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Capital markets muddle through

Federal Reserve Chairman Powell sounds note of caution

The current capital market environment remains dynamic. We introduced a three-stage framework several weeks ago to communicate our assessment of how the global economy and capital markets would likely traverse following the pandemic's onset. We characterized these stages as follows:

- Downward bias: A period where the economic path ahead is highly uncertain, markets have difficulty assessing COVID-19 depth and duration based on virus spread characteristics, and market liquidity is constrained. Markets require larger or more targeted policy responses.

- Muddle through: Economic path ahead remains uncertain, but clarity emerges due to the virus' path and some positives from regions hit earlier. Concerns about depth and duration remain, yet improvements in regions hit earlier provides hope. Policy responses address current challenges, but more may be required. Market functioning and liquidity improve.

- Growth and recovery: Economic path becomes clearer and improves, infection stability and reversal as economies reopen on a large scale with a tangible path to business as a "new" usual takes shape. Credit markets are open and capital market liquidity is abundant, risk appetites increase.

Based on our research, we believe we are in the muddle through stage. As the global economy slowly reopens, we are seeing gradual economic activity improvement while health experts warn against infection rebound risks should social distancing techniques lapse while we await a vaccine or treatment to eradicate the virus. We continue to monitor corporate earnings guidance, consumer sentiment indicators, economic readings (particularly on employment trends), and of course medical developments.

A Quick Look Back

At all-time highs in the S&P 500 on February 19, markets were pricing in a steady global economic expansion featuring low borrowing costs and a seemingly contained coronavirus impact. Twenty-three trading days later, the S&P 500 had fallen 35%, and capital markets were pricing in a significant labor market deterioration, weak corporate profits, and overall asset market functioning reflected poor liquidity. Stocks went from all-time highs to a bear market in the shortest timespan in history. Energy markets

 Important disclosures provided on page 3.

digested the coronavirus impact on demand but also a breakdown in negotiations between OPEC+ members, sending crude and other petrochemicals markedly lower. Credit markets, currencies, real estate, and other categories have also witnessed significant price declines.

Since domestic equities hit their most recent lows on March 23, they returned to a bull market just 12 trading sessions later, the fastest transition from bear to bull market in history. Central bank policy, legislative action, COVID-19 improvement, and better market liquidity led to fast recoveries in many asset classes. The recoveries have been uneven; for example, within equities, domestic large cap technology stocks had a positive total return for the year just two days ago, but domestic small cap, international emerging, and international developed stocks are down between 19% and 26% on a year-to-date basis. Companies with strong balance sheets and business models that can adapt to or even benefit from changes in how societies operate under current constraints are thriving while companies with more uncertain financing or fundamentals face more difficult outcomes.

Our Forward Views

We continue to have a cautiously optimistic view about the forward path. While we are all hoping for a cure or a dramatic reversal in disease spread, based on current estimates, we will likely have to wait a matter of months at the earliest for a medical fix. The policy responses mentioned above along with company and consumer adaptation have likely taken a substantially negative economic outcome off the table – however, a sharp economic snapback is unlikely.

The most recent capital market volatility represents the tug-of-war between economic reopening and the risk of disease spread. A myriad of approaches to testing, striving for herd immunity, and strict stay-at-home orders are reflected in countries like South Korea, New Zealand, Sweden, and within the United States. Differing approaches at the state and local levels present several possible outcomes of disease spread and containment.

Further, central bank policy responses and consumer and business spending trends are also highly varied. Some countries have provided considerable bridge financing to companies and individuals, while others have not. Certain industries have ramped up production and recalibrated supply chains; others eagerly await a better business climate and have capital shortfalls. A quote from U.S. Federal Reserve Chairman Jay Powell earlier today highlights that given uneven trends across government, business, and consumer activity: “While the economic response [so far] has been both timely and appropriately large, it may not be the final chapter, given that the path ahead is both highly uncertain and subject to significant downside risks.”

We would anticipate more back-and-forth movement within asset prices and portfolios as investors try to anticipate emerging outcomes to variables highlighted in the previous two paragraphs. Our optimism is based on several factors, but largely based on the medical community’s capabilities to help ramp up testing capacity and ultimately lead us to a cure, and secondly on the adaptability of consumers and businesses. From an investor’s point of view, the next few months will be a test for many companies that are trying to get to the other side of the current economic challenges. Bridge financing in the form of

several lending facilities may need to be further supplemented, and we will continue to monitor policy interplay within the U.S. and around the globe.

As always, the most important thing you can do is establish a plan tailored to your unique financial situation. While we do expect some more market volatility in coming weeks, we do see a positive resolution to the current health crisis and we believe that patient investors will be rewarded for the risks appropriate for their unique circumstances. Thank you for your trust and please don't hesitate with questions.