DIXON, HUBARD, FEINOUR & BROWN, INC. investment counsel

Third Quarter 2020 Review & Outlook
by Whitney Brown

Also in This Issue

INVESTMENT OUTLOOK

- Stock rally continues in third quarter.
- NASDAQ Composite far outpaces other major indexes.
- Federal Reserve commits to low rates until economy fully recovers.
- Pace of economic recovery depends on progress in containing virus.

A remarkable equity market rally has followed the first quarter pandemic selloff. Major market indexes rose steadily from the late March low through the end of August with only a pause in June. Unfortunately, investor enthusiasm, especially for the handful of mega cap tech and consumer darlings that dominate the indexes (Apple, Amazon, Facebook, etc.), got a little carried away. The major U.S. market indexes gave back in September much of the rally's final surge in August. Even so they remain above or within striking distance of their pre-pandemic highs. Broadly speaking, U.S. equities have outpaced international markets this year, both before and since the breakdown and recovery.

While much of the U.S. outperformance can be attributed to the mega cap tech names, there have been plenty of other winning stocks to choose from. In the September pullback, there were several key sectors such as Industrials, Materials, and Healthcare that held their gains better than Information Tech and Consumer Discretionary. Notably, U.S. small cap and value indexes have not retaken the pre-pandemic highs. Even as Consumer Staples stocks have done well as stay-at-home plays, the other value-heavy sectors, Energy and Financials, have struggled to draw investor interest in the COVID-stricken economy. Year to date the NASDAQ Composite stands head and shoulders above the other major equity indexes, sporting a +24% return compared to +4% for the S&P 500 and negative returns for the Dow Jones Industrial Average and the small cap Russell 2000.

Market Measures	3rd QTR	YTD
S & P 500 (price)	8.5%	4.1%
Dow Jones Industrial Average	7.6%	-2.7%
NASDAQ Composite	11.0%	24.5%
Russell 2000	4.6%	-9.6%
MSCI EAFE	4.5%	-8.9%
Barclays Capital Inter. Gov't/Credit Bond Index	0.6%	5.9%
	09/30/20	09/30/19
10-Year U.S. Treasury Bond Yield	0.69%	1.68%
Three-month U.S. Treasury Bill Yield	0.10%	1.86%

It is hard to overstate the importance of the Federal Reserve's early and aggressive action in sparking the equity market rally. Their plainly declared intention to do almost anything possible in the realm of monetary policy to sustain the economy through its pandemic-induced contraction gave the green light for investors to pour money back into risk assets. The CARES Act stimulus added plenty of fuel to the mix. But, by August the absence of any new Fed initiatives and the unwillingness of Congress to come together on a follow up stimulus bill combined with an inability to contain the virus allowed doubts to creep in about the sustainability of an economic recovery.

Looking to the end of the year and beyond, there is much to be concerned about given the persistence of the virus and the uncertain trajectory of the economy. The second quarter experienced a record plunge in GDP growth and the third quarter will record a sharp bounce, but we are not back to pre-pandemic levels. Millions are still unemployed and now struggling to make ends meet. Many small businesses have closed, some temporarily, some permanently. The economy will naturally heal without further Fed action or stimulus, but only slowly until the virus is contained or runs its course. The V-shaped market recovery has not translated to a V-shaped economic recovery.

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Culture Eats Strategy for Breakfast by Bob Martin

Peter Drucker is famous for this quote emphasizing the importance of culture throughout one's organization. Culture ultimately determines how everything gets done. And a culture ultimately affects the experience of each customer. Dixon, Hubard, Feinour, & Brown will celebrate our 40th anniversary next year—a milestone for sure. We have a long history of supporting our clients' investment needs and striving to help them achieve financial success. Clients seem to appreciate our accessibility, frequent communication, and guidance. As fiduciaries, we must act in your best interests. This responsibility drives our investment strategy and client focus. It is also driving how we want to evolve and grow as an organization. Behind the scenes, we are working hard to upgrade our technology platform and will have more to share in the coming months. This upgrade will provide more information and more access at your fingertips. It will also provide a robust financial planning platform to support your planning needs.

Our evolution and growth can only be best executed with direct feedback from you. We plan to send out a customer survey in the next month or so. If you receive a survey, we ask that you take a few minutes to respond. The questions are all focused around you. What are we doing well? How can we improve? Do we communicate effectively and clearly? Are there planning needs we can support? We will compile your responses and meet as a team. Your responses will help frame our *cultural* and *strategic* imperatives for 2021 and beyond and ensure proper alignment between the two.

Thank you for in advance for your responses and for the opportunity to serve you.

Your DHFB Team

A Warm Welcome to Kathleen Yengst

In early September, Kathleen Yengst became the newest member of our DHFB family. She has accepted the role of our Manager of Operations and Compliance. Kathleen is returning to the Roanoke Valley to be closer to family and friends after working 17+ years in compliance for large investment firms in Northern VA and Charlottesville.

Kathleen's educational background includes an undergraduate degree from UVA followed by graduate degrees from Case Western Reserve University School of Law and Georgetown Law.

When she's looking to unwind, Kathleen enjoys being a silversmith, reading, cooking, and fitness. Please welcome Kathleen to our family. We are fortunate to have her!

Second Quarter 2020 Review and Outlook (continued)

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As for the stock market, the September pullback looks more like a shorter term repositioning ahead of the election rather than a wholesale dumping of stocks. The contentious climate around the U.S. presidential election and the high level of social unrest are unsettling, but are things that the markets have historically taken in stride. It is important to remember that the Fed intends to support the economy, and thus markets, with low interest rates for some time to come, potentially through 2023. Also, the fiscal stimulus already signed into law dwarfs anything done during the Great Recession and is still working its way into the economy. Although selling has been contained to this point, there will need to be a return of strong demand in order for the market to renew its uptrend.

Presidential Elections and the Stock Market by John Hubard

2020 has been unlike any year in recent memory. While we have seen a global pandemic lead to a recession and the upending of the long-lived bull market followed by a swift recovery by the averages to at or near all-time highs, we still have one of the most contentious Presidential elections on tap. While the recent volatility seen in the stock market likely has more than one cause, it is well settled that investors and the market at large detest the type of uncertainty implicit in a tightly-contested presidential election. In an effort to better understand the relationship between a Presidential election and the stock market, and to know what to watch for in the weeks ahead, we can take a look at historic returns in election years from several different angles. Although history doesn't always repeat itself, it rhymes, as the old saying goes.

No material difference has been observed in the performance of the Dow Jones Industrials Average under Republican vs. Democrat administrations. While returns have been better during the first two years of a Republican presidential term, the difference is made up by the outperformance of Democrats in the last two years of a presidency. As we currently have an incumbent vying for re-election, it should be mentioned that there is a clear tendency for the stock market to perform better in years that the incumbent party wins than when the incumbent party loses. For Republicans this is even more true, as the largest gains have come in years of elections won by the Republican incumbent party and the largest losses, on average, in years when Republican incumbents lose.

Since 1900, the incumbent party has won five times and lost nine when there was a 20%+ decline in the DJIA or a recession in the election year. Furthermore, since 1952, no party has retained the White House when there was either a 20% decline or a recession. Both of these have occurred in 2020. So does this spell the end for Donald Trump? Whether Trump can buck the macro trends working against him will depend on the economy and whether the American people blame him. At this moment, it seems the aggressive monetary and fiscal stimulus has steadied the economy and markets, and it will need to continue to do so for a Trump victory.

Regardless of what has taken place to this point, it seems clear that the performance of the stock market between now and the election may go a long way in predicting the outcome of the election in November. The historic DJIA performance from the second convention to the election has gained a median of 5.7% in years that the incumbent party has won versus -1.4% when the incumbent has lost. The second convention ended on August 27th and the Dow is down over 4% since. In 2016, this was one of the only indicators to correctly predict the Trump victory, as the Dow return from the second convention to the election was -1.1%. Watch the Dow Jones closely between now and the election on November 2nd. Without a particularly strong October on the stock market, President Trump will have to beat the odds to stay in the White House.

SEC Reaffirms Fiduciary Duty for RIAs by Kathleen Yengst

DHFB is an investment adviser registered with the SEC pursuant to the Investment Advisers Act of 1940 ("Advisers Act"). As a registered investment adviser ("RIA"), we serve as fiduciaries throughout the entirety of our relationship with you and with respect to all services we provide to you. RIAs differ from broker-dealers in that broker-dealers are not fiduciaries and are only obligated to act in their customers' best interest at the time of a transaction and not on an ongoing basis. We derive our compensation solely from a percentage of assets under management, whereas broker-dealers often derive their compensation from commissions generated by securities transactions.

The SEC recently made effective a final interpretation that both reaffirms and clarifies the fiduciary duty standard set forth under the Advisers Act. The concept of fiduciary duty has long been associated with the duty for investment advisers to place their clients' best interests ahead of their own. This final interpretation emphasizes not only that duty but establishes that acting in the best interest of the client also involves the duties of care and of loyalty. It is important to note that an adviser's fiduciary duty cannot be waived under any circumstance.

The duty of care consists of three parts: (1) the duty to provide advice that is in the best interest of the client, (2) the duty to seek best execution, and (3) the duty to provide monitoring and advice over the course of the advisory relationship. Similarly, the duty of loyalty provides that an investment adviser must not place its own interests ahead of those of its clients.

What does this mean for our clients? Here at DHFB, we will continue to manage your assets with the care and diligence we have utilized over the years and will continue to put your interests ahead of our own. For your reference, we have various investor resources that can be found on our website. Of course, if you have any questions, please do not hesitate to contact us.

A New Donation Strategy for 2020 by Jim Hall

In our last newsletter, we featured an article explaining how Congress had approved a one-time-only exemption for RMDs during 2020. The article also explained how those withdrawals could be reversed if they had already been received in 2020 prior to passage of the exemption. (If you have questions feel free to reach out to us.) That same legislation opened a one-time-only expanded window for the possible deduction of greater charitable donations.

Regardless of whether you itemize (complete a Schedule A), you are probably able to deduct a little more than usual for charitable gifts this year. If your expenses exceed the qualification level for utilizing the "standard deduction," this year, Congress has waived the 60% cap tied to those charitable deductions. In 2020, your only cap will be the amount of your Adjusted Gross Income (AGI).

In previous years, taxpayers who itemize would add up their State and Local Taxes, Real Estate Taxes, Mortgage Interest, their charitable gifts, and perhaps out-of-pocket medical expenses. If the total number exceeded the "Standard Deduction," the taxpayer qualified to itemize and could deduct a little more from their taxable income. However, their charitable gifts were considered capped at 60% of AGI so the full taxable benefit of giving might have been "missed."

In 2020, with the cap removed, an itemizing taxpayer is allowed to deduct up to an amount equal to their Adjusted Gross Income as a "Thank You" for donating. In theory, if one wanted to gift enough, their taxable income could be reduced to zero. Of course, with anything crafted by the government, there are caveats. The gifts must be in cash; no extra credit allowed for gifting appreciated stock or property. Also, gifts to any donor-advised funds or gifts to 509(a)(3) organizations would not be eligible.

For those who do not qualify to itemize but instead use the Standard Deduction, a 2020 donation perk may still be enjoyed. In addition to claiming the standard deduction, a donation or donations totaling up to $300 may also be deducted from Adjusted Gross Income. Once again, these donations would need to be made in cash.

If you have questions about utilizing either of these donation strategies this year, a "planning" conversation with your tax adviser would be strongly encouraged to ensure you will receive the maximum benefit available.