Goldman Lancaster , Inc.
A Registered Investment Advisor

THE FOUNTAINHEAD(?)

HELPING BUSY PEOPLE MAKE SMART FINANCIAL DECISIONS

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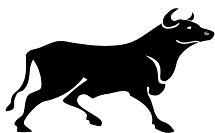
Second Quarter Summary

Summer 2020

It has certainly been a wild ride for the financial markets in 2020. Barely past the halfway point, the year has already brought the worst pandemic to hit the US in over 100 years, an unprecedented government-induced recession, stomach-churning market volatility and massive stimulus from policymakers totaling several trillion dollars - that's trillion with a "T". ($1,000,000,000,000 is an almost incomprehensible number.) Thankfully, the vertiginous price changes common a few weeks ago have ceased. The dizzying volatility began in late February with the fastest ever bear market decline. The S&P 500 fell 20% during the first quarter, one of the worst ever starts to a year. After the March 23 low, the record breaking continued as the S&P 500 staged its best 50-day rally since its inception. The strong snapback led to a big second quarter gain, the best for the index since the fourth quarter of 1998, and brought the S&P within striking distance of a positive year. But, the comeback was very concentrated and it wasn't great everywhere in the market. Through 6/30, just 121 of the stocks in the S&P 500 were positive on the year, with 153 down at least 25%, including 33 stocks down at least 50%. Growth stocks led the way, continuing their decade-long run of nearly uninterrupted dominance over value stocks. The US continued its multi-year trend of outperforming non-US equity markets. And consistent with historical patterns coming off major market lows, smaller cap stocks outperformed their larger cap counterparts during the quarter. In fixed income markets, interest rates on Treasuries continued their decline past unbelievably low levels. Rates are negative across the yield cure on Treasury Inflation Protected notes, with the 10-year hitting –0.89% in mid-July. Lower quality credit sectors also did well as the panic subsided because of the Federal Reserve's new policy of buying corporate and municipal credit. Consequently, credit spreads declined but still remain significantly above pre-crisis levels.

Over the last couple of months, stocks have been caught between positive and negative crosscurrents. On the positive side, markets have been supported by policy stimulus, hopes for improvement in economic conditions, optimism that a vaccine will be developed soon and a lack of appealing alternatives. On the negative side, there is a growing realization that the economy faces a long road to recovery. At this point, I'm concerned that much of the good news has already been baked into asset prices without proper consideration for potential bad stuff. The 2nd quarter earnings season kicks off this month and the outlook is particularly bleak. Current expectations are for earnings to decline in the 40-50% range from a year ago. At present, JP Morgan estimates the 12-month forward price/earnings ratio to be over 22. Even in a low interest rate environment, that's very high. Especially given the uncertainty regarding future earnings. Combine stratospheric valuations with uncertainty around a 2nd virus wave and the November elections and you have the textbook recipe for future market volatility. Caution is definitely required!

However, an environment without risk or uncertainty isn't a necessary condition for a positive stock market. (When have we ever had that?) What we need is to reach the "stop getting worse" point. In other words, markets tend to bottom and reverse direction, not in the absence of risk, but when risks stop accelerating. Seemingly, the investor consensus reached that conclusion a few months ago. So, it's not really surprising to see the stock market take off even though the global economy is mired in a deep recession.



2nd Quarter Summary

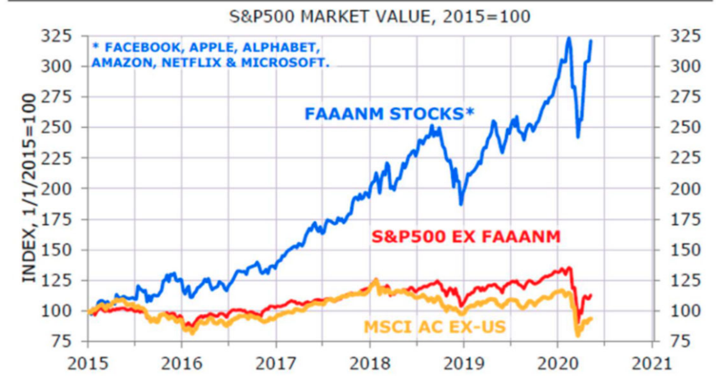
Total Return %

	3 month	12 month
S&P 500	+20.5	+7.5
Nasdaq Composite	+30.6	+25.6
Russell 2000	+25.4	-6.6
MSCI EAFE	+14.9	-5.1
MSCI Emerging Markets	+18.1	-3.4
Barclays U.S. Aggregate	+2.9	+8.7
Barclays High Yield	+10.2	+0.3

Treasury Bond Rates	6/30/20	6/28/19
2 year	0.16%	1.75%
10 year	0.66%	2.00%

Source: US Treasury, LPL Financial Research) Indices cannot be invested into directly. Past results are no guarantee of future performance

Not for the First Time, I Wonder if the Investor Class is Crazy?



A hot topic in the financial community the past few years is the performance disparity between the S&P 500 and that of the rest of the world. As you can see from the chart on the right, the difference has been almost entirely driven by the outsized performance of just a few stocks. An equity portfolio without exposure to these few companies has essentially gone nowhere the past 5 years. Over the past 6 years, the mega-cap FAAANM companies have doubled earnings while their stock prices have increased fivefold. They are all excellent companies with superior growth prospects. However, my fear is that investors are pricing all six for nearly continuous super-sized growth. History and logic tells us that is an unrealistic assumption. First, because of competitive pressures and organizational sclerosis, there are always limits to growth. (At least that's been the case historically.) Second, the underperforming assets often fall so much in price relative to the favorites, that the "growth" narrative reverts. In this case, that would be from the FAAANM stocks to the "old economy" like banking, manufacturing and commodities. I know it doesn't seem possible given the current market narrative, but if history is any indication, the question is not if it will happen, but when.

That's one of the crazy things: in the real world, things generally fluctuate between "pretty good" and "not so hot." But in the world of investing, perception often swings from "flawless" to "hopeless."
Howard Marks

"The history of the stock market is that it goes up a lot in the long run but falls often in the short run. The falls are painful, but the gains are amazing. Put up with one and you get the other. Yet a large portion of the investing industry is devoted to avoiding the falls. They forecast when the next 10% or 20% decline will come and sell in anticipation. They're wrong virtually every time. But they appeal to investors because asking people to just accept the temporary pain of losing 10% or 20% – maybe more once a decade – is unbearable."
Morgan Housel

We've had ample proof over the past few months of this an extremely trenchant observation from Howard Marks. The S&P 500 hits a peak on February 19th following a very big performance in 2019 based on optimism that we live permanently in a "goldilocks" world where nothing can go wrong. Literally overnight, the bottom drops out and the market narrative switches to doom, where even if we don't all die, the economy will take years to recover and be permanently damaged. And then, over a very short time, back to rainbows and unicorns again. I take that as confirmation of Morgan Housel's statement that, in terms of our financial health, short-term stock market movements are irrelevant and should be ignored. In reality, especially if viewed through the prism of an adult understanding, what really happened recently was that, because of a random exogenous event, we went from "pretty good" to "not so hot". Economic theory tells us that stock prices are determined by what investors are willing to pay for a long-term stream of earnings. So, unless you believe that we have been permanently crippled by this disease, what really has happened is that we have lost a big chunk of near-term earnings, but could very well be back on track soon. In other words, back to a "pretty good" scenario. Maybe when the market narrative periodically turns to "hopeless", we should ignore it?

I Actually Read it Somewhere

UCI July Newsletter

"Nudists wear just one item in COVID times. At some clothing-optional resorts, masks aren't optional, presenting issues with tan lines and logistics. At one camp, a 'Red, White & Nude Parade' of decorated golf carts is still set for July 4, but a naked skeet shooting event was canceled because participants stand shoulder to shoulder. Nude shuffleboard is still OK, but a monitor sanitizes the discs between pushes."

T. B. Macaulay

"We cannot absolutely prove that those are in error who tell us that society has reached a turning point, that we have seen our best days. But so said all who came before us, and with just as much apparent reason. On what principle is it that, when we see nothing but improvement behind us, we are to expect nothing but deterioration before us?''

Jonathan Safran Foer

"If you care about the working poor, racial justice, and climate change, you have to stop eating animals"

Deirdre Nansen McCloskey

"But you should know that the very words Socialism and Capitalism are deeply misleading. They were both of them coinages by the enemies of liberty. Capitalism should be called rather "innovism," which is what it also is, the system of liberated innovation that has made the poor so much better off. To call it "capitalism" is to fall in with the historically and economically erroneous notion that sheer accumulation is what did it. No. Innovation, new ideas from window screens to inoculations, did it. … Socialism" by contrast sounds sweet and collaborative. Socialism after all is literally and admittedly the use of the government's monopoly of physical coercion to force people to do what they would not otherwise choose to do. It's coercion in the economy."

Brian Wesbury on student loans

"What both sides are missing is that student loans have become a jobs and wage subsidy program for college professors and administrators. They, not the students, are the primary beneficiaries. The government is using young adults to deliver money to the intellectual class, much of whom is utterly lacking in marketable skills, and deeply hostile toward Western Civilization in general (and free-market capitalism in particular)."

Things That Probably Only Brad Cares About

I've been on this planet for a long time and, through a combination of timing and general good fortune, have experienced no traumatic lifestyle disrupting natural disasters. At least, until now. Since I'm an optimist who's always worried, it's been a niggling fear in the back of my mind for years. I was born in the 50s, so it's hard not to worry about things like a major quake, a "Red Dawn" style communist invasion or a nuclear holocaust. To that I guess we can now add climate change, which might be yet another looming cataclysm. Interestingly, until this year, the potential for a global pandemic has been almost completely discounted outside of a small circle of scientists and science fiction writers. (Station Eleven, The Stand, The Passage, I Am Legend, etc.) It's ironic, because given the loss of habitat and tendency for people in the developing world to eat bats and other bush game, the potential for a zoonotic disease disaster seems obvious in retrospect. This "covid" thing has certainly impacted me and almost everyone else. (I should have been worried about this years ago! I've read all of the above books.) As Maureen says, "For the first time in his life, the cards aren't coming up Brad's way." While the sentiment is undoubtedly a little snarky, it's hard to argue that this hasn't been my year. Aside from the stomach churning volatility in the financial markets, ski resorts, beaches and golf courses were all closed for a big chunk of the year. It didn't even feel safe to retreat to our "high altitude office" in Mammoth for a little solitary mountain biking or hiking because of worries about getting deathly sick in a tiny town with only 4 ICU beds. While the initial response from our health bureaucrats was grossly inadequate and bordered on malfeasance, I don't argue that the mid-March closures were an overreaction. In situations when we know little other than that the final outcome might be truly horrible, following the game theory strategy of minimizing the possibility of the very worst outcome seems the wisest course. (I say this even after Mammoth got more than 10 feet of fresh powder immediately following the closure!) But, we're more knowledgeable now. Assuming an exaggerated R0 (reproduction #) of 2.5 and calling it "science" when we now know how to minimize exposure (avoid super-spreader events, wear masks & social distance) grossly exaggerates the risks of transmission. Hopefully going forward, the bureaucrats will treat us like intelligent self-aware adults capable of assessing risk and reward

I love California. I know the taxes are too high and the politics too wacky. But, it's a beautiful place and the weather is fantastic. Below, views from Rolling Hills and the Mammoth Rock Trail. As Tupac said "West Coast 'til I die!"

Business Philosophy

Our objective is to make working with us a pleasant as well as rewarding experience

- We take our responsibilities seriously
- We return calls promptly
- We're nice when someone does call
- We don't lie or mislead
- We do what we say we're going to do.
- We're knowledgeable and current in our discipline
- We admit (infrequent) mistakes and do our best to right the wrong
- We listen to suggestions and take them seriously
- We work in your best interest in the most straightforward and transparent way possible

Enclosed please find our newest regulatory document, SEC form CRS (Customer Relationship Summary). According to the Securities Exchange Commission, the relationship summary is designed to assist retail investors with the process of deciding whether to (i) establish an investment advisory or brokerage relationship, (ii) engage a particular firm or financial professional, or (iii) terminate or switch a relationship or specific service. We're also including our current Privacy Policy statement. Please call us if you have any questions regarding either. Please notify me in writing if you would like a hard copy of our full ADV part 2A brochure or if there are any changes to your financial situation or investment objectives

Thank You ! !

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Kim Rouse

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