A look ahead: Second quarter 2020 outlook

What are some key factors influencing the economy and markets in the coming months?

Coronavirus leads to economic shutdown

- The coronavirus pandemic has flipped the global economy upside down, sending markets tumbling.
- Governments around the globe have effectively shut down economies to slow the infection and mortality rates of the virus.
- Severe economic consequences have followed, primarily massive losses to jobs and income.

Government response

- The Federal Reserve (Fed) and other central banks have cut rates and drastically eased monetary policies in an attempt to inject liquidity and support into financial markets.
- Congress has passed a $2+ trillion relief package to aid consumers, small businesses, states and municipalities, the health care system and other key industries.

What happens next?

- We expect markets to remain volatile for some time, with the real possibility of further market lows.
- Earnings are likely to suffer greatly, but should eventually stabilize with government support.
- Credit markets have generally stabilized, which is encouraging as they historically have been the first area to recover.
- We are looking closely at asset classes and sectors that have seen massive price dislocations for investment opportunities.

Asset allocation views: Current outlook

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<th>EQUITY VS. FIXED INCOME</th>
<th>Tactical vs. strategic position</th>
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<tr>
<td><strong>Total equity</strong></td>
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**Equities**

- We remain modestly underweight to our long-term strategic allocation to stocks.
- Near-term, we plan to stay cautious as the economic damage of the pandemic is still unclear.
- However, with the unprecedented monetary support from the Fed and similarly unprecedented fiscal stimulus, we are beginning to identify entry points for raising equity back toward prior strategic targets.

**U.S. VS. INT’L**

- We are in the midst of shifting our preferences from international to U.S. exposures.
- This historical contraction to global growth will leave some economies more damaged than others.
- As the U.S. entered the pandemic relatively stronger than many international economies, we feel it is the most durable region in these times of turmoil.
Asset allocation views: Current outlook (cont’d)

Equities (cont’d)

- We remain overweight to large caps.
- Small caps have been hit hard amid the coronavirus market correction, but that has led valuation metrics to see them more favorably.
- While we believe the moment to rotate to small cap will eventually come, now is not the time.
- When the economy does stabilize, we expect small caps will likely outperform large caps.

Fixed income

- Interest rates fell dramatically during the first quarter and Treasury yields reached record lows.
- The Fed will likely rely on quantitative easing measures such as buying a variety of bonds instead of cutting rates to negative levels.
- We believe rates will be relatively range-bound with a bias toward lower rates.

- The yield curve started the quarter in a flattening trend before steeping significantly after the Fed cut rates, which is common.
- The curve began to flatten again as expectations of the Fed buying longer maturity Treasuries grew.
- Going into the quarter, we intend to position portfolios for a flatter yield curve by adding to our longer-term holdings.

- Corporate credit markets underperformed with spreads widening at a record pace.
- Treasury bonds posted strong returns as interest rates plunged after the Fed rate cuts.
- The outlook for risk markets hinge on the breadth and depth of the coronavirus; should it worsen further, credit would likely reach further lows.
- However, spreads are now at levels that have historically presented attractive long-term investment opportunities.
- We have begun to add to credit on dips and expect to eventually move to an overweight to risk assets.

1 Credit Quality ratings are determined by credit rating agencies Moody’s Investor Services, Inc. or Standard & Poor’s Financial Services, LLC.

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