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.