THIRD QUARTER MARKET THOUGHTS

It's a Marathon, Not a Sprint

October 2020

Finally, the finish line to 2020 is in sight.

Investors, fatigued by the pandemic that has dominated most of the year and uncertainties around the looming U.S. presidential elections, are understandably eager for a fresh start. But to those in it for the long haul, we would like to remind you that investing is a marathon, not a sprint. While we have come a long way this year, weathering the various ups and downs of the market, we have a longer road ahead. This is not the time to falter; we urge you to stick to your strategic objectives, while keeping up with disciplined rebalancing and staying mindful of market liquidity.

Despite the prevailing weariness, the heightened market volatility and the gamut of unknowns—ranging from the economic fallout of COVID-19, the potential timing and success of a vaccine, and the electoral outcome—U.S. equities gained nearly 9% in the third quarter. These robust returns are fueled by our key market theme of *permanent interventions*. The Federal Reserve's continuing willingness to step in to bolster market sentiment—the largest monetary intervention in modern history—have led to gains of 5.6% in domestic equities through the first nine months of the year. The central bank's unprecedented show of support and the government's fiscal stimulus are enabling investors to not only tolerate the prevailing uncertainties, but also look beyond them.

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To that end, we recommend a strategic equity allocation that favors U.S. and emerging market stocks. We advocate a modest strategic overweight to domestic stocks and a bias to emerging markets, especially Asia, to exploit the potential higher return over the long term.

The stellar performance of risk assets notwithstanding, we still expect heightened volatility across capital markets given the existing uncertainties and the wide range of potential economic outcomes. While historical data show that presidential elections and party affiliation of the presidency have little bearing on long-term equity returns, this election year is unlike any other as it comes amid an economic downturn induced by a pandemic. The election outcome of most relevance for investors will be party control of the presidency, Senate and House of Representatives; a divided government dictates the ability of the President to carry out sweeping policy changes. Outsized market volatility associated with the elections may offer a buying opportunity for investors, but we believe the Fed remains the dominant influence on capital markets and investor sentiment. In addition to the availability of monetary and fiscal stimulus, managing the trajectory of COVID-19, another prominent NEPC key market theme, is also of great importance for financial markets.

Keeping in mind our expectations for continuing volatility, we encourage investors to appropriately size their safe-haven fixed-income exposure. We maintain our recommendation of a dedicated allocation to Treasuries of around 10% or more to support liquidity levels and cash-flow needs as potential market dislocations can introduce bouts of illiquidity across publicly-traded assets.

GLOBAL EQUITIES

Despite a pullback in September, equities ended the third quarter in the black. Returns in the first two months of the quarter were bolstered by better-than-expected corporate earnings, optimism surrounding a potential vaccine and the possibility for additional fiscal stimulus. Stocks snapped their winning streak in September as the much-anticipated stimulus became less of a given and investors contemplated a wide range of electoral outcomes.

Emerging markets equities—boosted by China and India—led performance for the three months ended September 30, with the MSCI Emerging Market Index returning 9.6%. Domestic stocks followed with gains of 8.9%, according to the S&P 500 Index; outside of North America, international developed equities were up 4.8%, according to the MSCI EAFE Index.

In the U.S., growth stocks maintained their lead over value despite coming under pressure in September; the Russell 1000 Growth Index returned 13.2% in the third quarter compared to 5.6% for the Russell 1000 Value Index. While large-cap equities bested small caps in the U.S., international small caps outperformed in emerging and developed markets. Led by consumer discretionary, all sectors in the U.S. posted positive returns expect for energy.

Within hedge funds, equity-linked strategies caught most of the market's upside in the quarter, with the HFRI Equity Hedge Index up 5.8%. Technology-focused strategies modestly outperformed, while healthcare funds lagged; both strategies are up 17% and 9.6%, respectively, so far this year. Overall, hedge funds were net sellers of assets during the first two months of the quarter, while adding to positions in September.

Meanwhile, in private equity, global fundraising totaled $127.1 billion in the third quarter, according to Preqin, down from $183.8 billion a year earlier. During the same period, U.S. buyout activity, at $152.7 billion, was up from $121.7 billion in the second quarter but still below recent averages, according to PitchBook. In venture capital, deal activity was stable in the third quarter at $37.8 billion; during this period, exit activity—fueled by software IPOs—totaled $103.9 billion, significantly up from $26.5 billion in the second quarter.

Global Equity Market Returns as of 9/30/2020

Global Equity	Quarter	1 Year	3 Yrs	5 Yrs
MSCI ACWI	8.1%	10.4%	7.1%	10.3%
US Equity	**Quarter**	**1 Year**	**3 Yrs**	**5 Yrs**
S&P 500	8.9%	15.1%	12.3%	14.1%
Russell 1000 Growth	13.2%	37.5%	21.7%	20.1%
Russell 1000 Value	5.6%	-5.0%	2.6%	7.7%
Russell 2000	4.9%	0.4%	1.8%	8.0%
Russell 2000 Growth	7.2%	15.7%	8.2%	11.4%
Russell 2000 Value	2.6%	-14.9%	-5.1%	4.1%
International Equity	**Quarter**	**1 Year**	**3 Yrs**	**5 Yrs**
MSCI EAFE	4.8%	0.5%	0.6%	5.3%
MSCI EAFE Hedged USD	1.2%	-4.7%	0.6%	4.8%
MSCI EAFE Small Cap	10.3%	6.8%	1.4%	7.4%
MSCI Europe	4.5%	-0.8%	-0.6%	4.2%
MSCI Japan	6.9%	6.9%	3.9%	7.5%
MSCI Emerging Markets	9.6%	10.5%	2.4%	9.0%
MSCI Emerging Markets Small Cap	11.8%	6.9%	-1.1%	4.6%
Alternative	**Quarter**	**1 Year**	**3 Yrs**	**5 Yrs**
HFRI Equity Hedge	5.8%	8.0%	3.7%	5.6%
HFRI Emerging Markets	5.7%	6.3%	1.5%	5.6%
HFRI ED: Activist	7.1%	0.0%	-0.6%	3.7%
HFRI ED: Merger Arbitrage	3.3%	-0.6%	2.3%	3.4%

GLOBAL FIXED INCOME

After months of steady gains since March, segments of the market saw their first month of negative returns in September. Investment-grade and high-yield spreads tightened during the quarter but widened towards the end; the widening was most noticeable in lower-quality securities. U.S. high-yield mutual funds have seen record net inflows this year, while bank-loan mutual funds reported outflows for 24 straight months. The Bloomberg Barclays U.S. Aggregate Index was up 0.6% in the third quarter and the Bloomberg Barclays US Corporate High Yield Index gained 4.6% for the three months ended September 30; during this period, the S&P/LSTA Leveraged Loan Index increased 3.5% but is in the red for the year.

Global Fixed-Income Market Returns as of 9/30/2020				
Global Fixed Income	**Quarter**	**1 Year**	**3 Yrs**	**5 Yrs**
BC Global Aggregate	2.7%	6.2%	4.1%	3.9%
JPM EMBI Global Diversified	2.3%	1.3%	3.5%	6.1%
JPM GBI-EM Global Diversified	0.6%	-1.4%	0.2%	4.8%
Domestic Fixed Income	**Quarter**	**1 Year**	**3 Yrs**	**5 Yrs**
BC Aggregate Bond	0.6%	7.0%	5.2%	4.2%
BC Municipal Bond	1.2%	4.1%	4.3%	3.8%
BC TIPS	3.0%	10.1%	5.8%	4.6%
BC US Treasury	0.2%	8.0%	5.5%	3.7%
BC US Long Treasury	0.1%	16.3%	11.9%	8.2%
BC MBS	0.1%	4.4%	3.7%	3.0%
BC US Credit	1.5%	7.5%	6.2%	5.7%
BC US Long Credit	2.0%	9.3%	8.6%	8.8%
BC High Yield	4.6%	3.3%	4.2%	6.8%
BC Muni High Yield	3.1%	1.3%	5.8%	6.0%
S&P LSTA Lev. Loan	3.5%	1.7%	3.4%	4.1%
BC T-Bills	0.0%	1.2%	1.7%	1.2%
Alternative	**Quarter**	**1 Year**	**3 Yrs**	**5 Yrs**
HFRI Credit Index	3.3%	1.3%	2.4%	3.9%
HFRI ED: Credit Arbitrage	5.7%	-0.1%	3.9%	5.0%
HFRI ED: Distressed/Restructuring	2.8%	-0.5%	0.8%	3.6%
HFRI Relative Value	2.7%	-0.2%	1.9%	3.4%

Within hedge funds, distressed and structured credit-focused indexes were positive for the quarter but remain down so far this year. In emerging markets, the JPM EMBI Global Diversified Index increased 2.3% and the JPM GBI-EM Global Diversified Index returned 0.6%.

REAL ASSETS

Real assets turned in a mixed performance in the third quarter with most sectors in the red so far this year as the pandemic roils economies around the world.

After rebounding in the second quarter, oil prices were flat at $40 per barrel; natural gas continued its upward trajectory, ending the quarter at $2.53 per MMBtu. Energy-related equities decoupled from energy prices and declined in the third quarter amid investors' concerns around the ability of upstream companies to generate free cash flow in the current environment. Rig counts declined, constraining new oil and gas supply. The EIA reported that demand for global liquid fuel was up 12% from the second quarter but still down 6% from a year earlier; distress in the sector will likely remain even if demand stabilizes close to 2019 levels.

Meanwhile, in private core real estate, returns were a modest 0.48% gross in the third quarter, according to the NCREIF ODCE Index. During the same period, publicly-traded real estate investment trusts were up 1.4%, according to the FTSE NAREIT Composite Index; REITs are still down 17.5% so far this year. Property types most impacted by COVID-19, for instance, retail and hospitality, continue to underperform, while sectors benefiting from the pandemic—industrial and data centers—are in the black so far this year. Traditional sectors such as residential and office remain stressed as rent collections and future outlook depend on asset quality and location. Price discovery for real estate assets is still challenging due to the lack of transactions; we expect bid-ask spreads to stay wide unless sellers are in distress.

Real Asset Returns as of 9/30/2020	Quarter	1 Year	3 Yrs	5 Yrs
Bloomberg Commodity	9.1%	-8.2%	-4.2%	-3.1%
GSCI Commodity	4.6%	-27.8%	-9.5%	-7.9%
Gold Spot	5.9%	28.1%	13.8%	11.1%
WTI Crude Oil Spot	2.0%	-26.0%	-8.1%	-2.3%
BBG Commodity - Agriculture	11.9%	2.8%	-5.1%	-5.0%
BBG Commodity - Energy	4.3%	-40.7%	-15.9%	-14.0%
BBG Commodity - Industrial Metals	11.2%	1.6%	-1.0%	4.5%
BBG Commodity - Precious Metals	7.8%	27.2%	11.8%	9.6%
S&P Global Natural Resource Equities	4.4%	-8.4%	-4.2%	2.5%
NAREIT Composite Index	1.4%	-13.2%	2.8%	6.4%
NAREIT Global REIT Index	1.7%	-20.5%	-1.3%	2.4%
Alerian Midstream	-9.4%	-34.8%	-11.9%	-4.5%

Diversified infrastructure indexes were moderately lower in the third quarter and are down around 10% so far this year with mixed results across asset types. Transportation-related infrastructure, for instance, ports, toll roads and airports, face ongoing headwinds amid dropping shipping volumes and air traffic. One bright spot: regulated utilities that have offset some of the transportation challenges in portfolios. In addition, pandemic-resistant sectors such as digital infrastructure and investments related to other logistics remain popular.

FINAL THOUGHTS

For investors sprinting toward 2021, we urge you to conserve your energies and pace yourself because the marathon isn't over yet. We encourage investors to maintain discipline and look to a strategic equity allocation that favors domestic and emerging market stocks. With the heightened level of uncertainty arising from the upcoming U.S. presidential elections, the ongoing pandemic and economic dislocation, we believe a dedicated allocation to Treasuries is vital for balancing portfolio risk and stretches of illiquidity in capital markets. As always, we look forward to helping you across the finish line. And, last but not least, please be sure to exercise your right to vote.

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