Investment Tally & Perspective

MAJOR ASSET CLASS RETURNS	1st Qtr. 2020	1-Year	3-Year	5-Year
Equities				
S&P 500	-19.6%	-7.0%	5.1%	6.7%
MSCI EAFE	-22.8%	-14.4%	-1.8%	-0.6%
MSCI Emerging Markets	-23.6%	-17.7%	-1.6%	-0.4%
Fixed Income				
Barclays Capital US Aggregate	3.1%	8.9%	4.8%	3.4%
Barclays Capital US Corp. Inv. Grade	-3.6%	5.0%	4.2%	3.4%
Barclays Capital Emerging Market	-9.5%	-2.9%	1.5%	3.3%
Other Assets				
MSCI US Reit Index	-27.0%	-21.0%	-3.0%	-0.4%
S&P GSCI	-42.3%	-41.0%	-13.3%	-12.8%
ICE WTI Crude Oil	-66.5%	-65.9%	-26.0%	-15.5%
Comex Gold	4.8%	21.8%	8.5%	6.2%

Source: Capital IQ — All returns greater than one year are annualized

Market Activity

Gold and treasuries were the only havens in the first quarter, as assets around the world suffered a swift and sharp drawdown. The S&P 500 declined 20%, this is after recouping 16% from its closing low on March 23rd. During the quarter information technology, consumer staples, and health care sectors performed the best. The worst performing sector was energy, which declined 50% during the quarter. What stood out in the first quarter was the pace of the decline; at 22 days, the S&P 500 posted its fastest 30% decline in its history.

Oil is worthy of mention as it was also caught in a historic decline. Compounding the demand driven coronavirus issues was a spat between Saudi Arabia and Russia. After failing to reach a production agreement, the Saudis initiated an all-out assault for market share, dramatically cutting prices on its crude and threatening large production increases. Both supply and demand issues sent crude down 67% in the quarter as storage capacity neared its limit. The price of crude will likely decline unless major producers cut a deal.

Economic Overview

The current pandemic, and global responses to curb its spread, will likely result in a decline in global economic output for 2020. In the U.S., recessions are declared by the National Bureau of Economic

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Research on a lag, but it is likely we are already in one. The apex of economic decline for the United States will occur in the second quarter with economic contraction estimates ranging from -10% to -30%. One important thing to note when reading and listening to these forecasts – GDP is presented on a SAAR basis (seasonally adjusted annualized rate). If seasonally adjusted GDP declines 5% from Q1 to Q2, this equals -20% GDP on a SAAR basis (5% decline for four quarters), which is the number quoted by economists and the press. With COVID-19 in over 180 countries at present, this is very much a global phenomenon; however, major centers of output – China, the U.S., and Europe (>60% of global GDP) – are all within months of each other in their battle against the virus.

Given how unique and fast this circumstance is, there is a lack of hard data to explain what is happening in real-time. Leisure and hospitality are at the focal point of this crisis, but the damage is pervasive. Marriott in mid-March provided an update and stated North American and European hotels are seeing occupancy levels of less than 25%, a 65% decline from normal occupancy. American Airlines in late March stated plans to reduce capacity by 70-80% on domestic routes, and 80-90% on international routes. Offsetting some of these impacts are other sectors of the economy like food and general merchandise. Target saw sales increase in essentials and food and beverage by 50% in March (through the 25th) while they saw a 20% decline in apparel and accessories. We will be learning more in the coming weeks as we receive high level economic reports for the month of March and earnings reports for the first quarter (starting next week).

Unemployment will be moving higher soon. Initial jobless claims are one of the most real-time indicators available, and the picture there is grim. We have seen close to 10 million new claims over the past two weeks, which translates to 6% of the labor force. We will be seeing unemployment levels in excess of the 2008-2009 financial crisis soon.

Coronavirus Aid, Relief, and Economic Security Act

Amount ($ bn)	Measure
$290	One-time stimulus checks amounting to $1,200 per adult and $500 per child up to certain income limits
$260	Enhanced, expanded and extended unemployment benefits, adding $600 per week to every unemployment check for 4 months, expanding program to cover contractors and self-employed and extending program to 39 weeks from 26 weeks
$510	Loans to distressed businesses, cities and states. Includes $29 billion for airlines, $17 billion for firms deemed important for national security and $454 billion as backstop for loans to other businesses, cities and states
$377	Small business relief, largely in the form of "forgivable loans" for spending on payroll, rent and utilities
$150	Direct aid to state and municipal governments
$180	Health-related spending
$516	Other spending and tax breaks
$2.283 trillion	**~10.8% of GDP**

Elected officials seem to be very much aware of the severity of the situation at hand. While it has hit some difficulties getting off the ground, the ability for small businesses to have loans forgiven for the amount paid on payroll, rent, utilities, and other items during this crisis targets the key pressure point for many enterprises. The graphic to the left (courtesy of JP Morgan) breaks down some of the bigger components of the CARES act.

Monetary Policy – Global central banks have aggressively eased policy, perhaps none more aggressively than the Fed. The following is a high-level list of accommodation being provided:

- Federal funds rate cut to 0.00-0.25%
- Treasury, agency MBS and CMBS purchases
- Short-term liquidity support for commercial paper, money funds, municipals, and asset backed securities
- Purchasing newly issued investment grade bonds, secondary market bond purchases, including buying exchange traded funds

Valuation & Sentiment – Sentiment appears to have hit a trough in March, and while currently bearish, it is not at an extreme level. Equity market valuation has improved from where we started the year. Goldman Sachs is expecting the S&P 500 to generate $170 in earnings per share in 2021, which would equate to a 15.9x multiple with the S&P trading at 2,700. This valuation level is about average, though it is attractive considering the ten-year treasury is yielding approximately 0.65%. The valuation is also highly dependent on future EPS estimates. For instance, Goldman's downside EPS case is $115, which would place the market in overvalued territory, at 23.5x earnings.

Investment Outlook and Strategy

Our economy entered the first quarter with growing momentum, and the same may be said for countries around the globe. When it became apparent that the virus was rapidly spreading, investors began selling stocks, and highly leveraged hedge funds activated programs added to selling pressures with prices declining to bear market levels. According to James Paulsen (Leuthold Group) there have been 13 bear markets in the post-war period (WW II). In the first 22 days of the prior bear markets, the average decline was 5.1%. The current bear market declined by 32% in 22 days - almost 6.5 times more rapidly than the average bear market.

Given the healthy status of businesses and consumers at the start of the year, and the depth and speed of the declines and offsetting responses, it is conceivable and probable that the economy and markets heal and move higher at a more rapid rate than the doomsday scenarios promulgated by much of the media.

As expressed in our past communications, our general investment strategy was Neutral exposure to risk assets with a defensive bias. This served us well in 2019 as our stock allocations fully participated in the extraordinary returns, and the defensive bias has been of benefit during this period of market volatility.

Prior to the market decline we viewed stock valuations and prices as stretched with many being richly valued. We were prepped for a pullback of 5% to 7%, or perhaps 10%. We did not envision a Black Swan event such as COVID-19. The fear of unknowns was manifested in panic selling causing prices to drop well beyond fair values. Selling pressures combined with the lack of liquidity in today's markets and changes in market structures brought most stocks from high and extended valuations to a valuation range from fair value to deeply undervalued, presenting opportunistic buys on a selective basis.

When stock prices hit their lowest level last month, we altered our general strategy to Neutral with expectations for market volatility to continue in the days and weeks ahead. As the market forms a bottom, which is a process and not one specific price level, we may well see a test of the March low level. In this swiftly moving landscape, we anticipate deploying cash reserves with selective and appropriate portfolio changes.

In closing, we do not know the course the virus and financial markets will take in the near term. Looking out one, two or five years we are confident stating that the economy (GDP) will be at much higher levels with commensurate increases in business revenues, earnings, and dividends. In our view, stocks will remain the asset class of choice for a combination of income and capital appreciation in the years ahead.

OUR LEADERS IN WASHINGTON SHOW THEY "CARES"

No, the above title is not a grammatical no-no. In response to economic costs associated with the virus "shut down", Congress passed the largest stimulus in history which President Trump signed into law on March 27th. The Coronavirus Aid, Relief and Economic Stability (CARES) Act is focused on economic relief to businesses of all sizes, local governments, hospitals and families. Retirees and retirement savers were also granted some relief with key points highlighted below.

For retirees, the CARES Act includes provisions that waive Required Minimum Distributions (RMDs) from IRA's, including inherited IRAs and most 401(k)-type defined contribution plans, for the 2020 year. Not included in the Act was language for those who have already withdrawn their RMD for 2020, though it will be addressed by the IRS in the coming weeks. The government is forgoing tax dollars from RMDs to allow time for accounts to recover from recent market declines as RMD's are determined by the account value on December 31, 2019 (which were generally much higher than current values). Those who need to withdraw from their retirement account can still do so, however the waiver of the RMD for those who have other sources to withdraw from could allow for additional savings in the form of lower income tax.

The Act included language expanding special hardship withdrawals from retirement accounts for those affected by the coronavirus, by allowing a penalty-free (not tax free) withdrawal of up to $100,000. Repayment of both principal and the taxes is allowed and may be spread over three years without impacting the annual contribution limit. Prior to the Act an individual could take as a loan 50% of their 401(k)'s value up to $50,000; CARES increased the maximum to $100,000.

The responses by the government to the coronavirus pandemic have been swift with additional pledges coming to help American's deal with these challenging times. The provisions on retirement accounts can be helpful in the proper situations. Each client has a unique financial situation that may or may not benefit from these changes. Please view our financial planning services as a resource and contact us with any questions or to discuss CARES or any planning or investment matter.

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