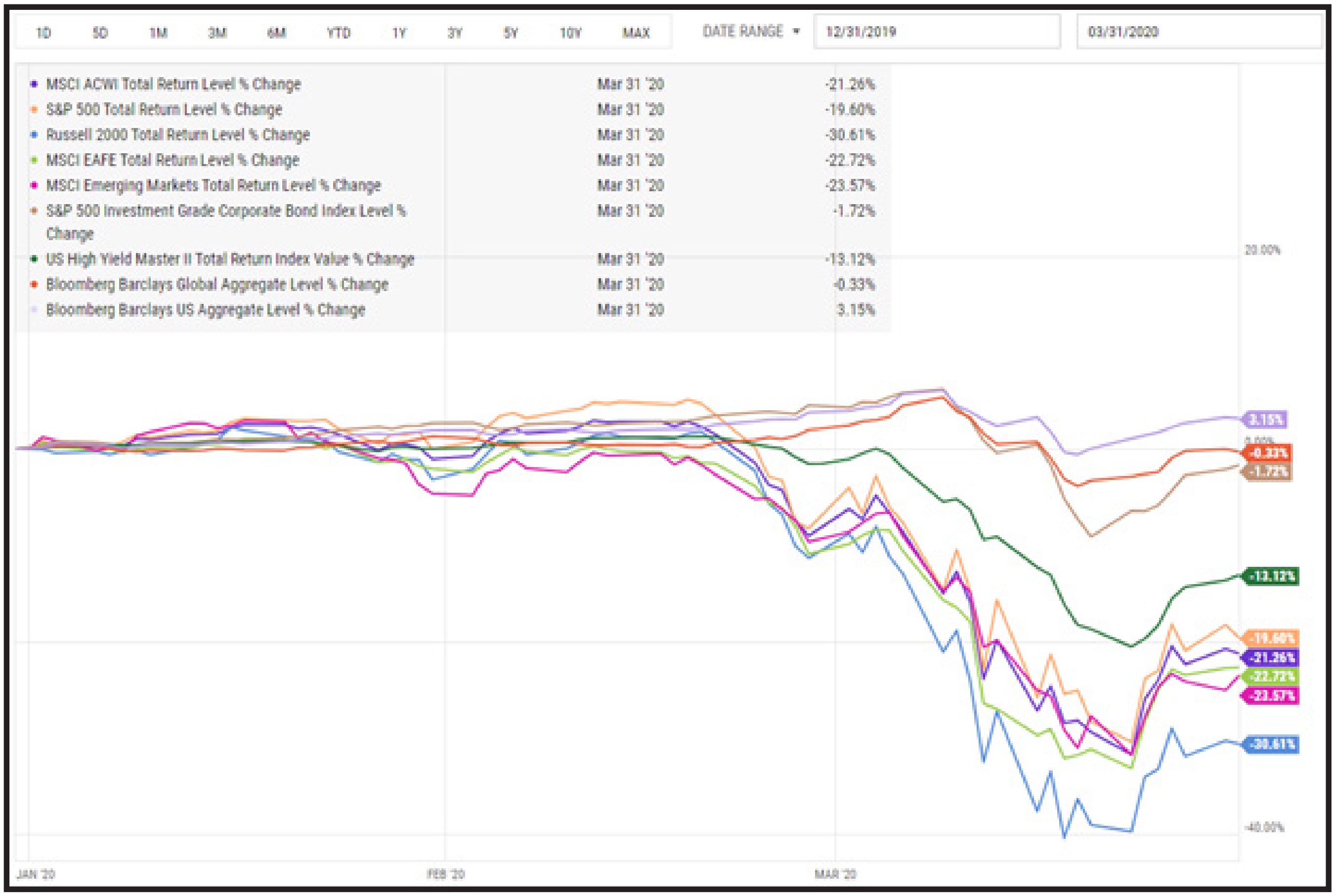
QUARTERLY INVESTMENT REPORT
Q1 2020

For many participants in global markets, early 2020 was shaping up to be another solid year—global financial markets had come off one of their best years in the cycle, earnings growth was projected to grow at a meaningful pace (~10% according to FactSet), and despite signs of global growth moderating, very few were predicting a recession in 2020. Then the coronavirus (COVID-19 for short) really started to the markets in late January and the chaos began—the proverbial punch to the mouth landed cleanly.

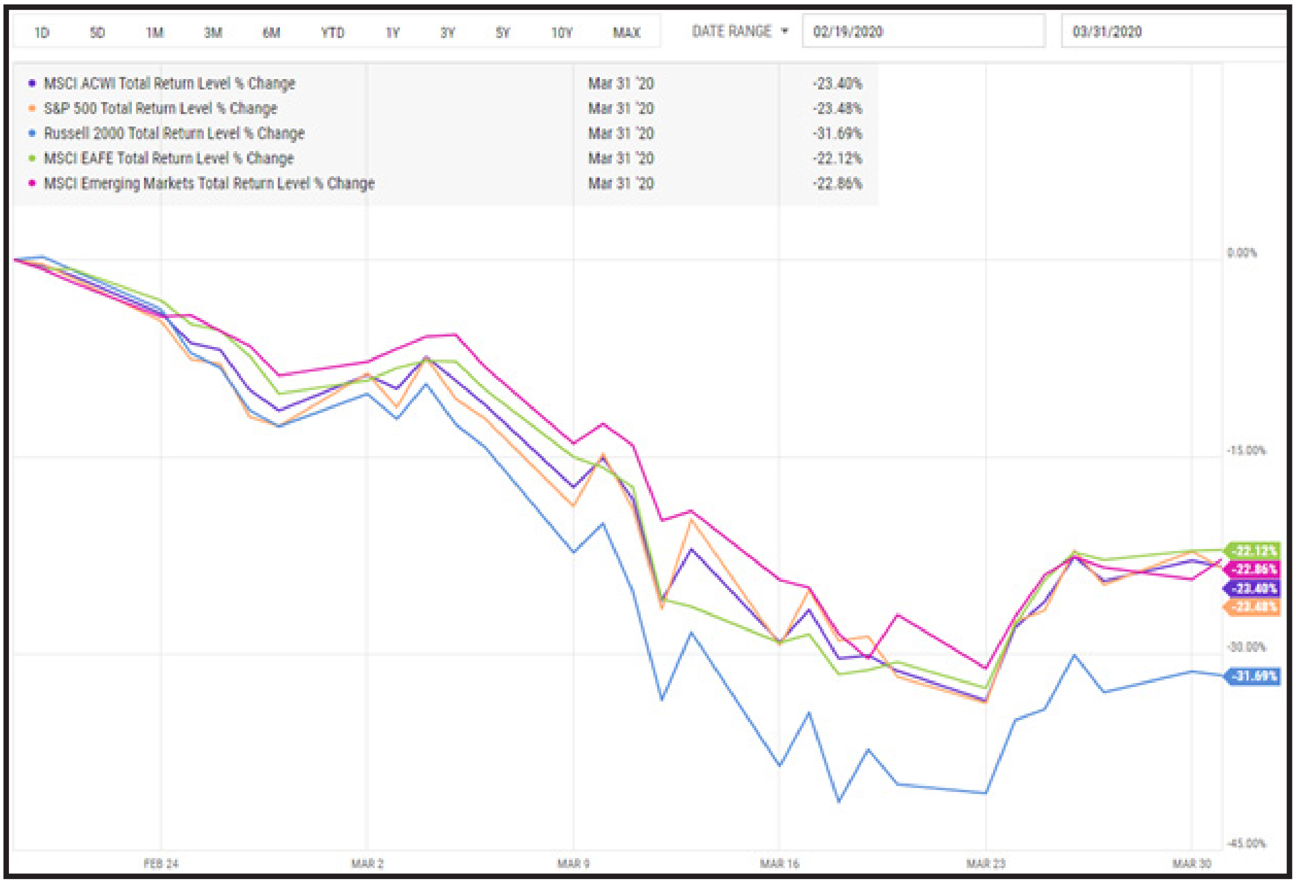
Markets and US Economy

For the first quarter, global equity market indices were sharply negative while fixed income indices were not as much as a safe haven as one might often expect. Credit sold off sharply during the February and March decline, while Treasuries outperformed—though also not without volatility.



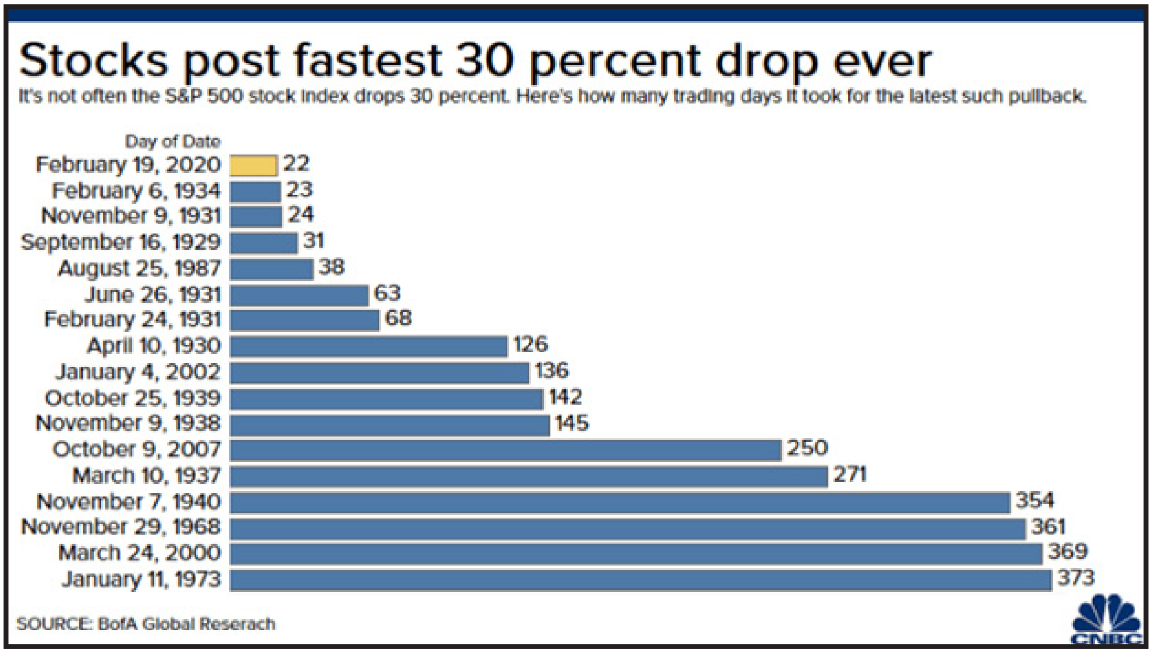
Source: YCharts

During the rout of February 19th through March 31st, there were very few places for investors to hide. Despite staging a late March rally—and though ending the month on a negative note—major equity indices were down across the board. Global stocks, as measured by the MSCI All Country World Index, lost 23.4%, the S&P 500 gave up 23.5%, the Russell 2000 dropped 31.7%, the MSCI EAFE Index lost 22.1%, and the MSCI Emerging Markets Index shed 22.9% in this period; and yet, the late March rally masked how steep the price decline was.

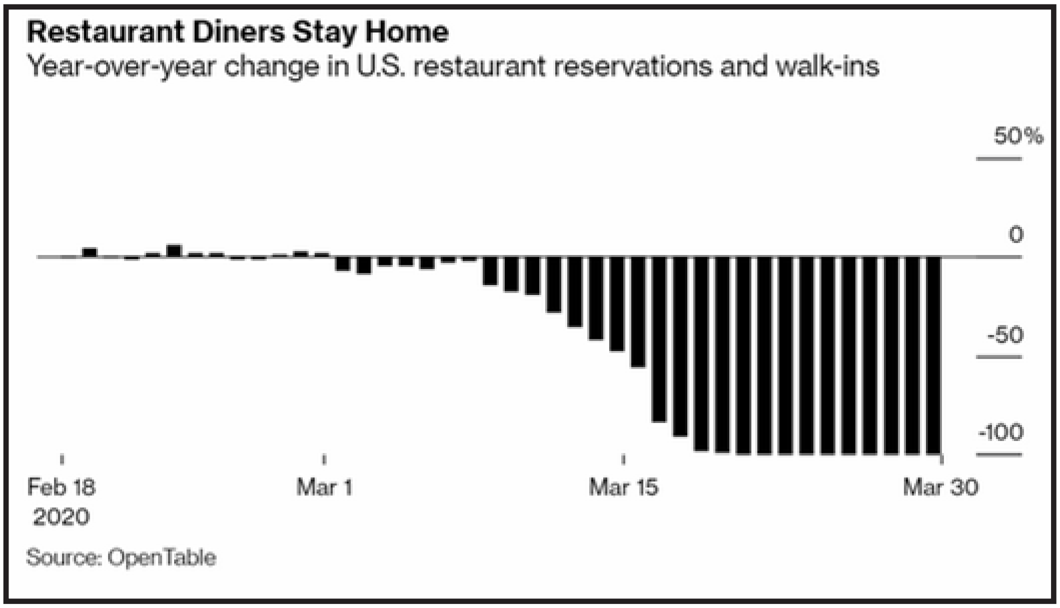


Source: YCharts

The S&P 500—which peaked on February 19 at 3,393.52—fell a whopping 35.4% to a low of 2,191.86 on March 23 (source: Yahoo Finance). As noted by Bank of America Global Research, this was the fastest 30% drop in the S&P 500's history, taking just 22 trading days, eclipsing the previous record set in the Great Depression. This extreme sell-off was driven by a variety of factors in our opinion, including sheer panic and a flight to cash, downwards earnings and economic data revisions as a result of COVID-19, and actions taken by governments around to help curb the spread of the virus.

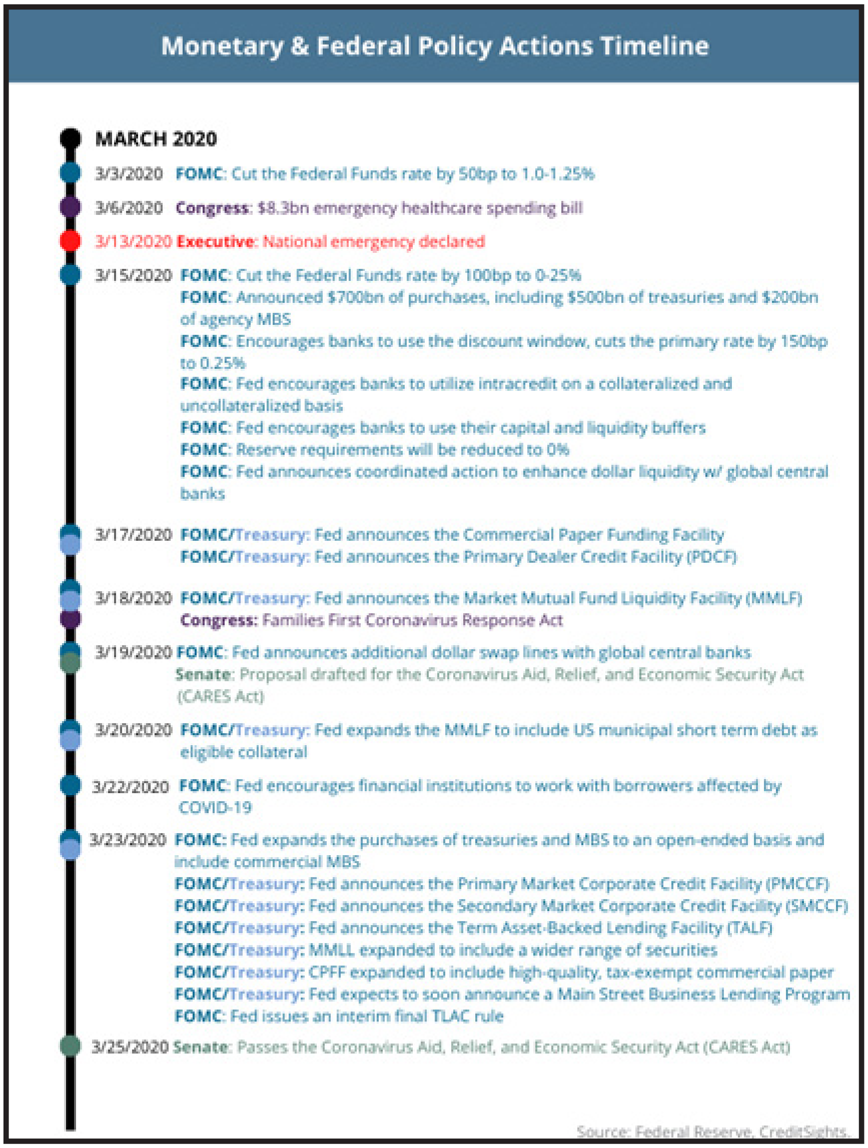


As one might imagine, the dramatic spread of the virus and the plunge in equity markets led fiscal and monetary authorities across the globe to throw their proverbial kitchen sinks at COVID-19. In the US, the federal government declared a state of emergency as state and local governments rapidly began issuing social distancing decrees and in many cases, shelter in place orders. Bars, restaurants, and other places of leisure closed at record speeds, leaving many small business owners scrambling.



In an attempt to help offset the impacts of these shutdowns, the US government rolled out a $2 trillion stimulus package that included support for a variety of sectors and industries hurt by actions meant to stop the spread of COVID-19. In addition, the stimulus bill also included direct payments to certain US citizens, a huge increase in unemployment benefits, and $350 billion in loans for small business.

For the US Federal Reserve's part, massive actions were taken to help shore up the financial system, including steps aimed at supporting credit, municipal, and money markets. Below is a very helpful chart summarizing the actions taken by US fiscal and monetary authorities to combat the economic fallout from COVID-19:



What is shocking to note is that despite these actions taken by the powers that be, it is increasingly likely that more stimulus will be needed in our opinion. In a late March DoubleLine Capital webcast, DoubleLine CEO and Chief Investment Officer Jeffrey Gundlach said in regards to the Fed “there’s another sink coming” while noting that the federal government will likely have to send money to both state and local governments. What’s more, while Senate Majority Leader Mitch McConnell is wanting a pause on any further legislative activity to see how the current stimulus package plays out, both President Trump and House Majority Leader Nancy Pelosi have called for additional stimulus, including an infrastructure package.

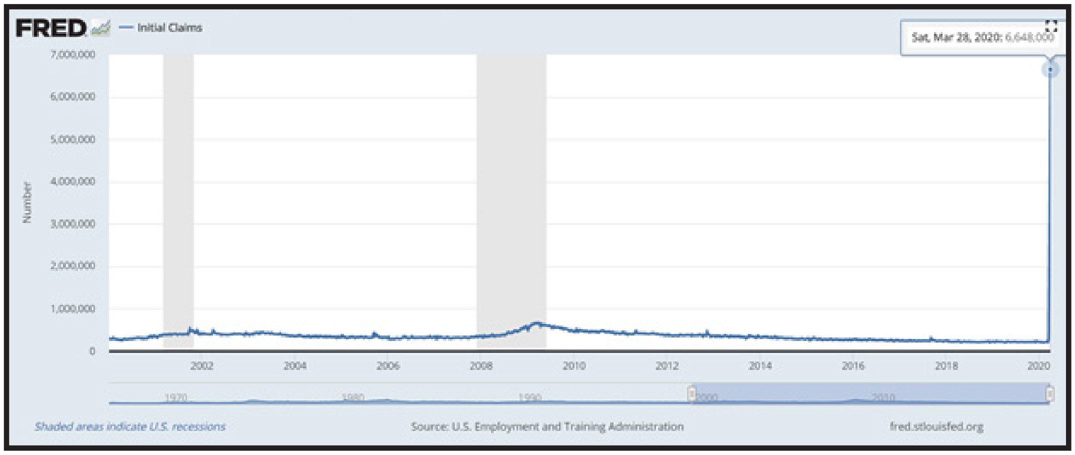
Undoubtedly, both investors and politicians are trying to front run what could be the worst quarter of GDP on record. A survey of various economic teams conducted by Charles Schwab shows just how brutal the next several months could be (note also some of these banks, like Morgan Stanley, have since revised their estimates lower):

Firm	2Q2020 GDP estimate
Bloomberg Economics	-9.0%
UBS	-9.5%
Pantheon	-10.0%
Strategas	-10.0%
Cornerstone Macro	-11.0%
Oxford Economics	-11.9%
Citigroup	-12.0%
Credit Suisse	-12.0%
Bank of America Merrill Lynch	-12.0%
Deutsche Bank	-12.9%
IHS Markit	-13.0%
Wells Fargo	-14.7%
TSLombard	-17.7%
Evercore ISI	-20.0%
JPMorgan	-25.0%
Morgan Stanley	-30.1%
Goldman Sachs	-34.0%
Capital Economics	-40.0%

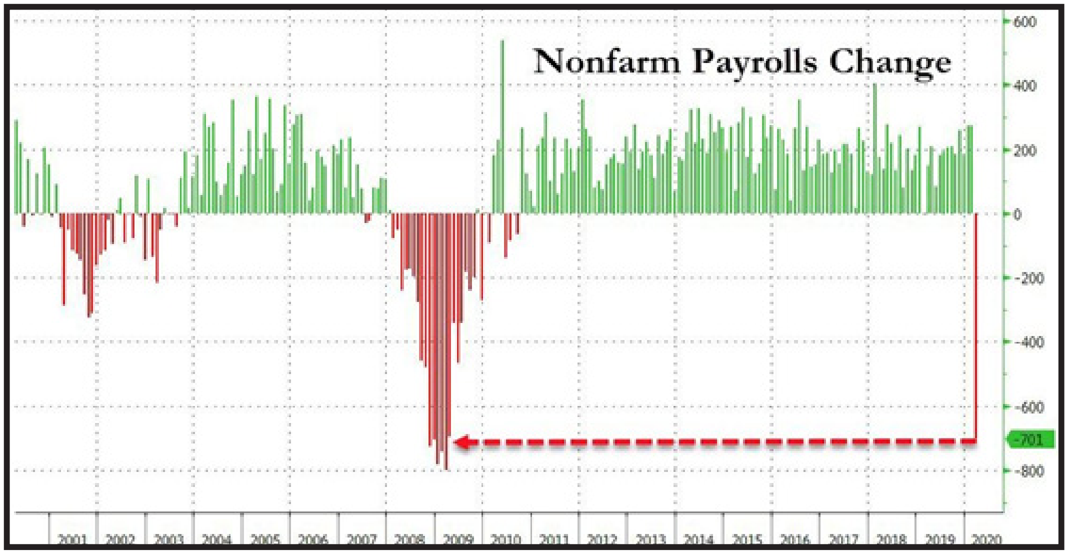
Source: Charles Schwab

As we begin April, US companies will en masse start reporting first quarter earnings and providing updates on the demand outlook, and this, in conjunction with more economic data, should help provide a clearer picture on just how gargantuan the COVID-19 impact has been and what the future may hold.

To be sure, the data released thus far has been very painful, and very likely to get worse in our estimation—the ADP private-sector employment numbers decreased by 27,000 from February to March on a seasonally adjusted basis, and the group expects much worse numbers in the coming months. Likewise, the two most recent unemployment insurance claims reports were record-breaking, with the March 26th report of 3.3 million claims shattering the weekly record of 665,000 claims seen in the Great Recession. The April 2nd report showed an even more startling number, as an additional 6.6 million people filed unemployment claims, bringing the two week total to an astonishing 10 million. Capital Economics estimates that based on these two weeks alone, the employment rate may have fallen by more than 6% and the April unemployment rate could climb to 10%, while Morgan Stanley says the rate could top out around 13%.

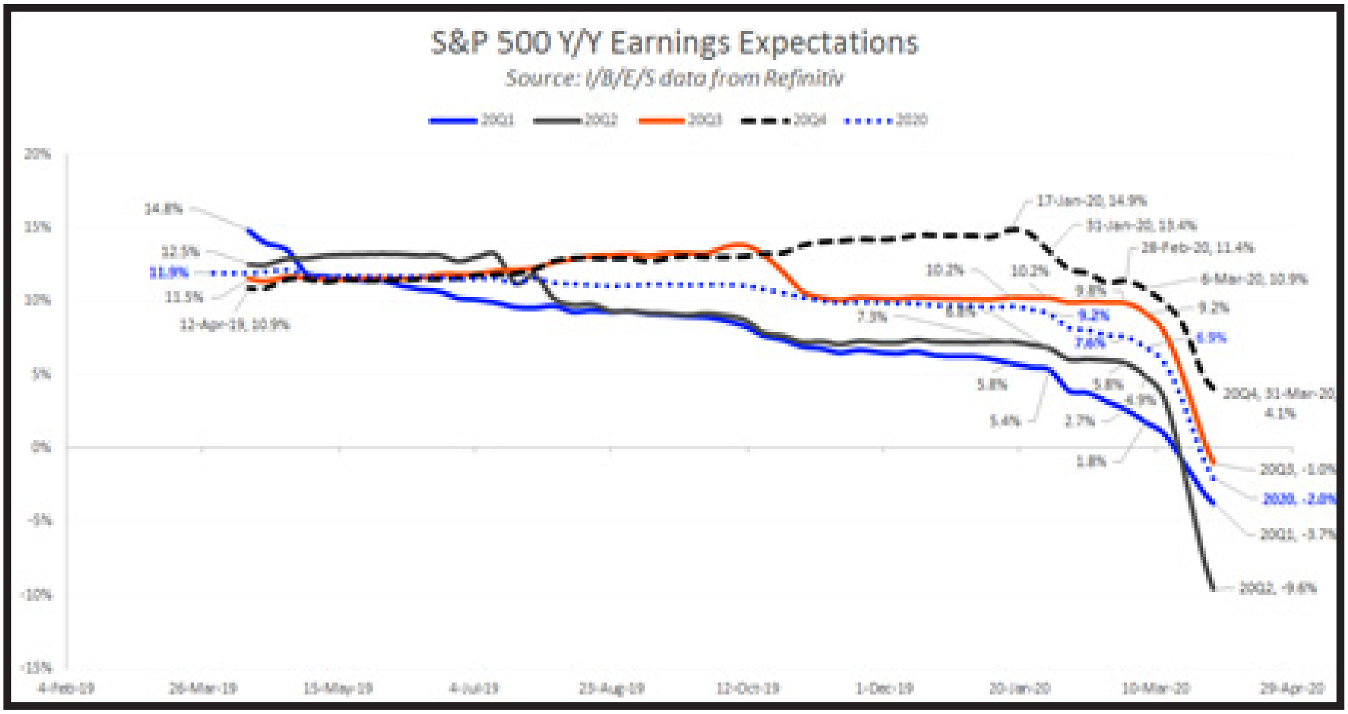


The Bureau of Labor Statistics (BLS) March employment report indicated that more pain is ahead for the US job market, as the US shed over 700,000 jobs in March, erasing months of payroll gains. Commenting on the BLS report, Capital Economics notes: “The impact was even more pronounced in the household survey, which showed a drop in employment of close to three million, causing the unemployment rate to jump to 4.4%, from 3.5%. But that rise would have been even higher if it wasn’t for a 1.6 million decline in the labor force. Furthermore, the BLS admits that without errors in recording some respondents as absent from work, and hence still counted as employed in the household survey, rather than on a temporary layoff, the unemployment rate would have risen to nearer 5.4% last month.”



Source: ZeroHedge, BLS

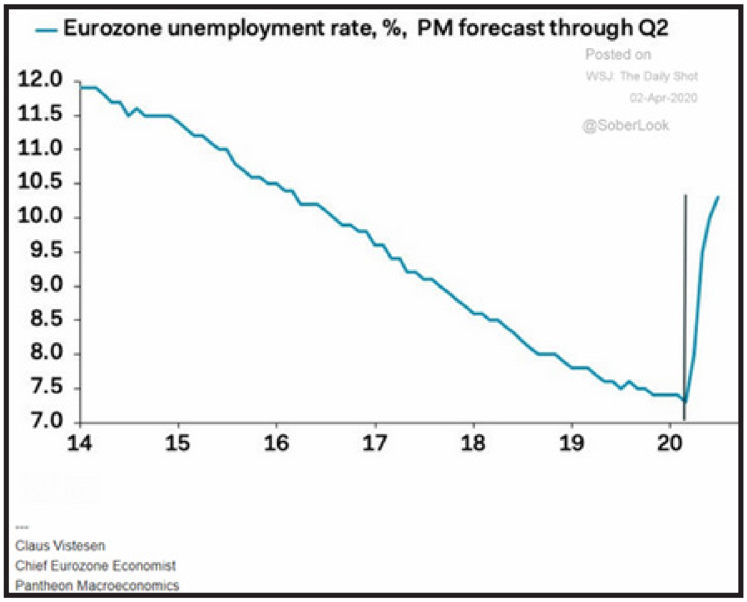
As we have written about extensively, the US economy hangs on the US consumer and right now, it appears that the US consumer is holding on by a thread. A recession at this point seems baked into the cake—what matters now is how long this recession will last, and just as importantly, how quickly the US economy and financial markets can bounce back. Lastly, turning to corporate America, earnings revisions have understandably plummeted, with sectors such as energy, transportation, travel and leisure, and automotive falling the most. According to data from Refinitiv, 2Q 2020 earnings are expected to fall nearly 10%, with full year earnings growth falling 2%.



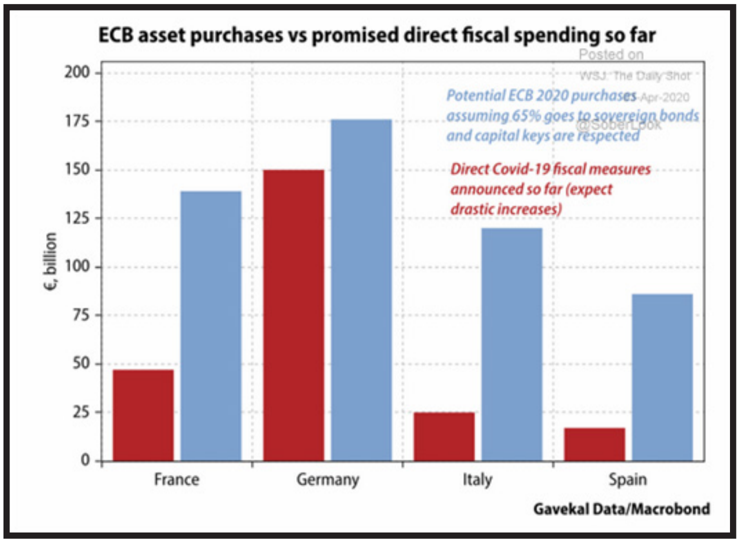
International Markets and Economy

As the famous boxer Mike Tyson so eloquently put it, “Everyone has a plan until they get punched in the mouth.” This statement couldn’t have been truer for the US economy, and it unfortunately is no different when it comes to global economies. To be sure, some countries have had success in containing COVID-19 quickly—such as South Korea—while others have struggled—Italy, for example. Of course, this is due to a variety of factors, some political, some demographic, some due to resources, and so on. What is true across the board is that every economy has been severely impacted.

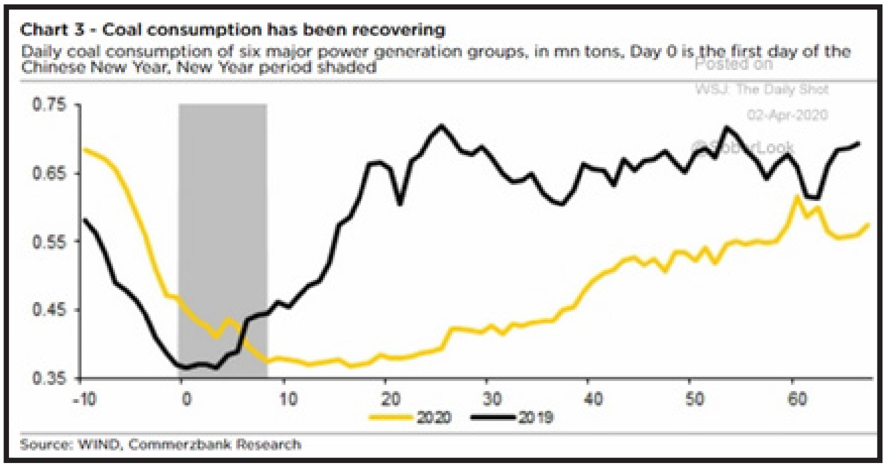
IHS Markit PMIs were disastrous throughout international economies, and there will very likely be further deterioration. The Eurozone final services and composite PMIs pointed to as much as a 10% annualized contraction in the GDP, according to IHS Markit. In terms of service PMIs, Germany's was the best at 31.7—as a reminder, 50 is the "flat growth" threshold. France and Spain were 27.4 and 23.0, respectively, while Italy's unsurprisingly was the worst of the major EU states, at 17.4. The UK's results were no better, as the fallout from COVID-19 greatly hurt the Kingdom's business sector. The services PMI fell to 34.5 from 53.2 in February, and the composite plunged to 36.0 from 53.0 in February. According to Claus Vistesen, Chief Eurozone Economist at Pantheon Macroeconomics, the second quarter Eurozone unemployment rate could jump to over 10%:



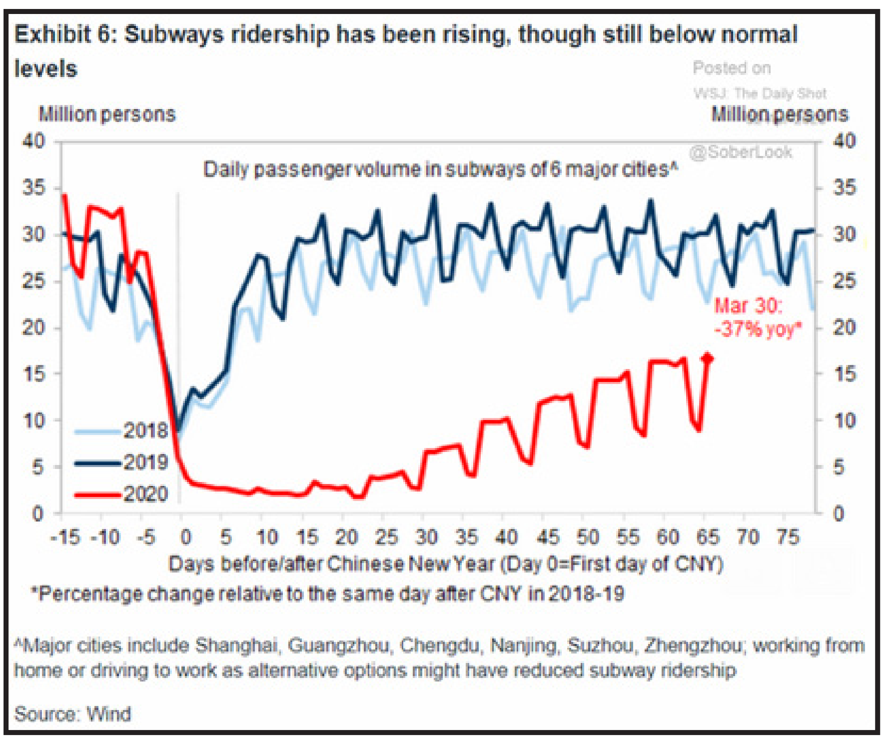
As with the US authorities, the European Central Bank, Bank of England, and fiscal powers were quick to provide monetary and fiscal support. Though the European stimulus doesn't appear to be at the levels seen in the US (yet), the size is certainly impressive and underscores how dire the situation in Europe is:



Turning finally to China, various data points and anecdotal evidence shows that the Chinese economy appears to be getting back on track. According to Commerzbank Research, coal consumption is on the rise, a sign that business activity and transportation is begging to resume:



In addition, subway ridership is on the rise—still below pre-virus levels, but a good sign, nonetheless:



Anecdotally, AerCap, the world's largest aircraft lessor with meaningful exposure to Chinese airlines, said in a March conference call that travel demand was beginning to return to Chinese skies and that load factors—a measure of how full planes are—are starting to turn around. Though these data points don't indicate that China is already back to pre-virus economy activity, it is a much-needed reminder that the impacts will not last forever, and eventually, things will return to normal.

PRIVATE WEALTH MANAGEMENT

DAVID YOUNG, CFA
Investment Management Director
Private Wealth Management

CHAD MAZE
President
Private Wealth Management

NORTH DAKOTA/ MINNESOTA
(701) 298-4100

PRIVATE WEALTH MANAGEMENT

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