

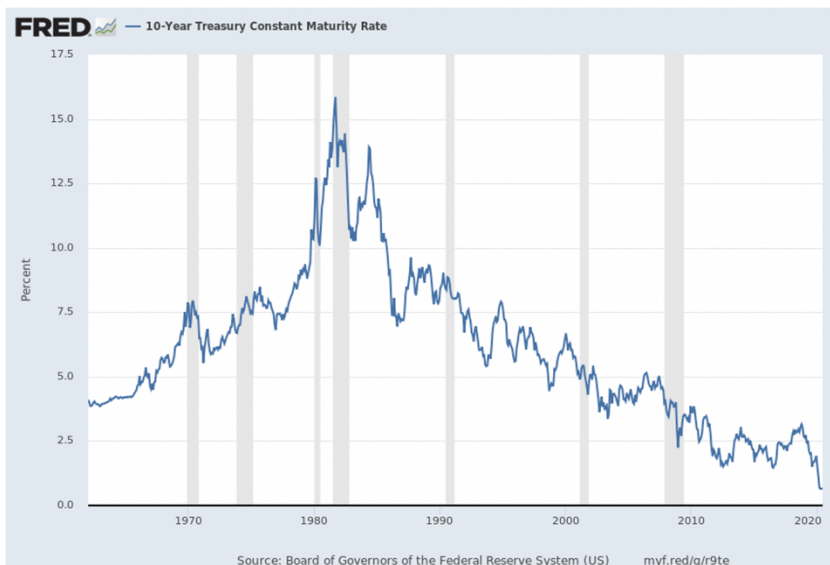
Capital Markets Review and Outlook

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Economy and Outlook

The Covid-19 coronavirus global pandemic continued to exact a human and economic toll worldwide. According to the World Health Organization (WHO), there were 5.9 million confirmed cases and over 367,000 deaths globally as of the end of May. The corresponding figures for the United States are 1.7 million cases and over 100,000 deaths. Various indicators of economic health have also dropped precipitously reflecting the forced shutdowns in a wide range of countries. The statistics are mind-numbing - tens of millions of people unemployed, double-digit declines in manufacturing, consumer spending and consumer as well as business confidence. While the numbers are bad, they are likely to get worse before improving. For example, the U.S. unemployment rate is likely to exceed 20%, a level not seen since the Great Depression. However, it is important to note that such statistics lead to the erroneous notion of comparing the current economic environment to that of the Great Depression in the 1930's. Former Federal Reserve Chairman Ben Bernanke, who is a leading expert on the Great Depression has stated that it is not very helpful to compare the current downturn with the Great Depression, the causes of which were very different. At that time, a financial and economic crisis was worsened by faulty fiscal and monetary policy responses which significantly deepened and lengthened the ensuing economic slump. In contrast, trillions of dollars, each by both the Federal Reserve and the U.S. government have been speedily deployed into the economy today to help mitigate the effects of the pandemic and the economic lockdown. In Europe, the European Commission proposed a €750 billion stimulus package in late May to assist in the recovery of the European Union. This would be the biggest package ever in European history, far greater than even the Marshall Plan post-World War II. In Japan, the total size of the stimulus packages now exceeds \$2 trillion, which represents 40% of Japan's economy. Additional stimulus measures are being considered in the United States to assist the beleaguered states and local governments whose finances are important for the health of the broader economy. While the House of Representatives approved a spending measure in mid-May that included \$1 trillion for state and local governments, this bill is facing opposition in the Senate. The consequence of these previously unthinkable sums of government spending is a ballooning budget deficit that will need to be funded. In the past, the prospect of the government issuing vast amounts of securities to fund its deficits would have caused interest rates to skyrocket.



This time, however, investors remain sanguine as reflected in the record low yield for the benchmark U.S. Treasury 10-year note as shown in the chart on the left.

As we have stated over the past few months, the answer

to the current economic downturn is a medical solution to the global pandemic in the form of effective vaccines and therapeutics. On that front, there are reasons for cautious optimism. Medical researchers worldwide have a laser-focus as never before on Covid-19. There are now over 100 vaccines in development and at least 10 are already in human trials; this is unprecedented in the field of vaccine development. The equally unprecedented global policy responses in the form of fiscal and monetary policy stimulus are likely to provide the necessary supportive measures for the global economy until the Covid-19 coronavirus is brought under control.

Equity Markets

Financial markets are a discounting mechanism that look beyond the here and now and, instead, anticipate the environment 12 to 18 months from now and beyond. In May, the equity markets extended the sharp gains seen in April despite the continuing rise of Covid-19 cases. The widely watched barometer for the domestic equity markets, the S&P 500 index, closed the month back above 3,000 less than three months after plunging -25% below this key level. The broad domestic equity market represented by the Russell 3000 Index rose +5.4% in May bringing its quarter-to-date return for the two months of the 2nd quarter to +19.3%. Year-to-date, the Russell 3000 Index is now down just -5.6%. 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 both over 9%.

There was a trend reversal in performance by capitalization as both Small Cap and Mid Cap outperformed Large Cap by +123 bp and +175 bp respectively for the month. Year-

to-date, however, Large Cap continues to dominate by a significant margin. Style-wise, Growth continued to outperform Value in the month of May across all capitalizations by +328 to +658 bp. Year-to-date, Growth has outperformed Value significantly by an average of +17 percentage points, one of the largest leads ever over a 5-month period. The rally in the shares of economically sensitive companies enabled a second consecutive month of Cyclical outperforming Defensives. Information Technology and Materials were the best performers for the month with gains of +7.1% and +7% respectively, while Consumer Staples (+1.5%) and Real Estate (+1.9%) lagged. Energy (+1.9%) took a breather after rising almost +30% the previous month. Year-to-date, Energy is the worst performing sector with a decline of -34.5%. The strong performance of Large Cap growth names is evidenced by the +7.3% return for the Technology sector this year. Economic stimulus measures outside the United States were supportive for international equity markets as well. The trade-weighted U.S. dollar index declined -0.7% in May. Against the major currencies, the dollar lost -1.4% versus the euro while gaining +0.5% against the Japanese yen. For the month, the MSCI EAFE Index which represents developed markets outside the U.S., rose +4.4%, while Emerging Markets gained only +0.8%. Year-to-date, both markets are trailing the U.S. With the broad U.S. equity market down -5.6% for the first 5 months of this year, Developed Markets declined -14.8% while Emerging Markets are down -16% for the same time period.

Fixed Income Markets

The second consecutive month of strong returns in the equity markets finally weighed on the U.S. Treasury market but primarily at the back end of the yield curve. Long maturity yields rose with the yield on the 30-year Treasury bond rising by 13 bp to 1.4%. However, the yield on the 10-year Treasury increased just 1 bp to 0.65%, while Treasury maturities down to 2 years experienced yield **declines** of 2 to 6 bp. Consequently, the Treasury coupon curve steepened significantly in May with the 2-year/30-year spread differential widening by 17 bp to end the month at +125. At the beginning of the year, the spread was +81 bp.

The corporate bond market had a second consecutive month of strong performance in May. Investment grade spreads tightened 27 bp resulting in the Bloomberg Barclays Credit Index outperforming duration-matched Treasuries by +185 bp. Issuance also continued to pick up significantly as companies took advantage of extraordinarily low yields. Net new issuance in the month of May was \$217 billion bringing total net issuance for the first 5 months of 2020 to \$782 billion. In contrast, total net issuance for the prior two calendar years averaged less than \$350 billion. Reflecting the positive tone in the corporate bond market, the corporate credit curve and quality curve both

flattened in May as longer maturity corporate bonds outperformed short and intermediate maturity issues by an average of +90 bp, while BBB rated bonds outperformed Single-A rated issues by +149 bp. Unlike the equity markets, Energy was the best performing sector in the investment grade credit market; for example, the Oil Field Services subsector generated excess returns +1125 bp. The financial companies subsector was the worst performer with excess returns of -55 bp for the month. In May, the Investment Grade Credit sector posted a total return of +1.6% resulting in a year-to-date return of +2.9%. Consistent with the strong performance in the equity markets, the High Yield bond sector extended its sharp gains from the prior month. Like the Investment Grade sector, the high yield quality curve also flattened as lower quality high yield bonds broadly outperformed in May. The BB sector was up +3.7%, while the Single-B sector had a return of +5%, and the CCC sector increased +6.1%. Even distressed issuers rated Single-C and below had a return of +4.2%. Similar to the Investment Grade sector, the best performing sector was Energy. The worst performing sectors included health Insurance and pharmaceuticals. The overall High Yield Index had a total return of +4.4% for the month paring down its year-to-date loss to -4.7%. A decline in the U.S. dollar index together with smaller increases, and in some cases declines, in non-dollar government bond yields, especially for long maturities, (relative to U.S. bonds) buoyed the non-dollar government bond market which posted a return of +0.5% for the month in contrast to the -0.2% return for the U.S. Government bond market. However, year-to-date, the non-dollar market with a return of +0.1% significantly lags the +8.5% return for the U.S. market.

		Returns as of 5/31/20 (In %)					
		Month	QTD	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	5.3	19.3	-5.6	11.5	9.5	9.2
Russell 1000®	US Large Cap Equity	5.3	19.2	-4.9	12.5	10.1	9.6
Russell 1000® Growth	US Large Cap Growth	6.7	22.5	5.2	26.3	17.2	14.5
Russell 1000® Value	US Large Cap Value	3.4	15.1	-15.7	-1.6	2.6	4.4
Russell Midcap®	US Mid Cap Equity	7.0	22.4	-10.7	2.6	5.5	5.9
Russell Midcap® Growth	US Mid Cap Growth	10.0	27.3	1.8	17.0	14.0	10.7
Russell Midcap® Value	US Mid Cap Value	4.6	18.6	-19.0	-6.9	-0.4	2.6
Russell 2000®	US Small Cap Equity	6.5	21.1	-15.9	-3.4	2.0	3.7
Russell 2000® Growth	US Small Cap Growth	9.4	25.8	-6.6	7.3	7.7	6.3
Russell 2000® Value	US Small Cap Value	2.9	15.6	-25.6	-14.7	-4.2	0.7
MSCI ACWI ex-US	Global Equity ex-US	3.3	11.1	-14.8	-3.4	-0.2	0.8
MSCI EAFE	Global Developed Mkts Equity	4.4	11.1	-14.3	-2.8	-0.4	0.8
MSCI EM	Emerging Mkts Equity	0.8	10.0	-16.0	-4.4	-0.2	0.9
Bloomberg/Barclays US Agg	US Core Fixed Income	0.5	2.3	5.5	9.4	5.1	3.9
Bloomberg/Barclays US Interim. Agg	US Intermediate Fixed Income	0.6	1.7	4.2	7.2	4.1	3.2
Bloomberg/Barclays US Credit	US Corporate Bonds	1.6	6.3	2.9	9.5	5.6	4.8
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	0.1	0.8	3.6	6.5	3.9	3.1
Bloomberg/Barclays US Corp HY	US High Yield	4.4	9.1	-4.7	1.3	3.0	4.3
FTSE Non-US WGBI	Global Fixed Income ex-US	0.5	2.0	0.1	3.1	2.5	3.1

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