Equity Market Summary

U.S. Equity Markets	Feb 19-May 31	YTD	Top/Bottom Sectors	Feb 19-May 31	YTD
S&P 500	-9.8%	-5.2%	Technology	-4.3%	7.3%
Russell 1000 Growth	-3.7%	5.2%	Cons. Discretionary	-4.0%	2.1%
Russell 1000 Value	-16.7%	-15.7%	Health Care	-0.6%	1.6%
Russell 2000	-17.2%	-15.9%	Industrials	-19.1%	-16.5%
Russell 2000 Growth	-11.2%	-6.6%	Financials	-24.3%	-23.4%
Russell 2000 Value	-24.2%	-25.8%	Energy	-27.8%	-34.3%

Non-US Equity Markets (in USD)	Feb 19-May 31	YTD	Non-US Regions (in USD)	Feb 19-May 31	YTD
MSCI AC World Ex U.S.	-15.2%	-15.8%	Developed Americas	-17.5%	-14.8%
MSCI EAFE (Developed)	-14.5%	-15.3%	Developed Asia	-6.1%	-8.4%
MSCI Emerging Markets	-15.7%	-16.5%	Developed Europe	-15.9%	-15.7%
MSCI China	-7.0%	-4.9%	Emerging Americas	-35.3%	-38.2%
MSCI Japan	-3.1%	-6.9%	Emerging Asia	-11.0%	-10.8%
MSCI Italy	-26.2%	-23.6%	Emerging EMEA	-20.4%	-23.4%

What's changed since our last report (on Apr. 30, 2020):

- Coronavirus (CV-19) continues to spread but the rate of infection is slowing, if only modestly. More countries are moving to allow economic activity to return to more normal levels as "stay at home" orders are eased around the world. In the U.S., 95% of the population is now out of state imposed lockdowns[1]. Japan ended its nationwide state of emergency, Britain outlined plans to allow retail outlets to open and Germany is lifting travel warnings to 31 European countries. Full recovery remains dependent on a widely available and effective vaccine. There are over 100 vaccine candidates under development with at least 8 in clinical studies. While large scale production likely remains at least a year away, production has already begun on multiple promising candidates and doses could be available in limited quantities as early as late third quarter.

Where are we now:

- CV-19: more than 6.2 million cases (88% M/M rise) and 372,000 deaths (62% M/M rise) worldwide. Daily new cases continue to rise globally, reaching 125,000 per day on May 29; however, the rate of spread is actually declining as total cases have taken 30 days to double vs. 20 days for the previous doubling. Daily new deaths are steadily declining, averaging 4,500 over the past week, after peaking at 8,400 in mid-April. The U.S. accounts for 30% of global cases and deaths. Brazil, Russia, Mexico and India are experiencing a surge in cases and deaths.

Economy:

- First quarter U.S. real GDP was revised lower to -5.0% Q/Q annualized. Estimates for the second quarter continue to drop; however, businesses are re-opening and the economy has likely bottomed.
- The U.S. personal savings rate rose 33% in April - possibly a good indication of consumers' ability to fund future spending.
- Over the past 10 weeks 1 in 4 (40.8 million) U.S. workers have filed for unemployment. The 4-week average is 2.6 million with the latest reading being 2.1 million. Continuing jobless claims, a more important barometer of the economic re-start, now stand at 21.1 million (in the week ending May 16). This is down 3.9 million from the prior week, reflecting people going back to work. The record prior to this year was 6.5 million in 2009.

Earnings:

- To date, 478 (95%) S&P 500 companies have reported first quarter earnings and Y/Y earnings growth is down 12.6% and revenues are down 1.4%. Excluding the energy sector earnings growth is down 11.9%. Health Care and Technology sectors have seen earnings growth rates of more than 6% while Consumer Discretionary earnings have fallen by 51%. For the quarter, S&P 500 share-weighted earnings have fallen $39 billion Y/Y to $274 billion.
- The four largest banks in the U.S. (JPMorgan Chase, Bank of America, Citigroup and Wells Fargo) reserved more than $23 billion for loan-losses during the first quarter. That figure represents less than 1% of their aggregate loan portfolios and is likely just the beginning of significantly higher provisioning over the next several quarters. However, banks are better capitalized today than during the financial crisis as tangible capital levels are 62% higher today than in 2008.
- Credit markets have stabilized and investment grade debt issuance is at record levels. However, levered loan defaults are frequently an early warning signal for credit markets and defaults are up by 175% over the past 12-months vs. the prior period. But the total level of defaults is still less than half the 2009 high[2].
- For the second quarter, the S&P 500 is expected to see a 42% drop in earnings, equating to a Y/Y drop of $142 billion. The current estimated Y/Y drop is almost twice as large as was expected at the end of April. None of the 11 sectors are expected to see a Y/Y earnings increase. Consumer Discretionary and Energy are

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100 Crescent Court, Suite 1150 | Dallas, Texas 75201 | 214.880.4600 | 800.582.3435 | F 214.880.4640 | www.smithasset.com

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each forecast for earnings to drop more than 100%. Revenues are expected to decline by 12.3% or a $348 billion Y/Y drop. Only Health Care at +1.4% and Utilities at +0.9% are expected to grow revenues Y/Y.

Financial Markets:

- After April's record performance, U.S. equities continued to rally in May, and the S&P 500 now sits 9.8% below its all-time high of Feb. 19. Small caps remain in bear market territory as the Russell 2000 is still 20% below the all-time high of Aug. 31, 2018.
- While still elevated, volatility has calmed meaningfully. The S&P 500 annualized rolling 20-day volatility currently stands at 22.9 after peaking at a reading of 96.7 on Mar. 27.
- Growth stocks outperformed again in May and the rolling 12-month outperformance of the Russell 1000 Growth vs. the Russell 1000 Value now stands at 27.9%, the 16th highest differential in the last 25 years. The largest differential took place in the 12-months ended Feb. 28, 2001, when the Russell 1000 Value outpaced the Russell 1000 Growth by 47.7%

Summary:

The disconnect between financial markets and the economy has been widely discussed in the financial media and for those investors that have remained short, expecting the markets and the economic numbers to merge, the long-standing mantra of “Don’t Fight the Fed” is once again a painful lesson to learn. But we may be entering a period where the economy is finding a bottom and starting to exhibit greenshoots of its own. While 1 in 4 workers filing unemployment claims over a less than 3 month period could never be considered good news, there is improvement and stabilization in the data. Additionally, Consumer Confidence appears to be bottoming and New Home Sales posted a stunning M/M rise in April, although Existing Home Sales sank 17.8% for the same period. In prior letters we’ve stated it was difficult for the economic figures to get much worse and that appears to be true. But at some point the absolute level of activity will come back into investors’ view, instead of just the near-term improvements, and that may prove a challenging hill for the markets to climb. Earnings are not likely to reach prior peak levels until mid-2022 and the same is likely true for the economy. Additionally, the permanent damage done to jobs is still largely unknown with some estimates that there may be a permanent 10 million jobs lost in the U.S. due to the crisis[1]. We do not believe a “V-shaped” recovery is necessarily in place, although the initial phases of the recovery are likely to look “V-shaped.” Tensions between the U.S. and China are rising and not likely to abate anytime soon. China voted to override Hong Kong’s autonomy and actions aimed at Taiwan are likely ahead. China believes it has a window to act while the world is focused on the pandemic.

Governments have four primary economic policy tools: Monetary (interest rates/money supply), Fiscal (taxes/spending), Trade (tariffs) and Regulations. During the Great Depression, the U.S. got all four economic policy tools wrong. To date the economic policy responses to the pandemic have been massive and directionally correct, but trade policy between the U.S. and China is rapidly reversing course and the risks of a misstep that damages the recovery are rising. U.S. action may well be necessary given Chinese policy on Hong Kong, Taiwan and other fronts, but regardless of appropriateness an escalation in tensions will hinder a recovery. This past week, the EU set out a $2 trillion pandemic response plan, a major step toward easing the economic pain of the pandemic, especially in the hardest hit southern nations. Negotiation and ratification will take some time but this is a very important first step. The U.S. still has at least one more round of stimulus to be passed, although momentum has stalled in order to better understand where the economy stands following the initial policy implementations. The past few weeks have confirmed that testing and treatment developments will continue to be the primary driver of day-to-day swings in the markets. On a positive note, economic data appears to have found a bottom and fiscal and monetary stimulus is providing a bridge to a re-opening.

[1]: Strategas Securities, LLC, May 2020, All rights reserved;
[2]: S&P Global Market Intelligence

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