The long-lasting bull market came to a close as the novel coronavirus spread globally. Investors braced for a recession by selling equities in favor of higher quality fixed income and gold. The 10-Year Treasury yield ended the quarter at 0.7%.

**The Markets at a Glance**

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Representative Benchmark</th>
<th>Q1 Return</th>
<th>YTD Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Large Cap</td>
<td>S&amp;P 500</td>
<td>-19.6%</td>
<td>-19.6%</td>
</tr>
<tr>
<td>US Small Cap</td>
<td>Russell 2000®</td>
<td>-30.6%</td>
<td>-30.6%</td>
</tr>
<tr>
<td>International</td>
<td>MSCI EAFE</td>
<td>-22.8%</td>
<td>-22.8%</td>
</tr>
<tr>
<td>Commodities</td>
<td>Bloomberg Commodity</td>
<td>-23.3%</td>
<td>-23.3%</td>
</tr>
<tr>
<td>Municipal Bonds</td>
<td>BBgBarc. Municipal</td>
<td>-0.6%</td>
<td>-0.6%</td>
</tr>
<tr>
<td>Taxable Bonds</td>
<td>BBgBarc. Aggregate</td>
<td>3.2%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Cash</td>
<td>FTSE 3-Month T-Bills</td>
<td>0.4%</td>
<td>0.4%</td>
</tr>
</tbody>
</table>

*Performance returns are as of 3/31/2020*

**Q1 Recap**

The bull market ended as the novel coronavirus spread across the globe. Investors braced for a recession by selling equities and adding to Treasuries, gold, and cash. Within equities, Growth outperformed Value, Large-Cap protected more than Small-Cap, and the US sold off less than International. Oil slumped due to weak global demand and increased production from Saudi Arabia and Russia.

International equities also dropped. Developed international markets and riskier emerging markets fell 22.8% and 23.6% respectively. Investors favored the safe havens, Japan and Switzerland, over commodity-oriented markets of Australia, Brazil, and Russia. Despite its central role in the pandemic, China was one of the top performing markets in Q1. Growth outperformed Value by a wide margin internationally.

The broad US bond market returned 3.2%. Investors sought quality by favoring Treasuries and high-rated fixed income, while higher yielding corporates and municipal bonds sold off. The Fed’s accommodative actions were welcomed by the bond market. Yields dropped dramatically in the Treasury market, with the 10-Year Treasury yield ending the quarter at 0.7%.
Perspectives on Market Volatility

The Quarter of COVID-19

1Q20 will go down in history as the quarter that the novel coronavirus went global. March was one of the most volatile months in stock market history, as major indices plummeted into bear markets before rebounding near quarter-end. The selling was broad and largely indiscriminate, as everything from commodities to corporate bonds sold off at times. Further exacerbating the turmoil, a Saudi-Russia oil price war erupted, sending WTI crude below $20/bbl for the first time in nearly twenty years.

Actions Speak Loudly

In response to the uncontained virus, social isolation measures were introduced across the globe to limit transmission. Unfortunately, the casualty of this endeavor was the global economy. Consumer demand dried up as restaurants, stores, and more shut doors. Supply chains were similarly strained as factories shuttered and travel restrictions were implemented. Historic jobless claims quickly became the norm as companies furloughed workers.

As a result, both the Federal Reserve and US Government unveiled historic policy actions to combat the economic damage. The Fed cut rates to 0%, restarted and expanded its quantitative easing program, and introduced lending facilities to shore up challenged fixed income markets. The government delivered $2T+ in stimulus, including direct payments to individuals, beefed up unemployment insurance, corporate loans, small business assistance, aid to state/local governments, and direct healthcare support.

Uncertainty Spikes

Forecasting markets and the economy is always challenging, but the range of outcomes seems especially wide at this moment in time. This is supported by the latest data from US Economy Policy Uncertainty Index, which hit record highs in March (see Figure 1). While spikes in this index typically portend above-average forward returns, they are accompanied by higher volatility.

Looking Forward

Social distancing measures and expanded testing capacity give reason for optimism, but we expect volatility to remain elevated through the coming quarter as uncertainty abounds. Projections for the “reopening” of the US economy are wide-ranging, with fundamental disagreements on a plan of action at even the highest levels of government. The world will closely monitor locations that are easing lockdown restrictions. Even rosy scenarios assume weeks to months of continuous isolation efforts, prolonging economic strain.

Additional stimulus from the Federal Reserve and US Government is likely, though expectations vary and partisan issues could add to market volatility, particularly in an election year. Many are forecasting a 20% or higher decline in 2Q GDP, while unemployment figures seem likely to skyrocket. Tremendous economic uncertainty will persist into the summer (or beyond) pending the path of the virus.

Sheltering (Portfolios) in Place

Although volatility has been painful, it’s important to focus on the long-term. It may be tempting to take drastic actions to preserve your portfolio, but there’s a significant risk of acting at the wrong time. Consider your portfolio to be in “shelter in place” mode — meaning it’s better to not make any drastic changes unless you have to. As all past bear markets have eventually come to an end, they have all represented unique buying opportunities for well-positioned investors. Certainly, a handful of companies will not recover, but well-capitalized, high-quality firms have an opportunity to consolidate share and emerge stronger. Further, compressed multiples and the possibility of a quicker-than-expected return to normalcy offer the opportunity to add to positions at bargain prices.

1Q20 also provided a succinct reminder that diversification and rebalancing are valuable tools in the investor toolkit. While the selling pressure during March was broad-based, traditional safety havens like Treasuries and Gold provided reprieve, while more defensive sectors outperformed. Diversification has not been an easy sell over the last decade, but it provided some relief during one of the worst quarters in history.
The beginning of the decade marked the end of the bull market. After hitting an all-time high on February 19th, the S&P 500 plummeted by more than 35% from peak to trough. More impressive than the magnitude of the decline was the velocity. The S&P 500 entered into a bear market (i.e., falling more than 20%) in just 16 trading days. In contrast, it took 188 trading days for the S&P 500 to decline that amount during the Great Financial Crisis and 242 days to reach that milestone in the Dotcom Bubble (see Figure 2).

The Song Remains the Same

While the direction of the market changed, many trends from the bull market remain. The US outperformed International, Large-Cap outperformed Small-Cap, and Growth outperformed Value. The divergence between Growth and Value is greater now than it was at the peak of the Dotcom Bubble. One reason Growth has held up is due to the index’s largest sector being Info Tech. Many tech products continue to be used during social distancing. Not surprising, Health Care and Consumer Staples also fared better as demand for these products and services persist. Meanwhile, Energy fell 50% during the quarter. Energy sold off due to a significant drop off in demand and simultaneous increase in supply from Saudi Arabia and Russia. Financials also suffered significant declines as interest rates fell.

Bye Bye Buybacks

Over the past 10 years, the S&P 500 Buyback Index outperformed the S&P 500 by 1.9% per annum. This stands in stark contrast to Q1 as the S&P 500 Buyback index fell 31%, trailing the S&P 500 by 11%. As market liquidity evaporated, poorly capitalized companies appeared much riskier. For instance, Boeing, which had been returning capital to shareholders rather than investing more in Research & Development, was forced to seek a bailout from the Federal government. The airline industry too requested relief despite reportedly spending 96% of free cash flow on share buybacks over the last decade. Wall Street’s worship of bolstering EPS at the expense of long-term balance sheet stability may be a casualty of this bear market.

All the Small Things Lagged

Small-caps, as measured by the Russell 2000 Index, produced their worst quarterly results ever, returning -30.6%. The Russell 1000 by comparison fell just 20.2%, demonstrating that investors were more fearful of holding smaller, potentially riskier companies. Investors favored Utilities and Healthcare over Energy and Consumer Discretionary. Roughly 40% of the Russell 2000 Index has negative earnings, but interestingly enough, those stocks tended to do better amidst the market turmoil, bucking an overall preference for companies with strong balance sheets.

Around the World

International equity markets also moved sharply lower. Emerging markets fell 23.6% and developed international equities fell 22.8%. As in the US, Growth protected better than Value. Within developed markets, Switzerland (-11.5%) and Japan (-16.8%) fared better than commodity-oriented Australia (-33.3%) and countries such as Spain (-30%) and Italy (-29%), which have been harmed by the virus. Similar to developed markets, the worst performing countries were also commodity exporters: Brazil (-50.3%), South Africa (-40.4%), and Russia (-36.4%). China, a central figure in the coronavirus crisis, was the best performing country with a return of -10.2%. China held up in part by its exposure to information technology and support by the Chinese government.

Figure 2: Fastest Times to Reach Bear Market in the S&P 500

<table>
<thead>
<tr>
<th>Equities</th>
<th>Representative Benchmark</th>
<th>Q1 Return</th>
<th>YTD Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Large</td>
<td>S&amp;P 500</td>
<td>-19.6%</td>
<td>-19.6%</td>
</tr>
<tr>
<td>US Mid</td>
<td>Russell Midcap®</td>
<td>-27.1%</td>
<td>-27.1%</td>
</tr>
<tr>
<td>US Small</td>
<td>Russell 2000®</td>
<td>-30.6%</td>
<td>-30.6%</td>
</tr>
<tr>
<td>US Value</td>
<td>Russell 3000 Value</td>
<td>-27.3%</td>
<td>-27.3%</td>
</tr>
<tr>
<td>US Growth</td>
<td>Russell 3000 Growth</td>
<td>-14.9%</td>
<td>-14.9%</td>
</tr>
<tr>
<td>Dev. Int’l</td>
<td>MSCI EAFE</td>
<td>-22.8%</td>
<td>-22.8%</td>
</tr>
<tr>
<td>Emg. Int’l</td>
<td>MSCI EM</td>
<td>-23.6%</td>
<td>-23.6%</td>
</tr>
</tbody>
</table>

Performance returns as of 3/31/2020
Fixed Income

U.S. Fixed Income Benchmarks

<table>
<thead>
<tr>
<th>Fixed Income</th>
<th>Representative Benchmark</th>
<th>Q1 Return</th>
<th>YTD Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable</td>
<td>BBgBarc. Aggregate</td>
<td>3.2%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Treasury</td>
<td>BBgBarc. Treasury</td>
<td>8.2%</td>
<td>8.2%</td>
</tr>
<tr>
<td>Corporate</td>
<td>BBgBarc. Corporate</td>
<td>-3.6%</td>
<td>-3.6%</td>
</tr>
<tr>
<td>High Yield</td>
<td>ICE BofAML US HY</td>
<td>-13.1%</td>
<td>-13.1%</td>
</tr>
<tr>
<td>Municipal</td>
<td>BBgBarc. Municipal</td>
<td>-0.6%</td>
<td>-0.6%</td>
</tr>
<tr>
<td>Int’l</td>
<td>BBgBarc. Global Agg.</td>
<td>-0.3%</td>
<td>-0.3%</td>
</tr>
</tbody>
</table>

Performance returns as of 3/31/2020

Fixed Income at a Glance

The broad US bond market, as measured by the Bloomberg Barclays US Aggregate Index, went on a wild rollercoaster ride during the quarter, and ultimately delivered a return of 3.2%. The sudden economic stop resulting from COVID-19 restrictions led to a mad dash for liquidity. Investors across financial markets preferred holding cash-like securities, which prompted massive redemptions, particularly within short-dated fixed income assets. As stress permeated through the markets, bid-ask spreads widened, and market participants were forced to sell what they could rather than what they wanted to.

During the quarter, fixed income cross-asset correlations spiked to positive territory. A significant drawdown occurred as credit spreads widened and liquidity evaporated. In anticipation of economic deterioration and market uncertainty, the Federal Reserve acted swiftly. The Fed lowered the Federal Funds rate to a target range of 0% to 0.25%, vowed to provide “unlimited” quantitative easing, and enhanced the market liquidity. The Fed’s actions served as a gravitational force pulling yields across the US Treasuries curve down to record levels. The bellwether 10 Year US Treasury yield finished Q1 at 0.70% after starting the year at 1.92%.

Corporate Credit Feels Pressure In Q1

Investors benefited from an allocation to US Treasuries, which returned 8.2% in Q1. In contrast, corporate credit experienced dramatic downside pressure. Corporate issuers experienced a material repricing during the quarter. Concerns rose about the ability of corporations to service large debt burdens in the coming quarters. As seen in Figure 3, significant changes to corporate balance sheets and enlarged leverage profiles have occurred across investment grade rated issuers. Given low interest rates, corporations increased debt loads in part to buyback shares of stock. This phenomenon led to rating agencies considering prospects for future growth in their ratings. Quick monetary and fiscal action may provide the necessary support to constrained issuers. However, investors took no comfort in the sector. Broad credit fell 3.6% and high yield dropped 13.1% during the quarter.

Securitized Credit Used As Liquidity

Securitized sectors were not immune to market volatility. Despite better underwriting and stronger fundamentals, liquidity-driven selling resulted in significant spread widening, even in government backed sectors. Policy intervention relieved a lot of the pressure, though concerns remained about lower quality consumer-backed debt. Given the increased economic uncertainty and jobless claims, the pressure was somewhat warranted.

Municipals Underperform In Q1

Municipal bonds returned -0.6% in Q1, lagging taxable peers by a wide margin. Municipal securities saw broad selling pressure and experienced a significant outflow of assets this quarter. High yield municipal bonds were the worst performing sector, down -6.9% while the high-quality nature of pre-refunded municipal bonds cushioned downside price action and delivered a return of 0.02% in Q1.

Figure 3: Debt to EBITDA for Investment Grade Corporate Issuers

Source: J.P. Morgan, TCW, Bloomberg
Appendix Definitions and Disclosures

Benchmark and Asset Class Definitions

S&P 500 Index (Large Cap / U.S. Stocks): A representative sample of 500 leading companies in leading industries of the U.S. economy. These are equity securities of large capitalization (generally $7 billion plus market cap) companies having growth and value characteristics.

Russell 3000° Growth Index (All Cap Growth / Growth Stocks): Measures the performance of the 3,000 largest U.S. companies based on total market capitalization with higher price-to-book ratios and higher forecasted growth values.

Russell 3000° Value Index (All Cap Value / Value Stocks): Measures the performance of the 3,000 largest U.S. companies based on total market capitalization with lower price-to-book ratios and lower forecasted growth values.

Russell 1000° Growth (Large Growth): Measures the performance of those Russell 1000° Index companies with higher price-to-book ratios and higher forecasted growth values. These are equity securities of large capitalization ($7 billion plus market cap) companies having growth stock characteristics (high price to earnings, high return on equity and low dividend yield).

Russell 1000° Value Index (Large Value): Measures the performance of those Russell 1000° Index companies with lower price-to-book ratios and lower forecasted growth values. These are equity securities of large capitalization ($7 billion plus market cap) companies having value stock characteristics (low forecasted price-to-earnings ratio, low price-to-book ratio, high dividend yield).

Russell Midcap® Index (Mid Cap / Mid Core): Measures the performance of the 800 smallest companies of the Russell 1000° Index, which represent approximately 31% of the total market capitalization of the Russell 1000° Index. These are equity securities of middle capitalization ($2-7 billion plus market cap) companies having growth and value characteristics.

Russell 2000° Index (Small Cap / Small Core): Measures the performance of the 2,000 smallest companies in the Russell 3000° Index, which represent approximately 10% of the total market capitalization of the Russell 3000° Index. These are equity securities of small capitalization (<$2 billion plus market cap) companies having growth and value characteristics.

Russell Micro Cap Index (Micro Cap): Measures the performance of the 1,000 smallest companies in the Russell 2000° Index, which represent approximately 3% of the total market capitalization of the Russell 3000° Index.

MSCI EAFE Index Net (International / Developed Markets): A free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. As of May 27, 2010 the MSCI EAFE Index consisted of the following 22 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

FTSE 3-month T-bill index (Cash): This index measures monthly return equivalents of yield averages that are not marked to market. It consists of the last one-month and three-month Treasury bill prices, respectively.

Bloomberg Commodity Index (Commodities): Composed of commodities traded on U.S. exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metal Exchange (LME). Sub-indices include Petroleum, Grains, Industrial Metals, Livestock, Precious Metals, and Softs.

MSCI Emerging Markets Index Net (Emerging Markets): A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of May 27, 2010 the MSCI Emerging Markets Index consisted of the following 21 emerging market country indices.

MSCI Country Indices (Country-Specific Markets): To construct an MSCI Country Index, every listed security in the market is identified. Securities are free float adjusted, classified in accordance with the Global Industry Classification Standard (GICS®), and screened by size and liquidity. MSCI then constructs its indices by targeting for index inclusion 85% of the free float adjusted market capitalization in each industry group, within each country. By targeting 85% of each industry group, the MSCI Country Index captures 85% of the total country market capitalization while it accurately reflects the economic diversity of the market. This includes the MSCI Japan Index. International indices.

BBgBarc Aggregate Bond Index (Global Bonds): Provides a broad-based measure of the global investment-grade fixed income markets. The three major components of this index are the U.S. Aggregate, the Pan-European Aggregate, and the Asian-Pacific Aggregate Indices. The index also includes Eurodollar and Euro-Yen corporate bonds, Canadian government, agency and corporate securities, and USD investment grade 144A securities.

BBgBarc Muni Bond Index (Municipal Bonds): Bonds must have a minimum credit rating of at least Baa, an outstanding par value of at least $3 million, part of a transaction of at least $50 million, issued after December 31, 1990 and have a year or longer remaining maturity.

BBgBarc U.S. High Yield Bond Index (High Yield): Covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets (e.g., Argentina, Brazil, Venezuela, etc.) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeros, step-up coupon structures, 144As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included.

BBgBarc U.S. Treasury Bond Index (Treasury Bonds): Comprised of U.S Treasury securities with at least one-year maturities.
Appendix Definitions and Disclosures

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