SECOND QUARTER | 2020

Straight Talk

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FMA ADVISORY INC
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Now is the summer of our discontent

Many years from now, we will look back at 2020 with the proper perspective. We will understand – in the fullness of time – just how monumentally the world is changing beneath our feet. That wisdom, unfortunately, will be hard won. 2020 is a year that will live in infamy.

As we move into the second half of the year, we are struck by the remarkable change in tenor. The cautious optimism we espoused at the end of 2019 was broadly shared among investors and market pundits. Although we noted concern about equity valuations and voluminous corporate debt, we still saw opportunities ahead, particularly in the context of an election year. Sadly, those notions now seem quaint - the faded memories of a time long past.

COVID-19 has promulgated tectonic shifts in the bedrock of our society and the structure of the global economy. Fragile companies and entire industries are confronting the reality of newfound irrelevance, or worse yet, outright extinction. The magnitude of the changes are not yet fully appreciated, and a casual observer would be hard pressed to see evidence of dislocation judging by the massive retracement of stock indexes off their March lows. With all that we've been through, is it not surprising that the total return of the S&P 500 for the first half of 2020 was only modestly negative (-4.52%)?

Therein lies the conundrum: with job losses in the tens of millions, double digit unemployment, trillions upon trillions of new federal and corporate debt, and domestic cases of the virus exceeding 3 million, the disconnect between the economy and the stock market has arguably never been more pronounced. Further, while the S&P 500 has long been recognized as the most representative index of large U.S. companies (~ 500 major corporations across 11 different sectors), even that indicator has become less relevant as five behemoths (Apple, Amazon, Microsoft, Facebook and Google) have now grown so much as to dominate the entire complex. Taken together, they represent 22% of the overall index, and their recent outperformance has pushed the benchmark higher despite more than 400 of the constituent firms being flat to negative on the year.

Quarterly Market Summary

Index Returns

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
2Q 2020	STOCKS				BONDS	
	22.03%	15.34%	18.08%	11.17%	2.90%	1.76%
Since Jan. 2001						
Avg. Quarterly Return	2.1%	1.4%	2.7%	2.3%	1.2%	1.1%
Best Quarter	22.0%	25.9%	34.7%	32.3%	4.6%	4.6%
	2020 Q2	2009 Q2	2009 Q2	2009 Q3	2001 Q3	2008 Q4
Worst Quarter	-22.8%	-23.3%	-27.6%	-36.1%	-3.0%	-2.7%
	2008 Q4	2020 Q1	2008 Q4	2008 Q4	2016 Q4	2015 Q2

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]). Bloomberg Barclays data provided by Bloomberg.

Mega cap technology firms are benefitting from both their incumbency and the acceleration of pre-existing trends that C-19 has exacerbated. Investors covet them for their ability to predictably grow earnings, even in a post-covid world. Not surprisingly, companies with such exceptional growth prospects are generally disinclined to be generous with dividend payments to shareholders. While we expect such firms to continue to perform well, we are reluctant to buy their stock when shares are trading at extremely high valuations. Amazon, for example, is trading at 175x corporate earnings for the trailing twelve months, and 80x expected earnings for the next twelve months. That's rich.

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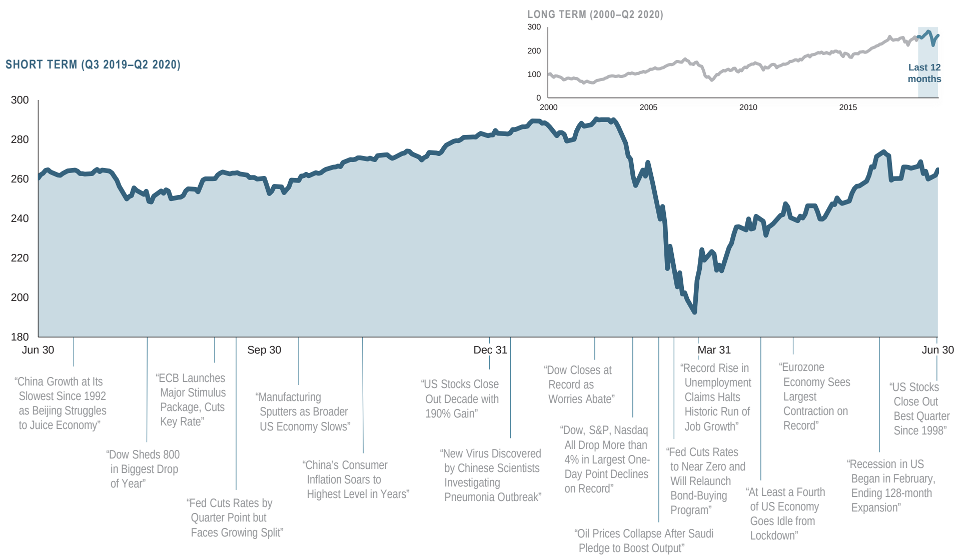
World Stock Market Performance

MSCI All Country World Index with selected headlines from past 12 months



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Graph Source: MSCI ACWI Index [net div.]. MSCI data © MSCI 2020, all rights reserved.
It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. **Past performance is not a guarantee of future results.**

Conversely, at the other end of the spectrum, small businesses (think Main Street and local firms) are under extreme pressure. Many will fail, because it doesn't look like American consumers are going to spend as much on many activities, especially social ones, in the future. The July 8th issue of Barron's quotes a recent study by American Express which suggests that more than 60% of small businesses will have to close by year end if demand doesn't bounce back to pre-covid levels. "Devastating" doesn't even begin to describe the potential ramifications if this proves to be true.

As investors, we have always favored companies with strong balance sheets, especially those with sufficient free cash flow to pay dividends consistently. While the validity of reported corporate profits can be debated, there's no ambiguity with cash on the barrel. Profits may be a matter of opinion, but dividends are fact. They are spendable and serve a vital purpose in creating the necessary income stream to fund clients' retirement. And with the passage of time, they are more important than ever. Consider:

For decades upon decades, the strategy to generate retirement income was simple: generate enough income buying U.S. Treasuries and highly rated corporate bonds to live off the interest. While this process was effective during the long era of robust U.S. Treasury yields, times have changed – dramatically. Interest rates have steadily declined over the past several years. This year, amidst the onset of the global pandemic, the Federal Reserve cut its benchmark interest rate to as close to zero as possible. Although the Fed had previously decreased its Fed Funds rate to the lower bound in the financial crisis of 2008, this year saw an unprecedented drop in the long end of the curve as the yield on the 10-year Treasury note fell to an all-time low. To top it all off, the Federal Reserve announced in early June that rates were likely to remain this low through 2022. The combination of low rates, compressed spreads, and heightened volatility have left many investors wondering, "What now?"

This is where FMA's core belief regarding the primacy of income generation is key. It's not merely a concern of retirees. Regardless of age or risk aversion preferences, we have always felt that income generation should be a top consideration when assembling portfolios. As we survey today's suppressed-rate marketplace, we are reluctant to stretch for yield when doing so would require taking on additional credit risk with lower rated bonds or longer-term maturities. Not surprisingly, dividend-paying stocks assume even greater importance to investors.

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Dividend-paying stocks may not have the same allure or conversational appeal as trendy growth companies, but upon deeper inspection their intrinsic value is apparent. Ordinarily, it is expected that attractive returns come at the price of increased risk. With high dividend stocks, we see a different trend. Past performance is not an indication of future performance, but stocks with high dividend yields have historically offered better risk attributes than stocks with no dividend. Two of these risk attributes, inherent downside protection in declining markets, and lower volatility overall, are specifically appealing given the current circumstances.

According to a study conducted by Deutsche Bank Group, high dividend stocks have held up better than the broader market during downturns. Since 1927, during months when the S&P 500 Index has declined, high dividend stocks declined by almost 19% less than the broader market. Without a COVID-19 vaccine clearly in sight and amidst a consistent daily uptick in cases, we do not view the tremendous equity returns we saw in Q2 as sustainable. Until volatility simmers, the possibility of another market downturn cannot be ignored.

We're living in a period of tremendous uncertainty, but we're confident that the fundamentals of investing are still important. Even though the dividend paying stocks we favor are not presently keeping pace with their mega cap technology counterparts, we are still finding quality companies across a broad range of sectors and industries. Market volatility affords us opportunities to acquire them at relatively attractive prices. We find inspiration in unearthing companies with strong, consistent dividends, talented management teams, and the enhanced resiliency to economic cycles that those attributes bring. Creating an efficient blend of dividend-paying stocks is a key component of what we do, and it provides a measure of protection to our clients that they find increasingly valuable.

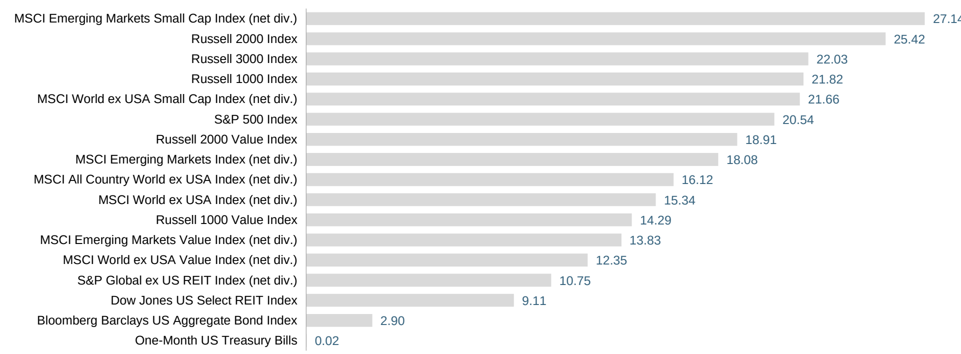
World Asset Classes

Second Quarter 2020 Index Returns (%)

Equity markets around the globe posted positive returns in the second quarter. Looking at broad market indices, US equities outperformed non-US developed markets and emerging markets.

Value stocks underperformed growth stocks, and small caps outperformed large caps.

REIT indices underperformed equity market indices in both the US and non-US developed markets.



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US Stocks

Second Quarter 2020 Index Returns

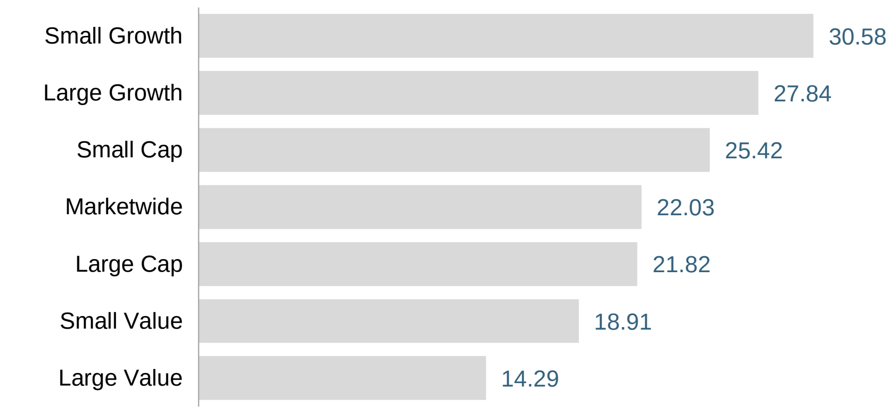
The US equity market posted positive returns for the quarter, outperforming non-US developed markets and emerging markets.

Value underperformed growth in the US across large and small cap stocks.

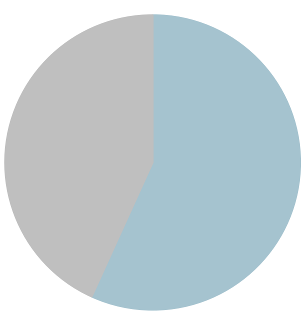
Small caps outperformed large caps in the US.

REIT indices underperformed equity market indices.

Ranked Returns (%)



World Market Capitalization—US



57%
US Market
$30.5 trillion

Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Large Growth	9.81	23.28	18.99	15.89	17.23
Large Cap	-2.81	7.48	10.64	10.47	13.97
Small Growth	-3.06	3.48	7.86	6.86	12.92
Marketwide	-3.48	6.53	10.04	10.03	13.72
Small Cap	-12.98	-6.63	2.01	4.29	10.50
Large Value	-16.26	-8.84	1.82	4.64	10.41
Small Value	-23.50	-17.48	-4.35	1.26	7.82

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Market segment (index representation) as follows: Marketwide (Russell 3000 Index), Large Cap (Russell 1000 Index), Large Cap Value (Russell 1000 Value Index), Large Cap Growth (Russell 1000 Growth Index), Small Cap (Russell 2000 Index), Small Cap Value (Russell 2000 Value Index), and Small Cap Growth (Russell 2000 Growth Index). World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. Russell 3000 Index is used as the proxy for the US market. Dow Jones US Select REIT Index used as proxy for the US REIT market. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes.

International Developed Stocks

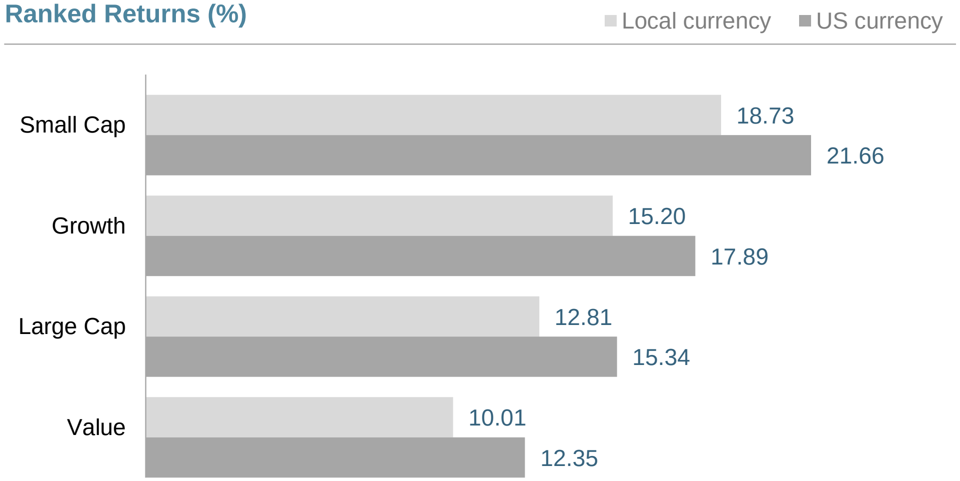
Second Quarter 2020 Index Returns

Developed markets outside the US underperformed both the US equity market and emerging markets equities for the quarter.

Small caps outperformed large caps in non-US developed markets.

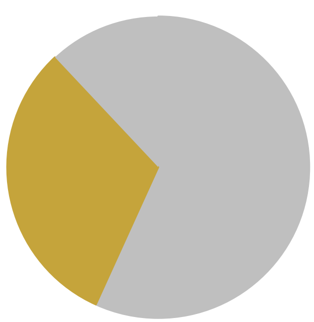
Value underperformed growth across large and small cap stocks.

Ranked Returns (%)



World Market Capitalization—International Developed

31%
International Developed Market
$16.7 trillion



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Growth	-3.11	4.25	5.93	5.29	7.36
Large Cap	-11.49	-5.42	0.84	2.01	5.43
Small Cap	-12.87	-3.20	0.53	3.56	7.26
Value	-19.96	-15.14	-4.42	-1.46	3.36

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Emerging Markets Stocks

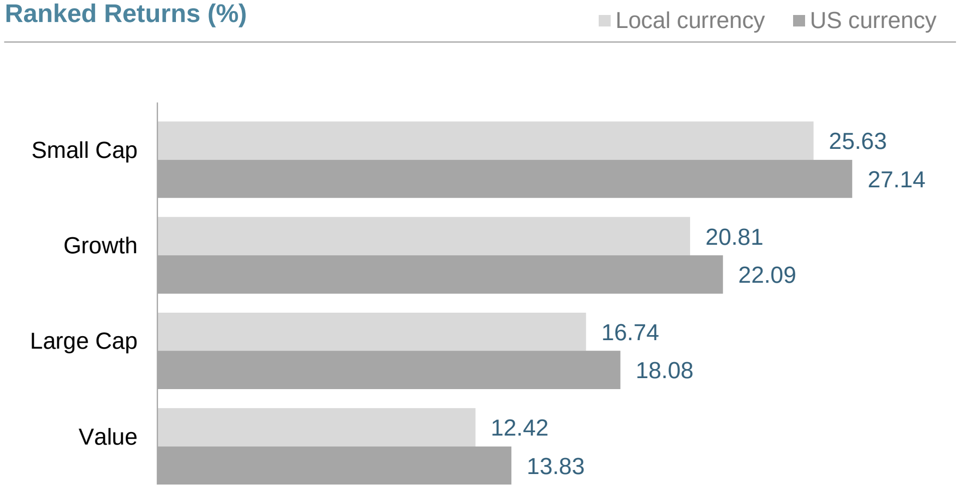
Second Quarter 2020 Index Returns

Emerging markets underperformed the US equity market but outperformed developed ex US equities for the quarter.

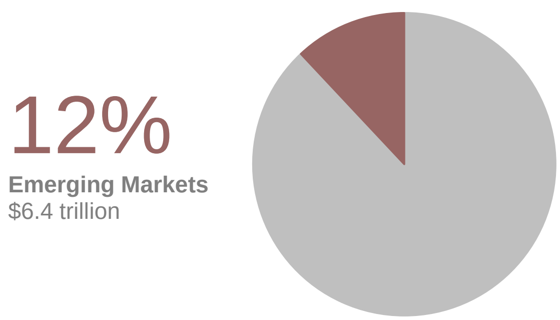
Value stocks underperformed growth stocks.

Small caps outperformed large caps.

Ranked Returns (%)



World Market Capitalization—Emerging Markets



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Growth	-1.52	9.67	6.19	6.35	5.76
Large Cap	-9.78	-3.39	1.90	2.86	3.27
Small Cap	-12.74	-8.82	-2.95	-1.38	1.78
Value	-18.05	-15.74	-2.64	-0.80	0.66

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Market segment (index representation) as follows: Large Cap (MSCI Emerging Markets Index), Small Cap (MSCI Emerging Markets Small Cap Index), Value (MSCI Emerging Markets Value Index), and Growth (MSCI Emerging Markets Growth Index). All index returns are net of withholding tax on dividends. World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. MSCI Emerging Markets IMI Index used as the proxy for the emerging market portion of the market.

Fixed Income

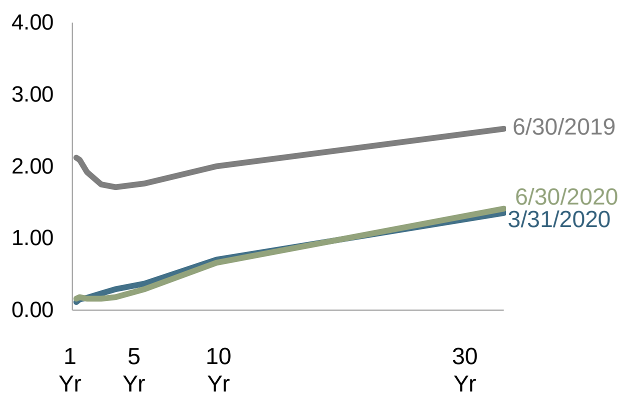
Second Quarter 2020 Index Returns

Interest rate changes were mixed in the US Treasury fixed income market in the second quarter. The yield on the 5-Year US Treasury Note decreased by 8 basis points (bps), ending at 0.29%. The yield on the 10-year note decreased by 4 bps to 0.66%. The 30-Year US Treasury Bond yield increased by 6 bps to 1.41%.

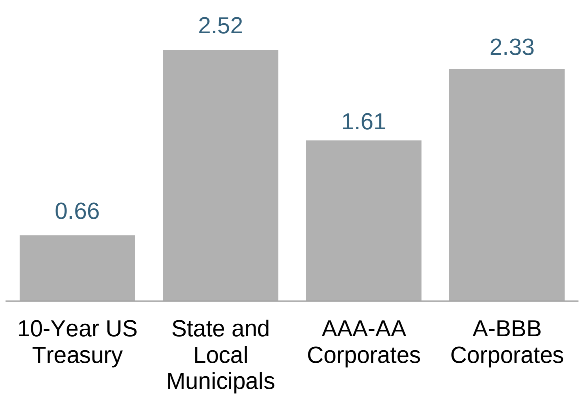
On the short end of the curve, the 1-Month T-bill yield rose by 8 bps to 0.13%, while the 1-year T-bill yield fell by 1 bp to 0.16%. The 2-year note finished at 0.16% after a yield decrease of 7 bps.

In terms of total returns, short-term corporate bonds returned 5.59% for the quarter. Intermediate corporates returned 7.63%. The total return for short-term municipal bonds was 2.38%, while intermediate-term muni bonds returned 3.19%. General obligation bonds outperformed revenue bonds.

US Treasury Yield Curve (%)



Bond Yield across Issuers (%)



Period Returns (%)

*Annualized

Asset Class	QTR	YTD	1 Year	3 Years*	5 Years*	10 Years*
Bloomberg Barclays US High Yield Corporate Bond Index	10.18	-3.80	0.03	3.33	4.79	6.68
Bloomberg Barclays US TIPS Index	4.24	6.01	8.28	5.05	3.75	3.52
Bloomberg Barclays US Aggregate Bond Index	2.90	6.14	8.74	5.32	4.30	3.82
Bloomberg Barclays Municipal Bond Index	2.72	2.08	4.45	4.22	3.93	4.22
FTSE World Government Bond Index 1-5 Years	1.41	2.11	2.27	1.86	1.68	0.62
FTSE World Government Bond Index 1-5 Years (hedged to USD)	0.53	2.79	3.96	3.09	2.38	1.96
Bloomberg Barclays US Government Bond Index Long	0.28	20.97	25.14	11.96	9.21	7.71
ICE BofA US 3-Month Treasury Bill Index	0.02	0.60	1.63	1.77	1.19	0.64
ICE BofA 1-Year US Treasury Note Index	-0.03	1.69	2.86	2.25	1.54	0.95

One basis point (bps) equals 0.01%. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.** Yield curve data from Federal Reserve. State and local bonds are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the ICE BofA Corporates, BBB-A rated. Bloomberg Barclays data provided by Bloomberg. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).

StraightTalk

Tailored Solutions.℠

Looking through the windshield

As we move into the second half of the year, we see powerful and conflicting forces buffeting the economy. The massive stimulus and improving liquidity conditions of the last quarter will be tested by a stubbornly persistent virus and the associated demand destruction as consumers sharply adjust their spending behaviors. The Federal Funds rate will remain at or near the zero bound, and long rates will remain low as inflation continues to be subdued. Not surprisingly, large companies have been taking advantage of low-cost funding to deal with the significant cash flow shortfalls due to the pandemic. Smaller companies, which cannot issue debt on such favorable terms or access the capital markets as efficiently as large companies, will be dependent on additional rounds of fiscal and monetary stimulus. Finally, we expect the dollar to weaken relative to other currencies as negative real interest rates persist and the horrible optics of what is sure to be an ugly election cycle weigh on global investors' perceptions of American leadership.

Risks for the remainder of 2020

The most obvious risk for the second half of 2020 is a second wave of Covid-19 and another mandated shutdown. Unfortunately, our domestic response has been less than coherent and the initial wave may not recede sufficiently enough to discern where the first wave ends and the second begins. This could lead to a deeper and longer recession than anticipated.

Another prime concern is the direction and durability of corporate profits. Even before the crisis, the growth rate of corporate profits had been decelerating for six years. Post-pandemic, we expect that capacity constraints, demand destruction and supply chain disruptions will exacerbate an already deteriorating situation. The additional debt some companies have issued may further sap their vitality.

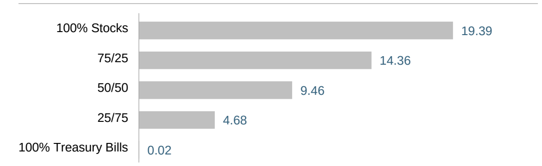
If policy makers in Washington misread the stock market rally and fail to deliver additional stimulus, that excessive caution could spell doom for small and very small companies. U.S. – China tensions could escalate further and jeopardize the trade deal, and the election results could also put downward pressure on equity prices. As of this writing, investors seem to be viewing a Biden win as modest positive for markets… but only if the Senate remains in Republican hands. A Biden win coupled with a change of control in the upper house would spell trouble for Wall Street. In that scenario stocks are likely to sell off, the prospect of which compels our attention.

Impact of Diversification

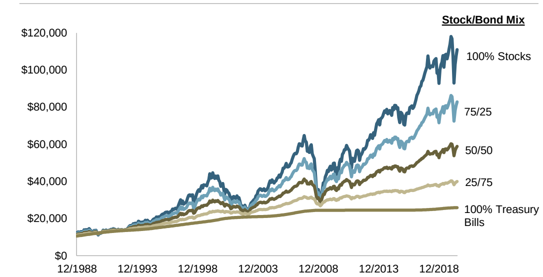
Second Quarter 2020

These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but have higher expected returns over time.

Ranked Returns (%)



Growth of Wealth: The Relationship between Risk and Return



Period Returns (%) ** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*	10-Year STDEV[1]
100% Treasury Bills	0.39	1.35	1.62	1.07	0.55	0.23
25/75	-0.86	2.10	3.12	2.73	2.97	3.49
50/50	-2.34	2.57	4.48	4.29	5.31	7.00
75/25	-4.05	2.75	5.67	5.72	7.57	10.51
100% Stocks	-5.99	2.64	6.70	7.03	9.74	14.02

1. STDEV (standard deviation) is a measure of the variation or dispersion of a set of data points. Standard deviations are often used to quantify the historical return volatility of a security or portfolio.
Diversification does not eliminate the risk of market loss. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio.** Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals.

Wrapping up

If the American economy is able to continue reopening, even gradually, that will enable firms to retain the workers they have recently hired back. We're in a race against time to get folks gainfully employed and productive once again. If we're successful, then stocks should avoid falling back near their March lows. The tremendous policy response thus far has taken much of that risk off the table and the markets have rebounded sharply. It's vital that we get the next phase right, however, to tide us over until effective treatments and a vaccine are eventually found.

As always, we value the confidence you have placed in us as your trusted advisor. We remain focused on the markets and dedicated to serving you. Our resources in the area of planning and financial modeling have never been stronger, and we would welcome the chance to meet with you to refresh our understanding of your current status and demonstrate our advanced capabilities.

Very best,

Your team at FMA Advisory, Inc.

Our Client Portal Offers Secure Account Access to Your Billing Statement

We remain committed to providing an exceptional level of service to our clients. Our secure online portal enables clients to quickly access their account information. Eliminating mailed account statements allows you to get your account information more quickly, reduces the need for filing paper copies and also helps the environment by eliminating waste.

As always, please feel free to contact us to set up an appointment to review your investment and financial plans.

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