SJS Investment Services
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MarketPlus Investing®

2020 SJS Capital Market Expectations

Executive Summary

SJS works with clients to specify investment goals, and then to decide which assets to invest in, in what percentages, and in which accounts to place these investments. There are many tradeoffs, some of which are known and some that cannot be fully predicted. Using the Four Core Fundamentals of MarketPlus Investing – markets are efficient and priced fairly, speculating is futile, global stocks and bonds have rewarded investors over the long term, and portfolio design matters most – SJS designs low-cost, diversified global portfolios across stock, bond, and alternative asset classes in order to better manage the relationship between expected risk and expected return.

One part of this portfolio design process is to project potential expected return and expected risk (volatility) scenarios for each asset class over long term (10+ years) periods. Investing is about forward-looking information. While we learn much from what happened in the past, asset prices are based on expectations of future economic conditions and company fundamentals. These expectations are inherently uncertain, as investors do not know what exactly will happen in the future. Therefore, we believe that providing a range of potential expected returns for each asset class is appropriate, as using a single number often creates a bias that leads to unrealistic and unrealized expectations.

SJS considers numerous factors when designing capital market expectations for the next decade plus, including academic research, historical trends, and the current market environment. For example, while the market risk premium (the return of the stock market over the Treasury Bill rate) has been approximately 8% over the last 90 years, muted inflation, slowing growth prospects, and stretched stock valuations contribute to return expectations being on the lower end of their historical averages.[1] The US Stock Market far exceeded that market risk premium since 2009 (in large part due to leaving out the financial crisis while experiencing much of the recovery), but international developed and emerging market stocks had a tough decade in comparison, so we would not be surprised to see the stocks abroad higher (relatively) in the 2020s. While small value stocks historically captured returns superior to large growth stocks, it was not the case at the end of the decade. Nevertheless, we remain confident in the tilt towards small and value stocks. Finally, with the Federal Reserve signaling its plan to keep interest rates low and the goal of 2% inflation, bond investors should be prepared for correspondingly low returns.[2]

Every MarketPlus Investing portfolio is diversified across and within asset classes, industries and securities globally through the use of low cost institutional-class mutual funds. Assets are invested where return premiums have historically occurred, and where market indicators imply they will continue. Portfolios are designed for lower turnover by rebalancing based on logical systematic criteria and staying invested regardless of market volatility, which can lead to lower transaction costs. We believe performance lies in the portfolio design itself, rather than stock picking or market timing, investors should focus on controlling what they can control. The average (nominal) annual return on (US) stocks from 1926 to 1987 was 9.44%. But if you had gone to cash and missed the best 50 of those 744 months, you would have missed all of the return.[3] We do not know ahead of time which months (or even years) will have the highest market returns, but through MarketPlus Investing, SJS will continue to support clients by applying these capital market expectations with caution and using them primarily for long-term strategic planning rather than short-term market decisions.

Sources:
[1]Dimensional Fund Advisors. Arithmetic average of annual premiums of the Fama/French Total US Market Index minus one-month US T-Bills (1928-2018).
[2] Why does the Federal Reserve aim for 2 percent inflation over time? (https://www.federalreserve.gov/faqs/economy_14400.htm)
[3]The Value of Predictions, or Where'd All This Rain Come From? (Oaktree Capital Management Memo, Howard Marks)

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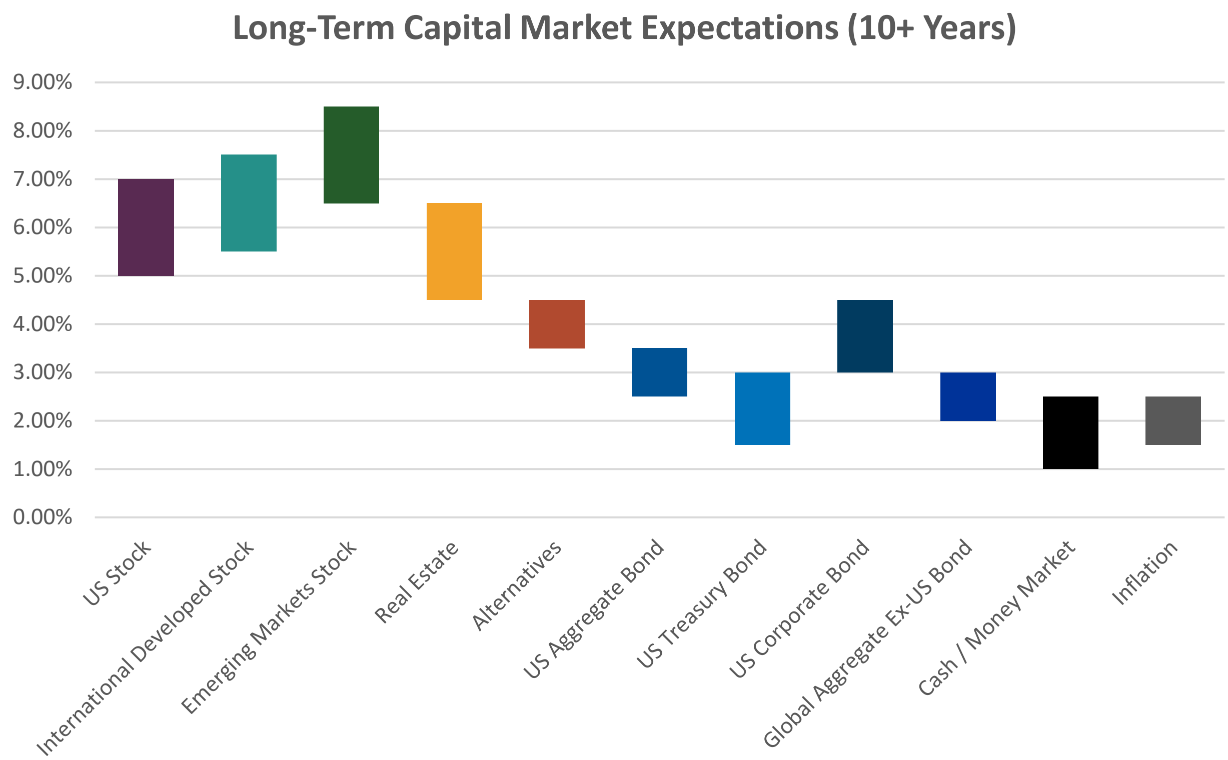


	Expected (Nominal) Return	Expected (Nominal) Standard Deviation	Trailing 10 Years Return	Trailing 10 Years Standard Deviation
Asset Class	**Range**	**Range**	**1/1/2010 - 12/31/2019**	**1/1/2010 - 12/31/2019**
US Stock	5.00 - 7.00%	13.00 - 17.00%	13.42%	12.87%
International Developed Stock	5.50 - 7.50%	14.50 - 18.50%	6.00%	14.58%
Emerging Markets Stock	6.50 - 8.50%	18.00 - 23.00%	4.04%	17.15%
Real Estate	4.50 - 6.50%	16.75 - 21.25%	10.51%	13.74%
Alternatives	3.50 - 4.50%	3.00 - 5.00%	1.94%	2.84%
US Aggregate Bond	2.50 - 3.50%	3.00 - 4.50%	3.75%	2.87%
US Treasury Bond	1.50 - 3.00%	3.00 - 4.50%	3.13%	3.53%
US Corporate Bond	3.00 - 4.50%	4.00 - 6.50%	5.54%	4.09%
Global Aggregate Ex-US Bond	2.00 - 3.00%	5.00 - 8.00%	1.50%	6.87%
Cash / Money Market	1.00 - 2.50%	0.25 - 0.50%	0.59%	0.23%
Inflation	1.50 - 2.50%	0.50 - 1.00%	1.74%	0.66%

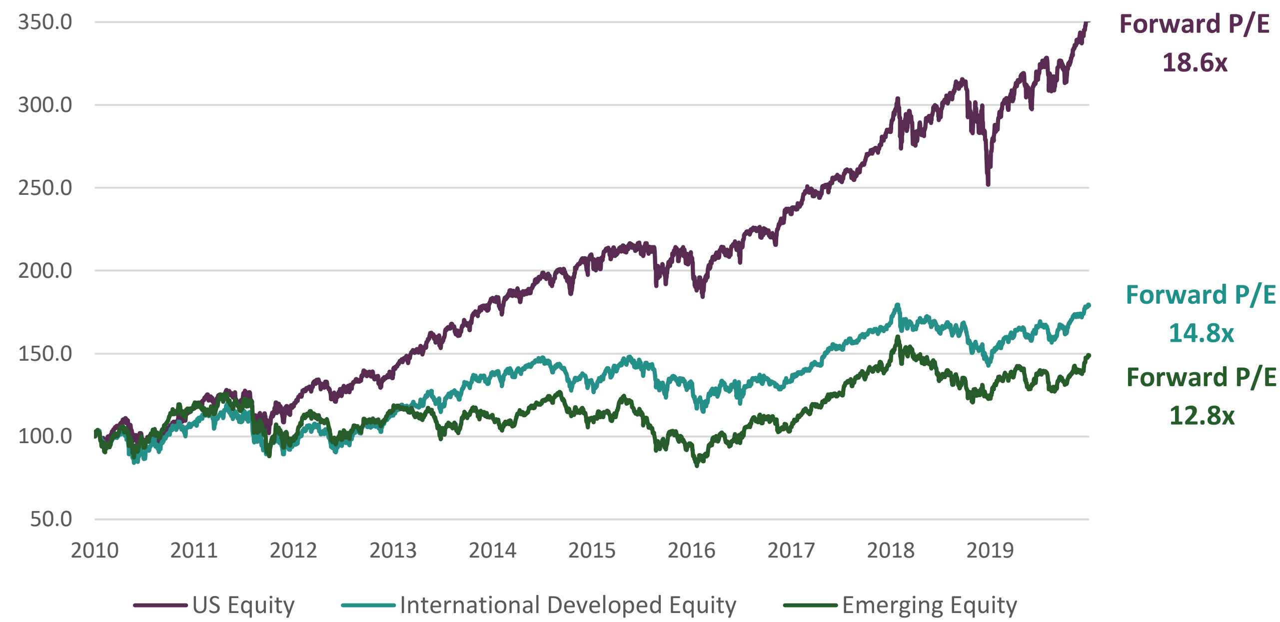
Source: Morningstar. Asset Classes are represented as follows – US Stock - Russell 3000 TR USD; International Developed Stock - MSCI EAFE GR USD; Emerging Markets Stock - MSCI EM GR USD; Real Estate - S&P Global REIT TR USD; Alternatives - Wilshire Liquid Alternative TR USD; US Aggregate Bond - BBgBarc US Agg Bond TR USD; US Treasury Bond - BBgBarc US Treasury TR USD; US Corporate Bond - BBgBarc US Corp Bond TR USD; Global Aggregate Ex-US Bond - BBgBarc Gbl Agg Ex USD TR USD; Cash / Money Market - USTREAS T-Bill Sec Mkt 3 Mon; Inflation - US BLS CPI All Urban SA

Statements contained in this report that are not statements of historical fact are intended to be and are forward looking statements. Forward looking statements include expressed expectations of future events and the assumptions on which the expressed expectations are based. All forward-looking statements are inherently uncertain as they are based on various expectations and assumptions concerning future events and they are subject to numerous known and unknown risks and uncertainties which could cause actual events or results to differ materially from those projected.

International Developed and Emerging Markets Looking to Reverse US Dominance

Valuations Stretched Across the Globe

Over the last decade, US Stocks have outpaced both International Developed and Emerging Markets by a wide margin. Since the start of 2010, the US stock market was up nearly 13.5% per year, while International Developed Stocks gained 6% annually, and Emerging Markets Stocks 4% annually.



All the while, the price that investors are willing to pay for earnings has risen. Looking at valuations from several common valuation metrics – Price/Earnings, Price/Book Value, Price/Sales, and Price/Cash Flow – for the trailing twelve months, the US is on the high end across the board. International and Emerging Markets, though not cheap, are far more favorable from a valuation perspective.

	US		International		Emerging Markets	
	Current	Historical Percentile	Current	Historical Percentile	Current	Historical Percentile
P/E	22.2	90%	17.4	87%	14.4	80%
P/B	3.2	92%	1.6	50%	1.7	57%
P/S	2.2	99%	1.2	94%	1.4	80%
P/C	14.0	92%	10.0	97%	8.9	94%
Average		**93%**		**82%**		**78%**

With the US Stock Market heading into a new decade after an era of dominance, International Developed and Emerging Markets are likely poised for a reversal in the next ten years. While maintaining a home country bias, SJS and MarketPlus Investing's design is intended to capture the favorable relative valuations and valuable diversification benefits abroad.[1]

Source: Morningstar. Asset Classes are represented as follows – US Stock (Russell 3000 TR USD); International Developed Stock (MSCI EAFE GR USD); Emerging Markets Stock (MSCI EM GR USD); through December 31, 2019. Percentiles are based on data going back to 1999.

[1] Diversification neither assures a profit nor guarantees against a loss in a declining market. There is no guarantee investment strategies will be successful. Past performance is no guarantee of future results.

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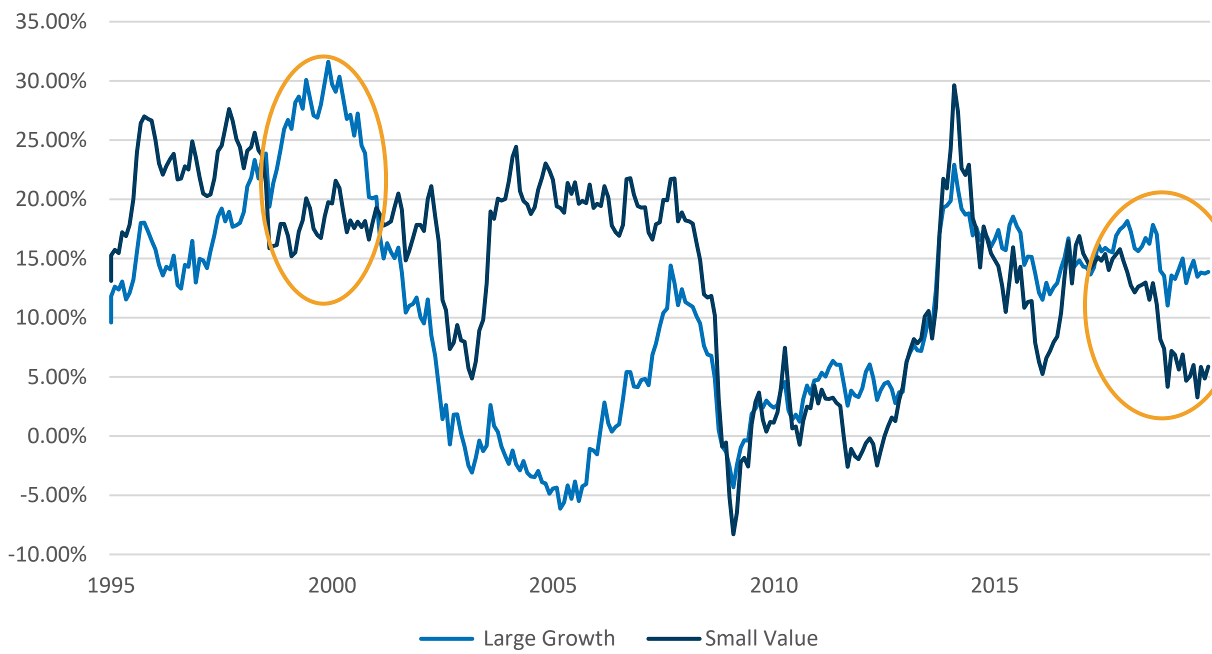
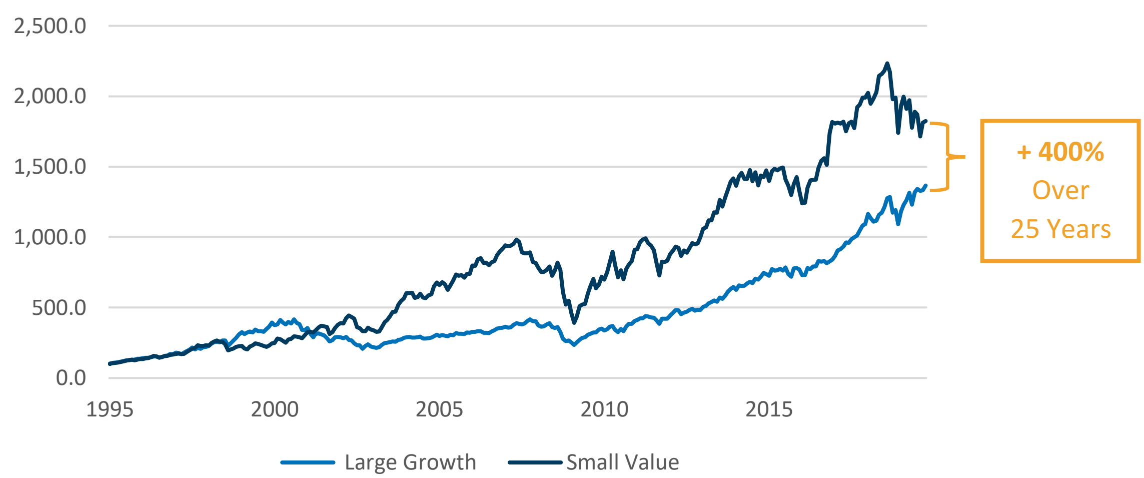
Small Value, While in a Tough Stretch, May Regain Reign Over Large Growth

Long-Term Dominance of Small Value Makes It a Favorable Tilt

Investors have seen the divergence between large growth and small value stocks continue. Over the trailing 5-years, large growth is up 13.9% annualized vs. 5.9% for small value. The rolling 5-year returns between large growth and small value are at the widest and most prolonged spread in favor of large growth since the early 2000s. Investors are paying top-dollar for low (or even no) earnings, with the hopes of outpaced growth in the future. What could go wrong?



This story may sound familiar to investors who experienced the dot-com era. While some chased the highflying large growth stocks and followed the fate of Icarus, the disciplined investor was rewarded. Over the last 25 years, small value outperformed large growth by over 400% in cumulative return. While MarketPlus Investing includes allocations to the large growth space, portfolios are tilted towards small value stocks, where academic research and history has demonstrated a premium exist; as small value looks for its crown, MarketPlus Investing's designed and positioned for small value's reign to return.

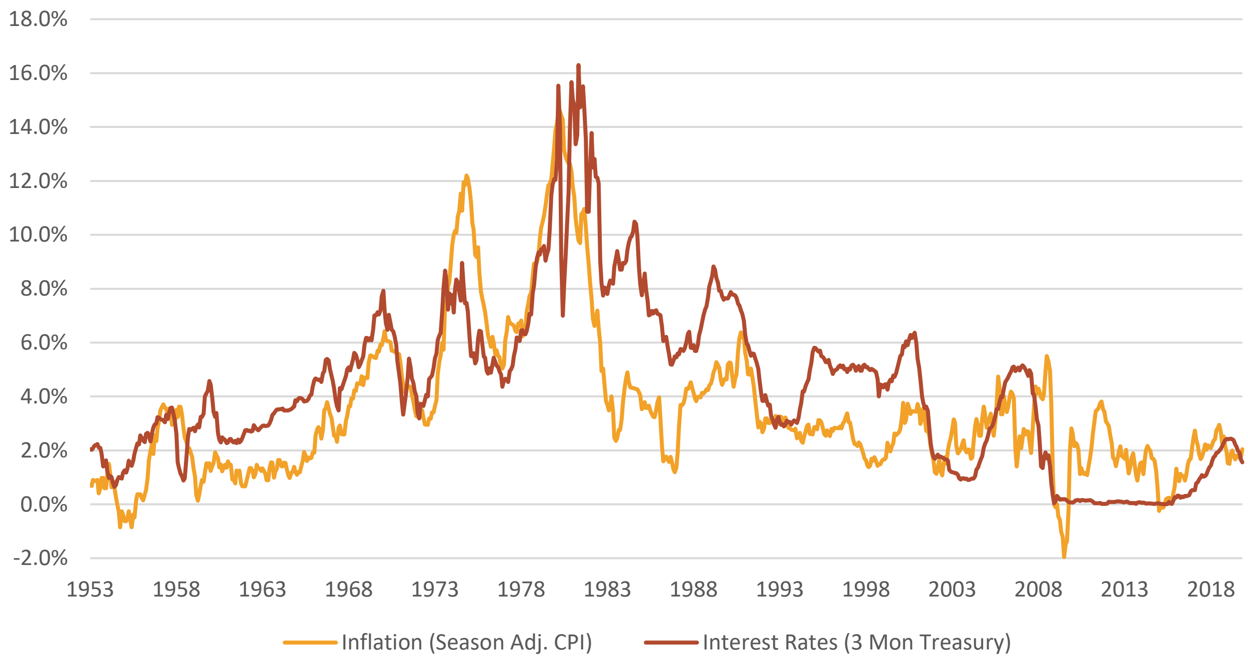


Source: Dimensional Fund Advisors. Returns as of 11/31/2019. Large Growth (Fama/French US Large Growth Research Index); Small Value (Fama/French US Small Value Research Index)

Relationship Between Inflation and Interest Rates

History and Signaling Suggest Both Will Be Low

The Federal Reserve of the United States of America (the Fed) has a dual mandate: to maximize employment and to stabilize prices for goods and services. To pursue this mandate, the Fed believes that a 2 percent increase in annual inflation is most appropriate in the long run. While the Fed cannot completely control inflation, the Fed influences inflation by setting a target Federal Funds Rate (the rate at which banks borrow money from the government) and more directly changing the amount of money circulating in the economy in order to push the current Federal Funds Rate to the desired rate. Consequently, while the Fed doesn't directly control most other interest rates, shorter-term interest rates (< 1 year) generally follow changes in the Federal Funds Rate, and longer-term interest rates (>= 10 years) tend to follow as well. When inflation is higher (lower) than the Fed is comfortable with, the Fed will typically aim to decrease (increase) the money supply in the economy, which consequently typically increases (decreases) both the Fed Funds Rate and other interest rates, with the goal for individuals to spend less (more) and save more (less).



As of December 31, 2019, the Fed projects inflation to average 1.86% over the next five years, close to the long-run target of 2.00%.[1,2] As illustrated in the graph above, the Fed has worked over the past 50+ years to influence (primarily to decrease) inflation to that 2 percent goal, significantly through affecting interest rates. Generally, as interest rates decrease, bond prices increase. Much of the strong returns for bonds over the past 40 years is due to positive price changes caused by generally declining interest rates. However, since expected inflation is near the long-term target, it is reasonable to expect that coupon payments, not price changes, will drive the majority of positive bond returns over the next 10+ years, and that interest rates will remain near current levels. This provides significant justification for why SJS projects a 2.50 – 3.50% return for US aggregate bonds over the next 10+ years. Using these return expectations as part of the MarketPlus Investing approach allows SJS to help clients develop the right portfolio design to meet their current and future needs.

Sources: Morningstar and Federal Reserve Bank of St. Louis - Interest Rates (USTREAS T-Bill Sec Mkt 3 Mon); Inflation (US BLS CPI All Urban SA)
[1]5-Year Forward Inflation Expectation Rate (https://fred.stlouisfed.org/series/T5YIFR)
[2]Why does the Federal Reserve aim for 2 percent inflation over time? (https://www.federalreserve.gov/faqs/economy_14400.htm)

Important Disclosure Information

Past performance does not guarantee future results.

Indices are not available for direct investment. Their performance does not reflect the expenses associated with management of an actual portfolio. Mutual fund investment values will fluctuate, and shares, when redeemed, may be worth more or less than original cost. Diversification neither assures a profit nor guarantees against a loss in a declining market. There is no guarantee investment strategies will be successful. Past performance is no guarantee of future results.

All returns represent total return for stated period provided by Morningstar Direct.

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Indexes are as follows:
US Stock (Russell 3000 TR USD Index measures the performance of the largest 3000 US companies representing approximately 98% of the investable US equity market. It is market-capitalization weighted.); **Intl Development Stock** (MSCI EAFE GR USD Index measures the performance of the large and mid cap segments of developed markets, excluding the US & Canada equity securities. It is free float-adjusted market-capitalization weighted.); **Emerging Markets Stock** (MSCI Emerging Markets GR USD Index measures the performance of the large and mid cap segments of emerging market equity securities. It is free float-adjusted market-capitalization weighted.); **Alternatives** (Wilshire Liquid Alternative TR USD Index measures the collective performance of the five Wilshire Liquid Alternative strategies that make up the Wilshire Liquid Alternative Universe. The Wilshire Liquid Alternative Index is designed to provide a broad measure of the liquid alternative market by combining the performance of the Wilshire Liquid Alternative Equity Hedge Index, Wilshire Liquid Alternative Global Macro Index, Wilshire Liquid Alternative Relative Value Index, Wilshire Liquid Alternative Multi-Strategy Index, and Wilshire Liquid Alternative Event Driven Index. The Wilshire Liquid Alternative Index is double-cap adjusted AUM weighted and rebalanced semi-annually); **Real Estate** (S&P Global REIT TR USD Index measures the performance of publicly traded REITs and REIT-like securities listed in both developed and emerging markets. The index is designed to serve as a proxy for direct real estate investment, in part by excluding companies whose performance may be driven by factors other than the value of real estate); **US Aggregate Bond** (Bloomberg Barclays US Aggregate Bond TR USD Index measures the performance of investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS. It rolls up into other Barclays flagship indices, such as the multi-currency Global Aggregate Index and the U.S. Universal Index, which includes high yield and emerging markets debt.); **US Treasury Bond (**BBgBarc US Treasury TR USD Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury. Treasury bills are excluded by the maturity constraint, but are part of a separate Short Treasury Index. STRIPS are excluded from the index because their inclusion would result in double-counting.); **US Corporate Bond** (BBgBarc US Corporate Bond TR USD Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers.); **Global Aggregate Ex-US Bond** (Bloomberg Barclays Global Aggregate TR USD Index measures the performance of global investment grade fixed-rate debt markets, including the Pan-European Aggregate, the Asian-Pacific Aggregate, Global Treasury, Eurodollar, Euro-Yen, Canadian, and Investment Grade 144A index-eligible securities.); **Cash / Money Market** (US Treasury T-Bill Secondary Market 3 Month rates are the daily secondary market quotation on the most recently auctioned Treasury Bills for the 13 week maturity for which Treasury currently issues new Bills. Market quotations are obtained at approximately 3:30 PM each business day by the Federal Reserve Bank of New York. The rate at which a Bill is quoted in the secondary market and is based on the par value, amount of the discount and a 360-day year.)
Inflation (US Bureau of Labor Statistics Consumer Price Index All Urban Seasonally Adjusted is a measure of the average monthly change in the price for goods and services paid by urban consumers between any two time periods. It can also represent the buying habits of urban consumers. This particular index includes roughly 88 percent of the total population, accounting for wage earners, clerical workers, technical workers, self-employed, short-term workers, unemployed, retirees, and those not in the labor force.)

Large Growth (Fama/French US Large Growth Research Index) & **Small Value** (Fama/French US Small Value Research Index):
Composition: The index portfolios for July of year t to June t+1 include all NYSE, AMEX, and NASDAQ stocks for which we have market equity for December t-1 and June of t, and (positive) book-to-market equity data for fiscal year ending in t-1.
Exclusions: ADRs, Investment Companies, Tracking Stocks, non-US incorporated companies, Closed-end funds, Certificates, Shares of Beneficial Interests, and negative book values. Sources: CRSP databases for returns and market capitalization: 1926 -present Compustat and hand-collected book values: 1926-present CRSP links to Compustat and hand-collected links: 1926- present
Breakpoints: “The size breakpoint is the market capitalization of the median NYSE firm, so the big and small categories contain the same number of eligible NYSE firms. The BtM breakpoints split the eligible NYSE firms with positive book equity into three categories: 30% of the eligible NYSE firms with positive BE are in Low (Growth), 40% are in Medium (Neutral), and 30% are in High (Value).”
Rebalancing: Annual (at the end of June) 1926-Present Fama/French and multifactor data provided by Fama/French.