STALEY CAPITAL ADVISERS, INC.
SECOND QUARTER 2020 REVIEW AND COMMENTARY

Market Review: The U.S. equity market rebounded from the worst first quarter in history to then post the strongest quarter since 1998. The Standard and Poor's 500 stock index gained 20.5% and the Russell 2000 Small Cap Index jumped 25.4% with the U.S. leading every country and region. The MSCI All World ex-US Index gained 16.0%. Year to date through June, the S&P 500 fell 3.1%, the Russell 2000 lost 13.0% despite the stellar 2nd quarter and the World ex-US declined 11.0%. The Barclay's Aggregate Bond Index benefitted from the collapse in interest rates, gaining 2.9% in the quarter and 6.1% year-to-date. Gold's return of 13.1% in the quarter brought the six-month gain to 17.1%.

Index Recovery: One undeniable factor in the sharp recovery of the market has been the Federal Reserve, which through numerous new programs and bold pronouncements has created a powerful tailwind for risk assets that has thus far overshadowed fears surrounding the pandemic. Chairman Powell acknowledged in late May that the Fed under his leadership "crossed a lot of red lines that had not been crossed before." The Fed is now in the business of printing money and buying assets, and since the end of February, has expanded its balance sheet by $2.9 trillion to $7.0 trillion. For perspective, the ballooning of the Fed balance sheet to $4.5 billion following the 2008 global financial crisis was viewed then as both unfathomable and unsustainable.

Although the broad indices have reflected the market's recovery, equity categories are not benefitting equally from the Fed-driven liquidity. The S&P 500 Index has become increasingly top-heavy to the point that the market capitalizations of Microsoft, Apple, and Amazon equal the market cap of the 300 bottom companies in the index. When adding Alphabet (Google) and Facebook to the group, these five stocks comprise 25% of the S&P 500 Index (the index is capitalization-weighted). These high-profile stocks, benefitting from Covid-19 proof business models, posted an average return of 24% YTD and have driven the relative outperformance of growth versus value, large cap versus small cap and the U.S. versus the rest of the world. The Growth style has been in a bull market versus the Value style for over a decade through largely incremental outperformance each year. However, this year represents the best start to a year of growth versus value on record. The iShares Russell 1000 Growth Index ETF (symbol IWF) has returned 9.6% year-to-date through June while the DFA Large Cap Value Fund (DFLVX) has lost 20.3%. Rather than expecting these highly valued, widely owned mega-cap companies to appreciate indefinitely, the longer-term portfolio opportunity is likely a broadening of performance across more industries such as financials (BKX Bank Index is down 32% YTD). This likely depends upon a durable economic recovery which thus far has not been signaled by Treasury yields given the near record low rates out the yield curve. This may not be attainable unless we continue to experience upside economic surprises. With regards to bonds, the risk and reward now appears to be worse than ever. The Barclay's Aggregate Bond Index currently offers an annual income yield of 1.2%. If intermediate interest rates were to rise by 1%, the price of the bond index would fall by 5.8% offsetting five year's income.

The Folly of Market Timing: This year's action, characterized by sudden reversals and intense moves seemingly disconnected from near term fundamentals, offers yet another vivid illustration of the futility of predicting market direction. And while there are always many unknowns, the current docket of the pandemic, the economic distress and associated fiscal stimulus, the unpredictability of corporate earnings, vaccine timelines and potential changes in taxes and regulations post-election all but guarantees more volatility. Which is again why our energies are focused not on predicting but on responding to pricing opportunities created by market instability. Asset values are one key to our process and your distinctive time horizon and tolerance of volatility are the others. Ultimately, we want to maximize your expected returns while staying within your risk tolerance profile and not shift your investment plan mid-stream. Our dialogue during these challenging periods is very informative for us and we hope it has increased your trust in our process. Our strategy in this environment remains a heavy tilt toward large cap U.S. stocks by holding both favored growth stocks and less favored cyclical stocks, diversification through short-term high-quality bond investments and gold related funds, and a margin of safety through cash or similar vehicles. We strive to execute this through consistency, humility and responsiveness.

We hope you are doing well, we are always available, and we thank you for your trust through this difficult period.

YOUR STALEY CAPITAL INVESTMENT TEAM