August 28, 2020

Dear client,

Re: **BFSG Conference Call September 2, 2020 at 6:00 P.M.**

The U.S. stock market[1] has come a long way from the March 23rd lows, but that doesn't mean that the stock market is out of the woods yet. The stock market's record recovery flies in the face of economic reality which raises the flag of a short-term equity correction. The strength of the stock market has been fueled by easy money from the Federal Reserve and the U.S. Government. Although we believe there is a big probability that there will be a market correction, cheap and easy money should keep the market afloat over the longer term.

However, as the U.S. Dollar declines and bond yields move up, the leadership of the market ought to change from tech stocks to cyclicals and industrials. Tech stocks tend to do well when the U.S. Dollar is strong, and inflation is low. However, the reverse is true when inflation is high, and the dollar is weak. Although inflation remains low at this juncture, Fed Chairman Jay Powell fired the first salvo in signaling to the market that the Federal Reserve will allow inflation to rise above the central banks' target. Before Powell's announcement, inflation expectations were already rising, sending the 10-year bond yield higher. Although the shift in stock leadership doesn't necessarily mean that the bull market will end, it does potentially mean that market volatility will be heightened.

Near-zero interest rates have allowed the valuation of growth stocks to rise to an unsustainable level. However, history has clearly demonstrated that valuation metrics often overshoot, and this is no different today. The NASDAQ[2] trades at a high 32 times 2020 earnings and trades at 27 times 2021 earnings. The only time this price-to-earnings has been higher was when the dot com bubble burst in 2000.

One question investors should ask is this: Can the stock market sustain its upward momentum? The outlook for stocks over the next 6 to 12 months is positive, but the near-term risks have risen due to high mega-cap valuations, rising inflation expectations, and the decline of the U.S. Dollar. In order for the stock market to move upward and sustain itself, the market will need more than the five tech stocks (Facebook, Apple, Amazon, Google, and Microsoft) to lead the way. In addition, there will need to be a shift from relying on cheap and easy money to solid economic earnings.

Cheap and easy money has fueled a housing boom in home resales and new construction. The prices of homes have been steadily creeping up and mortgages are easy to get and plentiful. Home inventories in most areas are at all-time lows with the exceptions of cities that have experienced explosive violence. Housing-related and timber stocks should continue to do well.

Lastly, the U.S. elections are entering the last stages of their campaigns, but there are many uncertain questions that need to be answered. Investors should be aware that the election could go either way and that there is no sure-fire way to predict the final outcome. In 2016, it was unlikely that President Trump would win the Presidency. However, late in the election night when the market realized that Donald Trump would win, the Dow futures dived 400 points. However, in the morning, when the U.S. stock market opened, the Dow Jones Industrial Average reversed course and closed up approximately 250 points. This proves that you have to hedge your investments for either outcome.

Please join us for our conference call via Zoom on **Wednesday, September 2nd, at 6:00 p.m.** If you have a laptop or desktop, please join us live. The https://bfsg.zoom.us/j/96725898805?pwd=aG5yQjhzZHhSdTRCZGYrb2MyMW4vQT09. For those who prefer listening by phone, the dial in instructions are as follows: **please dial: 1 (669) 900-9128. Once prompted, enter the access code: 96725898805, then # followed by another # button.** Please note there is ***not*** a participant ID.

We will have an informative and lively discussion so please join us. We will also have some special guests who I would like you to meet on the call.

All the best,

Steven Yamshon
Managing Principal

1. The S&P 500 is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
2. The NASDAQ Composite is a stock market index that is heavily weighted towards information technology companies.