SilverOak

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First Quarter 2020 Market Summary

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First Quarter 2020 Market Summary

First of all, we would like to thank all of the first responders and health care professionals on the frontlines in the fight against COVID-19. In addition, we pray for those impacted by this virus and hope you and your families remain safe and healthy. We will get through this and life will eventually resume a more normal routine, albeit possibly a "new normal" routine.

There is no "sugar coating" how poorly the markets performed in the first quarter of 2020. After coming off one of the strongest years of performance in decades, with economic and fundamental data still supportive of further expansion, COVID-19 wiped out years' worth of growth over the course of just three to four weeks. The longest economic expansion in U.S. history has now ended in a historic fashion with one of the sharpest and quickest pullbacks on record.

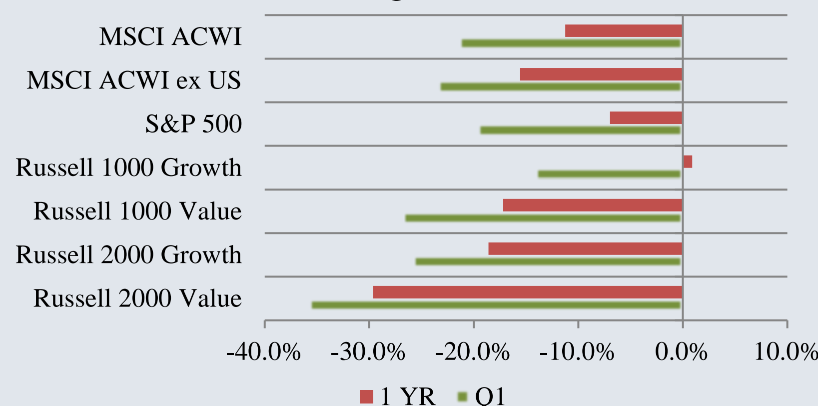
The magnitude of this pullback was likely exacerbated by the lack of information available regarding what has turned into a global health crisis. Although many experts expected the impact of this virus to mirror that of SARS, MERS, H1N1, Ebola, etc., the novel coronavirus caught everyone by surprise as the early data was conflicting regarding the infectiousness and the mortality rate. Given markets act as a discounting mechanism, they tend to overreact to the downside when no other information is available. Hence, as you will see below, equity markets ended the quarter down 20% - 30%.

The Bloomberg Barclays U.S. Aggregate Bond Index, which represents a broad basket of bonds, registered an impressive return of 8.7% for the year, as the 10-year Treasury bond yield fell from 2.69% to 1.90%. While a benefit in 2019, interest rate movement is a double-edged sword. A move back to 2018 levels for interest rates would likely lead to negative bond returns. Credit spreads declined during the year, benefitting sectors such as corporate bonds, high-yield and emerging market debt, which had the highest returns for the year. The Fed is signaling it will keep rates unchanged for the duration of the coming year as long as economic data remains stable.

We should also note the impact this one quarter of performance has had on trailing performance numbers, which was significant, as investors could be anchoring to the positive performance of past years and not fully incorporate recent negative performance. A standard 60/40 portfolio made up of various equity and bond sectors had a 3-year annualized trailing return of 9.41% at the end of 2019. This same portfolio had an annualized return of 2.94% by the end of the first quarter 2020.

In another example, if you started investing in the same 60/40 portfolio on January 1, 2016, your since-inception annualized return would have been cut in half simply by adding the first quarter 2020 performance to your returns series.

As we have discussed in past communications, utilizing short-term performance data to make long-term investment decisions can be a recipe for disaster. The same can be said of making drastic changes in an investment strategy during times of extreme volatility, which perfectly describes these past few weeks. Just in the span of 21 trading days over the past month, the Dow Jones Industrial Average Index experienced 3 of its top 20 worst days in market history, while also experiencing 3 of its best days in market history. What had been seen as normal market swings over the course of a few months or quarters is now occurring intra-day. This volatility only builds on the anxiety felt by investors as they grapple with the impact of "stay at home" orders on their daily lives and the fear of contracting COVID-19.



First Quarter 2020 Market Summary (continued)

Largest Daily Percentage Losses in DJIA History				Largest Daily Percentage Gains in DJIA History		
Rank	Date	% Change		Rank	Date	% Change
1	10/19/1987	-22.61%		1	3/15/1933	+15.34%
2	3/16/2020	-12.93%		2	10/6/1931	+14.87%
3	10/28/1929	-12.82%		3	10/30/1929	+12.34%
4	10/29/1929	-11.73%		4	3/24/2020	+11.37%
5	3/12/2020	-9.99%		5	9/21/1932	+11.36%
6	11/6/1929	-9.92%		6	10/13/2008	+11.08%
7	12/18/1899	-8.72%		7	10/28/2008	+10.88%
8	8/12/1932	-8.40%		8	10/21/1987	+10.15%
9	3/14/1907	-8.29%		9	8/3/1932	+9.52%
10	10/26/1987	-8.04%		10	2/11/1932	+9.47%
11	10/15/2008	-7.87%		11	3/13/2020	+9.36%
12	7/21/1933	-7.84%		12	11/14/1929	+9.36%
13	3/9/2020	-7.79%		13	12/18/1931	+9.35%
14	10/18/1937	-7.75%		14	2/13/1932	+9.19%
15	12/1/2008	-7.70%		15	5/6/1932	+9.08%
16	10/9/2008	-7.33%		16	4/19/1933	+9.03%
17	2/1/1917	-7.24%		17	10/8/1931	+8.70%
18	10/27/1997	-7.18%		18	6/10/1932	+7.99%
19	10/5/1932	-7.15%		19	4/6/2020	+7.73%
20	9/17/2001	-7.13%		20	9/5/1939	+7.26%

Source: S&P Dow Jones

During more typical bear markets, diversified investors can find solace in having a component of their investments in bonds, which tend to act as a ballast to the portfolio. While bonds certainly did not lose as much as stocks during the quarter, they also did not provide as much protection since the market drawdown was abnormally swift. A dash for cash led to significant liquidity issues and price dislocations in the bond markets. Although the Bloomberg Barclays U.S. Aggregate Bond Index (Agg's) was up 3.2% for the quarter, that does not tell the whole story. The Agg's large U.S. Treasury and government holdings benefitted in the selloff. Meanwhile, almost all other bond sectors had negative returns, including corporate bonds and municipals. Over the past few weeks, credit spreads have increased to levels not seen since 2008 and interest rates have fallen dramatically across the yield curve with the 30-year Treasury even breaking 1%.

In response to the market turmoil, the Federal Reserve and Treasury quickly responded with financial aid that is unprecedented in magnitude. First, the Fed cut the Fed Funds rate to a range of 0% - 0.25%. In addition, they revived the alphabet soup of relief programs used during the Great Recession and they have publicly stated they will do "whatever it takes" to maintain market stability. In addition, Congress and the Administration has acted with significant fiscal stimulus through the recently passed CARES Act (see SilverOak's summary of the CARES Act on our website at www.silveroakwealth.com). Actions that took more than a year to occur during the Great Recession have been enacted within weeks and at a level more than 2 times the amount during the Great Recession. All of this in an effort to get us through this self-induced economic shutdown to fight off the health impact of this pandemic.

We have yet to see if the monetary and fiscal policies enacted thus far will be enough to bridge the divide between where we stand today and the other side of the valley. Much of this will depend on the cycle this virus takes and whether these "stay at home" orders are effective in "bending the curve" of infections. Experts may be merely hoping to stretch-out the duration in which the virus is spread so as not to overwhelm the health care system all at one time. However, many are optimistic that therapeutic treatments will be developed more quickly than initially thought. There are already several possible treatments in clinical trials that are being fast-tracked for possible wider usage. In addition, several possible vaccines are in clinical trials with hopes of being available within 12 months.

Until testing and therapeutic treatments are widely available and ultimately a vaccine is developed, uncertainty and volatility in the markets is likely to persist. Looking back just a few months, anyone predicting the vast majority of the U.S. population would be on "stay at home" orders and the U.S. economy would essentially be shut down would be "laughed out of the room" or labeled a fringe "doomsayer". Nonetheless, this is exactly where we find ourselves today. So, now what?

It is fair to say the economic data coming out will be scary. We already saw weekly unemployment claims spike to 6.6 million this past week. That is 10 times that of the worst levels seen during the Great Recession. There are estimates that second quarter GDP will be -12% to -30%, again, a level multiple-times worse than the Great Recession.

First Quarter 2020 Market Summary (continued)

Having said this, we must remember the following, 1) this is a self-induced economic shutdown, 2) prior to this shutdown, our economy was on very sound footing, 3) the government has injected unprecedented levels of fiscal and monetary policy to get us through this valley and 4) the pandemic will not last forever. Most important, on the other side of this valley, the U.S. consumer will have lots of pent up demand and a desire to find some normalcy in their lives. Although just as with 9/11, some things in our day-to-day lives will likely change forever, we will find the "new normal". In addition, although our hearts goes out to all of those businesses, especially the small businesses in hospitality and entertainment that will not weather this storm, the economy as a whole will ultimately recover. Nobody knows if this recovery is going to be a V shape, W shape, U shape, L shape or square root shape, but we do know the economy will recover.

Looking back at history, we also know markets typically fall well before negative economic data is released, just as what has happened over the past few weeks, and they rise well before positive economic data is released. By the time "the smoke clears" and everyone feels confident, markets will likely have moved much higher. In addition, it is not out of the realm of possibility that they move much higher in a shorter period of time than expected, especially if positive news comes out regarding therapeutic treatments for COVID-19.

As a result, rebalancing can be used as an effective tool to ensure investors don't freeze-up in the face of challenging market returns. By rebalancing a portfolio back to an investors' agreed upon target allocation, which should be aligned with their risk profile, you are selling those investments that have performed the best most recently, while buying those investments that have performed the worst. This is exactly opposite of what normal human psychology would dictate you should do, but financially it has proven to be a winning strategy as markets tend to be cyclical in nature. Currently this rebalancing strategy would result in buying equities after they have lost 30% or more in value. However, history has shown these tend to be good opportunities to invest. Below is a table that shows past periods when the market has declined 30%+, and the subsequent performance over different periods.

Start Date	End Date	S&P 500 Change	Date Passed Decline Of At Least 30%	Further Decline To Bottom	Forward Return From At Least 30% Down Date:			
					1 Year	3 Years	5 Years	10 Years
11/29/1968	5/26/1970	-36.1%	5/14/1970	-8.2%	35.5%	40.4%	22.3%	41.6%
1/11/1973	10/3/1974	-48.2%	7/5/1974	-25.6%	11.8%	19.6%	22.4%	82.6%
8/25/1987	12/4/1987	33.5%	10/19/1987	-0.4%	23.2%	39.0%	84.6%	325.0%
3/24/2000	9/21/2001	-36.8%	9/17/2001	-7.0%	-15.9%	8.6%	27.2%	15.9%
1/4/2002	7/23/2002	-32.0%	7/22/2002	-2.7%	20.5%	50.5%	88.0%	64.7%
10/9/2007	3/9/2009	-56.8%	10/6/2008	-36.0%	-0.2%	10.2%	58.6%	172.9%
2/19/2020	?	?	3/20/2020	?	?	?	?	?

Past performance is not indicative of future results. Cumulative price change only. All returns are shown in U.S. dollars.
Source: S&P Dow Jones

We understand that risk tolerance (perception more than actual) can shift in good times and in bad. There are no "wrong" asset allocations, as they depend on an individual's own risk tolerance, time horizon, and unique circumstances. For some long-term investors, this down market could be an opportunity to purchase securities at lower prices. However, for others, caution should still apply. Psychologist Daniel Kahneman's quote on one of the keys to investing is to have "a well calibrated sense of your future regret".

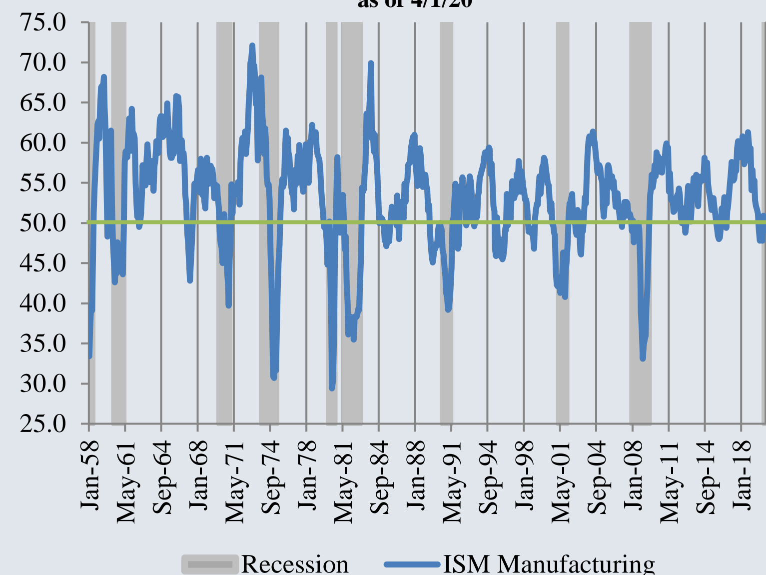
Although we are living in unprecedented times, investors should take comfort in knowing that markets have been through unprecedented times before. We are constantly "making history" and all things shall pass. Until then, as individuals we should move forward being diligent in practicing good hygiene and physical distancing so as to slow the spread of the virus. As investors, we should maintain our investment strategies and not allow emotions or short-term market swings to derail us from prudent decision making.

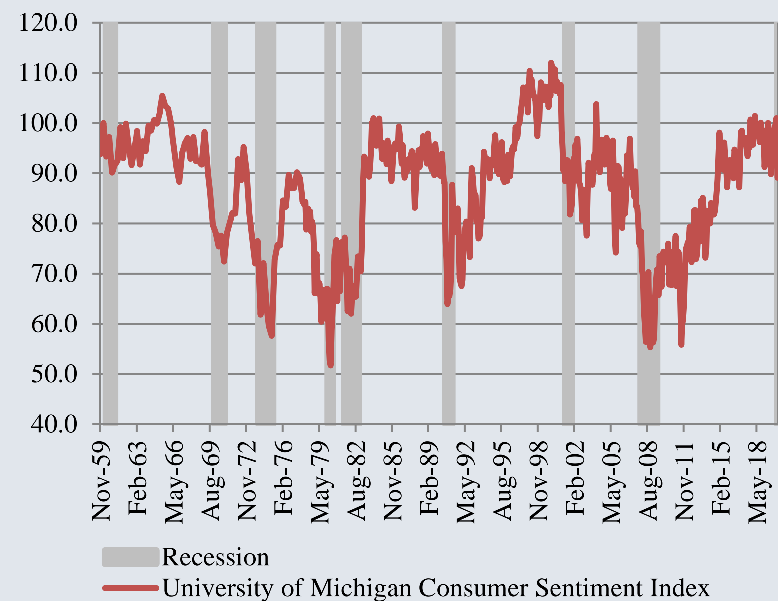
MACROECONOMICS

- The Bureau of Economic Analysis released the advanced estimate of first quarter 2020 real GDP, an annual rate decrease of 4.8% from the preceding quarter. The negative growth due to the economic shutdown is significant. Monetary and fiscal stimulus will likely be able to stem the damage but not completely offset it.
- The U.S. government passed a series of stimulus packages, including the CARES Act that provide loans and grants to companies, small businesses, state and local governments and other parts of the economy. As economic data comes in, the government indicated more stimulus may be needed.
- The ISM Manufacturing Index remained weak during the quarter, finishing at 49.1 in March, but up from 47.8 in December. Typically, when the ISM Index is above 55 it is bullish and when it is below 45 it is bearish.
- The ISM Non-Manufacturing Index declined during the quarter, finishing at 52.5 in March. Data will most assuredly continue to decline over the next few months.
- In March, the Conference Board Leading Economic Index decreased 6.7% month-over-month to 104.2. The index, which is a composite of leading employment, housing, manufacturing, and market indicators, had been relatively flat for over a year before this month's sizeable decline. Historically, the index has declined prior to recessions.
- The price of WTI Crude Oil was $20.51 at the end of March, which is 66.5% lower than $61.14 at the end of December. The price of Brent Crude Oil ended the quarter at $14.85, which is 78.1% lower than at the end of December. Increased supply and dramatically lower demand due to the weak global economy led to the declines.
- Inflation has remained stable over the past few years; however, the past month's reading was lower. In March, headline CPI increased only 1.5% year-over-year. Core CPI, which does not include food and energy, had a 2.1% increase.

CONFIDENCE METRICS

- Consumer confidence has weakened due to the impact of COVID-19. Lower confidence levels will likely impact consumer spending, especially as there is not a clear view of how long the economic shutdown will last. Due to the stay-at-home orders, retail sales, restaurant traffic and hotel occupancy have fallen off a cliff.
- The University of Michigan Consumer Sentiment Index final reading for March was 89.1, which is a decline from its highs, but the index is expected to fall further.
- The Conference Board's Consumer Confidence Index March reading was 120.0, down from 128.2 in December.



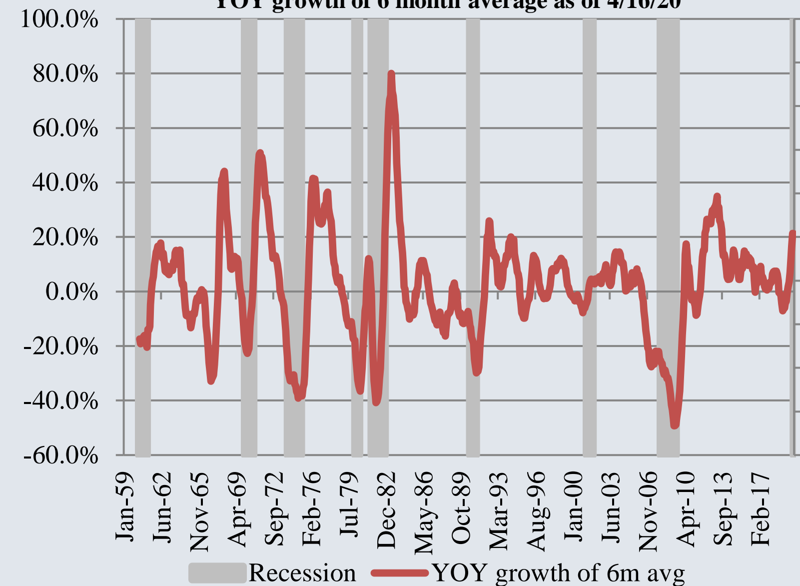


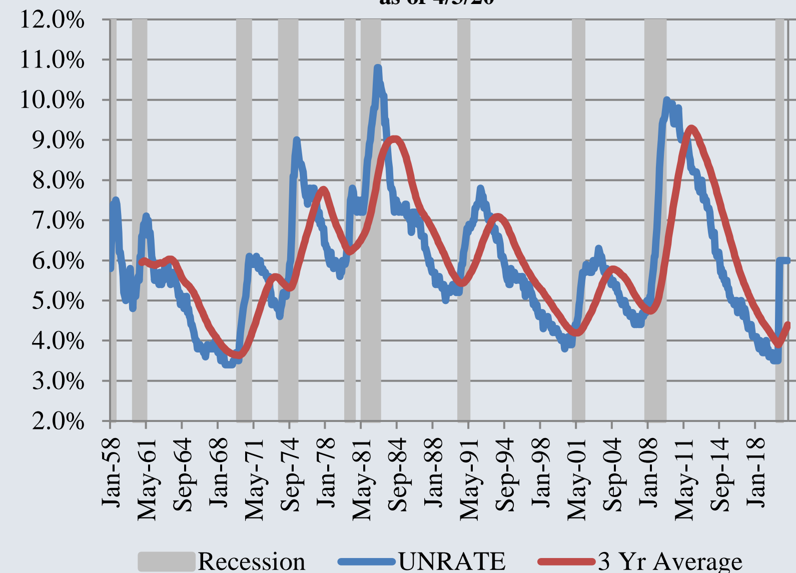
HOUSING

- The housing sector had generally been positive over the past year; however, that was before the stay-at-home orders put in place across the nation. We have yet to see the impact that COVID-19 has had on the housing sector data but home sales are expected to be down significantly over the next few months.
- Preliminary existing home sales increased in the quarter, with a monthly average annualized rate of 5.48 million units from 5.42 million units in the fourth quarter. Unsold home supply remains at low levels.
- The preliminary existing home sale prices for March were 8.0% higher than the levels of one year ago. Prices have been trending up since the beginning of 2012 and reached an all-time high in June 2019.
- New home sales and prices were positive during the quarter and showed strong growth year-over-year.
- S&P Case-Shiller 20-City Home Price Index (seasonally adjusted) showed home prices rose over 3.4% year-over-year in February. Of the locations in the Index, home prices in San Francisco, Seattle, Phoenix, Las Vegas, and Denver have risen the most since 2011, while New York, Chicago and Washington DC have seen the least price growth.
- Housing starts were down during the quarter and finished with a weak March number compared to the previous months.

EMPLOYMENT

- The labor market has weakened significantly due to the impact of COVID-19 and the shutdown of many parts of the economy.
- During the quarter, nonfarm payrolls averaged 71,000 jobs subtracted per month due to a March report that saw a substantial decline in payrolls.
- The unemployment rate increased during the quarter to 4.4% but is expected to climb to double-digits. If this happens, all of the job growth of the past decade will have disappeared.
- Initial Jobless Claims surged to an all-time record in March due to the impact of COVID-19. Many of the jobless claims are in the restaurant, leisure, retail and education sectors.



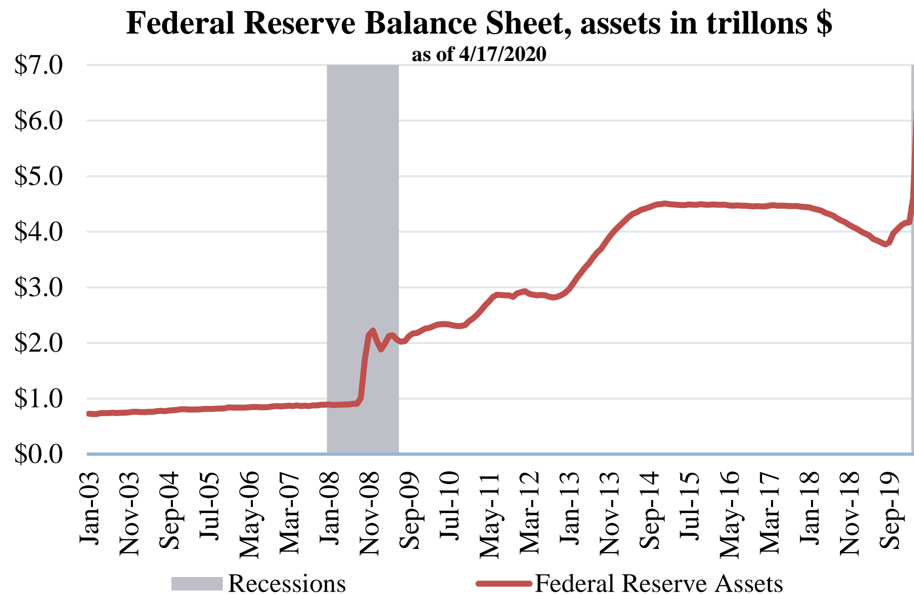


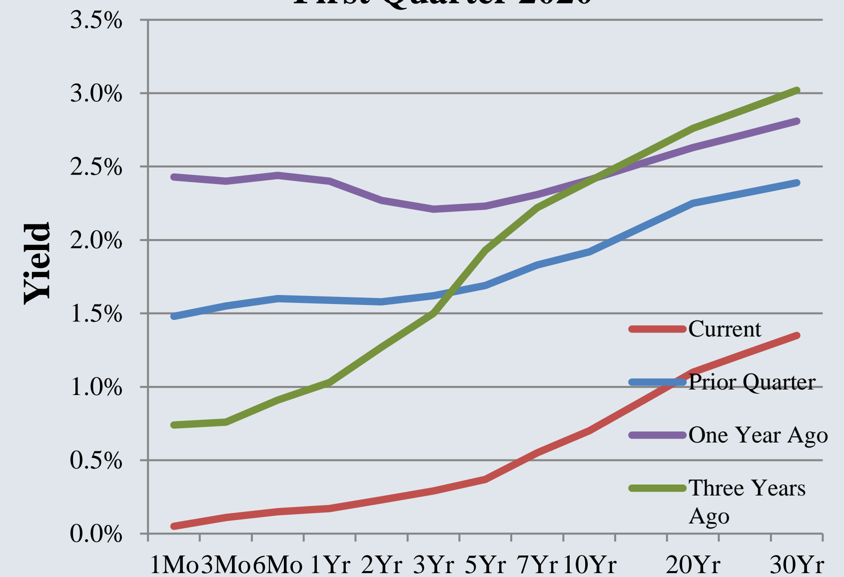
FED POLICY

- The Federal Open Market Committee (FOMC) swiftly decided to lower the federal funds rate to a target range of 0.00% - 0.25% in two unscheduled announcements in March. The Fed cited heightening risks from the coronavirus on economic activity and employment. The Fed will keep the fed funds rate low for an extended period of time.
- The Fed instituted purchasing programs to support multiple fixed income markets including Treasuries, agency MBS, commercial paper, U.S. investment grade bonds, etc. Recently, the Fed is even purchasing HY ETFs. The Fed's seemingly unlimited buying power is seen in the chart below showing the growth of the Fed's balance sheet.
- In addition, the Fed has eased bank regulations and created facilities to increase lending to small businesses. They will do "whatever is necessary" to maintain their objectives.

FIXED INCOME

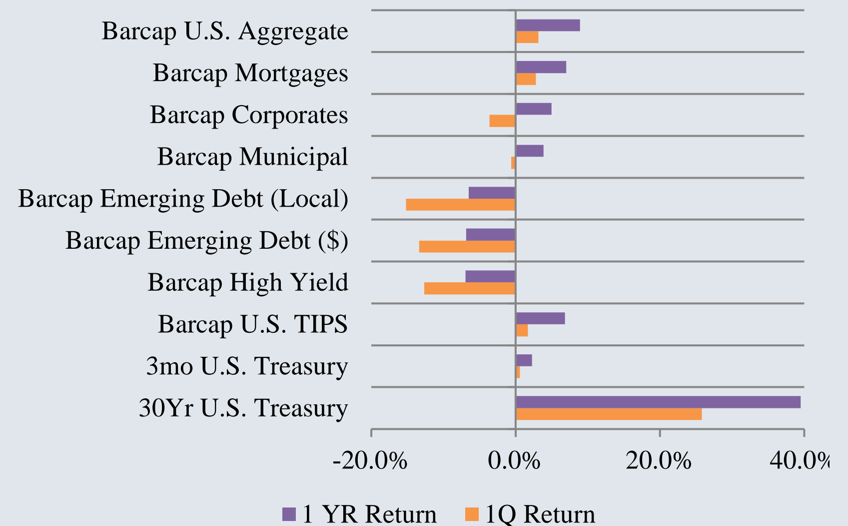
- During the first quarter, U.S. Treasury yields declined significantly across the curve as the Fed lowered the federal funds rate and investors sought safety from falling equity prices. The 10-year Treasury and 30-year Treasury yields reached all-time lows in March.
- Short-term interest rates are controlled or heavily influenced by central banks, whereas long term interest rates are controlled by market forces and economic growth.

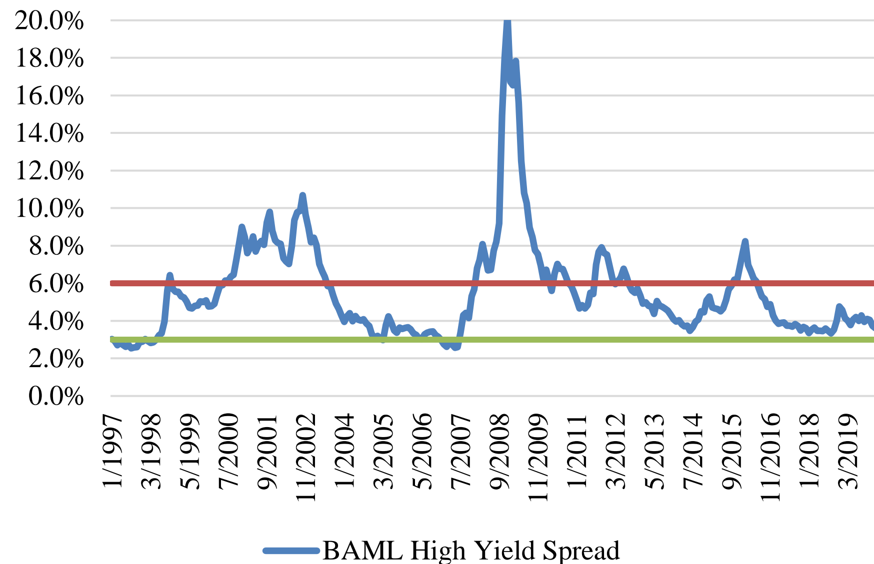


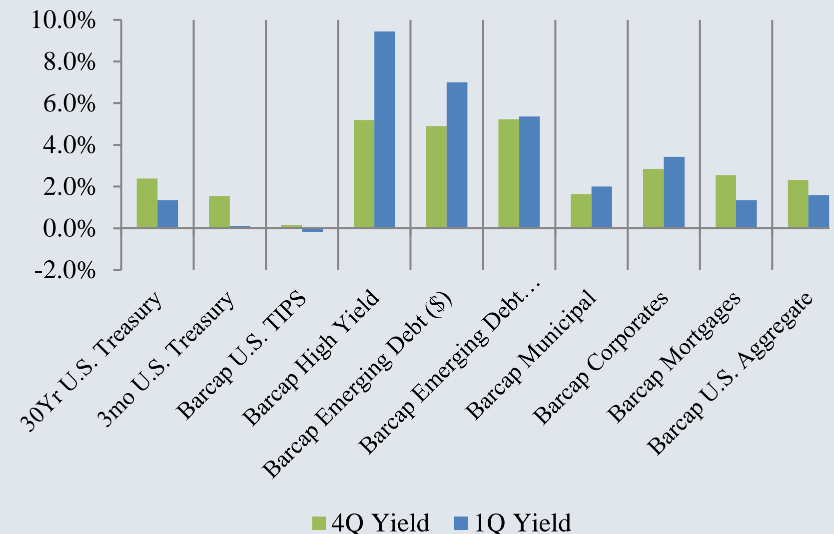


FIXED INCOME (continued)

- During the quarter, the Bloomberg Barclays U.S. Aggregate Index returned 3.2%. The Aggregate benefitted from investors' rush into U.S. Treasuries since the index has considerable exposure.
- Liquidity was extremely challenged in all sectors, including the traditionally highly liquid Treasury market. The Fed stepped in to provide liquidity and promote the stability and functioning of the markets.
- Credit spreads widened significantly during the quarter as investors sold indiscriminately. In this environment, credit-oriented sectors such as corporates, high yield and emerging market debt underperformed.
- With the unprecedented Fed support, the credit market stress appears to be easing and certain credit sectors rebounded somewhat in the last week of the quarter.
- Many areas in fixed income saw record outflows in the month of March.

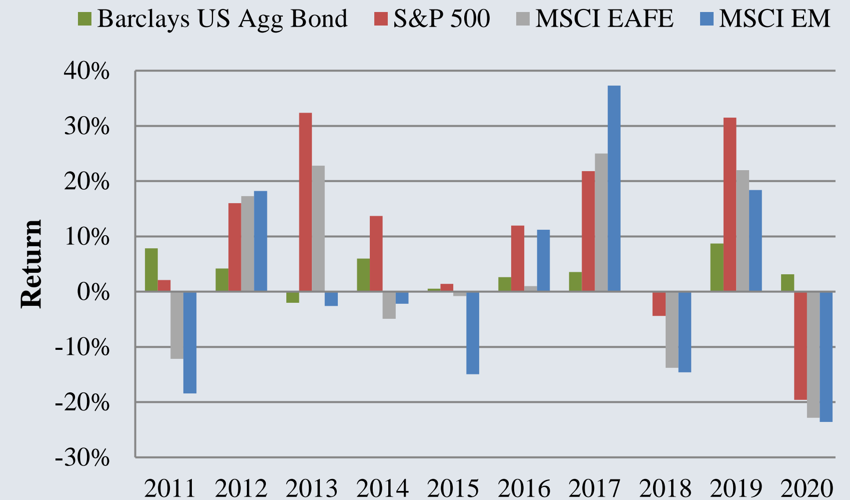


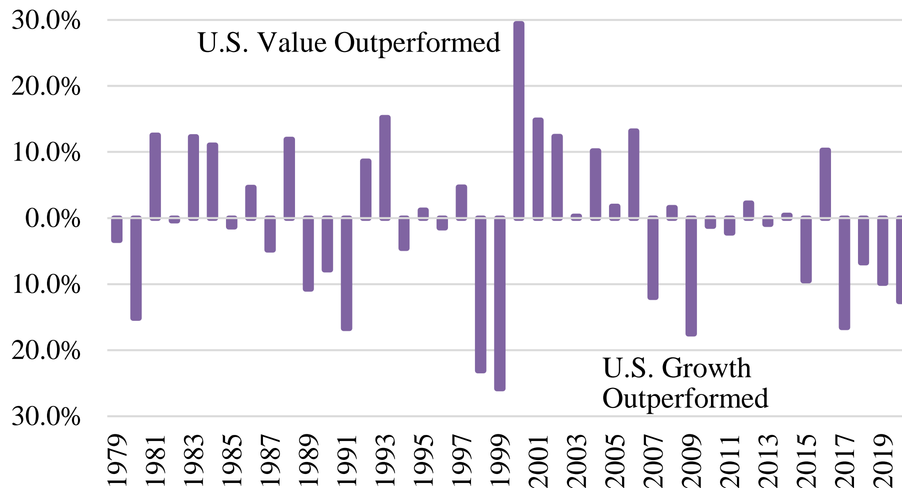




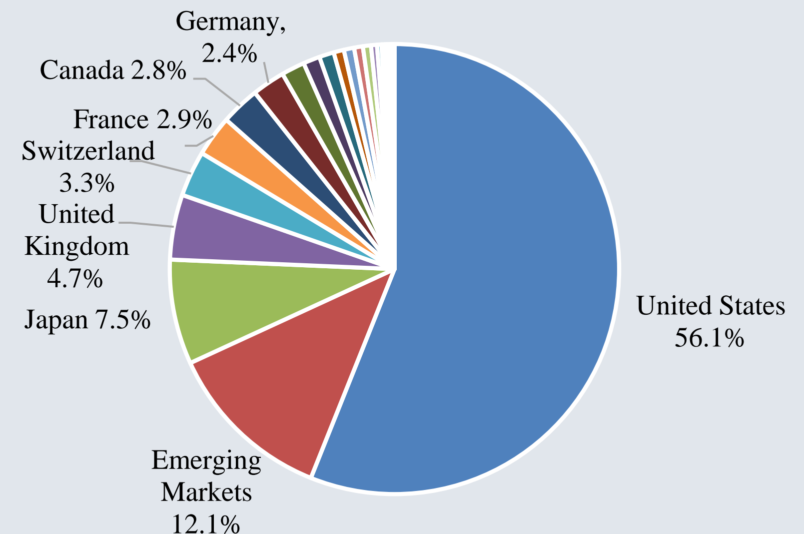
EQUITIES

- U.S. equity markets reached all-time highs during the quarter. However, the COVID-19 pandemic quickly spread from China to across the world which has resulted in the shutdown of global economies, causing a demand and supply shock that is unprecedented.
- Risk assets were caught off guard with the magnitude of the novel virus's affects. Equities experienced a significant market correction, falling over 30% during the quarter peak to trough, which was the fastest pace in history.
- The CBOE Volatility Index, otherwise known as the VIX, spiked to levels not seen since the depths of the Great Financial Crisis in 2008.
- In the quarter, the U.S. equity markets experienced some of the largest one day losses and gains in their history.
- As a style, growth continued to outperform versus value during the down-market.





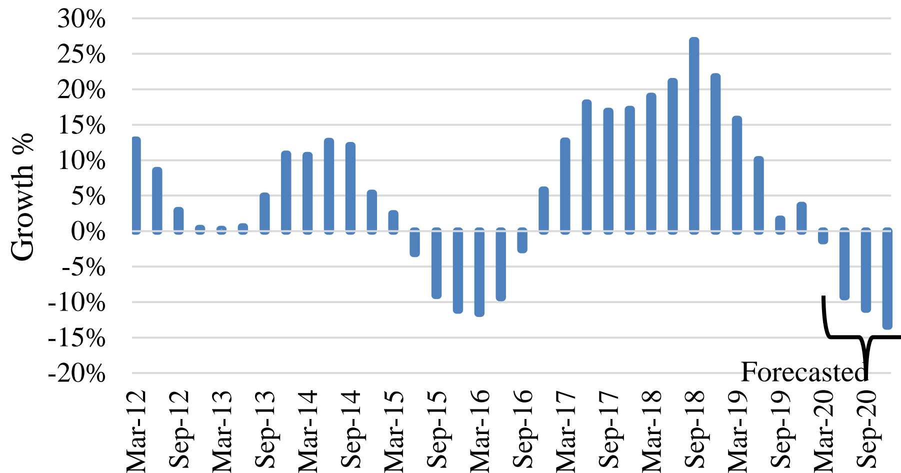
Russell 1000 Growth TR vs. Russell 1000 Value TR

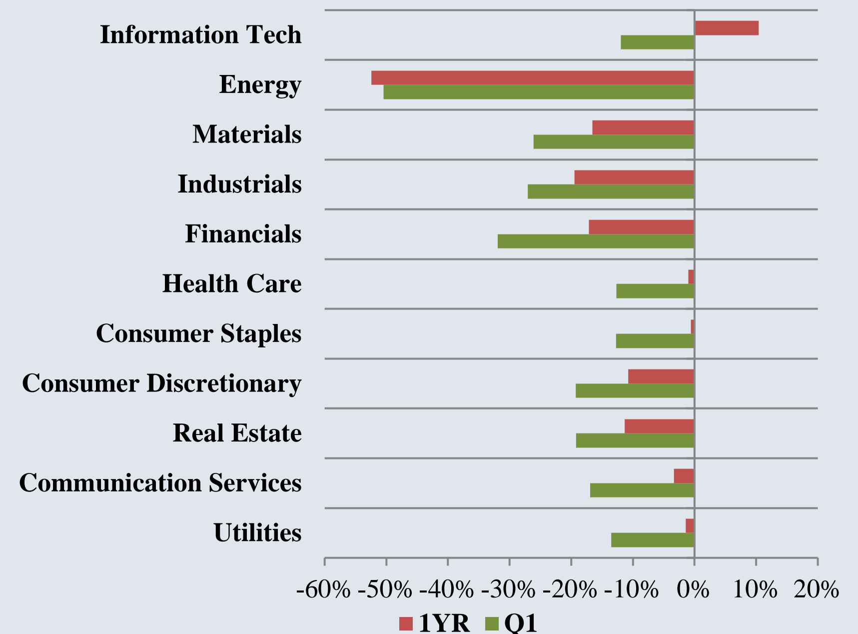


DOMESTIC EQUITIES

- The Russell 1000 Index, comprised of large and mid-capitalization stocks, posted a total return of -22.0% during the first quarter. All sectors were down during the quarter but there was great variability in magnitude. On a year-over-year basis, the Russell 1000 Index has decreased 8.0%.
- Small capitalization stocks, as represented by the Russell 2000 Index, decreased 30.6% during the first quarter. On a year-over-year basis, the index has decreased 24.0%.
- The collapse of the oil markets was initially due to a dispute between Saudi Arabia and Russia, creating an oversupply as Saudi Arabia sold oil at below market prices. Then, COVID-19 related economic shutdown created a demand shock as oil demand plummeted. The Energy sector in the S&P 500 was down over 50% during the quarter.
- Corporate operating earnings are expected to see significant declines over the next few quarters. Industries such as energy, retail, leisure and financials will be impacted more by the current environment than many technology and health care companies.

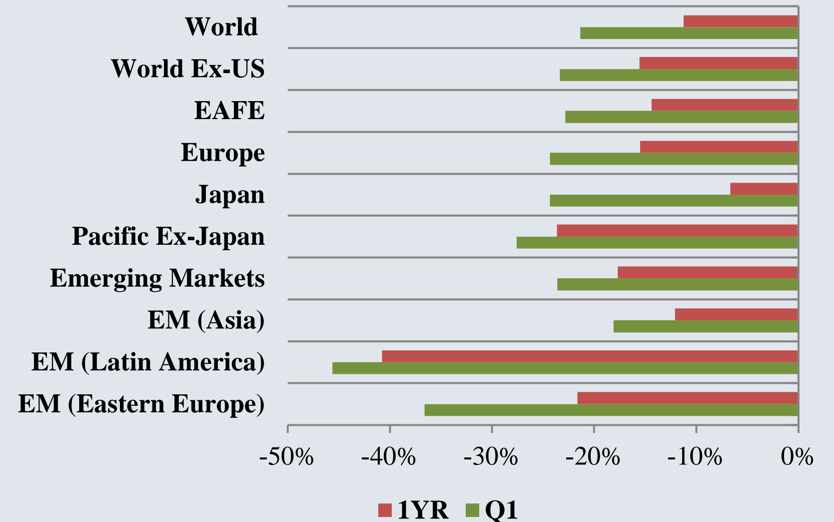
First Quarter 2020 Returns			
	Value	Core	Growth
Mega Cap		-15.9%	
Large Cap	-26.7%	-20.2%	-14.1%
Mid Cap	-31.7%	-27.1%	-27.1%
Small Cap	-35.7%	-30.6%	-25.8%
Micro Cap	-36.1%	-32.0%	-26.6%

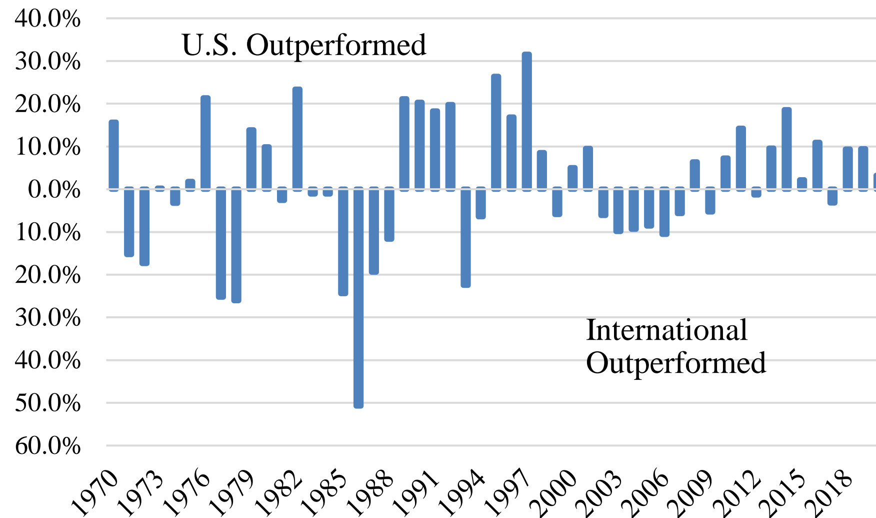




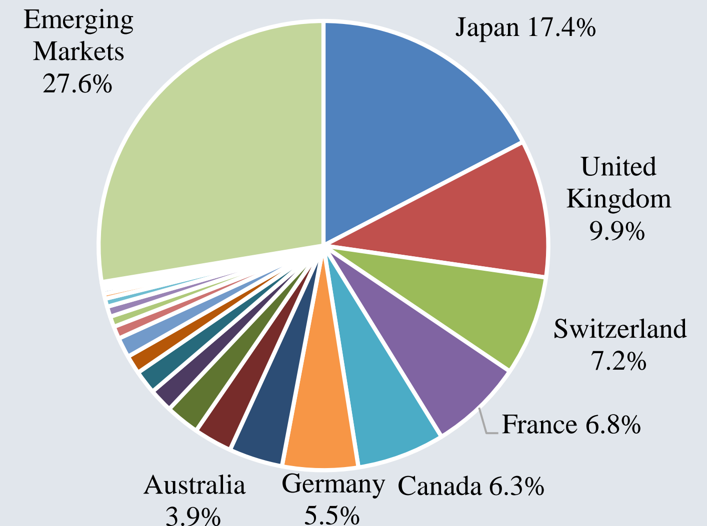
INTERNATIONAL EQUITIES

- Developed international stocks, as represented by the MSCI EAFE, were down 22.8% during the quarter. On a year-over-year basis, the EAFE is down 14.4%, performing worse than U.S. domestic equities.
- Emerging market stocks underperformed developed markets during the first quarter as the MSCI Emerging Markets Index decreased 23.6%. Many oil producing countries such as Mexico, Brazil and Russia saw their returns decline more than the overall EM market. On a year-over-year basis, emerging market stocks trailed developed markets with a return of 17.7%
- Policy response internationally to COVID-19 has also been historic. Monetary stimulus from global central banks and country-level fiscal stimulus packages that rival the U.S.'s response on a % of GDP basis have been announced around the world.
- The U.S. dollar appreciated during the quarter, reducing international equity performance.
- China has seen some rebound in its economy as it has slowly re-opened.





S&P 500 TR vs. MSCI EAFE NR



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