NOTTINGHAMADVISORS
ASSET MANAGEMENT

2020 MID-YEAR UPDATE

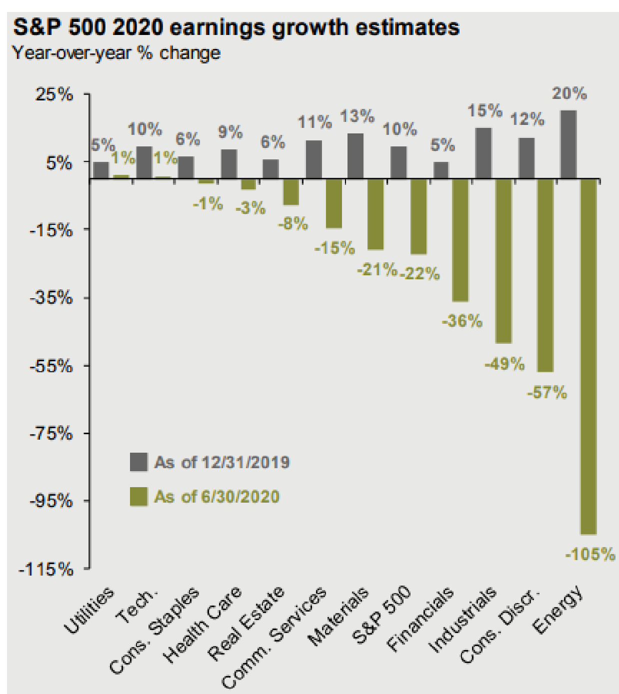
The S&P 500 closed up 20% in the second quarter of 2020, marking the best quarterly return since 1998. Of course, this comes on the heels of Q1's somewhat less exuberant -20% decline, bringing the 1H return to a more ho-hum -4%. But what a ride it was. Confusion around Covid-19 reigned with even the foremost "experts" failing to agree on the fundamentals of the novel virus. Investors were by and large left to fend for themselves, backed "only" by the Fed's rapidly expanding $7.5 trillion balance sheet and Congress's seemingly unlimited ability and desire to spend. Liquidity was ample to say the least.

What the second half of the year brings is anyone's guess. As our clients tend to look to Nottingham for guidance on the economy and markets, we'll take a shot at putting forth our investment thesis for the coming 6-12 months (the "short term), as well as the next 5-10 years (aka the "long term"). Fair warning, our crystal ball, which has occasionally been cloudy and hard to read, has actually gone missing altogether here in 2020, so please keep that in mind.

The Short Term

The next few weeks will bring second quarter earnings reports from much of corporate America. Many companies dropped guidance completely after Q1, so we'll be looking closely at the numbers in an effort to distinguish temporary dislocations from more permanent damage. Our friends at Strategas Research Partners are predicting $110 in Operating Earnings Per Share for 2020, down from $163 in 2019. Much of the decline will likely come in the Q2 report, a so-called "kitchen sink" quarter whereby companies write down the value of anything and everything under cover of the pandemic, a free pass if you will.

This chart comes from the Q3 JP Morgan ***Guide to the Markets*** *and highlights the change in earnings expectations for each industry sector. Note the marked decline in estimates for Financials, Industrials, Consumer Discretionary and Energy. The good news is that when the bar is set very low, companies have a better chance at beating estimates and providing a near-term spark to equity prices. Solid reports from bellwethers like Apple, Amazon, Microsoft and Disney will likely be key for the broader market to remain stable. Stay tuned.*



Analyst expectations for earnings are quite low (and are likely little more than wild guesses at this point), which leaves room for the positive surprises that investors love – under promise, over deliver. Had stocks not run up so much coming into Q3, we would suggest there's room for a decent rally from here if companies can message a recovery is in the works. As it is, equities remain expensive by historical standards, so further near-term gains going forward could be limited. Should the news prove worse than expected, investors could see material downside for individual companies.

As we pointed out in our last letter, *A Tale of Two Markets*, many S&P 500 company stock prices remain in the red for the year. Outside of Technology, investors appear to be pricing in a more realistic, albeit sanguine outlook for equities going forward. We would fall more into this camp. The Tech sector will need some pretty robust earnings reports to justify current prices. Case in point, Tesla recently hit $1,400 per share (up from roughly $200 a year ago), giving it a market cap of $260 billion – that's more than Ford, GM, Volkswagen, Toyota and Honda combined. And Tesla only delivered 180,000 cars through the first 6 months of 2020. Ford alone sold 172,000 vehicles last month! Wonders never cease.

In a nutshell, US equities have experienced more of a V-shaped recovery than the economy. At Nottingham, we've been getting a little more defensive lately, transitioning from some higher beta ETF's to less volatile sectors like utilities and healthcare. Our weekly research discussions have trended more on the theme of capital preservation than aggressive positioning at this point. We could be wrong, or early in our call, but we think the market may trend sideways for a while until the facts around the virus change. We don't think we'll re-test the lows as long as the virus doesn't necessitate a lockdown again.

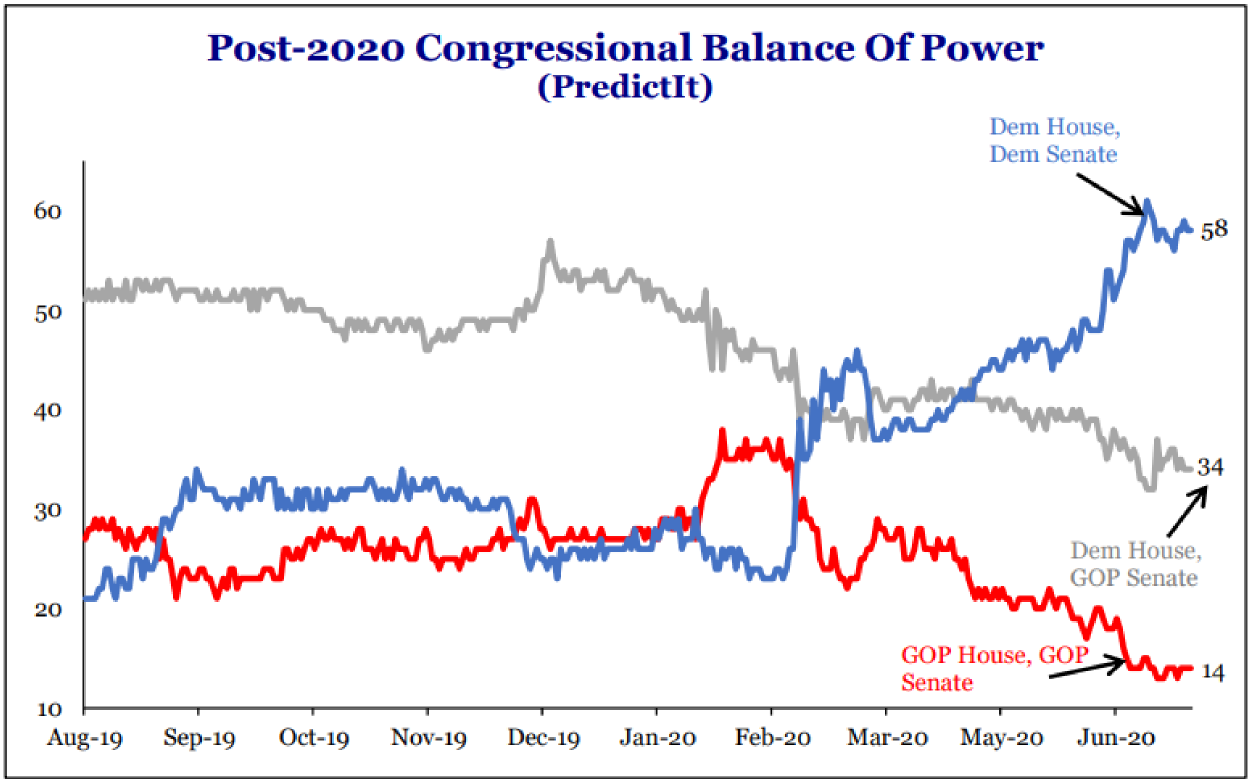
The Long(er) Term
Our more defensive tactical positioning notwithstanding, we believe equities remain an investors best bet at achieving positive real returns over the coming decade. Currently, buying a 10-year Treasury Note will yield the holder 0.66% per year for 10 years. Factoring in inflation of 1.5%, that's a negative 0.84% loss in purchasing power each year. Now, Treasuries remain a safe bet (not to be discounted) and should we see a re-test of the March lows, investors will be darn glad they own them. But, if one's holding period / time horizon extends out five to ten years, we would make the bet that stocks will beat bonds, albeit with greater volatility. The days of modest returns for modest risk are over.

While international stocks are fundamentally cheaper than domestic equities, we continue to prefer the growth prospects within the USA relative to the rest of the world. Chinese equities are currently on a bit of a tear, but we remain cautious with respect to much of that market, outside of some of the leading tech names there. Emerging market equities could be poised to rally should we see a decline in the US Dollar, and given the relatively cheap fundamentals of many EM companies, any move to the upside could be meaningful. Developed market equities, including Europe, remain somewhat stuck in the mud – fundamentally attractive, but lacking a growth catalyst to drive incremental value.

The fixed-income arena is growing increasingly challenging. With the absolute level of interest rates near historical lows across the board, maintaining a steady discipline and rigor with respect to security selection is paramount. In other words, be careful chasing yield! We've been finding pockets of value here and there, but patience is required. Nottingham is favoring the <u>return of capital</u> at this point relative to the <u>return on capital</u>. If and when rates rise, we will likely shift our thinking on this. Municipal bonds are still attractive versus taxable equivalents, but again investors should be prepared to venture out the yield curve to get a meaningful return. Despite low yields, bonds continue to play an important role in our client portfolios.

Looking Ahead
We're increasingly fielding questions around the coming presidential election, with clients asking for our thoughts on possible policy changes should President Trump lose his re-election bid. The betting odds for a Democratic sweep are growing, and with that so too are the odds of major policy changes, especially

around the tax code. While details of potential revisions are sketchy at this time, we're willing to make the bet that marginal tax rates won't be going lower.



Source: Strategas Research Partners

Needless to say, the coming months could be challenging for investors. The facts and opinions around Covid-19 seem to change daily. States are reopening, only to have to shutter segments of industry once again. Schools are trying to figure out if it's safe for students to return in the Fall. Airlines are seeing travelers return, but is that sustainable if the virus surges again? There are definitely more questions than answers right now. Remaining intellectually flexible will be important going forward.

Summary

Troubling and uncertain times can lead to heightened volatility in markets, as well as in investor behavior. Maintaining a calm, rational approach to navigating through uncertainty is what Nottingham has done for the past 40 years. We made a point above of distinguishing between the short term and long term. Investors should consider where they are today in life relative to their investments. Has their situation materially changed? Is time on their side? Has their tolerance for risk changed? How will you feel if we fall -35% again? Each individual will likely have a unique answer. Maybe some changes in one's asset mix are warranted (if so, please call us to discuss!).

If one takes a longer term view – maybe one has 15 or 25 years until retirement, the questions one should be asking are different. Am I saving enough? Do I have enough equity exposure or am I too conservative? Time is a great diversification tool and an excellent way to mitigate risk. Less concern should be paid to the inevitable drawdown, whether it be -15%, -25% or -35%, for they will happen over time. The long-term view nearly always reinforces the notion of staying the course. As we pointed out above, conservative portfolios are being penalized by low interest rates. Yes, equities are generally expensive, but we believe they will handily outperform bonds over the coming decade plus. And stay diversified – just because international stocks trailed US markets over the past decade doesn't mean they will during the next decade.

The past few months have been troubling on a lot of levels for a lot of people. Our hearts go out to all those that experienced loss during the pandemic, and whose lives have been turned upside down. At the same time, we're heartened by the heroic actions of our healthcare professionals and scientific community that battle this virus every day and are working 24/7 to find a vaccine. Sadly, the media has been less focused on everyday heroes and more centered on bad news and misinformation. Data can be malicious in the wrong hands. As we suggested back in our April letter, try and stay sane and supportive of others through these challenging times. And feel free to reach out to us any time, our team is standing by.

P.S. We usually like to begin these missives with a relevant quote. Editorial challenges prevented us from adding one to the first page, so we'll end with a recent gem from the always informative Grant's Interest Rate Observer:

"Low interest rates are notorious mischief makers. Seeking the returns unavailable at the bank or in government debt or even in conventional 60/40 investment portfolios, savers become investors, investors become speculators and millennials turn to day-trading."

Hoping for a safe and healthy summer,

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President/Chief Investment Officer
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