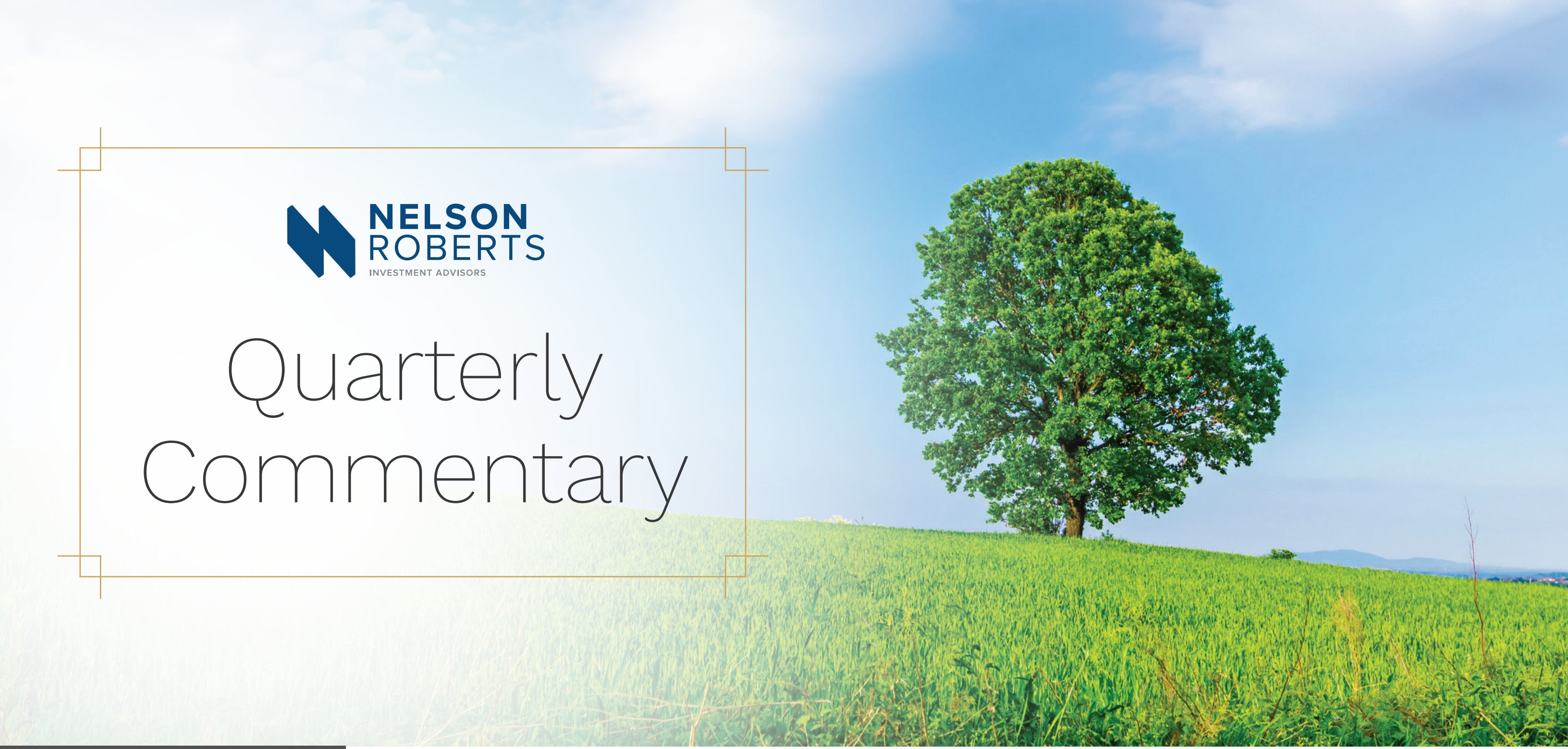

NELSON ROBERTS
INVESTMENT ADVISORS

Quarterly Commentary

2020 | Q2

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Miraculous Market Recovery

The S&P 500 hit a bottom of 2,192 on March 23, down 35% from its February 19th high. Much of this downturn was recovered in the second quarter, with the S&P rising to 3,100, finishing the quarter down about 3% from the beginning of the year. Positive (albeit early) data from treatment and vaccine trials as well as massive monetary and fiscal stimulus were the primary reasons behind the market's quick recovery. As states

S&P 500

Source: FactSet

have begun allowing businesses to reopen, incremental data has signaled better-than-expected demand. Technology and healthcare stocks led the way higher at the beginning of the recovery, while more cyclical industries like finance and energy began to participate in the rally later in the quarter. Market commentators have highlighted FOMO (fear of missing out) and TINA (there is no alternative) as key forces driving stocks higher.

The booming stock market recovery belies the barrage of poor economic data. After several years of healthy job growth of around 200,000 per month, the U.S. lost over 21.5 million jobs in March and April, bringing the unemployment rate from 3.5% in February to nearly 15% in April. Year-over-year GDP growth dropped from 2.3% at the end of 2019 to 0.2% at the end of March. Abysmal retail sales numbers have notched new record declines during the quarter. Manufacturing data is as bad as it was during the 2008 Financial Crisis. Many companies have reduced their earnings expectations for the remainder of the year and around half of the companies in the S&P 500 have withdrawn their 2020 guidance completely. And yet, the market races higher.

Index Performance	Q2 '20	YTD
Dow Jones Industrials	18.51%	-8.43%
Standard & Poor's 500	20.54%	-3.09%
EAFE (international stocks)	15.15%	-11.03%
Russell 2000 (small stocks)	25.42%	-12.99%
Barclays Interm. Gov/Credit	2.81%	5.28%
Barclays Municipal	2.72%	2.08%

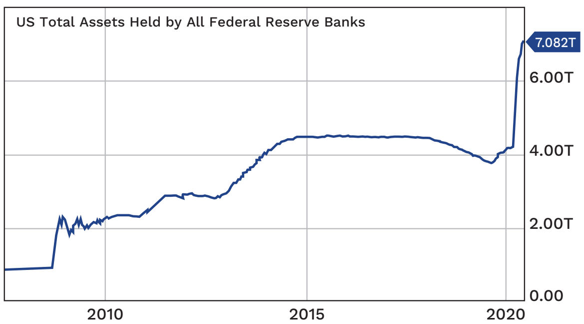
We apply rigorous analysis in asset selection so you can focus on your passion

ECONOMIC OVERVIEW

Miraculous Market Recovery (cont.)

In the first 12 weeks after broad shutdowns began, the Federal Reserve added $3 trillion to its balance sheet, bringing the total to just under $7.2 trillion, an increase of more than 70%. Fiscal stimulus including the CARES Act passed by Congress and signed by President Trump added another $2.44 trillion of stimulus for individuals and businesses. The U.S. government debt-to-GDP ratio is expected to reach 131% this year, up from 109% in 2019 and higher than the debt burden seen after World War II.

Federal Reserve Balance Sheet



Source: YCharts

The firehose of stimulus from the Fed has caused money supply to skyrocket while the velocity of money, or the rate at which money is exchanged, has plummeted. In other words, there is a lot more money in the banks, but no one is spending it. Stimulus checks from the government appear to have been stashed away in savings accounts to prepare for troubled times ahead. The personal savings rate reached an all-time high of 33%, spiking from under 10% prior to the pandemic.

The pandemic is likely to send the U.S. into a recession. This changes the election outlook substantially, and is reflected in current polls.

The dramatic recovery has brought valuations roaring higher, especially with most companies experiencing a severe cut to earnings. We generally look at forward price to earnings (P/E) ratios, using projected earnings, but the withdrawal of guidance from most companies makes the forward “E” very unreliable. The (backward-looking) trailing 12-month P/E ratio of the S&P 500 has surged from 15x on March 23 to over 22x. We have also witnessed a few signs of speculative excess both in the options market and in the large wave of retail stock buying in the last few months. Furthermore, even though demand trends and economic data have been better than feared, they are still not favorable.

We are looking to invest in companies and sectors where significant supply and demand disruptions did not occur due to coronavirus. We are also trying to parse which consumer behaviors will snap back and which have changed more permanently. Longer term, we are most concerned about how the fiscal and monetary stimulus gets unwound, although that impact could be years into the future. In the near term, we believe that at some point the economy and the market must relink. Whether this means a rapid economic recovery or a drop in the market, only time will tell. As a result, we think now is the time to be cautious.

ASSET TRANSACTIONS

Finding Opportunity

In the wake of the first quarter market decline, we found opportunities to add companies to our client portfolios and take advantage of a tax loss for taxable accounts. We purchased a position in DocuSign (tkr: DOCU, see Featured Equity) early in the quarter. The stock has outperformed dramatically since then, nearly doubling our initial position. DocuSign provides cloud-based electronic signature solutions, enabling companies and individuals to sign documents remotely, securely collect information, and automate data workflows. The adoption of electronic document execution has accelerated due to the pandemic and we anticipate that this will continue to benefit DocuSign even as things begin to return to normal.

Where we were able to realize a tax loss for the benefit of our clients, we sold the iShares S&P SmallCap 600 Index (tkr: IJR) and replaced it with the Vanguard Small-Cap Index Fund (tkr: VB). These two ETFs have similar exposure, though the Vanguard ETF expense ratio is slightly lower at 0.05% compared to the iShares ETF 0.07% expense ratio.

We took advantage of the excessive decline the price of Ventas (tkr: VTR) to add to our existing position. Ventas is a real estate investment trust (REIT) that owns a portfolio of senior housing, medical office buildings, life science buildings and hospitals. From its peak in February, Ventas had declined 73% by mid-March. Though Ventas has significant exposure to senior housing facilities, which have been hit hard by COVID-19, our initial investment theme that the aging baby boomer demographic is growing still holds true. Over the longer term, Ventas should benefit from a decline in senior housing construction which should help offset the oversupply of senior housing facilities, ultimately leading to superior occupancy rates and a stronger recovery.

In the healthcare sector, we added a position in Thermo Fisher Scientific Inc. (tkr: TMO). Thermo develops and manufactures scientific instruments and laboratory equipment, diagnostics consumables, and life science reagents. It also provides software and services for research, analysis, discovery, and diagnostics. Thermo aspires to become a one-stop shop for researchers in academia, Big Pharma, biotech, and government. Demand for its tools and supplies are higher than ever as the world attempts to manage and eradicate the COVID-19 outbreaks. Looking ahead, Thermo is well-positioned to benefit from a rise in infectious disease and epidemiologic research over the next several years.

> "In the near-term, we believe that at some point the economy and the market must relink. Whether this means a rapid economic recovery or a drop in the market, only time will tell. As a result, we think now is the time to be cautious."

FIRM UPDATES

Nelson Roberts remains fully operational during this pandemic. We are not scheduling any in-person meetings at this time out of concern for the well-being of clients and employees. The majority of Nelson Roberts employees continue to work remotely and we do not have more than three people in our office at any one time. These measures allow us to remain in compliance with CDC, California and San Mateo County social distancing guidelines.

WEALTH MANAGEMENT

In Lieu of RMDs, Consider Roth Conversion

In the Nelson Roberts Q1 2020 Quarterly Commentary, we wrote about the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020. In that Act are provisions related to individual retirement accounts (IRAs). Some of these provisions allow relief for all individuals, enabling access to assets in their IRA accounts, without penalty, to help those that might have seen their incomes impacted by COVID-19. The more meaningful provision for clients of Nelson Roberts is the waiving of the required minimum distribution (RMD) for calendar year 2020.

The following is a case study detailing how a client might utilize the suspension of the RMD requirement in 2020 to fund a Roth IRA account:

Scenario:

- Married couple in their 80s with Social Security income of $30,000.
- The couple has a required minimum distribution of $200,000 in 2020 from their IRAs.
- The couple has non-retirement assets of $1.5 million.

In a normal year, the combination of Social Security income and RMD would put them in a federal tax bracket of 24%. By electing not to take an RMD in 2020, this couple would only have Social Security income, which would put them in the 12% federal tax bracket.

In consultation with their tax accountant and Nelson Roberts relationship manager, this couple could determine how much of their IRA they could instead convert into a Roth IRA. The long-term benefit of a Roth IRA is that it grows tax free and is not subject to future income taxes for either the couple or potentially their Roth IRA beneficiaries upon withdrawal.

	With RMD	No RMD & Roth Conversion
Income before IRA RMD	$30,000	$30,000
RMD Income	$200,000	$0
Income from Roth Conversion	$0	$50,000
Taxable Income	$230,000	$80,000
Marginal Federal Tax Bracket*	24%	12%
Tax Liability	~$43,360	~$9,235
Roth Assets	$0	$50,000

*The computations are for demonstration purposes only; please consult a tax professional for precise calculations

In the above scenario, the couple could convert approximately $50,000 of their current IRAs into a Roth IRA and remain in the 12% federal tax bracket. They would then pay federal taxes of $6,000 on the $50,000 conversion.

A conversion can be especially beneficial when the client couple has access to non-retirement assets to fund their living expenses and the tax liability created by the Roth conversion. It can also be valuable in a scenario where the ultimate beneficiaries of their Roth IRA, often the IRA owner's children, are in high tax brackets.

Please contact your Nelson Roberts relationship manager to determine if a Roth IRA conversion might be of value to you.

TOP 15 HOLDINGS

VANGUARD DEVELOPED MARKET ETF

AMAZON.COM INC.

iSHARES S&P SMALL-CAP ETF

ALPHABET INC.

MICROSOFT CORP.

APPLE INC.

COSTCO WHOLESALE CORP.

ILLUMINA INC.

CISCO SYSTEMS INC.

HOME DEPOT INC.

VERIZON COMMUNICATIONS INC.

VANGUARD EMERGING MARKETS ETF

MEDTRONIC

WALT DISNEY CO.

LINDE PLC

FEATURED EQUITY

DocuSign Inc.

As the shelter-in-place orders started to go into effect around the country in March, many companies scrambled to configure effective remote work environments for their employees. We initiated a position in DocuSign (tkr: DOCU) at the beginning of the quarter, recognizing that the company would likely benefit from the new work-from-home trend. DocuSign is most well-known for its e-signature solution, which management estimates has a $25 billion total addressable market. DocuSign is the clear leader in the space, by at least a factor of two. There is potential for the company to increase their revenue opportunity as they add ancillary features. DocuSign has been effective at this “land and expand” strategy, as customers continue to add on additional products and services. Even as employees begin returning to work, companies are unlikely to stop using DocuSign, as they realize the time savings and cost effectiveness of electronic document execution.

Source: FactSet

One of DocuSign’s key offerings is Agreement Cloud. This software suite helps automate the entire agreement process. Agreement Cloud consists of DocuSign’s core eSignature solution as well as other applications for automating pre- and post-signature processes. These include automatically generating an agreement from data in other systems, supporting negotiation workflow, collecting payment after signatures, and using AI to analyze a collection of agreements for risks and opportunities.

Relative to other software companies, DocuSign’s market is remarkably less saturated. It sells into a broad range of customer verticals: financial services, insurance, real estate, mortgage, government, education, healthcare, life sciences, etc. Government is a significant and upcoming opportunity. The Department of Labor recently adopted DocuSign to help streamline its process for handling emergency unemployment benefits alongside the colossal wave of claims filed since the middle of March.

DocuSign went public in May 2018, although the company was founded in 2003. The U.S. government passed the Uniform Electronic Transactions Act and the Electronic Signatures in Global and National Commerce Act in 1999 and 2000, respectively. These laws helped legitimize electronic signatures, but the trend has really taken off in the last 10 years. Early e-signature tools were clunky and complex, and DocuSign has been successful in capturing the market by offering a simple, stream-lined solution that has gained significant brand recognition over time.

DocuSign’s segments are Subscription (94% of revenue) and Professional Services (6% of revenue). A high percentage of its revenue recurs, based on contracts of 12-18 months. The stock has run up significantly since we bought it, and its valuation is now arguably expensive. However, we believe DocuSign’s success is likely to continue because of the overall improved efficiency and the cost savings it brings to companies, even as we return to “normal” times.

(The preceding information regarding the featured equity should not be construed as a recommendation to purchase the security. It should not be assumed that future returns will be profitable or will equal the historical performance. Please contact us for a complete list of holdings.)

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SPECIAL TOPIC

The Race for a COVID-19 Vaccine

The world is anxiously awaiting a vaccine to stop the spread of SARS CoV-2, the virus that causes the disease COVID-19. Scientists have been working with unprecedented speed to develop a vaccine, as there is yet no definitive treatment that can cure this disease.

There are several different types of vaccines. One type uses the whole inactivated virus, which is unable to infect the body's cells but can still elicit an immune response. The measles, mumps and rubella (MMR) vaccine is an example that has been used for many years. Chinese company CanSino is developing a COVID-19 vaccine of this type that is currently in clinical trials. Other companies are working on gene-based vaccines, which use only a small fraction of the virus. Moderna (tkr: MRNA), AstraZeneca (tkr: AZN), in collaboration with Oxford in England, and Johnson and Johnson (tkr: JNJ) are all researching this type of approach.

Once a vaccine candidate is manufactured, it must be tested in three phases. In the first phase, a small group of healthy people is vaccinated then tested for an immune response and observed for side effects. In phase 2, more people across a broader spectrum of ages receive the vaccine. In phase 3, thousands of people are vaccinated and the rate of infection in this group is compared to a non-vaccinated group. Phase 3 testing for several COVID-19 vaccines is anticipated to begin later this summer. Previous vaccines have taken many years to come to market. The mumps vaccine took four years—at the time, a new record for speed of development.

Still, important questions remain. Will a COVID-19 vaccine last a lifetime, or will people need an annual shot, as with influenza? Will people need a "booster" a month after the first shot? Will the antibodies induced by the vaccine be protective against the disease or just decrease the severity of disease?

Furthermore, there are the logistical challenges of manufacturing, distributing, and administering billions of doses of vaccine. This is one major reason that experts are giving a best-case timeline of 12 to 18 months.

We have elected not to chase Moderna, or to invest in any of the other big pharmaceutical companies working on vaccines. Due to the humanitarian nature of this issue, it is highly likely that vaccines will be either given away or sold at very modest prices, at least initially. Inventing a vaccine, therefore, will be a wonderful achievement, but not one that will move the revenue needle for Johnson and Johnson, AstraZeneca or Pfizer. Our portfolio currently includes GlaxoSmithKline (tkr: GSK), which produces adjuvants (substances that help boost the immune response) for vaccines. We believe our holdings in Illumina (tkr: ILMN) (sequencing the virus), Thermo Fisher (tkr: TMO) (testing and supplies), Gilead (tkr: GILD) (remdesivir for treatment of hospitalized COVID-19 patients) and Glaxo together provide balanced investment exposure without betting on one specific type of vaccine or that one particular company will be successful in its quest to make and manufacture an effective vaccine.

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