A Matter of Trust

Fall 2020

Third Quarter Investment Update

Scott Richardson
Vice President
Trust Investment Officer

Scott has been in the financial services industry for over 15 years. He has a Bachelor of Business Administration from Texas Tech University. He has spent the last 13 years as a financial planner helping clients meet their financial goals. He serves as a volunteer with the Cub Scout pack at Windsor Elementary and also assists as the District Chairman for the Golden Eagle District of the Golden Spread Council BSA.

The summer brought an economic rebound and a continuation of the stock market rally that began in spring. In late September, the Federal Reserve Bank of Atlanta's GDPNow tracker estimated real Gross Domestic Product (GDP) growth of 32.0% for the third quarter. All three of the major Wall Street benchmarks advanced in Q3; the S&P 500 added nearly 8%, ending the quarter up about 4% for the year. Even so, U.S. equities slumped in September as traders worried that the stock market might be getting ahead of the economy.[1,2]

In Washington, the Federal Reserve altered its monetary policy stance and forecast low-interest rates for the near future. Hopes for another economic stimulus dimmed in Congress. On Main Street, the coronavirus pandemic remained top of mind, but improvements in hiring, consumer confidence, and retail sales were evident.

Entering the fourth quarter, analysts wondered how skillfully the financial markets might manage some unknowns: a potential uptick in COVID-19 cases in the fall, the pace of vaccine development, the outcome of the presidential election, and undetermined prospects for additional economic support of businesses and households.

The U.S. Economy

Many positive signals appeared in the quarter. Millions of Americans went to work again; monthly net job growth topped 1.7 million in July and 1.3 million a month later. Unemployment, which had hit 14.7% in April, fell from 10.2% in July to 8.4% in August, and the U-6 rate counting both underemployed and unemployed Americans declined from 16.5% to 14.2%.[3,4]

Consumer confidence, as measured by the Conference Board's monthly index, leaped to 101.8 in August from 86.3 in July. Households kept up their buying—retail sales were up year-over-year through August even though supplemental unemployment benefits expired at the end of July.[3]

Industries also grew, according to research from the Institute for Supply Management. When ISM's Monthly Purchasing Manager Index for the manufacturing and services sector surpasses 50, those sectors are judged by ISM to be expanding. ISM's services PMI was at 58.1 in July and 56.9 in August; its manufacturing index reached 54.2 in July (a month that saw a 6.4% rise in U.S. factory orders) and 56.0 in August.[3]

Home sales soared as summer began, and although that momentum tailed off, sales did not retreat. Residential resales were up 24.7% in July, and another 2.4% in August. New home buying increased 4.8% for August after a 14.7% July climb. Housing starts and building permits were both up 17.9% in the first month of the quarter, but then they both declined; permits dipped 0.9% and starts 5.1% in the eighth month of the year.[3]

For more than a century, the Federal Reserve has had two primary monetary policy objectives: to manage inflation and to guide the economy toward a state of maximum employment. Historically, managing inflation has come first. So, it made news on August 27 when Fed Chairman Jerome Powell announced that the central bank would "seek to achieve inflation that averages 2 percent over time," rather than proactively adjust short-term interest rates when inflation approaches that established target. In other words, it would tolerate a little more inflation than it had in the past as a trade-off for spurring the economy. The Fed kept the federal funds rate in the 0%-0.25% range in the quarter, and its September consensus interest rate forecast showed it expected no change for short-term interest rates through 2022.[4,5]

The Global Economy

As economies worldwide continued to labor under the coronavirus pandemic, the International Monetary Fund (IMF) and Organization for Economic Cooperation and Development (OECD) revised their estimates of global economic activity for 2020 and 2021. The IMF sees a 3.0% contraction for global Gross Domestic Product (GDP) this year, with the global economy growing 5.8% next year. The OECD estimates a 4.5% pullback for global GDP in 2020, and then a 5.0% rebound in 2021.[6]

INDEX RETURNS

	U.S. Stock Market	International Developed	Emerging Markets	Global Real Estate	U.S. Bond Market	Global Bond ex U.S.
Q3	STOCKS				BONDS	
	9.21%	4.92%	9.56%	2.37%	0.62%	0.68%
1 YEAR	STOCKS				BONDS	
	15.00%	0.16%	10.54%	-18.58%	6.98%	1.82%

The quarter ended with no agreement yet on a post-Brexit trade deal between the United Kingdom and the European Union, as the post-Brexit transition period ends December 31. Complicating matters, U.K. lawmakers introduced a bill that would disregard conditions for trade with Northern Ireland established as part of Brexit, which the E.U. has hotly protested. U.K. Prime Minister Boris Johnson wants both parties to reach a free trade agreement this month; Johnson is aiming for a pact without quotas or tariffs attached, similar to the arrangement the U.K. has with Canada.[7]

Looking at foreign stock exchanges, some significant quarterly gains stand out. South Korea's Kospi index rose 11.2% in three months; no other consequential overseas benchmark advanced double digits in Q3l. China's Shanghai Composite added 7.82%, Taiwan's TWII 7.70%, Argentina's Merval 4.69%, Japan's Nikkei 225 4.02%, and Germany's DAX 3.65%. On the other side of the ledger, Hong Kong's Hang Seng retreated 3.96%, and Spain's IBEX 35 dipped 7.12%. MSCI's EAFE index, which tracks large companies across developed countries in Europe and Asia, rose 4.90% in Q3.[8,9]

Looking Back, Looking Forward

Stocks powered through July and August, entering historic territory in mid-summer. In particular, August saw a powerful rally. The Nasdaq Composite climbed 9.59% in August, and the Dow Jones Industrial Average gained 7.57%, finishing with its best August since 1984. Advancing 7.01% to cap a 5-month winning streak, the S&P 500 had its best August since 1986. September got off to a good start, with a new record close for the S&P: 3,580.84.[10,11]

Then, reservations about the rally surfaced. Traders began to question the sustainability of the summer economic recovery, and whether a fall uptick in coronavirus infections might hurt business and consumer spending. The S&P ended September at 3,363.00, retreating 3.92% for the month. The Dow lost 2.28% in September to fall to 27,781.70, and the Nasdaq gave up 5.16%, declining to 11,167.51.[12,13]

The 10-year Treasury yield spent all of Q3 between 0.52% and 0.74%, reaching the top of that range in late August.[14]

Wall Street enters the fourth quarter with a bit of uncertainty. The November election results may produce any number of reactions. There are only educated guesses as to when coronavirus vaccines may appear, and how effective they may be. The first reading on 3rd-quarter Gross Domestic Product growth is on October 27, roughly one week before election day.

Federal Reserve officials expect low-interest rates and very little inflation through 2022. Sustained low-interest rates could drive more borrowing and business investment, and improve the outlook for the housing market.

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6. Nasdaq.com, September 30, 2020
7. Associated Press, September 29, 2020
8. Barchart.com, September 30, 2020
9. Wall Street Journal, September 30, 2020
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12. CNBC, September 30, 2020
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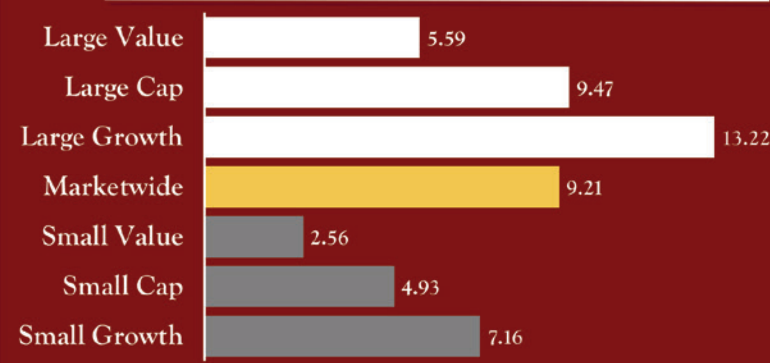
14. Treasury.gov, September 30, 2020

Third Quarter Market Summary

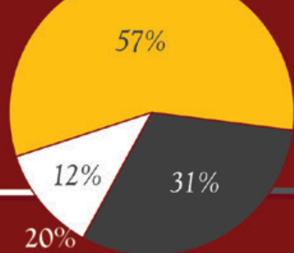
In the third quarter, all major global equity indices continued their rebound from the market sell-off earlier in the year. Small cap stocks underperformed in the U.S., but outperformed around the rest of the world. Growth stocks fared better than value across the board. Bonds rose modestly while continuing to provide that protection of diversification that investors have clearly needed this year. For a more detailed quarterly report please see the publications tab at www.happytrust.com.

US Stocks

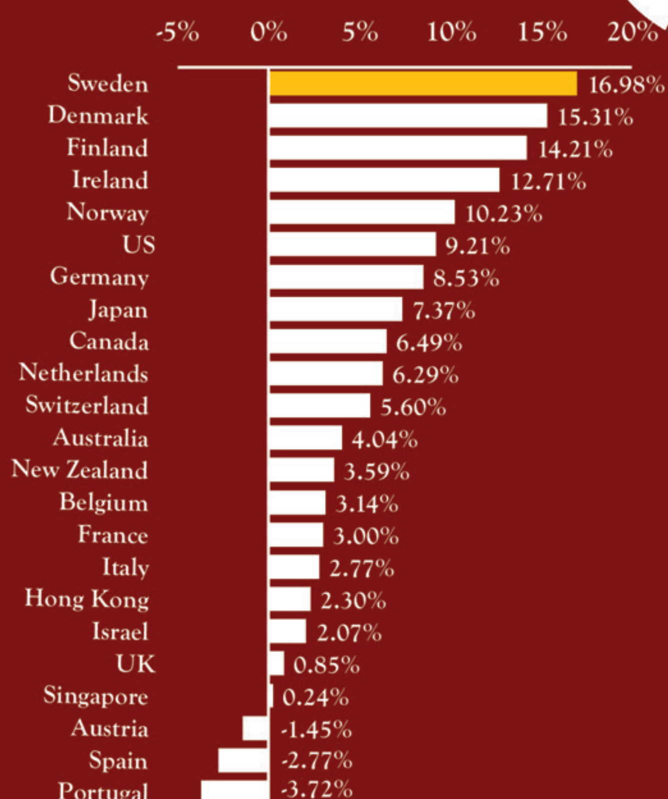
Ranked Returns for the Quarter (%)



World Market Capitalization



Emerging Markets



International Developed

Coronavirus & More

Todd Wetsel
Senior Vice President
Senior Trust Portfolio Manager

The 24-Hour News Cycle moves from Impeachment to COVID-19 to the Elections – What's next?

So far this year, it feels like we have seen it all. We've had so many major new stories it has been difficult to keep track of them all. On the political front, we battled through the 2020 caucuses and primaries with the presidential election coming in November. It seems like a lifetime ago, but yes it was this year that we went through the third presidential impeachment in American history. Does anyone even remember the murder hornets? Most importantly, the COVID-19 outbreak has wreaked havoc around the world with significant health concerns and the shutdown of many of the world's economies.

It's not so much the facts of what's going on that are unusual as none of these matters are completely unprecedented. However, the way that they are reported in the media and the speed at which they are coming at us can be alarming. Even frightening.

How might this affect me?

When major events make headlines, it's easy to put yourself in the picture. Knowing, as well, how such events might affect the financial markets, it's also easy to wonder how your investments and retirement strategy might fare. The truth? Political ups and downs, virus outbreaks, and other circumstances might lead to some short-term volatility on Wall Street. But it's important to remember two things: 1) your portfolio is positioned to reflect your risk tolerance, time horizon, and goals; and 2) the way we experience news has changed over the years, and not all of it for the better.

Never-ending news.

On June 1, 1980, businessman and broadcaster Ted Turner debuted Cable News Network (CNN), the world's first 24-hour television news channel. In the four decades since, other similar channels have emerged. Collectively, they changed how the world experiences news. Notably, it was the dawn of the 24-hour news cycle.[2]

Before 1980, news was very different. Major newspapers might have published several editions during a day, but most areas only had a morning or evening edition. Radio might offer news break updates at the top of the hour, with news programs in the morning, afternoon, and evening. Television followed a similar pattern. The never-ending news cycle means that news organizations have an interest in continuing to report on the same news story even though little or nothing has changed. Twenty-four hours is a lot of time to fill, and they need ratings in order to be of value to advertisers. While this doesn't necessarily mean that the news has become inaccurate or sensationalistic, it might be perceived as repetitive. It's also becoming ubiquitous. With our smartphones, we're often receiving news updates immediately throughout the day.

Keep informed, but don't be rattled.

Your investment and retirement strategy, which we have worked with you to design and put into place, has considered big news events, both major and minor. We understand the difference between something that may be a minor force in your financial life and something that might require you to make some changes. A good strategy gives you room for market changes that might see reactions that last a few days or even a few years. Staying the course is often the smartest move, partially because you aren't reacting immediately to a dip, and you might benefit from a potential recovery. So, keep yourself informed, but if you get too worried, please reach out to us to discuss your concerns. We can work with you to understand what the news means for your financial life and offer you the context you need to remain confident in your strategy.

CITATIONS:

1 - sciencemag.org/news/2020/02/bit-chaotic-christening-new-coronavirus-and-its-disease-name-create-confusion [2/12/20]

2 - history.com/this-day-in-history/cnn-launches [2020]

Stocks & Presidential Elections

What does history tell us – and should we value it?

Todd Wetsel
Senior Vice President
Senior Trust Portfolio Manager

Todd has 16 years of trust and banking experience. He began his banking career while attending West Texas A&M University. After graduating with a BBA in Finance, he went to work in a local trust department where he served as an assistant trust administrator. Todd enlisted in the United States Army in 2005 and served two tours of duty in Iraq. In 2010, he joined Happy State Bank where his principal duties include market research and portfolio management. Todd has attended the Texas Trust School and Texas Graduate Trust School offered by the Texas Bankers Association. He is a member of the Amarillo East Rotary Club and serves on the board of the Wesley Community Center Foundation.

As an investor, you know that past performance is no guarantee of future success. Expanding that truth, history has no bearing on the future of Wall Street.

That said, stock market historians have repeatedly analyzed market behavior in presidential election years, and what stocks do when different parties hold the reins of power in Washington. They have noticed some interesting patterns through the years, which may or may not prove true for 2020 or for any other election year down the line.

Do stocks really go through an "election cycle" every four years?

The numbers really do not point to any kind of pattern. If you examine the S&P index going back the last 21 election cycles, all the way back to 1928, there were only three years with an overall negative return. That may sound great, but you also have to consider that not every pattern we find necessarily demonstrates that one factor (e.g. a Presidential election) directly affects another (such as market returns).[1]

For instance, it is also a fact that every year of the twentieth century ending with the number "5" (1905, 1915, 1925, and so on) turned a profit. That might be true, but it is not useful information when making financial decisions.[1]

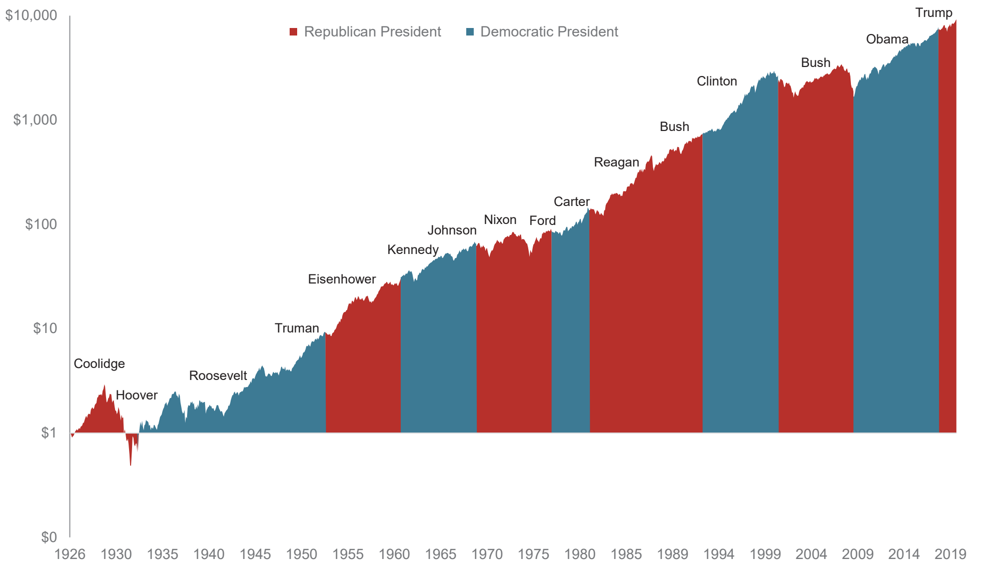
It is also worthwhile to keep in mind that as consequential as presidential politics may be, there may be other, larger factors looming. The S&P 500 returns dipped 37% in 2008. While that was a presidential election year, that was also in the wake of a major financial crisis. It can be important to keep that bigger picture in mind.

What about midterm elections?

Do the congressional elections, which come at roughly the midway point in a president's four-year

Markets Have Rewarded Long-Term Investors under a Variety of Presidents

Growth of a Dollar Invested in the S&P 500: January 1926–December 2019



Past performance is not a guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. Source: S&P data © 2020 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

term, have any relevance? As with presidential election years, it can depend on the year.

Over the last five midterms, the S&P dropped an average of 18%. The year 2002, however, saw a much larger drop of 34.5%.

Investing with a long-term view in mind.

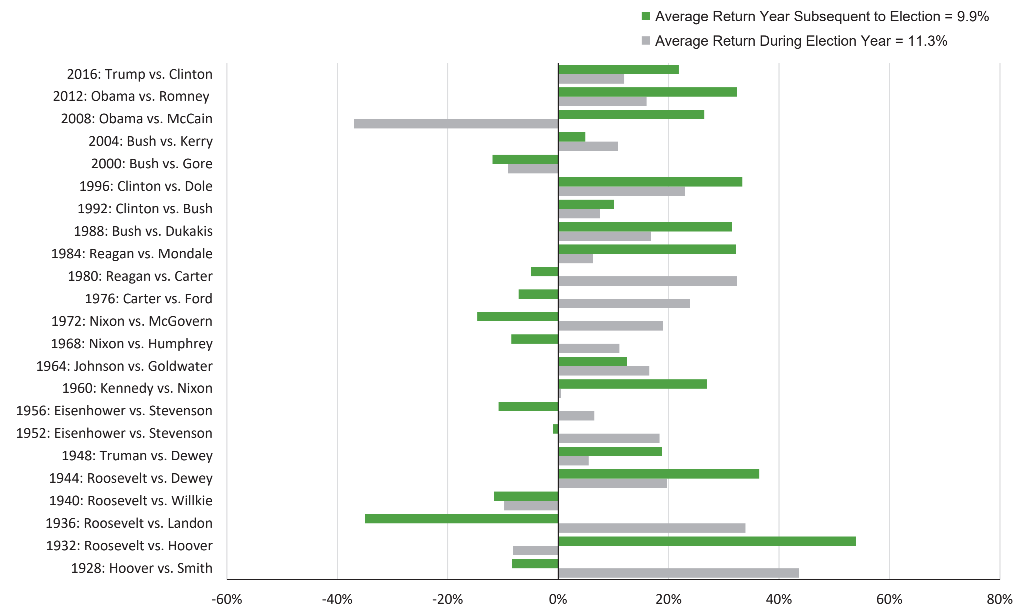
These numbers are interesting and may give you a great deal to think about in the short term. That said, if you are taking a longer view with your investment, you may see the markets rise and fall a number of times, for any number of reasons. History can be informative and give you an idea of what might be possible, but it cannot tell you with any certainty what is coming next.

How much weight does history ultimately hold?

Not as much as you may expect. It is intriguing, and some analysts would instruct you to pay more attention to it rather than less. Historical "norms" are easily upended, however. We have included several charts that show the impact of elections on markets as well as the market performance over time during different political circumstances. The conclusion here is that there is no discernible pattern of market performance when it comes to the Democrat vs Republican debate. Staying focused on the long-term is the most important thing. Working with a financial professional may offer perspective on major events and allow you to think less in terms of the next few years and more toward your ultimate future.

Returns During and After Election Years

S&P 500 Index: 1928–2017



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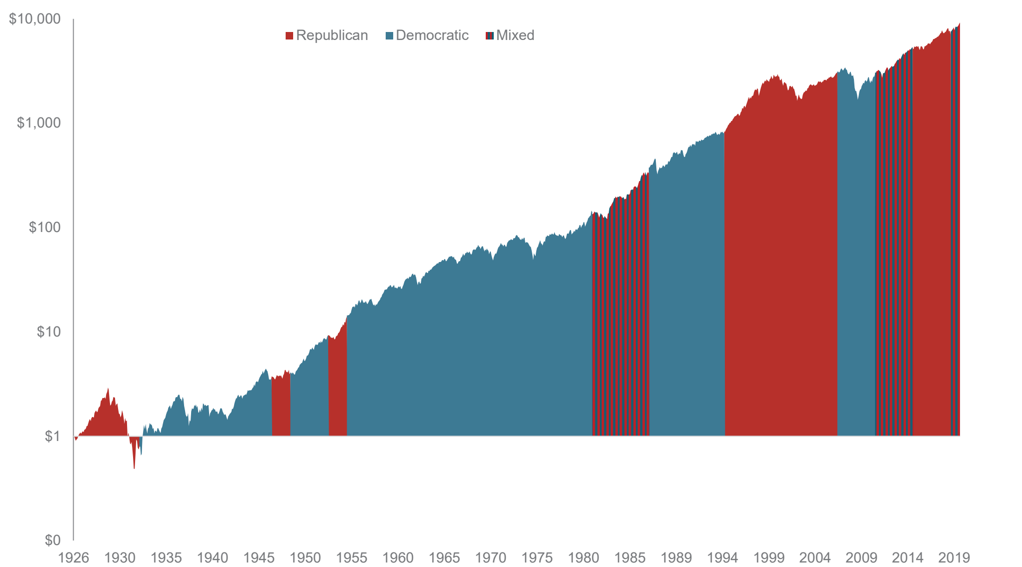
Hypothetical Growth of $1 Invested in the S&P 500 Index and Party Control of Congress

January 1926–December 2019



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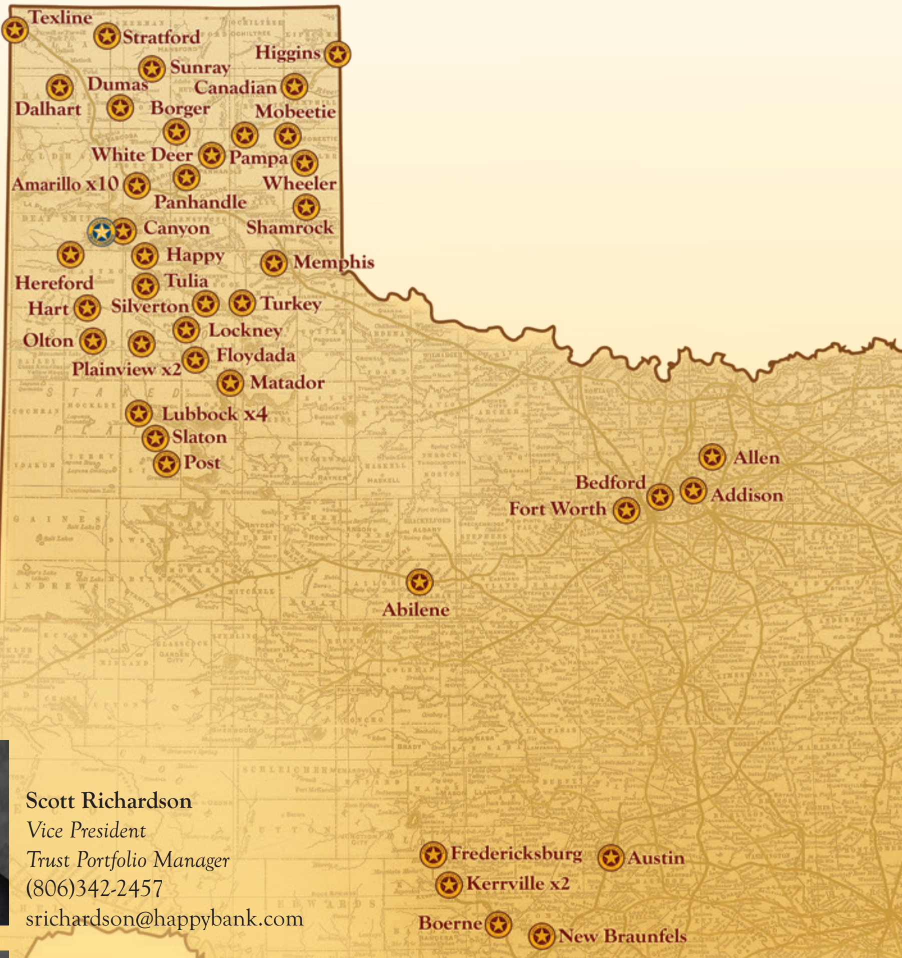


AMARILLO

Joby Mills, J.D.
Senior Vice President
Director of Trust Services
(806) 349-9893
jmills@happybank.com

Todd Wetsel
Senior Vice President
Senior Trust Portfolio Manager
(806) 349-9901
twetsel@happybank.com

Alisa Scott, J.D.
Senior Vice President
Senior Trust Officer
(806) 349-9880
ascott@happybank.com

Terri Wright
Vice President
Trust Officer
(806) 379-5409
terri.wright@happybank.com

Buffy Haden
Vice President
Trust Operations Officer
(806) 349-9890
bhaden@happybank.com

Kevin Rider
Vice President
Trust Officer - Farm and Ranch
(806) 349-9940
krider@happybank.com

Scott Richardson
Vice President
Trust Portfolio Manager
(806)342-2457
srichardson@happybank.com

Terry Wright
Senior Trust Officer
Oil and Gas
(806) 379-5410
terry.wright@happybank.com

Hunter Vagrosky
Assistant Vice President
Trust Officer
(806) 349-9891
hvagrosky@happybank.com

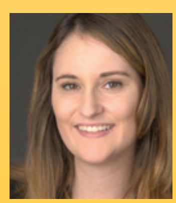
LUBBOCK

Bryan Limmer
Senior Vice President
Senior Trust Officer
(806) 798-4827
blimmer@happybank.com

DALLAS

Chris Klemme, J.D.
Senior Vice President
Senior Trust Officer
(972) 407-4959
klemme@happybank.com

Brooks Smith
Senior Vice President
Trust Portfolio Manager
(972) 407-4966
bsmith@happybank.com



Shannon Van Campen
Assistant Vice President
Trust Officer
(972) 407-4947
svancampen@happybank.com

FORT WORTH

Jason Carter, J.D.
Vice President
Trust Officer
(817) 989-3960
jcarter@happybank.com

Sue Turnage
Senior Vice President
Senior Trust Officer
(817) 989-3955
sturnage@happybank.com