Asset Strategy Consultants

MARKET REVIEW

Second Quarter 2020

We are pleased to present *Market Review,* featuring a discussion of the Capital Markets during the Second Quarter 2020 and a summary of historical performance for the major asset style passive indices for the period ending June 30, 2020. We hope you find the information useful and helpful in your investment considerations.

We welcome your comments.

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ASSET STRATEGY CONSULTANTS

Founded in 1991, Asset Strategy Consultants provides investment consulting services to institutional clients representing $10 billion under advisement. Headquartered in Baltimore, Asset Strategy Consultants has offices throughout the East Coast.

THE MACROECONOMIC ENVIRONMENT

Main Street vs. Wall Street

The S&P 500 Index notched its best quarter since 1998 with a 20.5% return, nearly erasing its first quarter loss. Developed and emerging market equity indices posted returns approaching 20%. High yield bond and emerging market debt markets were up over 10%. Oil prices doubled, closing at roughly $40 a barrel (WTI). However, year-to-date returns across these market segments remain negative, and some in red double-digits. The Russell 1000 Growth Index, up nearly 10% ytd due to its heavy weight in high- flying technology stocks, is a lone exception.

While Wall Street was in celebration mode, much of Main Street continued to suffer. Against the backdrop of stellar asset price performance, rising cases of the virus in the US tempered optimism going into quarter-end. Some cities have reversed their re-openings as new COVID-19 cases have mounted. While certain economic data have surprised on the upside (from very depressed levels), much uncertainty remains. “The path forward for the economy is extraordinarily uncertain and will depend in large part on our success in containing the virus,” said Fed Chair Jerome Powell at a recent meeting. “A full recovery is unlikely until people are confident that it is safe to reengage in a broad range of activities.”

Officially, the U.S. economy entered a recession in February 2020, according to the National Bureau of Economic Research. Some estimate that we emerged in May, which would make this the shortest recession ever. A number of promising statistics point to a rebound—but it should be noted that they have yet to recoup the losses incurred in March/April. Retail sales grew a record 18% (-6% year-over-year) in May. Durable goods orders also delivered on the upside; up 16% in May (-18% yoy). And housing received a boost from relatively low mortgage rates. Pending home sales were up 44% in May, but remain down 5% yoy. Personal spending rose 8% in May, a monthly record, but is down 9% yoy. Further, certain segments of the economy have not participated in this recovery and are likely to be impacted for some time. Hotels, restaurants, airlines, and many small businesses have been among the hardest-hit.

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Not all the economic data have been good. While roughly 5 million jobs returned in May and June, 19 million were lost in April. Unemployment (11.1% in June) remains elevated, and while jobless claims have decelerated, they continue to hover around 1.5 million per week, with those receiving state benefits at roughly 18 million.

Further evidence of the ongoing stress is reflected in downgrades and defaults. According to data from J.P. Morgan, defaults across bonds and loans total $100 billion thus far in 2020, already the most since the entire year of 2009, and defaults in U.S. high yield bonds reached a 10-year high of 6.2%. As for equities, a recent Wall Street Journal article noted that "more than 40% of the companies in the S&P 500 have pulled their guidance as the coronavirus pandemic has doused U.S. corporations in uncertainty."

First quarter GDP contracted 5.0%, but the second quarter is expected to be far worse, with estimates spanning a wide range (-30% to -40% annualized) and changing by the day. For 2020, the median expectation from the Fed is for a decline of 6.5%, but the range among FOMC members is -10.0% to -4.2%. Fed forecasts for 2021 are similarly disparate, with a median 5.0% gain and a range of -1.0% to 7.0%.

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A tsunami of central bank support and fiscal stimulus fueled confidence and pumped liquidity into the markets. The Fed not only left rates at close to 0%, but it also announced that it would likely leave them there until at least 2022. Fiscal stimulus in a multitude of flavors approaches $3 trillion, nearly 14% of GDP, and globally the figure is a stunning $8 trillion, or 9% of global GDP, according to Natixis PRCG and the International Monetary Fund. While some of these programs have been controversial, collectively they have been incredibly effective in restoring liquidity and confidence. In some cases, a mere announcement had a significant impact on markets before the program was implemented.

Overseas, a similar story unfolded. Central bank support and rate cuts have bolstered confidence and liquidity; some economic indicators seem to indicate the worst is over. However, it is worth noting that virus-related statistics are far more favorable in Europe and Asia than in the U.S. And emerging markets have not seen their "virus curves" flatten, especially in Latin America, India, and Russia. Far from rosy, the OECD recently released its global 2020 real GDP forecast: -6.0%—and this assumes no "second wave" for the virus. ■

EQUITY MARKETS

U.S. stock markets posted double-digit returns in the second quarter, with some segments erasing all of the first quarter's sharp losses. Growth, benefiting from its 44% exposure to Technology, sharply outperformed value (R1000 Growth: +27.8%; R1000 Value: +14.3%) and the spread is even larger on a ytd basis (R1000 Growth: +9.8%; R1000 Value: -16.3%). Small caps outperformed large (RMicrocap +38.8%; R2000: +25.4%; R1000: +21.8%). Within the S&P 500 (+20.5%), several sectors posted returns over 30% (Energy, Consumer Discretionary, Technology) while Utilities (+2.7%) fared the worst. It is worth nothing that the "FAAMG" stocks accounted for nearly 30% of the return for the S&P 500; collectively the group was up 35% for the quarter.

Outside of the U.S., double-digit returns were broad-based across developed and emerging markets (MSCI ACWI ex-USA: +16.1%; MSCI EM: +18.2%) but both remain down roughly 10% over the six-month period. As in the U.S., growth outperformed value. ■

FIXED INCOME

U.S. Treasury yields were range-bound in the second quarter; the 10-year U.S. Treasury yield closed the quarter at 0.66%; down only 4 bps from March 31 but off far more sharply from the year-end level of 1.92%. As a result, the Bloomberg Barclays US Treasury Index was up a modest 0.5% for the quarter. Other sectors recovered from sharp underperformance in the first quarter as investor confidence improved. For the quarter, the Bloomberg Barclays US Aggregate Bond Index gained 2.9%, with non- Treasury sectors faring the best. This is a stark contrast to the first quarter, when U.S. Treasuries were virtually the lone sector to post a positive return. The Bloomberg Barclays US Corporate Bond Index rose 9.0% in the second quarter but has underperformed like-duration U.S. Treasuries by 540 bps ytd. The Bloomberg Barclays High Yield Bond Index posted a double-digit return (+10.2%) in Q2 but remains down 3.8% ytd.

Rates were lower overseas, fueled by rate cuts across a broad swath of countries and strong performance from corporates. The Bloomberg Barclays Global Aggregate ex-US Bond Index rose 3.4% (unhedged). Emerging market debt indices posted lofty results (EMBI Global Div: +12.3%; GBI-EM GI Div: +9.8%) but remain down single digits from year-end. Municipal bonds also rebounded from relatively poor performance in the first quarter; the Bloomberg Barclays Municipal Bond Index rose 2.7% in the second quarter but is up only 2.1% ytd. ■

CLOSING THOUGHTS

It is no exaggeration to say that we are living in unprecedented times, and we face a vast array of social, geopolitical, financial, and health challenges. Uncertainty remains high across these arenas, and yet markets have recovered swiftly from the wreckage of the first quarter. While there are some indications that there is light at the end of the tunnel, the ultimate impact of the pandemic on the economy remains unclear. Wall Street prices reflect a relatively optimistic viewpoint that has yet to be proven by fundamental data. While central bank intervention has been swift and heavy, helping to restore confidence and liquidity, investors should be mindful that we remain in uncharted territory. The oft-cited economic recovery alphabet descriptors (V, W, L, U) do little to describe the pace of the recovery or the ultimate repercussions for the economy and society. Amid this uncertainty, social justice, environmental awareness, and wealth inequality are issues that seem to have gained some momentum and perhaps have drawn strength from these challenging times, during which we have had to adapt to new rules in a swift fashion.

While the economic picture remains fluid and uncertain, Asset Strategy Consultant's advice to investors remains clear and consistent: We recommend adherence to a disciplined investment process that includes a well-defined long-term asset allocation policy. ■

Source: Asset Strategy Consultants and Callan Associates

Stay safe and healthy

If there is anything we can do to assist you and your organization during this time, please do not hesitate to reach out. All of you remain in our thoughts, and we hope that you and your families remain safe and healthy.

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PRELIMINARY RETURNS FOR VARIOUS PERIODS: 2Q20

		April	May	June	Last Quarter	Year to Date	Last Year	Last 3 Years	Last 5 Years	Last 10 Years	Last 15 Years
	1 Russell:3000 Index	13.24	5.35	2.29	22.03	(3.48)	6.53	10.04	10.03	13.72	8.78
	2 Russell:1000 Index	13.21	5.28	2.21	21.82	(2.81)	7.48	10.64	10.47	13.97	8.91
	3 Russell:1000 Growth	14.80	6.71	4.35	27.84	9.81	23.28	18.99	15.89	17.23	11.32
	4 Russell:1000 Value	11.24	3.43	(0.66)	14.29	(16.26)	(8.84)	1.82	4.64	10.41	6.24
	5 Russell:Midcap Index	14.36	7.03	1.80	24.61	(9.13)	(2.24)	5.79	6.76	12.35	8.51
	6 Russell:Midcap Growth	15.66	10.05	2.34	30.26	4.16	11.91	14.76	11.60	15.09	10.32
	7 Russell:Midcap Value	13.35	4.64	1.13	19.95	(18.09)	(11.81)	(0.54)	3.32	10.29	7.00
	8 Russell:2500 Index	14.55	7.39	2.89	26.56	(11.05)	(4.70)	4.08	5.41	11.46	7.85
	9 Russell:2500 Growth	16.03	10.44	3.68	32.87	2.02	9.21	12.10	9.57	14.45	10.07
EQUITY	10 Russell:2500 Value	13.22	4.57	1.86	20.60	(21.18)	(15.50)	(2.60)	1.85	8.81	5.76
	11 Russell:2000 Index	13.74	6.51	3.53	25.42	(12.98)	(6.63)	2.01	4.29	10.50	7.01
	12 Russell:2000 Growth	14.89	9.45	3.84	30.58	(3.06)	3.48	7.86	6.86	12.92	8.85
	13 Russell:2000 Value	12.34	2.87	2.90	18.91	(23.50)	(17.48)	(4.35)	1.26	7.82	4.97
	14 S&P:500	12.82	4.76	1.99	20.54	(3.08)	7.51	10.73	10.73	13.99	8.83
	15 S&P:400 Mid Cap	14.18	7.31	1.26	24.07	(12.78)	(6.70)	2.39	5.22	11.34	8.21
	16 S&P:600 Small Cap	12.70	4.31	3.74	21.94	(17.85)	(11.29)	0.56	4.48	11.24	7.65
	17 MSCI:ACWI ex US	7.58	3.27	4.52	16.12	(11.00)	(4.80)	1.14	2.26	4.97	4.44
	18 MSCI:EAFE	6.46	4.35	3.40	14.88	(11.34)	(5.13)	0.81	2.05	5.73	4.09
	19 MSCI:EM	9.16	0.77	7.35	18.08	(9.78)	(3.39)	1.90	2.86	3.27	6.33
	20 MSCI:ACWI	10.71	4.35	3.20	19.22	(6.25)	2.11	6.14	6.46	9.16	6.42
	21 Blmbg:Aggregate	1.78	0.47	0.63	2.90	6.14	8.74	5.32	4.30	3.82	4.39
	22 Blmbg:Gov/Credit	2.23	0.58	0.87	3.71	7.21	10.02	5.87	4.74	4.13	4.50
	23 Blmbg:Credit	4.58	1.63	1.83	8.22	4.82	9.07	6.14	5.54	5.24	5.26
	24 Blmbg:Corporate High Yld	4.51	4.41	0.98	10.18	(3.80)	0.03	3.33	4.79	6.68	6.84
	25 Blmbg:Municipal Bond	(1.26)	3.18	0.82	2.72	2.08	4.45	4.22	3.93	4.22	4.28
FIXED INCOME	26 Blmbg:US TIPS	2.78	0.30	1.12	4.24	6.01	8.28	5.05	3.75	3.52	4.00
	27 Blmbg:Glob Agg ex USD	2.04	0.30	1.01	3.38	0.61	0.71	2.52	2.89	1.98	2.85
	28 S&P:LSTA Levg Loan	4.50	3.80	1.14	9.70	(4.61)	(1.99)	2.07	2.89	4.16	4.28
	29 ML:US Treasuries 1-3 Yrs	0.04	0.07	0.03	0.13	2.94	4.07	2.69	1.84	1.33	2.29
	30 LIBOR - 3 Month	0.06	0.03	0.02	0.11	0.52	1.57	1.97	1.48	0.90	1.72
	31 3 Month T-Bill	0.01	0.00	0.01	0.02	0.60	1.63	1.77	1.19	0.64	1.34
	32 Blmbg:Commodity TR Idx	(1.54)	4.34	2.28	5.08	(19.40)	(17.38)	(6.14)	(7.69)	(5.82)	(4.34)
	33 GS Commodity Index	(9.67)	16.37	5.09	10.47	(36.31)	(33.90)	(8.71)	(12.54)	(8.53)	(8.40)
REAL ASSETS	34 MSCI:US REIT Index	8.24	0.18	3.02	11.70	(18.45)	(12.87)	0.08	4.08	9.06	5.99
	35 Alerian:MLP Index	49.62	8.95	(7.87)	50.18	(35.71)	(41.43)	(16.79)	(12.85)	(1.41)	2.64
	36 DJB:Glbl Infrastructure	8.33	4.37	(1.34)	11.55	(11.81)	(5.99)	2.79	3.90	9.69	8.19
	37 US DOL:CPI All Urban Cons	(0.67)	0.00	0.55	(0.12)	0.32	0.65	1.72	1.56	1.69	1.90

Source: Callan Associates