gains for stocks is that in hindsight we might read that investors seem to have remained reasonably calm through the crisis. Perhaps the gains since the Financial Crisis of 2008-09 left the strong impression—foundational to our investment—that remaining invested during market drawdowns generally is the better reaction for longer-term investors. And the surge in cases saw reasonably quick responses to tighten restrictions for personal interactions that may prove to have the intended effect of slowing ongoing infection rates. Even more importantly, recent data generally show more positive outcomes for the infected, a welcome trend that may lead to a more systematic approach to management of the outbreak and of the reopening of reginal economies.

Optimistic? Yes.

Stock markets around the globe remain volatile. So do the rates of change in trends of the COVID-19 outbreak. Meantime, the broader economy remains in the doldrums, having stalled perhaps not as forcibly as had been speculated, but still by many metrics as weak as has been the case since the Great Depression. But, we continue to find the balance shifting toward greater stability as we adjust to our now far more restricted lifestyles. Our present pace is far from flank (max speed of a ship, in keeping with the metaphor). And the bias for potential surprise, in our view, remains to the downside. Eventually, we will have to come to terms with the longer-term effects of the monumental increase in largesse offer in response to the outbreak. Still, we will gladly accept the progress where it is occurring on both the public health and investing fronts.

Figure 1: Quarter Summary

Overall Take			
↑	↑	Equity: Strong gains for sure, but we must remember how far markets had fallen. Welcome green, nonetheless	
	↑	Fixed Income: Spreads shrank anew, while yields generally fell, leaving gains across the board	
Equity			
↑	Domestic Depending on where one looked, the quarter ranged from super to stellar	↗	International Lagging the U.S. performance until later in the quarter, returns were similarly positive

Directions and colors of arrows reflect a subjective interpretation of the quarter's market events and performance; upward (downward) and angled-upward (-downward) arrows indicate relatively favorable (unfavorable) reviews in the aggregate. They are not indicative of any specific underlying data. SOURCE: SRCM

Equity Market Review

The first quarter was a stellar one from a historical performance perspective, for sure. But, we doubt we need remind too strongly that the results were merely an impressive bounce off the bottom found after one of the sharpest declines in market history. Through quarter end, total return for the year remain modestly negative for the broader U.S. market, down 2%-3%, depending on the index. International stocks remain down on the year by about 11%, with emerging-market stocks outperforming their developed-market peers by a few hundred basis points. Over the longer-term, domestic stock returns remain strongly positive, depending on which part of the market one is referencing. Stocks outside the U.S. just have not received the same sort of attention over the past decade.

Figure 2: Trailing Broad Equity-Market Performance

Best-performing index for each period is shaded in blue; worst-performing in grey. See index details at the end of this report

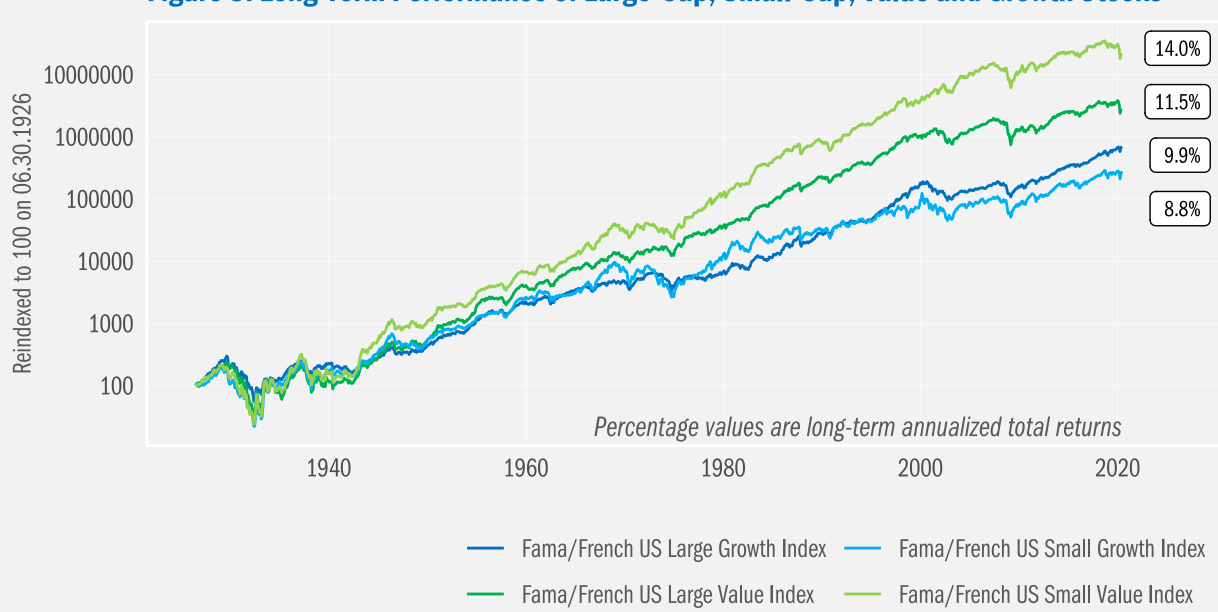
	3 Month	1 Year	3 Year	5 Year	10 Year
Global	19.83	1.17	5.55	6.11	9.10
World ex. U.S.	16.96	-4.74	0.96	2.30	5.11
World ex. U.S. Large-Cap	15.29	-4.57	1.35	2.24	4.87
World ex. U.S. Mid-Cap	19.91	-5.77	0.20	2.34	5.45
World ex. U.S. Small-Cap	22.83	-4.34	-0.17	2.50	6.05
U.S.	22.26	6.60	10.05	10.06	13.73
U.S. Large-Cap	21.17	9.74	11.63	11.32	14.24
U.S. Mid-Cap	26.29	-0.84	7.08	7.51	12.92
U.S. Small-Cap	26.26	-6.81	2.25	4.43	11.15
Developed Markets	15.57	-4.90	0.77	2.29	6.02
Emerging Markets	18.93	-3.97	1.35	2.35	3.11

From 06.30.10 to 06.30.20. Total return data are annualized for periods greater than 1 year. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

And the same could be said, too, for U.S. stocks that don't happen to be big and growthy. Contrary to longer-term historical experience, smaller-capitalization stocks and stocks that can be seen as less expensive have underperformed more expensive large-cap stocks. The trend may be the result of investors seemingly having focused on the potentially higher longer-term growth of these companies, regardless of the present relative cost of those shares. If that's the case, the COVID-19 crisis likely reinforced that notion, with relative stock performance providing confirmation.

But, if there's any validity to the empirical and notional foundations of corporate valuations, it must be true that specific pockets of stocks cannot continue to become relatively more expensive forever. After all, shares in companies are meant to be "worth" collective investor determinations of the present value of all future earnings. If we accept that basis, the fact that investors have bid up Growth stocks suggests much stronger future growth is expected, versus views of just a few years ago. But, that also means that superior growth already is incorporated into the price of the shares. For those shares to continue to outperform, future growth even greater than presently expected may need to be realized. If readers will allow us an editorial moment, future expectations for some of the more notable contributors to the recent outperformance of Growth, versus Value, may have become a bit bonkers. Those same names also being among the large and very large capitalization stocks, we believe there must be limits to absolute growth for individual business models in terms of potential revenue and relative profitability (e.g., let's not forget that heightened profitability generally fosters heightened competition). That reality, we believe, will at some point be reflected in the return of investor interest in stocks with those characteristics we have chosen to emphasize in our portfolios.

Figure 3: Long-Term Performance of Large-Cap, Small-Cap, Value and Growth Stocks



From 06.30.1926 to 05.31.2020. Logarithmic scale. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from the Data Library of the Web site of Professor Kenneth R. French

Figure 4: Trailing Equity-Market Performance

The tables below display the relative performance of different indexes representing U.S. and international stock markets. Broad market performance is shown in the upper left of each group (3-month and 1-year periods). The remainder of the table displays the performance of various indexes, including large-, mid- and small-cap stocks, Value and Growth stocks, and combinations of each. Indexes that outperform (underperform) the broader market are shaded in blue (grey) in depth according to their respective relative performance.

U.S. Stocks

3-Month Period ended 06.30.20		Value	Growth
All Stocks	22.3%	14.0%	29.8%
Large	21.2%	12.2%	29.4%
Mid	26.3%	20.9%	30.6%
Small	26.3%	20.0%	31.8%

1-Year Period ended 06.30.20		Value	Growth
All Stocks	6.6%	-9.4%	23.2%
Large	9.7%	-7.4%	27.8%
Mid	-0.8%	-13.9%	11.7%
Small	-6.8%	-18.4%	4.8%

International Stocks

3-Month Period ended 06.30.20		Value	Growth
All Stocks	17.0%	13.4%	20.1%
Large	15.3%	12.3%	18.1%
Mid	19.9%	15.5%	22.6%
Small	22.8%	18.1%	27.2%

1-Year Period ended 06.30.20		Value	Growth
All Stocks	-4.7%	-14.8%	5.5%
Large	-4.6%	-15.2%	7.1%
Mid	-5.8%	-15.3%	0.9%
Small	-4.3%	-12.0%	3.3%

From 06.30.19 to 06.30.20. Data are total returns for the period shown. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

Fixed Income Market Review

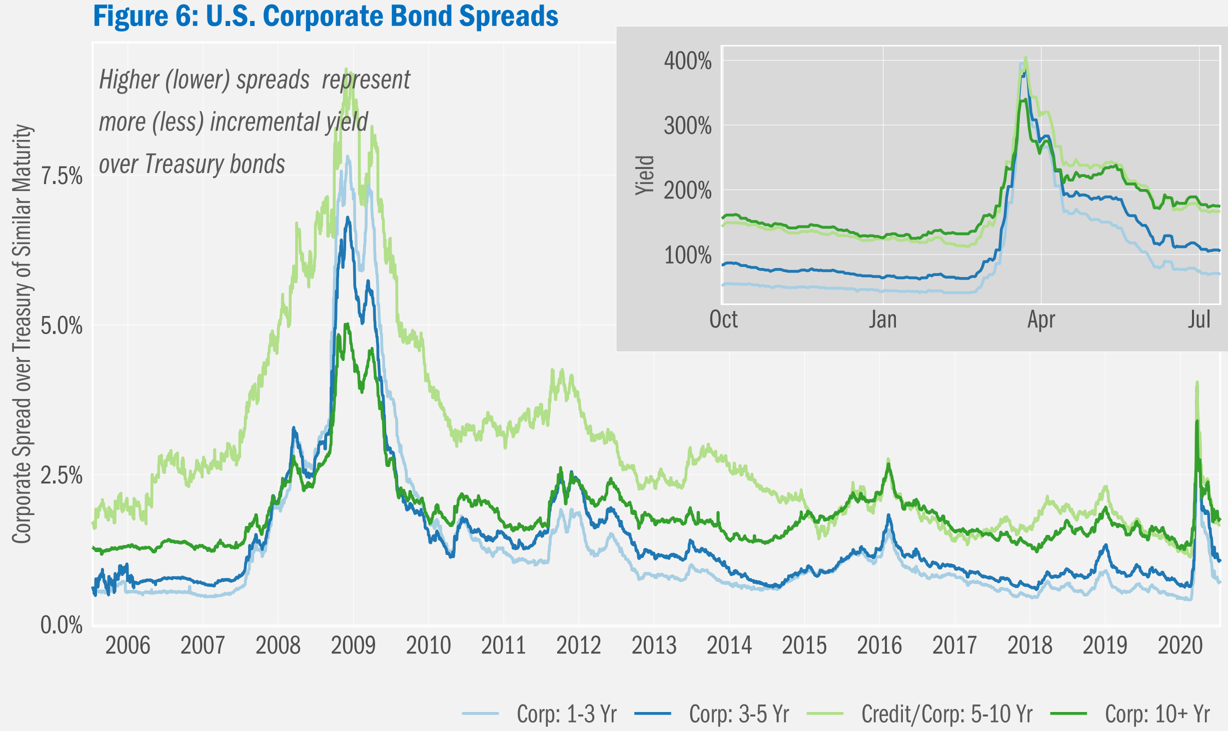
After a reasonable amount of movement in the quarter, interest rate changes during the quarter were mixed. While very short-term rates ended June higher over the three-month period, intermediate-term rates were lower, while long-term rates rose. These shifts generally were rather modest, though, while rates across the board remain substantially below levels seen even at the end of 2019. The pandemic having quickly reversed the general lift in rates that began in 2016 (see Figure 5), expectations for forward income from Treasury positions now are as meager as they ever have been. And that means that, though U.S. Government-issued bonds likely will continue to serve as a ballast against downside equity volatility, they likely won't provide much in terms of incremental return.

Figure 5: U.S. Treasury Yields

From 02.15.77 to 07.13.20. SOURCE: SRCM using data from Bloomberg

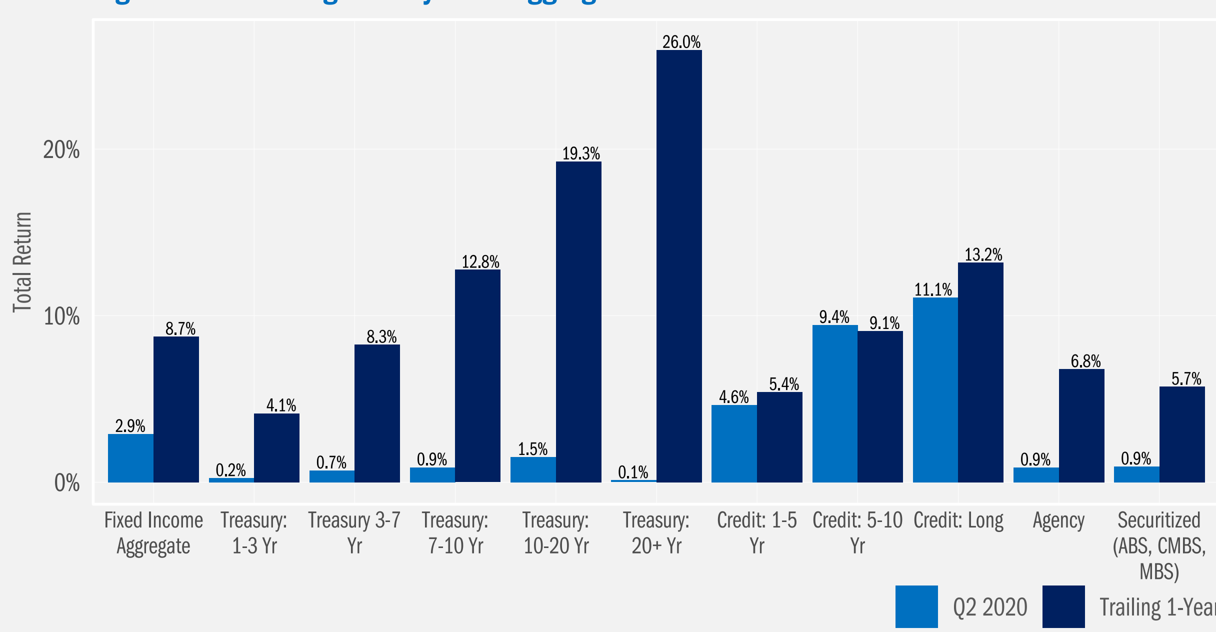
Because of the nature of the outbreak, many (perhaps most) businesses are struggling to generate revenue sufficient to meet operating expenses, let alone cover interest on and repayments of existing debt. Several notable bankruptcies already have occurred, while a host of smaller companies surely have failed. Expectations for ongoing pressures on corporate solvency therefore remain high. While spreads on corporate debt—the incremental yield required by investors to assume the potential for default—have fallen from highs set earlier on in this crises (see Figure 6), they remain at the high end of the past few years-worth of history. The extra yield should provide a bit of a cushion were default rates to continue to grow (not unlikely, in our opinion, given the perseverance of the pandemic). But, spreads are likely to remain volatile along with equities as investors translate government directives and corporation updates into expectations for ongoing profitability and sensitivity to default.

Figure 6: U.S. Corporate Bond Spreads



From 07.13.05 to 07.13.20. Spread is measured as difference between yields on corporate and Treasury bonds of similar maturity. SOURCE: SRCM using data from Bloomberg

Figure 7: Bloomberg Barclays U.S. Aggregate Bond Index and Sub-Index Performance



From 06.30.19 to 06.30.20. The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. Components of the index include Treasury, Corporate, Agency and Securitized bonds. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

SRCM Portfolio Context

The rebound in credit-oriented exposures across our portfolios saw the fixed income side of the ledger generally outperform the Bloomberg Barclays 1-5 Year Government/Credit Index (the bond-component of our benchmarks). The contribution to return increased relative to the benchmark as one moved up the risk spectrum. Still, returns over the 1-year horizon remain subdued, versus the benchmark, primarily due to our relatively lighter exposure to duration as rates broadly fell and the challenging environment for credit.

Within equities, domestic and international exposures, alike, outperformed the broader indexes in the quarter, with the Size factor generally providing the incremental boost. These more recent gains amount to a great start to a recovery for our preferred exposures, which experienced relative underperformance that greatly intensified during the February/March market plunge.

Historical performance details relevant to each model may be found on our Composite Fact Sheets. Past performance is not indicative of future results. Individual client portfolios may maintain exposures different from, sometimes materially so, the models for which performance is discussed above. Actual portfolio performance thus may differ from that shown on the Fact Sheets.

Regularly Scheduled Programs

With the Coronavirus outbreak still raging, many will begin to shift at least one eye to the campaign trail as we head into the closing rounds of the U.S. presidential election. Surely we will be forced to remind folks that it's barely possible to assign any direct impact on the broader markets to one politician or political party. For sure many try, but the associations are tenuous at best. So, we will leave this update with the suggestion not to be too distressed (from an investment perspective, at least) about the upcoming election. Or…if you expect to (or intend to) panic, you may want to consider speaking with your advisor for perspective and to discuss any potential shifts in positioning. Meantime, we are sure markets will continue to key off developments in progress with respect to the battle against the pandemic, with volatility therefore likely to continue. Please just remember that the market's future nearly always has turned out brighter than we had in thought in real-time. We expect this round of anxiousness to prove no different many years hence.

Important Information

Investing involves risks including the possible loss of principal. Past performance is not indicative of future results.

One cannot invest directly in an index. Index performance does not reflect the expenses associated with the management of an actual portfolio.

Asset classes and their respective indexes mentioned in this report include the following:

Domestic (U.S.) fixed income (Fixed Income Aggregate): The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. Components of the index include Treasury, Corporate, Agency and Securitized bonds. The Bloomberg Barclays U.S. 1-5 Year Government/Credit Bond Index is a broad-based benchmark that includes investment grade, U.S. dollar-denominated, fixed-rate Treasuries, government-related and corporate securities with maturities between 1 and 5 years.

Global equity (stocks): The MSCI ACWI Investable Market Index (IMI) captures large-, mid- and small-cap representation across 23 Developed Markets (DM) and 24 Emerging Markets (EM) countries. The index is comprehensive, covering approximately 99% of the global equity investment opportunity set. May be referred to as "global", "global equity" and/or "global stocks". "Value" and "Growth" versions of this index are constructed as described in the "MSCI Value and Growth Indexes" note below.

International equity (stocks): The MSCI ACWI ex USA Investable Market Index (IMI) captures large-, mid- and small-cap representation across 22 of 23 Developed Markets countries (excluding the United States) and 24 Emerging Markets countries. The index covers approximately 99% of the global equity opportunity set outside the U.S. May be referred to as "World ex. U.S.", "international equity", "international stocks" and/or "All Stocks" in a section specifically describing only international stocks. "Value" and "Growth" versions of this index are constructed as described in the "MSCI Value and Growth Indexes" note below.

International large-cap equity (stocks): The MSCI ACWI ex USA Large Cap Index captures large-cap representation across 22 of 23 Developed Markets countries (excluding the United States) and 24 Emerging Markets countries. The index covers approximately 70% of the free float-adjusted market capitalization in each country. May be referred to as international large-cap stocks, "World ex. U.S. Large-Cap", and/or "Large" in a section specifically describing only international stocks. "Value" and "Growth" versions of this index are constructed as described in the "MSCI Value and Growth Indexes" note below.

International mid-cap equity (stocks): The MSCI ACWI ex USA Mid Cap Index captures mid-cap representation across 22 of 23 Developed Markets (excluding the United States) and 24 Emerging Markets countries. The index covers approximately 15% of the free float-adjusted market capitalization in each country. May be referred to as international mid-cap stocks, "World ex. U.S. Mid-Cap", and/or "Mid" in a section specifically describing only international stocks. "Value" and "Growth" versions of this index are constructed as described in the "MSCI Value and Growth Indexes" note below.

International small-cap equity (stocks): The MSCI ACWI ex. USA Small Cap Index captures small-cap representation across 22 of 23 Developed Markets countries (excluding the United States) and 23 Emerging Markets countries. The index covers approximately 14% of the global equity opportunity set outside the U.S. May be referred to as international small-cap stocks, "World ex. U.S. Small-Cap", and/or "Small" in a section specifically describing only international stocks. "Value" and "Growth" versions of this index are constructed as described in the "MSCI Value and Growth Indexes" note below.

Developed markets equity (stocks): The MSCI EAFE Investable Market Index (IMI), is an equity index which captures large-, mid- and small-cap representation across Developed Markets countries around the world, excluding the United States and Canada. The index covers approximately 99% of the free float-adjusted market capitalization in each country. May be referred to as "Developed Markets". "Value" and "Growth" versions of this index are constructed as described in the "MSCI Value and Growth Indexes" note below.

Emerging markets (EM) equity (stocks): The MSCI Emerging Markets Investable Market Index captures large, mid and small cap representation across 24 Emerging Markets countries. The index covers approximately 99% of the free float-adjusted market capitalization in each country. May be referred to as "Emerging Markets". "Value" and "Growth" versions of this index are constructed as described in the "MSCI Value and Growth Indexes" note below.

Domestic (U.S.) equity: The MSCI U.S. Investable Market 2500 Index is designed to measure the performance of the large-, mid- and small-cap segment of the U.S. equity market. The index represents approximately 99% of the free float-adjusted market capitalization in the U.S. equity market. "Value" and "Growth" versions of this index are constructed as described in the "MSCI Value and Growth Indexes" note below. May be referred to as "All Stocks" in a section specifically describing only U.S. stocks.

Domestic (U.S.) large-cap equity: The MSCI U.S. Large Cap 300 Index is designed to measure the performance of the large-cap segment of the U.S. equity market. The index represents approximately 71% of the free float-adjusted market capitalization in the U.S. equity market. “Value” and “Growth” versions of this index are constructed as described in the “MSCI Value and Growth Indexes” note below. May be referred to as “Large” in a section specifically describing only U.S. stocks.

Domestic (U.S.) mid-cap equity: The MSCI U.S. Mid Cap 450 Index is comprised of the next largest 450 companies in terms of market capitalization of the U.S. equity market and designed to measure the performance of the mid-cap segment. The index represents approximately 16% of the free float-adjusted market capitalization of the U.S. equity market. “Value” and “Growth” versions of this index are constructed as described in the “MSCI Value and Growth Indexes” note below. May be referred to as “Mid” in a section specifically describing only U.S. stocks.

Domestic (U.S.) small-cap equity: The MSCI U.S. Small Cap 1750 Index is comprised of the remaining smallest 1,750 companies in the U.S. Investable Market 2500 Index of the U.S. equity market and designed to measure the performance of the small-cap segment. The index represents approximately 11.5% of the free float-adjusted market capitalization of the U.S. equity market. “Value” and “Growth” versions of this index are constructed as described in the “MSCI Value and Growth Indexes” note below. May be referred to as “Small” in a section specifically describing only U.S. stocks.

MSCI Value and Growth Indexes: The value investment style characteristics for MSCI index construction are defined using the following variables: book value to price, 12-month forward earnings to price and dividend yield. The growth investment style characteristics are defined using the following variables: long-term forward earnings per share (EPS) growth rate, short-term forward EPS growth rate, current internal growth rate, long-term historical EPS growth trend and long-term historical sales per share growth trend. The objective of the MSCI Value and Growth Indexes design is to divide constituents of an underlying market capitalization index into a value index and a growth index, each targeting 50% of the free float-adjusted market capitalization of the underlying index. The market capitalization of each constituent should be fully represented in the combination of the value index and the growth index, and, at the same time, should not be double-counted. One security may, however, be represented in both the value index and the growth index at a partial weight.

Fama/French U.S. Book-to-Market Research Indexes: Provided by Professors Eugene Fama and Kenneth French. Index constituents are formed on book equity (BE) / market equity (ME) at the end of each June using NYSE breakpoints. The BE used in June of year t is the book equity for the last fiscal year end in t-1. ME is price times shares outstanding at the end of December of t-1. The reconstitution considers all NYSE, AMEX, and NASDAQ stocks for which we have ME for December of t-1 and June of t, and BE for t-1. The Fama/French U.S. Value Research Index includes the lower 30% in price-to-book. The Fama/French U.S. Growth Research Index includes the higher 30% in price-to-book.

Fama/French U.S. Size Research Indexes: Provided by Professors Eugene Fama and Kenneth French. Index constituents are formed at the end of each June using June market equity and NYSE breakpoints. The reconstitution considers for July of year t to June of t+1 include all NYSE, AMEX, and NASDAQ stocks for which are available market equity data for June of t. The Fama/French U.S. Small Research Index includes the lower 30% in market capitalization. The Fama/French U.S. Large Research Index includes the higher 30% in market capitalization.

Fama/French U.S. Profitability Research Indexes: Provided by Professors Eugene Fama and Kenneth French. Index constituents are formed on profitability (OP) at the end of each June using NYSE breakpoints. OP for June of year t is annual revenue minus cost of goods sold, interest expense, and selling, general and administrative expenses divided by book equity for the last fiscal year end in t-1. The reconstitution considers all NYSE, AMEX and NASDAQ stocks for which are available market equity data for June of t, (positive) book equity data for t-1, non-missing revenues data for t-1, and non-missing data for at least one of the following: cost of goods sold, selling, general and administrative expenses, or interest expense for t-1. The Fama/French U.S. Robust Profitability Research Index includes the higher 30% of stocks by profitability. The Fama/French U.S. Weak Profitability Research Index includes the lower 30% of stocks by profitability.

Fama/French U.S. Investment Research Indexes: Provided by Professors Eugene Fama and Kenneth French. Index constituents are formed on the change in total assets from the fiscal year ending in year t-2 to the fiscal year ending in t-1, divided by t-2 total assets at the end of each June using NYSE breakpoints. The reconstitution considers all NYSE, AMEX and NASDAQ stocks for which we have market equity data for June of t and total assets data for t-2 and t-1. The Fama/French U.S. Conservative Investment Research Index includes the lower 30% of stocks by profitability. The Fama/French U.S. Aggressive Investment Research Index includes the higher 30% of stocks by profitability.

The S&P 500 Index measures the performance of the large-cap segment of the U.S. equity market.

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