Investment Update

July, 2020

2020 Second Quarter Update

Review: The S&P 500 continued to rally from the March 23rd trough, returning 20.5% in the quarter. What was one of the fastest market declines on record in February and March was followed by one of the fastest rebounds on record, with the S&P 500 recovering most of its losses. At the end of the quarter, the S&P 500 total return for the year was -3.1%. Fixed income also delivered positive returns in the quarter, as improved confidence led to a decrease in credit spreads.

Period	2Q20	1Q20	2019
S&P 500	*20.5%*	*-19.6%*	*31.5%*
MSCI EAFE[1,2]	*15.1%*	*-22.7%*	*22.7%*
MSCI Emerging Markets[2]	*18.2%*	*-23.6%*	*18.9%*
Barclays U.S. Aggregate Bond	*2.9%*	*3.1%*	*8.7%*
Barclays Municipal Bond	*2.7%*	*-0.6%*	*7.5%*

[1]Europe, Australia, Far East

[2]MSCI returns are in U.S. Dollars

Market Rebound Not a Sign of Irrational Exuberance

There continue to be questions about the pandemic and the timing and pace of the economic recovery, so it is reasonable to ask why the stock market has rebounded so quickly. There are two key factors contributing to the rapid recovery of the stock market:

- Aggressive measures taken by the Federal Reserve and the federal government to support the financial markets and the economy
- Pandemic viewed by the market as a transitory event

The monetary and fiscal stimulus measures were obviously critical to stabilizing the markets in late March. Also critical to the recovery in the stock market is the second point. Since a company's stock price is tied to all future cash flows—not just the current year—the importance of a single year of earnings to the total valuation of a company should be relatively small if the longer-term earnings trajectory remains the same. So, by rebounding quickly and recovering most of the February-March losses, the market is suggesting that the impact of the pandemic, while severe in the near-term, will not have a lasting impact on overall corporate earnings in the long-term.

It is clear that the pandemic will have a significant impact on near-term corporate earnings. In aggregate, it is estimated that S&P 500 earnings could drop at least 20% this year. However, the pandemic has not been

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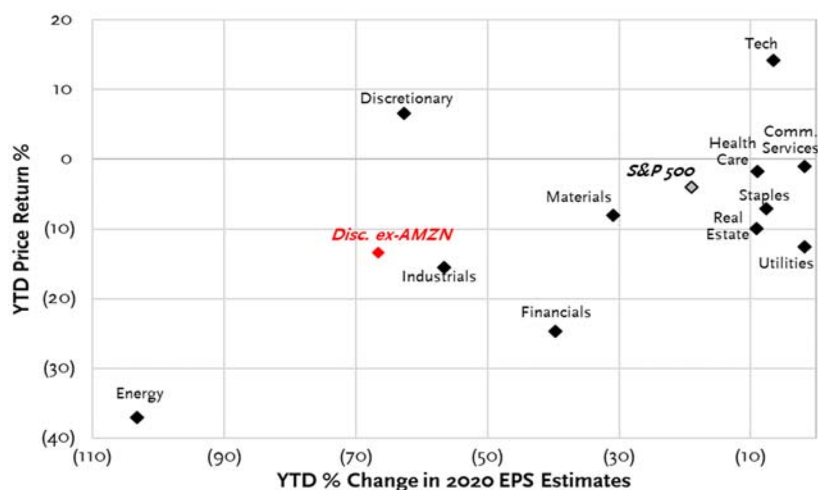
felt evenly by all sectors and companies. In fact, as the chart below illustrates, the year-to-date (YTD) price returns for S&P 500 sectors are closely linked with the YTD change in earnings estimates for 2020. In other words, the sectors most impacted by the economic downturn—Energy, Industrials, Consumer Discretionary (excl. Amazon) and Financials—are also the worst performing sectors YTD. This to us is a sign of rational market behavior.

S&P 500 YTD Price Return vs YTD % Change in 2020 EPS Estimates



Sources: FactSet, Bloomberg; data as of June 30

Outlook: There are early indications of an economic recovery in the US, from consumer spending and jobs data to industrial activity metrics. We expect the recovery to continue in the second half of the year, but we will continue to closely monitor data, particularly as COVID-19 case counts rise in certain states.

We expect international growth to be mixed. Certainly, some countries have done a better job at managing the pandemic, but their economic prospects may be tied to the US or other countries that are still trying to get the disease under control.

Potential risks to our near-term outlook include:

- Resumption of widespread shutdowns in the US to control COVID-19
- Stalled recovery in employment, pressuring consumer spending
- US political risks
- Re-escalation of US-China tension

Strategy: We could see increased volatility in the near term as companies begin to report quarterly earnings. As such, we continue to prefer higher quality companies less dependent on the economic cycle. Despite the rebound in the stock market, we continue to prefer the risk-reward in equities versus fixed income, as equities have historically done well during periods of economic recovery with very low interest rates.