

Nauset Market Commentary First Quarter 2020

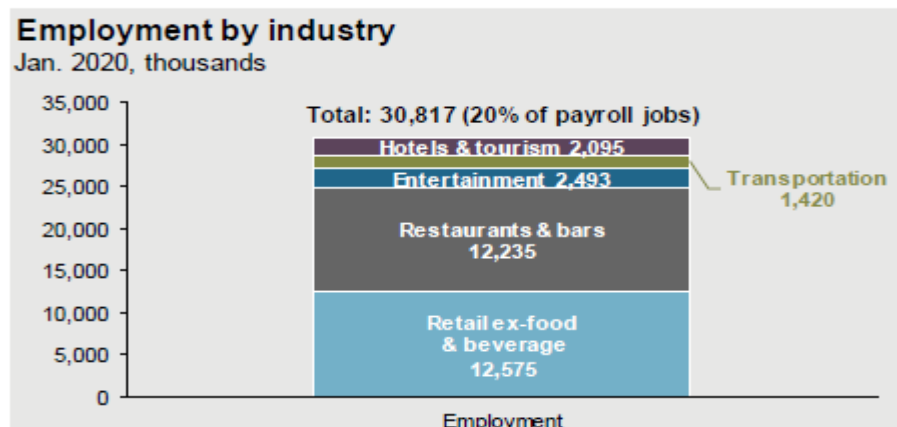
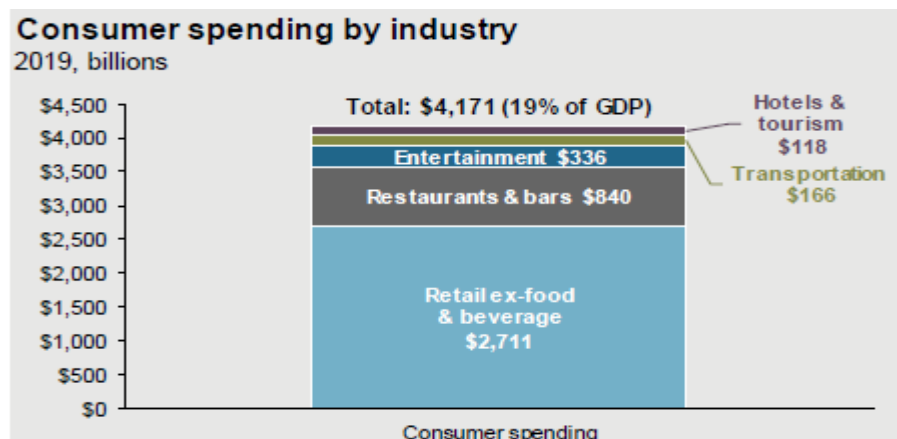
Market Performance Recap: **Covid-19 Crisis Shocks Stocks**

The global pandemic led to shocking first quarter declines in US and global financial markets. The Russell 1000 US stock index fell over -30% from February highs and finished Q1 off -20.2% as the rapid spread of Covid-19 virus caused a partial shutdown of the US and much of the global economy. This decline marked the fastest bear market, defined as an index price decline of over -20%, in US stock history. Not all areas suffered equally. Tech and health care stock sectors posted the smallest declines, while energy stocks, affected by both the virus and a production war between Saudi Arabia and Russia, fell the furthest. US small caps, seen as most vulnerable to the effects of the shutdown, fell -30.6%. International stocks of developed countries lost -22.8% and emerging markets stocks lost -23.6%. Significant gains in US Treasuries made up for losses in corporate bonds leading the Barclays Intermediate Gov't/Credit bond index to post a +2.4% increase in Q1.

Economic & Market Discussion: **Two Kitchen Sinks Thrown into the Unknown**

This is truly a time of unprecedented uncertainty. Let's examine the pandemic's impact on the US, evaluate the government's response and then provide a view on a path forward.

- Closed Until Further Notice** – We are in the midst of a planned recession with roughly 25% of the economy shut down unevenly across sectors. Per the chart below, a large chunk of the US economy, 19% of US GDP and 20% of payroll jobs, resides in sectors almost completely shut down by social distancing protocols. As the virus spreads, unemployment claims surged to 16.7 million in three weeks, and consumer confidence has crumbled. The sudden economic stop will continue to drive record-setting weakness in services, manufacturing and corporate earnings for the second quarter and likely extend into the back half of 2020. Our research sources estimate the depth of the recession could reach over 20% unemployment with GDP falling over -30% for Q2.



Source: Bureau of Economic Analysis, Bureau of Labor Statistics

- **Two Kitchen Sinks** – To combat the dire economic situation, the US government has responded swiftly with a gusher of emergency aid. The Federal Reserve has taken an “and the kitchen sink” approach to its efforts to keep the financial markets operating and support credit markets, including the unprecedented move of buying corporate bonds. Congress passed its version of “and the kitchen sink” with the CARES Act, which aids individuals, small businesses and large corporations via over \$2 trillion in loan and grant money. And the help will likely not end there. As the economic effects of the Covid-19 crisis ripple through every industry and region of the country, more fiscal and monetary response may be required. The bottom line is the rapid government response will likely prevent a worst-case scenario for the economy and financial markets.
- **Into the Unknown** – We are in a natural disaster, emergency response situation. The human tragedy of the pandemic is historic, as is its effect on the US economy. The government response to help people and businesses stay afloat has been massive, will continue, and is likely to prevent the worst-case scenario. However, we are in uncharted waters and there are no models to confidently predict what will happen over the next several quarters to the virus, the economy or the markets. We do know that the ramp up for rebuilding consumer demand and restarting businesses large and small all hinge on virus containment. While that short-term track is unclear, we are confident there will be an economic recovery and financial markets reflect it early.

In summary, our position is we don't need to predict the precise recovery path. Instead we will focus on evolving economic and market conditions while we execute our strategy as explained below.

Portfolio Strategy: Bear Market Playbook

As we have laid out in our recent email updates, our portfolio management playbook during this unusual time of market upheaval is to think long-term, be patient and follow these primary strategies:

- **Rebalance** – Over the next several months, we expect to shift assets from cash to equity and credit exposures in portfolios at several points as the market bottoming process occurs. We believe rebalancing even as high volatility persists will benefit portfolios over the next several years.
- **Emphasize Strength** – In seeking opportunities amid the economic turmoil, we want to overweight quality in both stocks and income-producing securities during this period of high market uncertainty. While we favor investments that have a margin of safety in the underlying entities, such as large cap US tech and health care, we will also look for undervalued opportunities in other areas as well.
- **Harvest Losses**– We have harvested losses in many brokerage portfolios and will continue to seek this opportunity. As we lock in the capital losses to be used later to offset taxes on future gains or income, we replace sold positions with similar securities to keep your portfolio on track.

| Market Index | Market Performance | | | | | % Change for Periods Ended 3/31/2020 | | | | |
|------------------------------------|--------------------|----------|--------|----------------|----------------|--------------------------------------|--|--|--|--|
| | First Quarter | 2020 YTD | 1-Year | 3-Year Annual. | 5-Year Annual. | | | | | |
| Russell 1000 | -20.22 | -20.22 | -8.03 | 4.64 | 6.22 | | | | | |
| MSCI EAFE – Non-US | -22.83 | -22.83 | -14.38 | -1.82 | -0.62 | | | | | |
| Russell 2000 | -30.62 | -30.62 | -23.99 | -4.64 | -0.25 | | | | | |
| MSCI Emerging Markets Equity | -23.60 | -23.60 | -17.69 | -1.62 | -0.37 | | | | | |
| DJ US Real Estate | -24.39 | -24.39 | -16.74 | -0.15 | 1.60 | | | | | |
| NASDAQ 100 | -13.95 | -13.95 | 0.70 | 10.39 | 10.70 | | | | | |
| Barclays Gov't/Credit Interm. Bond | 2.40 | 2.40 | 6.89 | 3.79 | 2.76 | | | | | |
| Wilshire Liquid Alternative | -8.48 | -8.48 | -5.41 | -1.06 | -0.83 | | | | | |
| 3-Month T-Bill | 0.39 | 0.39 | 2.04 | 1.74 | 1.12 | | | | | |