Smith Group
ASSET MANAGEMENT

MARKET PERSPECTIVES

MARCH 20, 2020

Equity Market Summary

U.S. Equity Markets	Feb 19-Mar 19	YTD	Top/Bottom Sectors	Feb 19-Mar 19	YTD
S&P 500	-28.7%	-25.1%	Cons. Staples	-16.4%	-14.2%
Russell 1000 Growth	-27.1%	-20.4%	Technology	-27.3%	-18.5%
Russell 1000 Value	-32.7%	-31.8%	Health Care	-20.9%	-19.3%
Russell 2000	-37.4%	-36.4%	Industrials	-35.6%	-33.6%
Russell 2000 Growth	-36.3%	-33.0%	Financials	-37.2%	-36.4%
Russell 2000 Value	-38.5%	-39.8%	Energy	-53.2%	-57.4%

Non-US Equity Markets (in USD)	Feb 19-Mar 19	YTD	Non-US Regions (in USD)	Feb 19-Mar 19	YTD
MSCI AC World Ex U.S.	-30.2%	-31.9%	Developed Americas	-37.8%	-35.8%
MSCI EAFE (Developed)	-31.5%	-31.9%	Developed Asia	-27.0%	-28.8%
MSCI Emerging Markets	-30.6%	-31.1%	Developed Europe	-33.7%	-33.5%
MSCI China	-20.1%	-18.3%	Emerging Americas	-46.0%	-48.5%
MSCI Japan	-23.2%	-26.3%	Emerging Asia	-27.0%	-26.8%
MSCI Italy	-39.0%	-36.8%	Emerging EMEA	-36.0%	-38.4%

What's changed since our last report (on Mar. 13, 2020):

- Coronavirus (CV-19) has spread rapidly around the globe with cases increasing by 85%, deaths doubling and number of countries impacted rising 40% all in the last week. International borders are largely closed and "social distancing" is now our primary mode of interaction. Financial markets continue to swing wildly with the U.S. dollar as the only remaining safe haven.

Where are we now:

- CV-19: 250,000 cases, 10,500 deaths. Reported cases in more than 175 countries. Multiple countries are now in regional if not national quarantines and Italy has surpassed China in total deaths. There is progress being made, as China continues to average single digit daily new virus cases and South Korea new cases are on average rising by 1% per day.

Economy:

- The global economy almost certainly entered recession in late February or early March.
- Jobless claims spiked by 70,000 to 281,000 this week and will climb meaningfully over the coming weeks.
- A deflationary shock is hitting the economy causing real interest rates to rise and making credit more expensive. While the 10-year Treasury yield may be down, nominal rates on "Main Street" are rising and real rates are rising faster (nominal rates plus deflationary expectations = higher real rates) - Harvey Rosenblum, PhD., Former Director of Research, Dallas Federal Reserve; Mar. 19, 2020.

Financial Markets:

- Over the past month, the average stock is faring far worse than the market cap weighted indices. The average U.S. stock has tumbled 43% and the average non-US stock is down 29%. China and Hong Kong are the best performing markets falling 19%. Half of global equity markets are down by more than 35%.
- In a very welcome sign, 10-year Treasury yield bottomed at 0.57% on Mar. 9 and has now risen to 1.15%.
- Oil markets continue to gyrate wildly, falling 40% over 3-days at one point this week before recovering to finish down 20% on the week (thru Mar. 19).

Earnings:

- Earnings expectations have been slow to react to what will surely be a strong and synchronized downward trend in earnings. A year over year decline in earnings of at least 15% is likely in a recession.
- Given the downturn in the global economy we would expect near term company guidance to be centered around liquidity and solvency positions and less centered on earnings guidance. We count no less than 15 companies that issued statements over the past day regarding their current liquidity and solvency positions.
- Over the past month Consumer Discretionary, Energy and Financial companies have experienced the most earnings downgrades. Among Information Technology companies Software & Services have seen the most downgrades, a surprising development given that Semiconductor companies are generally more economically sensitive and have greater exposure to Southeast Asia.

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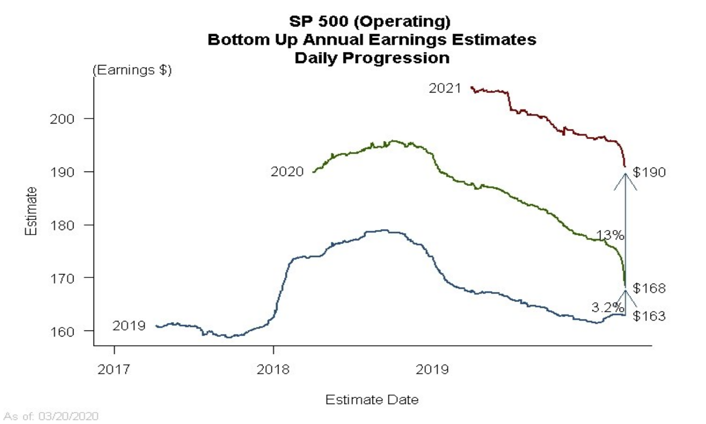
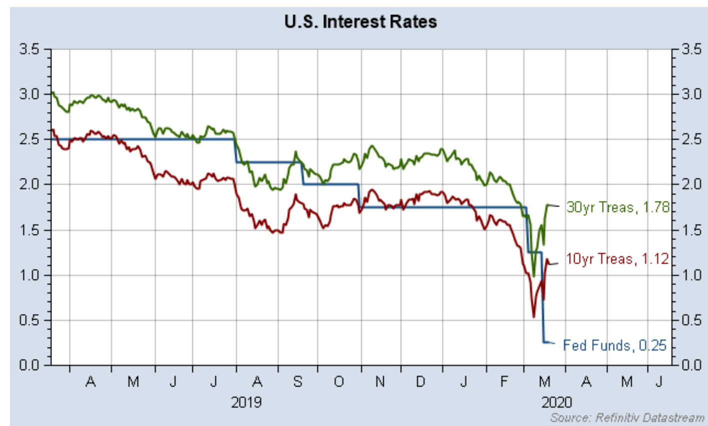
Summary:

The list of financial markets support programs put in place by the Fed and other central banks continues to grow. Fiscal authorities are just now starting to put legislation together. The current White House proposal calls for $800 billion for families and small businesses, and $200 billion in loan guarantees for airlines and other industries, but not direct aid. Undoubtedly, the final plan that is signed could look markedly different, but all plans under discussion are approaching a level of 5% of more of GDP. Last week we wrote of the encouraging news of new virus cases falling to single digits in China and Apple's reopening of all stores in China. Only to have virus cases outside China spike and Apple indefinitely close all stores outside China. This will be the news cycle for awhile until a stabilization in the growth rate of new virus cases. Governments around the globe are acting and acting aggressively to stem the tide. It will likely be a matter of months not weeks before the global economy begins to stabilize, but financial markets are always forward looking and traditionally markets bottom about four months before the economy. We continue to watch earnings revisions and the upcoming earnings season for company guidance as the timely indicators of the depth of the economic downturn.



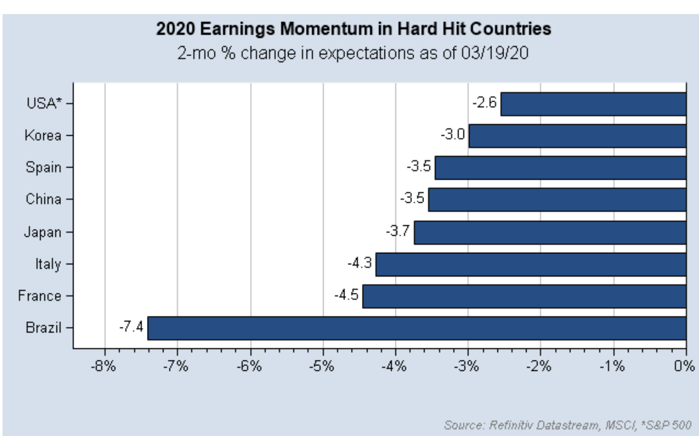
Earnings Trends

Domestic earnings expectations have begun to fall, but there's a long way to go. Small Cap earnings are actually still expected to climb more than 20% on the year. The earnings diffusion index (which measures the number of up and down earnings revisions relative to all revisions) just hit –1 standard deviations from mean within the past week. If the Global Financial Crisis is any guide then the diffusion index is only 1/4th of the way to the bottom.



Interest Rate Environment

After bottoming on Mar. 9, interest rates have climbed back to yields of the beginning of March, just prior to the Fed's first emergency interest rate cut. The 5-year inflation breakeven rate is below 20bps, it's lowest level since Jan. 2009, but still well above the depths of the Global Financial Crisis. The stock of global sovereign debt at negative yields has risen more than 50% year-to-date. 54 central banks have now cut interest rates year-to-date



Global Earnings Momentum Environment

One might have thought that since Chinese companies were shut down first that their earnings estimates may have fallen the most in the last couple of months. Actually, French and Italian earnings expectations have been the hardest hit of countries reporting significant cases of COVID-19. Brazilian earnings expectations have been hardest hit. While their cases are more modest so far the virus is expected to get out of hand in the country due to less robust medical systems. Additionally, the slowdown in China and oil price war have been an anchor around the commodity export prices and volumes that the Brazilian economy is so dependent."

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