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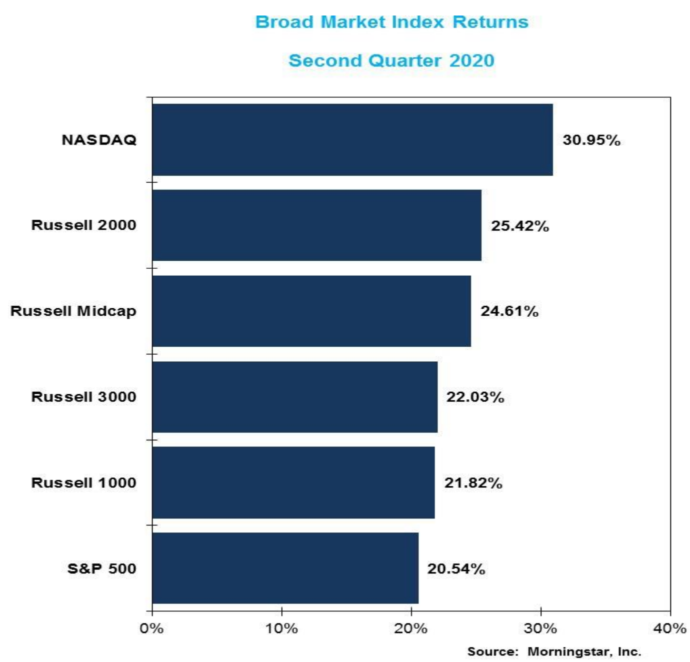
If nothing else, this year has reinforced the reality that we cannot predict the future. COVID-19 has significantly altered and impacted so many lives and in ways few, if any, could have predicted at the beginning of the year. In a short period of time, we've seen massive changes in the economy, employment, the markets, how we shop, and even how we interact with friends and family. Before delving into the report – we just want to say that we hope everyone is adjusting to the new normal and staying safe.

In the first quarter we saw the quickest bear market ever experienced. The second quarter was practically the reverse, as we saw a very strong market recovery. While, the market did not recover all of the first quarter market decline, it came closer than most people would have imagined at the end of March. There is a lot to discuss and unpack with the economy and the markets….so let's get started.

The Economy



The US economy remains mired in an economic maelstrom resulting from the lockdowns brought on by the COVID-19 virus. The phased re-opening that states have begun to implement has provided a boost to economic activity, but there are still many segments of the economy that will take time to recover. The anxiousness to re-open in hopes of having the economy return to pre-lockdown levels is now also being met with an increase in the number of new coronavirus cases in certain portions of the country. Still, governmental leaders and business owners are resolute in their efforts to re-open the economy while attempting to mitigate the effects of COVID-19. The economic effects of the coronavirus became clear in the first quarter data (the latest quarter reported). The Bureau of Economic Analysis reported its third estimate of first quarter 2020 gross domestic product (GDP) of -5.0%, in line with the prior estimate, but of course far below the fourth quarter 2019 reading. The negative impact of COVID-19 on the employment situation was significant in March and April, with employers shedding 1.4 million and 20.7 million jobs, respectively. However, the May employment report showed an astonishing increase in the number of jobs, as 2.5 million were added to payrolls when analysts had expected additional losses of 7.5 million. The May report showed an average of approximately 6.5 million jobs lost each month of the quarter, and that the unemployment rate climbed to 13.3%. The Federal Open Market Committee (FOMC) maintained the aggressive monetary policy response to the crisis, leaving the funds rate target range of 0% to 0.25% unchanged. The central bank is unlikely to consider raising interest rates anytime soon.

The global economic environment is encountering historic supply and demand shocks that will take time to overcome. COVID-19 precipitated the swiftest and most severe global downturns on record. We are now embarking on what is likely to be a slow road to recovery that could potentially be hampered by the current surge of the virus.

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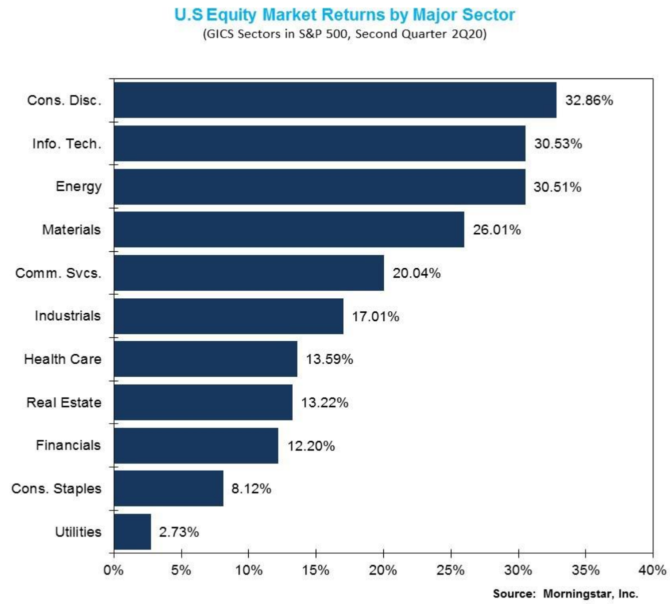
Highlights and Persepctives

GROSS DOMESTIC PRODUCT (GDP)

In the latest data available, the Bureau of Economic Analysis released the third estimate of the first quarter 2020 real GDP, a seasonally adjusted annualized decline of 5.0%, in line with the prior estimate, but of course far below the growth in the fourth quarter of 2019. Consumer spending and non-residential investment were primary contributors to the decline. Residential spending, government spending and imports partially offset these declines. Corporate profits fell by 12.3% (not annualized) during the quarter. Analysts expect this recession to be one of the most severe in U.S. history.



HOUSING

The pandemic has had a materially negative impact on the housing market, as potential homebuyers have put plans on hold. Existing-home sales for May (the latest monthly data available) declined to an annualized rate of 3.9 million units, 9.7% lower than the results from April, and down about 27% from year-ago levels. The inventory of existing homes was almost five months of supply, much higher than levels of the prior year. Existing-home prices in May increased 2.3% from May 2019. In the new-home segment, the NAHB Housing Market Index, a measure of homebuilding activity, ended the quarter at 58, significantly higher than the prior month's reading but lower than year-ago levels. The data indicate that homebuilders are becoming confident that the worst of the impacts of COVID-19 are behind us, and the outlook for the housing market is becoming very positive.

EMPLOYMENT

The May employment report (the latest data available) produced a significant positive surprise in terms of payrolls. Employers added 2,509,000 jobs during the month, approximately 10 million more than the consensus expectations of a loss of 7.5 million jobs. Re-openings in various states happened more quickly than had been anticipated, and while jobs growth numbers are likely to be volatile in the coming months, the trend seems to be moving in a positive direction. Many analysts expect the unemployment rate to end the year at about 10%, with a full recovery not coming until a vaccine is hopefully available sometime in the first half of 2021. The unemployment rate in May declined to 13.3%, and the labor force participation rate edged higher to 60.8%.

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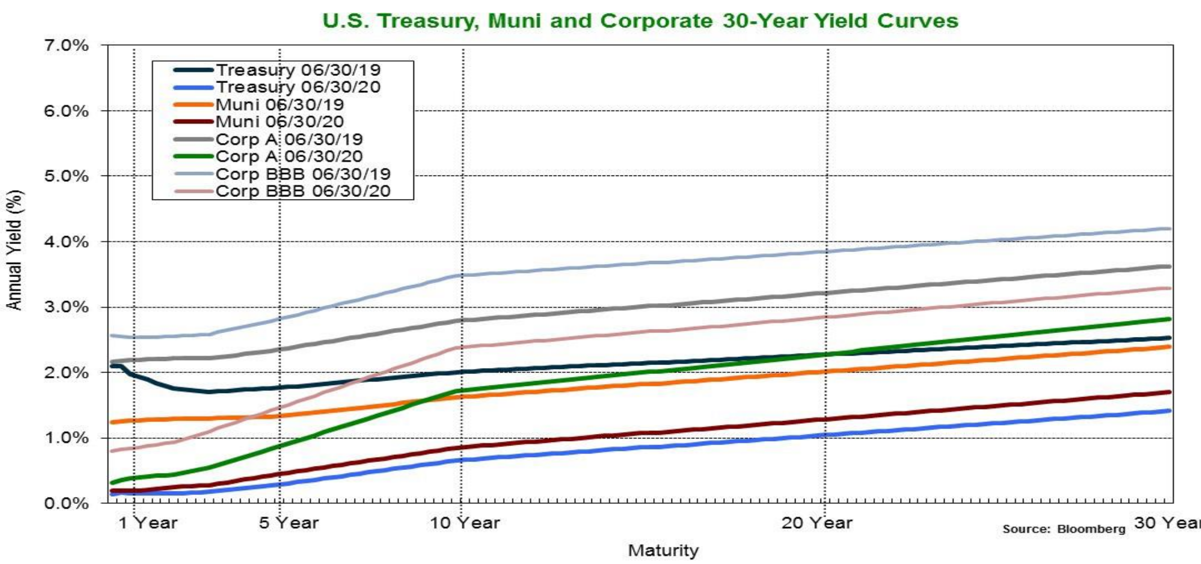
FEDERAL RESERVE POLICY

The FOMC made no change to either the federal funds rate target range of 0% to 0.25%, or its forward-looking guidance. The Fed's Summary of Economic Projections anticipates no change to the fed funds rate through 2022, and that inflation will be lower than its target of 2%. From a balance sheet perspective, the FOMC will continue to buy $80 billion of Treasury securities per month and about $40 billion of mortgage-backed securities. The bottom line is that without any so-called economic "green shoots" on the horizon the Fed will continue to be aggressive in terms of monetary policy.

Interest Rates

Fixed income securities' prices generally trended higher (and yields lower) in the quarter with monetary conditions easing, and more of a risk-on environment beginning to take hold. Central bankers throughout the world remained very aggressive in their policy response to the economic effects of COVID-19. Volatility in both fixed income and equity markets also subsided during the quarter as businesses began to re-open. As mentioned above, the FOMC made no change to the previous policy steps it took in the first quarter to ensure sufficient market liquidity. As such, the FOMC is expected to maintain the target federal funds rate range at between 0% to 0.25% for the foreseeable future.



The shape of the Treasury yield curve was little changed during the second quarter, with yields on the shortest-term maturities rising modestly relative to yields in the intermediate-term segment of the curve. Overall, the Treasury curve edged slightly higher from the prior quarter, as investors weighed the economic impacts of businesses beginning to re-open. Yields rose by about 0.10% on short-term maturities, while falling a similar amount on intermediate-term securities. By the end of the quarter, the yield on the benchmark 10-year US Treasury note was little changed, ending at 0.66%, compared to 0.67% on March 31.

Inflation expectations were little changed, with the Fed's gauge of five-year forward inflation expectations ending at approximately the same level of 1.25% as on March 31. At this point it is too early to predict when inflation will be a major concern, which it will inevitably be at some point.

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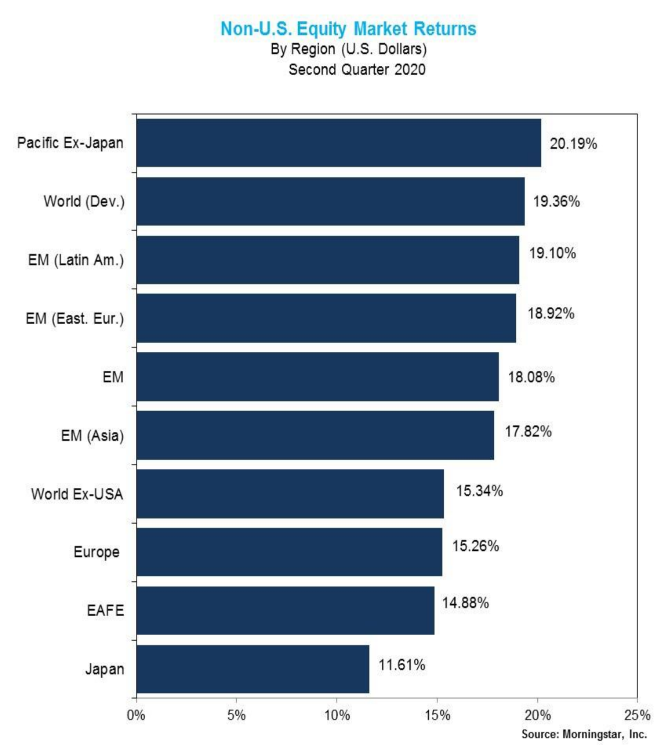
Total returns on fixed income securities were higher, with positive returns in almost every segment of the market. The Bloomberg Barclays Treasury 5-7 Yr. Index rose by +0.8% for the quarter. The Bloomberg Barclays US Corporate 5-10 Yr. Index gained +10.0% during the three months. High yield securities, which often follow the performance of equities, surged, posting a return of +10.2%. Municipals also had a good quarter, as the Bloomberg Barclays Municipal Bond Index advanced by +2.7% during the quarter. Prices of non-US fixed income securities were higher in the quarter, as the Bloomberg Barclays Global Aggregate ex-US Index gained +3.4%. Emerging markets bonds posted significant gains, with the JPM EMBI Global Index rallying +11.2%.

Equity Markets

While the health-related effects of COVID-19 were still playing out in the second quarter, stock prices staged one of the most impressive rallies on record as investors attempted to discount the magnitude and timing of an economic recovery. While broad stock indexes had plummeted about 34% in about five weeks of trading in the first quarter, they surged approximately 45% from the closing low on March 23 to the quarter's closing high in June 8. Driving the rally was the belief that since the economic downturn was self-imposed, a re-opening of the economy might enable a recovery approximating the strength experienced prior to the lockdown. Investors were heartened by the huge positive surprise in the May employment report, which showed that employers added more than 2.5 million jobs in the month when the consensus expectation had been a loss of 7.5 million jobs. The rally in stock prices came to an end in June, however, as new coronavirus cases were reported, potentially as a result of people wanting to resume normal activities after being in lockdown for months. As a result, stock indexes declined approximately 5% from their early June levels. However, when the quarter ended, the S&P 500 Index had surged +20.5%.

Performance of each of the eleven primary economic sectors was positive during the quarter. Consumer Discretionary, Information Technology, and Energy were the strongest performers on a relative basis, generating returns of +32.9%, +30.5%, and +30.5%, respectively. The Utilities, Consumer Staples and Financials sectors were the poorest relative performers, posting returns of +2.7%, +8.1%, and +12.2%, respectively.

The Russell 1000 Index of large capitalization stocks generated a +21.8% total return. Within the large cap segment, growth stocks significantly outperformed value stocks. Small cap stocks, as represented by the Russell 2000 Index, outperformed large caps, and finished the quarter with a total return of +25.4%. Small cap growth outperformed small cap value. The NASDAQ Composite, dominated by information technology stocks, finished the quarter with a gain of +31.0%. The Dow Jones Industrial Average of 30 large industrial companies advanced by +18.5%.



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Real Estate Investment Trusts (REITs) also participated in the rally during the quarter, with the DJ US Select REIT Index up +9.1%. Commodities were modestly higher, with the Bloomberg Commodity Index adding +5.1% for the quarter. International stocks also experienced significant gains during the quarter, and generally performed in line with US equities. The MSCI ACWI Ex-USA Index, which measures performance of world markets outside the US, jumped by +16.1%. The MSCI EAFE Index of developed markets stocks advanced by +14.9%. Regional performance was positive across the board for the quarter. Eastern Europe was the strongest performer on a relative basis, with a return of +18.9%. Japan was the poorest relative performer, gaining +11.6%. Emerging markets performance was also strong, as the MSCI Emerging Markets Index was higher by +18.1%.

Looking Forward

The U.S. economy is now emerging from what has been termed the swiftest and most severe recession in U.S. economic history. The peak of the last expansion occurred in February, and the low point came in May, making the recession a short-lived three months, the shortest recession since prior to the Civil War.

Driving the turnaround has been the quick pace of re-openings. According to Moody's Analytics, in mid-April approximately 2,600 U.S. counties were in lockdown, representing approximately 30% of GDP. Given the surge in new cases, each day seems to bring more counties in lockdown which will continue to have an impact on GDP going forward.

In addition to businesses re-opening, the FOMC's aggressive initial policy response ensured liquidity and served to protect the financial system from the problems within the general economy. The Fed is also sending a clear signal that it will maintain interest rates at current low levels (near zero) until the economy is back to full employment, which could potentially take multiple years. Economists also believe that continued fiscal policy support will be critical to returning the economy to full employment as quickly as possible. While some have questioned the efficacy of the fiscal programs put in place so far, most analysts are of the opinion that additional fiscal stimulus is necessary so that the rebound is not slowed, and that the economy does not experience a double-dip recession in the latter half of the year.

With a low interest rate environment that will last perhaps into 2022, investors have been willing to adopt a risk-on investment stance and bid up the prices of risk assets. We feel everyone should be prepared for continued market volatility. It is likely that we will see more big swings on both the upside and the downside. Eventually we will come out of this, but it will take some time. We are reminded that patience is a virtue and something that will be badly needed as we navigate this uncertain, uncharted phase in our lives and in the world.

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