



FULLEN FINANCIAL GROUP

Quarterly Market Summary – Q1 2020

Market Results as of the First Quarter of 2020

Selected Index Results for Q1 – 2020

<u>Index⁽¹⁾</u>	<u>%Growth For FY 2019</u>	<u>%Growth For YTD 2020</u>	<u>%Growth For Q1 2020</u>
DJIA	22.34%	-23.20%	-23.20%
Core U.S. Aggregate Bond Index (U.S. multi-sector bond)	5.52%	2.67%	2.67%
S&P 500 (large cap)	28.88%	-20.00%	-20.00%
S&P 400 (mid cap)	24.05%	-30.03%	-30.03%
Russell 2000 (small cap)	23.72%	-30.89%	-30.89%
MSCI EAFE Index (developed international)	18.14%	-23.01%	-23.01%
iShares MSCI Emerging Market Index	14.87%	-23.94%	-23.94%
iShares Dow Jones US Home Construction	47.87%	-34.87%	-34.87%
MSCI US REIT Index	20.94%	-27.80%	-27.80%
Amex Oil Index	9.62%	-51.02%	-51.02%
Barclays Global Agg ex-US Corp Bond Index	3.70%	-9.02%	-9.02%

(1) These results do not include reinvestment of dividends.

Q1 Quick Summary

- Global equities were down across the board as investors priced in the likelihood that COVID-19, and related containment efforts, will cause material damage to the world economy. The uncertainty surrounding the disease's trajectory complicated economic forecasts and marred fundamental visibility for market participants.
- During Q1, the S&P 500 Index lost 20%, while the MSCI EAFE Index fell by a little more than 23%. Non-core bond segments lost considerable ground as most risk assets recognized indiscriminate selling pressure. Of note, the Bloomberg Barclays U.S. High Yield Index lost 12.7% and the Bloomberg Barclays Investment Grade Corporate Index was down 3.6%. The sell-off across most risk asset segments was faster than what occurred during the recession of 2008.
- The iShares Core U.S. Aggregate Bond Index rose 2.67% as investors fled to government bonds and cash. In some cases, forced selling contributed to the speed of the drawdown and the unusual buying activity in Treasuries. The 10-year Treasury yield ended the period at 0.67%
- U.S. fiscal policymakers worked to offset the virus-induced economic damage by rolling out a \$2 trillion economic relief package, and the Federal Reserve dusted off 2008-era market support programs. Relative to 2008, fiscal and monetary action materialized much more swiftly.



- Although the stock markets have since shown signs of a rebound, the potential still exists for further significant deterioration in equity values, as the economic impacts of current mitigation activities become known. High market volatility could continue for at least the next several months.

S&P 500 Index Sector Returns – Q1 2020

Source: Bloomberg

Sector	Cyclical or Defensive	Total Return	Sector	Cyclical or Defensive	Total Return
Consumer Discr.	Cyclical	-19.3%	Info Tech	Cyclical	-11.9%
Consumer Staples	Defensive	-12.7%	Materials	Cyclical	-26.1%
Energy	Cyclical	-50.5%	Real Estate	Cyclical	-19.2%
Financials	Cyclical	-31.9%	Telecom	Defensive	-17.0%
Health Care	Defensive	-12.7%	Utilities	Defensive	-13.5%
Industrials	Cyclical	-27.0%			

Shock to Economy and Markets

As COVID-19 cases emerged globally from east to west, a material health crisis was transformed into an economic shock as world governments enacted strict containment policies and shuttered many sectors of their economies. The precipitous rise in the number of coronavirus cases globally and the uncertain extent of the economic damage caused some panic in markets and forced selling of financial assets. All risk asset prices came under pressure during the period as investor behavior was consistent across sectors. Selling pressure was indiscriminate, which left Treasury bonds and cash being seen as the lone assets of relative security. Even gold prices buckled as investors reached for all available assets in an effort to raise cash.

Indeed, the speed of the risk-asset drawdown was faster than in 2008, as equity markets reached correction territory (-10%) and bear market territory (-20%) in record time. Historically, equity corrections and bear markets have taken months to develop. During this drawdown, major equity indices reached bear-market levels in a matter of days.

Economically, disease containment efforts have caused most economists to slash Q1 and Q2 GDP growth expectations in the U.S. and globally. Unemployment rates have risen dramatically as well, with depression-like U.S. readings potentially in-store. However, many forecasters are indicating a material economic rebound may follow in the third quarter. Any recovery should remain dependent on the length of government containment efforts. In such a rebound scenario, employment is expected to recover as well, but perhaps not as rapidly as GDP. While the expectation of some economic rebound in Q3 is good news, the potential lasting economic fallout as a result of the virus shutdown is rightly leaving investors with cause for concern.



Our biggest concern for the economy may not necessarily be the here and now, but the aftermath of the current economic lockdowns. Many direct customer-facing industries have been ordered closed and industrial activity has been halted in numerous sectors. Supply chains have been detoured or cut off. Most consumer activity has been relegated to purchases online or focused in grocery or other essential categories. Many consumer and business incomes have been impaired or pushed to zero. The effects of containment may spell an end to many businesses, large and small, despite new government legislation that is attempting to extend a lifeline. Although the government has incited businesses to retain employees, workers may permanently lose jobs or be slow to return to work as industries recover. Visibility into the economic quagmire is without material precedent...one key reason risk-based assets may still endure bouts of volatility.

D.C Relief Programs

Constructively, Washington D.C. has certainly reacted relatively quickly, repeatedly, and with considerable force. Both monetary and fiscal programs instituted may have to clear some red tape before relief hits pocketbooks and balance sheets, however policy support has indeed been more decisive than during 2008.

The Federal Reserve has revived 2008-era relief programs to support markets and has operated at the full extent of its power to backstop both private and public markets. The central bank has shown that it is not short of policy tools to potentially affect the economy, even with its policy rate effectively at zero. The most recent Fed action (announced on April 9) provides as much as \$2.3 trillion in loans to support small and mid-sized businesses, state and local governments, as well as expanded support for large firms.

According to Bloomberg, the \$2.3 trillion package is three times larger than the total borrowed by the U.S. non-financial business and state and local government sectors last year (\$747 billion), and the package is more than 10% of those segments' debt at the end of 2019 (\$19.1 trillion). It is clear the Fed has aimed considerable firepower at the problem.

Some of the lending/support facilities in which the Federal Reserve is now engaged include:

- The Main Street New Loan Facility and the Main Street Expanded Loan Facility—both programs combined will purchase as much as 95% of eligible business loans from depository institutions. The depository institutions will retain 5%. The combined size of the two facilities will be as much as \$600 billion, backed by \$75 billion of Treasury funds. Effectively, this allows the Fed to buy loans off bank books allowing those banks to engage in additional loan activity. Recall that current bank regulations place a limit on certain loan activities relative to bank capital.
- The Paycheck Protection Program Lending Facility will supply liquidity to participating financial institutions via term financing backed by Paycheck Protection Program loans to small businesses. This facility is intended to incent depository institutions to write Paycheck Protection Loans for small businesses.
- The Municipal Lending Facility will purchase as much as \$500 billion of short-term notes directly from U.S. states and eligible counties and cities. The facility is backed by \$35 billion from the Treasury.

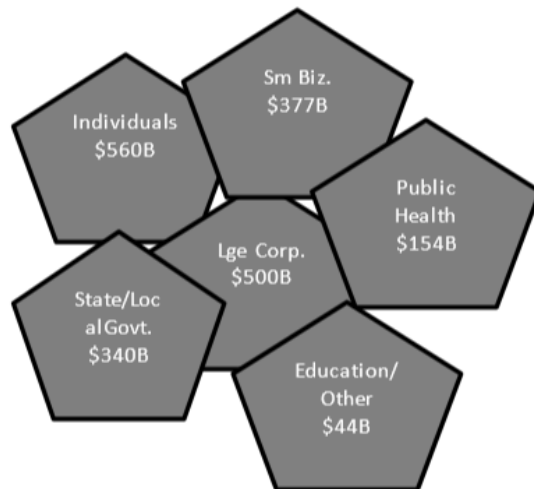
- The Primary and Secondary Market Corporate Credit Facilities and the Term Asset-Backed Securities Loan Facility are backed by \$85 billion from the U.S. Treasury and scheduled to provide as much as \$850 billion in direct primary and secondary market purchase support for U.S. investment grade corporate bonds, portions of the high-yield U.S. corporate bond market, commercial mortgage-backed securities, and other asset-backed securities that fund a wide range of lending, including student loans, auto loans, and credit cards.

What is unique about the recent Fed action is the central bank is using a portion of the CARES Act funding, left to the discretion of the U.S. Treasury, to effectively collateralize its lending and financial market support activity. We do believe such policies will have a dramatic effect on the U.S. economy and contribute heavily to its stability and recovery. This supports a view that a Q3 rebound in economic activity, and the reignition of sustained demand for risk-based assets is a possible (though optimistic) outcome.

Although the policy strategy is innovative and points to the power and resolve of policymakers to address the problem, such an endeavor does further expose the central bank to moral hazard criticism. For the longer term we are concerned the policies may further erode the foundation of a laissez-faire economic system and lead to a crowding out of the private sector.

Figure 1: \$2 Trillion Dollar CARES Act Relief Package

Source: U.S. Government, B = Billion



The CARES (Coronavirus Aid, Relief and Economic Security) Act also provides widespread relief to multiple areas of the economy. This legislation is thought to be transitional and aimed at reducing the disruption from the COVID-19-induced economic shutdown as much as possible. Further Congressional policy action, targeted at stimulating the economy once the crisis has eased, is being debated as we prepare this report. Detail around the CARES act is far-reaching and details on the program still must be worked through, but some of the key highlights are below:



- Individual cash payments and unemployment assistance
- Mortgage relief for homeowners
- Mortgage foreclosure moratorium
- Eviction relief for renters
- Student loan payment suspension
- Increased 401k loan limits
- Suspension of required minimum distributions from retirement plans
- Small business loans (deferred payments and loan forgiveness)
- Loans and loan guarantees for large corporations
- Financial support of the health-care system
- Financial aid to state and local governments
- Increased fiscal support for the agriculture sector.

Recovery Trajectory

As we survey this volatile economic and market environment, there are four primary areas of focus. The positive progression of each could help shape the foundation for a sustained recovery in markets, followed by an economic bounce back, although a market recovery could lead the timing of an economic rebound by 3-6 months. The four areas of focus are the following:

- 1. COVID-19 case trajectories** - It appears the growth in the number of COVID-19 cases and resulting deaths has slowed. Improvement has been definitive in the Asia-Pacific, and trajectories are improving materially in Europe. In the U.S., expectations for deaths and case growth in several hot-spot states, and overall, have come down. Containment efforts appear to be working.
- 2. Lifting of virus containment measures by governments** - The timing of and economic return to normalcy in the U.S. is uncertain and will be heavily debated in the coming weeks. Delays in restarting the economy and or a decidedly slow restart could curtail expectations for an economic rebound in Q3 and weigh on financial markets. This may be the biggest source of uncertainty for investors
- 3. Sustainability in fixed-income markets** - Helped in large part by Federal Reserve policy, fixed income markets have begun to correct from the dramatic spread-widening witnessed just a couple weeks ago. Fed support for both investment-grade and high-yield corporate markets should offset some of the balance sheet problems likely to be exposed by the economic shock. Such support has materially helped equity markets and could set the stage for a sustained recovery in stocks.



4. Fiscal and monetary policy responses - As we have detailed in this report, the policy responses have been extraordinary and there may be more to come. They have helped stabilize markets and should have a positive short-term influence the U.S. economy once restarted. The degree of relief/stimulus supports a case for a Q2 recovery in risk-based asset prices and a Q3 recovery for the economy. Much of this depends, however, on near-term developments in the first two focus areas listed above.

Conclusions

COVID-19 has had far-reaching impacts on public health systems, the global economy and the financial markets. In the course of this pandemic, single-day movements in stock market indices, both negative and positive, have been almost unprecedented. Sensationalized press coverage and program trading certainly contribute to this volatility, and can make market gyrations seem worse (or better) than they otherwise would be. In this type of market environment, investors often feel the need to do something with their investments, even though history has shown that large moves at times like these can do lasting damage to investment portfolios.

Significant uncertainties remain at the time of this writing, but we are generally optimistic that the mitigation measures, combined with significant government stimulus, will support a substantial recovery over the next two quarters. Downside risk still remains, and could be significant, if new developments result in further delays to re-starting economic activity in the U.S. and globally. Fundamentally, stock valuations are based on long-term expectations for dividend payments and price appreciation. Assuming a vaccine and effective drug therapies are developed to combat this virus, which we believe will happen, the long-term impact on economic growth, and equity values, should not be significant.

One counterweight to this argument is the unprecedented level of government stimulus, both fiscal and monetary, undertaken over the past several weeks. Prior to this pandemic, we had voiced concerns about deficit spending and the corresponding growth in national debt. While such stimulus may be critical in times of stress, the long-term implications for economic growth are likely to be negative. In the near term, with a partisan political environment and a presidential election coming in November, uncertainties around these policies (among other developments) will likely result in continued high levels of market volatility.

In periods of higher market volatility, maintaining investment discipline will be more difficult emotionally. However, we need to remember that market timing as an investment strategy has never worked consistently (and results in lower longer-term yields). Trying to time markets has a high probability of creating permanent losses.

Market shocks also tend to give rise to “can’t lose” investment strategies that seem too good to be true. If someone appears to have found a way around market volatility, be very wary – they are either not showing you all their “cards” or are taking risks that you are not aware of. Fullen Financial is always available to help sort out false claims so don’t be concerned about asking us.

As always – stay with a consistent and disciplined investment strategy – it is the only course of action with any track record of success (in any investment environment). There is no reason to believe, even with the changing economic dynamics, that the disciplined approach to investments will be less effective than in the past at delivering the best possible relative returns.



At the most fundamental level, match your investment time horizon to your spending timeline – if you have short term cash needs then those funds should be in short term investments. These are simple asset/liability matching principles practiced by the most sophisticated investment managers every day (but far too complex to explain in sound bites and not conducive to selling products). Additionally, don't try to solve short-term financial problems with long-term equity exposure. If you try to chase returns, you may get lucky sometimes but, if pursued long enough, it always ends in extreme frustration and often with serious financial losses. The reality is that no one has ever consistently predicted investment markets and they never will - and there is always a consequence to continued unsound financial behavior.

As always, if your personal or family situation has changed (or is likely to), a discussion with us as to how this may impact your financial plan and your overall asset allocation is warranted. Or, if you simply feel a need to discuss any aspect of your portfolio and/or financial plan, or you haven't had a planning update within the last 12 months, please contact us to review your financial plan and investments.

Your financial plan is the most important financial document that you possess! Keep it updated and use it.

Please note that you are entitled to receive Fullen Financial's Form ADV whenever you would like to. This document outlines many details of who Fullen Financial is, their investment methodologies and their advisor's education and experience. You may do so by contacting Aigool Zhumasheva at aigool@fullenfinancial.com and requesting such. Alternatively, you can go to the Fullen Financial website at www.fullenfinancial.com and click on "Resources" in the top menu bar, and then on "Client Forms."

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