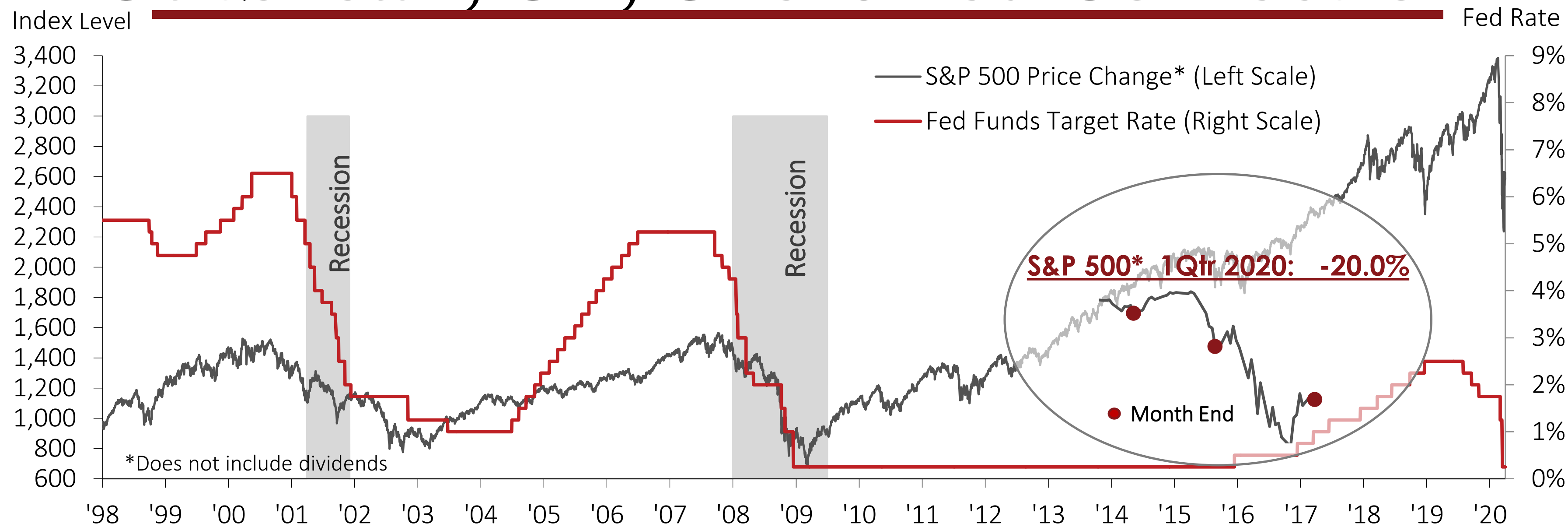
Capital Market Review

March 31, 2020

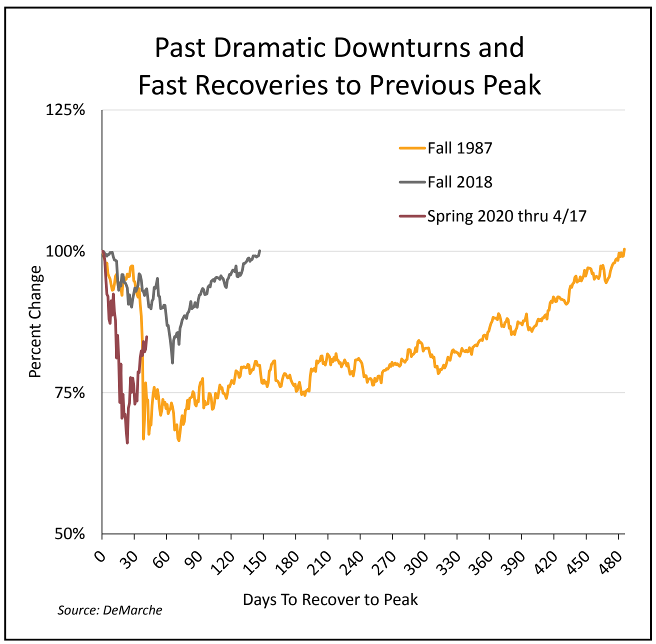



DeMarche

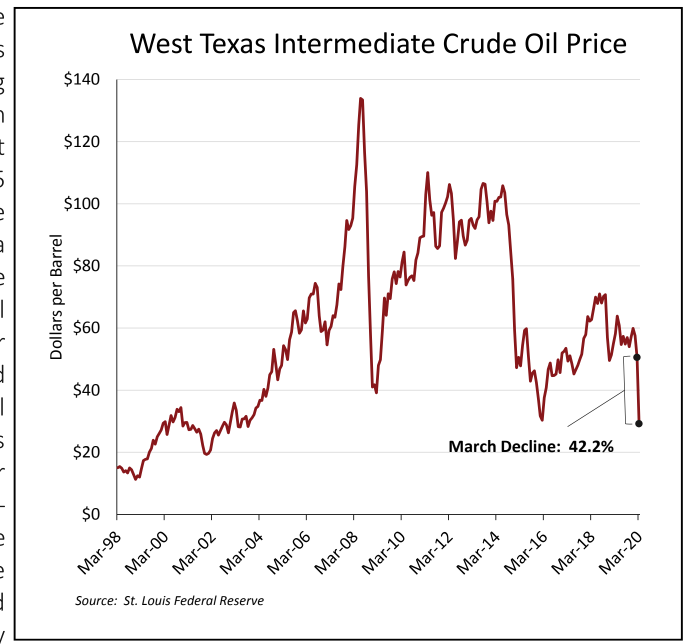
Outbreak, Oil, Oversized Correction



Source: Standard & Poor's, Federal Reserve



In a blow few saw coming, COVID-19 became the driving force in the market. The S&P 500 fell 20%, its worst quarterly loss since 2008. The fall was lightning fast. The S&P 500 reached an all-time high of 3,386 on February 19, but a few weeks later, on March 23, it dropped to a low of 2,237, before rebounding to 2,585 at quarter's end. Volatility ruled the day as large swings seemingly happened every day as new data were released. The 10-year Treasury yield opened the quarter at 1.92% and closed the quarter at 0.69%. Oil prices collapsed on the double whammy of a price war and slack in demand. The Federal Reserve dropped interest rates to zero. However, this is not a financial crisis, per se, so comparisons to recent bear markets are difficult. Perhaps an apt comparison is 1987 or 2018 when the markets fell far and fast on non-financial contagion news and quickly recovered. The chart to the left shows the comparisons. In 2018, the market dropped fast on tariff worries and recovered within 5 months. In 1987, the market fell dramatically fast and recovered within 16 months.

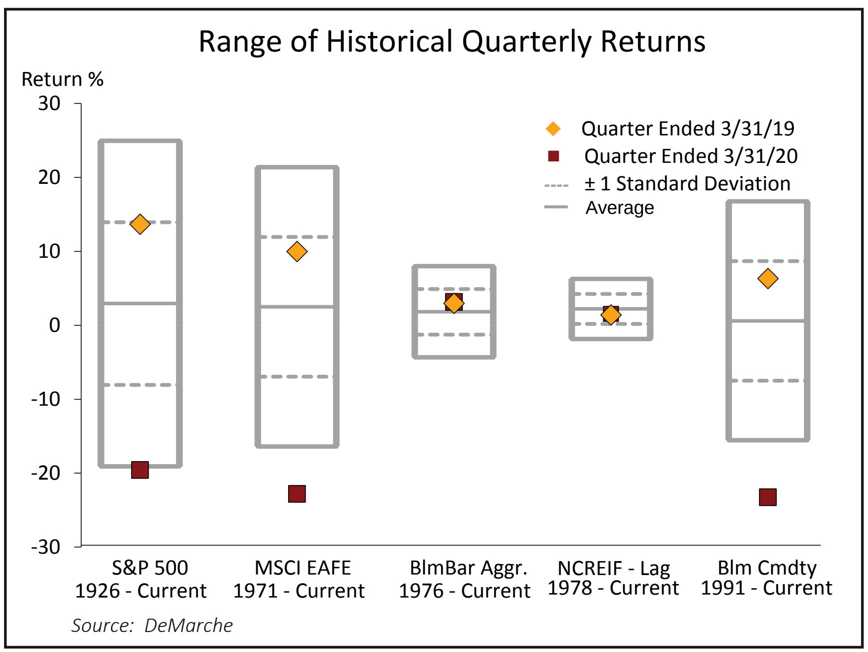


Broad Market Overview

INDEX	1st Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
MSCI World	-21.1	-10.4	1.9	3.2	6.6
DeMarche 3000	-21.7	-12.1	1.8	3.9	7.4
Russell 3000	-20.9	-9.1	4.0	5.8	10.1
S&P 500	-19.6	-7.0	5.1	6.7	10.5
MSCI EAFE USD	-22.8	-14.4	-1.8	-0.6	2.7
BlmBarc Aggregate	3.1	8.9	4.8	3.4	3.9
FTSE Non-US Gov't Bond	-1.9	1.8	3.1	2.4	1.4
BlmBarc Global Aggregate	-0.3	4.2	3.6	2.6	2.5
NCREIF (Private RE)	0.7	5.3	6.4	7.6	10.2
Bloomberg Commodity	-23.3	-22.3	-8.6	-7.8	-6.7

Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized.

Indicator Year Ending 3/31	2020	2019	2018	2017	50 Yr Average
GDP Annual Growth Rate	0.3	2.7	2.9	2.1	2.8
Unemployment	4.4	3.8	4.1	4.5	6.2
Inflation (CPI)	1.5	1.9	2.4	2.4	3.9
10-Year Interest Rates	0.7	2.4	2.7	2.4	6.3



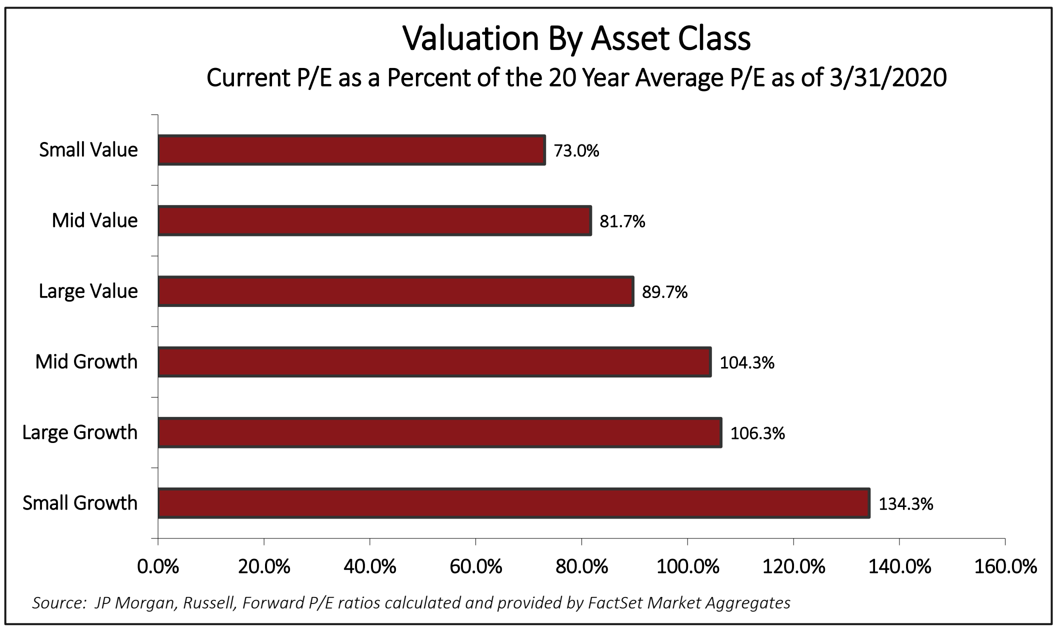
- Global stock markets roiled throughout March as news about the virus worsened daily. Economic activity shut down and layoffs mounted. The Federal Reserve cut interest rates to zero and began asset purchases to stabilize markets. The S&P 500 was down 19.6% in the quarter, the most since the fourth quarter 1987. Despite the S&P's recent pull-back, long-term returns remain positive, with a 10-year annualized return of over 10%.
- Demand for oil fell in face of the coronavirus. In early March, Russia rejected demands by Saudi Arabia to pare back production to stabilize prices. In response to Russia's action, the Saudis decided to protect market share by slashing its prices. Oil prices, as measured by West Texas Intermediate (WTI), fell 66%, its worst quarter ever.
- Bond prices rose on the most liquid and safest securities – Treasuries – in the month. Credit spreads on everything from investment grade to high yield widened due to concerns about corporate earnings, negatively impacting bond portfolio returns.
- The chart to the left shows the ranges of hundreds of quarterly returns for various indexes. The first quarter of 2020 proved to be a three standard deviation event for domestic and international stocks. Also shown on the chart is the first quarter of 2019 – a rebound quarter after a dismal fourth quarter 2018 – a quarter that is close to one standard deviation event of positive returns.

DeFact

As many people are staying at home, doing work or school work, many are not doing it alone. Animal shelters across the country are reporting a record number of pet adoptions since the pandemic began as shelters have had to cut back on staff and volunteers. Shelters are reporting that their websites are seeing increased traffic, and some are even crashing as prospective pet owners search online for available pets. ~USA Today, NPR

INDEX	1st Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
DeMarche Growth	-17.8	-5.2	7.0	7.3	10.0
DeMarche Value	-28.7	-23.5	-5.9	-1.3	3.6
DeMarche Aggressive	-30.7	-25.0	-4.9	-3.4	3.5
DeMarche Defensive	-20.9	-10.9	2.5	4.6	7.8
DeMarche Large Cap	-19.2	-8.9	3.6	5.0	7.5
Large Cap Growth	-15.5	-1.9	9.1	8.8	10.4
Large Cap Value	-26.2	-20.8	-4.5	-0.6	3.5
DeMarche Small Cap	-36.2	-31.5	-9.3	-2.9	5.1
Small Cap Growth	-32.5	-24.8	-5.8	-1.5	6.0
Small Cap Value	-38.9	-36.2	-11.9	-4.0	4.3
S&P 500	-19.6	-7.0	5.1	6.7	10.5
S&P Mid-Cap 400	-29.7	-22.5	-4.1	0.6	7.9
S&P Small-Cap 600	-32.6	-25.9	-5.3	0.5	8.1
Russell 1000	-20.2	-8.0	4.6	6.2	10.4
Russell 1000 Growth	-14.1	0.9	11.3	10.4	13.0
Russell 1000 Value	-26.7	-17.2	-2.2	1.9	7.7
Russell 2000	-30.6	-24.0	-4.6	-0.2	6.9
Russell 2000 Growth	-25.8	-18.6	0.1	1.7	8.9
Russell 2000 Value	-35.7	-29.6	-9.5	-2.4	4.8

Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized.



- Small cap stocks struggled mightily in the quarter, but the pain was not evenly distributed. Small cap energy stocks were the hardest hit, down almost 59%, followed by small cap financials, which declined over 34%. Small cap value stocks underperformed growth by nearly 10 percentage points, -35.7% versus -25.8%.

- Large cap growth stocks held their own during the decline, falling 14.1% as compared to large cap value falling 26.7%. Again, energy was the main culprit in the value space, declining 51.2% in the quarter. The health care and technology sectors, which dominate large cap growth, fell 12.2% and 11.8%, respectively.

- Just last quarter, the 1-year return of the S&P 500 was 31.5%. Now the 1-year return is -7.0%. Recall that the fourth quarter of 2018 experienced a market correction of almost 20% for the S&P 500, so the starting point of 2019 was at a low point. This highlights the importance of staying invested. Despite recent market pullbacks, the S&P 500 has still produced a 10-year annualized return of 10.5%.

- The chart to the left shows just how extended valuations are for growth stocks compared to 20-year averages, despite the recent drawdown in the market. Value stocks, particularly in small cap, seem to look “cheap” compared to long-term valuations.

DeFact

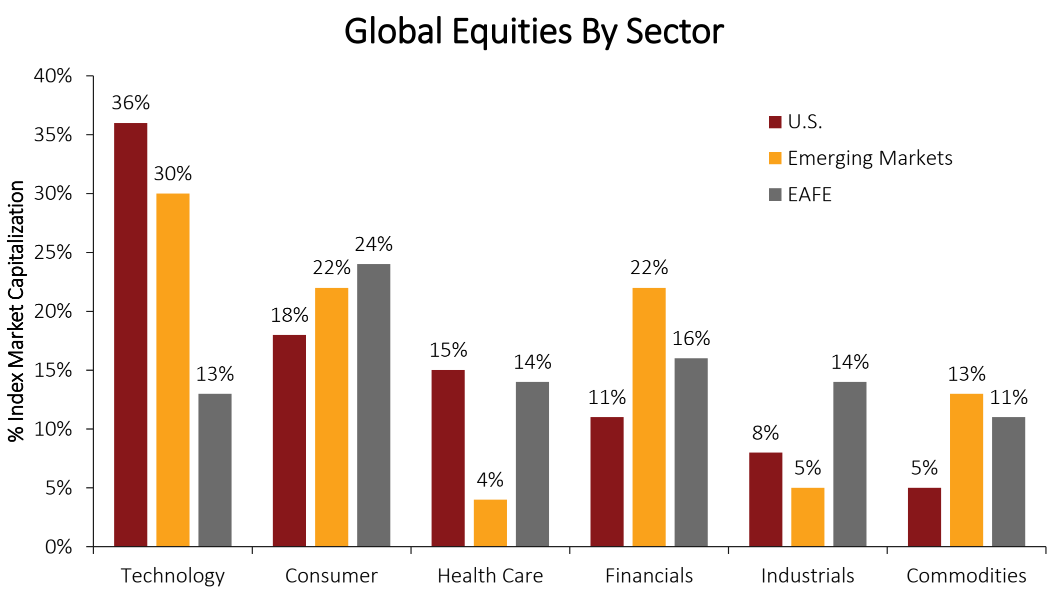
The so-called “Presidential Cycle” tells us that the third year out of a president’s four-year term is the highest returning year for the S&P 500. Since 1927, the S&P 500 has posted an average return of 18.5% at the end of the president’s third year. But the fourth year is the second best. Since 1928, there have been 23 presidential election years, averaging an 11.3% return for the S&P 500. This fourth year average includes the negative 37% return of 2008. ~DeMarche

International Equities

March 31, 2020

INDEX	1st Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
MSCI EAFE Local	-20.5	-12.6	-1.8	-0.1	4.4
MSCI EAFE USD	-22.8	-14.4	-1.8	-0.6	2.7
Growth	-17.5	-5.8	3.0	2.5	4.7
Value	-28.2	-22.8	-6.6	-3.8	0.6
MSCI Japan	-16.8	-6.7	1.0	1.8	3.8
MSCI AC Asia-ex Japan	-18.4	-13.4	1.1	1.3	3.8
MSCI China	-10.2	-5.8	7.1	3.6	4.4
MSCI Germany	-27.0	-17.5	-6.8	-4.0	2.2
MSCI France	-27.6	-17.7	-1.6	0.5	2.1
MSCI UK	-28.8	-23.0	-4.9	-3.3	1.6
MSCI EAFE Small Cap	-27.5	-18.1	-2.9	1.0	4.8
MSCI EM	-23.6	-17.7	-1.6	-0.4	0.7
MSCI All Country-ex US	-23.4	-15.6	-2.0	-0.6	2.1

Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized.



Source: JPMorgan Guide to Markets

- International stocks, as measured by MSCI EAFE, fell 22.8% for the quarter. When quoted in local currency, international stocks dropped 20.5% for the quarter as the dollar proved to be a slight headwind. The dollar strengthened slightly during the quarter as investors purchased U.S. Treasuries for protection. International stocks are now posting a negative 5-year annualized return.

- Japanese stocks proved to be more resilient than European stocks in the quarter. Japanese stocks fell 16.8%, while UK fell 28.8% and Germany fell 27%. So far in 2020 Japan has suffered less from the COVID-19 virus than other countries in Asia and Europe. The yen has also strengthened against other currencies, providing more evidence that the Japanese economy has been less impacted by the virus relative to other economies.

- Emerging market stocks, as with other equities, fell in the quarter. Asian stocks performed the best among emerging market countries. Ironically, Chinese stocks, performed the best among the Asian countries. As with developed international, longer-term returns have suffered due to the large drawdown in the quarter.

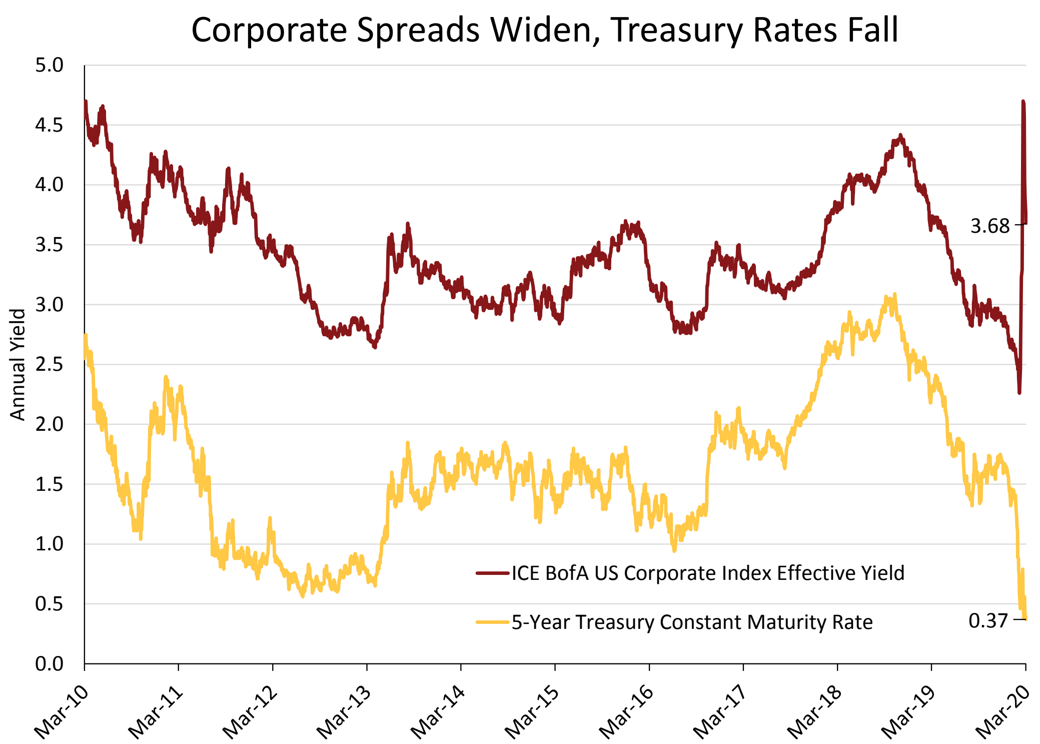
- The chart to the left shows the differences in the index composition between U.S. large cap and international indexes. The U.S. stock market weight in technology (including communication services) is 36%, far outpacing the EAFE index weight. The technology sector outperformed all other equity sectors over the past decade. Conversely, the weights of slower growing consumer, financials and commodity stocks make up a greater percentage of EAFE than in the U.S. market.

DeFact

Both large and small brewers and distillers have switched production lines to produce hand sanitizer. Pernod Ricard USA, the American division of the French spirits giant, retooled its Fort Smith Arkansas distilling process (where it makes Malibu rum and Seagram's gin) in a matter of days to produce hand sanitizer. Now across three distilleries in the U.S., it has produced more than 10,000 gallons. ~Bloomberg Businessweek, Parade.com

INDEX	1st Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
BlmBarc 1-3 Gov Credit	1.7	4.5	2.6	1.9	1.6
BlmBarc Aggregate	3.1	8.9	4.8	3.4	3.9
BlmBarc Gov Credit Long	6.2	19.3	9.7	6.0	8.1
BlmBarc US TIPS	1.7	6.8	3.5	2.7	3.5
Merrill Lynch High Yield	-13.1	-7.4	0.6	2.7	5.5
CSFB Leveraged Loan (bank loans)	-13.2	-9.5	-0.7	1.2	3.3
BlmBarc Global Aggregate	-0.3	4.2	3.6	2.6	2.5
JPM EmgMkt Bd Glbl Dvrsfd (hard)	-13.4	-6.8	0.4	2.8	4.9

Notes: Data are presented as percent returns. All 3, 5-, and 10-year returns are annualized.



Source: St. Louis Federal Reserve

- Bonds were not immune to the effects of the virus. Corporate credit spreads on high yield and investment grade widened to Treasuries and negatively impacted returns. The BlmBarc Aggregate is weighted heavily in Treasuries and provided the bright spot for returns. Falling rates in March provided an additional tailwind to government bonds.
- The investment grade bond return, while volatile in the short run, shows a more stable long-term return. The BlmBarc Aggregate has posted returns of 3.4% and 3.9% annualized for the last 5 and 10 years, respectively.
- High yield proved to be vulnerable to the concerns about credit and fell over 13% for the quarter. Credit spreads widened from about 400 to 1,100 basis points during the month, wider than any time since the 2008-2009 recession. Other bond sectors sensitive to economic disruption, such as bank loans and emerging market debt, also struggled in the quarter. As with stocks, end-point sensitivity drove 5-year returns to be lower than 10-year returns.
- As noted to the left, corporate bond yields have jumped from their recent low point as credit spreads have dramatically widened. The actual yield on corporate bonds are just about where they were a year ago. This suggests that even though credit spreads are wide, the total return potential for investment grade bonds is modest.

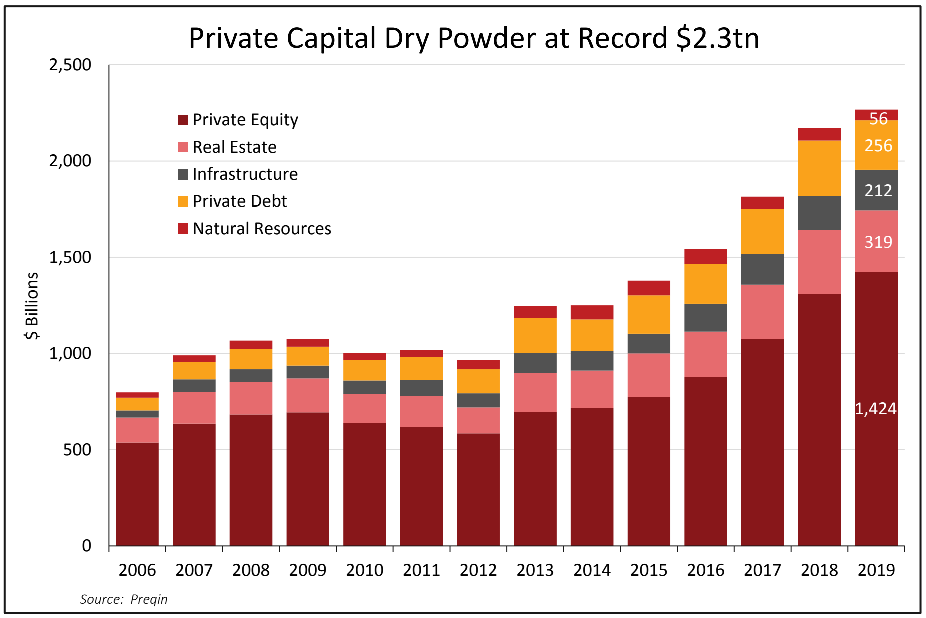
DeFact

Negative rates came to the U.S. for a brief time in March. The three month T-bill traded at negative yields during the day of March 24th but ended up closing that day at a zero yield. This occurred the day after the stock market hit its low point on March 23rd. The three month T-bill finished the month with a 10 basis point yield.

~FRED, Bloomberg

INDEX	1st Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
NCREIF Property (Private RE)	0.7	5.3	6.4	7.6	10.2
Apartment	1.0	5.1	5.8	7.0	10.3
Industrial	2.6	12.9	13.5	13.4	13.0
Office	1.3	6.2	6.5	7.2	9.5
Retail	-2.1	-1.9	2.0	5.2	9.4
NCREIF Timberland	0.1	1.3	2.5	2.8	4.5
NCREIF Farmland	-0.1	4.0	5.7	6.6	10.9
NAREIT (Public RE)*	-25.4	-18.2	-0.9	1.5	8.2
Bloomberg Commodity	-23.3	-22.3	-8.6	-7.8	-6.7
HFR FOF Composite	-6.0	-2.6	1.0	0.6	2.1
Conservative	-1.6	1.4	2.2	1.6	2.4
Diversified	-1.1	2.4	2.7	1.5	2.6
Strategic	-7.8	-4.0	0.6	0.5	2.1
Private Market Indexes as of 9/30/2019	**3rd Qtr**	**1-YEAR**	**3-YEAR**	**5-YEAR**	**10-YEAR**
Preqin Private Equity	2.8	10.7	14.7	12.9	13.8
Preqin Private Debt	0.5	3.3	6.4	6.4	9.3
Preqin Infrastructure	3.4	11.3	9.9	10.0	10.8

Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized.
**Public RE is not a less liquid strategy. It is listed for comparative purposes.*



- Real estate proved to be a diversifier for portfolios in the quarter. It returned 0.7%. REITs, which are public equities, exhibited significant volatility in the quarter. Some real estate sectors, like retail, continue to take it on the chin. That trend was further exacerbated due to non-essential business shutdowns across the U.S. and worldwide.
- Commodity indexes were driven lower by the collapse of oil prices. WTI crude fell 66% for the quarter in response to a "price war" between Russia and Saudi Arabia that took place while COVID-19 was ravaging demand. Conversely, gold, in a flight to quality, posted a 5.6% return for the quarter.
- Hedge funds provided downside risk protection relative to stocks in the quarter. Tail risk strategies, ones that profit when markets are volatile, posted positive returns. Longer-term returns are still low as markets have shown muted volatility over the long bull market in place since 2008.
- The chart to the left shows there has been no shortage of demand for private assets. Private capital firms are continuing to build up storehouses of dry powder to put to work in 2020. At the end of the year, almost $2.3 trillion was available to be deployed in private equity, private debt, real estate, infrastructure and natural resources. Private equity makes up the bulk of the amount, with up to $1.4 trillion in dry powder.

DeFact

Earlier this year, Amazon was posting for 36,000 job openings around the globe. Now, Amazon is looking to hire 100,000 people to meet the increased need for delivery, warehouse and other supply-chain jobs related to meeting the needs of consumers subject to COVID-19 quarantines. Warehouse jobs just received a $2/hour pay raise in addition to a $2/hour signing bonus for the first month to meet the massive online shopping demand. ~WSJ

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Long-Dated Private Equity: A Problem Solved?

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February

Looking at Management Fees from a Different Perspective

https://www.demarche.com/looking-at-management-fees-from-a-different-perspective/

January

Fallen Angel Risk & the Need for Active Management

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