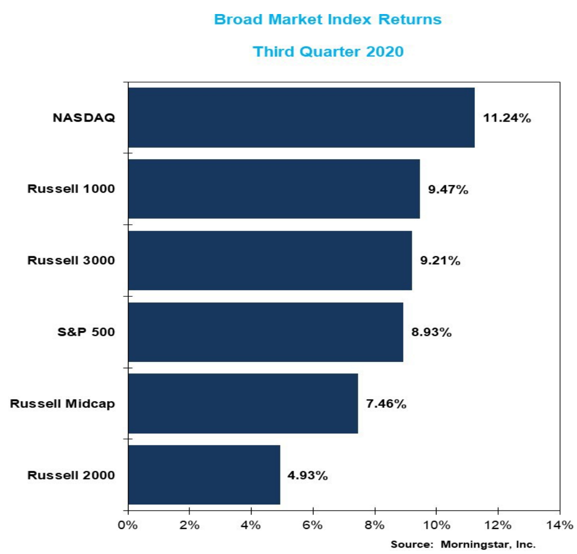
Ramsey & Associates, Inc.
(206) 324~1950
info@RamseyAssoc.com

It is hard to believe that with all that has happened so far in 2020, we still have a few more months, as well as a presidential election to go! We hope, amid all the turmoil, chaos, and uncertainty, that you are well and staying safe.

The economic and market recoveries that started in the second quarter extended into the third quarter. This was not surprising as the economy continued to reopen during the quarter. While some areas of the financial markets remain down for the year, others such as large caps moved solidly positive for the year. There is much to discuss, so let's get into it.

The Economy



The US economy is in the midst of a strong recovery from the unprecedented and sharp declines brought about by the policies implemented to stem the spread of the COVID-19 virus. A Depression- level contraction has been avoided, with some economists now expecting third quarter growth to exceed 25%. However, while the manufacturing segment has staged an impressive recovery, the service segment continues to be hampered by targeted lockdowns. It will not be possible for the economy to return to pre-COVID levels without the participation of the service segment, and analysts believe for that to happen widespread distribution of an effective vaccine would need to be in place. While release of third quarter data is still several weeks away, the extent of the adverse economic effects of the coronavirus are evident in the second quarter data (the latest quarter reported).

The Bureau of Economic Analysis reported its third estimate of second quarter 2020 gross domestic product (GDP) of -31.4%, somewhat better than the prior estimate, but far below the first quarter reading. The employment situation improved dramatically over the past three months, with employers adding 4.8 million, 1.7 and 1.4 million jobs in June, July and August, respectively. The August report showed an average of approximately 2.6 million jobs added each month of the quarter, and that the unemployment rate fell to 8.4%. The Federal Open Market Committee (FOMC) maintained the aggressive monetary policy response to the crisis, leaving the funds rate target range of 0% to 0.25% unchanged. The central bank also stated that it is unlikely to consider raising interest rates anytime soon, perhaps not before 2023.

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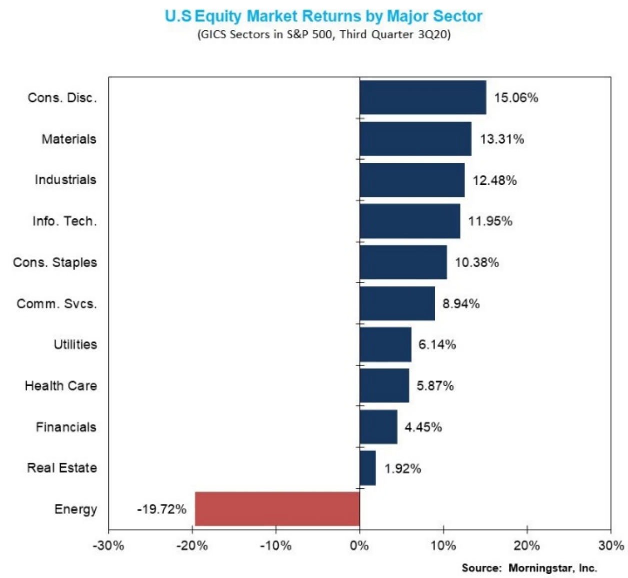
The global economic environment is similar to that in the US, with the economic contraction a result of supply shocks stemming from worldwide lockdowns. Even though manufacturing in many countries is now ramping back up, aggregate demand remains weak, and perhaps will return to pre-COVID levels only when an effective vaccine is available.

Highlights

GDP

In the latest data available, the Bureau of Economic Analysis released the third estimate of the second quarter 2020 real GDP, a seasonally adjusted annualized decline of 31.4%, slightly better than the prior estimate a decline of 32.9%, but understandably far below the 5.0% decline in the first quarter. The weakness was widespread throughout all segments of the economy, with consumer spending, exports and inventories serving as the primary detractors. Government spending and imports partially offset these declines. Corporate profits fell by 11.1% (not annualized) during the quarter. With consensus expectations of a third quarter rise in real GDP of perhaps 25%, analysts continue to anticipate this recession being one of the most severe – but shortest - in US history.



HOUSING

While housing suffered a significant hit in the first quarter due to the pandemic, the segment has rebounded nicely as potential homebuyers regain their confidence as economies re-open. Existing-home sales for August (the latest monthly data available) rose to an annualized rate of 6.0 million units, 2.4% higher than the results from July, and up about 10.5% from year-ago levels. The inventory of existing homes was almost three months of supply, lower than levels of the prior year. Existing-home prices in August increased 11.7% from August 2019. In the new-home segment, the NAHB Housing Market Index, a measure of homebuilding activity, ended the quarter at 83, a record high, and significantly above the prior month's reading as well as year-ago levels. The housing market is being supported by both low mortgage rates and low levels of inventory.

EMPLOYMENT

The August employment report (the latest data available) showed additional sharp payroll gains that exceeded expectations. Employers added 1,371,000 jobs during the month, matching the consensus expectations. The job market is clawing its way out of the virus related hole, and while the trajectory is certainly strong, there remains a significant amount of work to be done. The unemployment rate in August declined to 8.4%, even while the labor force participation rate edged higher to 61.7%.

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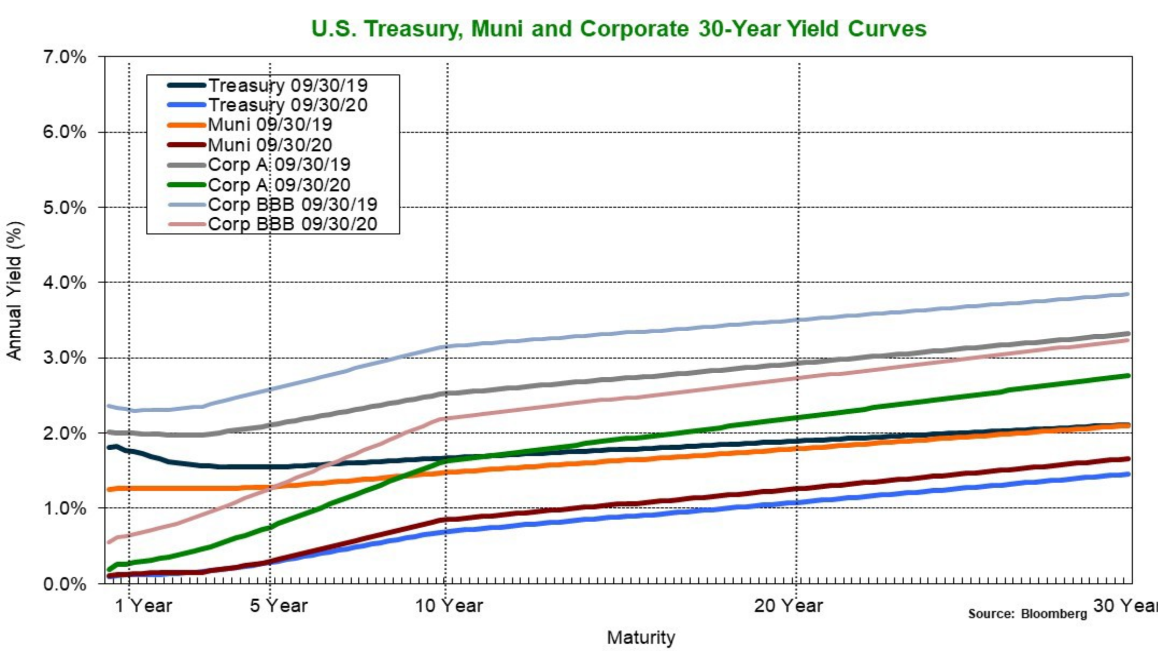
FED POLICY

The FOMC made no change to the federal funds rate target range of 0% to 0.25%, but the important news in the quarter was that the committee indicated that it would not raise rates through 2023. The Fed's statement said that a rate increase would not occur until the economy is at full employment and the economy is on track for a moderate overshooting of the FOMC's 2% inflation target. Analysts point out that the statement did not indicate how far above the 2% level the committee was willing to allow inflation to run before raising rates. The FOMC did not change the $120 billion of Treasuries and mortgage-backed securities purchased each month, and analysts expect this amount could increase as Congress continues to have difficulty passing additional fiscal stimulus.

Interest Rates

Fixed income securities' prices on balance edged somewhat higher (and yields lower) in the quarter with monetary conditions continuing to be supportive, and expectations of a continued rebound in the economy encouraging investors. The FOMC, as well as central banks throughout the world, continued to maintain an aggressive policy stance in an effort to minimize the adverse economic effects of COVID-19. As in the prior quarter, volatility in the fixed income market remained subdued as bond investors assessed the interaction between the FOMC's actions and the trajectory of the economic recovery. In addition, both the fixed income and equity markets are in the process of evaluating the policies of the presidential candidates, as well as the potential outcome of the election. As mentioned above, the FOMC made no change to the previous policy steps it took in the first quarter to ensure sufficient market liquidity, but added important language indicating the committee believes the fed funds rate will remain at near-zero levels through 2023. As such, the FOMC is expected to maintain the target federal funds rate range at between 0% to 0.25% for the foreseeable future.



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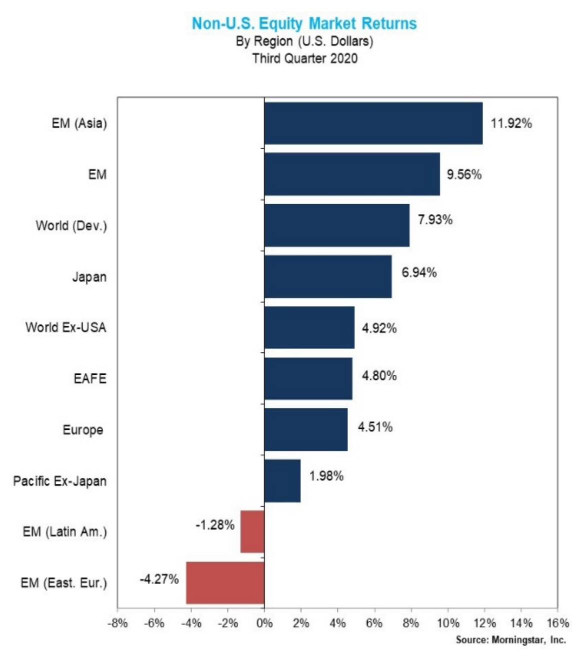
The shape of the Treasury yield curve was little changed during the third quarter, with yields on the shortest-term maturities declining modestly relative to yields in the intermediate- and long-term segments of the curve. Overall, in terms of level and shape the Treasury curve remained almost identical to the prior quarter, as the FOMC has signaled its monetary policy is unlikely to change for at least three years.

Inflation expectations were modestly higher, with the Fed's gauge of five-year forward inflation expectations exceeding the level of 1.38% on June 30.

Total returns on fixed income securities were higher, with slightly positive returns in almost every segment of the market. The Bloomberg Barclays Treasury 5-7 Yr. Index rose by +0.4% for the quarter. The Bloomberg Barclays US Corporate 5-10 Yr. Index gained +1.8% during the three months. High yield securities, which often follow the performance of equities, rallied, posting a return of +4.6%. Municipals also had a good quarter, as the Bloomberg Barclays Municipal Bond Index advanced by +1.2% during the quarter. Prices of non-US fixed income securities were higher in the quarter, as the Bloomberg Barclays Global Aggregate ex-US Index gained +4.1%. Emerging markets bonds posted solid gains, with the JPM EMBI Global Index edging higher by +2.3%.

Equity Markets

After having staged an impressive rally in the second quarter, stocks continued to trend higher in the third quarter as businesses continued to open and the effects of COVID-19 became better known. Analysts have pointed out that the country seems to be learning to live with the virus. Broad stock indexes exhibited a steady march higher from the beginning of the quarter through September 2, at which point the S&P 500 had advanced +15.9% for the quarter. Prices then declined about -9.5% for the next three weeks before rising once again heading into the quarter end. Helping drive the rise was a perception that even though we are still learning about the effects of COVID-19, the world seems to be learning to live with it. Businesses continued to open, and in some cases schools attempted to bring students back on campus, either fully in person or through a hybrid program. Some analysts expressed surprise that stock prices were not more volatile, given that the presidential election polls are very close, and Democrat candidate Joe Biden's platform of higher taxes would be detrimental to corporate profits and personal earnings. When the quarter ended, the S&P 500 Index had advanced +8.9%, and is now up +5.6% year-to-date.



Performance of each of the eleven primary economic sectors was generally positive during the quarter. Consumer Discretionary, Materials and Industrials were the strongest performers on a relative basis, generating returns of +15.1%, +13.3%, and +12.5%, respectively. The Energy, Real

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Estate and Financials sectors were the poorest relative performers, posting returns of -19.7%, +1.9%, and +4.4%, respectively.

The Russell 1000 Index of large capitalization stocks generated a +9.5% total return. Within the large cap segment, growth stocks once again outperformed value stocks. Small cap stocks, as represented by the Russell 2000 Index, underperformed large caps, and finished the quarter with a total return of +4.9%. Small cap growth outperformed small cap value. The NASDAQ Composite, dominated by information technology stocks, finished the quarter with a gain of +11.2%. The Dow Jones Industrial Average of 30 large industrial companies advanced by +8.2%.

Real Estate Investment Trusts (REITs) were modestly higher during the quarter, with the DJ US Select REIT Index up +0.8%. Commodities rallied sharply, with the Bloomberg Commodity Index adding +9.1% for the quarter.

International stocks also posted solid gains during the quarter, and generally performed in line with US equities. The MSCI ACWI Ex-USA Index, which measures performance of world markets outside the US, rose by +6.3%. The MSCI EAFE Index of developed markets stocks advanced by +4.8%. Regional performance was mixed for the quarter. Asia was the strongest performer on a relative basis, with a return of +11.9%. Eastern Europe was the poorest relative performer, declining -4.3%. Emerging markets performance was strong, as the MSCI Emerging Markets Index was higher by +9.6%.

Looking Forward

The U.S. economy continues to recover from the unprecedented downturn resulting from efforts to stop the spread of COVID-19. While many economists expect third quarter real GDP growth will exceed 25% Q/Q, the economy is still on track to contract by an estimated 4.3% for the year. Consensus expectations for 2021 indicate that growth should rebound to approximately 3.6%. While the economy has avoided a Depression-level recession, there is still much work to be done to reach pre-COVID levels, with some economists estimating this could take as long as two years. However, there are so-called “green shoots” emerging, particularly in housing and the consumption of goods.

Research firm Strategas Research Partners cautions that the “easy” part of the recovery – with 3Q growth estimated to be ~25% - may be over, and the trajectory will be more “shallow” moving forward unless more durable drivers of organic growth emerge. Factors that could potentially hinder the economy from reaching that level include a Democrat sweep in the election and a significant second wave of the virus that causes some states to re-impose lockdowns. Catalysts that could accelerate growth include widespread distribution of a safe and effective vaccine sooner than anticipated, and increased confidence that the country is learning to live with the virus. The outlook for both the global and US economies remains positive, but how quickly we are able to return to pre-COVID levels will depend on several factors, including how quickly point-of-care testing is available. Stock prices have rallied in a V-shape recovery, and while there are certainly early signs of froth in the market, analysts point out that with an expectation of low interest rates for several years there are few alternatives.

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If nothing else, 2020 continues to remind us of how quickly things can change and how unpredictable life really is. We were happy that the rally experienced in the second quarter extended into the third quarter, but with the pandemic moving into the winter months and the presidential election close, we suggest that everyone expect the unexpected, and be prepared for volatility.

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