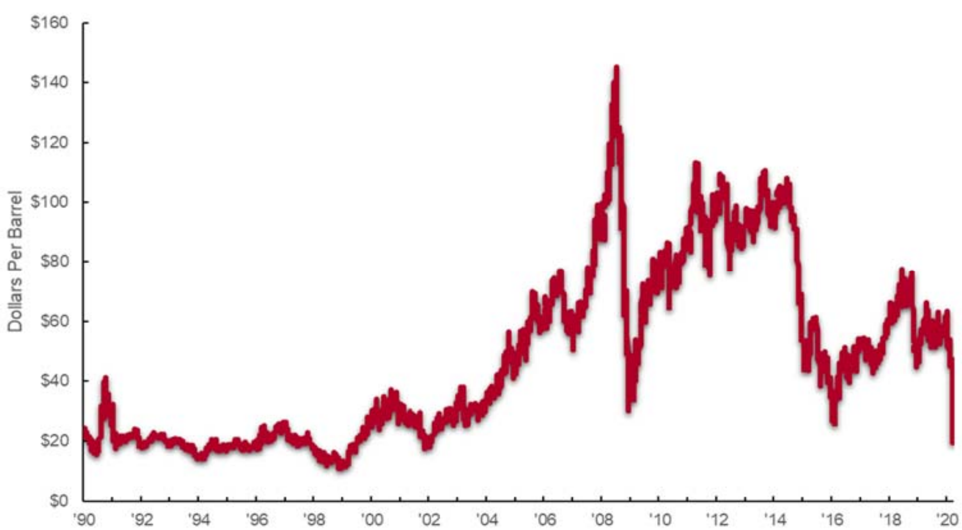
Quarterly Investment Perspectives

Q1 2020 Review & Outlook

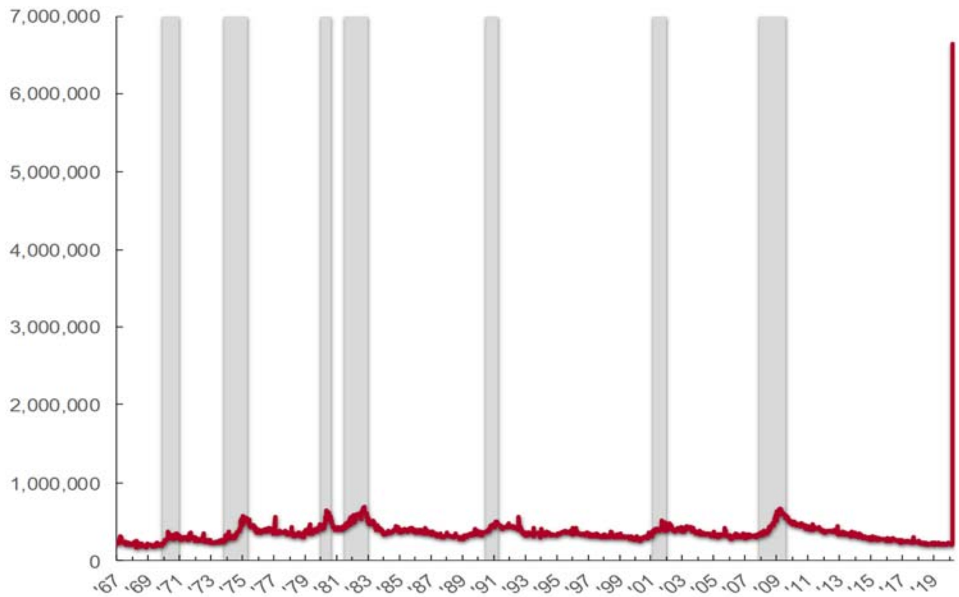
As we entered the first quarter of 2020, we were cautiously optimistic about our economic and capital market outlook. It would be unlikely to repeat the capital market performance of 2019, but the trade disagreement with China was abating, the Federal Reserve had lowered interest rates, energy prices were moderate, and the U.S. consumer was supported by a strong employment market. For the month of January and the first half of February, interest rates held steady and equity markets moved higher, setting a series of new all-time record highs. A new respiratory virus was identified in China, but it seemed that it could be contained as their government took significant actions to limit population movement. However, as the steps required within China got harsher, including quarantining entire cities, and then cases of the coronavirus disease now known as COVID-19 began to expand internationally, it became apparent the world was dealing with a global problem. In the midst of this growing health threat, the Organization of Petroleum Exporting Countries (OPEC), along with Russia, a non-OPEC country, met to discuss how they could reduce production to avoid price declines. Global growth expectations began to be reduced as COVID-19 spread more broadly and oil demand fell as well. However, in an unexpected outcome, Saudi Arabia and Russia could not reach an agreement. Rather than cutting production, Saudi Arabia announced price cuts and an increase in daily production. The result was a precipitous decline in oil prices and a world awash in oversupplied oil. The combination of the two events were a “double whammy” for the global economy and markets.

Oil Price, 1990 to March 2020
Source: Federal Reserve Bank of St. Louis



Countries around the world began to take the steps necessary to slow the spread of COVID-19 by issuing stay-at-home orders, closing restaurants, bars, parks and schools. Companies began limiting travel and instituting work-from-home policies, which combined to have the effect of essentially shutting down several sectors of the economy. Air travel fell by as much as 90% and multiple airlines parked hundreds of airplanes at airports around the country. It was a response to a pandemic unlike anything we have seen before. U.S. economic data has only just begun to show the impact of this engineered economic shut-down. Weekly jobless claims are one of the most timely data points released by the Bureau of Labor statistics (BLS). As we entered March, weekly jobless claims were running at multi-decade lows – a reflection of the ongoing strength of the U.S. labor market. By the end of March, weekly jobless claims were at record levels with consecutive weeks of job losses of 3.3MM, 6.9MM, and 6.6MM. In three weeks, we had given up almost all of the jobs added to the economy since the end of the Financial Crisis. The monthly employment report will begin to fully reflect these job losses in early May. If the restrictions stay in place, U.S. unemployment could rise to levels not seen since the Great Depression and GDP, a quarterly measure of U.S. economic output, could decline by 20-40% from "normal" levels. Still, within all of this bad news is a source of some of our longer-term optimism. The severity of the economic impact and the toll on people's lives is spurring a drive to find solutions to the spread of COVID-19 and to get back to a more normal level of economic activity.

Jobless Claims, 1967 to March 2020
Source: Federal Reserve Bank of St. Louis



U.S. stock markets saw the fastest decline from record highs to a bear market (defined as a 20% decline) ever. Before the sell-off was over, the S&P 500 Index, a capital weighted index of large U.S. companies, had fallen over 34% from the highs set in mid-February. Interest rates fell and bond prices rose as stocks declined in the early stages of the recent period of market volatility until questions about creditworthiness caused by high yield, and then investment grade corporates, resulted in widening spreads and declining prices for many corporate bonds. Lower energy prices also added to questions about creditworthiness as markets began to anticipate bankruptcies within the energy sector. At one point, even Treasuries saw prices falling as liquidity evaporated within bond markets and investors found it difficult to sell anything. Similarities to market stresses witnessed during the Financial Crisis in 2008-09 were becoming evident. Unlike the Financial Crisis, however, the response from the Federal Reserve and Congress has been swift and material.

The Federal Reserve has announced a number of actions to provide liquidity to the markets and provide economic support. The list of actions is long, but the overall goal of the Fed's actions is to make sure markets are functioning and the economy is supported. Lowering short term interest rates to 0% and purchasing Treasury securities and agency mortgage backed bonds, also known as Quantitative Easing (QE), were actions taken during the Financial Crisis, as well as within the past several weeks; but the Fed did not stop there. The latest round of QE was open-ended, including specific measures to support money markets and commercial paper markets. Actions unseen in the

Financial Crisis were announced as well, with the Fed purchasing investment grade corporate bonds, municipal bonds, and even high yield bonds in an effort to assure a smooth-functioning bond market.

As the Federal Reserve stepped to the plate, so did Congress with the passing of multiple fiscal measures capped off by the $2 trillion CARES Act. The largest fiscal plan in history provides money to individuals, businesses, and health care facilities as we try to build a bridge over the economic slowdown. Direct checks to individuals and small business loans, which can become forgivable, are attempts to provide direct support to a large portion of those impacted. Increases in unemployment benefits are designed to help those laid-off, as parts of our economy have been asked to close. And, like the Federal Reserve, Congress has committed to take additional actions should they be needed.

We are all hopeful we can return to a more normal life soon, yet we know the right response is to take the actions and precautions necessary to keep ourselves and our families safe and healthy. COVID-19 will dictate when and how we reopen the economy. Our continued optimism is based upon the resilience of our economy and the U.S. public. While the reasons for this economic and market decline are different than before, we have been through tough periods in the past. We are confident this pandemic will pass. The actions of the Federal Reserve and Congress won’t keep our economy from having a recession, but they have reduced the chances of this recession becoming another economic depression.

Our response from an investment standpoint has been to make minimal changes. We lean heavily on our pro-active risk-managed approach and our efforts to ensure you are managed to an investment objective that considers many factors including a reflection of your personal risk profile. Conservative investment objectives have small allocations to equities; therefore, returns on those portfolios are not nearly as negative as equity indexes. For those with higher risk tolerances, we would note that the returns of equities are not outside the norm of what we have seen before. Over time, we expect equity markets to respond to better economic growth and earnings. How much time? It is hard to say, but we know the virus will be temporary and, as its impact fades, we expect a return to positive growth and better days. As always, we thank you for your continued trust and confidence.

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