consequent capital management

John C. Robinson
Chief Executive Officer
Tel: 404-883-2577
john@consequentcm.com

Capital Markets Review and Outlook

By: Cyril M. Theccanat, Chief Investment Officer

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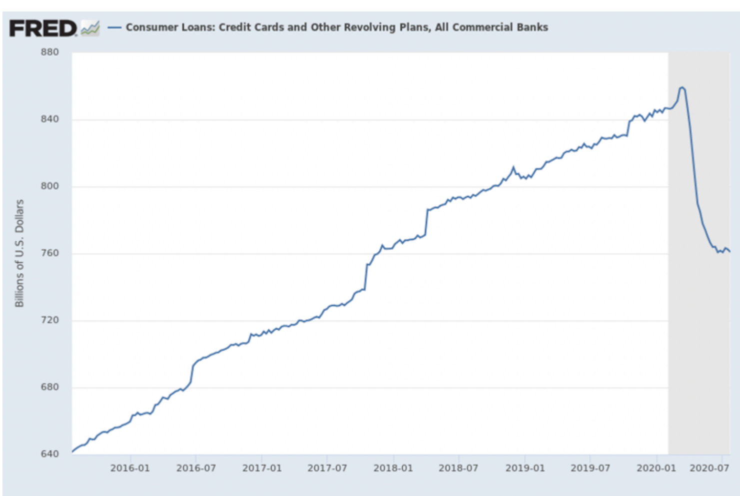
Economy and Outlook

After several weeks of steady improvement, economic data recently turned down on the heels of a renewed surge in the Covid-19 coronavirus pandemic. The United States had a monthly record of more than 1.9 million new cases of the disease in July. With the total number of cases in the U.S. exceeding 4.8 million, and a death toll that has surpassed 158,000, the world's largest outbreak of Covid-19 is now centered in the United States. Worldwide, the number of confirmed cases is fast approaching 19 million, and the number of deaths has exceeded 700,000. The headline-grabbing massive decline in 2nd quarter GDP growth which resulted in a GDP contraction for the first half of 2020 that averaged almost -14% across developed economies was, for the most part, expected given government-mandated economic lockdowns to curb the spread of the virus. However, after 15 straight weeks of improvement, weekly jobless claims in the U.S. rose for the past two consecutive weeks signaling a slowdown in employment recovery. The fate of the economy is inextricably tied to the global health crisis. The inability of businesses and consumers to operate in a normal environment has been a significant drag on the economy. Fortunately, the unleashing of vast amounts of stimulative fiscal and monetary policy measures have proven to be an effective counterbalance thus far. As the effects of the pandemic began to unfold back in March, there were widespread concerns that the skyrocketing unemployment rate would lead to a sharp increase in consumer indebtedness and delinquencies. However, not only have consumer debt levels steadily fallen since March, as shown in the chart on the left, but delinquency rates have also declined over that period.



This is a direct result of the massive stimulus programs launched by the government which have raised household income 4% above pre-pandemic levels despite the high

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unemployment rate. Congress and the White House are currently in negotiations over the magnitude and composition of an additional stimulus package to continue supporting the economy. There have also been significant increases in economic supportive measures outside the U.S. The European Union reached an agreement in July to issue 750 billion euros in bonds to provide loans and grants to support growth in Europe over the next three years. This is the first time for such a bond issuance that is the obligation of the EU itself and not the individual member countries.

As mentioned in our prior monthly write-ups, the key to ending this global economic crisis is a medical solution to the Covid-19 coronavirus. On that front, there are now over 165 vaccines in various stages of development globally. Of the 27 vaccines that are in human trials, 6 are already in final Phase 3 clinical trials. Given the fast progress that has been made, there is a reasonable probability that one or more vaccines may receive approval by year-end. The pace of vaccine development for Covid-19 is unprecedented. To provide a context of the rapidity of the Covid-19 vaccine development effort, the previous record from development to final approval for a vaccine was 4 years for mumps. In the interim, policy makers have pulled out all the stops in providing supportive measures for the global economy as a bridge until the risk from the coronavirus is effectively mitigated.

Equity Markets

July marked the fourth consecutive month of gains for the equity markets as investors looked beyond the current coronavirus gloom and anticipated a markedly different environment 12 to 18 months from now. The broad domestic equity market represented by the Russell 3000 Index rose +5.7% in July turning its year-to-date return positive (+2%) for the first time since February. Long-term investors should note that despite the highest volatility in decades in the financial markets, the annualized returns for the past three and five years for the broad U.S. equity market are now 11.4% and 10.9% respectively, while the annualized return over the past 10 years is above 13%. In terms of performance differentiation by capitalization, there was a reversal in July with Large Cap outperforming Small Cap (by +310 bp) for the first time in the past three months. Year-to-date, Large Cap continues to dominate Small Cap by a sizeable margin: +1,350 bp. Performance by Style continued its trend this year with Growth outperforming Value across all capitalizations by +138 to +374 bp in July. From a sector perspective, after three consecutive months of economically sensitive stocks powering the stock market rally, some of the Defensive sectors joined the party in July. While Cyclicals such as Consumer Discretionary and Materials were leaders in July with returns of +9% and +7.1% respectively, Defensive sectors including Utilities (+7.8%) and

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Consumer Staples (+7%) were also standouts. A notable laggard was Energy which lost -5.1% for the month. For the first seven months of the year, sector performance has been characterized by the dominance of Cyclicals with Technology and Consumer Discretionary way ahead of the pack with returns of +21.4% and +16.9% respectively. Financials (-20.7%) and Energy (-38.7%) are the worst performers year-to-date. The sharp decline in the U.S. dollar in July (-4.5% for the dollar index) was a tailwind for the investment performance of international markets, especially emerging markets. The MSCI Emerging Markets index rose +8.9% in July boosted by the strong +10.4% to +14.4% returns for the month in countries such as Brazil, India and Taiwan. China's +9.4% return in July brings its year-to-date return to +13.3%. The return for the Developed Markets, MSCI EAFE index, was more muted with a return of +2.3% in July. Despite +5% to +6% returns for countries such as Germany, Canada and Australia, the overall index's return was weighed down by the sub-par performance of a major constituent, Japan, which lost -1.8% in July. The stronger yen and weak earnings were a headwind for the Japanese equity market. Year-to-date, the Developed Markets index posted a return of -9.3%, significantly behind the -1.7% return for Emerging Markets.

Fixed Income Markets

Typically, the Treasury market has an inverse relationship with the equity markets, whereby Treasury prices decline (yields rise) when the equity market rallies, and Treasury prices rise (yields decline) in a risk-off environment when equity markets decline. However, despite the strong rally in the broad equity markets for a fourth consecutive month, Treasury yields declined markedly in July. The yield on the 2-year Treasury note decreased by 5 bp to 0.11%, while the yield on the 30-year Treasury bond dropped 21 bp to 1.2%. The Treasury coupon curve flattened significantly with the 2-year/30-year spread narrowing from +125 bp to end the month at +109 bp. However, year-to-date, the coupon curve has steepened by 28 bp.

In line with the rally in the equity markets, the corporate bond market also registered strong gains for a fourth consecutive month. Investment grade corporate bond spreads tightened by 16 bp in July leading to +167 bp of outperformance over duration-matched Treasuries in July. Also consistent with a strong corporate bond market, the corporate credit curve and the quality curve both flattened further in July. Longer maturity corporate bonds outperformed short and intermediate maturity issues by an average of +177 bp, while BBB rated bonds outperformed Single-A rated issues by +49 bp. New Issuance slowed down materially for the month. Net new Issuance was just $15 billion compared to a monthly average of $144 billion in the first half of the year. Unlike the equity markets, Energy was one of the best performing Investment grade sectors with

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an excess return for the month of +215 bp, while Finance (+138 bp) was a laggard. For the month of July, the Investment Grade Credit Index posted a total return of +3.1% increasing its year-to-date return to +8.1%. The High Yield sector also had strong performance in July with the spread of the Bloomberg Barclays High Yield Corporate Index narrowing significantly by 138 bp producing +425 bp in excess return. The option-adjusted spread (OAS) of the Index broke below 500 bp for the first time since February and ended the month at +488 bp. Unlike the Investment Grade sector, the High Yield quality curve remained unchanged with excess returns relatively the same across the quality stack. The best performing High Yield sectors include Aerospace/Defense and Automotive with excess returns of +953 bp and +602 bp, while Airlines (+66 bp) and Oil Field Services (+32) lagged. The High Yield Index posted a total return of +4.7% in July which turned the year-to-date return positive (+0.7%). While yield declines for the non-U.S. developed government bond markets (except for Japan) were comparable to the decline in U.S. Treasury yields, currency played a major role in relative performance for the month of July. The across-the-board weakness in the U.S. dollar, with the dollar index down -4.5% In July, led to a +5.1% return for the FTSE non-US WGBI Index compared to the +1.1% return for the U.S. Government Bond Index. This strong relative performance enabled the non-dollar government bond market to attain a year-to-date return of +6.2%, thereby, significantly paring its underperformance to the U.S. government bond market which returned +9.8% for the same period.

				Returns as of 7/31/20 (In %)		
		Month	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	5.7	2.0	10.9	11.4	10.9
Russell 1000®	US Large Cap Equity	5.9	2.9	12.0	12.0	11.3
Russell 1000® Growth	US Large Cap Growth	7.7	18.3	29.8	20.9	16.8
Russell 1000® Value	US Large Cap Value	4.0	-12.9	-6.0	2.7	5.4
Russell Midcap®	US Mid Cap Equity	5.9	-3.8	2.0	7.3	7.8
Russell Midcap® Growth	US Mid Cap Growth	8.0	12.5	18.1	17.1	13.0
Russell Midcap® Value	US Mid Cap Value	4.7	-14.2	-8.4	0.6	4.3
Russell 2000®	US Small Cap Equity	2.8	-10.6	-4.6	2.7	5.1
Russell 2000® Growth	US Small Cap Growth	3.4	0.3	6.0	8.8	7.5
Russell 2000® Value	US Small Cap Value	2.1	-21.9	-15.9	-3.9	2.2
MSCI ACWI ex-US	Global Equity ex-US	4.5	-7.0	0.7	1.4	3.2
MSCI EAFE	Global Developed Mkts Equity	2.3	-9.3	-1.7	0.6	2.1
MSCI EM	Emerging Mkts Equity	8.9	-1.7	6.5	2.8	6.1
Bloomberg/Barclays US Agg	US Core Fixed Income	1.5	7.7	10.1	5.7	4.5
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	0.6	5.3	7.1	4.3	3.4
Bloomberg/Barclays US Credit	US Corporate Bonds	3.1	8.0	11.9	7.0	6.1
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	0.2	3.7	5.4	3.9	3.1
Bloomberg/Barclays US Corp HY	US High Yield	4.7	0.7	4.1	4.5	5.9
FTSE Non-US WGBI	Global Fixed Income ex-US	5.1	6.2	6.8	3.7	4.3

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