Capital Markets Review
First Quarter 2020

STRATEGIC ASSET ALLIANCE

THE INSURANCE INVESTMENT SPECIALIST

Summary Capital Market Commentary – 1st Quarter 2020

- **The spread of Covid-19 profoundly affected global markets in the first quarter. Equities suffered steep declines as uncertainty rocketed higher causing investors to flee toward safe-haven assets and their perceived safety. Governments and central banks announced unprecedented support programs for businesses, households and the financial system, helping to stabilize markets late March.**

- GLOBAL FINANCIAL MARKETS – EQUITIES & COMMODITIES
  - Shares fell across developed markets as coronavirus spread and countries went into lockdown to try to contain the outbreak.
    - US equities declined significantly over the quarter as the coronavirus outbreak spread. Confirmed US cases of Covid-19 rose from 150 to over 100,000 between 4 March and 27 March, and the economic impact grew clearer. Jobless claims rocketed by over three million in the last week of March and economic indicators suggest more pain will follow.
    - Eurozone equities experienced a sharp fall in Q1 due to the spread of coronavirus. Italy and Spain became some of the most severely affected countries. Nations across Europe took steps to restrict the movement of people and shut down parts of the economy in an effort to slow the spread of the virus. Growth in Europe was already fragile - the eurozone economy grew by just 0.1% in Q4 2019, with Germany registering zero growth. A sharp economic downturn is expected.
    - Emerging market (EM) equities also tumbled, slightly underperforming developed markets as a strong US dollar proved to be an additional headwind.
  - In commodities, oil prices plunged as the spread of coronavirus weakened the outlook for demand, at the same time as there was a breakdown of an agreement between oil producers to constrain supply. Industrial metals also fell, led by copper, as the demand outlook deteriorated. The agriculture component posted a negative return with cotton and sugar prices falling heavily. Conversely, precious metals generated a small gain, aided by an increase in gold prices.

Source: Schroders & SAA

Summary Capital Market Commentary – 1st Quarter 2020

- **The spread of Covid-19 profoundly affected global markets in the first quarter. Equities suffered steep declines as uncertainty rocketed higher causing investors to flee toward safe-haven assets and their perceived safety. Governments and central banks announced unprecedented support programs for businesses, households and the financial system, helping to stabilize markets late March.**

- GLOBAL FINANCIAL MARKETS – FIXED INCOME
  - Government bond yields declined over the quarter, meaning bond prices rose, as higher risk assets such as shares saw heavy declines amid rising fears over the Covid-19 pandemic. Investors favored the perceived safety of government bonds due to the growing likelihood of a deep global recession. The moves largely occurred in late-February and March as numerous countries went into lockdown in response to the pandemic, seriously depressing economic activity. This resulted in severe declines and extreme daily swings in assets prices on a scale comparable to the crises of 2008 and 2011.
    - The US 10-year yield dropped from 1.92% to 0.63% over the quarter, while the two-year yield dropped from 1.57% to 0.23%. Jobless claims rocketed by over three million in the last week of March with an additional thirteen million through the second week of April.
    - The German 10-year yield fell from -0.19% to -0.49%, France's from 0.12% to 0%. The Italian 10-year yield rose from 1.41% to 1.57%. Spain's increased from 0.47% to 0.71%. The UK 10-year yield fell from 0.82% to 0.32%
    - Corporate bonds, and emerging market debt and currencies declined significantly, mainly in March, and underperformed government bonds, with moves exacerbated by a sharp tightening in liquidity. For several days, companies were unable to issue bonds although this improved later in the month. US investment grade bonds ultimately saw a record month of issuance in March, as the Federal Reserve announced it would buy corporate bonds.

Source: Schroders & SAA

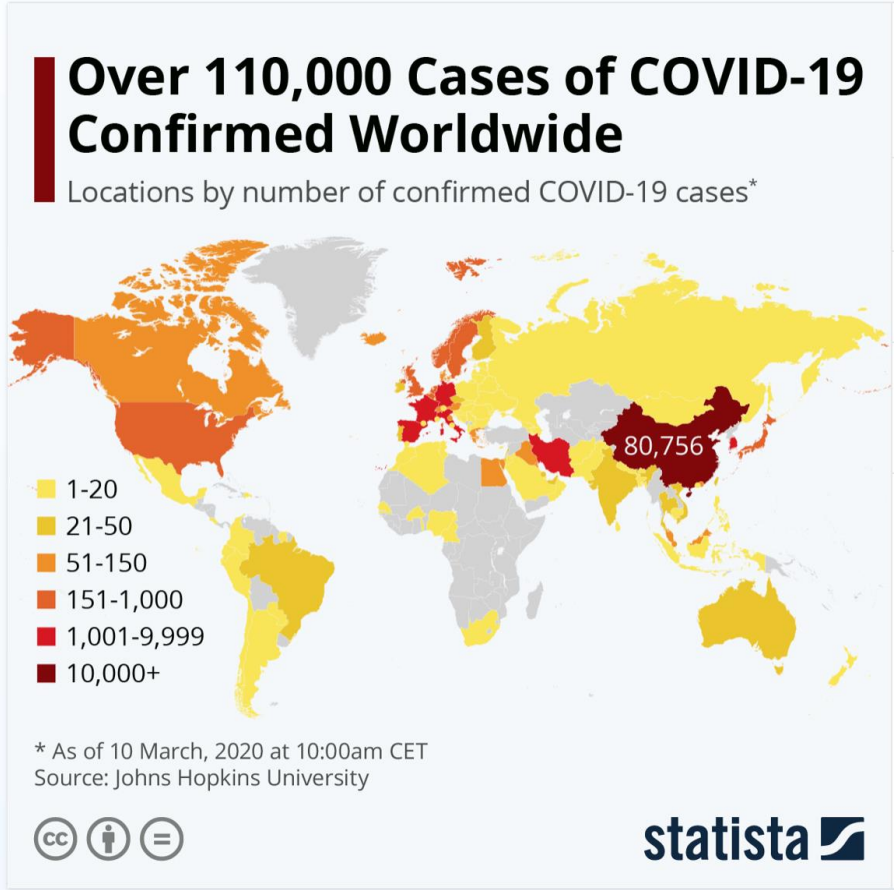
Capital Markets' Performance

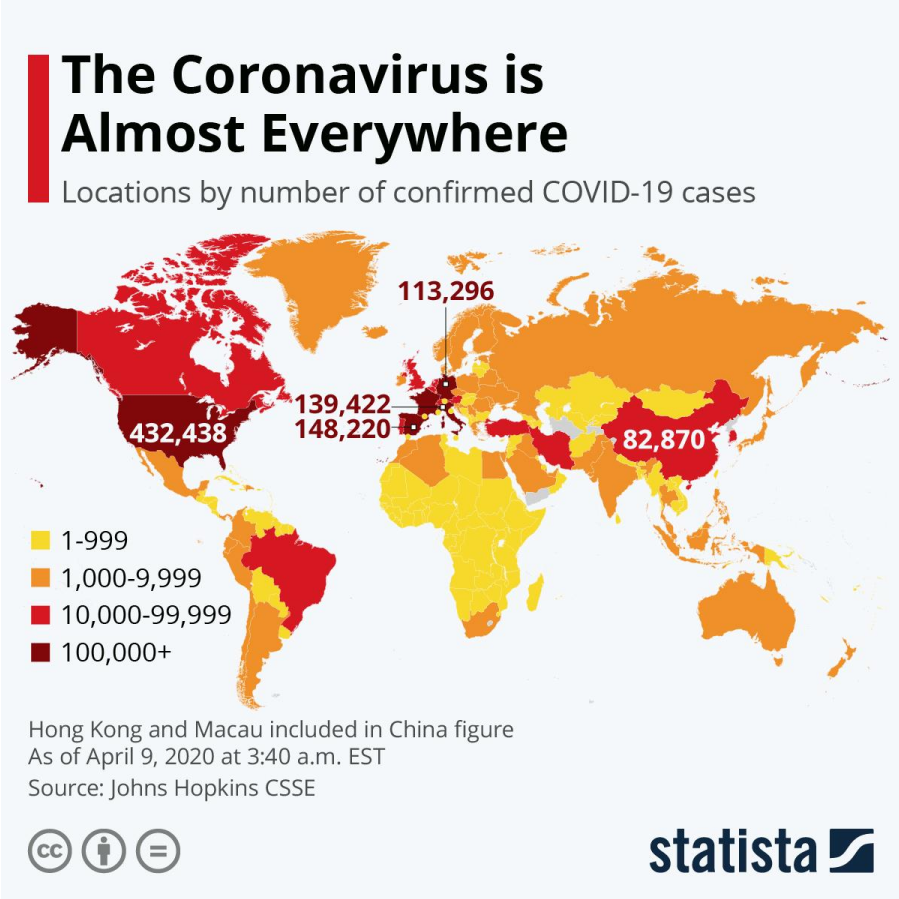
Index	Asset Class	Jan-20	Feb-20	Mar-20	Q1'20	Trailing 1 Yr	Trailing 3 Yr	Trailing 5 Yr
10-Year US Treasury	U.S. Treasury	3.71%	3.62%	4.16%	**11.93%**	18.25%	7.27%	4.08%
Merrill Lynch US Treasury Master	U.S. Fixed Income	2.56%	2.73%	3.26%	**8.80%**	13.92%	6.08%	3.79%
5-Year US Treasury	U.S. Treasury	1.83%	2.07%	2.62%	**6.66%**	10.88%	4.74%	2.96%
Barclays U.S. Government/Credit	U.S. Fixed Income	2.38%	2.09%	-1.11%	**3.37%**	9.82%	5.17%	3.54%
Barclays Capital U.S. Aggregate	U.S. Fixed Income	1.92%	1.80%	-0.59%	**3.15%**	8.93%	4.82%	3.36%
Barclays Intermediate U.S. Government/Credit	U.S. Fixed Income	1.42%	1.41%	-0.44%	**2.40%**	6.88%	3.79%	2.76%
Barclays U.S. Treasury: U.S. TIPS	U.S. Fixed Income	2.10%	1.38%	-1.76%	**1.69%**	6.85%	3.46%	2.67%
Citigroup 3-month T-bill	**Cash/Cash Equivalent**	0.13%	0.13%	0.13%	**0.39%**	2.04%	1.74%	1.12%
Citigroup WorldBIG Index	World Fixed Income	1.43%	0.71%	-1.78%	**0.33%**	4.94%	3.90%	2.78%
Barclays Capital Municipal Bond	U.S. Fixed Income	1.80%	1.29%	-3.63%	**-0.63%**	3.85%	3.96%	3.19%
Barclays Capital U.S. Corporate Investment Grade	U.S. Fixed Income	2.35%	1.34%	-7.09%	**-3.63%**	4.98%	4.20%	3.36%
Barclays Capital U.S. Corporate High Yield	U.S. Fixed Income	0.03%	-1.41%	-11.46%	**-12.68%**	-6.94%	0.77%	2.78%
S&P/LSTA US Leveraged Loan Index	U.S. Fixed Income	0.56%	-1.32%	-12.37%	**-13.05%**	-9.16%	-0.78%	1.14%
BofA Merrill Lynch US Convertibles	U.S. Convertible Bond	2.81%	-2.82%	-13.54%	**-13.62%**	-3.52%	4.75%	4.71%
S&P Composite 1500 Growth	U.S. Equity	1.96%	-7.28%	-10.60%	**-15.48%**	-3.91%	8.61%	8.82%
S&P 500	U.S. Equity	-0.04%	-8.23%	-12.35%	**-19.60%**	-6.98%	5.10%	6.73%
S&P Composite 1500	U.S. Equity	-0.30%	-8.34%	-13.08%	**-20.57%**	-8.51%	4.22%	6.15%
MSCI World Index	U.S. Equity	-0.58%	-8.41%	-13.17%	**-20.93%**	-9.87%	2.49%	3.83%
MSCI EAFE Index	International Equity	-2.08%	-9.03%	-13.25%	**-22.72%**	-13.92%	-1.33%	-0.13%
Dow Jones Industrial Average	U.S. Equity	-0.89%	-9.75%	-13.62%	**-22.73%**	-13.38%	4.42%	6.86%
MSCI EAFE (Net)	International Equity	-2.09%	-9.04%	-13.35%	**-22.83%**	-14.38%	-1.82%	-0.62%
MSCI World Ex. US Index	World Equity	-1.92%	-8.86%	-14.02%	**-23.15%**	-14.42%	-1.56%	-0.25%
MSCI EM (Emerging Markets)	World Equity	-4.66%	-5.27%	-15.38%	**-23.57%**	-17.36%	-1.25%	0.01%
S&P Composite 1500 Value	U.S. Equity	-2.84%	-9.60%	-16.08%	**-26.29%**	-13.82%	-0.70%	2.98%
Dow Jones U.S. Select REIT	U.S. Real Estate	0.42%	-8.41%	-22.28%	**-28.52%**	-23.96%	-4.28%	-1.42%
S&P MidCap 400	U.S. Equity	-2.61%	-9.49%	-20.25%	**-29.70%**	-22.51%	-4.09%	0.56%
S&P SmallCap 600	U.S. Equity	-3.97%	-9.61%	-22.40%	**-32.64%**	-25.89%	-5.34%	0.45%
S&P GSCI Commodities	U.S. Equity	-10.82%	-8.39%	-29.43%	**-42.34%**	-41.01%	-13.33%	-12.82%
Alerian MLP	Master Limited Partnerships	-5.61%	-14.05%	-47.23%	**-57.19%**	-60.95%	-28.91%	-20.66%
S&P GSCI Crude Oil	U.S. Equity	-15.36%	-13.48%	-54.72%	**-66.84%**	-65.97%	-26.04%	-23.62%

Indices sorted high/low by Q1-2020 performance.

Source: Zephyr StyleAdvisor

Coronavirus Pandemic





March 10, 2020

April 9, 2020

❖ **<u>KEY THEME</u> - A global health natural disaster is the catalyst for a global financial crises, which assures that capital market and societal <u>uncertainty</u> will remain high for the next few weeks…**

Source: statista.com

Equity Market Volatility – The VIX Index (i.e. the Fear Index)

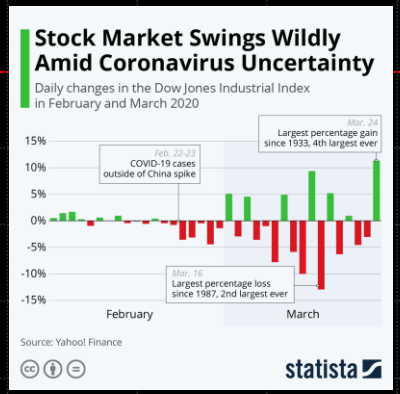
VIX Index | 95) Compare | 96) Actions | 97) Edit | Line Chart

12/31/2006 - 04/13/2020 | Last Px | Local CCY | Mov Avgs | Key Events

1D 3D 1M 6M YTD 1Y 5Y Max Daily | Table | Chart Content

Last Price 43.10
High on 03/16/20 82.69
Average 19.55
Low on 11/03/17 9.14
SMAVG (200) 21.29
SMAVG (60) 36.35

Average



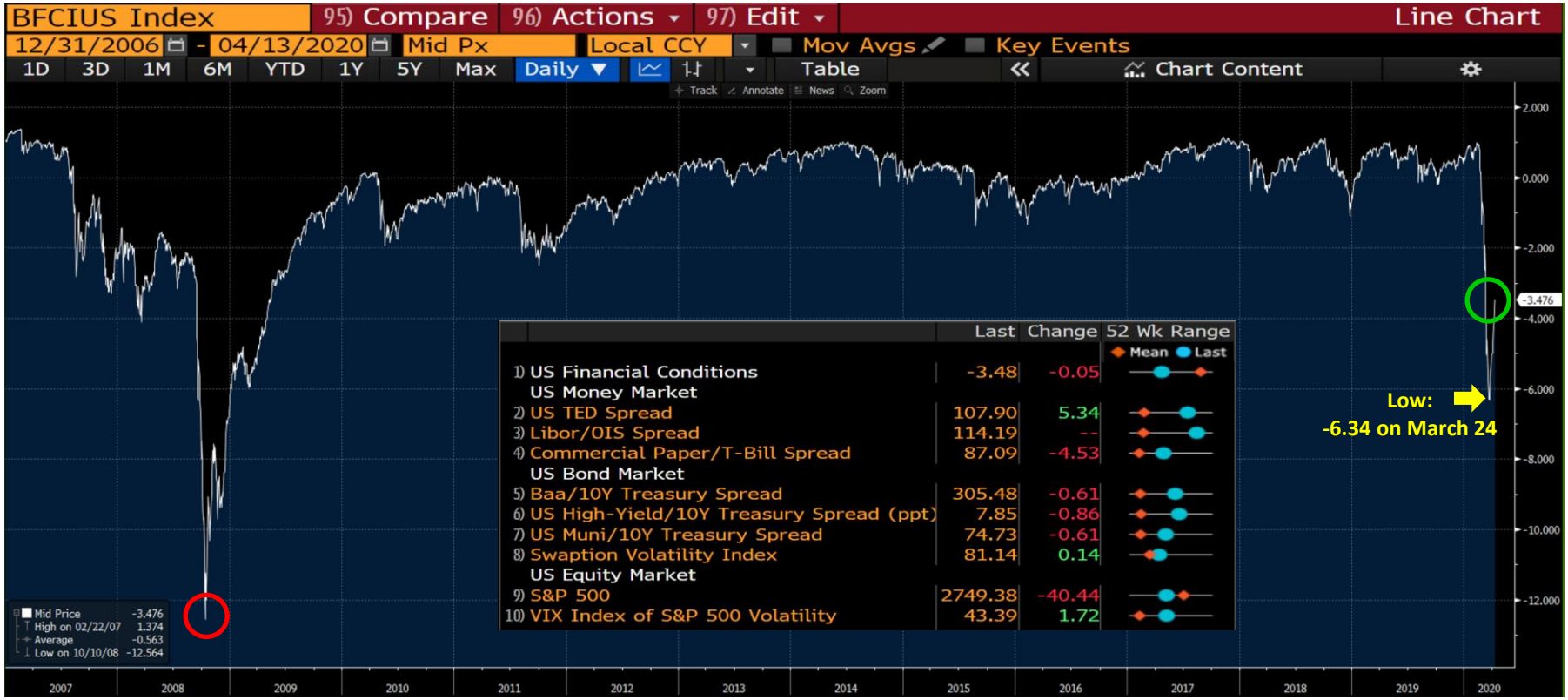
Chicago Board Options Exchange Volatility Index FIGI BBG000JW9B77

Cboe Volatility Index® (VIX) is a calculation designed to produce a measure of constant, 30d expected volatility of the US stock market, derived from realtime, mid-quote prices of S&P 500® Index (SPX) call & put options. SPX & SPX Weeklys options with >23 days & <37 days to expiration ensures the VIX will always reflect an interpolation of two points along the S&P 500 volatility term

- **<u>KEY THEME</u> – For the time being, unprecedented monetary and fiscal stimulus measures have helped bolster investor confidence across the U.S. equity markets (the VIX level of 82.69 on March 20, 2020 briefly surpassed the high of 80.86 experienced on November 20, 2008). Although markets are forward looking and anticipate abysmal results for Q1 earnings season, expect volatility to continue as the markets absorb/react to fast moving information flows regarding COVID-19.**

Source: Bloomberg

US Financial Condition Index – 4/13/2020



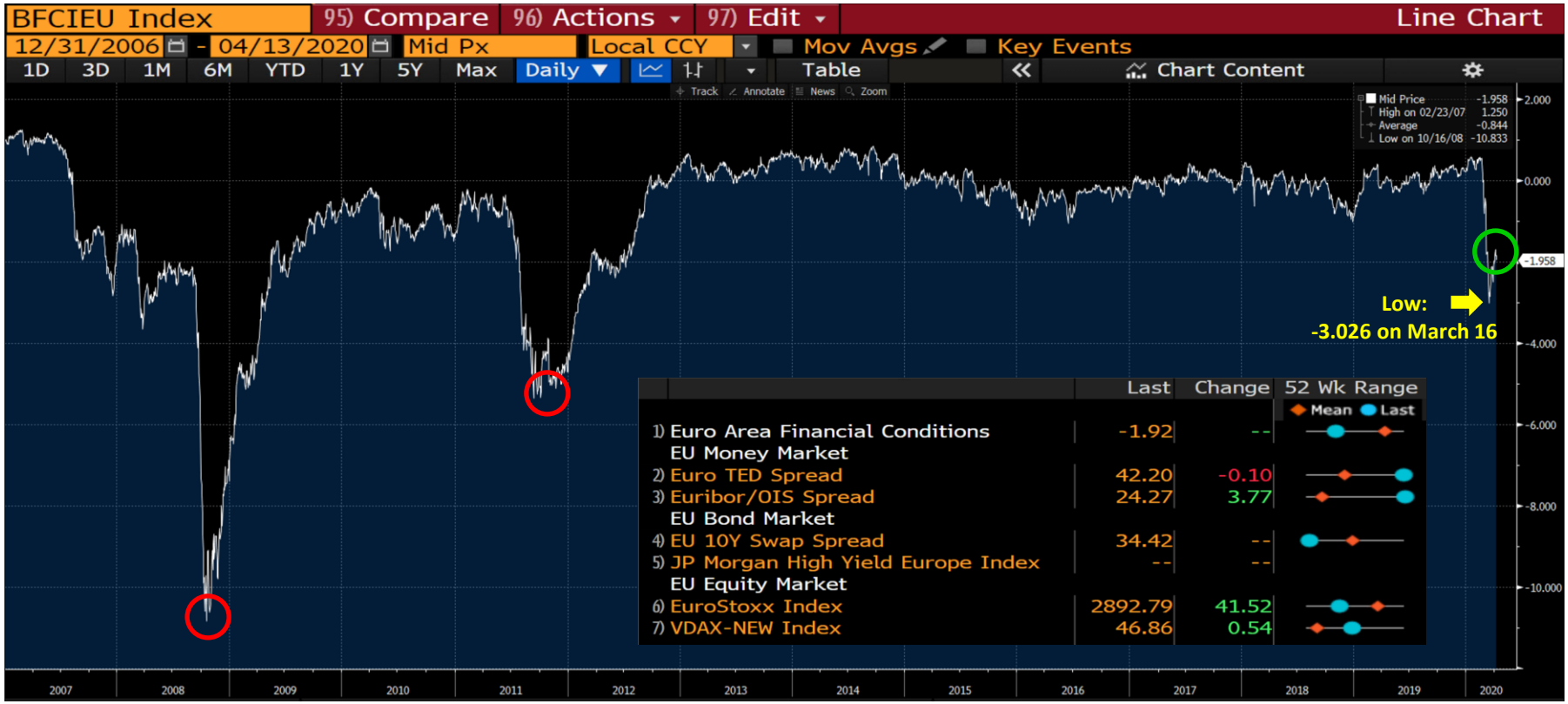
The Bloomberg U.S. Financial Conditions Index tracks the overall level of financial stress in the U.S. money, bond, and equity markets to help assess the availability and cost of credit. A positive value indicates accommodative financial conditions, while a negative value indicates tighter financial conditions relative to pre-crisis norms.

All of the indicators included in the composite BFCIUS index are normalized by subtracting the mean and dividing by the standard deviation for each series. The mean and standard deviation are calculated from observations during the pre-crisis period, which is defined as the period from 1994 to July 1, 2008. The normalized values are then combined into the composite BFCIUS index, which is itself normalized relative to its pre-crisis values. As such, the BFCIUS index is a Z-Score that indicates the number of standard deviations by which current financial conditions deviate from normal (pre-crisis) levels.

- **<u>KEY THEME</u> – For the time being, unprecedented monetary and fiscal stimulus measures have helped bolster confidence across the U.S. capital markets. Although capital markets are forward looking and anticipate an abysmal short/intermediate term outlook, expect financial conditions' volatility to continue as the markets absorb/react to fast moving information flows regarding COVID-19.**

Source: Bloomberg

Euro-Zone Financial Condition Index – 4/13/2020



The Bloomberg Euro Area Financial Conditions Index tracks the overall level of financial stress in Euro area money, bond, and equity markets to help assess the availability and cost of credit. A positive value indicates accommodative financial conditions, while a negative value indicates tighter financial conditions relative to pre-crisis norms.

All of the indicators included in the composite BFCIEU index are normalized by subtracting the mean and dividing by the standard deviation for each series. The mean and standard deviation are calculated from observations during the pre-crisis period, which is defined as the period from 1999 to July 1, 2008. The normalized values are then combined into the composite BFCIEU index, which is itself normalized relative to its pre-crisis values. As such, the BFCIEU index is a Z-Score that indicates the number of standard deviations by which current financial conditions deviate from normal (pre-crisis) levels.

- **<u>KEY THEME</u> – For the time being, unprecedented monetary and fiscal stimulus measures have helped bolster confidence across the European capital markets. Although capital markets are forward looking and anticipate an abysmal short/intermediate term outlook, expect financial conditions' volatility to continue as the markets absorb/react to fast moving information flows regarding COVID-19.**

Source: Bloomberg

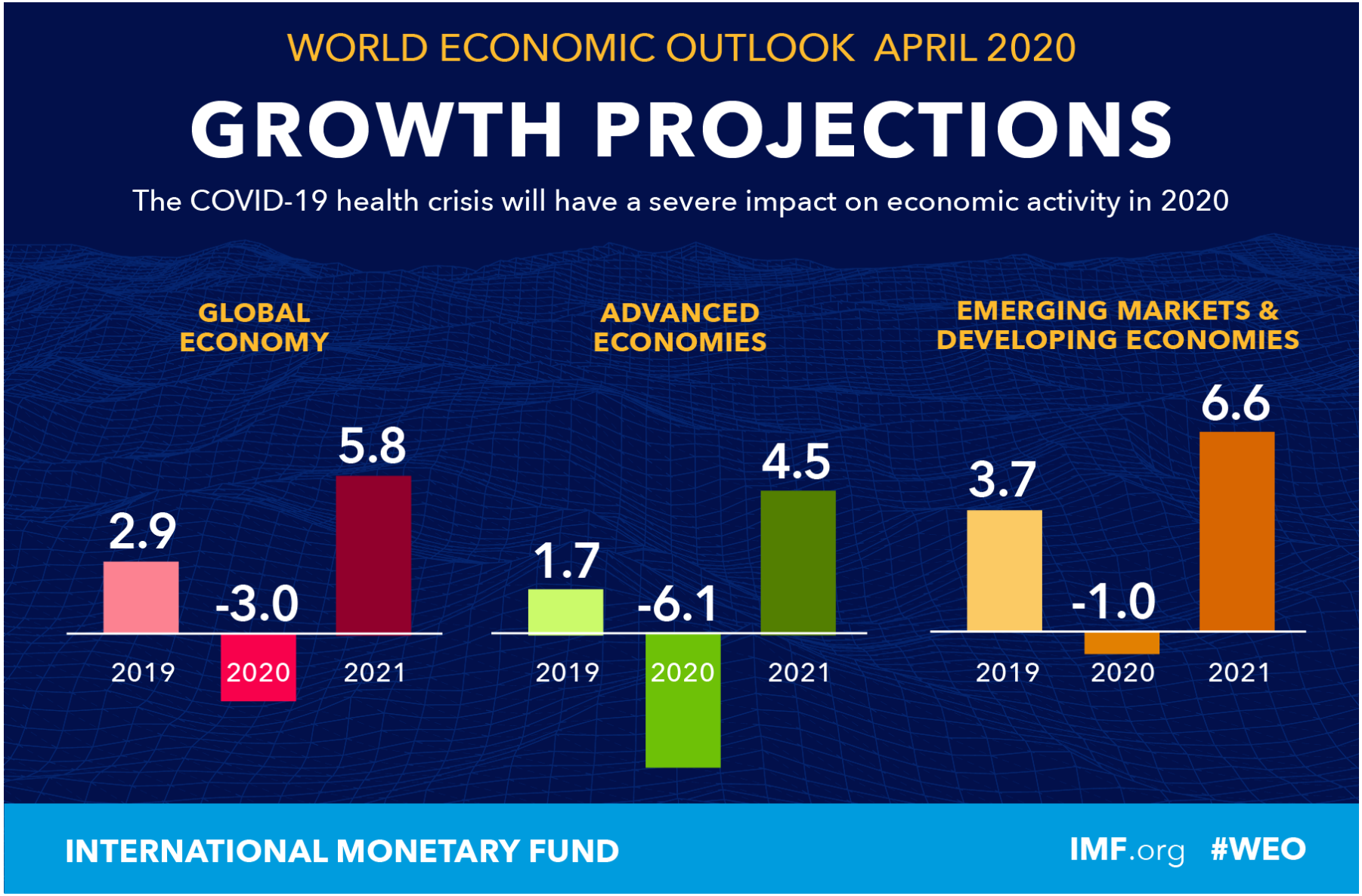
Navigating Uncertainty

- **Restarting the Economy**
  - COVID-19 Containment vs. World Economic Carnage
    - Impact within the U.S.
  - Debt, debt, and more debt
    - Plenty of time to be concerned with long-term inflation, but not for awhile yet…
  - Global poverty

- **Credit Markets**
  - Market liquidity and the refinancing window
  - Downgrades – any more room at the junk yard?

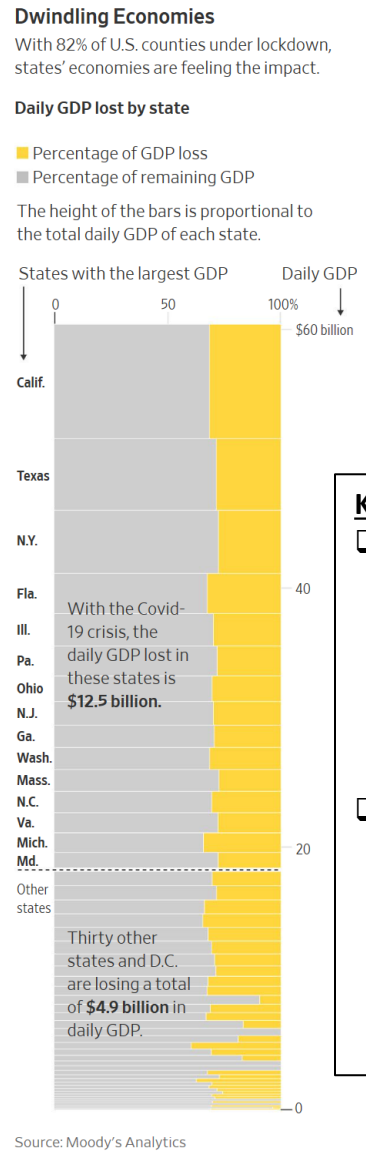
- **Strategic Asset Allocation & Investment Policy**
  - Confirm and/or reexamine investment risk appetite and liquidity needs allowing for any potential use(s) of your organizations' surplus in support of COVID-19 considerations.

World Economic Outlook (Base Case)



Source: IMF

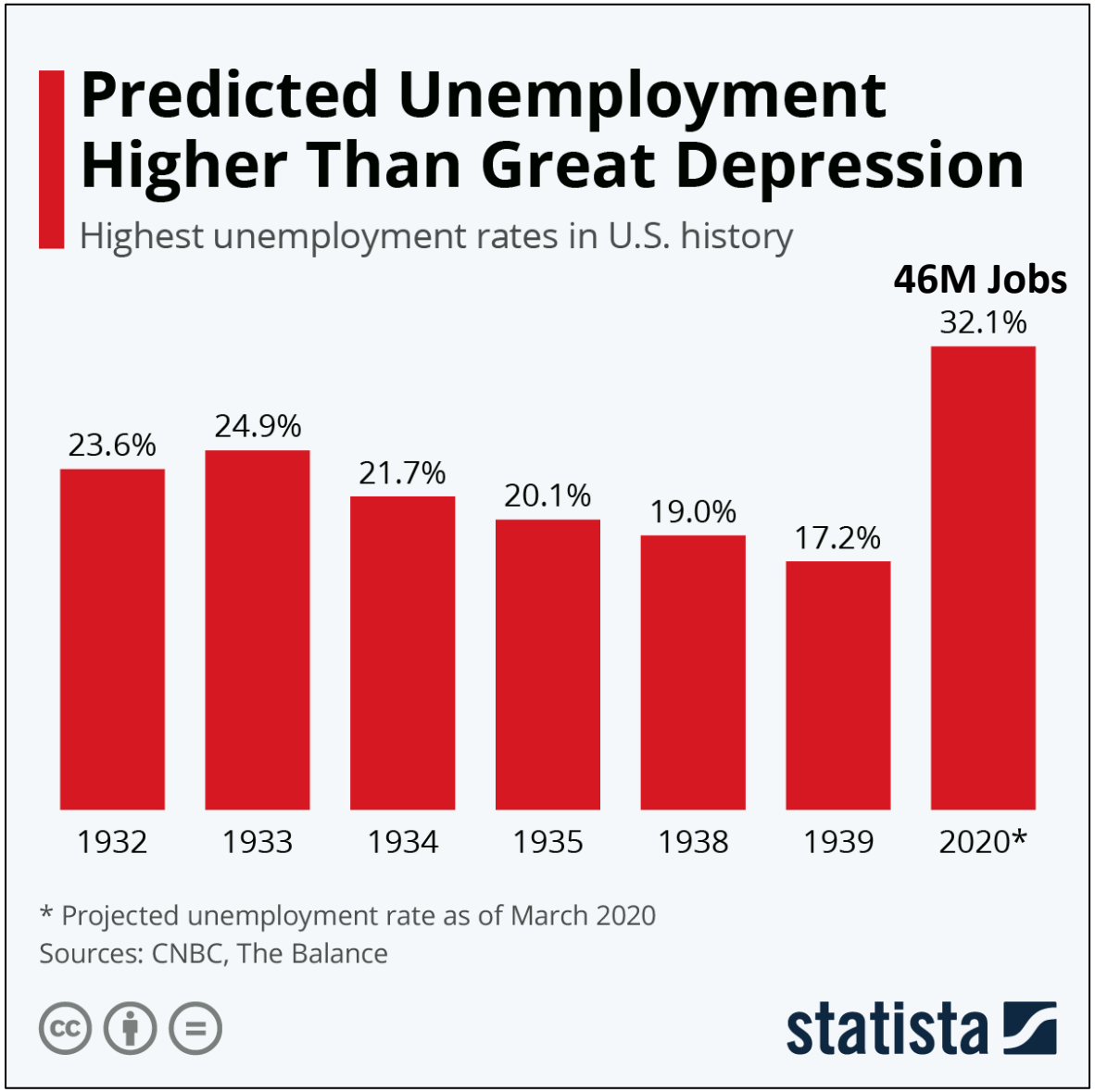
Uncertainty Reigns For Now - How to restart the economy?



KEY THEME -

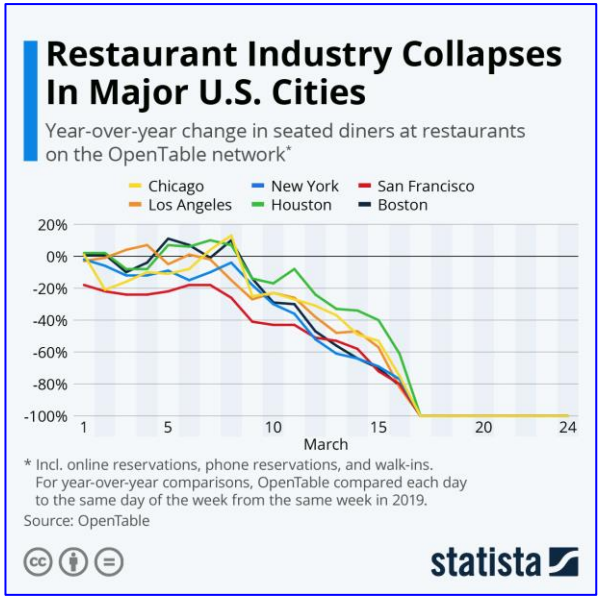
- **With approximately 25%-30% of the $22T U.S. economy currently on "COVID-19" hold, the challenges and pressures to restart the economy will rise.**
- **$60B per day equals approximately $1.8T per month. Contrasted with the most recent fiscal stimulus of $2T, the amount, although huge, is not, perhaps, huge enough…**

Unemployment Projections (High Uncertainty But Trending This Direction)



KEY THEME -

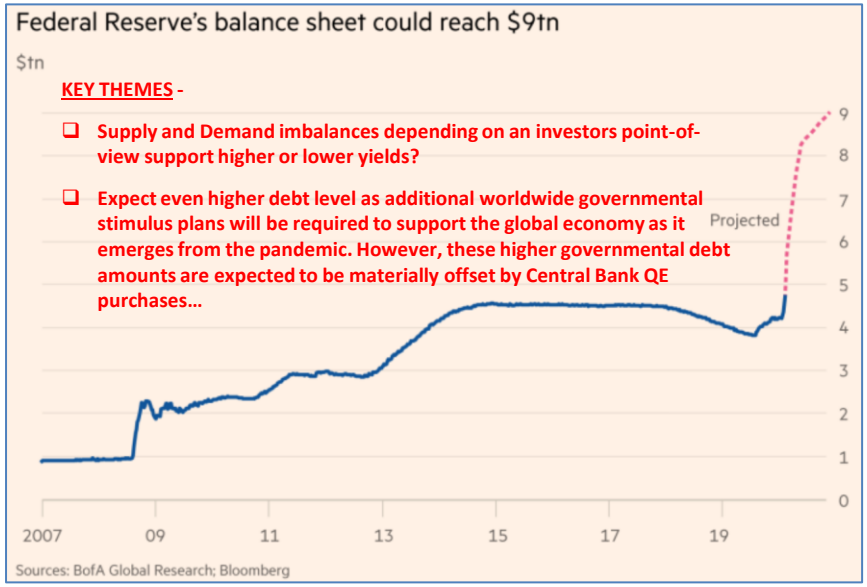
- ❑ **Hard to contemplate as a result due to 25%-30% of the $22T U.S. economy on "COVID-19" hold.**
- ❑ **Before the $2.2T fiscal stimulus was enacted, the chart to the left captures the St. Louis Fed's dire estimate that the U.S. could see as many as 47 million people lose their jobs as a result of the coronavirus-driven shutdown.**
- ❑ **Spillover effects across generations as politics and/or consumer behavior patterns changes in response to COVID-19 over the short and long term?**

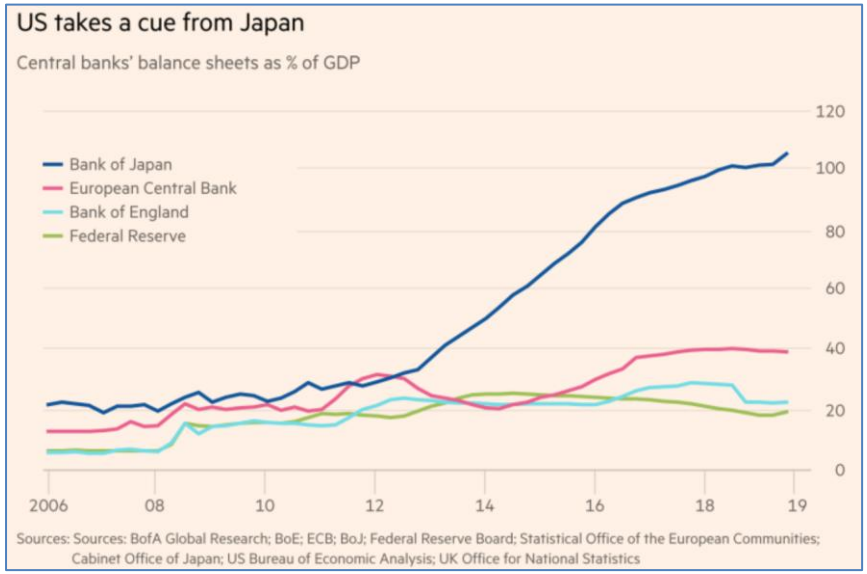


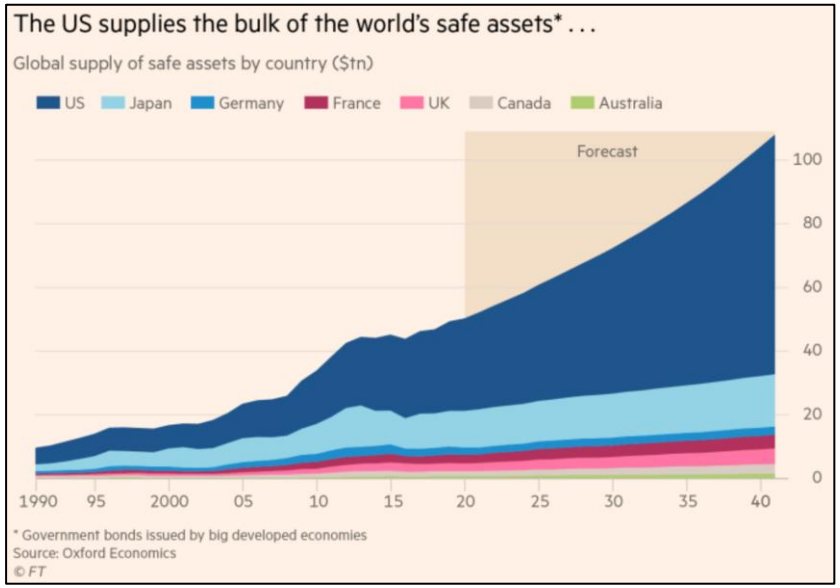
An unemployment view from one sector: Estimated US Restaurant Employees May 2019 was 13.5 million.

Source: statista.com

Debt, Debt, and more Debt…

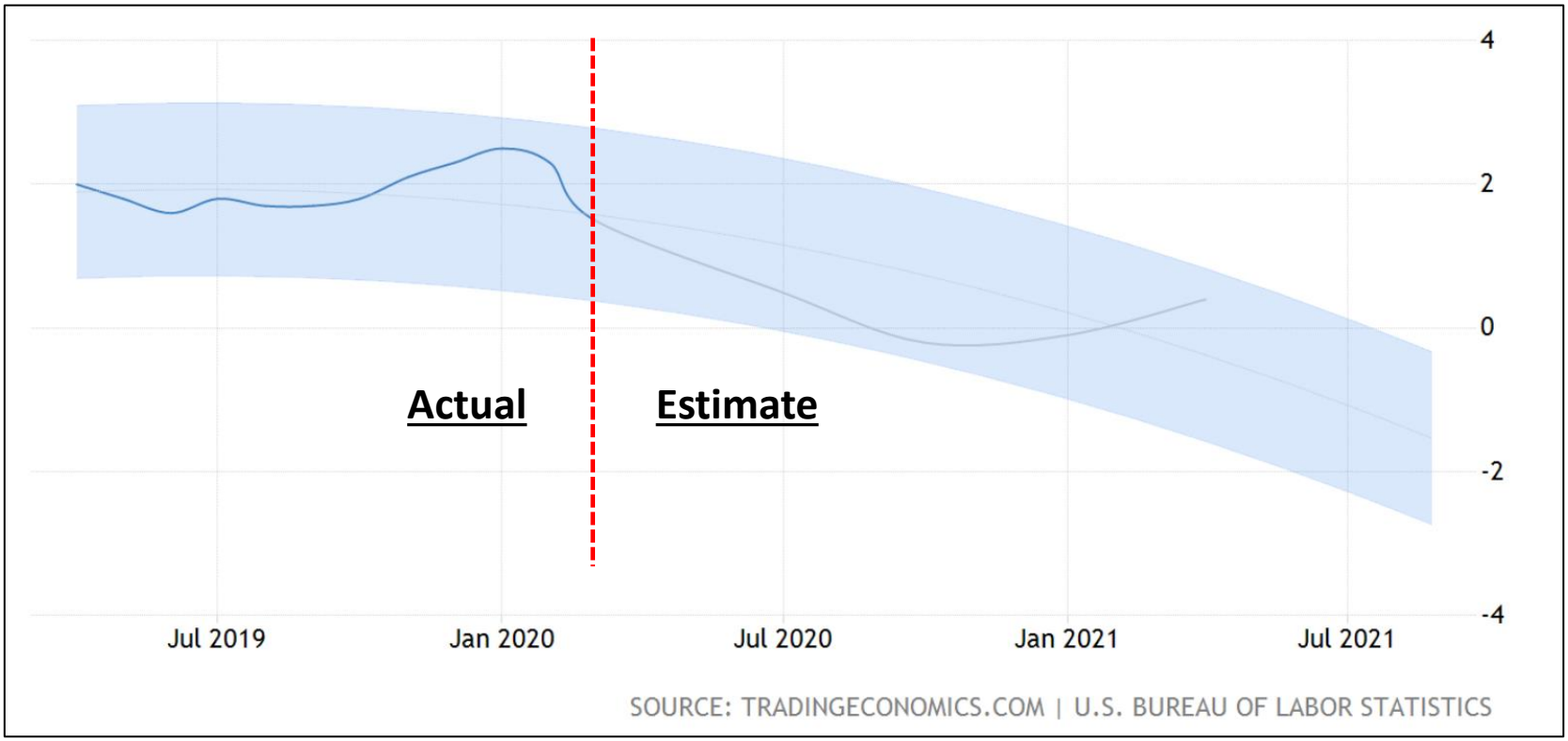






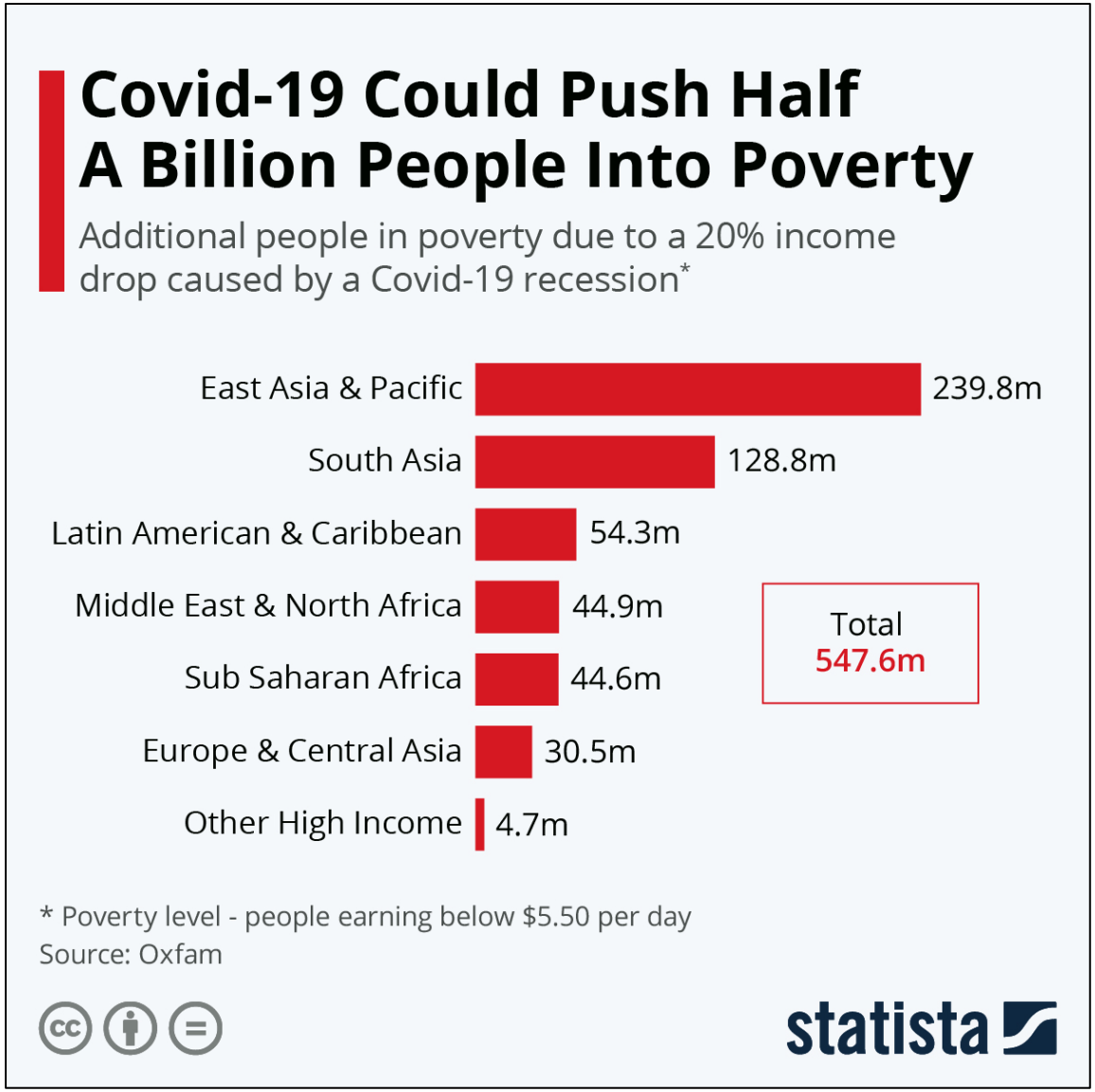
Source: Financial Times

United States Inflation Rate Estimates



- Annual inflation rate in the US fell to 1.5% in March of 2020 from 2.3% in February and slightly lower than market expectations of 1.6%. It is the lowest inflation rate since February of 2019, mainly due to a 10.2% slump in gasoline costs (5.2% in February) and a 1.6% drop in apparel prices (vs -0.9%). Prices of shelter also slowed (3% vs 3.3%) while food inflation edged up (1.9% vs 1.8%). On a monthly basis, consumer prices fell 0.4%, after a 0.1% gain in February and worse than expectations of a 0.3% decline. It is the largest monthly drop since January of 2015, mainly due to a 10.5% slump in gasoline prices while decreases in airline fares, lodging away from home, and apparel also contributing. In contrast, increases were seen in prices of food, medical care, used cars and trucks, motor vehicle insurance, and education. Core consumer prices rose 2.1% year-on-year but fell 0.1% month-over-month, its first monthly decline since January of 2010.
- Given the economic suppression impacts of COVID-19, the inflation Rate in the United States is expected to be 0.50 percent by the end of this quarter, according to Trading Economics global macro models and analysts' expectations. Looking forward, we estimate Inflation Rate in the United States to stand at 0.40 in 12 months time. In the long-term, the United States Inflation Rate is projected to trend around 1.00 percent in 2021 and 1.30 percent in 2022, according to our econometric models.

Coronavirus Pandemic – Poverty Spike

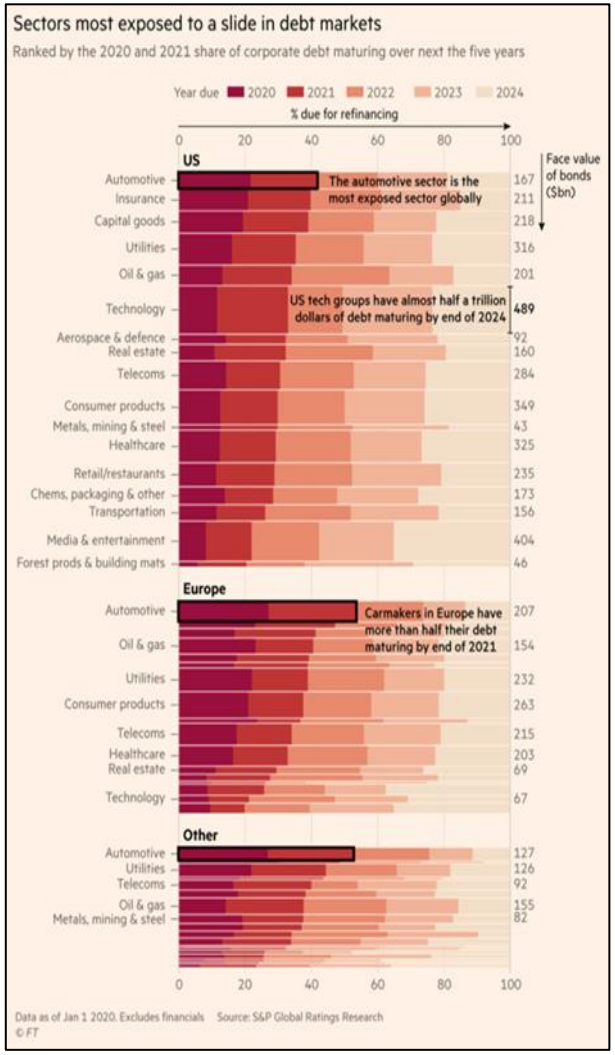


KEY THEME -

- ❑ **As the developed world focuses inward, the developing economies are projected to suffer the most from COVID-19 effects, both direct and indirect.**
- ❑ **How might this generate spillover effects across generations as politics and/or consumer behavior patterns change in response to COVID-19 over the short and long term?**

Source: statista.com

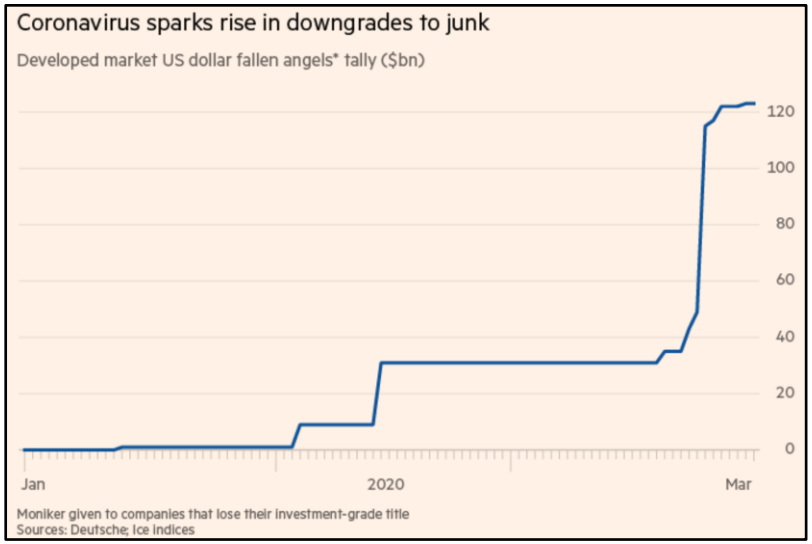
Corporate Debt Maturities, By Rating – Next Five Years

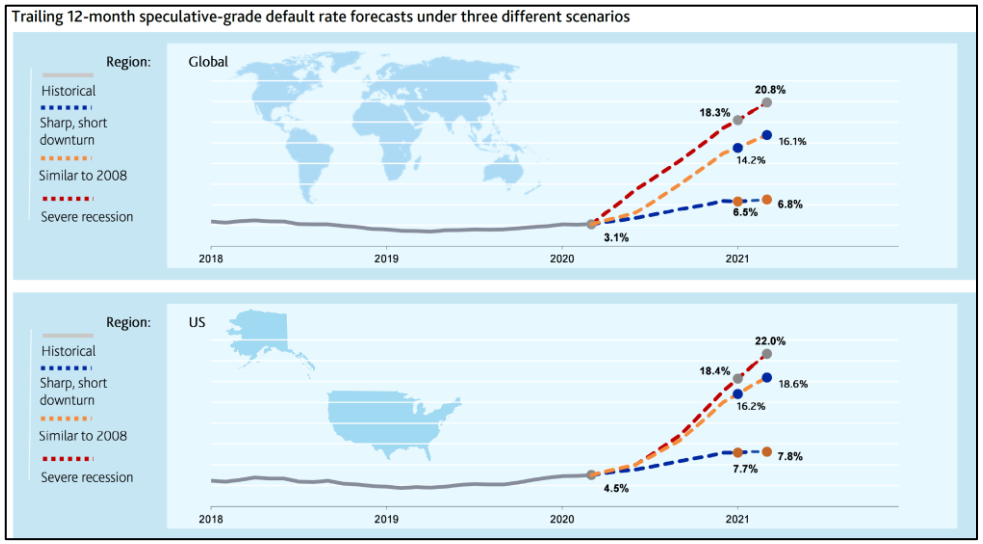


- **<u>KEY THEME</u> - As compared to 2008/2009, quick monetary and fiscal policy stimulus actions have provided broad and deep liquidity support, thus far, and help bolster investor confidence levels across the global credit markets, which face high maturity volumes over the next two years (as seen in the graphics above and right).**
- **Credit research teams will be poised to earn their pay navigating these markets with due diligence and stress testing.**
- **In SAA's opinion, expect many sectors of the economy to undergo material transformations and/or dislocations in response to changes in prospective consumer behavior as a result of COVID-19.**

Source: Financial Times

Credit Downgrades & Default Expectations





KEY THEMES:

- **Forced economic suppression due to COVID-19 mitigation strategy stressing corporate balance sheets; especially BBB-rated companies. Already for 2020, over $120B of initially-rated investment grade credits have fallen to below investment grade (i.e. speculative grade, high yield or junk bond status).**
- **Moody's (*a well-known provider of corporate bond default research and projections*) has speculative grade annual default rates rising materially from 3.1% (current) to 7.7% to 22% depending on the severity of COVID-19 impacts.**
- **Again, credit research teams will be poised to earn their pay over the next 12-24 months as they navigate these markets with due diligence and stress testing.**

Source: Financial Times & Moody's Investor Services