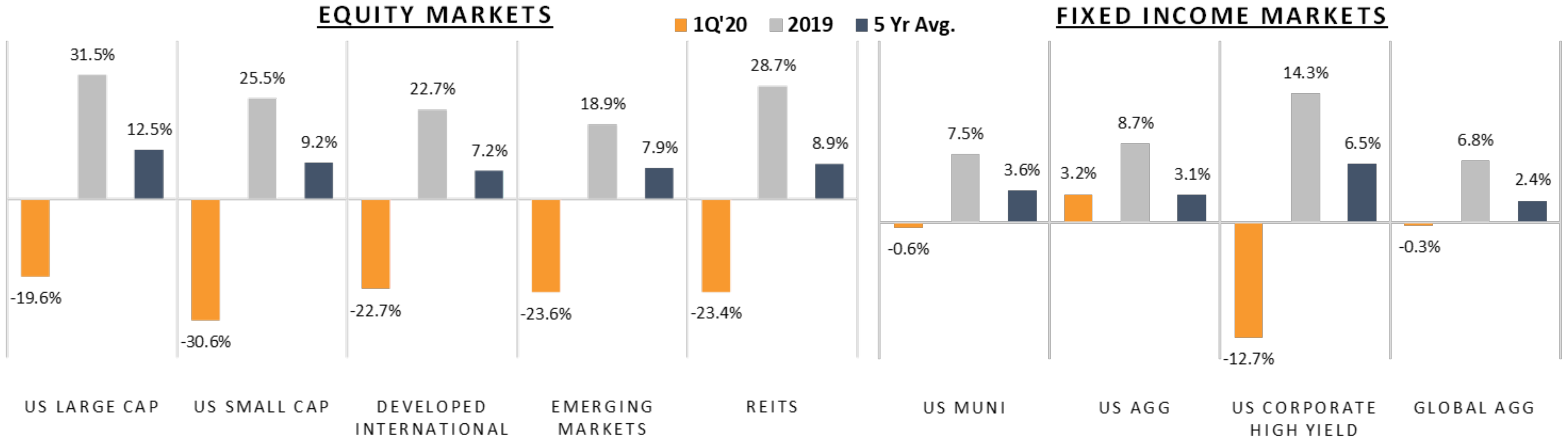
1Q'20 Market Review



- Equity markets turned sharply negative in Q1'2020 as the COVID-19 pandemic brought the world to a halt. Market volatility skyrocketed as a result. From 2/19 to 3/23, the U.S. market saw the quickest meltdown in history, a loss of 33.9%, which was followed by the best three-day stretch since the 1930s, gaining 17.5%.
- **Large Cap** equites were down -19.6% in Q1, which was the worst quarterly selloff since 2008. Valuations across equities are a question mark as last-twelve-month valuation multiples will be clouded by the lack of earnings due to the self-imposed shutdown, and forward earnings multiples are not meaningful as companies across the globe pull forward estimates. Nevertheless, the market closed the first quarter trading at 15.4x forward earnings per share in comparison to the 25-year historical average of 16.3x.
  - From a relative standpoint, **Technology** was the top performing S&P 500 sector, down -11.9% as the sector continues to provide substance to the fact that subsectors such as software have "utility like" features that are counter-cyclical.
  - The combination of the COVID-19 crisis, layered with the conveniently timed price war between the Saudis and Russia, led to a combined demand and supply shock in oil that saw the **Energy** sector suffer its worst quarter on record, down -50.4%.
- **US Small Cap** equities were down -30.6% for the worst quarterly loss since the inception of the Russell 2000 index.
- Given that COVID-19 hit China first, **International** and **Emerging Market** equites were hit particularly hard, down -22.7% and -23.6%, respectively. Interestingly, both segments performed in line or even outperformed some US equities segments in March, as the reporting of new cases in China slowed.

- The impact of COVID-19 in fixed income markets was shown in the liquidity-born panic throughout most areas of fixed income. The securitized sectors experienced heightened volatility until the Fed stepped in, announcing they would buy mortgage backed securities. In anticipation of economic hardship, the 10-year Treasury yield saw a large drop of 43 bps and closed the quarter yielding 0.67%.
- With yields falling, the **US Agg** was one of the few positive asset classes in Q1, up +3.2%. Municipal bonds were caught in the liquidity crunch to the point that the Fed announced the creation of the Municipal Liquidity Facility. With trading conditions strained, the **US Muni** fell -0.6% in Q1.
  - Interestingly, Q1 saw record setting amounts of investment grade corporate debt issued, with a $110b priced in the last week of March alone.
  - Municipal bonds traded at historically low yields at the beginning of March but stabilized. Demand is presumed to be consistent moving forward, given the assumption that future tax hikes will fund the record amounts of stimulus being put in place to support the economy.
- **US High Yield** was impacted on two fronts in Q1. The potential for higher defaults from persistent low oil prices and the economic collapse from COVID-19 led high yield bonds to have their worst quarter since Q4'08, down -12.7%. Municipal High Yield also suffered in Q1, as concerns about defaults were not contained to just the corporate high yield market.

Data Source: Zephyr

Underlying indices are S&P 500® Index, Russell 2000® Index, MSCI EAFE, MSCI Emerging Markets Index, FTSE NAREIT All Eq REITs Index, Barclays Municipal Bond Index, Barclays U.S. Aggregate Bond Index, Barclays U.S. Corporate High Yield Bond Index and the Barclays Global Aggregate Bond Index.

Market conditions and trends will vary. Past performance is no guarantee of future results. Investments cannot be made in an index

1Q’20 Integrated TOI: How Bear Markets Tend to Bottom

1987 Bear Market:

1998 and 2000 – 2003 Bear Markets:

2008 Bear Market:

- A “V-shaped” recovery was the overwhelming opinion of nearly every early forecast we read regarding the economic reaction to the COVID-19 pandemic. To determine the likelihood of a V-shaped recovery, some important questions need answers:
  - What will it take to bring the economy back online once this is all over, and what if second quarter GDP declines by 15% or more? For context, the worst quarter on record was a 10% decline in 1Q’58. Also, what happens if we also see S&P earnings decline by 100% or more?
- Technically, the S&P 500 entered a bear market on March 12, 2020 when the market officially sold off 20% from the high in February. The term V-shaped recovery hasn’t only been used to presume the anticipated economic response. Many market forecasters assume a V-shaped recovery in stock prices is also likely. While it is possible that the market quickly recovers once we find some sort of normalcy, history tells us that previous bear markets of this magnitude took time to work themselves out. The charts above are snapshots of various historical bear markets for the S&P 500 and partially explain why we are comfortable with a conservative approach moving forward.
  - In **1987**, the market peaked in August and proceeded to fall precipitously in October (on Black Monday). The market initially rallied after the crash before re-testing the October lows in December, capping a peak-to-trough bear market drop of -33.5%. The August 1987 highs weren’t seen again until July 1989.
  - In **1998**, after the severe currency depreciation of major emerging market countries, the well-known hedge fund, Long-Term Capital Management, blew up in August, causing shock waves across equity markets. The S&P was pushed to the cusp of a bear market, falling -19.4% from the July highs. Like the 1987 bear, the market initially rallied after the selloff, but eventually it retested the previous lows and bottomed shortly thereafter. Unlike 1987, the previous July highs were surpassed just a few months later in December.
  - In **2000,** the market peaked in March before the tech-related bubble in valuations inevitably burst in the fall. Equity prices dropped -27.8%, first bottoming in April of 2001. A subsequent rally was short lived as **9/11** caused the market to take out the April lows. The market didn’t bottom again until late 2003, resulting in a nearly -50% peak-to-trough decline. The highs seen in March of 2000 weren’t seen again until May of 2007.
  - Shortly after retaking the March 2000 highs in May of **2007**, the market peaked again in October. With the housing market showing cracks, the stock market sold off -22.4%, as derivatives tied to the housing market led to the eventual fire sale of Bear Sterns in March of 2008. The bankruptcy of Lehman Brothers in September triggered a panic that multiple financial institutions would not be able to remain solvent and led to stock prices crashing, eventually bottoming in March of 2009. This capped a -56.7% peak-to-trough pullback and left the S&P 500 at levels last seen in September of 1996. This period didn’t see equity prices recover their previous highs until April of 2013. Had an investor put in $100 in the S&P 500 in January of 2000, it would have taken him or her more than 13 years to make a profit (excluding dividends) in what has since been deemed “the lost decade” of equity investing.

Chart Source: Quotestream