



SIERRA INVESTMENT  
PARTNERS, INC.®

# NEWSLETTER

*24 Years of Excellence 1996-2020*

**2Q20**

## MARKET REVIEW

The second quarter of 2020 saw a broad rally in risk assets following a period in March/early April that was one of the most volatile in financial history. Uncertainty surrounding the COVID-19 pandemic resulted in historic daily moves across markets that were eventually quelled by as nearly a historic response out of the Federal Reserve and the U.S. government to universally support financial markets and Main Street America. Government-declared lockdowns and behavioral changes rapidly led to recession in 1Q20, though the primary impact was felt in 2Q20; estimated GDP decline: -35%. However, multiple pronouncements of market supportive programs and repeated rounds of fiscal stimulus quickly eased financial conditions, allowed new issue markets to reopen and boosted all risk assets. Interest rates traded range bound around record lows, leading housing to rebound. On the other hand, credit spreads continue to be historically wide and investors have shown little appetite for distressed situations.

## DOMESTIC EQUITY

Our **Large Cap Intrinsic Value Equity** strategy dramatically outperformed the Russell 1000 Value index by nearly 10% during the second quarter of 2020, as lockdowns were lifted and economic activity began to recover following the fastest and one of the deepest recessions on record. Growth stocks have reached significant extremes compared to Value stocks. We believe the extraordinary actions being taken by the government to keep the base of the economy intact, coupled with more significant stimulus programs to recover from the Covid-19 induced recession, are indicative that a durable economic expansion is beginning. The last five recoveries lasted an average of eight years. Our Intrinsic Value portfolio is positioned for the recovery to come.

For the second quarter of 2020, our **U.S. Concentrated Growth** strategy (composite) returned 23.80%, while the Russell 1000 Growth Index returned 27.84%. The benchmark's performance represented its highest quarterly return on record. Year-to-date through June 30, 2020, the Strategy returned 3.77%, while the Russell 1000 Growth Index has returned 9.81% as a few highly priced stocks fuel the index. Since Inception (Jan. 1, 1994), our U.S. Concentrated Growth Strategy has

outperformed, compounding at 11.97% compared to the 10.03% of the Russell 1000 Growth index.

The high-quality nature of our holdings combined with defensive positioning that helped last quarter, held back relative performance for our **Small Cap Value Equity** portfolio this period. Our Small Cap Value Equity Portfolio trailed the benchmark Russell 2000 Value with a gross return of 13.26% versus 18.91% for the benchmark. For the year-to-date, our Portfolio returned -18.12% gross of fees versus the benchmark Russell 2000 Value return of -23.50%. Since inception (Mar. 1, 2005), our Small Cap Value Portfolio has outperformed, with a gross annual return of 6.98% versus 5.05% for the Russell 2000 Value.

## INTERNATIONAL EQUITY

In **Global and Non-U.S. Value Equity**, our portfolios generated high absolute returns over the quarter, but lagged their benchmarks. The absolute volatility of our returns has been significantly lower than markets year-to-date, which is consistent with our cautious positioning. We do not believe the recent exuberance in markets is sustainable. In our opinion, share prices have decoupled from fundamentals and some areas of the market are in a bubble that will inevitably deflate over time ... or burst. Broadly speaking, this was also our view pre-virus. When the Federal Reserve cut interest rates last year at the merest hint of an economic slowdown, we believe it heralded a new phase in markets in which getting "on trend" overwhelmed all other considerations.

In **International and Global Plus Equity**, overall global equity markets, as measured by the MSCI World Index, soared in the second quarter, advancing almost 20% in U.S. dollar terms. Some markets even managed to rally back to January levels. During the quarter, the United States and Europe led markets higher, with Japan and the United Kingdom lagging a bit. On a sector basis, the Consumer Discretionary and Information Technology sectors were strong, while defensive sectors such as Utilities, Real Estate and Consumer Staples did not keep pace. Those areas of the market that have seen their businesses thrive during the pandemic, such as e-commerce, online payments and automation, were

particularly strong, while travel and leisure names were mostly left out of the recovery bounce. For the second quarter of 2020, our EAFE Plus Equity portfolios (composite) returned 31.81%, outperforming the MSCI EAFE Index return of 15.08% and the 17.10% return of the MSCI EAFE Growth Index. Year to date, our EAFE Plus Equity portfolios (composite) returned +5.07%, compared to the -11.07% of the MSCI EAFE Index and the -3.29% MSCI EAFE Growth Index.

## FIXED INCOME

In the **Fixed Income** market arena, the fear of the unknown that caused financial market participants to avoid risk has essentially been subdued by the Federal Reserve. Massive fiscal and monetary support created a strong appetite for public and private issuance. With Treasury issuance at a record pace, it was no surprise that government bonds underperformed in the second quarter. As the Federal Reserve pinned down short-term interest rates at 0.00% to 0.25%, Treasury rates inside of ten years were slightly lower while longer 30-year rates rose 9 basis points (0.09%) to 1.41%. Two-year notes declined 10 basis points (bps) to 0.15% while ten-year notes slid only 1 bps lower to 0.66%, modestly steepening the U.S. Treasury yield curve (two-year versus ten-year). After being inverted by as much as 21 basis points in the fourth quarter of 2019, the curve ended last quarter positively sloped at 51 bps. That was modestly steeper than 42 bps at the end of the previous quarter.

Our **High Yield** strategy underperformed in 2Q20 due to sector allocation. The portfolio returned +8.94% on a gross basis or -124bps to the benchmark Bloomberg Barclays U.S. Corporate High Yield Index return of +10.18%. Aggressive downgrade actions by rating agencies led to a wave of Fallen Angels which had a particularly large impact on Independent Energy. The addition of these names combined with rapid appreciation and a prior underweight resulted in -107bps of allocation. An overweight to Midstream partially offset the Independent Energy allocation, and multiple overweighted positions in Independent Energy and Midstream provided positive security selection. The severe fundamental effects caused by COVID-19 resulted in an auto rental holding declaring bankruptcy and notable negative security selection. Investors' lack of

interest in distressed issuers allowed the strategy's higher quality bent to once again lift performance as CCC-rated securities trailed in 2Q20.

## EMERGING MARKETS

Signs that the Covid-19 virus had been brought under control in Asia allowed the resumption of economic activity, most notably in China. When combined with ultra-loose monetary stimulus this triggered the sharpest rally in emerging market equities for over a decade. We remain focused on companies with resilient business models and strong balance sheets, and are concerned that market valuations may have run ahead of the economic fundamentals in the short term.

## THANK YOU

We would like to extend our gratitude to the **Cement Masons Annuity Trust Fund for Northern Nevada** for allocating a portion of its assets to Sierra's EAFE Plus Equity (International Equity) commingled fund, and the **UFCW Local 655 Food Employers Joint Pension Plan** for allocating a portion of its assets to Sierra's High Yield Fixed Income commingled fund.

Also, we would like to thank the **Carpenters Pension and Annuity Fund of Philadelphia and Vicinity** for additional contributions to Sierra's Concentrated Growth Equity product; the **International Union of Operating Engineers Eastern Pennsylvania and Delaware Pension Fund** for additional contributions to Sierra's Concentrated Growth Equity product; the **Northern California Glaziers Architectural, Metal and Glass Workers Pension Plan** for additional contributions to Sierra's Intrinsic Value Equity product; the **Northeast Carpenters Annuity Fund** for additional contributions to Sierra's Concentrated Growth Equity product; the **Operating Engineers Local #101 Pension Fund** for additional contributions to Sierra's Fixed Income product; the **Operating Engineers Local #139 Welfare Fund** for additional contributions to Sierra's Small Cap Value Equity product; the **Sacramento Area Electrical Workers Pension Trust Fund** for contributions to Sierra's Concentrated Growth Equity product; and the **San Diego Electrical Pension Trust** for additional contributions to Sierra's Small Cap Value Equity product. We at Sierra Investment Partners, Inc., value each of our clients and are grateful for the opportunity to manage a portion of your assets.

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Gross of fees performance is calculated after the deduction of trading costs, but before the deduction of management fees, custodial fees or other fees. Fee schedules are described in Part II of Sierra's Form ADV. Sierra client returns would be reduced by investment management fees. For example, a five-year gross annualized return of 20.10% would be reduced to 18.96% after the deduction of annualized fees of 1%. The information provided is historic in nature and should not be taken as any indication of future performance as future investments will be made under different economic conditions and may utilize different securities. The MSCI World Index is a free float-adjusted market capitalization weighted equity index comprised of securities in MSCI's developed market country-specific indexes. The secondary benchmark is the MSCI World Growth Index. The MSCI World Growth Index is a free float-adjusted market capitalization weighted equity index comprised of securities in MSCI's developed market country-specific indexes that have more growth-oriented investment style characteristics. The MSCI EAFE Index is an equity index calculated by MSCI. The index measures the total return (gross dividends are reinvested) of equity securities in the developed markets in Europe, Australasia and the Far East. Securities included in the index are weighted according to their Free Float adjusted market capitalization (Price x Shares outstanding x Foreign Inclusion Factor). The MSCI EAFE Growth is a free float-adjusted market capitalization weighted equity index comprised of securities in MSCI's developed market country-specific indexes, excluding the U.S. and Canada, that have more growth-oriented investment style characteristics. The MSCI All Country World Index is a free float-adjusted market capitalization weighted equity index comprised of securities in MSCI's developed and emerging market country-specific indexes. The MSCI All Country World ex-U.S. Index is free float-adjusted market capitalization weighted equity index comprised of securities in MSCI's developed and emerging market country-specific indexes, excluding the U.S. The MSCI World Index is a free float-adjusted market capitalization weighted equity index comprised of securities in MSCI's developed market country-specific indexes. The MSCI EAFE Value Index captures large and mid-cap securities exhibiting overall value style characteristics across Developed Markets countries around the world, excluding the U.S. and Canada. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. The Russell 2000 Value Index measures the performance of the small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell Indices are a trademark of the Frank Russell Company. Indices are unmanaged and are not available for direct investment. The Russell 1000 Growth Index measures the performance of the Russell 1000's growth segment, which is defined to include the firms whose share prices have higher price-to-book ratios and higher expected earnings growth rates. The Standard & Poor's 500 Index (S&P 500) is 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. The S&P 500 is a market value weighted index where each stock's weight is proportionate to its market value. The Russell 1000 Value Index is a widely recognized index of market activity based on the aggregate performance of common stocks from the Russell 1000 Index, with lower price-to-book ratios and lower forecasted growth values. The performance data was supplied by Frank Russell Trust Company. The Bloomberg Barclays U.S. Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. The Bloomberg Barclays Int. Govt/Credit Index is a market capitalization weighted index consisting of all U.S. dollar denominated public obligations of U.S. and foreign Governments, their agencies and instrumentalities and all corporate issuers of fixed rate, non-convertible, investment grade bonds having maturities of greater than one year and less than 10 years. The Bloomberg Barclays Govt/Credit Index is a market capitalization weighted index consisting of all U.S. dollar denominated public obligations of U.S. and foreign Governments, their agencies and instrumentalities and all corporate issuers of fixed rate, non-convertible, investment grade bonds having maturities of greater than one year. The Bloomberg Barclays Aggregate Bond Index is a market value-weighted index that tracks the daily price, coupon, pay-downs, and total return performance of fixed rate, publicly placed, dollar-denominated, and nonconvertible investment grade debt issues with at least \$250 million par amount outstanding and with at least one year to final maturity. The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries, including Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Russia, Qatar, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates. With 846 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. The indexes chosen to compare performance are not identical in structure to the composites and are provided to represent the investment environment existing during the time periods shown. Indexes are unmanaged, fully invested and do not include deduction of fees or expenses. This information is only an explanation of investment philosophy and historic performance and is not meant to be an investment recommendation. For a disclosure prepared in compliance with the Global Investment Performance Standards (GIPS®) and a list of composites and performance results, please call our corporate headquarters at (925) 941-6300. GIPS has not been involved with the preparation or review of this report. Past performance is no guarantee of future results.