August 6, 2020
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Virus Market

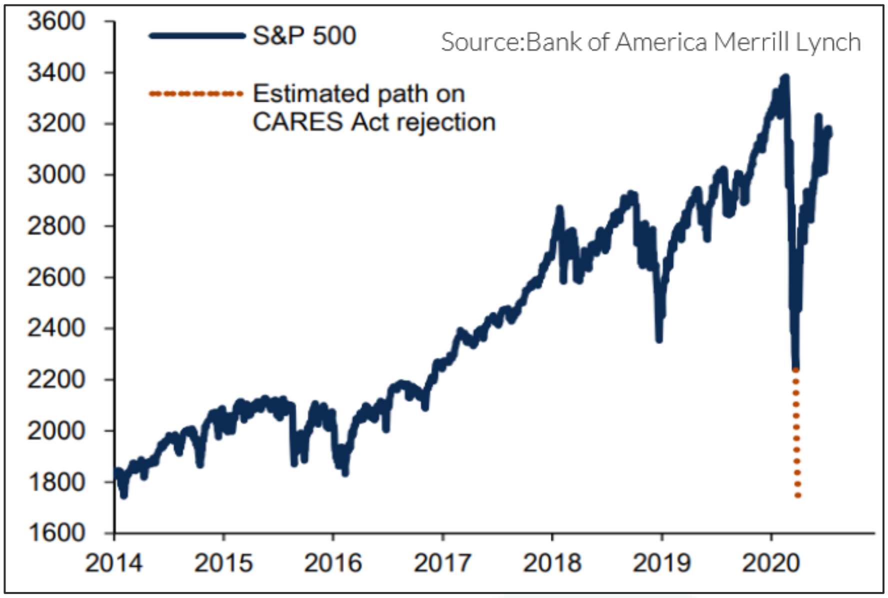
What a difference a quarter makes. Uncertainty and volatility remain high, but risk assets recovered sharply. Markets reflected an abundance of liquidity and hopeful expectations about re-opening after the global shutdown. Economic conditions improved sequentially from extremely low levels, but progress has been uneven and will largely depend on Covid-19's trajectory and on continued policy support. While the market has rebounded quite substantially, there are still risks worth keeping an eye on.

COVID-19 Has Not Gone Away in the United States

There has been a new wave of Covid-19 infections and hospitalizations in the southern and western US. Reopening in some hard-hit states – Texas, Arizona, California, and Florida – has already started to slow as governors reimpose restrictions on bars, restaurants and other high-density venues. There is evidence in mobility and consumer spending data that the US economic recovery has been put on pause. However, we believe the likelihood of more draconian lockdowns and a subsequent severe downturn is slim. Therefore, the main risk is the continued presence of COVID-19 at high levels into the fall, as more activities move indoors and thus, the rate of transmission increases. COVID-19 is a downside risk we will not ignore, and while that might cost us some performance advantage on the upside, we believe that it will protect Clients against nasty drawdowns.

The Looming Fiscal Cliff

Congress has mostly plugged the hole in revenues and wages for the private sector, but if fiscal hawks succeed in reducing support this month, the impact would be dire. Imagine if, instead of the CARES Act, we endured a repetition of the House TARP rejection in September 2008; the analogous S&P plunge would have been to 1720! However, with 2008 still fresh on policymakers' minds, we see a high probability that Congress will reach some deal on a new aid package, but the real question is whether it will target schools (a reopening cannot work without funding its COVID-19 cost) and municipalities, who have seen tax revenues vaporize over the last five months. Basic services, health, schools, police are all in jeopardy. Stimulus remains politically popular nationwide, and more importantly, in swing states – the US elections, believe it or not, are only four months away!



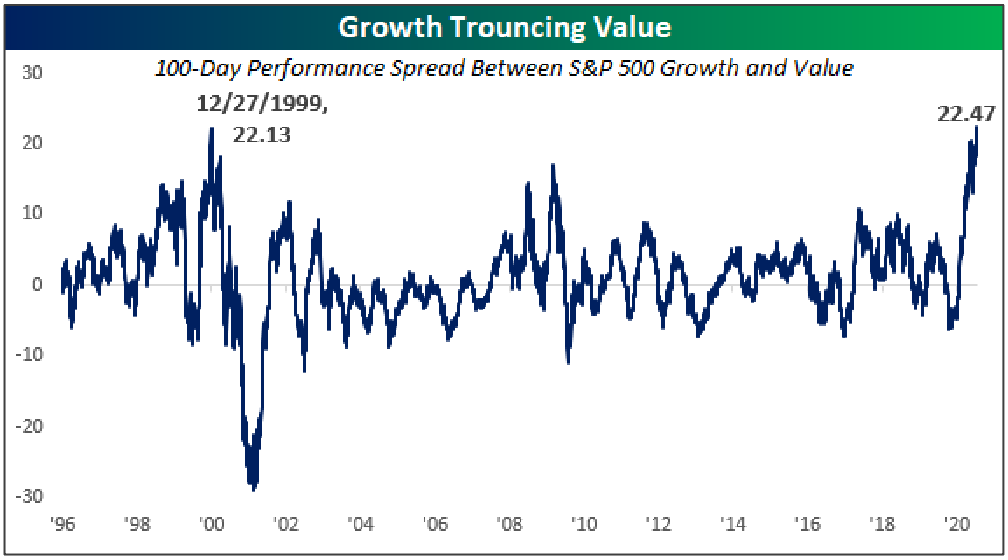
Due to these risks, markets will likely trade nervously over the coming weeks. However, the new bull market will continue. The primary reason? It might seem crazy to conclude that the fair value of the S&P 500 may have increased at a time when the US and the rest of the world have plunged into the deepest recession since the 1930s, but, thanks to extremely low bond yields, extraordinary fiscal stimulus and central bank support, that is exactly what has happened. But we believe corporate earnings will eventually matter again so choosing the right regions, sectors and factor exposure will be as important as ever. We will continue to monitor financial conditions and stand ready if our risk management process warrants action

Growth Trouncing Value

For much of the second quarter, as growth stocks seemingly move in one direction (higher) while value stocks remain stagnant and drift lower, the spread in performance between the two investment strategies continues to widen. In the 100 trading days ending July 20, the S&P 500 Growth Index was up over 14% while the S&P 500 Value Index declined 8% for a spread of 22.5 percentage points. When was the last time the spread got that wide? Well, not since at least 1996.

This chart to the right shows the rolling 100-trading day spread between the performance of the S&P 500 Growth and Value Indices going back to 1996. Prior to July 20, 2020, the record spread between the two indices was 22.1 percentage points, which was reached during the dot-com boom in December 1999. Besides that period, the only time the spread was even close to current levels was in March 2009 when it topped 17 percentage points.

In other words, the last two times the performance spread between the S&P 500 Value and Growth Indices was anywhere close to as wide as it is now represented both the worst and the best entry points for the broader market in the last 25 years.



Source: Bespoke Investment Group

We continue to focus on the need in a financial crisis (whatever the origin) to help craft easy-to-understand, longer-term narratives for Advisors and their Clients. Panicking and abandoning diversified investment strategies during volatility and market crashes/surges is a time-tested losing proposition.

We have continued to carefully assess exposure across all our portfolios over the past quarter, as per our risk management process. Certain portfolios reflect defensive/conservative positioning amid historic volatility in asset markets, while others are more aggressively positioned. In our fundamental strategies, we have deployed cash in high quality credit and equities. Many of our rules-based portfolios are still defensively postured, which we have outlined in more depth below. We remain cautiously optimistic to the continuation of the recovery but recognize the possibility of some pain ahead in the near-term due to several risks outlined above.

We feel now more than ever having a tactical component within your overall portfolio makes sense and that being nimble and approaching the market with caution is warranted. W.E. Donoghue's solutions are designed to be client-centric and deliver strong risk-adjusted return streams through both our rules-based, tactical strategies as well as our global macro, fundamentally driven tactical solutions. We aim to capture the majority of the upside but more importantly to avoid the majority of the downside.

We will stay vigilant with our goal of seeking strong risk-adjusted returns. Please visit our website at www.donoghue.com for our latest information including Fact Sheets for the entire suite of products. Thank you for your confidence in W.E. Donoghue. Please let us know if you have any questions.

Regards,

Jeffrey R. Thompson
Chief Executive Officer
Portfolio Manager

The following reflects W.E. Donoghue's portfolios positioning as of June 30, 2020.

Power Dividend Index Portfolio

Positioning: 100% allocated to Short-Term Treasuries via ETF exposure.

The principal goal of our strategy is to capture most of the upside and limit participation on the downside following our belief that "It's not what you make, it's what you keep." As you know, the Power Dividend Index uses a set of technical and fundamental indicators to determine if it should be invested in equities or be in a defensive position. The portfolio began the second quarter 50% allocated to high dividend Large/Mid-Cap Stocks but received a defensive sell signal on June 20 to exit its entire index in favor of short-term Treasury ETFs. Our focus continues to be risk-adjusted returns over a full market cycle. We continue to believe that Power Dividend is well positioned as the market demographics are shifting from a position of accumulation to seeking income-producing investments. In addition, as we enter the later stages of the credit cycle, we see dividend-paying stocks potentially benefiting from shifting market conditions.

Power Momentum Index Portfolio

Positioning: 80% invested in high Sharpe Ratio Large-Cap Stocks; 20% invested in Short-Term Treasuries via ETF exposure.

The portfolio began the second quarter fully defensive. Since, the Power Momentum Index Portfolio has received multiple bullish signals, the first of which came through on May 26, when we bought back into Healthcare. As the market continued to rebound, various other sector signals came across the tape in June. On June 1, the portfolio bought back into Technology. On June 4, we received the buy signal for Consumer Discretionary, and then on June 5, we received a signal to buy back into the Communications sector. On June 10, we received a buy signal in Materials, June 19 bought back into Consumer Staples and Energy, and finally on June 24, the portfolio bought back into Industrials. We would suggest considering diversifying into this strategy to complement the Power Dividend Index Portfolio as the Power Momentum strategy has ten tactical overlay trigger points and is less binary.

Power Dividend Mid-Cap Index Portfolio

Positioning: 100% allocated to Short-Term Treasuries via ETF exposure.

The Power Dividend Mid-Cap Index Portfolio began the second quarter fully defensive. The Portfolio remained fully defensive for the entirety of the quarter. Our focus continues to be on risk-adjusted returns over a full market cycle.

Power Dividend International Index Portfolio

Positioning: 100% invested in Short-term Treasuries via ETF exposure.

The Power Dividend International Index Portfolio began the quarter in a fully defensive posture. The Portfolio remained fully defensive for the entirety of the quarter. Our focus continues to be risk-adjusted returns over a full market cycle. We continue to believe that Power Dividend International is well positioned as the market demographics are shifting from a position of accumulation to seeking income-producing investments. In addition, as we enter the later stages of the credit cycle, we see dividend-paying stocks potentially benefiting from shifting market conditions.

Power Treasury Index Portfolio

Positioning: 100% invested in intermediate-term U.S. Treasury bonds via ETF exposure.

The Power Treasury Index Portfolio began the quarter defensively invested in long-term US Treasuries. In mid-April, as credit conditions improved, the portfolio's technical signals triggered a shift into intermediate-term US Treasuries. Year to date, the Power Treasury Index Portfolio has been our best performing strategy, as the rally in bonds has been nothing short of incredible. We continue to suggest that this strategy should not be utilized as a standalone solution, but rather should be blended with other solutions to provide a potential hedge in risk-off market environments, like the one we are currently experiencing.

BLENDED SOLUTIONS

The blended solutions combine the best ideas from our rules-based and global macro solutions into long-term investment solutions.

Power Income Portfolio

The Power Income Portfolio's allocations at quarter end are as follows: 4.27% in cash, 86.91% in fixed income, 5.51% in equities, and 3.31% in alternatives.

Being that we are late in the credit cycle and are likely at or near a secular turning point in the bond market, the overall portfolio, and particularly the Power Income Fund, shifted towards a more diversified global, multi-asset income approach to seek opportunities in the fixed income and yield-oriented equity markets. We believe that future potential returns will predominantly come from coupon and dividend yield performance moving forward. The Floating Rate fund began the quarter fully defensive but shifted exposure back into Floating Rates and High Yield throughout May and into June.

Target Allocations: 56.25% in Power Income Fund, 31.25% in Power Floating Rate Index Fund, and 12.50% in a short-term treasury bond fund.

Power Dividend and Yield Portfolio

The Power Dividend and Yield Portfolio's allocations at quarter end are as follows: 4.36% in cash, 71.39% in fixed income, 19.44% in equities, and 4.80% in alternatives.

Target Allocations: Power Income Fund (35%); Power Global Tactical Allocation/JAForlines Fund (35%); Power Floating Rate Index Fund (15%); Power Dividend Index Fund (7%); Power Dividend Mid-Cap Index Fund (5%); Power Momentum Index Fund (3%).

Power Growth and Income Portfolio

The Power Growth and Income Portfolio's allocations at quarter end are as follows: 4.35% in cash, 59.56% in fixed income, 31.65% in equities, and 4.43% in alternatives.

Target Allocations: Power Global Tactical Allocation/JAForlines Fund (49%); Power Momentum Index Fund (15%); Power Dividend Mid-Cap Index Fund (12%); Power Floating Rate Index Fund (5%); Power Income Fund (10%); Power Dividend Index Fund (9%).

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There can be no assurance that the purchase of the securities in this portfolio will be profitable, either individually or in the aggregate, or that such purchases will be more profitable than alternative investments. Investment in any Portfolio, or any other investment or investment strategy involves risk, including the loss of principal; and there is no guarantee that investment in W.E. Donoghue's Portfolios or any other investment strategy will be profitable for a client's or prospective client's portfolio. Investments in W.E. Donoghue's Portfolios, or any other investment or investment strategy, are not deposits of a bank, savings, and loan or credit union; are not issued by, guaranteed by, or obligations of a bank, savings, and loan, or credit union; and are not insured or guaranteed by the FDIC, SIPC, NCUSIF or any other agency. The composite strategy provides diversified exposure to various asset classes such as equities, fixed income, and alternatives utilizing liquid exchange-traded products. Diversification does not guarantee a profit or protect against a loss.

The S&P 500 Index is a market capitalization weighted index of 500 widely held stocks often used as a proxy for the stock market. Standard and Poor's chooses the member companies based on market size, liquidity, and industry group representation. Included are stocks of industrial, financial, utility, and transportation companies.

The S&P 500 Value Index measures the performance of value stocks drawn from the S&P 500 index. The complete market capitalization of S&P 500 index is divided into growth and value segments by using three factors: sales growth, the ratio of earnings change to price, and momentum. The index is market capitalization weighted.

Investors cannot invest directly in an index. Indexes are unmanaged. Index returns assume the reinvestment of distributions, but do not reflect the deduction of a management fee, transaction and custodial charges, or other expenses; the incurrence of which would reduce the indicated historical performance results. Economic factors, market conditions and investment strategies will affect the performance of any portfolio, and therefore there are no assurances that any portfolio will match or outperform any particular benchmark.

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TACTICAL ASSET MANAGEMENT