GIA PARTNERS

3rd Quarter 2020

Highlights

- **Aided by the Fed, financial markets had an excellent quarter. Even with mounting COVID cases, higher risk sectors did well. Most of our portfolios outperformed their benchmarks;**
- **Pent-up consumer demand gave the economy a big boost in 3Q. Unfortunately, the stubbornly infectious virus and the expiration of stimulus programs dimmed the outlook for 4Q;**
- **A benefit of economic inactivity has been a reduction in carbon emissions. Away from the pandemic assist, the U.S. is moving toward decarbonization joining global efforts to combat climate change.**

Markets

		Returns (%)			
GIA*	Average Quality	3Q20 Gross	3Q20 Net	12 Months Gross	12 Months Net
Core Plus Composite	**(A-)**	**1.99**	**1.90**	**7.18**	**6.81**
Global Credit Plus Composite	**(BBB+)**	**2.55**	**2.42**	**7.38**	**6.85**
Emerging Market Corporate Debt Composite	**(BB+)**	**3.87**	**3.71**	**2.18**	**1.57**
High Yield Composite	**(B+)**	**4.39**	**4.25**	**-0.02**	**-0.56**
Benchmark Bonds					
Bloomberg Barclay's U.S. Agg. Index	(AA+)	0.62		6.98	
Treasury	(AAA)	0.17		8.04	
Credit	(A)	1.50		7.50	
Mortgage	(AAA)	0.11		4.36	
Government/Credit	(AA)	0.78		8.03	
ICE BofA U.S. Corporate & Yankees	(A-)	1.66		7.69	
ICE BofA U.S. Corporate	(A-)	1.69		7.84	
ICE BofA U.S. High Yield	(B+)	4.71		2.30	
ICE BofA EM Corporate Plus	(BBB)	2.75		5.48	
ICE BofA Global Gov't ex-US	(AA-)	0.66		-0.04	
JPM Emerging Markets EMBI+	(BB+)	1.75		4.76	
JPM CEMBI Broad Diversified	(BBB-)	2.75		4.85	
JPM GBI-EM Global Diversified	(BBB)	0.61		-1.45	
Benchmark Equities					
S&P 500	NA	8.47		12.98	
Nasdaq Composite	NA	11.02		39.61	
Russell 2000	NA	4.60		-1.03	
MSCI EAFE	NA	4.20		-1.80	
Europe	NA	4.07		-2.95	
Japan	NA	6.16		4.73	
MSCI Emerging Markets Equity	NA	8.73		8.09	

* Please refer to the respective factsheets for the long-term composite and benchmark returns for each strategy.

Markets

Market reviews for the third and fourth quarter of 2020, and perhaps beyond, will likely focus on the Fed. The central bank's provision of liquidity, purchases of treasuries and agency mortgages, and deployment of its multiple Cares Act facilities have kept treasury rates low and encouraged investors to reach for yield in riskier asset classes. Despite a modest back-up in September, global stocks and higher risk bonds enjoyed a phenomenal quarter. The S&P 500 erased the first half losses and started posting near-daily record closings from August 18 through September 2. Abundant liquidity led all credit sectors to outperform U.S. treasuries despite unrelenting bond issuance and a deteriorating outlook for the pace of economic recovery. Perversely, as COVID-19 cases began to spike in July, threatening the reopening and the nation's service industries, U.S. equity markets began to rise. Markets reasoned the government would apply more stimulus to support the economy. While additional stimulus did not arrive, investors' delirious comfort with the Fed's inevitable presence kept the "risk on" trade in place.

Investment grade credit had another good quarter driven by abundant investor flows and the Fed's support actions. During the quarter, the Fed activated the primary and secondary market support facilities, in effect putting the central bank in competition with investors for the bonds of high-quality companies. With such a favorable liquidity backdrop, companies borrowed to refinance near term maturities and lower their borrowing costs. The investment grade corporate bond index, the ICE BofA U.S. Corporate Index (C0A0), was up 1.69% in third quarter and 6.62% year-to-date. By comparison, the U.S. treasury index returned 0.18% for the quarter and 9.22% year-to-date. Corporate option adjusted spreads (OAS) narrowed by 17 b.p. to 143 b.p., while the yield to worst of the index declined from 2.21% to 2.03%. The big story in investment grade credit was issuance. Following record months in April and May, issuance continued at a relentless pace. For the quarter, investment grade companies borrowed $459.6 billion in public markets, including $204.5 billion in September. Year-to-date issuance topped $1.835 trillion comfortably surpassing 2017's record borrowing of $1.47 trillion.

The high yield market also had a good quarter despite the tenuous outlook for various industries and higher defaults in energy and retail. Like investment grade, high yield benefited from sizable inflows and benign financing conditions even though the Fed's facilities could not target the sector directly. With low rates and tightening spreads, industries not negatively affected by the pandemic borrowed at all-in rates that were certainly not "high." The ICE BofA U.S High Yield Index (H0A0) was up 4.71% for the quarter, not quite enough to fully offset the first quarter's steep loss. For the year through September the index was down -0.30%. Energy, the largest industry in the index, continued to recover with a 2.65% return for the quarter, but still posted a -17.6% fall year-to-date following a dismal -4.30% performance in September. Spreads to worst narrowed further by 112 b.p. from 651 b.p. to 539 b.p., while the yield to worst decreased from 6.87% to 5.70%. High yield retail investors added $10.7 billion during the quarter, despite a withdrawal of $4.3 billion in September. The default rate declined to 5.8% in September from 6.2% in June (6.36% including distressed exchanges). Market liquidity and stabilizing oil prices arrested the second quarter's spike in defaults, and economic improvement during the quarter enabled many companies to delay bankruptcy. Like investment grade, the new issue market remained lively with $131.9 billion pricing during the quarter. For the first nine months, volume exceeded $350.3 billion, a 68% increase over the same period last year.

Emerging markets bonds benefitted from improved financial conditions and favorable flows. Away from China, COVID-19 infections had a deleterious effect on most emerging economies. Like other nations, emerging countries' monetary and fiscal authorities provided economic support, although they faced tighter deficit constraints and more limited monetary policy flexibility. Supporting these economies were improved terms of trade and recovering commodity prices. China's early exit from the lockdowns aided many as it purchased grains, energy and other commodities. For the quarter, the JPM Emerging Markets Bond Index – Global Diversified (EMBIGD), a dollar denominated sovereign index, was up 2.32%, but remained down –0.51% over the last nine months. The JPM Corporate Emerging Markets Broad Diversified Index (CEMBI BD) improved 2.75% for the quarter and gained 2.58% year-to-date. The JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index, rose 0.61% for the quarter, yet remained down -6.32% for the year.

Economy

The COVID-19 pandemic has proven to be a global economic disrupter. While the statement seems obvious given the damage inflicted on global activity, alterations in the economy's composition and changes in personal behavior may prove to have long-lasting implications. Government fiscal support efforts have increased deficits globally, taking governments' share of economic output higher. With unemployment elevated and service sector activity depressed, it is likely a full output recovery will take longer than originally envisioned. In addition, many industries may be permanently changed as consumer preferences realign to accommodate new modes of work, travel and leisure.

The pandemic affected every industry forcing a rethink of operations, strategy and marketing. In negatively affected industries like services, energy and retail, financial stress became part of the calculus. Those lucky enough to benefit have worked overtime to keep customers adequately supplied. From a macro perspective, the U.S. and global economies appear to be performing better in 3Q than initially expected, but results will be uneven across countries. Sadly, underdeveloped regions like India, Latin America and Africa may experience the worst economic damage because they do not have the resources to adequately fight the virus or fund massive stimulus programs.

After a euphoric consumption boost in the U.S. as we exited lockdowns, the virus' second wave thrust an intermittent reopening pattern on most of the country. Europe suffered a similar fate. This new drag combined with the expiration of stimulus programs to dim the outlook for the fourth quarter. After a two-month pause, the WSJ Economic Survey's September forecasts lowered 4Q expectations to 4.7% from 7.5% previously. Even the revised forecast may prove rosy given recently released infection data.

With uncertainty pervasive due to the ongoing presence of the virus and to the stalled additional stimulus, the range of outcomes for the rest of 2020 remains broad. A fourth quarter deterioration seems inevitable, although on a positive note, earnings appear to have held up reasonably well in 3Q, and consumers have savings to draw upon to give retail sales some vigor. Low interest rates should also continue to boost auto and home sales through year-end and a new fiscal package could materialize by early 2021.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the economy growing about 2.5% at an annual rate in 4Q, and then accelerating to a 6.0% rate in 1Q 2021. Third quarter results will likely show a very strong recovery as consumers jumped into action when the economy reopened. Demand associated with returning service and leisure options began to fade as infections mounted across many states. From an economic perspective, the full-year damage will likely be lower than envisioned last quarter, however the composition of 3Q and 4Q performance will likely vary meaningfully given the virus' intransigence. A discouraging 4Q slowdown will likely be reversed in 1Q 2021 because the election will be resolved and, hopefully, a COVID-19 vaccine will be approved. Regardless of the electoral outcome, we expect another stimulus package by early February that will help reignite the economy's momentum. PROBABILITY 60%

2. A second scenario has the economy deteriorating due to increasing infection rates and the expiration of much of the CARES Act stimulus. Furthermore, a vaccine may not materialize and government stimulus could take time to surface. In this scenario fourth quarter growth may decline to 1.0% and the first quarter 2021 recovery may stall at around 3.0%. In this scenario the global battle against the virus remains in stalemate, leading to a more arduous and lengthier path to recovery. PROBABILITY 20%

3. A third scenario has the economy retaining the third quarter's momentum due to still pent-up demand and confidence in the government's eventual support. In this scenario 4Q performance exceeds 4.0% and the first quarter jump reaches 8.0% at an annualized rate. For this scenario to unfold, a successful vaccine becomes available by year-end 2020 and a comprehensive stimulus package gains traction for signing shortly after the presidential inauguration. PROBABILITY 20%

Market Outlook

In this unusual year, rational investment logic needs to be inverted. Normally, when the economy begins to deteriorate a prudent investment reaction is to withdraw risk from portfolios. This year, economic deterioration will likely be met with additional federal government stimulus and central bank liquidity. From a macro perspective, therefore, retaining elevated levels of risk makes sense, and in fixed income, prolonging the "carry trade" should generate excess returns. Assistance from the authorities will likely boost the GDP recovery, keep markets flush with liquidity and ease credit availability. However, from a micro perspective, the benefits of the support will not be shared evenly as struggling industries need demand for their products and services to return to pre-pandemic levels. While the economy's former size and activity level is restored, investment selectivity and prudent management will be essential because plenty of companies will be forced to navigate a treacherous path.

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Important Information

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Index Definitions

Bloomberg Barclays U.S. Aggregate Index

The Barclays U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Bloomberg Barclays U.S. Treasury Index

This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Bloomberg Barclays U.S .Government/Credit Index

The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Bloomberg Barclays U.S. Credit Index

This index is the U.S. Credit component of the U.S. Government/Credit index. Publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

Bloomberg Barclays U.S. Mortgage Backed Securities Index

This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

ICE BofA U.S. Corporate & Yankees Index

The ICE BofA U.S. Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

ICE BofA U.S. Corporate Index

The ICE BofA U.S. Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

ICE BofA U.S. High Yield Index
The ICE BofA U.S. High Yield Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

ICE BofA Global Government Excluding the U.S. Index (N0G1)
The ICE BofA Global Government Excluding the U.S. Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency. N0G1 excludes U.S. government bonds.

JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI Broad Diversified)
The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. The CEMBI Broad Diversified limits the weights of those index countries with larger corporate debt stocks by only including a specified portion of these countries' eligible current face amounts of debt outstanding.

JP Morgan EMBI+ Index
The EMBI+ tracks total returns for U.S-dollar-denominated debt instruments of the emerging markets: Brady bonds, loans, Eurobonds. The EMBI+ currently covers 104 instruments across 15 countries.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)
The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

S&P 500 Index
An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index
An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI EAFE- Europe Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe.

MSCI EAFE- Japan Index
The index is a capitalization weighted index that monitors the performance of stocks from Japan.

MSCI Emerging Markets Equity
The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.