INVESTORS' SERVICE, INC.

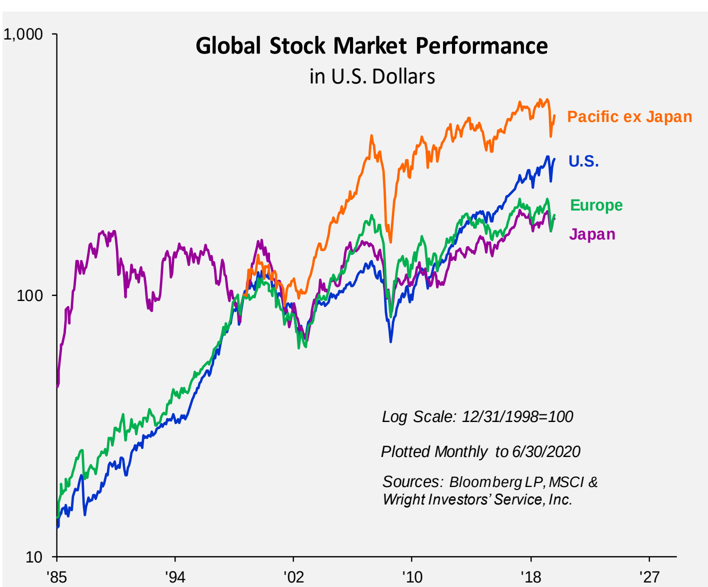
Quarterly Investment Report

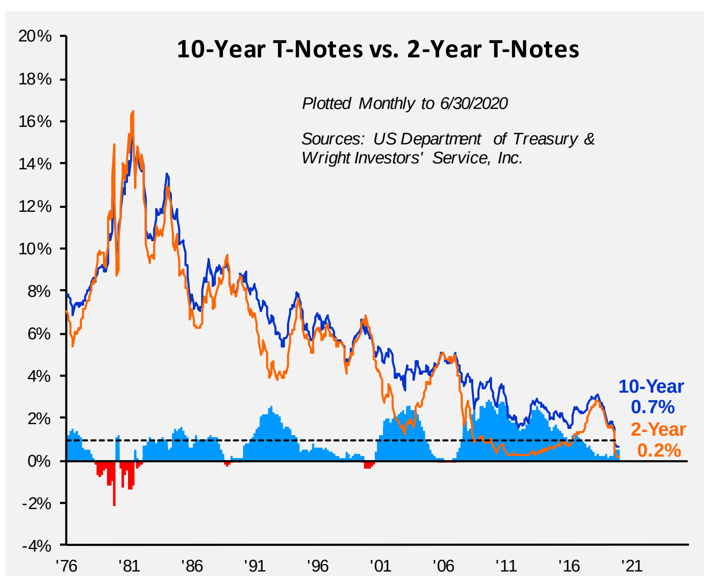
July 2020

***SUMMARY*: Stocks rebounded dramatically in the second quarter, recouping most of their losses from the previous quarter, as the U.S. and global economies began to reopen following a three-month lockdown. The initial rebound in U.S. consumer spending and job creation has been stronger than expected. While the strength in forward economic growth is dependent to some degree on containing the spread of COVID-19, the financial markets are supported by accommodative monetary policy, low interest rates, aggressive government stimulus, and Federal Reserve asset purchases, which act as a price support for investing in risk assets.**

U.S. stocks rebounded sharply in the second quarter, recording their best quarterly performance in more than 20 years. After posting some of the worst returns ever in the first quarter, stocks roared back in the second quarter, rising three straight months. Tech-heavy NASDAQ was by far the best performer, climbing 30.9% for the quarter to push it well into the green for the first half with a 12.7% return, one of the few major global indexes to post positive first-half returns. The S&P 500 returned 20.5% in the second quarter, its best performance since the fourth quarter of 1998, reducing its loss for the year to 3.1%. The Dow Jones Industrial Average gained 18.5%, its best three-month gain since 1987, although it is still down 8.4% year to date. The smaller cap indexes also did well but lagged the big caps. The S&P 400 MidCap index gained 24.1% in the second quarter to lower its year-to-date loss to 12.8%, while the S&P 600 SmallCap index gained 21.9% to raise its year-to-date return to minus 17.9%.

All 11 sectors in the S&P 500 ended in the green in the second quarter, with nine of them posting double-digit returns. Consumer discretionary stocks were the best performers, returning 32.9% to post their year-to-date return to 7.2%, one of only two sectors to be net positive for the year. The other is information technology, which is up 15.0% after adding another 30.5% in the second quarter. Beaten-down energy stocks also returned 30.5% in the quarter but are still down 35.3% for the first half as the price of crude oil rebounded by nearly 92% in the second quarter, although it remains down more than 35% for the year. Financial stocks are the next worst





performers, down 23.6% for the year, as rock-bottom interest rates and high loan-loss provisions due to the pandemic are weighing on profitability.

Foreign stocks also produced strong positive returns in the second quarter in dollar terms. Asian stocks outside Japan were the best performers, returning 20.2% although they remain down 13.0% for the year. Emerging markets were next best, returning 18.1% for the quarter to reduce their year-to-date loss to 9.8%. Chinese stocks continued to be among the best performers globally, gaining 15.3% for the quarter to push them into positive territory for the year by 3.5%. Euro zone stocks gained 17.7% in the second quarter but remain down 9.1% for the first half.

Bonds posted positive returns for the third consecutive month. In the U.S., the Bloomberg Barclays U.S. Aggregate returned 2.9% for the quarter to boost its first-half return to 6.1% as bond yields held fairly steady. The yield on the benchmark 10-year Treasury note, for example, ended the second quarter at 0.66%, just about where it closed the first quarter. But corporates and high-yield bonds were the standout performers in the second quarter, returning 8.2% and 10.2%, respectively. The sector got a big boost from the Federal Reserve, which began buying corporate bonds – including so-called "fallen angels" that have slipped below investment grade since March 22 – both individually in the secondary market and through exchange-traded funds. The Fed is also buying newly-issued bonds directly from corporate issuers. Corporate bonds have returned a positive 4.8% year-to-date while high-yield bonds are still in the red by 3.8%. The Fed's balance sheet, which includes U.S. government bonds, mortgage-backed securities and recently corporates, now totals more than $7 trillion, up over $3 trillion in just a little over four months. Bank loans also had a solid quarter, returning 9.7%, although they remain down 4.6% year-to-date. Outside the U.S., the Bloomberg Barclays Global Aggregate ex-U.S. returned 3.4% in the quarter, pushing it into positive territory for the year at 0.6%. Gold continued to find favor as a safe haven, rising 13.7% in second quarter to increase its first half gain to 18.2%.

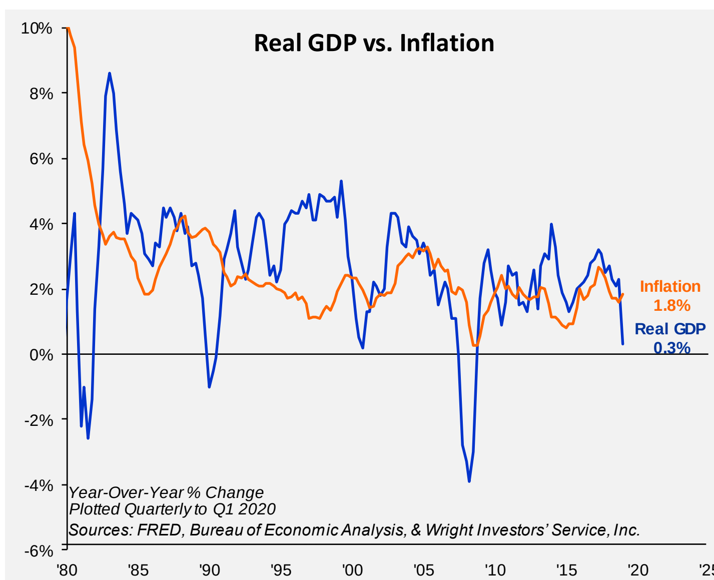
U.S. ECONOMY

Whether it will be a V-, U-, W- or even L-shaped recovery, the economic rebound from the coronavirus-induced shutdown has started off in zig-zag fashion, although the trend is clearly upward. To probably no one's surprise, the economy officially entered into a recession in February, ending the longest expansion in U.S. history after 128 months, according to the National Bureau of Economic Research. Likewise, the second and final revision of first quarter U.S. GDP showed the economy declining at a 5.0% annualized pace after growing at a 2.1% rate in the fourth quarter of last year. While projections for second quarter growth average a dismal drop of 34.7%, the outlook is much brighter for the third and fourth quarters, with the economy expected to grow at 24.4% and 9.0% annual rates, respectively, according to a consensus survey reported by Bloomberg.

Global Investment Returns In U.S. Dollars

	Q2 2020 Stocks	Q2 2020 Bonds	Trailing 12 Months Stocks	Trailing 12 Months Bonds
U.S.	**21.6%**	**2.9%**	**7.8%**	**8.7%**
Canada	20.2%	6.8%	-8.2%	3.1%
Mexico	11.0%	13.1%	-25.2%	2.8%
Japan	**11.6%**	**-0.5%**	**3.1%**	**-1.8%**
Pacific ex Japan	20.2%	5.3%	-12.7%	3.7%
Australia	28.9%	12.4%	-11.5%	2.4%
China	15.3%	-1.0%	13.1%	2.5%
Hong Kong	9.2%	N/A	-14.7%	N/A
Europe	**15.3%**	**4.8%**	**-6.8%**	**0.4%**
France	16.1%	6.3%	-10.3%	-2.2%
Germany	26.5%	2.5%	-2.6%	-0.3%
Italy	16.1%	6.8%	-11.4%	3.3%
Netherlands	24.8%	3.2%	8.9%	0.0%
Spain	10.3%	6.4%	-21.0%	N/A
Switzerland	10.9%	4.2%	5.9%	2.4%
U.K.	7.8%	3.5%	-17.7%	7.0%
World	**19.4%**	**3.3%**	**2.8%**	**4.2%**
World ex U.S.	15.3%	3.4%	-5.4%	0.7%

Sources: MSCI Stock & Bloomberg Barclays Bond Indexes as of 6/30/2020



In particular, government and private statistics show a strong snapback in the second quarter, especially among consumers, as more retail stores and restaurants reopened, indicating a great deal of pent-up demand after three months of lockdown. Retail sales jumped a record 17.7% in May after declining by an upwardly revised 14.7% the prior month, well ahead of projections. In fact, retail sales totaled $486 billion in May, which is off a relatively modest 7.7% from February's pre-pandemic figure. Likewise, consumer spending – a larger category – rose 8.2% after declining 12.6% in April despite a 4.2% drop in personal income, largely due to the end of one-time government stimulus payments. The Conference Board's consumer confidence index jumped more than 12 points in June to 98.1 while the University of Michigan's consumer sentiment index fell slightly to 78.1. "Consumers are less pessimistic about the short-term outlook, but do not foresee a significant pickup in economic activity," the Conference Board commented. "Faced with an uncertain and uneven path to recovery, and a potential COVID-19 resurgence, it's too soon to say that consumers have turned the corner and are ready to begin spending at pre-pandemic levels."

One of the most hopeful signs of a quick recovery has been the resurgent job market. Employers added 4.8 million jobs in June, about 60% more than the consensus forecast, after adding 2.7 million the prior month. That pushed the jobless rate down to 11.1% from 13.3%; while that's still a lot higher than the pre-pandemic 3.5% level, it's certainly good news. At the same time, the number of people filing new unemployment claims fell to 1.43 million in the last week of June, which is down from 1.8 million a month earlier.

Housing snapped back sharply in May. Sales of existing homes fell by nearly 10% to an annualized rate of 3.9 million, the third monthly decline in a row, largely due to seller and buyer reluctance for in-person home viewings. But pending home sales – an indicator of future closings – shot up 44% compared to the previous month's depressed level. Contract signings are still 5.1% below last year's level, but home prices have held firm, with the median price in May at $284,600, up 2.3% from a year earlier. "This bounce back also speaks to how the housing sector could lead the way for a broader economic recovery," said Lawrence Yun, the National Association of Realtors' chief economist. Sales of new homes also rebounded, climbing 16.6% to an annualized rate of 676,000, above expectations. Housing starts, a harbinger of future sales, rose 4.3% to an annual rate of 974,000 after falling to a five-year low of 934,000 in April, the first increase since January; building permits, another forward indicator, increased more than 14% to a 1.22 million annual pace. Not surprisingly, the National Association of Home Builders confidence index soared 21 points in June to 58.

The industrial sector also rebounded strongly. The Institute for Supply Management's manufacturing index jumped back into expansion territory for the first time since February, climbing nearly 10 points in June to 52.6 from 43.1 the prior month and well ahead of forecasts. The Conference Board's index of leading economic indicators rebounded by 2.8% in May after falling a downwardly revised 6.1% in April and 7.5% in March. Industrial production increased by 1.4% after falling 12.5% in April while durable goods orders jumped 15.8% after declining more than 18% the prior month. Core capital goods, a proxy for business investment, rose 2.3% following April's 6.5% drop. John Williams, the president of the New York Fed, said on July 1 that the recent economic data may "indicate that we've likely seen the low point of the downturn and that the overall economy has begun to recover."

INVESTMENT OUTLOOK

While the recent economic news is certainly heartening, we must remember that the pandemic is not over. Whether it's the "second wave" or – more likely – a rise in cases due to overly-eager reopenings in a few large states, the disease has likely yet to run its course. While some Fed officials have voiced optimism about the nascent economic rebound in recent weeks, they've also tried to tamp down overly optimistic future expectations. "The economic outlook remains highly uncertain and it's going to take considerable time to restore the economy to its full potential," the New York Fed's Williams said, adding that "the economy's fate is inextricably linked to the path of the virus." St. Louis Fed president James Bullard told the Financial Times that "we're still in the middle of the crisis here. Even though we got past the initial wave of the March-April timeframe the disease is still quite capable of surprising us." Indeed, the Fed is operating under the assumption that things are just as likely to go south as they are to improve. "In light of the significant uncertainty and downside risks associated with the pandemic, including how much the economy would weaken and how long it would take to recover, the [Fed] staff judged that a more pessimistic projection was no less plausible than the baseline forecast," the minutes of its June 10 meeting said. "In this scenario, a second wave of the coronavirus outbreak, with another round of strict limitations on social interactions and business operations, was assumed to begin later this year, leading to a decrease in real GDP, a jump in the unemployment rate, and renewed downward pressure on inflation next year."

Nevertheless, as we saw in the second quarter, that possibility doesn't necessarily portend a negative outlook for stocks. While some of the initial government and Fed response to the economic crisis – such as individual stimulus checks, extended and expanded unemployment benefits, loan forbearance and multiple credit programs to help businesses and institutions large and small – have already run their course, we believe more assistance will likely be coming if the rebound doesn't stick. Everyone from President Trump to Fed Chair Powell to congressional leaders has pretty much promised as much. "We are strongly committed to using our tools to do whatever we can and for as long as it takes to provide some relief and stability," Powell said following the Fed's June 10 meeting, adding: "We're not thinking about raising rates. We're not even thinking about thinking about raising rates." While the success of each of the programs will vary, they have indeed provided support for risk asset prices. Of course, let's not forget that expected corporate earnings also play a large part in determining stock prices and their direction. No doubt many investors have basically written off the second quarter, when the virus hit with full force, but many industries – such as infotech, consumer staples and health care, to some degree – have actually prospered in this environment and are driving the market forward. The third and fourth quarters will be a bigger test. But the only sure way to get back to where we were economically is for the effects of the virus to finally come to an end, which will likely require a vaccine or at least an effective treatment. We continue to believe that a well-diversified portfolio of high-quality stocks, bonds and funds, with an emphasis on the long-term, is the best path forward to achieve investors' investment objectives with an acceptable level of risk.

The U.S. Economy 2018–2021

		% Change In			End of Period Rates	
		Real GDP*	PCE Core Deflator*	Profits from Operations#	90-Day T-Bills	10-Year T-Notes
2018	Q1	2.5%	2.3%	16.3%	1.7%	2.7%
	Q2	3.5%	2.1%	19.4%	1.9%	2.9%
	Q3	2.9%	1.6%	24.6%	2.2%	3.1%
	Q4	1.1%	1.7%	19.3%	2.4%	2.7%
2019	Q1	3.1%	1.1%	14.4%	2.4%	2.4%
	Q2	2.0%	1.9%	8.6%	2.1%	2.0%
	Q3	2.1%	2.1%	1.1%	1.8%	1.7%
	Q4	2.1%	1.3%	1.6%	1.5%	1.9%
2020	Q1	-5.0%	1.7%	-4.5%	0.1%	0.7%
	Q2 e	-34.5%	1.0%	-13.5%	0.1%	0.7%
	Q3 e	20.0%	0.8%	-22.8%	0.4%	0.8%
	Q4 e	7.8%	0.8%	-29.7%	0.4%	0.9%
2021	Q1 e	5.2%	0.8%	-19.3%	0.4%	1.1%
	Q2 e	4.0%	1.3%	-2.6%	0.5%	1.1%
	Q3 e	3.8%	1.5%	23.3%	0.5%	1.3%
	Q4 e	3.2%	1.6%	43.4%	0.6%	1.3%

e: Bloomberg Consensus Estimates; *: Annual Rates; #: Year-Over-Year Change in S&P500 EPS
Sources: Bloomberg LP, Wright Investors' Service, Inc.