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MARKET MATTERS

WEEKLY INVESTOR UPDATE June 3, 2020

Executive Summary

- American cities are trying to cope with civil unrest against social injustices.
- Officials fear that protests will lead to spikes in COVID-19 cases.
- There is a wide dispersion in financial strength among emerging markets, which could warrant active management.
- U.S. equity markets continue to go up, seemingly looking past the civil unrest.
- Equities are priced for a quick V-shaped recovery, which becomes less likely the longer the virus continues to spread and the longer unemployment and consumer confidence remain weak.

COVID-19 Update: A Week of Civil Unrest

Leaders in many American cities are trying to cope with the civil unrest and outrage of protestors wanting to highlight social injustices within the criminal justice system. The unrest, which erupted as the country was reopening after lengthy lockdowns meant to slow the spread of the coronavirus, began with peaceful protests over the death of George Floyd, who died while police were arresting him in Minneapolis on May 25. In the days since, protests have turned increasingly violent. Videos of officers kneeling on Mr. Floyd for an extended period sparked the outrage.

The size of the protesting crowds makes social distancing next to impossible. Officials are now concerned that the protests will lead to spikes in COVID-19 cases[1] on the heels of many "hotspots" showing progress with declining new cases in the last 14 days, such as New York, Washington, DC, and Massachusetts.[2] Although the overall number of new daily cases has been trending downward in the U.S., the virus continues to circulate widely with close to 1.8 million confirmed cases. World-wide, new daily cases have been trending up since mid-May after having flattened somewhat. Throughout the world, we've seen a total of over six million confirmed cases.[3] The next few weeks will show if the protesting crowds will have an impact on new infections in the U.S and abroad.

On June 1, the U.S. entered into a $628 million contract with drug maker Emergent BioSolutions to boost manufacturing capacity for a potential COVID-19 vaccine. This is a move meant to help

[1] "Officials Fear U.S. Protests Will Spread Coronavirus; No New Deaths in Spain," *Wall Street Journal*. June 1, 2020.
[2] "Coronavirus in the U.S.: Latest Map and Case Count," *The New York Times*. Visited June 1, 2020.
[3] "COVID-19 Dashboard," Johns Hopkins University & Medicine Coronavirus Resource Center. Visited June 1, 2020.

ensure that when a vaccine is ready, it can be mass produced and distributed quickly.[4] In an additional medical advancement, scientists at Britain's Francis Click Institute found proteins that are present in various levels of coronavirus patients, which they say could act as a predicative indicator for how sick a patient will become. This information will help doctors best manage the disease for each infected patient.[5]

Economic Update: EM Financial Strength

A couple of weeks ago, Argentina defaulted on its sovereign debt for the ninth time. The country was already on bad footing when COVID-19 hit and the pandemic exacerbated the financial stress.[6] Emerging markets in general are less equipped than the U.S. and other developed markets to provide monetary and fiscal support to their economies. About a month ago, *The Economist* ranked the financial strength of 66 emerging markets based on public debt, foreign debt, cost of borrowing, and reserves.[7] Below we present an excerpt, with blue representing relative strength and orange representing relative weakness.

Rank	Country	Rank	Country
1	Botswana	18	India
2	Taiwan	28	Mexico
3	South Korea	30	Brazil
4	Peru	47	South Africa
5	Russia	57	Argentina
10	China	66	Venezuela

Source: *The Economist*

It is important to note that the weakest economies represent only a small portion of global GDP. Nonetheless, with such a wide dispersion in financial strength, an argument could be made for active management when investing in emerging market equity or debt.

Market Index Trailing Total Returns				
as of 6/2/2020	**MTD**	**YTD**	**1 Year**	**3 Year**
S&P 500	1.21%	-3.82%	14.20%	10.26%
Russell 2000	1.74%	-14.49%	-1.76%	1.70%
MSCI EAFE USD	2.82%	-11.85%	-0.08%	0.09%
MSCI Emerging Markets USD	4.05%	-12.56%	-0.52%	0.84%
Bloomberg Barclays U.S. Agg Bond	-0.05%	5.42%	9.37%	4.98%
Bloomberg Barc U.S. Corp High Yield	0.99%	-3.79%	2.32%	3.31%
Bloomberg Barc Global Agg Bond USD	0.31%	-0.09%	2.98%	2.21%

Periods longer than a year are annualized. Returns include dividends or interest. Source: Morningstar.

[4] "U.S. awards new $628 mln contract to boost output of potential COVID-19 vaccine," Nasdaq. June 1, 2020.
[5] "Proteins in COVID-19 patients' blood could predict severity of illness, study finds," *Reuters*. June 2, 2020.
[6] "Argentina Defaults on Sovereign Debt Amid Coronavirus Crisis," *Wall Street Journal*. May 22, 2020.
[7] "Which emerging markets are in most financial peril?" *The Economist*. May 2, 2020.

Market Update: Markets Look Past Protests

U.S. equities have increased in five out of the last six trading days as investors look to lockdowns easing across the country. Investors seem to be looking past the civil unrest currently engulfing the U.S., indicating that the protests are not expected to negatively impact corporate profits.[8] Markets may not be looking at headline risk at this moment, but instead are focusing on improving economic numbers, such as the Institute for Supply Management's manufacturing index reading for May, which increased to 43.1 from 41.5 in April.

In fixed-income markets, major companies are taking advantage of record low rates. Amazon issued $10 billion in various debt offerings, including a three-year $1 billion offering yielding 0.4%, which is a record low in U.S. corporate bond history.[9]

Review of Key Economic Indicators

The economic data for April and May continued to show that the U.S. and much of the global economy continue to be in the middle of a deep economic recession. During May, states began to relax certain retail and other restrictions that were put in place due to COVID-19. But certain measures, such as social distancing, remain in place and economic activity remains well below healthy levels.

Central banks globally have continued to provide large amounts of stimulus into the economy through asset purchases and very low interest rates. Meanwhile, governments have also provided fiscal stimulus through tax and cash incentives along with enhanced unemployment benefits to many individuals and businesses. These combined monetary and fiscal stimulus efforts have likely softened the impact of the recession to date on both equity and fixed-income markets.

Equity markets had another strong month in May and, as a result, most valuation models show that U.S. equities are now overvalued based strictly upon valuation metrics. We continue to believe that equity markets are now requiring a V-shaped economic recovery to be able to sustain or grow current valuations.

We still believe it's possible, but not likely, that a very sharp but short recession occurs (V-shaped). However, the longer that the virus continues to spread and unemployment and consumer confidence data remains weak, the more challenging it will be for the U.S. economy to thrive.

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[8] "Dow closes 267 points higher as Wall Street focuses on easing coronavirus lockdowns amid civil unrest," *Wall Street Journal*. June 2, 2020.

[9] "Amazon raised $10 billion in the bond markets, including $1 billion of debt yielding just 0.4% — reportedly the lowest rate in the history of US corporate bonds (AMZN)," *Business Insider*. June 2, 2020.

In this time of great uncertainty, it is important to be invested in a highly diversified portfolio. Those with short-term investment horizons will likely continue to face heightened volatility. At the same time, those with intermediate and long-term investment horizons may find very attractive opportunities that have presented themselves in financial markets.

We are here to support you and navigate these times of uncertainty together. Knowledge is power, and we're committed to equipping you and your financial professional with the tools and information you need to weather this storm. We are continuing to watch market developments and are here to assist you with evaluating and understanding these economic changes. Please contact your financial professional to discuss your portfolio or should you have any questions/concerns.

Investing involves risk, including the potential loss of principal. No investment strategy can guarantee a profit or protect again loss. In general, the bond market is volatile; bond prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed-income security sold or redeemed prior to maturity may be subject to a substantial gain or loss. Vehicles that invest in lower-rated debt securities (commonly referred to as junk bonds or high-yield bonds) involve additional risks because of the lower credit quality of the securities in the portfolio. International investing involves special risks not present with U.S. investments due to factors such as increased volatility, currency fluctuation, and differences in auditing and other financial standards. These risks can be accentuated in emerging markets.

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