1st Quarter 2020

We are living through a period of history that none of us are likely to forget. The global pandemic that has reached our shores is having a profound impact on our families, communities, and nation. For our readers in the medical, healthcare, and first responder communities- we thank you for the incredible and courageous work you are doing on the front lines of the coronavirus battle. For everyone we sincerely hope that you and your loved ones stay safe and healthy through this difficult time.

The events of the first quarter in financial markets have marked a period of extreme volatility across asset classes and an equally extreme policy response from governments and central banks around the globe.

> The U.S. stock market fell from an all-time high to a 20% bear market decline in the shortest time ever, and then went on for a total decline of 35% from the high.
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> The yields on 10-year and 30-year Treasury Bonds fell to all-time lows of 0.54% and 0.99%.
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> The price of oil collapsed 25% in one day on March 9.
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> Credit spreads widened dramatically on both investment grade and high yield corporate bonds.
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> The Federal Reserve cut interest rates to near zero and restarted their QE bond buying at a minimum of $700 billion in Treasury and mortgage-backed securities.
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> The U.S. Congress passed a $2 trillion fiscal stimulus package for individuals and businesses.

With all of this, U.S. stocks finished their worst quarter since the financial crisis of 2008. The S&P 500 was down 20%, the Dow Jones Industrial Average fell 23%, the Russell 2000 Small Caps were down 30%, and the NASDAQ fell 14%. Developed international stocks fell 23% while emerging market equities were off by 24%. The Barclays Aggregate Bond Index rose by 2.67% for the quarter. The 10-year Treasury note yield fell from 1.92% at the start of the year to 0.70% to end the quarter.

At the beginning of the quarter things had started to improve for the economy with the consumer in good shape, wages rising, low unemployment, trade tensions settling down and the services sector of the economy and housing both doing well. At the same time the Fed was signaling its desire to keep interest rates low and support the ongoing recovery while stocks had continued to rally to all-time highs. Then everything changed dramatically with the spread of the coronavirus and the dual shock that it brought to both the demand side and supply side of the economy. Consumers can't spend as much when sheltered in place, and businesses try their best to preserve cash by cutting spending, with both causing a big hit to demand. At the same time, production takes a hit since most workers can't get to their jobs to produce. Needless to say, a massive negative shock hit the economy and has rippled through financial markets.

The service sector of the economy was doing better than the manufacturing sector before COVID-19 hit. More than two thirds of GDP in most developed countries comes from the services sector of the economy. In past recessions, the service sector has helped to offset the usually sharper declines in the more cyclical parts of the economy (housing, manufacturing). This is not happening in this episode since the service sector is being temporarily crushed by the broad-based shutdowns across the country.

We long for the day when "social distancing" and "flatten the curve" are no longer part of our daily lexicon. But we accept the rational tradeoff of a sudden-stop economy in order to save lives and flatten the curve. We've all become astute followers of the coronavirus containment curve data put out by the global health professionals. The shape of the curve should be the single best economic indicator in the near term for some visibility (not certainty) into the timeframe when the mitigation efforts could be relaxed, and economic activity could begin to build back up. Here in the U.S., the virus case curve is tracking Italy's with about a two-week lag. The latest data out of Italy shows their curve beginning to peak and turn downward. This is very good news if it holds, as it shows that a democratic country can also mitigate and eventually slow the rate of new cases as was done in China.

The rapid path of COVID-19 cases in the U.S., and the aggressive response taken to attempt to slow the spread will likely impact the second quarter GDP in a dramatic way. We've seen economists with forecasts ranging from -14% to -30% contraction. (for comparison, the 4th quarter of 2008 saw a contraction of 8.4%). Most expect the contraction to be deep but brief. Growth could begin to rebound in the 3rd and 4th quarters as pent-up demand results in more spending and investment. This may hinge on the effectiveness of the policy response.

In terms of the policy response it has been big and broad. Both monetary policy and fiscal policy measures have been brought to bear on assisting the economy. The monetary policy response by the Fed as noted earlier, was large, swift and decisive. In times of crisis the Fed steps in to grease the gears of the financial markets when external shocks begin to show signs of friction in otherwise stable markets. The rate policy and bond buying programs and other stabilizers support the inner workings of financial markets so that the medical crisis at hand does not morph into a full-blown financial crisis. There were signs of this beginning to happen before the Fed acted which were contributing to the heightened volatility in financial markets. They did what they needed to do and then signaled that congress would need to act with a fiscal package of similar heft.

The fiscal response came next with a $2 trillion package representing 10% of GDP. Direct payments to consumers, enhanced unemployment benefits, forgivable loans to businesses, direct support to the healthcare system are all components of the plan designed to plug the temporary holes in incomes and obligations that can't be met during the shutdown period. The size and scope of the plan met the challenge of going big out of necessity. While it wasn't perfect, and likely to have inefficiencies arise in deployment, it was required action under the unprecedented circumstances to help sustain individuals and businesses during the period of maximum virus containment measures.

While the fiscal and monetary measures described above will do their part to alleviate some of the economic pain resulting from the coronavirus shutdowns, they cannot stave off a recession. We've already seen a huge jump in the weekly claims for unemployment and other higher frequency data points (GDP is reported with a lag). The question turns to how long to recovery and what is priced in? These are very difficult to pinpoint with a high degree of certainty given the largest unknown out there is still the timeline for virus mitigation relief. We think there is some merit to the case of pent-up demand and the potential for a strong recovery in the back half of the year. We also recognize the potential for negative "aftershocks" to arise that may need even more targeted stimulus. The lessons from the Great Depression will not be lost on policy makers in this time of crisis- if they need to act again with more fiscal policy then they will. We don't see the risk of a premature tightening in policy, but the fact that policy will act with somewhat of a lag will likely keep volatility high. Markets tend to lead the economy, meaning the markets have historically moved higher in advance of the turn in economic data.

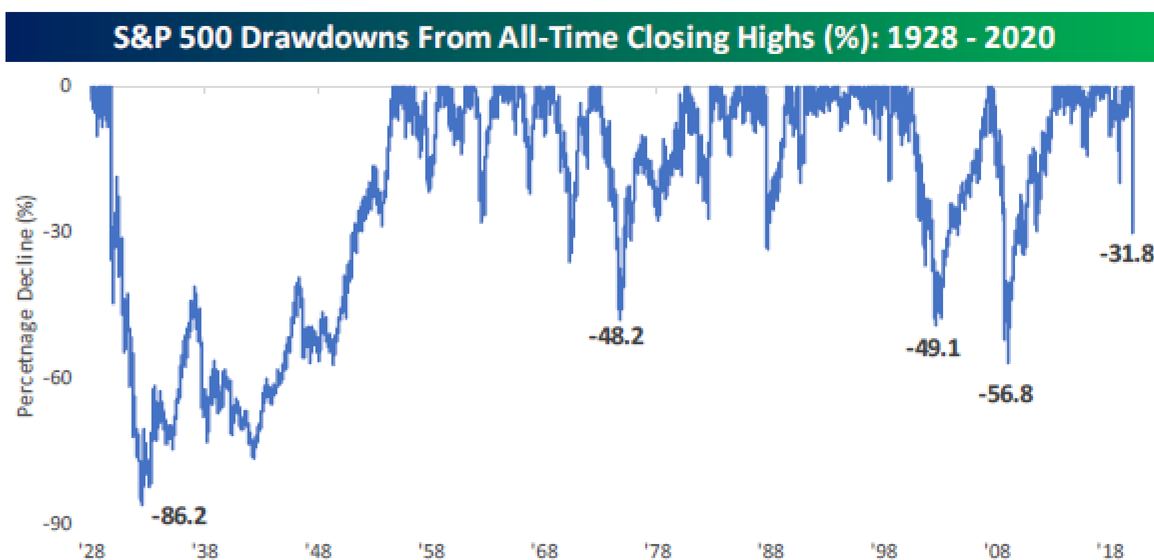
In this period of heightened uncertainty risk assets should remain volatile; but this volatility can serve up unique opportunities when the prices dislocate too far from long term value. Here, we are talking about the long run earnings and cash flow generating abilities of businesses, well beyond the period of recovery from this economic shock.

We have begun adding incrementally to equity portfolios. It is important to realize that the market went into the coronavirus led selloff at a very high valuation relative to historical levels. So, while a lot of damage to stock prices has been done, they were starting at very high levels. Trying to predict market tops and bottoms is an impossible task. Market history is littered with examples of investors who interrupt their long term returns by trying to do so. That said, there are many businesses that have come down significantly in price and are currently priced at very attractive

valuations- regardless of whether the market has bottomed or not. When we buy, we are looking at the reward to risk calculus on a five-year forward-looking basis. We are also not trying to time the market, but rather let the individual valuations tell the story of when to buy. We think it makes more sense (and is more repeatable) to adjust portfolios to the changing risks and rewards in asset classes and companies in a patient and disciplined manner.

You would see us get more aggressive with higher equity allocations in our diversified multi asset portfolios if we were to see stocks decline even further from here. An increase in equity allocation would be funded from the liquid alternative sleeve, investment grade fixed income and absolute return fixed income funds- all of which would be expected to have performed better than stocks on a relative basis. That last point is an important one in that it allows for the increase in stocks to be funded from a part of the portfolio that was less impaired by the decline in stocks.

The volatility this year has been relentless, and the stock declines have been severe. Putting stock market declines in perspective can help see the light at the end of the tunnel. These two charts from Bespoke Investment Group help frame some perspective. We are in the midst of a sharp downturn and we can't know for sure when it will end; but we can know that previous declines set the stage for strong rallies and new bull markets.



The forward returns for the market have historically shown strong rebounds from the depths of 30%+ declines in the past. A key point from this data is that if one needs to sell stocks for either allocation changes related to risk tolerance or to replenish cash reserves, there is likely a better price to do it than in the heat of the decline.

S&P 500 Performance Following Rebounds From 30%+ ATH Declines

	S&P 500 Change (%)				
Date	One Week	One Month	Three Months	Six Months	One Year
6/1/32	3.86	4.55	92.50	52.95	121.36
5/26/70	12.34	6.03	17.20	22.80	43.73
10/3/74	12.06	18.63	13.54	30.88	38.01
12/4/87	5.09	14.30	19.37	18.99	21.39
10/9/02	10.72	15.19	19.42	11.49	33.73
3/9/09	11.43	26.61	39.30	52.75	68.57
Average	**9.25**	**14.22**	**33.56**	**31.64**	**54.46**
Median	**11.08**	**14.74**	**19.39**	**26.84**	**40.87**

Of course, all past periods and future periods have unique circumstances surrounding them, but we have faced severe conditions in the past and our financial markets and economy have survived the challenges and emerged from the depths of despair to rise again. While we do not want to minimize the unknowns and challenging circumstances of this tragic human and economic event, we do have full confidence that we will get through this to the other side.

We are committed to helping you navigate through these rough waters in this difficult time for our nation and the world. There are many unknows for sure, but we are confident that brighter days lie ahead for our lives, businesses, and economies. Armed with the knowledge of your specific financial situation and personal goals, we can use the time-tested tools of valuation analysis and portfolio construction, representing the diversified mix of strategies and asset classes that can give us the highest probability of delivering an outcome over the long term that's inline with your objectives. We very much value the trust and confidence that you place in us in this endeavor- it is never taken lightly.

We wish you all health and safety for you and your loved ones.

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