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Capital Markets Review and Outlook

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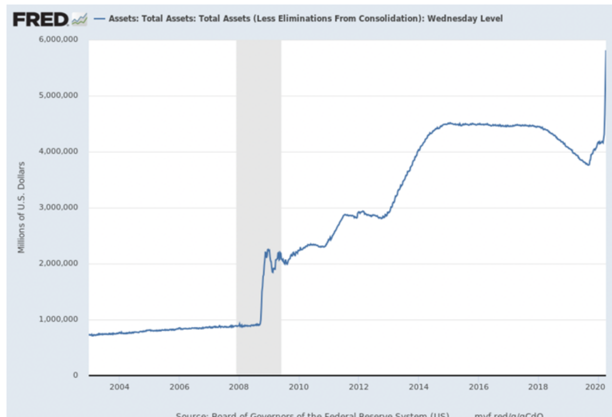
Economy and Outlook

The unexpectedly rapid and deadly spread of the Covid-19 coronavirus around the world and across the United Sates has upended the global economic landscape. With the largest economy in the world, the United States, accounting for the greatest number of positive coronavirus cases in any country, the U.S. government closed large parts of the economy to slow the spread of the virus. Until just a few weeks ago, the U.S. economy was on a positive trajectory with real GDP expected to grow at an annualized 2 to 2.5% rate. The economThe economy is now likely to decline at a double-digit rate in the second quarter, and a recession is now inevitable. While this would likely represent the worst decline ever in economic output, including the Great Depression, it is important to recognize that, unlike prior economic downturns, most of the sharp declines in economic activity currently unfolding are government-induced in an effort to stop the spread of the virus.   This is analogous to a doctor inducing a coma in a patient to prevent further damage and to enable the healing process. While economic data releases such as millions of Americans filing for unemployment benefits, and the shut-down of many businesses, especially in service industries, is shocking, these are the results of government-enforced actions and not due to some major underlying weakness in the economy. Importantly, an unprecedented stimulus package of $2 trillion has been enacted to help businesses and individuals affected by the government's shutdown measures. Since 70% of U.S. households have annual incomes below $100,000, the vast majority of unemployed households will now receive incomes that replace 100% of pre-health crisis earnings for the next four months. In addition to the $2 trillion fiscal stimulus, the Federal Reserve is also providing $4 trillion in monetary stimulus through a variety of measures including unlimited purchases of Treasury and mortgage-backed securities, bridge financing for investment grade companies, and supporting lending to small and medium-sized businesses as well as households. The chart on the left illustrates the magnitude and speed of the Fed's actions. Prior to the Great



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Financial Crisis (GFC), the Fed's balance sheet was well under $1 trillion. Supportive measures by the Fed during GFC increased the balance sheet to $4.5 trillion over the next 7 years. As economic growth accelerated, the Fed reduced monetary accommodation decreasing its balance sheet to $3.8 trillion by September 2019. Supportive actions by the Fed over just the past few weeks have sharply increased its balance sheet, almost doubling it to $5.8 trillion, well above the peak during GFC. Additionally, the Fed slashed its primary interest rate, the federal funds rate, by 150 bp to zero. The aggressive fiscal and monetary actions have been both massive and speedy, exceeding by a wide margin even the significant steps taken during the Great Financial Crisis more than 10 years ago.

Because Covid-19 has spread indiscriminately around the world, both developed and emerging economies have also undertaken measures, both fiscal and monetary, to combat the adverse economic effects of the coronavirus. Simultaneously, in one of the most coordinated efforts ever, scientists world-wide are working with a laser-focus on two fronts - therapeutic treatments to effectively treat patients seriously sickened by the virus, and vaccines to prevent Covid-19. There are positive signs on both fronts although successful breakthroughs may take some more months. While the current environment appears bleak and filled with uncertainty, it behooves institutional investors to visualize the economic landscape, not a few months or a few quarters hence, but what this landscape is likely to look like one to three years from now. Just like the night sky looks darkest just before dawn, the enormous measures that are being undertaken world-wide on multiple fronts to help support the global economy while medical researchers are racing to develop treatments and vaccines may soon yield a light at the end of our dark tunnel.

Equity Markets

Lack of liquidity and investor risk-aversion resulted in a sharp rise in stock market volatility. Intra-month in March, the VIX index spiked to 82.7, a level higher than during the peak of the Great Financial Crisis in 2008. By the end of the month, the index closed lower but at a still elevated 53.5. In contrast, the index began 2020 at just 12.5. While the broad domestic equity market represented by the Russell 3000 Index rebounded from its mid-month lows, it still declined sharply by -13.8% for the month of March bringing its return for the first quarter of 2020 to a dismal -20.9%. It is, however, instructive to note, especially for institutional investors, that despite the steep -21% loss in the first quarter of this year, the annualized return for the past 7 years (including the dismal first quarter) is 9%, while the annualized return for the past 10 years is 10%.

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Equity markets investment performance in March was differentiated by capitalization and style. Large Cap outperformed Small Cap by +850 bp, while Growth outperformed Value across all capitalizations by +560 to +780 bp. Sector performance reflected the risk-off environment as Defensives outperformed Cyclicals. Health Care and Consumer Staples were the best performers for the month with declines of -3.8% and -5.4% respectively. Energy and Financials continued their worst performers trend with double-digit declines in March. The collapse in oil prices during the month with the price per barrel cut by more than half weighed hard on the Energy sector which lost -35% in March bringing its losses for the first quarter of 2020 to -50%. The Financials sector was buffeted by the continued decline in interest rates. The sector lost -21% for the month and -32% year-to-date. The Technology sector held up relatively well with a decline of -8.6% in March. For the first quarter, Technology was the best performing sector with a loss of -11.9% compared to the -19.6% decline for the broader S&P 500 index. A stronger U.S. dollar and risk aversion weighed on international equity markets in March. For the month, the MSCI EAFE Index which represents developed markets outside the U.S., declined -13.3%, while Emerging Markets lost -15.4%. For the first quarter, both markets underperformed the U.S. equity market by -190 to -270 bp.

Fixed Income Markets

Treasury yields continued their steep decline in March as the Federal Reserve cut the Federal Funds to effectively zero as the global pandemic created dislocations across markets. Treasury yields dropped to historic lows with all yields out to 10-year maturities closing below 1%. Shorter maturity yields declined by 50 to 60 bp, while 10-year and 30-year maturity Treasury yields dropped by 43 and 30 bp respectively. The Treasury coupon curve steepened with the 2-year/10-year spread differential widening by 20 bp to end the month at +47 bp. As the Fed cut rates aggressively during the month, the 3-month TBill/10-year spread normalized to +59 bp after having inverted to -14 bp at the end of the prior month. The corporate bond market weakened significantly in March mirroring the downturn in the equity markets. Investment grade spreads widened sharply by 138 bp resulting in the Bloomberg Barclays Credit Index underperforming duration-matched Treasuries by -986 bp. As is typically seen in times of weakness, the corporate credit curve and quality curve both steepened in March as short and intermediate maturity corporate bonds outperformed longer maturity issues by an average of +756 bp, while Single-A rated bonds outperformed BBB bonds by +592 bp. Energy was the worst performing sector, and Pharmaceuticals one of the best, similar to equity sector performance. Despite the steep decline in Treasury yields, the significant widening in corporate bond spreads resulted in a -6.6% return for the Credit Index in March bringing its return for the first quarter to -3.1%. Performance in the

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High Yield bond market was significantly worse as the spread on the Bloomberg Barclays High Yield Index widened by 380 bp to end the month at 880 bp. This led to a return of -11.5% for the month and -12.7% year-to-date. Similar to the investment grade sector, the High Yield quality spread steepened as the BB sector outperformed the Single-B sector by +230 bp. Like the other asset classes, Energy was the worst performing sector and Consumer Staples the best in High Yield as well. While U.S. Treasury yields declined significantly in March, government bond yields in other markets declined by less or increased. A stronger dollar was an additional headwind for non-dollar markets. As a result, the non-dollar government bond market's return of -2.9% significantly lagged the +2.8% return for the U.S. Government bond market.

			Returns as of 3/31/20 (In %)				
		Month	1st Qtr	1 Year	3 Years	5 Years	7 Years
Russell 3000®	US AllCap Equity	-13.8	-20.9	-9.1	4.0	5.8	9.0
Russell 1000®	US Large Cap Equity	-13.2	-20.2	-8.0	4.6	6.2	9.3
Russell 1000® Growth	US Large Cap Growth	-9.8	-14.1	0.9	11.3	10.4	12.9
Russell 1000® Value	US Large Cap Value	-17.1	-26.7	-17.2	-2.2	1.9	5.6
Russell Midcap®	US Mid Cap Equity	-19.5	-27.1	-18.3	-0.8	1.8	6.4
Russell Midcap® Growth	US Mid Cap Growth	-14.9	-20.0	-9.4	6.5	5.6	9.5
Russell Midcap® Value	US Mid Cap Value	-22.7	-31.7	-24.1	-6.0	-0.8	4.1
Russell 2000®	US Small Cap Equity	-21.7	-30.6	-24.0	-4.6	-0.2	4.2
Russell 2000® Growth	US Small Cap Growth	-19.1	-25.8	-18.6	0.1	1.7	6.5
Russell 2000® Value	US Small Cap Value	-24.7	-35.7	-29.6	-9.5	-2.4	1.8
MSCI ACWI ex-US	Global Equity ex-US	-14.5	-23.4	-15.6	-2.0	-0.6	1.1
MSCI EAFE	Global Developed Mkts Equity	-13.3	-22.8	-14.4	-1.8	-0.6	1.8
MSCI EM	Emerging Mkts Equity	-15.4	-23.6	-17.7	-1.6	-0.4	-0.4
Bloomberg/Barclays US Agg	US Core Fixed Income	-0.6	3.1	8.9	4.8	3.4	3.2
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	0.0	2.5	6.9	3.9	2.8	2.6
Bloomberg/Barclays US Credit	US Corporate Bonds	-6.6	-3.1	5.1	4.2	3.3	3.4
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	1.1	2.8	7.0	4.0	2.9	2.9
Bloomberg/Barclays US Corp HY	US High Yield	-11.5	-12.7	-6.9	0.8	2.8	3.3
FTSE Non-US WGBI	Global Fixed Income ex-US	-2.9	-1.9	1.8	3.1	2.4	0.6

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