FINANCIAL MARKETS COMMENTARY

1ST QUARTER, 2020

TELEMUS®

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FIRST QUARTER HIGHLIGHTS

- Economic conditions, which were strong to start the quarter, deteriorated quickly as measures to contain the COVID-19 pandemic were implemented. Policymakers responded swiftly, and in the U.S., an unprecedented amount of fiscal and monetary stimulus was launched.
- After grinding higher for the first half of the quarter, equities encountered a severe selloff, down nearly -34% from peak-to-trough over a one month period. Returns for the month of March marked the 4th worst monthly decline for the S&P 500 in the last 50 years.
- Bond returns held up during the quarter, helping to offset losses in equities. Safe haven Treasury bonds proved to the ballast of fixed income portfolios, while corporate bonds experienced moderate declines. Lower interest rates also served as a boon to bond prices.
- Oil prices experienced a severe price correction, falling by 66% during the quarter. A combination of expectations for softer demand along with a sizable increase in production out of Saudi Arabia drove the decline.
- Gold generated slightly positive returns for the month. The precious metal is often viewed as a safe haven asset and store of value, which proved to be in demand during the later half of the quarter.

ECONOMY

"IT WAS THE BEST OF TIMES, IT WAS THE WORST OF TIMES...

The opening line from Charles Dicken's novel, *A Tale of Two Cities*, summed up the economic conditions going into and coming out of the first quarter. The U.S. economy showed increasing strength during the first two months of the quarter. Employment rates remained near all time lows, wage growth hovered around 3%, consumer sentiment was positive and manufacturing activity was rebounding. As levels of uncertainty lifted following late 2019 trade agreements, it appeared 2020 might stave off a recession. Economies in Europe and many emerging economies exhibited signs that they may be experiencing similar recoveries

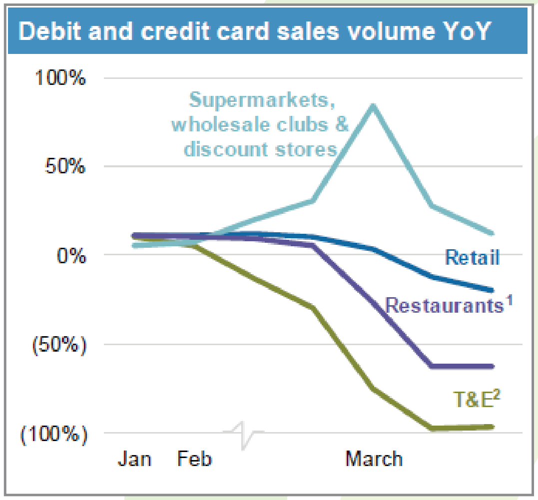
That all changed in late February when it became apparent that the COVID-19 virus was not isolated to the Hubei province in China, but was spreading to other parts of the globe. Italy, Iran and South Korea were the more prominent countries impacted by a second wave of infections. As the quarter played out, the spread of the virus had impacted nearly every country in the world, with the United States experiencing the largest number of cases.

Policymakers in the U.S. took swift and substantial actions to support the economy with fiscal and monetary stimulus. The monetary actions taken by the Federal Reserve sought to stabilize markets during a period of extreme uncertainty and risk aversion. Congress' unprecedented $2.2 Trillion stimulus plan was designed to support individuals and businesses impacted by the shuttering of the economy in response to social distancing measures taken to prevent the spread of the virus.

As the first quarter ended, economists had gone from expecting 2% growth in GDP for the year, to a decline in GDP growth of -3.2%, with the most severe contraction occurring in the 2nd quarter. At the time of this writing, the expectations for Q2 GDP among Wall Street economists range from -10% to -45%. Quite frankly, without a visibility into the timeline and structure of social isolation measures, its challenging to be precise with any economic forecasts. It is important to note that these GDP figures are quarterly comparisons, expressed as annualized measures. So while they these GDP figures sound large, and they are, a -20% decline in Q2 GDP translates back to roughly a -5% quarter-over-quarter decline from the 1st quarter to the 2nd quarter.

ECONOMY

The key challenge the economy is facing at present are the social isolation measures that are effectively shutting down portions of the economy being deemed non-essential. During past recessions, including the Great Depression, we haven't experienced portions of the economy being completely closed down. The chart below, from J.P.Morgan Chase & Co's first quarter earnings report, shows first quarter debit and credit card sales volumes run through their card processing business. As many of us experienced, there has been a significant spike in grocery and wholesale club sales. Restaurant card volumes have declined to levels that are 50% below year ago levels. Finally travel and entertainment spending has been nearly shut down.



Source: JPMorgan Chase & Co., Q1 2020 earnings presentation.

These levels of decline are temporary and the combination of fiscal and monetary policy measures are likely to go a long way to help those businesses and individuals most impacted by portions of the economy shutting down. The exact shape of the recovery is yet to be known and is likely to be predicated on how long the social isolation measures last.

INTEREST RATES AND MONETARY POLICY

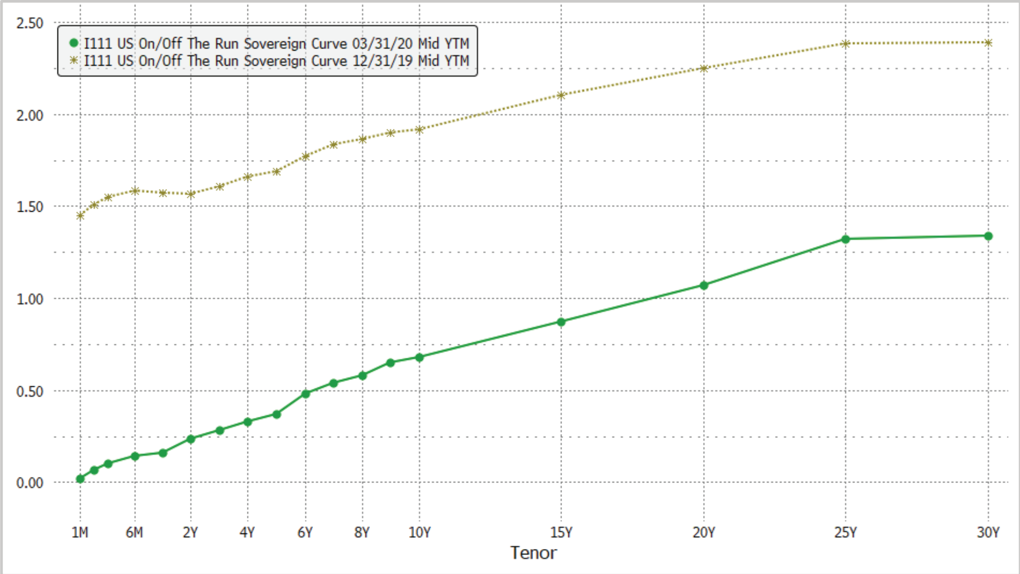
Interest rates fell in a steep but parallel fashion across the yield curve during the first quarter. Going into the quarter, the 10-year Treasury was yielding 1.92%, and finished yielding 0.68%, roughly 1/3rd of where it began the quarter. Interest rates began to fall early on in the quarter as concerns around COVID-19 spreading in China raised questions on its impact to Global GDP growth.

As the virus spread beyond China and ultimately into the United States, investors began to recognize the potential need for the Federal Reserve to cut rates. The Federal Reserve made an initial percentage point cut to the federal funds rate at the beginning of March. As concerns around the potential spread of the COVID-19 virus in the United States grew, the Federal Reserve made an additional interest rate cut on March 15th. This decision slashed interest rates to the Fed's 'lower effective bound' of 0-0.25%.

ECONOMY

The current level of interest rates is likely to remain low for some time. We believe it will take time for the economy to gradually recover from the impacts of COVID-19. In addition, a learning the Fed has taken away from the Great Financial Crisis is that it can be patient in raising rates, preferring to see inflation at or above its 2% target. While savings rates will likely be low for an extended period, the yield curve could steepen given the significant supply of government debt that is being issued to support fiscal stimulus measures.

US Treasury Yield Curve



Source: Bloomberg

INDUSTRIAL ACTIVITY

Industrial activity had been improving prior to the spread of the COVID-19 virus. Business activity remained strong through February, with March readings down, but less than feared. In addition, concerns around supply chain disruptions, particularly from China, were not materially impactful. Granted slowing activity in the United States and the rest of world likely served to ease any potential effects.

Current conditions are unique to past economic slowdowns given there is likely to be a larger than average hit to the services industry. Over time, services have become a growing share of the U.S. economy, with manufacturing becoming a smaller portion. The services segment has tended to be less economically sensitive, however, given the dynamics of social isolation, the category is likely to be impacted more than in past recessions. The charts below show the change in manufacturing and non-manufacturing (services) activity. While levels have fallen as of late, they are not yet to extreme lows.

ECONOMY

Given the rapid rate of change in economic conditions, and the expectations that the economy will reopen to some degree later during the summer, current economic indicators are less valuable, in our view, than during normal economic conditions. We expect economic readings to get worse over the next couple of months, but ideally rebound in the second half of the year.

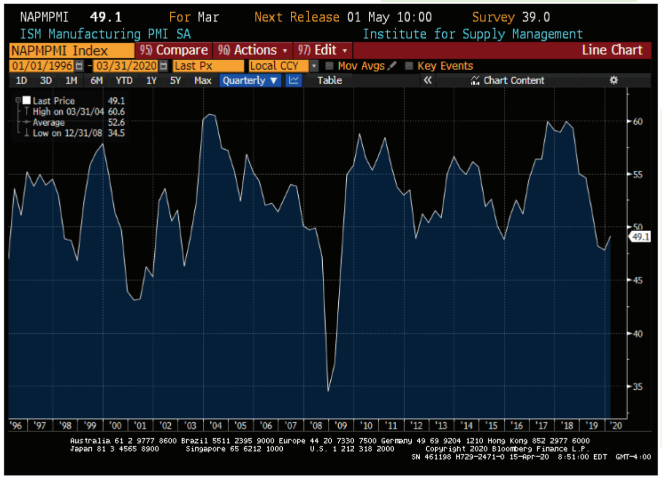
CONSUMER CONSUMPTION

Consumer consumption was strong throughout the quarter. Given that most social isolation initiatives didn't begin until the later part of March, the data we have seen shows limited impact during the first quarter.

We would expect consumer consumption to soften in upcoming months, although federal stimulus payments to consumers are likely to provide a one-time artificial boost. While a segment of consumers are becoming financially challenged, in aggregate, conditions currently remain palatable. Its likely that conditions will worsen for some consumers during April and May, as a constrained economy takes its toll.

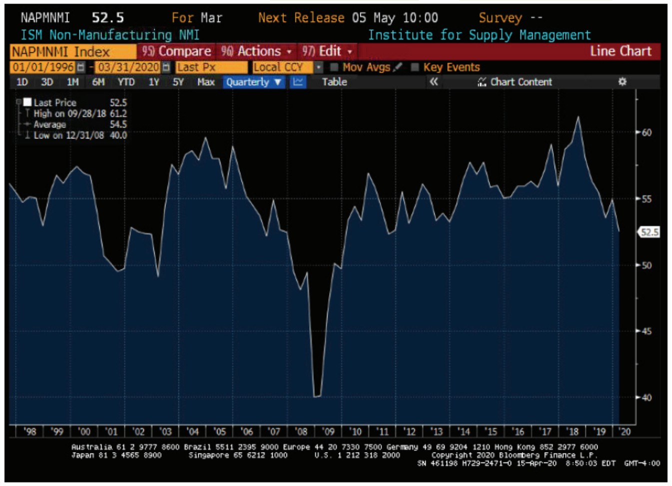
As of early April, consumer trends were on the decline, but not yet at levels of extreme stress. For example, data from the National Multifamily Housing Council noted there was a 12% year-over-year decline in on-time rent payments, as of April 5th. The most recent reading of 69% of rents paid on time, was down from a level of 82% a year ago. Alternatively, a survey by the Mortgage Bankers Association revealed that, as of early April, 3.7% of mortgage loans are in forbearance.

ISM Manufacturing Activity



Source: Bloomberg

ISM Non-Manufacturing Activity



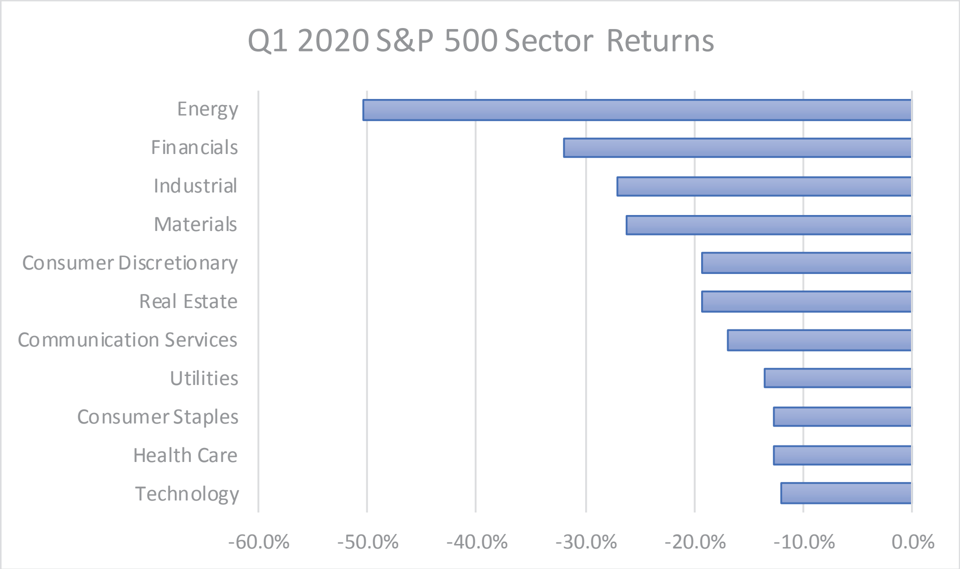
Source: Bloomberg

EQUITIES

Stocks experienced two very distinct halves to the first quarter of 2020. The first half, extending to a peak on February 19th, resulted in the S&P 500 appreciating by +5.1%. The index declined -23.5% from that point onward, to closed out the quarter with a return of –19.6%. The returns on the S&P 500 bottomed on March 23rd, marking a drawdown of -33.8% from the February 19th peak.

Index	Q1 2020
S&P 500	-19.60
NASDAQ	-14.18
Dow Jones Industrials Avg.	-22.73
Russell 2000	-30.61
MSCI EAFE	-22.83
MSCI Emerging Markets	-23.60

Characteristic of typical market corrections, higher quality, defensive oriented, large cap stocks held up best during the quarter. In addition, growth indices, whose major constituents include market stalwarts such as Apple, Amazon, Alphabet, Google and Microsoft, performed much better than market averages. The stocks left behind were traditional value stocks, namely those in more cyclical sectors such as energy, financials, industrials and materials.



Small cap companies were particularly hard hit, falling -30.6% during the quarter. The less diverse nature of small cap business models left the stocks more exposed to market fears around business disruption associated with COVID-19. It is not uncommon for small cap and value stocks to lag during market downturns, as these styles have historically tended to be the better performers coming out of a downturn.

International markets faired moderately worse than domestic equities. The developed market MSCI EAFE index dropped -22.8% in the quarter, while the MSCI Emerging Market index slipped further at -23.6%.

FIXED INCOME

Similar to equity markets, the bond market experienced a bifurcated quarter, as up until February 19th, there was strong demand for fixed income assets. As concerns around the contagion of the COVID-19 virus increased, riskier fixed income instruments sold off.

What became apparent during the selloff was the impact that changes in regulations had on bond market liquidity during periods of stress. Bond dealers, which include large money center banks, had faced new regulations coming out of the financial crisis that limited their ability to trade bonds for their own accounts. As a result, bond dealers shifted from buying and selling out of their own inventory, toward playing the role of matchmaker between buyers and sellers. As worries began to mount, there were few buyers in the market and the lack of dealers willing to step in and take the other side of the trade resulted in severely impaired liquidity across the market. Even the Treasury market faced strains in liquidity.

Markets saw signs of recovery and improvement going into quarter end as aggressive actions by the Federal Reserve served to provide buying support to sellers. Credit spreads, which quantify the difference in yield between corporate bonds and comparable Treasuries, were notably higher with the pace of spread widening occurring at unprecedented speed.

Returns for the quarter, ended positive, with the Bloomberg Barclays U.S. Aggregate index appreciating +3.15%. The two primary contributors to the positive outcome were strong returns among Treasury bonds, and a sizable decline in bond yields. Treasuries were sought after as a flight to safety benefited these safe haven assets. The sizable decline in bond yields resulted in longer-dated Treasuries performing particularly well. For example, the Bloomberg Barclays U.S. Treasury 10-20 Year index, which holds bonds with maturities of 10-to-20 years in length, gained a remarkable +15.3% in the first quarter alone. Long-term corporate bonds experienced a different outcome, and fell -4.7% on the quarter as wider credit spreads more than offset the benefit of lower interest rates. High Yield bonds were more severely impacted by wider credit spreads, declining -12.7%, with nearly all of their losses coming in the month of March.

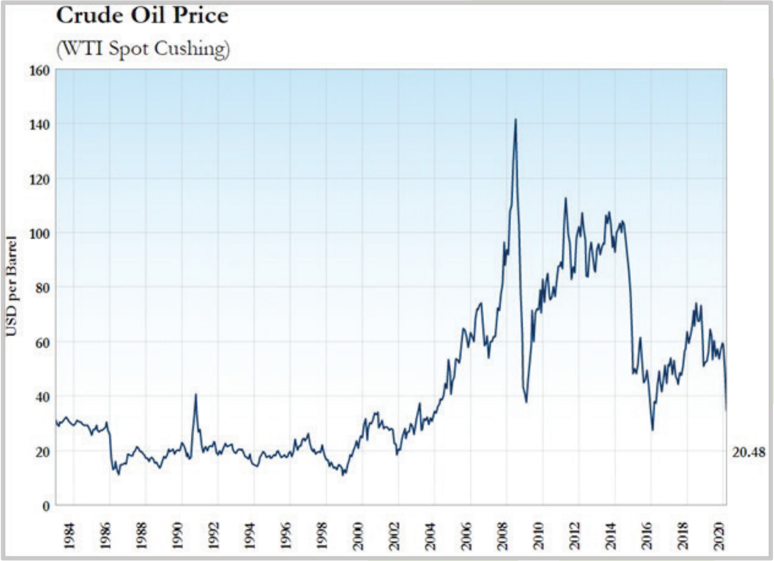
Municipal bonds experienced losses as March witnessed a sharp reversal in demand. Municipal bonds had been experiencing strong demand early in the quarter and were trading with yields at very low levels. Concerns around the impact of COVID-19 on segments of the municipal bond market, such as airport bonds, led to selling pressure. A. lack of demand and limited liquidity drove yields, relative to Treasuries, to levels we had not seen before.

COMMODITIES

OIL

Oil prices sold off materially following a decision by Saudi Arabia to lower the price of its crude oil and increase production. The significant increase in supply at a time when global oil demand was beginning to fall, led to a severe drop in price. West Texas Intermediate Crude (WTI) began the quarter at roughly $60 a barrel and closed out at $20, resulting in just over a 66% drop. The economics of the oil business are such that production at current prices is not economically sustainable. The United States, with its sizable shale reserves, has grown to become the largest oil producer in the world, ahead of Saudi Arabia. However, the cost of production in shale basins are much greater than in other regions of the globe, making U.S. shale the highest incremental cost producer. Given the current price of crude, U.S. production is likely to be a casualty of the actions taken by Saudi Arabia.

Energy related assets, such as pipelines, fell in sympathy with the price of oil. The Alerian MLP index, which tracks these assets, fell a staggering 57.2% during the quarter.



Source: Refinitiv

COMMODITIES

GOLD

Gold prices remained steady during the first half of the quarter, but encountered considerable volatility during the second half. As investors flocked toward safe haven assets, gold benefited with increased demand. The precious metal ended the quarter up 4.0%, although it experienced wild swings of over 10% intra-quarter as investors repositioned portfolios.

Given the significant size of fiscal and monetary stimulus measures enacted across the globe, we would expect gold to be of greater interest to investors as it is often viewed as an inflation hedge and store of value against changes in the value of currencies.

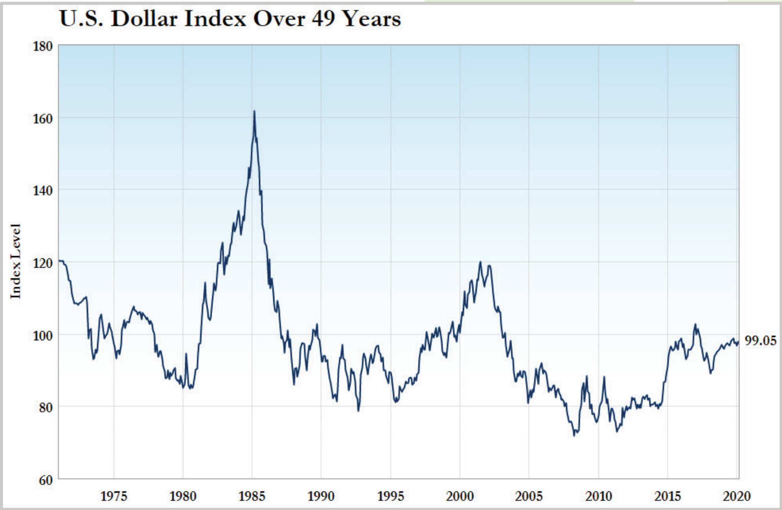
Source: Refinitiv

COMMODITIES

CURRENCY

The U.S. dollar experienced above average volatility during the quarter. In total, it ended up appreciating by +2.8% in the first quarter, as demand for dollars was sought after by foreign corporations and investors.

Source: Refinitiv



Source: Refinitiv

LOOKING AHEAD

The economic and market environment has changed considerably this past quarter. We have gone from being optimistic about the economy to being more concerned about both the economic shock and the range of possibilities around an expected recovery.

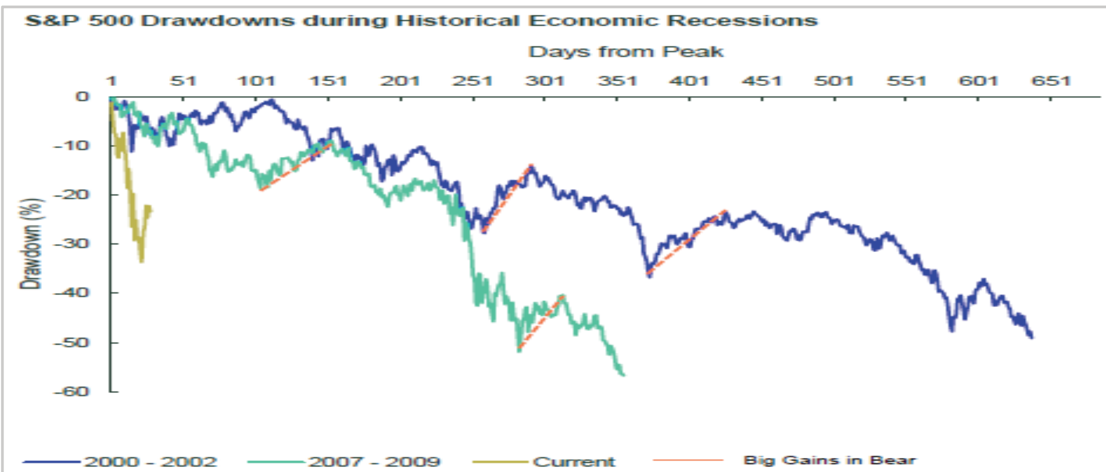
The challenge of the current climate is the high degree of uncertainty. In an interview, Dr. Anthony Fauci, the Director of the National Institute of Allergy and Infection Diseases, made the comment “the virus makes the timeline.” Investors must recognize that predicting the exact path forward for the economy is uncertain. However, as serious as the virus is, we do believe that there will be a return to normalcy in some manner and at some pace. In periods such as this, we believe its prudent to follow the old adage “Hope for the best, plan for the worst” when investing our clients’ capital.

During episodes of volatility and uncertainty, remaining strategic and disciplined with portfolios is what’s best for compounding wealth over the long-term. We expect that some will look back at this time period and point to assets that were oversold and made for great buying opportunities. Being opportunistic in looking for mispriced assets is important, and we will be active in doing so. However, a focus on managing risk will be our priority. Given greater uncertainty in economic outcomes, our approach to being opportunistic is to only consider those investments where there is a clear understanding that the probabilities are in the investor’s favor.

Portfolios that have been diversified across stocks, bonds and alternatives held up much better than the broader equity indexes during the past quarter. The principals of diversification have delivered and continuing to optimally diversify portfolios will remain a focus of ours going forward.

LOOKING AHEAD

As we look ahead its important to remember that market downturns are rarely straight down and straight up. Until there is greater clarity around the long-term economic ramifications from the COVID-19 pandemic, which is likely to take months or quarters, and not weeks, we expect markets to remain depressed with above average volatility. The chart below compares the recent market correction to the past two major downturns. It highlights that downturns aren't linear and go through periods of decline followed by relief rallies. In an effort to plan for the worst, we have a bias toward protecting to the downside at this moment. At some point, it will make sense to become more constructive and look to add assets with more upside potential to portfolios.



Source: State Street Global Advisors and Factset

We recognize that during these periods of uncertainty it is only natural to have questions and concerns. Our quest at Telemus is to enrich the lives of our members, and this is of increased importance during times like the present. We aim to keep you informed with a variety of updated information available at www.telemus.com. In addition, feel free to reach out to your Advisor at any time. For those of you who are not our clients feel free to contact us as well.

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