U.S. Stocks Hit It Hard in Q3

Quick Overview:

- Deciding to Grip it and Rip it, U.S. stocks, as represented by S&P 500 Index, pulled the driver out in Q3, returning 8.93%.
- Much like most of the year, Large beat Small and Growth Beat Value, as the growth tilt faired even better in smaller capitalization territory.
- For the year, small cap stocks, represented by Russell 2000 Index, have caught a case of the shanks, trailing its larger cap brethren by 14.26%, returning -8.69%.
- Within small, companies who lost more money than John Daly on a two-day blackjack bender outperformed both in Q3 and year-to-date.
- In a quarter, and frankly year-to-date, that saw a slew of lower quality factors outperform, creating a difficult playing environment for the strategy, OSCV still came out on top on Championship Sunday, a.k.a., Q3 and year-to-date, outperforming its benchmark, the Russell 2000 Value, by 3.32% and 8.31%, respectively. Shot (stock) selection continues to drive OSCV's outperformance on all periods – Q3 2020, YTD 2020, 1-year, and since inception outperformance.
- The market took a page out of John Daly's singing career, as it Only Knows One Way Up, the title name of his only musical album, with U.S. stocks looking to get back into bull market form.
- We'll keep swinging here, as we believe that we created a concoction for success within the small cap space, even though it may or may not include an Arnold Palmer and vodka.

Market Review:

With what we viewed as virtually unlimited monetary policy and unprecedented stimulus, which is expected to significantly benefit the regular American consumer, we decided to take a look back at golf's "working man"; John Daly. Daly, an iconic golf figure from the 1990s, was someone you'd actually pay money to see golf, to the point where he probably would have sold out the Dallas Open before Happy Gilmore. Known for his caveman mullet, his mid-round chain smoking, and his non-country club attitude, John revolutionized golf's driving game. With the wind in his face and a situation that would call for playing it safe, Daly would routinely pull out his driver, and say, "I'm young at heart, and I hit it hard."

In our view, this is exactly what U.S. stocks did in Q3. They hit it hard, returning 8.93% in a year that has seen increased volatility and its first recession in 10 years. We believe preparing for the worst, expecting a potential double-dip in the market, managers played it safe with a 7-iron, being overweight defensives, with many managers hitting their ball into the water more times than Roy "Tin Cup" McAvoy.

From our perspective, active managers, who tend to skew towards higher-quality companies, have had a difficult time outperforming their benchmarks this year as the market favored low-quality stocks. The rally in low-quality stocks, has been somewhat surprising to us, as these types of stocks have historically underperformed when the market experiences heightened volatility. We believe this rally from the bottom (since 3/18/2020), has been led by companies that do not earn money, have the highest quintile in valuations and beta, and do not pay a dividend. With higher quality being out of favor, money has been flowing into passive vehicles faster than it would take Daly to burn through $55M at a blackjack table. We believe this bias cannot last forever, as effects of quantitative easing, which there has been a record amount, can only bank roll so many casino visits, potentially crippling many of the 40% of companies within the Russell 2000 Index that do not have positive earnings.

This quarter, U.S. small cap (and large cap) stocks rallied on the heels of a Fed backstop of financial assets and a large influx of fiscal stimulus from Congress. Given this sizeable amount of capital being distributed to consumers, our earnings expectations are now expecting to fully recover back to 2019 earnings-per-share levels in 2021 – coined as a "v-shaped" recovery from investors. With this, we've seen GDP expectation rise, as we believed that estimates were very low coming off of the market bottom in March. Historically, better-than-expected GDP revisions tend to benefit U.S. small cap stocks, especially value-oriented stocks. Though, neither of these things happened as large beat small and growth beat value. The Russell 2000 finished the quarter up 4.93%, led by Discretionary, Industrials, and Materials, but trailing its larger brethren, U.S. Large, by 4.00%. Like larger market cap peers, Small Value has caught a case of the shanks, underperforming Small Growth in Q3 by 4.60% and a staggering 25.42% year-to-date. To put this outperformance into perspective, investors are now back to March 2000's performance gap between Small Growth and Small Value.

Unlike John Daly's obscure singing career, it is well known that investors have seen the fastest run-up in the history of stock prices in such a short time period. Since the market bottom on March 23rd, the market "Only Knows One Way", which is up, and ironically the title of Daly's most recent album. In this high-priced and potentially volatile market, we believe active managers know that this low-quality rally cannot last forever. We believe high-quality stocks are highly undervalued and are poised to lead the market going forward, which tends to bode well for stock pickers, like OSCV.

Portfolio Review:

In a quarter that saw a large run-up in asset values, OSCV came out on top on Championship Sunday, a.k.a., Q3 2020, outperforming its benchmark, the Russell 2000 Value (R2KV), by 3.32%. For the year, OSCV continues to lead the points standings, besting the R2KV by 8.31%. Stock selection continues to drive OSCV's outperformance over longer time intervals.

Over the past few years, momentum has become a larger influence in our investment process – obviously coupled with our cornerstone "D + G Framework". We have learned, especially within small caps, based on our standards, that we need to let what we view as our winners run, while cutting what we categorize as our losers early – creating an asymmetry to the upside. During the quarter, we added a little bit of risk to the portfolio, adding some of those names that have been hit the hardest during the COVID19-induced recession. These names started to gain momentum off the March 2020 bottom, and we added accordingly. Understanding that we did not want to substantially increase the "risk-on" nature of some of our current portfolio holdings, we paired these purchases with what we believe are some very high-quality stocks. Historically, what we classify as, letting our winners run has added value, and that was the case for this quarter.

During Q3 2020, we added Allegiant Travel Company (ALGT), Boyd Gaming Corporation (BYD), and M.D.C. Holdings, Inc. (MDC) as a play on a faster-than-our-expectations of an economic recovery, while purchasing what we view to be high-quality names like Entegris, Inc. (ENTG) and UFP Industries (UFPI) at higher weights, which have historically outperformed through various economic Environments.

Top Ten Holdings as of 9/30/2020

Security Description	Weight
Pool Corp	3.0%
Logitech International, S.A	2.9%
CHEMED Corp.	2.6%
The Ensign Group, Inc.	2.6%
Watsco, Inc.	2.5%
NextEra Energy Partners	2.4%
Toro Company	2.1%
Algonquin Power & Utilities	2.0%
Sapiens International Corp.	2.0%
Hasbro, Inc	1.9%

The majority of our outperformance in Q3 2020 was from stock selection, specifically Financials and Technology. Though, we did find ourselves in a few of the Old Course's pot bunkers, as poor selection in Energy and Durables detracted from performance. Luckily, when we did hit into the sand, we did not find ourselves buried to a point that we had to take an unplayable, i.e., sell the stock due to negative momentum.

For the year, both stock selection and sector allocation have added to performance, as our largest underweight in the portfolio, Energy and Financials Services, i.e., Banks, contributed to almost 500 bps of relative outperformance. Energy and Financial Services have returned -51.84% and -32.04%, respectively year-to-date. Our near zero weighting in Energy, was significantly additive, even though we didn't own the near-bankrupt energy companies that ran during the quarter.

Health Care, led by biotech, is the only sector within U.S. Small to have a positive return during 2020. Surprisingly, unlike U.S. Large, Technology was only the fourth best performing sector in this asset class, behind Health Care, Staples, and Discretionary. OSCV is overweight Health Care and Technology, and slightly underweight Discretionary and Staples.

Given our strong stock selection both in Q3 2020 and YTD, we were able to find the fairway a number of times, unlike Bryson DeChambeau, who won the 2020 U.S. Open, only hitting 20% of the course's fairways. Recent additions like M.D.C. Holdings, Inc. and Aaron's, Inc. (AAN) were up over 30% in the quarter, boosting relative performance. Furthermore, some of our long-term and higher-weighted holdings like Pool Corp. (POOL), Watsco, Inc. (WSO), and Ensign Group, Inc. (ENSG) were also clear leaders going into the clubhouse.

Even though we had more "greens-in-regulation", we also had some accidental shanks, i.e., stocks that underperformed, that negatively contributed to performance. Some of the accidental fades were: Hil-Rom Holdings, Inc. (HRC), Brigham Minerals, Inc. (MNRL), NIC, Inc. (EGOV), and a slew of regional banks.

Fuzzy Zoeller, 2-time major champion, once bet that John Daly would not live past the age of 50, liking his odds so much, he bet $150,000 on it, ultimately losing. Value investors have also been on the losing side of a bet - the duration of the market favoring growth stocks. Understanding that this rally cannot last forever, we believe that there can be a shift to value-oriented stocks, as we currently have the largest performance spread disparity between Small Value and Small Growth since March 2000 and never-before-seen market valuation disparities between the two asset classes. We also continue to believe that there will always be a place for active management in the small cap space, especially those tilted towards Value and dividend-payers. With valuations near all-time highs, increasing volatility, and pockets of irrationality reminiscent of the late 1990s, we believe that active management and superior stock picking abilities will add value going forward.

Even though we have been substantially outperforming across all time periods, we'll keep swinging in the U.S. Small cap space, as we believe that high-quality stocks, one of our many bailiwicks at Aptus, are highly undervalued and ready to lead the market going forward. We continue to be what we view as pragmatic, refining our investment approach, creating what we believe to be the perfect investment concoction, dare I say an Arnold Palmer with vodka, between risk and reward in the U.S. small cap space.

	Q3 2020	YTD 2020	1-Year	Since Inception
Opus Small Cap Value ETF (Market)	5.88%	-13.23%	-8.49%	-1.47%
Opus Small Cap Value ETF (NAV)	5.60%	-13.34%	-8.72%	-1.62%
Russell 2000 Value	2.56%	-21.54%	-14.88%	-10.60%
Russell 2000	4.93%	-8.69%	0.39%	-3.75%

Disclosure: Performance as of 9/30/2020

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