

Investor Quarterly

Massive Policy Response Fuels Price Gains



Central Banks and Governments Respond Forcefully to Pandemic Crisis

In an effort to limit the economic impact of the global pandemic, which fueled unprecedented 1Q20 volatility in financial markets and double-digit declines in asset values, central banks and sovereign governments stepped up to “fill the gap” through a combination of quantitative easing and massive fiscal stimulus. The effort appears to be succeeding, though long-term implications are unclear.

Rockingstone Performance

We were fortunate to have shorted the market in size during 1Q20 and then covered the bulk of our shorts in early April. We used the sell-off to initiate first time positions in TTD, SHOP, MKTX, PING, TDG and NVDA in size. These actions led to solid performance +12.2% in 2Q20. Our historical annualized returns include: YTD + 3.3%; 1-yr +10.4%; 3-yr +8.2%; 5-yr +10.1%; and 10-yr +10.1%.

2Q20 in Review

Financial markets rebounded fueled by a combination of over-sold conditions, optimism around Covid-19 treatments and vaccines, and most importantly, massive policy response from central banks and governments intended to soften the supply and demand shocks.

Still Planning for a “W-Shaped” Recovery

Given the additional waves of infection from re-opening, we still expect the virus to impede a rapid return to normalcy. However, we note the combination of a Fed back-stop, decent economic performance in key sectors and progress on an effective vaccine or therapeutic treatment is keeping us fully invested for now.

S&P500 Forecast & Other Key Indicators

Our new forecasts include: EPS (2020/2021: \$105/\$150), S&P500 (2020 year end = 3175), GDP (2020/2021: -8.0%/+8.4%), Gold (\$2000), Oil (\$45), 10-yr US Bond Yield (0.8%), Inflation (.5%), 5-yr expected CAGR (US Large Cap -0.3%, US Mid Cap +1.8%, US Small Cap +6.6%, Developed +1.3%, Emerging +7.0%).

About Us

Rockingstone Advisors LLC is a boutique asset management and corporate advisory firm co-managed by Brandt Sakakeeny and Eric Katzman, CFA.

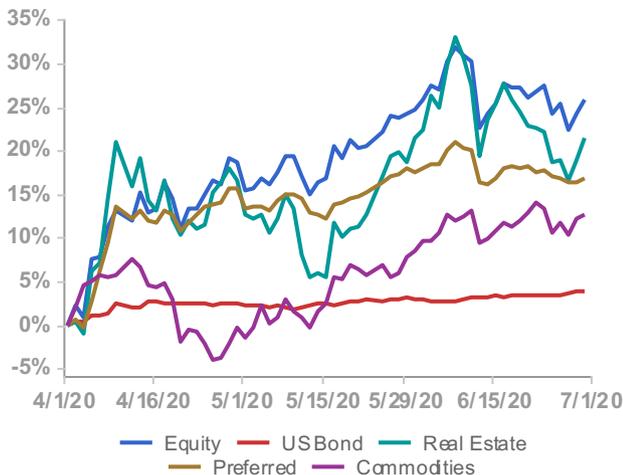
As an SEC-registered investment advisor, we provide multi-asset investment strategies to individuals, families and small institutions through separate accounts.

Our investment strategies attempt to capitalize on pricing inefficiencies across broad asset classes and then across individual securities, with a strong emphasis on fundamental research and analysis.

Thank you for your interest. You can find more information (and some interesting articles) at:

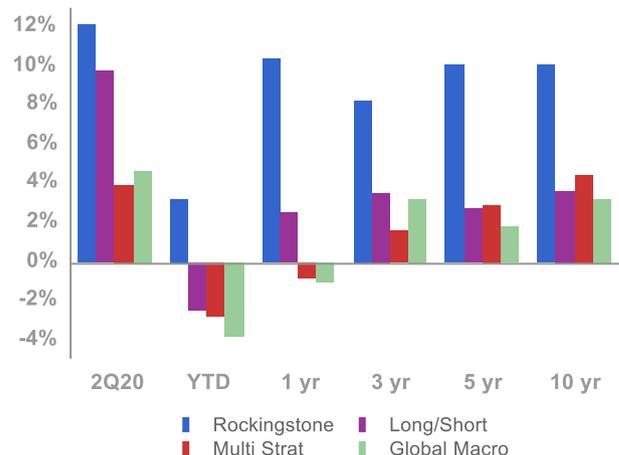
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Figure 1: 2Q20 Asset Class Performanceⁱ



Source: FactSet

Figure 2: Rockingstone: 2Q20 & Historical Annualized Returnsⁱⁱ



Source: Rockingstone Advisors, Morningstar, DJ Credit Suisse Indices

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Asset Prices Rebound

Overwhelming policy response drives asset prices higher

In an effort to stem the liquidity crisis in financial markets and coincident record volatility, central banks and sovereign governments devised a series of asset purchases and stimulus measures, respectively, in an effort to return proper functioning to capital markets. The efforts, at this point, appear to have been overwhelmingly successful, although we caution the seeds of the next crisis are always sown by policy makers solving the current crisis.

By any measure US markets have returned to normalcy, or at least how a market would normally behave when supported by \$6 trillion in quantitative easing and fiscal stimulus. Bond yields have fallen, spreads have narrowed, equities have rallied, the US dollar has declined, and liquidity has returned. No doubt while central banks can take the bulk of the credit for the speed and breadth of their actions, several federal stimulus packages have moved money directly into the pockets of laid-off employees through generous unemployment benefits and \$1,200 checks, as well as directly into businesses through forgivable PPP loans and other vehicles. Markets have also been aided by positive news on both the therapeutic front and on the vaccine front: predictions of a vaccine by summer of 2021 are now being accelerated to as soon as the fall of 2020, with multiple potential candidates in play.

Lastly, markets have realized that there are clear winners and losers rising out of the pandemic: technology and technology-enabled businesses whose services are delivered over the internet have materially outperformed the losers, primarily made up of hospitality, travel and leisure companies. What is notable is that while consumer preference is driving revenue to the former set of businesses, the Fed is essentially protecting the latter set of businesses through its asset purchases, which is allowing those companies most at risk (not all of them, but many) to issue debt at attractive prices and stabilize their balance sheets until normalcy returns.

Of course, when “normalcy” returns is a critical question. Indeed, how to define the “new normal” is a key question with no clear answer. Consistent with the expectations of most epidemiologists, as the US economy re-opened and testing ability improved, case numbers would accelerate, and that, unfortunately, is exactly what has happened.

The only silver lining is that the rapid rise in case numbers has not yet translated into the type of CFRs (case fatality rates) that were seen earlier this spring in New York, northern Italy and parts of Spain. Whether this is simply due to a lag in the data, improving treatment protocols, a mutation making the virus less virulent or lastly that younger, healthier cohorts are now being infected, is still unclear.

What is clear, though, is that until a viable and effective vaccine is deployed in large numbers, the global economy will continue to need external stimulus and policy makers will have to continue to “bridge the gap.” How effective these additional measures are – and what the long-term implications are for those actions – will be of critical importance.

Near-term investment framework: How we are navigating the markets

During the second quarter, our investment decisions were based on a framework that rested on three pillars: (i) the size and strength of the governmental response, which

effectively removed the risk of a chain of multiple bankruptcies; (ii) the nature of the shut-down of the pandemic, which resulted in a clear bifurcation between winners and losers among businesses and individuals, and (iii) the spread of the pandemic, including its ebb and flow across the globe away from hard hit regions into previously unaffected regions, as well as the global pursuit of therapeutics and vaccines and the prospects and timing for success. It is fair to say the above three pillars could very well guide our investment decisions for an extended period!

Government Response

Looking at each of these three factors independently, the measures taken by the Fed and Congress have made the most significant impact, in our view. The combination of the speed and the unprecedented size of the intervention led us to cover our shorts and build positions in a handful of names that we have always wanted to own but have never been able to justify given the valuations. The calculus was relatively straight forward: our downside was reasonably well protected by a combination of the interventions plus the impact of super low rates on our discounted cash flow models; markets were oversold and the coordinated actions signaled that the government was “all in” and would continue to be supportive.

The Federal Reserve committed up to \$2.3 trillion in lending and other extraordinary measures to combat the economic downturn associated with Covid-19. Each time the Fed announced another policy intervention, capital markets responded positively.

Figure 3: Federal Reserve Measures to Combat Covid-19 Downturn.

Program	Details	Goal
Interest Rate Cut	150 bps cut to 0%	Help financial conditions
Discount Window	Rate cut to 0.25%, terms extended to 90 days	Boost borrowings
Bank Reserves	Reduced to \$0	Boost bank lending
Repo Operations	\$6.5B max repo facility Each facility has \$500B cap	Ease short-term liquidity funding
Intl Swap Lines	Increase swap lines with 14 non-US Central Banks	Aid \$US funding
Asset Purchases	Unlimited quantitative easing	Stabilize US Treasury and MBS agency markets
Commercial Paper (CPFF)	\$10B equity backing from Treasury Exchange Stabilization Fund	Aid short term liquidity in commercial paper markets
Primary Dealer (PDCF)	\$150B daily usage limits	Improve overnight liquidity for primary dealers
Money Market (MMLF)	\$10B equity backing	Backstopping money markets
Term Asset Backed Securities Loan (TALF)	\$10B in equity backing, \$100B in new financings	Stabilize and support ABS markets
Primary Market Corporate Credit Facility (PMCCF)	\$10B equity backing \$100B in new financings	Help corporate bond market
Secondary Market Corporate Credit Facility (SMCCF)	\$10B equity backing \$100B new financings	Aid investment grade secondary corp. bonds
Paycheck Protection Program (PPP) Liquidity Facility	\$600B in funding support	Preserve employee paychecks through crisis
Municipal Liquidity Program	\$500B funding support	Backstopping municipal bond market

Source: FactSet

The Fed's actions were supported by several pieces of legislation, including the CARES Act, providing \$2.2T in aid to American citizens and businesses and the Families First Coronavirus Response Act, which expanded sick leave protections for workers and their families, and is expected to cost up to \$192B over the next two years. These laws supplemented spending in the amount of \$8.3B that was passed by Congress on March 6 to support US agencies dealing with Covid-19 and provide additional funding to Medicare. In late April Congress passed another \$484B in spending to extend the PPP, of which \$310B was allocated to the PPP, \$60B for small-business emergency loans, \$75B for hospitals and healthcare providers, and \$25B for testing.

Other developed economies have also provided fiscal and monetary stimulus. The EU recently announced an agreement to provide €750B across seven individual programs, made up of €390B in grants and €360B in repayable, non-forgivable loans (thanks to the Germans, Austrians and Dutch). This is supplemental to measures previously passed, including the €37B *Corona Response Investment Initiative*, the €28B of funds made available to member nations, and the €8B of funds committed to more than 100,000 European firms to provide working capital lending.

As Congress debates yet another stimulus package to supplement the latest package, (we note many of the unemployment benefits are set to expire at the end of July), the Fed has encouraged Congress to spend whatever is necessary to continue to bridge the gap in demand.

As we get ready to publish this newsletter, never one to ignore a spending challenge, Congress appears to be rising to the challenge. The spending plan is expected to be between \$1T and \$3T, and will likely include a continuation of jobless benefits at a lower level, some aid to state and local governments and perhaps some liability protection to schools and small businesses.

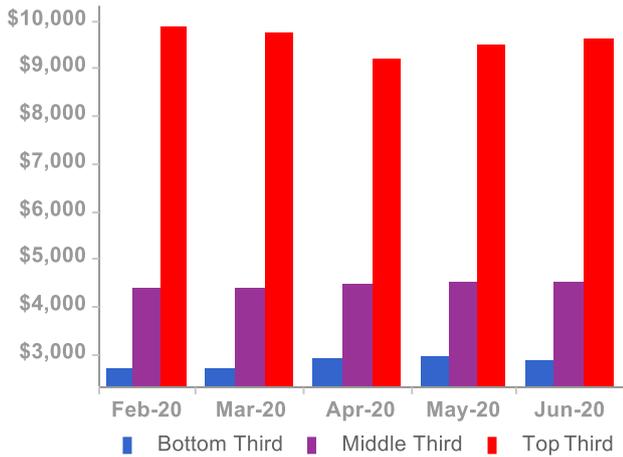
Bifurcation of the Economy

The second factor driving our investment decisions in the second quarter was our conclusion that while the virus would temporarily disrupt the normal operations of the economy, the bulk of the sustained disruption was fairly isolated to the hospitality (gaming, live events, sports) and travel (airlines, cruise lines, hotels) industries, with some residual impact on real estate and construction.

Moreover, there would be some clear winners, mainly technology companies and technology-enabled companies who deliver digital services direct to consumers, as well as supermarkets and consumer packaged goods providers. Many argue and we agree that a more technology driven economy has simply been accelerated by the virus with stocks linked to such a move discounting rapid adoption by both companies and consumers.

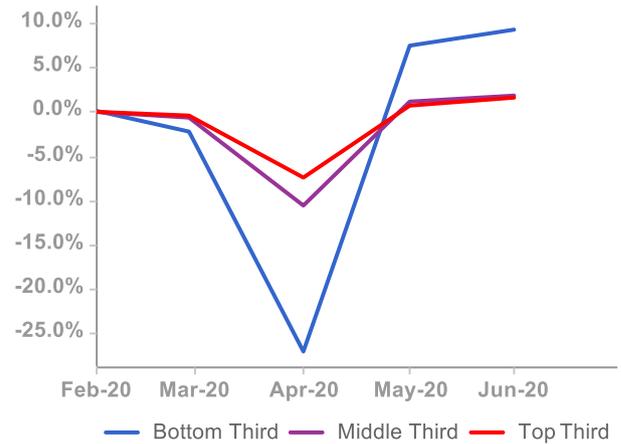
Some economists have been concerned about the levels of wealth disparity in the US, although the most comprehensive studies (Auten & Splinter; Smith, Yagan, Zidar, Zwick) indicate very little, if any, widening of the wealth gap over the last 30 years. That said, the impact of the virus appears to be exacerbating existing inequalities between skilled and unskilled labor. For example, a disproportionate number of well-paying, highly skilled jobs seem to be largely unaffected by the virus and indeed have benefitted from the aforementioned transition to a more digital economy. Meanwhile, the industries hardest hit generally provide relatively low wages. Our segmentation and analysis of wage and employment data (see Figure 4 and 5) supports this bifurcation.

Figure 4: Monthly Wage Rate by Industry Cohort



Source: Bureau of Labor Statistics

Figure 5: Job Losses (% Chg. YoY) by Industry Wage Cohort



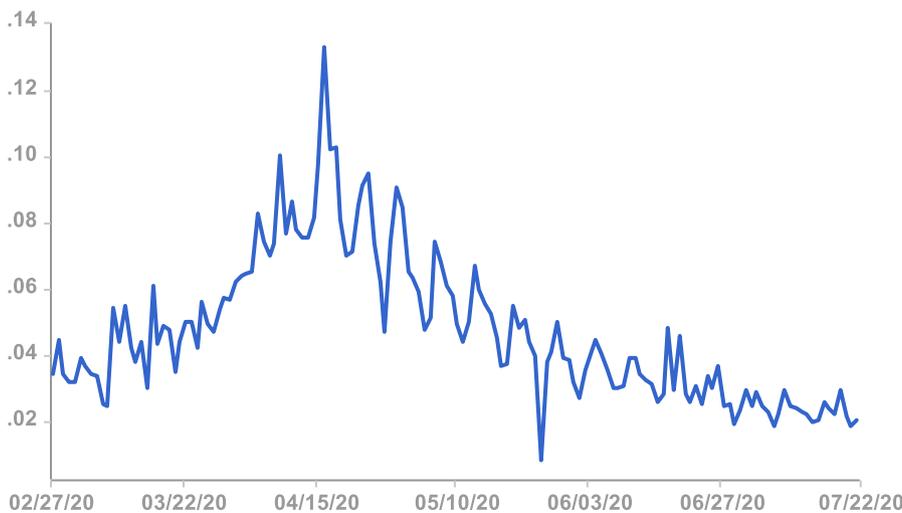
Source: Bureau of Labor Statistics

Thus, while the headline unemployment figures were no doubt jarring, adjusting for relative wage rates across industries, we believe the damage was not as bad as the market was discounting in late March. Certainly, unemployment benefits of \$600 per week have helped to offset wage declines, but incomes have also been aided by the stimulus checks of \$1,200 per individual. Personal incomes declined YoY 2% in March but rose more than 10% in April due to the impact of the distributions

Pandemic Spread

The third factor we assessed in portfolio positioning was progress in both treating Covid-19 (therapeutics) and in prevention (vaccines).

Figure 6: Worldwide Covid-19 Case Fatality Rates (CFRs)



Source: University of Oxford, GCDL

In general, it appears that healthcare providers are getting better at treating the disease. As we noted previously, it is unclear to us if this is a function of more experience, better therapeutics, younger cohorts or viral mutation. But it is clear that across the globe, Case Fatality Rates (CFRs) are generally declining. On both the therapeutic front and the vaccine

front, the data from early state clinical trials have been promising, and perhaps, at the margin, a bit better than the market feared. Indeed, on a global scale, the health care industry and policy makers are coordinating a response to the Covid-19 threat that is arguably unprecedented in its scope.

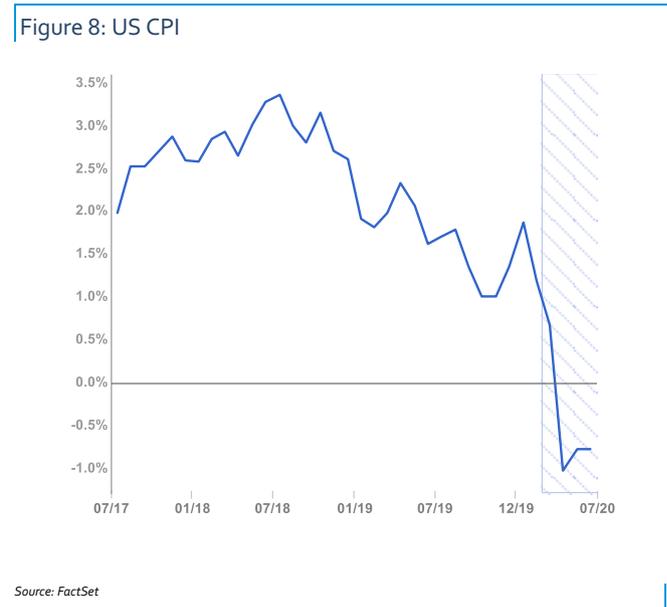
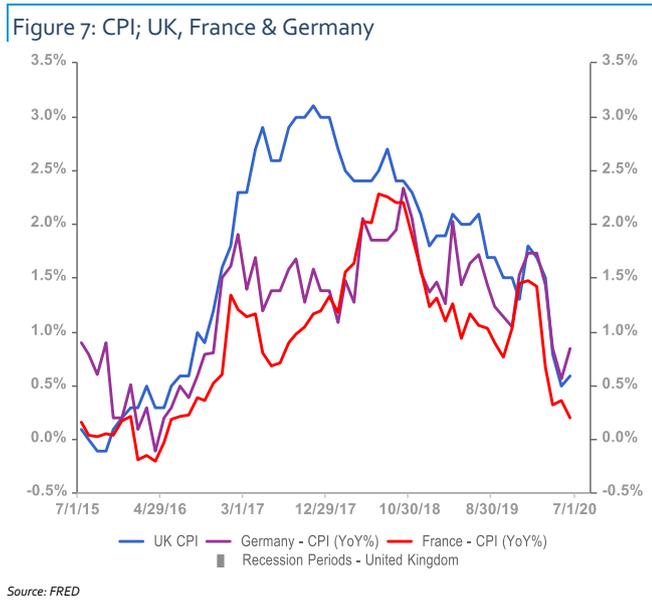
On the therapeutics front, the good news is CFRs are declining, as noted above. To date, three therapeutics are approved to treat Covid-19: dexamethasone in the UK, Avigan (Fujifilm Toyama & Zhejiang Hisun Pharma) in China, Italy and Russia; and Veklury (remdesivir-Gilead) in Japan and Australia. Currently, INOpulse (Bellerophon Therapeutics), Veklury, Dexamethasone, Actemra (Roche) and RLF-100 (NeuroRX and Relief Therapeutics) are currently at least in Phase II or Phase II/Phase III studies.

On the vaccine front, there are several viable candidates on a fast track; it appears that viable vaccines may be available as soon as fall 2020. How effective the vaccines are, how long they provide protection, and whether they can be produced in the type of numbers to protect global citizens will not be evident for several months. But here again the takeaway is that progress on a vaccine appears to be slightly ahead of prior market expectations.

The US Government, through Operation Warp Speed (OWS), is partnering with 18 biopharmaceutical companies to accelerate the development and production of drug and vaccine candidates for Covid-19. The government has selected three vaccine candidates to fund for Phase III trials: Moderna's mRNA-1273; the University of Oxford and AstraZeneca's AZD1222 and Pfizer and BioNTech's BNT162. It is our understanding that the government is currently funding the production of all three, such that once efficacy and safety is established, there should be limited delay in distributing vaccines to the public.

Long-term Investment Framework: Sowing the Seeds of Inflation?

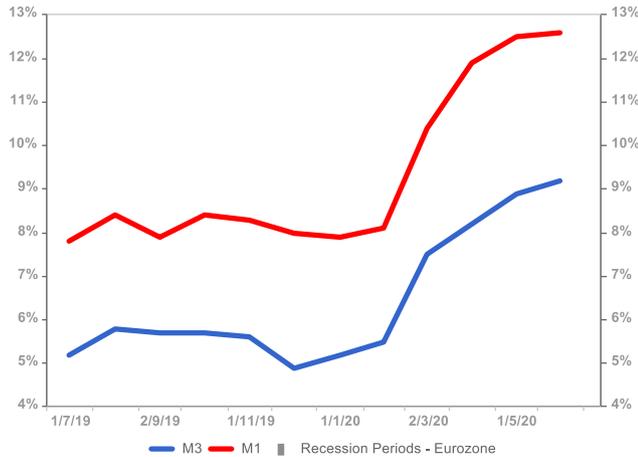
Assessing the long-term implications of the current policy response is fraught with danger. We, like others, worried about the potential risk of inflation given the response to the global financial crisis (GFC) that never quite materialized.



Yes, there were pockets of inflation over the last decade, but in general the combination of excess capacity, embrace of free trade, an over-supply of oil, aging demographics in the

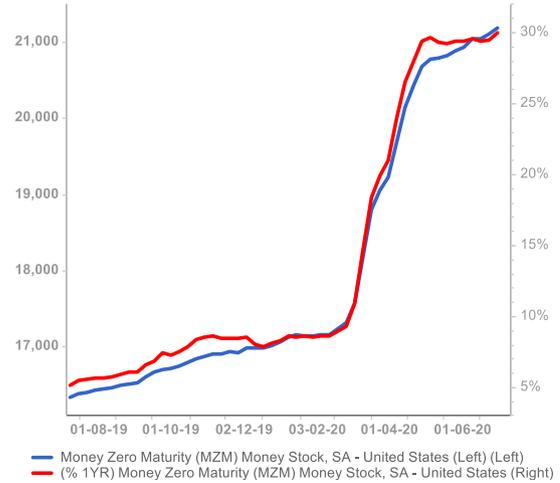
developed world, technological innovation and the rise of low-cost exporters to US markets (China) has led to fairly subdued and declining inflation rates for the last few years. How much of this decline is cyclical vs. secular is tough to divine, but clearly price levels have remained stubbornly low and chronically below the Fed's 2% target. Of course, there is the argument that we are looking for inflation in the wrong places (goods and services) instead of where it really is (financial assets).

Figure 9: M1 and M3, Eurozone



Source: FRED

Figure 10: MZM, US



Source: FactSet

While it is clear that price levels have generally been declining since early 2018 in the Eurozone and since the summer of 2018 in the US, broad measures of money supply growth both in the Eurozone and in the US show a material acceleration in the last few months as a result of the policy decisions implemented in response to the pandemic (Figures 9 & 10).

Figure 11: Gold (LHS) vs. TIPS (RHS – Inverted)



Source: FactSet

The rise in the money supply and the potential concomitant rise in price levels has not been lost on investors. Assets generally perceived to be inflation hedges, such as gold and TIPS

(Treasury Inflation Protected Securities), have been rising in tandem (R-sq. of 0.89) since early June (See Figure 11 on the previous page).

If the expansion of the money supply around the globe results in material inflation, investors that fled to cash in March 2020 (and remain in that position) will suffer from poor financial returns in the future. Indeed, one could argue that higher-than-expected inflation would allow governments to effectively pay down their significant borrowings more easily from lenders who were content accepting a fixed risk-free rate of near zero.

As we have noted several times in this newsletter, the investment implications of the aforementioned concerns are difficult to navigate. In looking at the near to intermediate term, we are keeping a watch on the following factors or issues and making portfolio changes as appropriate:

1. Virus (mutation or second wave) vs. Vaccine. We see the potential for either outcome as likely to move financial markets significantly. While the price of volatility has made options expensive to purchase, a longer dated strangle (i.e. long volatility) is one possible means of navigating the above divergent outcomes.
2. Growth vs. Value. The former has dominated the latter investment style for well over a decade. However, the second quarter saw better relative performance of Value as investors started to anticipate a "V" shaped global economic recovery. With an eye towards valuation discipline as many "growth" leaders have reached surprisingly high multiples and the S&P has become more concentrated, we have begun to rebalance our portfolios by adding more value positions.
3. Inflation vs. Deflation. As noted above, the emergence of inflation would argue for owning commodities, real estate, emerging market stocks, TIPS and floating rate notes. On the other hand, should the global economy face a virulent second wave hit, investors may need to worry more about deflation. Such deflation would argue for a very different portfolio, including US Treasuries and high-quality companies with rock solid balance sheets.

NB: The authors would like to thank both Thomas Berle Carman and Alex Herzig, our summer interns, for their help and research support in producing this quarterly newsletter.

Forecast: 2020 & 2021

Rockingstone Advisors: Our Latest Forecasts

We have updated our forecasts to reflect the latest views on 2020 and some initial perspective on 2021. We are generally cautious on both growth factors for 2020 with slightly more optimism regarding the world's ability to rebound in 2021. We see an ongoing battle between the public health policy challenges of the pandemic and the desire to restart economies around the world.

Figure 12: Key Metric Forecast

Metric	Year End December	
	Band	Point
US Real GDP (2020)	-5.0% to -10.0%	-8.0%
US Real GDP (2021)	+5.0% to +11.0%	8.4%
S&P 500 2020 EPS (RSA/Street)	NA	\$105 / \$109
S&P 500 2021 EPS (RSA/Street)	NA	\$150 / \$161
S&P 500 2020 Index	2700-3250	3175
10-Yr US Treasury Yield	0.4% - 0.9%	0.8%
Oil (WTI-2020 End)	\$25- \$50	\$35
Gold (2020 End)	\$1,800 - \$2,200	\$2,000
Inflation (NTM)	0% to +1.5%	0.5%

Source: Rockingstone Advisors, The Economist, Standard and Poor's, NYSE Arca, St. Louis Federal Reserve

We have updated our key metrics forecast given the current economic environment. We stress, though, that given the binomial nature of the pandemic, the uncertainty around the pace of the recovery, as well as the potential impact of current Federal Reserve policy, it is exceptionally hard to forecast with any degree of confidence. In updating our latest outlook and making some preliminary assumptions regarding the impact of the virus, it is clear that significant estimate changes are required along with wider than usual ranges. A few observations and comments:

1. Gross Domestic Product (GDP). We are now forecasting an 8.0% decline in US Real GDP for 2020 and an 8.4% rebound in 2021. Based on our review of prior pandemics including 1957-58, we expect a deeper contraction in 2Q20 and 3Q20 vs. the consensus outlook at this time. Given ongoing battles to contain the outbreak in southern states, plus the risk of a second wave this winter, we believe it is prudent to assume a bigger reduction in the economy's output. Similarly, we think 2021 will rebound but are cautious that next year could start out poorly as the virus continues to impact production.
2. S&P 500 EPS. We are reducing again our forecast for 2020 S&P earnings from \$125 per share to \$105. While demand is slowly recovering, the pace of improvement will be patchy, and companies will take advantage of the "free pass" the pandemic affords them to undertake long-desired investments. Looking to 2021 on a preliminary basis, we believe corporate profits can rebound to \$150, which is a downgrade from our earlier expectation of \$161. Yet we emphasize such a forecast is challenging given the vagaries of predicting the virus impact into 2021 and how companies adapt.
3. S&P500 2020 Index. Our outlook for the year end 2020 S&P500 rises to 3175 although we note our unusually wide range of 2700 to 3250. We use a 21.2x

multiple on “normalized” 2021 EPS of \$150 to arrive at our target. With the pandemic impacting so many different variables, we can understand some investors using a lower multiple. However, with the 10-year Treasury yield at 0.59%, we stress that record low discount rates could support “historically inflated” P/E multiples.

4. 10-Yr Treasury Yield. We noted earlier that historically low Treasury yields exercise a disproportionate impact across all financial assets, as financial assets are generally priced off of this yield. We continue to believe fiscal stimulus and quantitative easing may ultimately put pressure on higher yields. We expect to end the year around 0.8% on the 10-year.
5. Oil. Production cuts and rising demand overseas have stabilized energy prices for now. Assuming ongoing discipline among energy producers (admittedly a big assumption as low interest rates have arguably spurred on production that hasn't generated a positive return) and increases in demand in the US, we would expect oil to remain above \$40 per barrel. Our year-end target is \$45.
6. Inflation. The PCE is currently trending around 1.64%, and CPI a bit lower. We do expect, at least near-term, some additional downward pressure on prices due to excess capacity and lack of demand. Overtime, however, we expect inflation to start to rise again, though not at least until 2021.

Five Year Asset Value Forecastⁱⁱⁱ

Our calculations point to reasonable long-term equity returns

As usual one of our main assumptions regarding capital markets is that asset values mean-revert (with respect to margins and P/E multiples) over time. It is difficult to have a lot of confidence in forecasting these days with the pandemic altering behaviors, central banks being more aggressive than ever along from the usual trade disputes, political squabbles and creative destruction associated with free market capitalism

With the S&P500 being dominated by a few large cap tech companies where valuation has reached unprecedented levels, it isn't too surprising for our "US Large Cap Stock" projected returns to be essentially flat. The same analysis holds true for "US Mid Cap Stocks" as well as "Foreign Developed Market (DM) Stock." Both "US Small Cap Stock" and "Foreign Emerging Market (EM) Stock" appear to offer the best returns. As noted earlier in this report, we shifted to more exposure to the latter group.

Figure 13: Five-Year Total Equity Return Calculations (Incremental Contribution)

Five Year Total Equity Return Calculations (Incremental Contribution)

Asset	Index	LT Exp. Return		Sales		Profit Margin		Div.Yield		Valuation
US Large Cap Stock	S&P500	-0.3%	=	5.3%	-	0.5%	+	1.8%	-	7.0%
US Mid Cap Stock	S&P400	1.8%	=	4.9%	+	0.3%	+	1.8%	-	5.2%
US Small Cap Stock	S&P600	6.6%	=	6.1%	+	9.0%	+	1.9%	-	10.5%
Foreign DM Stock	MSCI-EAFE	1.3%	=	2.9%	+	1.0%	+	3.1%	-	5.7%
Foreign EM Stock	MSCI-EM	7.0%	=	6.5%	+	3.9%	+	2.5%	-	5.8%

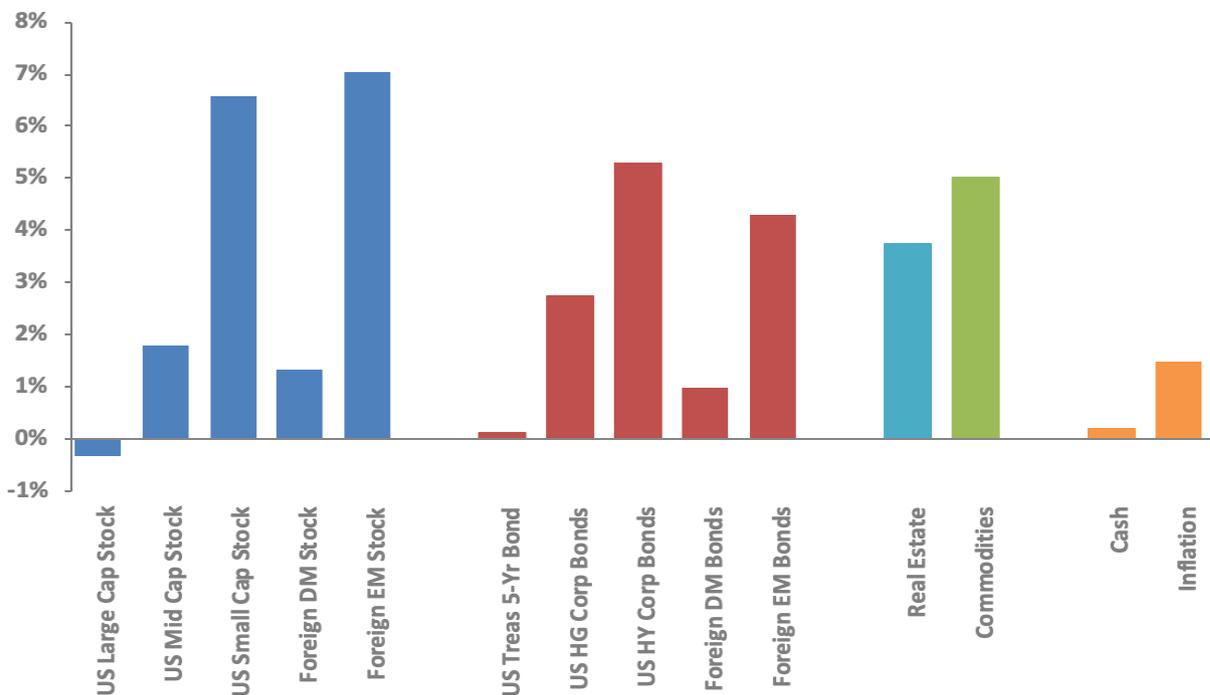
Source: Rockingstone Advisors

We analyze equities using four variables such as (1) historical sales growth, (2) corporate profit margins, (3) dividend yields, and (4) valuation to determine potential long-term returns. Using valuation as an example, P/Es should theoretically decline (if currently above the historical mean) or expand (if currently below the historical mean) over the long term.

Based on our outlook for total returns, we expect the "give" of sales growth, valuation and dividends to be partly offset by the "take" of mean-reverting margins. We expect sales growth to be relatively close to long term average performance although presently the economy suggests lowered expectations are likely prudent. Profit margins are high vs. history but we don't see significant pressure (due to ongoing productivity and cost reduction measures) in the next few years as well as benign inflation.

In fixed income (see the next page for various assumptions), we expect the "give" of coupons will be exceeded by the "take" of mean-reverting inflation and real rates, both of which are below their historical mean. Of course, short-term returns may not necessarily match our longer-term return predictions; markets are significantly more random over the short-run than the long-run.

Figure 14: Five-Year Asset Class Total Return Forecast



Source: Rockingstone Advisors

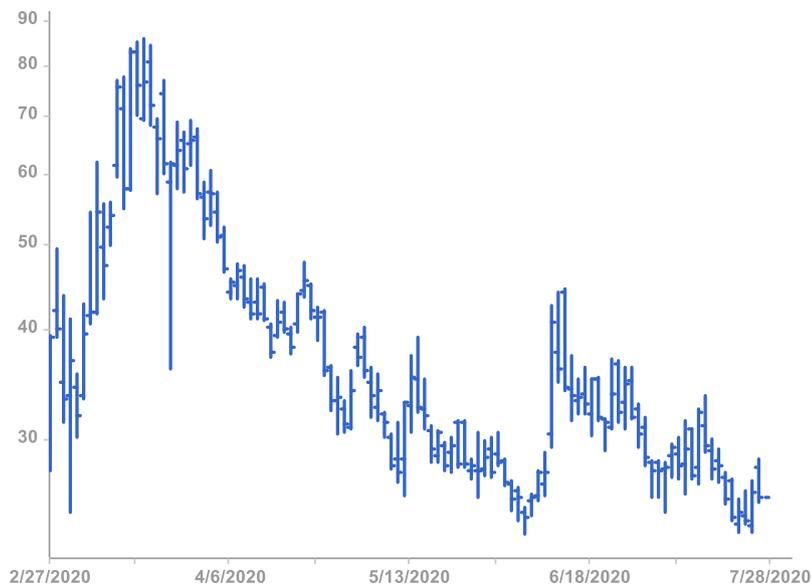
Asset Class Performance Review

So far looks more like a “V” for now

As noted previously, the second quarter witnessed a robust and generally unfettered rise of asset prices across global markets as volatility declined after peaking in March 2020. For investors unfamiliar with the VIX, it is a measure of volatility that uses forward looking options which gauge investor views on future price probabilities.

As evidenced in Figure 15, during the latest crisis fueled by the global pandemic, the VIX hit a high of 85.5 on March 18, 2020, a few days before the market bottomed on Monday, March 23rd. Subsequently, the VIX has generally declined through the second quarter, although it rose briefly in early June. Currently the VIX stands at 25.

Figure 15: CBOE Volatility Index



Source: FactSet

As noted previously, the sources of the decline in volatility and the rise in asset prices were due to a combination of a flood of liquidity from central banks and fiscal stimulus from governments, a sense that the sell-off had gone too far too fast, and lastly, perhaps a view that ultimately the health crisis would be contained within a finite period of time, say one-to two years, three at worst, and life would subsequently return to pre-pandemic levels.

It is an important reminder to investors that securities are generally worth the present value of a stream of discounted cash flows. In any given year, that year's cash flow is just one out of a stream of many future cash flows, theoretically in perpetuity. This is typically the answer to why equities can remain at price levels that sometimes can seem irrational given the near-term outlook.

Equity Performance Review

Stocks shrug off SARS-CoV-2 case numbers

After a wild ride down in the first quarter, global equities staged a remarkable recovery in the second quarter.

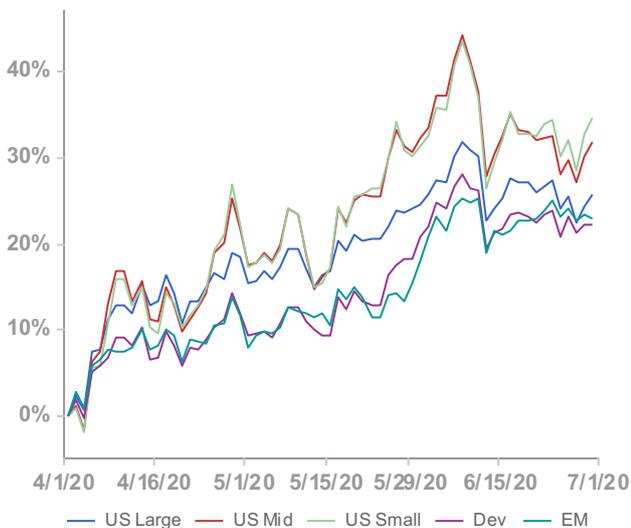
US small and mid-cap stocks led the way, besting their large cap brethren in the rebound as large caps had been a relatively safe harbor in the downturn. US small and mid-cap stocks peaked in early June (up over 40% in the quarter), declined in mid-June and then closed the quarter off their lows but below the early June highs, rising about 25% in the quarter. International Developed and Emerging stocks underperformed US stocks given the ongoing strong dollar and less robust stimulus packages, rising in the high teens.

Equity investors were generally focused on new SARS-CoV-2 case numbers; as case numbers began to decline in the spring, equities began to rally. Mobility data and other coincident economic indicators were beginning to signal that the pace of declines in economic activity were starting to ebb as the lockdowns ended first in southern states, and then in May, in the northern states. As equities are discounting mechanisms, investors were looking out to the summer and fall with the expectation of an economy that while not back to its previous high would at least be operating well above its current levels.

And while case numbers began to expand in June following Memorial Day celebrations and crowded BLM protests, the rise was generally isolated to southern states that had opened previously with few Covid-19 cases. Despite the rising caseload, most hospitals in Arizona, Florida and North Carolina have spare capacity, although California is currently capacity constrained, which may explain why investors have shrugged off the data.

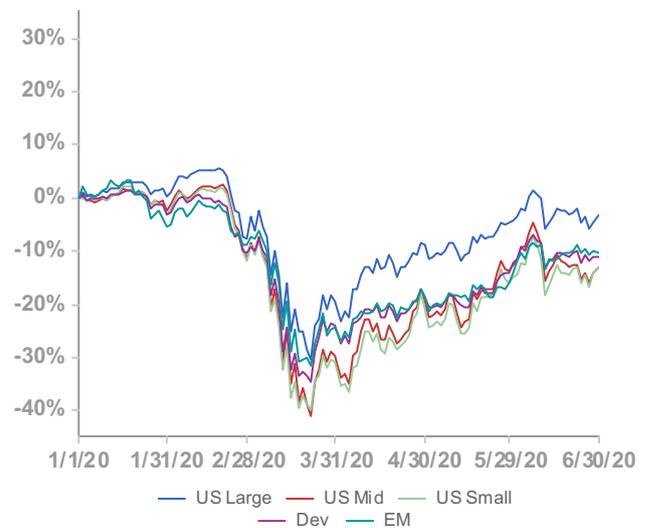
We highlight the following performance metrics regarding 2Q20 and 1H20, respectively, results: US Large Cap (+20.2% and -3.3%), US Mid Cap (+25% and -7.2%), US Small Cap (+25.5% and -13%), Developed (+16.9% and -11.2%), Emerging (+18.6% and -10.4%).

Figure 16: 2Q20 Equity Performance^{iv}



Source: FactSet

Figure 17: 1H20 Equity Performance



Source: FactSet

Fixed Income Performance Review

Sharp reversal in fixed income performance as riskiest bonds rally

Treasuries were the sole bright spot during the first quarter; however, during the second quarter Treasuries lagged as investors chased “spread” products: EM bonds, corporate bonds, municipals, high yield bonds and asset backed securities, essentially mirroring the Fed’s buying.

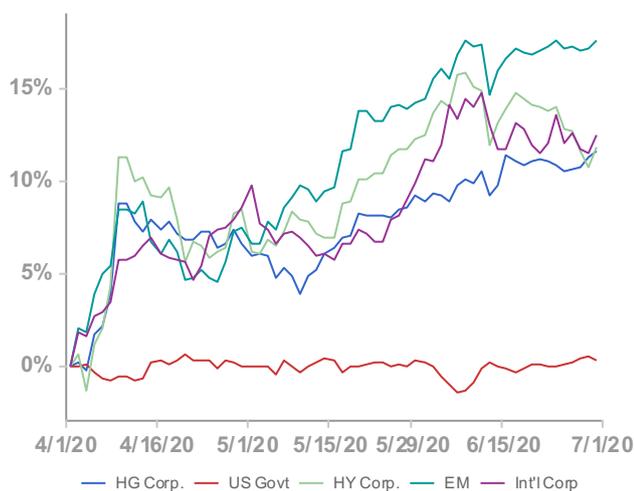
Perhaps because the Fed’s liquidity mechanisms were targeted directly to the bond market, there was a wider variability of performance relative to equities. Emerging market bonds rose 14%, corporate bonds and preferreds jumped 10%, high yield 8%, while mortgage backed securities and Treasuries rose less than 1%. Mortgage backed bonds perform particularly poorly in a rapidly declining rate environment as investors assume maturities will be shortened as homeowners look to refinance at lower rates.

What is notable is that it was merely the Fed’s statement of intention to buy bonds that resulted in the tightening of spreads and a return of liquidity. In actuality, the Fed has plenty of capacity and availability on its previously announced programs.

The most obvious outcome of the Fed’s jawboning of the markets was to drive record new issuance activity. High yield issuers raised \$63.7B in June alone, bringing the 1H20 total to \$225B. Investment grade plus securitized bond issuers raised more than \$775B, bringing total debt issuance over \$1T.

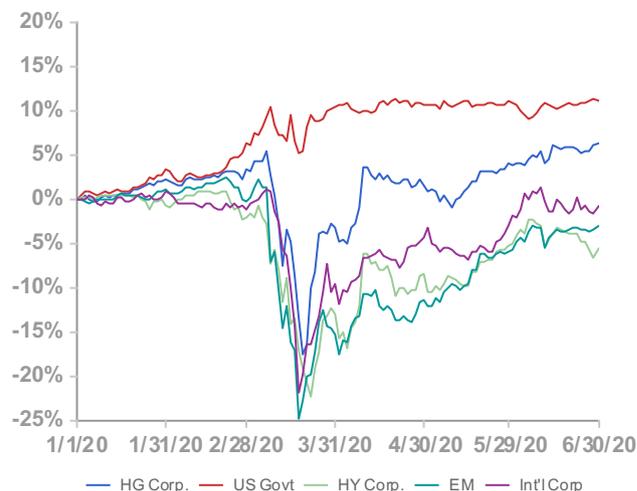
We note the following performance figures for 2Q20 and 1H20, respectively: US High Grades (+9.7% and +6.4%), US Governments (+0.7% and +11.2%), US High Yield (+8.3% and -5.5%), International developed (+2.9% and +2.5%), Emerging Markets (+14% & -3%).

Figure 18: 2Q20 Fixed Income Performance^v



Source: FactSet

Figure 19: 1H20 Fixed Income Performance



Source: FactSet

Commodity Performance Review

Precious metals retain their luster

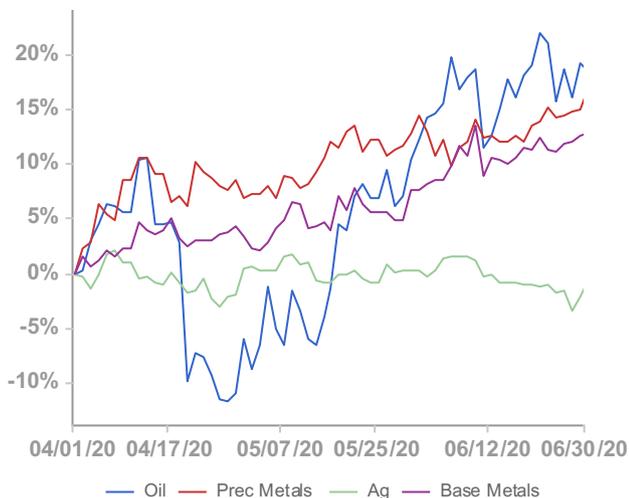
Investors should normally expect greater volatility in commodity prices relative to equities or bonds. This is because unlike stocks and bonds, commodities do not generate a stream of free cash flows that can be discounted back to present value. Commodities are also frequently susceptible to sudden supply and demand shocks impacting price.

During the first quarter, oil (indeed the entire energy complex) sustained a slew of negative developments. As governments closed transportation networks, demand for jet and auto fuel collapsed. Lower electricity from shuttered factories reduced demand for natural gas. These factors combined helped to reduce demand for oil by about 25-30 million barrels a day (mb/d). However, on April 12, 2020, major oil producing countries settled on a new agreement to cut production by about 9.7 mb/d a day; this agreement was extended in early June. Supply is currently at a nine-year low of roughly 86.9 mb/d. Demand for energy rebounded in China and India, and is recovering in the US. As a result, oil prices have begun to rise, closing the quarter above \$43 per barrel.

Outside of energy commodities, gold retained its historical role as a store of value and an inflation hedge. In fact, all precious metals performed well in the quarter, rising more than 17%. Gold settled at \$1768/oz as of June 30th, and has continued its run into 3Q20.

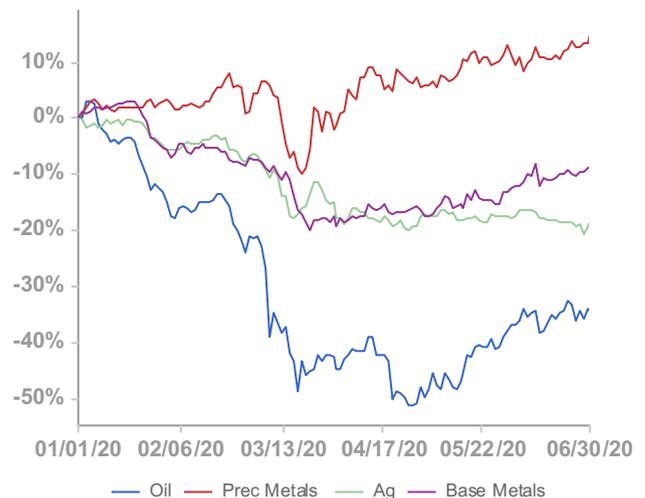
As a reminder, Rockingstone will typically invest in commodities via ETFs and the below graphs display what we view as representative performance for the underlying commodities. We point to the following returns during the 2Q20 and 1H20, respectively: Oil +14% and -34.9%, Precious Metals (+17.4% and +15%), Agriculture (-4.0% and -18.5%), Base Metals +10.2% and -8.9%.

Figure 20: 2Q20 Commodity Performance^{vi}



Source: FactSet

Figure 21: 1H20 Commodity Performance

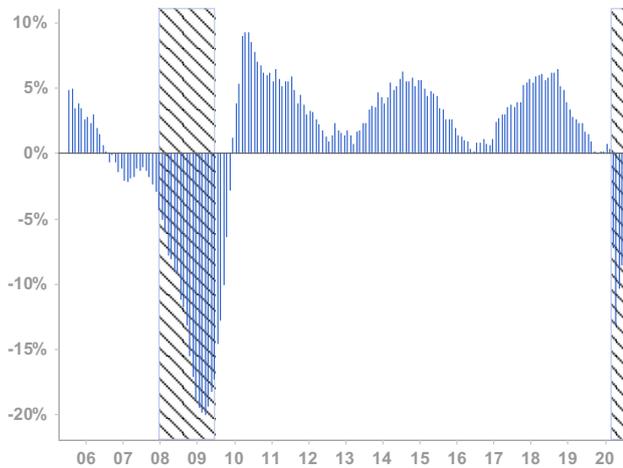


Source: FactSet

Chart Book

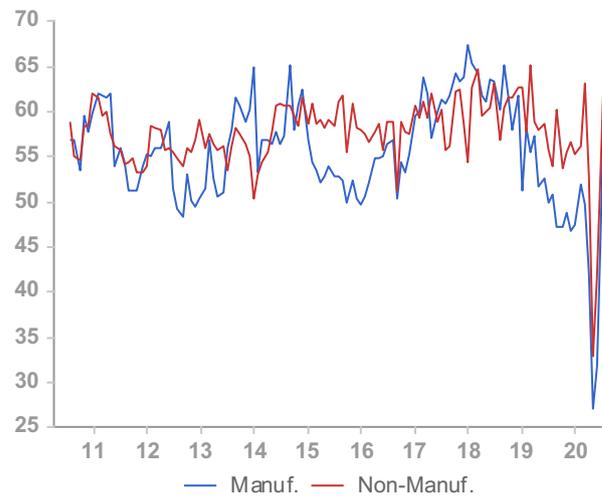
Leading Indicators

Figure 22: Index of Leading Economic Indicators



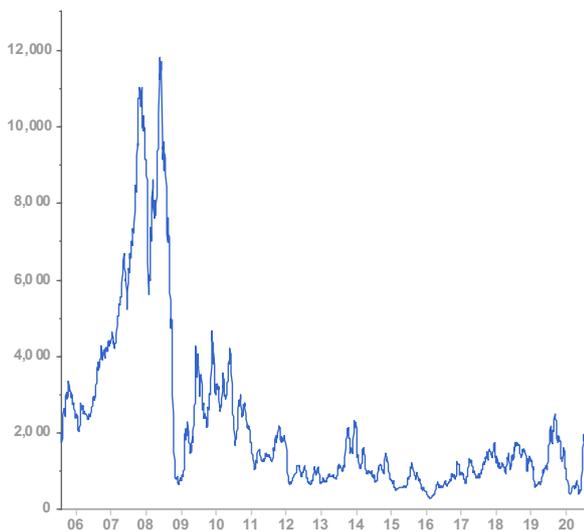
Source: FactSet

Figure 23: ISM New Orders



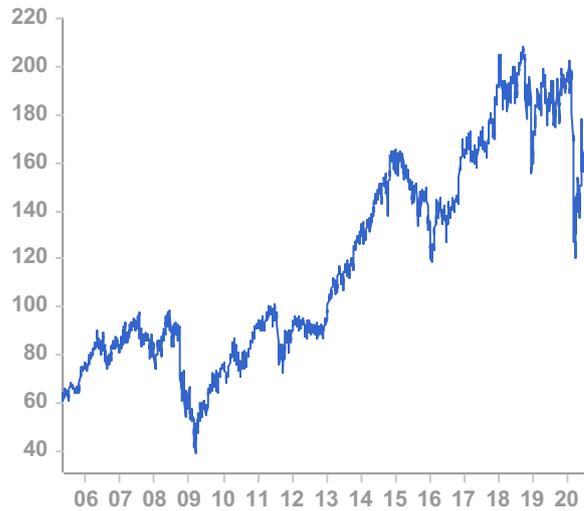
Source: St. Louis Federal Reserve, FRED Database

Figure 24: Baltic Freight Index



Source: FactSet

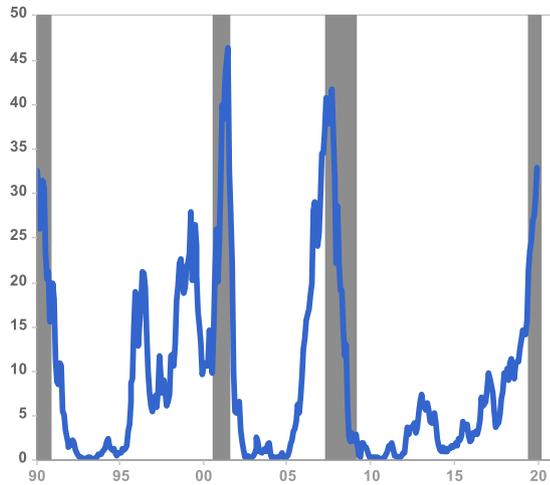
Figure 25: DJ Transports



Source: FactSet

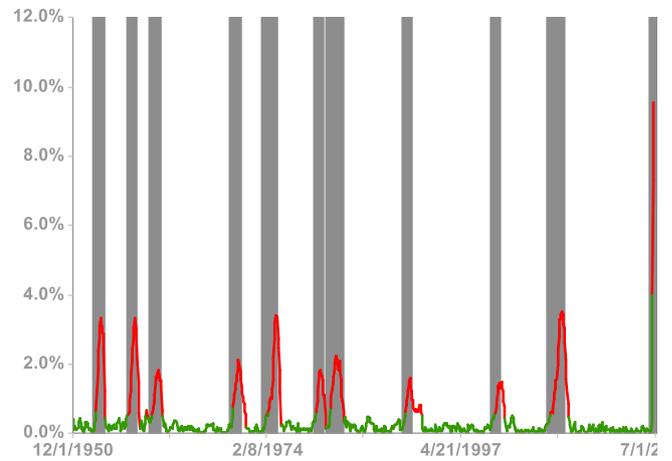
Real-time Recession Risk Indicators

Figure 26: Treasury Spread Recession Predictor



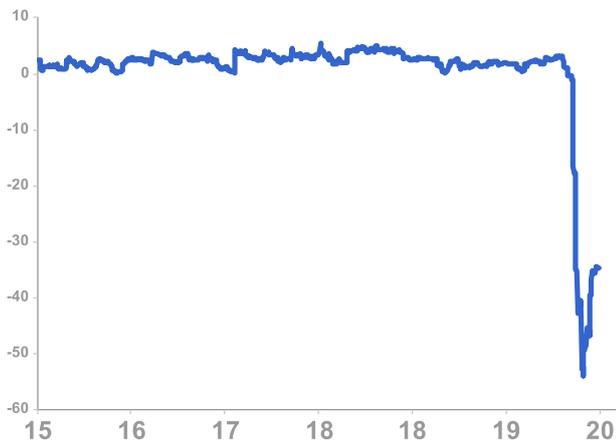
Source: FactSet, FRED Database

Figure 27: Sahm Real-time Recession Predictor



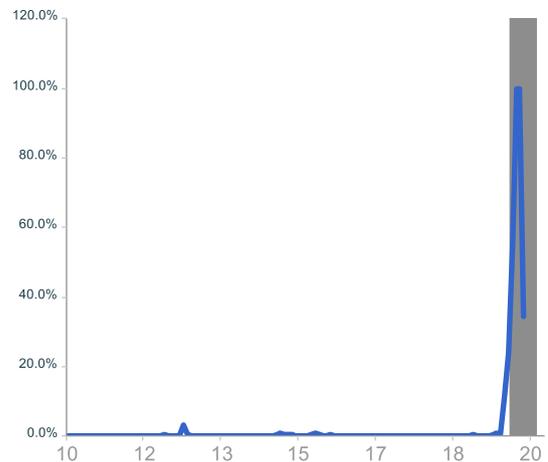
Source: St. Louis Federal Reserve, FRED Database

Figure 28: GDP Now (Atlanta Fed)



Source: FactSet, FRED Database

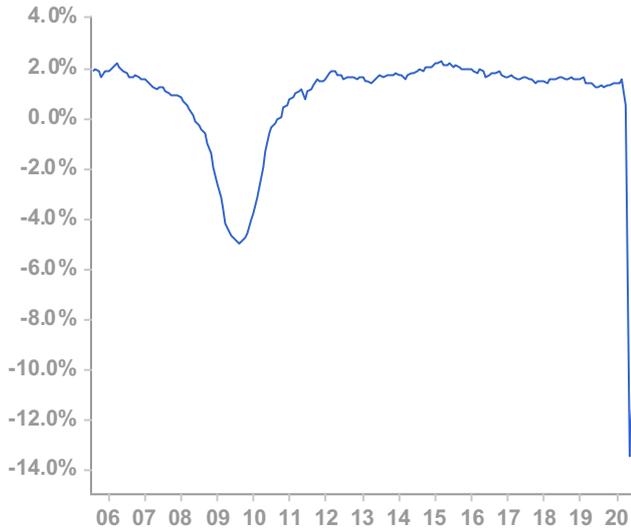
Figure 29: Smoothed US Recession Probabilities



Source: FactSet, FRED Database

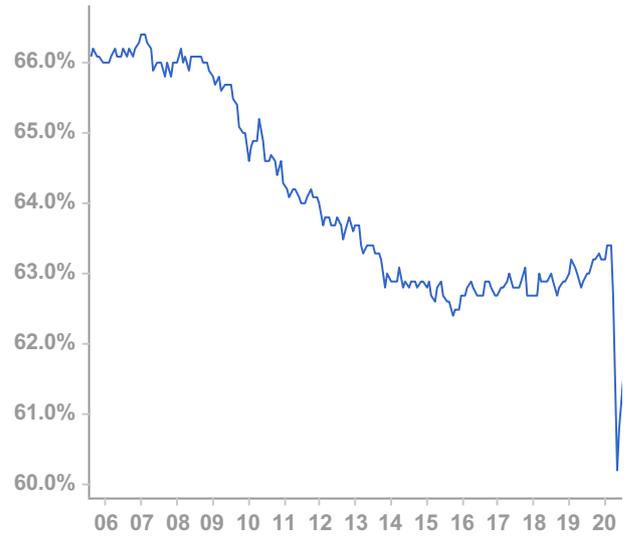
Labor Market Indicators

Figure 30: Payroll Growth (Establishment Survey, % Chg YoY)



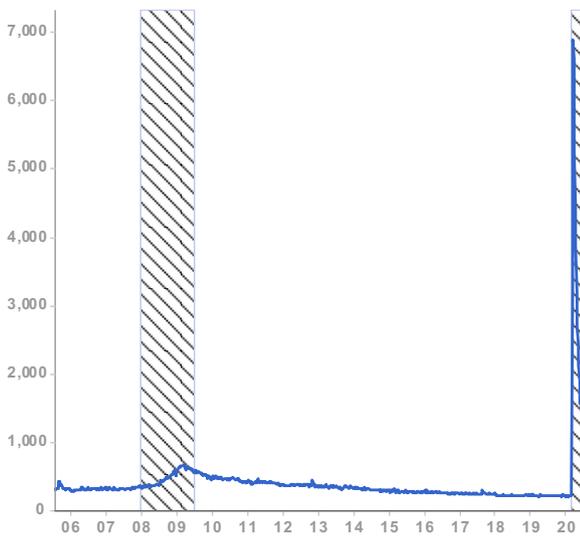
Source: FactSet

Figure 31: Labor Participation Rate (% of Workforce)



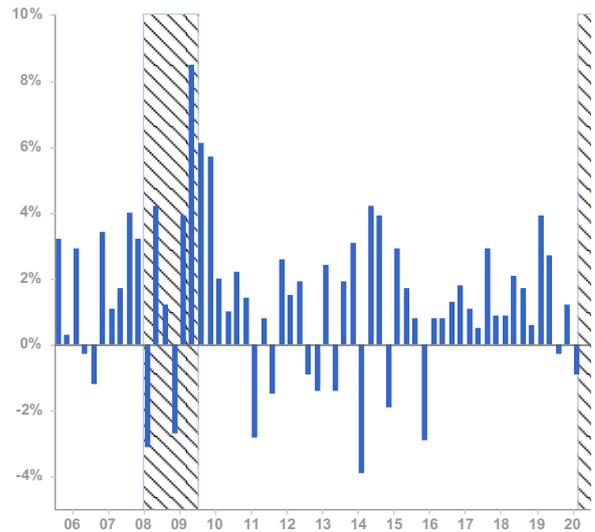
Source: FactSet

Figure 32: Initial Unemployment Claims



Source: FactSet

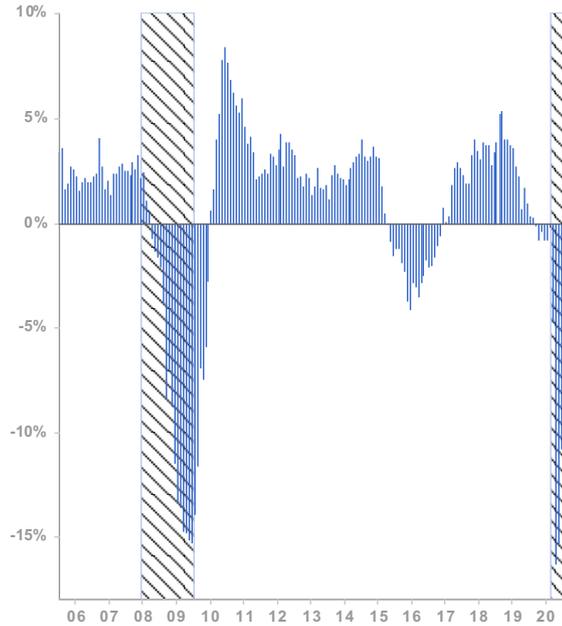
Figure 33: Non-Farm Productivity (% Chg YoY)



Source: FactSet

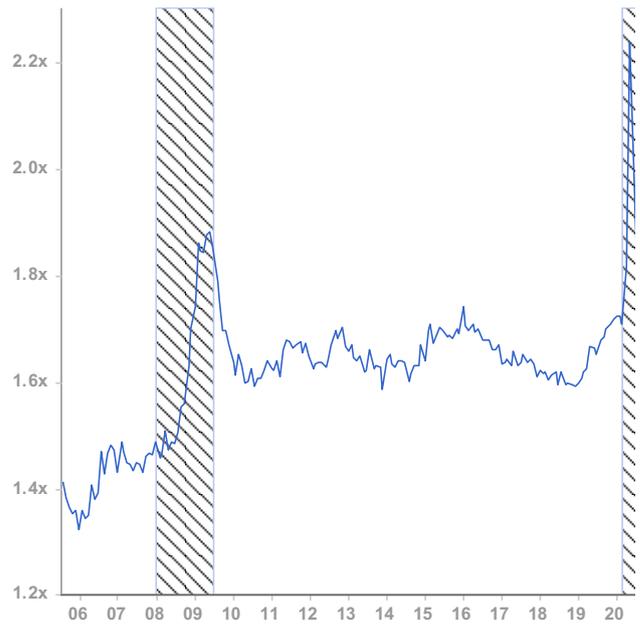
Production and Business Activity Indicators

Figure 34: Industrial Production (% Chg YoY)



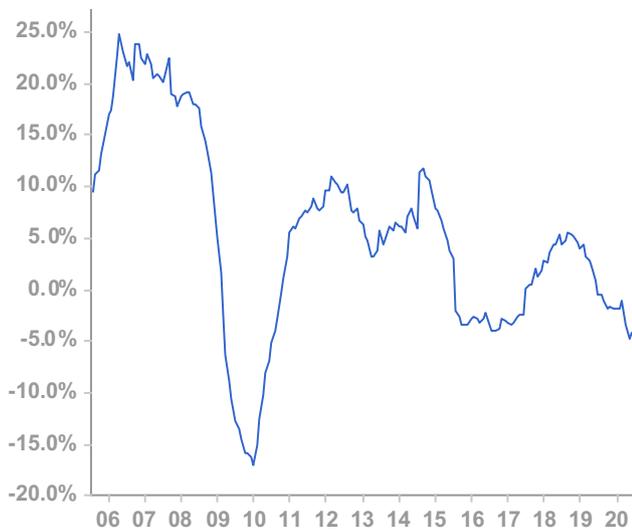
Source: FactSet

Figure 35: US Inventory to Shipment Ratio



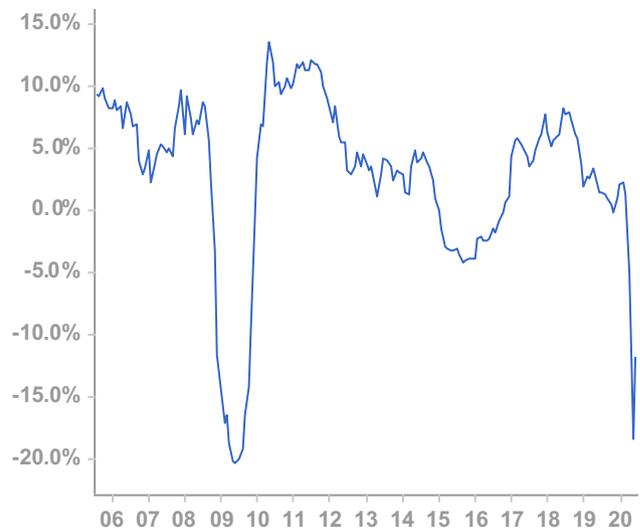
Source: FactSet

Figure 36: Unfilled Orders (% Chg. YoY)



Source: FactSet

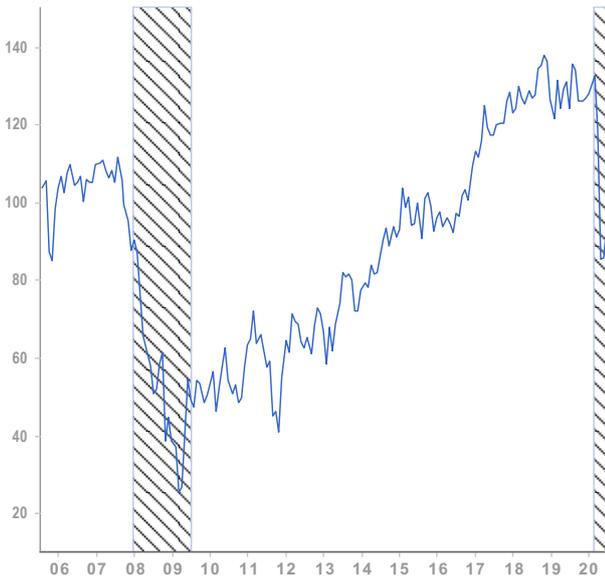
Figure 37: Business Sales (% Chg. YoY)



Source: FactSet

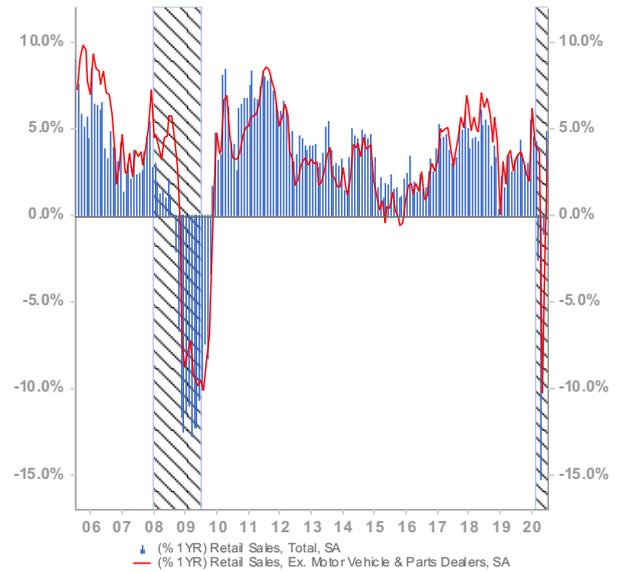
Consumer and Household Activity Indicators

Figure 38: University of Michigan Consumer Sentiment



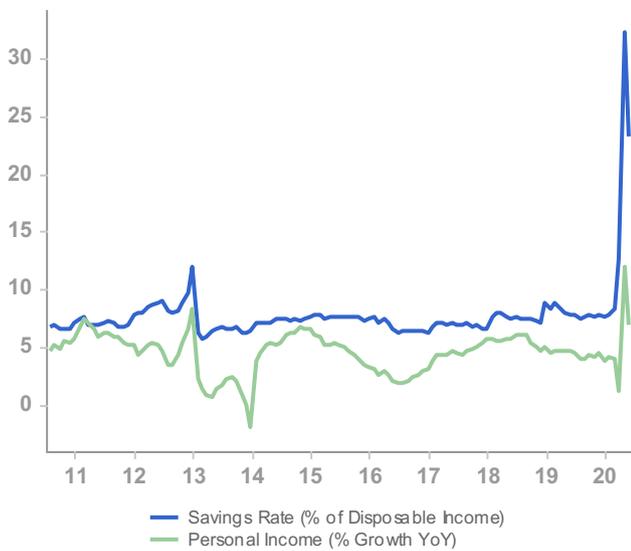
Source: FactSet

Figure 39: Retail Sales



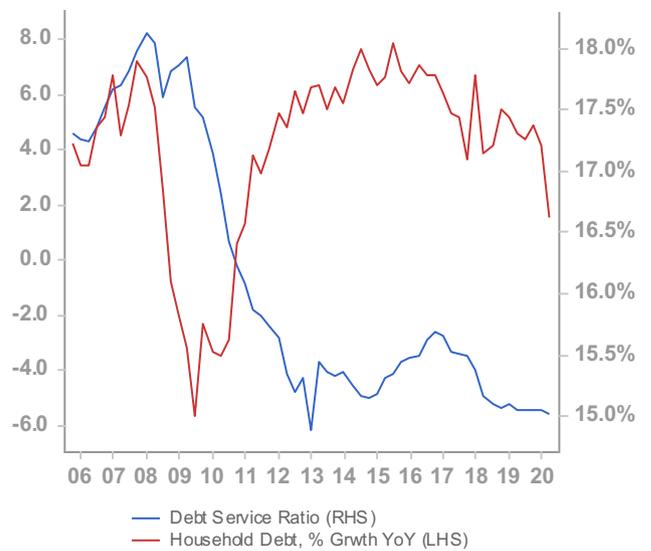
Source: FactSet

Figure 40: Personal Income and Savings Rate



Source: FactSet

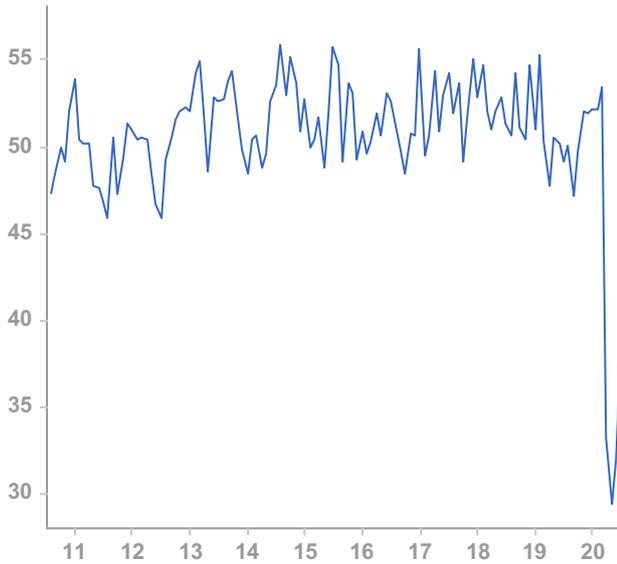
Figure 41: Household Debt



Source: FactSet

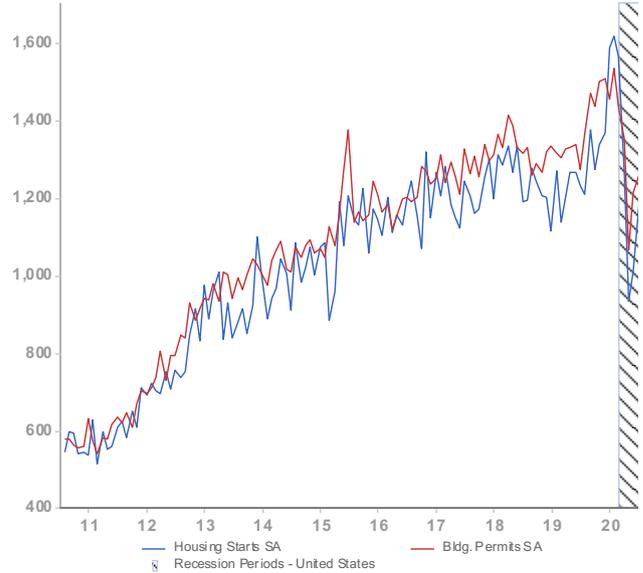
Housing and Construction Indicators

Figure 42: Architecture Billings Index



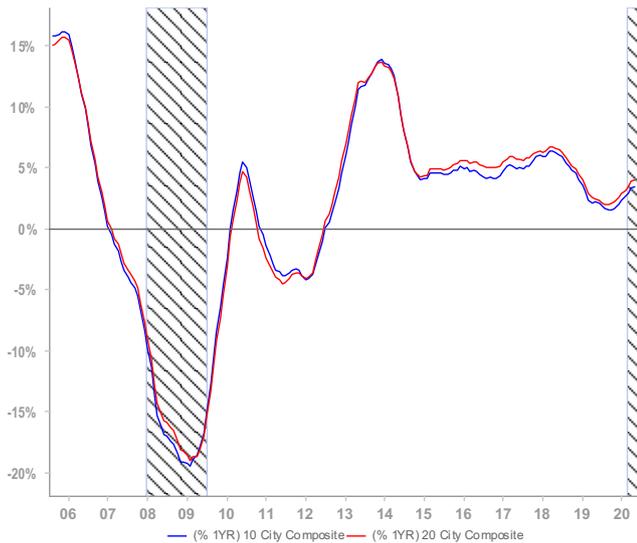
Source: FactSet

Figure 43: Housing Starts and Building Permits



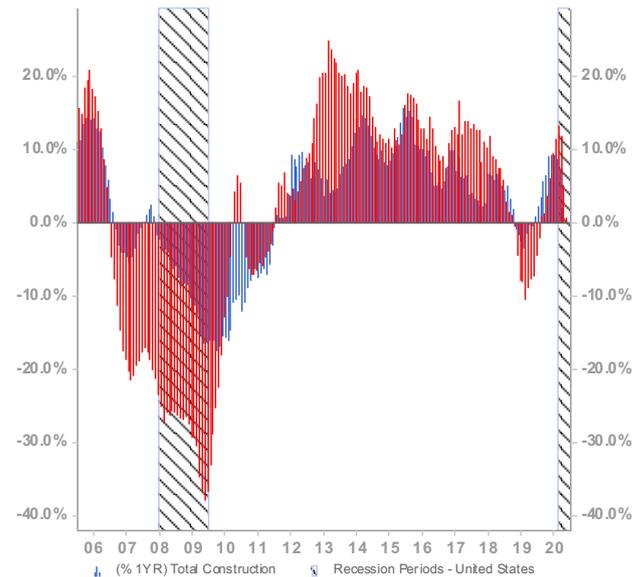
Source: FactSet

Figure 44: Case-Shiller 20-City & 10-City Index, % Chg YoY



Source: FactSet

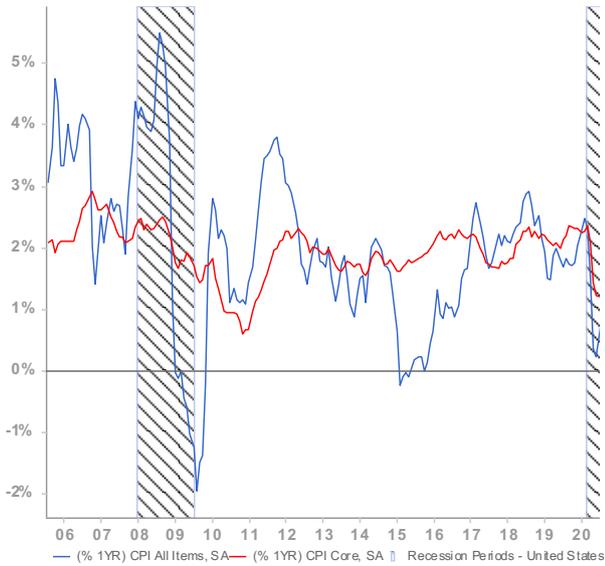
Figure 45: Private and Total Construction (% Chg YoY)



Source: FactSet

Price Indicators

Figure 46: Consumer Price Index



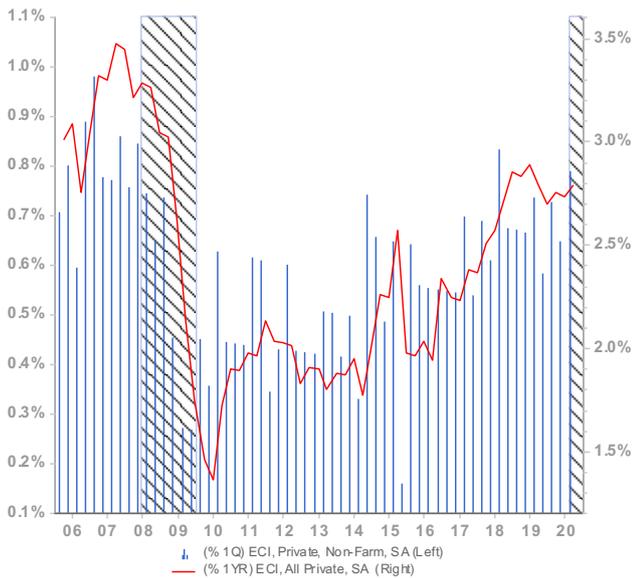
Source: FactSet

Figure 47: Producer Price Index



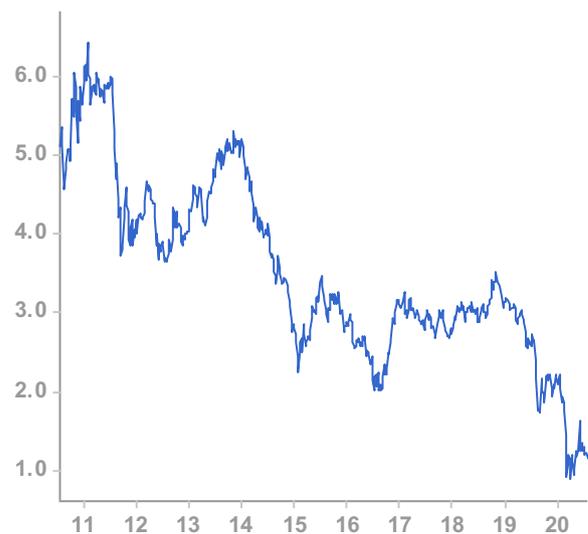
Source: FactSet

Figure 48: Employment Cost Index



Source: FactSet

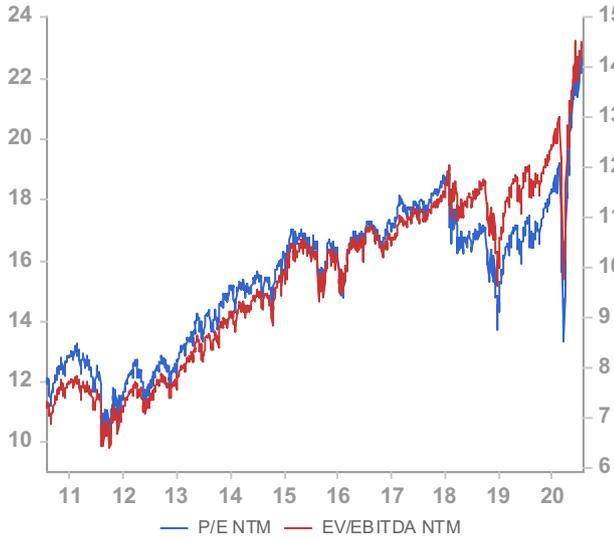
Figure 49: 10-Year, 5-Year Forward Inflation Expectations



Source: FactSet

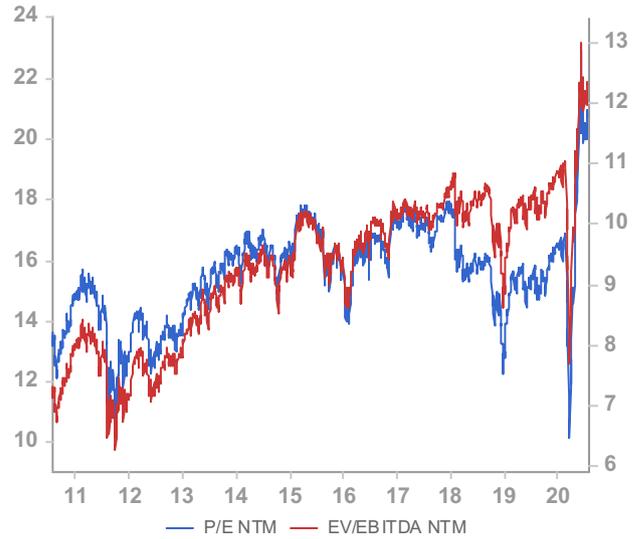
Valuation Indicators

Figure 50: S&P 500 P/E (LHS) & EV/EBITDA (RHS)



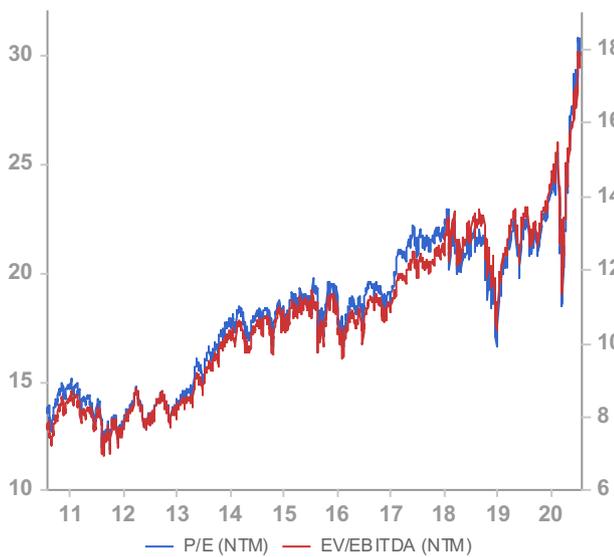
Source: FactSet

Figure 51: S&P Midcap 400 P/E (LHS) & EV/EBITDA (RHS)



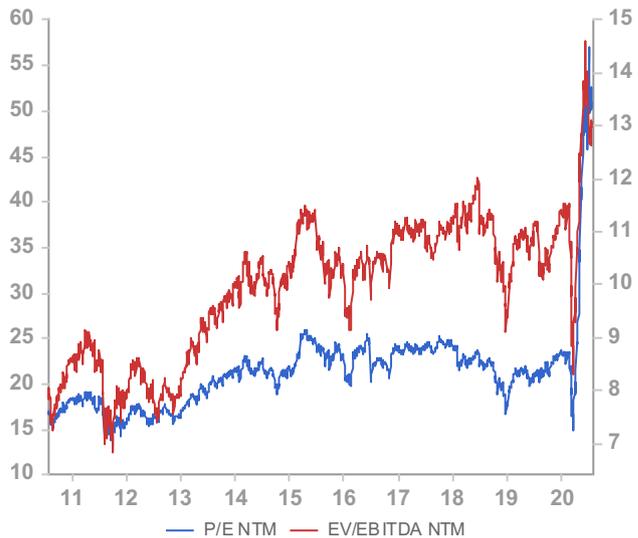
Source: FactSet

Figure 52: Nasdaq 100 P/E (LHS) & EV/EBITDA (RHS)



Source: St. Louis Federal Reserve, FRED Database

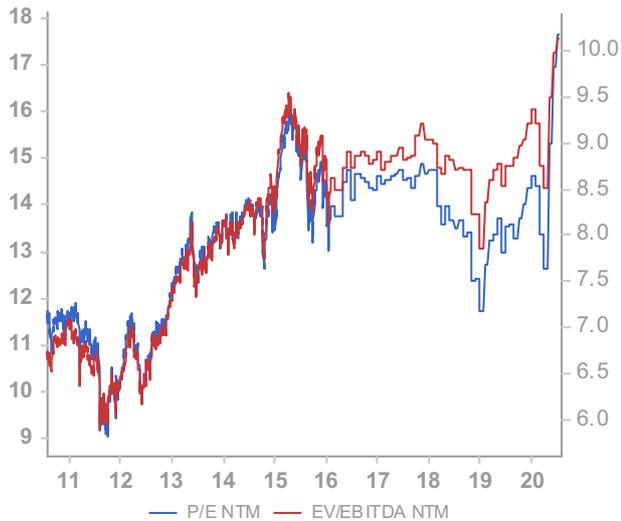
Figure 53: Russell 2000 P/E (LHS) & EV/EBITDA (RHS)



Source: St. Louis Federal Reserve, FRED Database

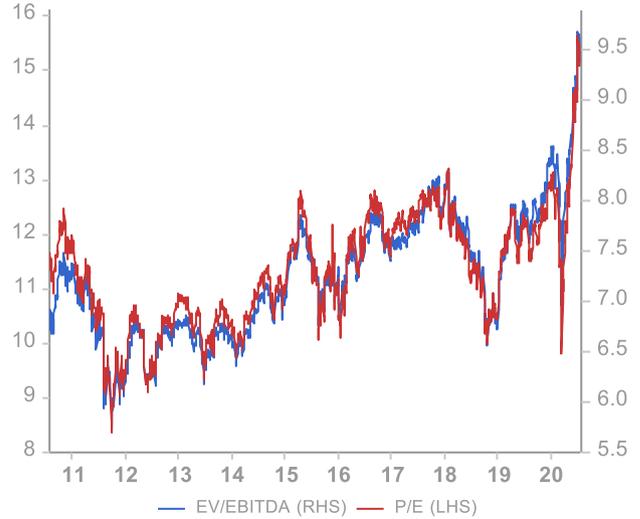
Valuation and Volatility Indicators

Figure 54: Intl Developed P/E (LHS) & EV/EBITDA (RHS)



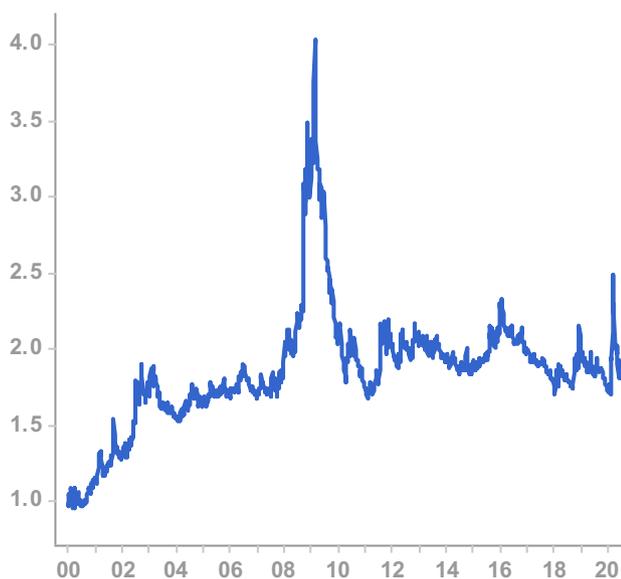
Source: Robert Shiller, Yale University, Rockingstone Advisors, Standard & Poor's

Figure 55: Emerging Markets P/E (LHS) & EV/EBITDA (RHS)



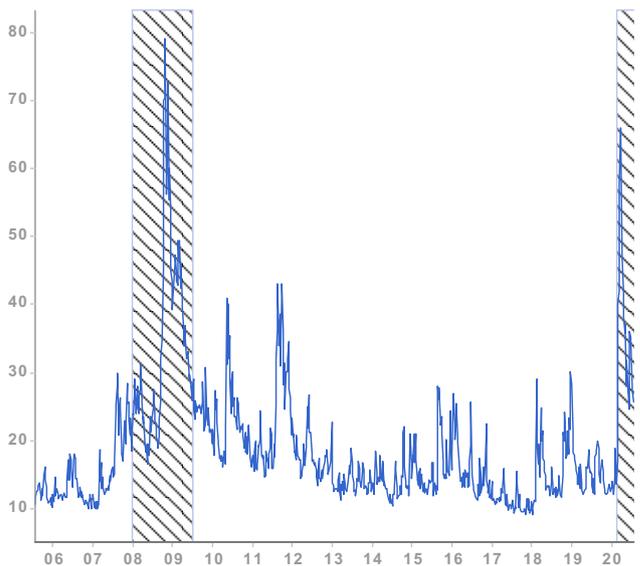
Source: Robert Shiller, Yale University, Rockingstone Advisors, Standard & Poor's

Figure 56: S&P 500 Dividend Yield



Source: FactSet

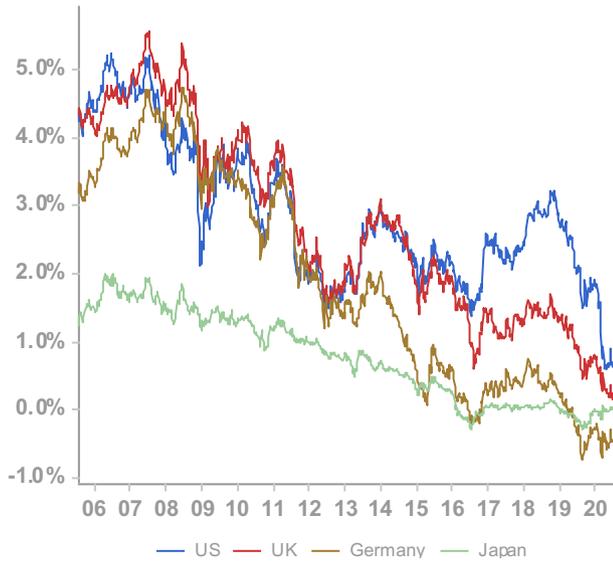
Figure 57: CBOE Volatility Index



Source: FactSet

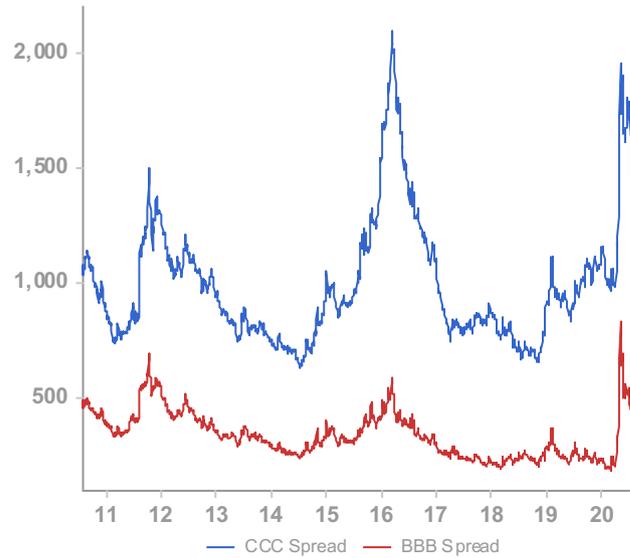
Bond Market Indicators

Figure 58: 10-Year Global Bond Yields



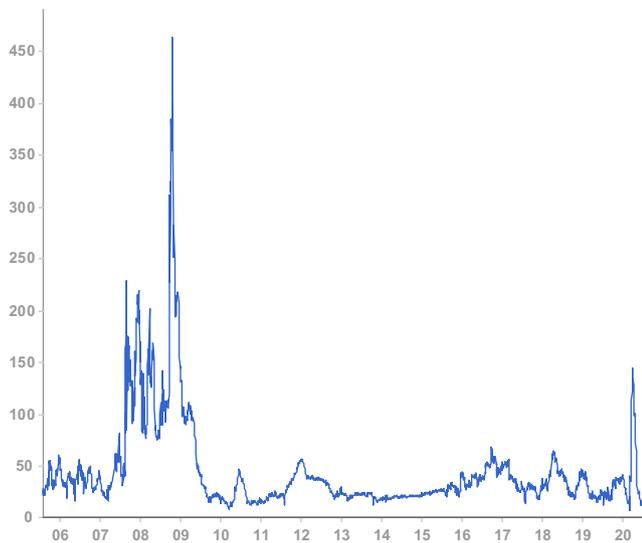
Source: FactSet

Figure 59: CCC and BBB Spreads (Option Adjusted)



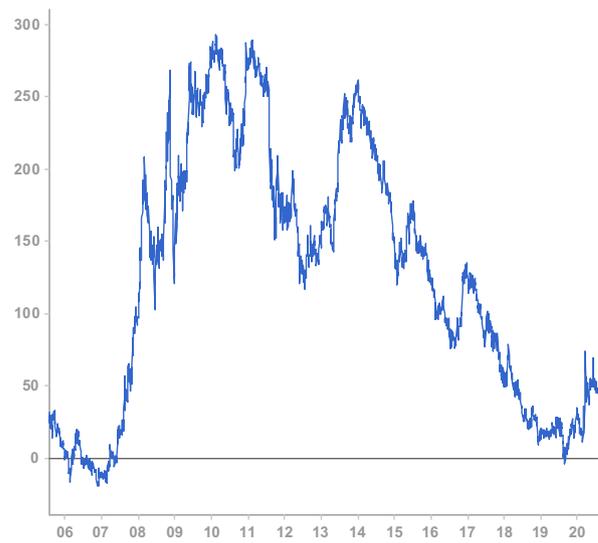
Source: FactSet

Figure 60: TED Spread (bps)



Source: FactSet

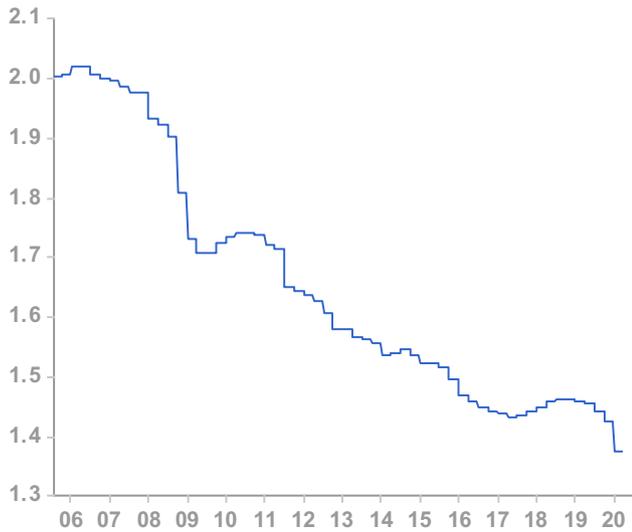
Figure 61: 10-Year Minus 2-Year Treasury



Source: FactSet

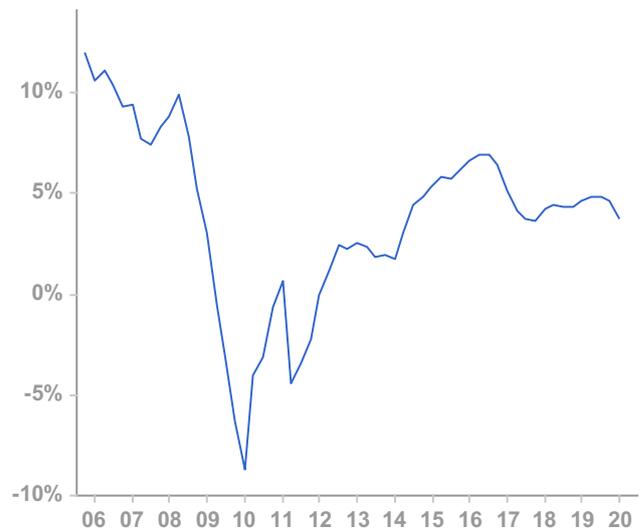
Liquidity and Other Indicators

Figure 62: Velocity of M2 Money Stock



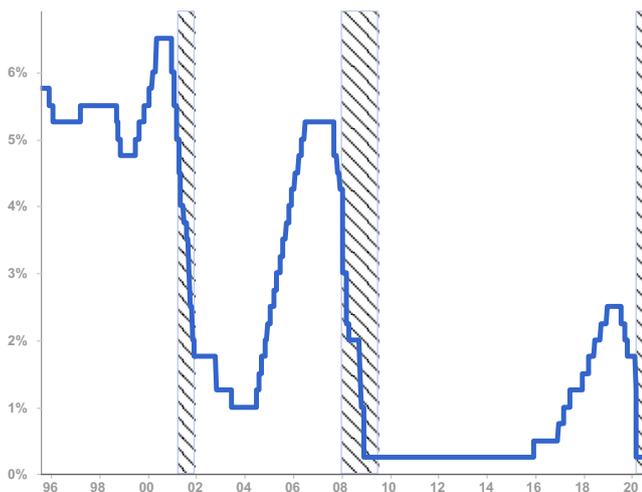
Source: FactSet

Figure 63: Loan Growth (Non-Financial, Private Sector)



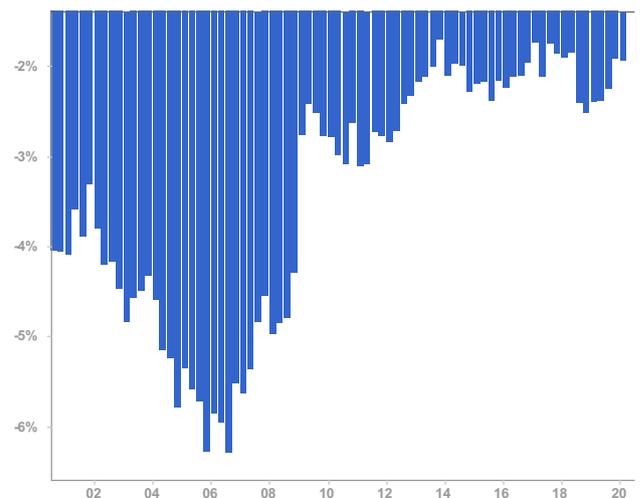
Source: FactSet

Figure 64: Fed Funds Target Rate



Source: St. Louis Federal Reserve, FRED Database

Figure 65: Current Account Deficit (as % of GDP)



Source: St. Louis Federal Reserve, FRED Database

Appendix

Important Regulatory Disclosures and End Notes

Form ADV available upon request. This quarterly is only for informational purposes and not a solicitation to buy or sell securities or as a source of specific investment, legal or tax recommendations.

Rockingstone Advisors is solely responsible for the content of this Quarterly. The information and statistical data contained herein have been obtained from sources we believe are reliable but cannot guarantee.

Rockingstone Advisors performance charts depict the mean aggregate return of all accounts invested with a similar objective and risk tolerance during the entire return period; individual account performance may materially differ according to strategy and portfolio composition. Returns are calculated using time-weighted method (TWM) and are weighted by portfolio assets. Returns can be influenced not only by the actual performance of the underlying portfolios, but by the mix (composition) of portfolios in any given year and the number of portfolios within the sample set. Public equity returns are calculated by Morningstar based on information received from our custodian(s). Other investment returns, including private equity and real estate investments are calculated based on valuation data from parties other than Rockingstone Advisors or at cost. Fixed income returns generated by private notes are recognized when the cash coupon is paid, rather than on an accrued interest basis (except for PiK securities). Annualized return is based on portfolios invested as of June 1, 2009. The sample set of portfolios within each annual cohort has increased over time and the mix changes every year. Our investment returns may reflect investment opportunities that are unavailable to all of our clients, for reasons including: (i) certain funds in which we have invested are now closed to new investors, (ii) certain clients may not meet "accredited investor" standards, (iii) certain investments are available only to officers or directors of a business, and /or (iv) we may believe that historical returns most likely will not be generated by a specific security or strategy and thus are no longer allocating new capital to a specific security or strategy. Past performance is neither indicative of-- nor a predictor of-- future performance. Mean reversion is a powerful force, meaning periods of outperformance are typically followed by periods of underperformance. All figures are net of fees and expenses. Rockingstone's performance must be assessed in light of not just how we performed relative to the benchmarks, but how much risk we assumed in generating portfolio returns.

Quarterly Data prices are as of June 30, 2020; most other prices and yields are as of July 27, 2020.

We are happy to provide the raw data and source links for any of the charts or tables in this Quarterly. We are also happy to provide individual account performance data by annual cohort or by IRR (instead of TWM) so you can better understand the range of portfolio returns. We thank you for your interest and always appreciate any feedback.

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ⁱ Asset class performance charts depict Equity (SPY ETF), Bonds (BND ETF), Commodities (DBC ETF), Preferred (PFF ETF) and Real Estate (VNO ETF) price change plus dividends and interest during the selected period.

ⁱⁱ Rockingstone Advisors performance charts depict the mean aggregate return of all accounts invested with a similar objective and risk tolerance during the entire return period; individual account performance may materially differ according to strategy and portfolio composition. Returns are calculated using time-weighted method (TWM) and are weighted by portfolio assets. Returns can be influenced not only by the actual performance of the underlying portfolios, but by the mix of portfolios in any given year. Public equity returns are calculated by Morningstar based on information received from our custodian(s). Other investment returns, including private equity and real estate investments are calculated based on valuation data from parties other than Rockingstone Advisors. Fixed income returns generated by private notes are recognized when the cash coupon is paid, rather than on an accrued interest basis. Annualized return since inception is based on portfolios invested as of June 1, 2009. The sample set of portfolios within each annual cohort has increased over time. Our investment returns may reflect investment opportunities that are unavailable to all of our clients, for reasons including: (i) certain funds in which we have invested are now closed to new investors, (ii) certain clients may not meet “accredited investor” standards, (iii) certain investments are available only to officers or directors of a business, and /or (iv) we may believe that historical returns most likely will not be generated by a specific security or strategy and thus are no longer allocating new capital to a specific security or strategy. Past performance is not indicative or a predictor of future performance. Mean reversion is a powerful force, meaning periods of outperformance are typically followed by periods of underperformance. All figures are net of fees and expenses. Rockingstone’s performance must be assessed in light of not just how we performed relative to the benchmarks, but how much risk we assumed in generating portfolio returns.

ⁱⁱⁱ Our Five-Year Forecast is updated quarterly and reflects our best judgment on future performance based on current valuations relative to historical valuations, as well as our outlook for earnings and macroeconomic conditions. We caution that predicting outcomes is inherently risky and subject to change.

^{iv} Equity performance charts depict U.S. large-cap (SPY ETF), U.S. mid-cap (VO ETF), U.S. small-cap (IWM ETF), International Developed (VEA ETF), and Emerging Markets (VWO ETF) price change plus dividends and interest during the selected period. We note that Vanguard highlighted a trading glitch in the shares of VO during March 31, 2015 that led to prices materially higher than underlying NAV. Hence you should assume VO’s valuation and total return was inflated as of the end of the first quarter.

^v Fixed income performance charts depict Intermediate Government (IEF ETF), High Yield Corporates (JNK ETF), High Grade Corporates (LQD ETF), International Corporates (PICB), and Emerging Markets bonds (EMB ETF) price change plus interest income earned over the selected period.

^{vi} Commodity performance charts depict Precious Metals (DBP ETF), Base Metals (DBB ETF), Oil (DBO ETF), and Agriculture (DBA ETF) price change.