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Capital Markets Review and Outlook

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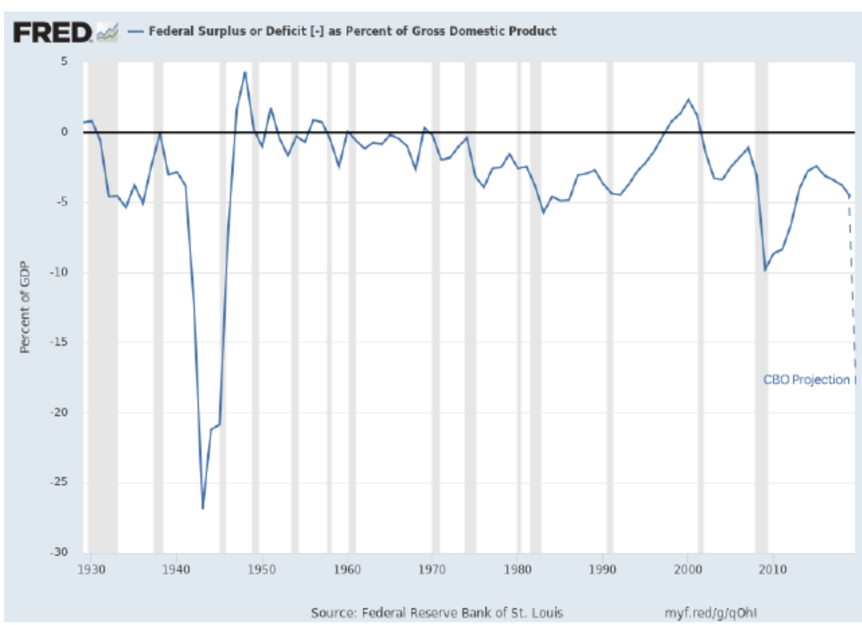
Economy and Outlook

In April, large parts of the United States as well as many parts of the world went into lock-down mode as the COVID-19 coronavirus continued its relentless spread globally. The widespread shut-downs had a crippling effect on global economic growth as businesses and consumers came to a near standstill on all but essential services. Governments and central banks have stepped in aggressively to help mitigate the massive economic fall-out from COVID-19. In the United States, congressional-approved stimulus measures reached close to $3 trillion by the end of April. Additionally, the magnitude of the Federal Reserve's enormous policy response is reflected in the 60+% increase in the central bank's balance sheet from $4.1 trillion at the beginning of this year to $6.6 trillion by the end of April. The Fed's supportive actions are in the form of intermediation rather than spending in order to alleviate lenders' fears about borrowers' bankruptcies. The U.S. government's stimulus measures thus far amount to over 13% of GDP, well above the total fiscal stimulus of 10% of GDP during 2008-2010 to combat the Great Financial Crisis. A negative consequence of the unprecedented fiscal spending is the massive increase in the U.S. government's debt and budget deficit. For the current fiscal year that ends September 30, the government expects to borrow a record $4.5 trillion, more than triple last year's $1.3 trillion, while the Congressional Budget Office (CBO) projects a budget deficit that is likely to reach 18% of GDP, the highest since the end of World War II. The chart on the left shows the historical budget deficit as a percentage of GDP.



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Foreign governments have also spent considerable amounts to offset the effects of the global pandemic. Stimulus measures are near or above 10% of GDP across several countries with Japan in the lead at 20%. The scale of the actions taken by governments and central banks world-wide is needed considering the precipitous decline in economic activity. In the United States, over 30 million Americans are now unemployed, and the jobless rate is likely to skyrocket to the mid-teens. Just a few months ago, in February, the U.S. unemployment rate was 3.5%, the lowest rate in half a century. Manufacturing output has plummeted across the world with April seeing the sharpest fall in output on record. While all the news on the economic-front is dire, it is important to recognize that the speed and depth of the current economic downturn is government-induced to stop the spread of COVID-19. Past major downturns, including the Great Depression and the Great Financial Crisis, were driven by financial or economic events. This time the cause is a health crisis not seen in over 100 years. The lasting solution to the current downturn must, therefore, come from the medical field. Based on the vast amount of scientific research taking place globally, it appears likely that, over the next few months, medical researchers will discover effective therapeutics to prevent fatalities as well as the more severe symptoms of the disease, and will also create, by the end of this year, a vaccine to prevent the disease. So, while global economic output will decline precipitously this quarter, a sharp rebound is likely to unfold by year-end and continue in 2021.

Equity Markets

Despite the rapid spread of the coronavirus with increasing numbers of both infections and deaths, the equity markets rebounded strongly in April as investors looked beyond the flattening of the virus curve and anticipated positive developments in the area of effective therapeutics and vaccines for COVID-19. The broad domestic equity market represented by the Russell 3000 Index rose sharply by +13.2% in April cutting its year-to-date losses to -10.4% after the dismal first quarter results of -20.9%. The annualized 3-year and 5-year returns for the Russell 3000 are now both over 8%. Along the capitalization spectrum, Large Cap underperformed Small and Mid Cap by -50 bp and -120 bp respectively for the month. However, Large Cap continues to maintain a significant dominance of +690 to +1140 bp year-to-date. In terms of style differentiation for the month, Growth continued to outperform Value across all capitalizations by +230 to +360 bp, thereby widening its lead further for the year. Sector performance reflected the risk-on investment environment as Cyclicals outperformed Defensives. Consumer Discretionary and Materials were among the best performers for the month with gains of +20.5% and +15.3% respectively, while Consumer Staples

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(+6.9%) and Utilities (+3.2%) lagged. Energy was the best performing sector for the month with a gain of +29.8% as oil prices rebounded sharply. However, year-to-date, Energy remains the worst performing sector with a decline of -35.7%. The strength and resilience of Technology names is reflected in the fact that, for the year, this is the only sector that does not have a negative return (+0.2%). Positive investor sentiment buoyed international equity markets as well, although to a lesser degree compared to the U.S. While the trade-weighted dollar index was little changed in April, the U.S. currency gained +0.9% versus the euro and lost a little ground (-0.3%) against the Japanese yen. For the month, the MSCI EAFE Index which represents developed markets outside the U.S., rose +6.5%, while Emerging Markets gained a stronger +9.2%. Year-to-date, both markets are trailing the U.S. equity market by -620 to -740 bp.

Fixed Income Markets

In April, Treasury yields declined a little further, but more notably at the back end of the Treasury yield curve. Longer maturity yields decreased by 6 to 7 bp, while shorter maturity yields declined by less than half as much. As a result, the Treasury coupon curve flattened with the 2-year/10-year spread differential narrowing by 3 bp to end the month at +44 bp. The corporate bond market mirrored the strong performance in the equity markets. Investment grade spreads narrowed by 64 bp resulting in the Bloomberg Barclays Credit Index outperforming duration-matched Treasuries by +391 bp. Issuance also picked up significantly. Net new issuance in the month of April was $302 billion compared to $356 billion for the entire year 2019. Consistent with the positive tone in the corporate bond market, the corporate credit curve and quality curve both flattened in April as longer maturity corporate bonds outperformed short and intermediate maturity issues by an average of +208 bp, while BBB rated bonds outperformed Single-A rated issues by +160 bp. In line with the sharp rebound in oil prices in April, Energy was the best performing sector with excess returns for the Independent Energy sub-sector of just under +2000 bp. The negative impact of the lock-down on the travel industry was reflected in the -417 bp excess return for Airlines which was the worst performing sector for the month. In April, the Investment Grade Credit sector posted a total return of 4.6% which turned the year-to-date return positive (+1.3%). The High Yield bond sector also reversed its sharp losses from the prior month. However, unlike the Investment Grade sector, lower quality high yield bonds underperformed in April. The BB sector was up +6.5%, while the Single-B sector had a return of +3.2%, and the CCC sector increased only +0.5%. Reflecting the stressed economic environment due to the global pandemic, distressed issuers rated Single-C and below had negative returns of -7.4%. Sector performance was similar to the Investment Grade sector. The best performing sector was Energy, and the worst,

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Transportation. The overall High Yield Index had a total return of 4.5% for the month which still left the year-to-date return at -8.8%. With the U.S. dollar index little changed in April, the greater declines in non-dollar government bond yields (relative to U.S. bonds) were a bigger driver of relative performance. As a result, the non-dollar government bond market's return of +1.5% was ahead of the +0.6% return for the U.S. Government bond market. However, year-to-date, the non-dollar market with a return of -0.4% significantly lags the +8.8% return for the U.S. market.

			Returns as of 4/30/20 (In %)			
		Month	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	13.2	-10.4	-1.0	8.0	8.3
Russell 1000®	US Large Cap Equity	13.2	-9.7	0.1	8.7	8.7
Russell 1000® Growth	US Large Cap Growth	14.8	-1.4	10.8	15.7	13.3
Russell 1000® Value	US Large Cap Value	11.2	-18.5	-11.0	1.4	3.9
Russell Midcap®	US Mid Cap Equity	14.4	-16.6	-10.0	3.5	4.8
Russell Midcap® Growth	US Mid Cap Growth	15.7	-7.5	0.2	11.3	8.9
Russell Midcap® Value	US Mid Cap Value	13.4	-22.6	-16.7	-2.0	2.0
Russell 2000®	US Small Cap Equity	13.7	-21.1	-16.4	-0.8	2.9
Russell 2000® Growth	US Small Cap Growth	14.9	-14.7	-9.2	4.2	5.2
Russell 2000® Value	US Small Cap Value	12.3	-27.7	-23.8	-6.1	0.3
MSCI ACWI ex-US	Global Equity ex-US	7.6	-17.5	-11.5	-0.3	-0.2
MSCI EAFE	Global Developed Mkts Equity	6.5	-17.8	-11.3	-0.6	-0.2
MSCI EM	Emerging Mkts Equity	9.2	-16.6	-12.0	0.6	-0.1
Bloomberg/Barclays US Agg	US Core Fixed Income	1.8	5.0	10.8	5.2	3.8
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	1.1	3.7	8.0	4.0	3.1
Bloomberg/Barclays US Credit	US Corporate Bonds	4.6	1.3	9.4	5.4	4.3
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	0.6	3.5	7.8	4.0	3.1
Bloomberg/Barclays US Corp HY	US High Yield	4.5	-8.8	-4.1	1.9	3.4
FTSE Non-US WGBI	Global Fixed Income ex-US	1.5	-0.4	4.0	3.1	2.3