



# MID-YEAR MARKET INSIGHTS

2020 REVIEW



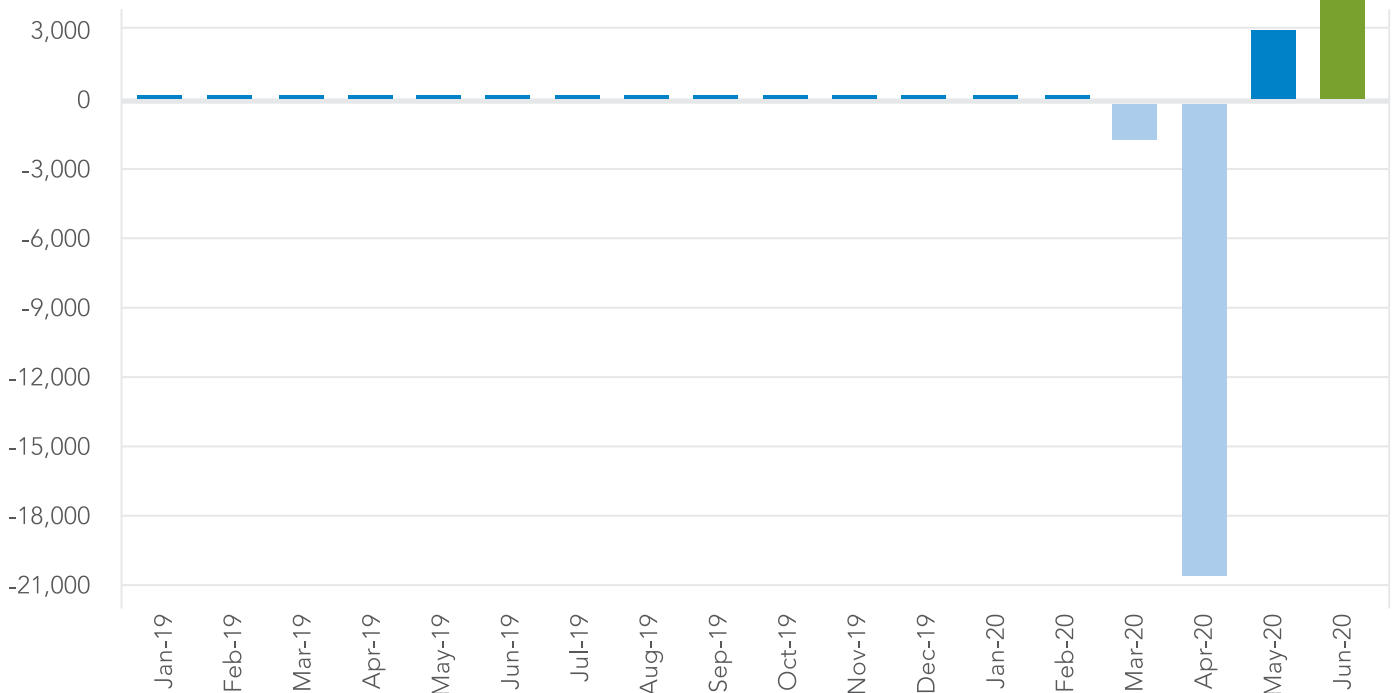
The U.S. economy for 2020 has experienced unprecedented disruptions due to the Coronavirus pandemic. Heading into the new year, the economy was in a strong position, with unemployment at the lowest level in fifty years, high consumer confidence, and nearly all sectors of the economy expanding. The biggest struggle in January was the threat of a labor shortage hindering potential growth.

The emergence of the pandemic represented a classic example of a “black swan” event to the economy. Its impact was sudden and severe, requiring dramatic restrictions on individual and business activities. This caused historic drops in economic activity throughout the country. In March, more than 20 million people were laid off or furloughed, causing the unemployment rate to skyrocket to nearly 15 percent. The gross domestic product contracted 5 percent in the first quarter and may have contracted another 35 percent in the second quarter. While all sectors of the economy suffered from the contraction, those directly related to intrapersonal interactions have been hit particularly hard, especially the leisure and hospitality and retail trade sectors.

While it is difficult to tell how the economy will recover, it appears that the contraction ended in April. The economy added 2.7 million jobs in May and another 4.8 million jobs in June, and the unemployment rate is now down to 11.1 percent. However, even with the strong growth recently, U.S. employment is still 14.7 million, or 9.6 percent below its February level. Ultimately, the economic recovery will be driven by the pandemic and the ability of businesses to continue to reopen. Unfortunately, the recent resurgence of Coronavirus cases throughout the country could slow economic growth. Several states paused or even reversed reopening plans for many businesses, which could threaten employment gains in impacted sectors. And with many federal stimulus benefits set to expire at the end of July, workers and businesses could face another wave of economic difficulty this summer.

We expect the economy to continue to heal over the remainder of 2020, but the pace and strength of improvement depend on whether COVID-19 infection rates can be effectively managed. An increase in virus cases at the end of the second quarter led to some states rolling back re-opening plans, which may delay a return of normal consumer behavior. The road back to pre-COVID-19 levels of activity is likely to be uneven and long.

### JOB GROWTH SWINGING AT HISTORIC LEVELS MONTH-TO-MONTH EMPLOYMENT CHANGE (IN THOUSANDS)



Source: BLS, 6/30/2020

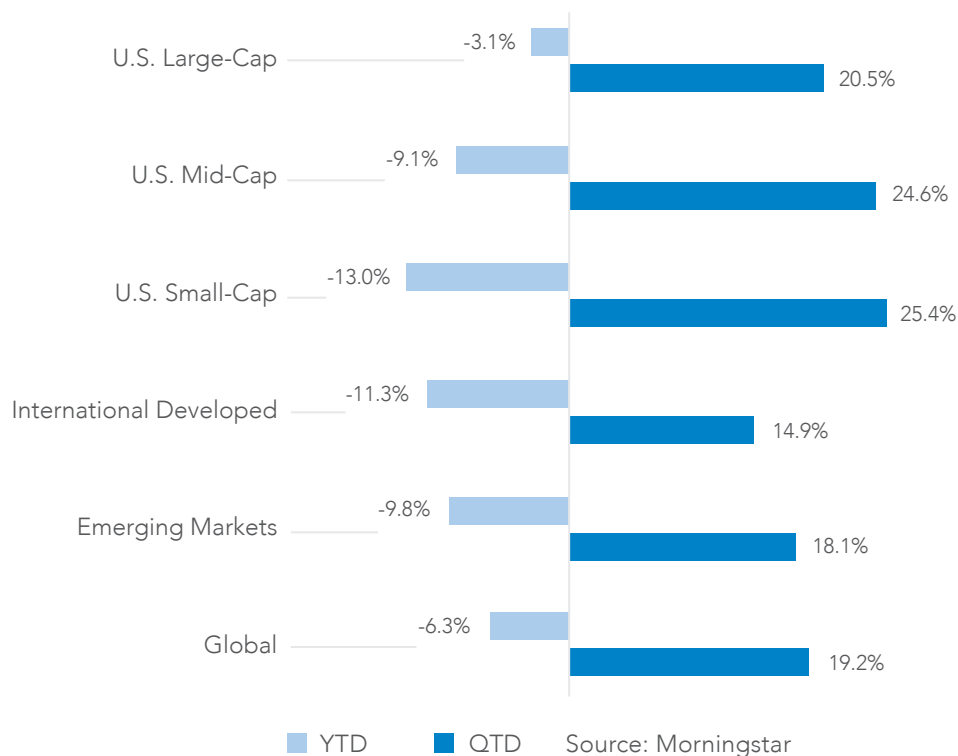
U.S. large-cap stocks, as measured by the S&P 500 Index, rebounded by 20 percent during the second quarter of 2020 adding to the strong recovery made in late March. At one point in early June, stocks had generated one of the strongest rallies in history—a more than 44 percent gain for the S&P 500 Index from March 23 through June 8—before pulling back about 5 percent by quarter-end. After underperforming their large-cap brethren during the first quarter, U.S. small-cap stocks posted even stronger returns as the Russell 2000 Index rose over 25 percent as economic prospects began to show signs of improvement.

Equity markets advanced globally. Developed international stocks were higher by almost 15 percent, as measured by the MSCI EAFE Index, while emerging market stocks fared somewhat better as the MSCI EM Index returned 18 percent on stronger growth prospects.

The robust rebound in stock prices was aided by the massive stimulus response by policymakers and initial progress toward a vaccine. While we expect the economic recovery to continue, the rebound in stock prices has factored in a lot of good news considering a still uncertain path for COVID-19. On one hand, gains appear appropriate based on the likelihood that the recession may be the shortest ever. On the other hand, the risk of a second wave of COVID-19 remains and many of the jobs lost in March and April will take a while to come back due to social distancing constraints and potentially lasting changes in consumer behavior.

At the end of June 2020, stock market pricing suggested a return to pre- COVID-19 levels for the economy and corporate profits by the end of 2021, which may be pricing in an overly optimistic scenario. Since the end of World War II, economic growth and corporate profits have taken nearly three years to return to pre-recession levels, suggesting a mid-to-late 2022 time frame for a return to pre-recession levels. While we remain optimistic on the longer-term prospects of stocks, especially relative to bonds, stock market improvement is likely to slow, with volatility likely to persist over the second half of 2020.

**EQUITY PERFORMANCE**



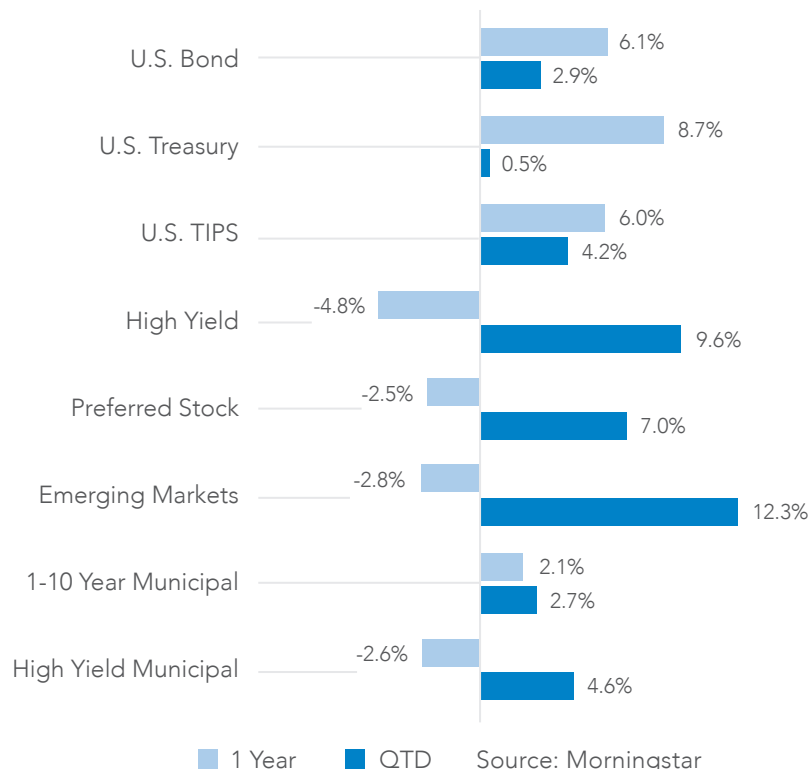
U.S. Treasury yields remained range-bound during the second quarter as evidence of economic recovery was counterbalanced by the Federal Reserve (Fed) signaling lower rates for a longer period. The 10-year Treasury yield was unchanged at 0.70 percent while the rest of the Treasury yield curve also remained stable. The stability of the Treasury market masked significant improvement and strong performance across many fixed income sectors. Lower-rated, more economically sensitive sectors, fared best during the quarter reflecting economic improvement and the beneficial impact of aggressive monetary and fiscal policy.

The Fed's aggressive response, which included a heavy dose of bond purchases and a variety of lending programs to boost liquidity in the bond market, was a key ingredient for improvement in non-Treasury sectors. Prices of both investment-grade and high-yield bonds rebounded with the average yield advantage, or spread, to comparable maturity Treasuries narrowing sharply. However, average yield spreads remain above long-term averages suggesting an attractive valuation relative to Treasuries. Emerging market debt also benefited over the quarter as policymakers across the globe followed the Fed's lead and took an aggressive response. Monetary policy across the globe remains supportive of these more economically sensitive sectors.

In the U.S., tax-exempt municipal bonds also benefited from the Fed's measures. As market functioning returned to normal, municipal bond prices improved. Fears over state and local government finances increased early in the quarter but passage of the CARES Act helped address shortfalls even if more federal assistance may be needed. States and municipalities are likely to manage through the crisis just as they did in the post-2008 environment. Despite municipal bond improvement, average AAA-rated municipal bond yields finished the quarter above their Treasury counterparts, indicative of a valuation that is attractive relative to history.

The Fed stated it will maintain its overnight lending rate between 0-0.25 percent until the end of 2022. As a result, bond returns are likely to remain low and investors need to adjust return expectations accordingly. However, even at lower yields, high-quality bonds still provide diversification benefits to equities and remain a key component of investment portfolios.

### FIXED INCOME PERFORMANCE





# ALTERNATIVE INVESTMENTS

Alternative investment strategies lagged behind the robust returns of equities, but all major strategies delivered positive results. Year-to-date through the end of June 2020, alternative investments, as measured by the HFRX Global Hedge Fund Index, were down 1.1 percent, but above that of most equity categories.

## MASTER LIMITED PARTNERSHIPS (MLPs)

Crude oil experienced historically volatile swings before a strong rebound over May and June. The inability of Russia and Saudi Arabia to come to an agreement on production in March sparked a sell-off that continued into the second quarter and culminated in spot crude (i.e., the shortest-dated contract) closing in negative territory on April 20. Oil prices subsequently recovered as Russia and Saudi Arabia agreed to reduce production and the global economic outlook improved. These events propelled MLPs to a 50 percent gain for the quarter as measured by the Alerian MLP Index.

## REAL ESTATE (REITs)

The second quarter saw a comeback from many of the sectors that were hit hardest in the first quarter, with Shopping Centers leading the way and Regional Malls not far behind. Single-Family-For-Rent also outperformed as the sector saw record demand as people looked for more space as they continued to work from home. Self-Storage and Office ended the quarter as the weakest performers. Office continues to lag given the uncertainty regarding the future of working from home while Self-Storage suffered from rotation into some of the weaker sectors. The new technology-based sectors, Cell Towers and Data Center REITs, which have benefited from the current work-from-home environment remain the only REIT sectors with positive year-to-date returns.

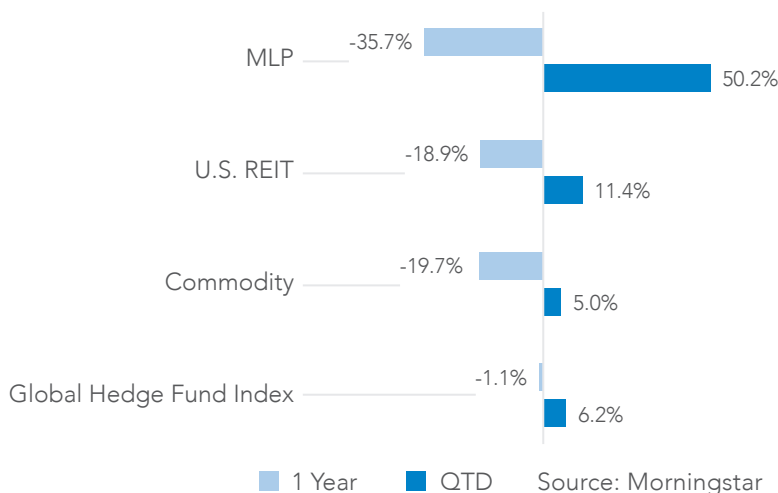
## COMMODITIES

After performing poorly during the first three months of the year, commodities rallied in the second quarter. The prospect of a slowing global spread of COVID-19 coupled with economic data from China indicating the country is returning toward normalcy fueled expectations for stronger commodity demand in the second half of 2020. Given China’s role as the world’s largest consumer of commodities, the positive direction of the nation’s growth was a key driver. Commodities were also supported by the combination of producer supply discipline and U.S. dollar weakness over the quarter.

## REAL ASSETS

Gold and silver were top performers among the major commodities, as both metals benefited from investors’ search for “safe havens,” a weaker U.S. dollar, and lower real (i.e., inflation-adjusted) interest rates worldwide. Industrial metals also rallied, led by copper, thanks to both producer supply discipline and expectations for rising demand from China. Agricultural commodities failed to keep pace with the broader market. Favorable weather patterns led to increased estimates for yields in the 2020 growing season, pressuring prices.

## REAL ASSETS AND ALTERNATIVE INVESTMENTS PERFORMANCE



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