INVESTOR NEWSLETTER Armbruster Capital Management, Inc. 2ND QUARTER 2020

The ACM Journal

Dog Days of Summer

It has been several years since we had a dog. Our last experience involved adopting a former police dog, and it didn't work out so well. We've been gun shy about trying again, but the kids talk about it all the time and the pressure has been relentless. Everyone being cooped up at home has only bolstered their arguments.

I love dogs, and we do live on a farm. So, there is some sense in having another four-legged pet. However, Nipa is less excited about the idea, and when you figure in vet bills, dog accessories, and an invisible fence, it will not be an inexpensive undertaking.

We're holding strong, but last Christmas my sons gave my 10-year-old daughter, Nyla, a life-size stuffed dog. I'm not sure if it is supposed to be a Husky or Shepard or mutt of some sort, but Nyla loves it and carries it with her everywhere. It is particularly funny to watch because the dog is almost as big as Nyla.

Nyla named the dog Skye. Just to be funny, I started hanging out with Skye when Nyla left her laying around. I would take her over to the couch with me, and

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Portfolio Review

The second quarter was marked by a global pandemic, a largely paralyzed global economy, racial tensions that boiled over into violence, heightened political discord, record jobless claims with 40 million people unemployed, continuing business failures, geopolitical tensions with Hong Kong largely being subsumed by China, locusts in India and Pakistan that could result in famine, and even murder hornets in the pacific northwest. So, of course, the stock market rose, posting its best quarterly performance in over 20 years.

The S&P 500 gained 20%, mid-cap and small-cap stocks did even better, and international stocks rose 15%. Returns for all major segments of the stock market are still down year-to-date, but certain industries, such as technology, are now at all-time highs.

To be fair, we were starting at a fairly low level for the second quarter. The stock market had declined quite a bit by the end of the first quarter, so a rebound off those lows wasn't completely crazy. However, given the circumstances today, it is hard to fathom that the S&P 500 is only 7% off its high and the NASDAQ has eclipsed its previous high and is now trading 7% above where it was at its peak last February.

Government stimulus has played no small part in this. Both fiscal and monetary policy have been accommodative to say the least. PPP loans and $1,200 stimulus checks are just the tip of the iceberg. The Fed has expanded its balance sheet far beyond what we have ever seen in the past. Perhaps some or all of this was necessary to save the economy, but there is no question it is warping the stock market.

Things are not as bad as the most ebullient days of the 1990s, but there are definitely signs of speculative excess. Tesla's share price has more than tripled so far this year and the company is now worth more than Toyota. Never mind that upstart Tesla sells a few hundred thousand cars and might be profitable this year while the 82-year-old Toyota sells over 10 million vehicles annually and earns $19 billion in profits.

Stories like Tesla's are becoming more common. Nikola is a start-up truck manufacturer that has yet to make a production version of its trucks, yet it was trading at a level that made it worth almost as much as Ford. Shares of bankrupt companies, such as Hertz and Chesapeake Energy, have traded at irrationally high levels even though the shares will ultimately be worthless.

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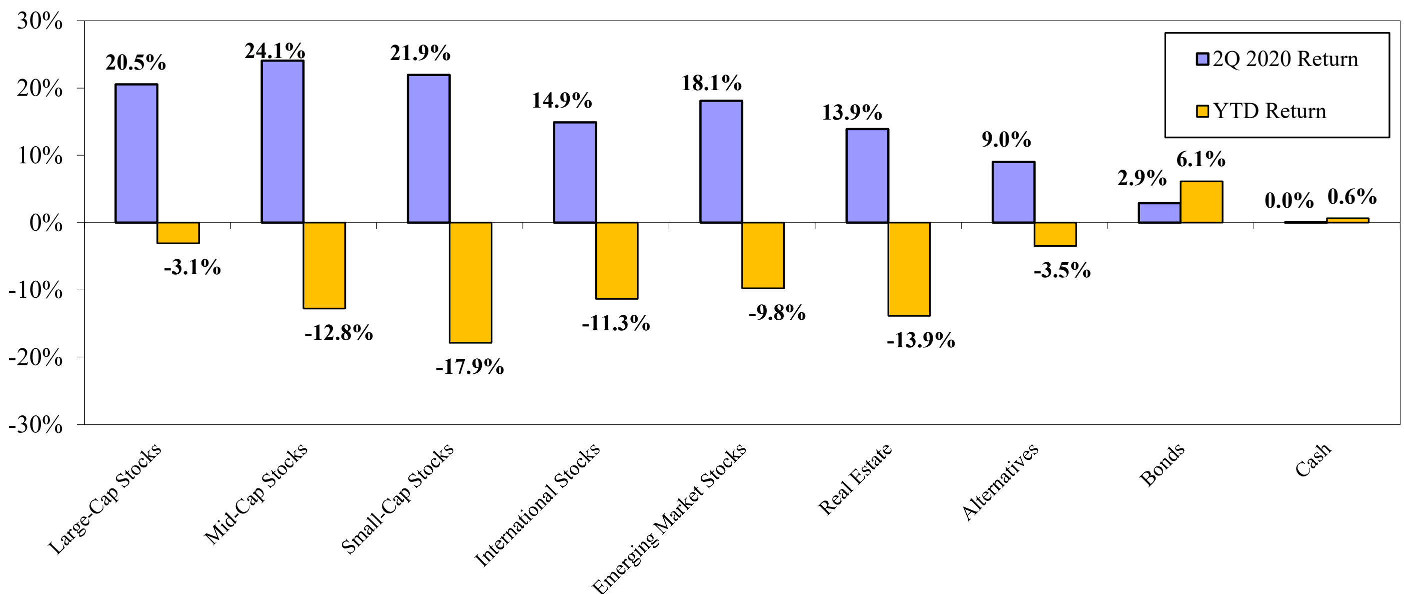

Large-cap, mid-cap, and small-cap stocks are represented by the S&P 500, 400, and 600 indices. International and emerging market stocks are represented by MSCI indices. Real estate is the Dow Jones Real Estate index. Bonds are the Barclays Aggregate Bond Index. Cash is the yield on the 3-month T-Bill.

Portfolio Review

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Today's market is hard to understand, but the future is even more cloudy. Will government stimulus measures be able to buffer the economy until Covid has passed? Will the Fed be able to withdraw liquidity as the economy recovers before inflation becomes a concern? Will the elections in November result in a transformation of our economy away from capitalism? Can today's high stock market valuations continue? Will interest rates remain low for years to come? These are big, but unanswerable questions.

While uncertainty seems extreme today, the reality is we never know what the future holds. No one could have predicted a global pandemic and subsequent economic shut down. I saw a graph recently with the title "Reasons to Sell". It showed the S&P 500 over many decades continuing its upward trajectory but had notes with negative events throughout history. Despite world wars, oil shocks, inflation, natural disasters, terrorism, and countless other horrors, the economy and stock market have proved resilient.

That doesn't mean there won't be speed bumps along the way. Our one guarantee is that the market will be volatile and at some point, portfolios will lose money. The best way to protect against that is diversification. Spreading your "bets" across various asset classes (stocks, bonds, and alternative investments) and diversifying broadly within those asset classes is the best we can do. It isn't a panacea, but it has proven effective in the past at minimizing loss, providing liquidity when it is needed the most, and also generating long-term growth while keeping pace with inflation.

Despite the zaniness in the stock market today, we'll continue to build diversified portfolios with long-term risk and return characteristics that give the best chance of surviving and thriving in the years to come. And, despite short-term uncertainties, a steady, long-term strategy remains your best bet for building and preserving wealth over time.

Firm News

Our newest team member is Kim O'Brien. Kim will be helping with reception, account maintenance, cashiering requests, and other service-related duties. Previously, Kim has worked for other firms in this area and brings much-needed relief to our operations team. You will certainly talk with Kim when you call or visit, so I suspect most of you will get to know her in short order.

New Educational Tools

On the education and communications front, we recently launched a new "VidCast" series. It turns out a VidCast is like a podcast, but with a video element to it. We have been covering various investment topics in short segments with charts and graphs running in the background to illustrate the points we're making. These VidCasts are posted at our YouTube channel. You can find them by going to YouTube and searching for Armbruster Capital. We also try to post each of these episodes on LinkedIn, so feel free to connect with us there. You can subscribe to our YouTube channel, which will send you alerts each time we post a new episode. Please take a look and let us know what you think or if you have suggestions for future episodes.

We also recently wrote an article for the CFA Institute on rethinking bond portfolios, and subsequently built a VidCast around this as well. This article was the first of what we hope will become a series of "white papers" addressing some fairly large challenges we face in the investment world today. These articles will be a bit more technical in nature, positioned largely for other financial professionals. However, we will do our best to circulate them to clients and would be happy to discuss any of the topics further.

New Compliance Summary

We recently sent everyone a copy of our Form CRS compliance document. This is new requirement by the Securities and Exchange Commission. We have always been required to file Form ADV, which is a longer form that describes our business practices and disciplinary history, among other disclosures. By law, we give Form ADV to all new clients and offer it to current clients each year. We also post it on our website. However, the SEC was concerned that no one was reading this document. So, in an effort to improve investor education, the one-page Form CRS was born.

Form CRS is a summary of Form ADV. Much of the language is boilerplate and refers back to the full Form ADV. I'm not sure most investors will find it any more useful than Form ADV (which we encourage everyone to read), but no one asked me when they wrote the rules. Take a look and see what you think. Feel free to call us if the document raises any questions.

Chris's Corner: Update on RMDs & the CARES Act

When the CARES Act was signed into law on March 27th it suspended Required Minimum Distributions (RMDs) from Individual Retirement Accounts (IRAs) for 2020. It also allowed account holders to redeposit any prior distributions up to 60 days from the date of withdrawal. This was good news for many, as it potentially meant a lower tax bill for 2020 since there could be less reportable income.

However, anyone who took their RMD early this year was unable to redeposit the funds since it was already past the 60-day window. This effectively punished those who were efficient and proactive.

Fortunately, on June 23rd, the IRS issued "Notice 2020-51" which amends the timing and allows for everyone to suspend their 2020 RMD, and redeposit funds already drawn. The only catch is that you must get the money back into your account before August 31st.

As with everything, there are some considerations before rushing to put money back into your retirement account, including:

- **Your current tax bracket:** It may make sense to max out a lower bracket in 2020 through a full or partial distribution.

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New Benchmark

Investment performance needs to be put into context to be truly meaningful. For example, assume you earned a 10% return over some period. Is that good? It seems so at first, but what if all your neighbors got returns of 11%? Or, what if the overall stock market was up 15%? The same return can look different under different assumptions.

Enter benchmarks. A benchmark is really just an index or a mix of indices that show the performance of various segments of the capital markets. The S&P 500 is the most common index, as it shows the returns of a broad swath (500 stocks) of the U.S. stock market. For international stocks, a different index is required, which is also true for small-cap U.S. stocks, bonds, real estate, etc.

We have historically compared our stock performance against a composite of indices for large-cap, mid-cap, small-cap, and international stocks, as well as real estate investment trusts. We have chosen indices that are hard to beat. For example, we use the S&P 600 as our small-cap benchmark even though it is far easier to outperform the industry-standard Russell 2000. To us it just seemed more fair. However, that also has meant that our returns were not always ahead of our benchmark.

Investment advisors, and most of their clients, like to always outperform the market. However, "the market" can mean different things with different advisors and different investors. That leaves an opening for many advisors to use benchmark indices that are easier to outperform. It can also result in frequent changes to those benchmarks, to always portray returns in the best light.

We have never believed in these tactics and have been consistent in our approach since the inception of Armbruster Capital. However, we are now making a change to how we benchmark the stock component of our portfolios.

Typically benchmark changes mean picking indices that make your historic returns look better. We're doing the opposite. Looking back through time, the new benchmark we'll be using outperformed our existing benchmark, so we are not making this change to "whitewash" past performance. Rather, we truly feel it is a better representation of a core portfolio that would be a default option for investors if we were not managing their portfolios. Thus, any returns above or below the benchmark in the future will be to our credit or blame (we expect periods of both but hopefully outperformance over longer periods).

We're making this change because we made some changes to our investment approach over the past few months (see our article in the last newsletter about factor-based investing), and we feel a new benchmark would better represent the new approach.

The new benchmark will be simpler, consisting only of a total U.S. stock market index (the S&P 1500 index) and a total international stock market index (MSCI ACWI ex U.S.). The benchmark will be weighted 70% U.S. and 30% international, reflecting the targets we have in most of our managed portfolios.

We will start using this new benchmark on most of our reporting starting next quarter. The benchmarks we have been using for the bond and alternative investment components of our portfolio will remain the same. Feel free to give us a call if you have questions or are confused by the new reports.

Chris's Corner: Update on RMDs & the CARES Act *continued from page 3*

- **Your beneficiaries:** If you have a large account and only a few beneficiaries, or if your beneficiaries are in higher tax brackets than you, it may make sense to pay taxes now, particularly since any inherited IRA money must be taken out within 10 years.
- **Your cash position:** Since taxes are generally withheld when RMDs occur, you may need to find cash from other accounts to redeposit the gross amount. You will receive a refund for those amounts withheld, but not until 2021 when you file your 2020 return.

If you have already taken an RMD for 2020 we have reviewed your account to see if it makes sense to refund the balance. As always though, if you have questions, want to talk through the details, or would like to hear more about the ruling, please let us know.

Value Stocks: Overdue?

Making and saving money is hard. Perhaps that is why human beings are wired to look for bargains. We're constantly looking for sales, coupons, rebates, and discounts. It feels better to know you didn't overpay for something.

Interestingly, that isn't always true in the stock market. There are investors who prefer to pay more for highly priced stocks in the hope that those stocks will rise even further. And, there are times when most of the market seems ready to overpay for the privilege of investing. Today is one of those times.

In the first half of this year, the largest, most expensive stocks have enjoyed the strongest performance. The top 10 stocks in the S&P 500 had a median market value of almost $850 billion. Those stocks traded at a median price-to-earnings ratio of 31. As a group they returned almost 10%. If you compare that with the smallest stocks in the S&P 500, their median market value was only $5 billion, and they traded at an ultra-low price-to-earnings ratio of less than 14. Those stocks lost almost 40% in the first half of the year.

It may seem crazy that the most overpriced stocks continue to become even more overpriced, but it isn't unprecedented. The decade of the 1990s, when technology and internet stocks dominated the landscape, had a similar dynamic. These periods can go on for longer than we expect, but they do not last forever. Ultimately, human nature takes over and bargain hunting begins again.

That may be why value stocks outperform over time. Value stocks are those that trade at lower prices relative to their intrinsic worth. That isn't always easy to measure, but relative to the overall market or to growth stocks, value stocks as a group can be clearly defined. They are the stocks that trade most cheaply to their earnings, sales, cash flows, and book values.

Value stocks have had a tough go of it lately, but the future looks much brighter. They currently trade at the biggest valuation discount to growth stocks ever, even larger than during the 1990s technology bubble. Historically, these disparities have been an opportunity for long-term investors to profit in the years ahead. Coming off such lows, value stocks tend to provide outsized returns that last for many years. That was true in the wake of the tech boom, as large-cap growth stocks lost money during the decade of the 2000s, while value stocks provided positive returns.

The problem is, there is no free lunch in the world of finance. The excess returns that value stocks have provided also come with a higher level of risk. That isn't always visible in traditional statistical analysis, but when markets turn down and liquidity dries up, value stocks often show their true risk profile. That was true this year as well. Value stocks fell much more than the market during March and April. They have rebounded some, but still remain significantly off their highs, whereas the overall stock market is only down a little from its high point last February.

That risk/reward profile means that value stocks aren't for everyone, and they probably shouldn't comprise your entire portfolio. However, as part of a diversified portfolio, they can make a lot of sense. We've been invested in value stocks since the inception of our firm, and we plan to continue holding them for the long haul. That can make for some uncomfortable periods (see year-to-date returns), but over time should result in larger portfolios.

Dog Days of Summer

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when Nyla saw that Skye wasn't where she left her, I would tell her that Skye jumped up on her own to hang out with me. It became a running joke that Skye followed me around when Nyla wasn't looking.

For a while I would go into Nyla's bedroom after she fell asleep and take Skye to our room. Nyla would be angry when she woke up, but I would always plead innocence and insist that Skye came in on her own.

So, for my birthday this year Nyla's gift to me was a pet adoption certificate that entitled me to joint custody in Skye. It was very sweet, but I'm too much of a jerk to dwell on that. Instead, we immediately started arguing over which half was mine and which half was Nyla's. I claimed the front half, but that didn't go over very well. The argument continues to this day.

Custody has its privileges, however, and I am now entitled to have Skye sleep in my bed up to 3 nights per week. We tried that a few times, but you can imagine how happy my wife was with a life-sized stuffed dog hogging much of her side of the bed.

I thought the novelty of Skye would eventually wear off, but she is still omnipresent in our lives. Nyla always has her nearby, and Skye has effectively become part of the family. Skye even made trips to the office, and Nyla decided that she had to be dressed appropriately in case any clients came to visit that day. So, Skye "borrowed" one of my sport coats and spent the day analyzing data with me. It turns out dogs have a keen eye for statistical anomalies and don't argue with you about your market insights.

Despite Skye's presence, talk of a real dog hasn't subsided much. Nipa is starting to show signs of weakness, but apparently the quarantine has resulted in huge demand for dogs, so they are hard to find currently. Hopefully we can continue to kick that can down the road. Besides, I'm happy with my 50% of Skye. At least she doesn't soil the rugs.

What is ACM?

Armbruster Capital Management, Inc. (ACM) is a boutique wealth management firm serving high-net-worth individual and institutional clients. The firm's innovative "Passive Quant" investment approach incorporates cutting edge financial research to help control risk and pursue superior returns. ACM uses index funds, exchange-traded funds (ETFs), and other investment vehicles to build portfolios designed to reduce investment-related costs and taxes in order to maximize net returns.

Located in Pittsford, NY, ACM is employee owned, independent, and minimizes conflicts of interest. Acting as a fiduciary, the firm creates truly customized investment portfolios tailored to each client's unique objectives.

Armbruster Capital Management, Inc.
(585) 381-4180
info@armbrustercapital.com
www.armbrustercapital.com

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