—New Albany—
Investment Management

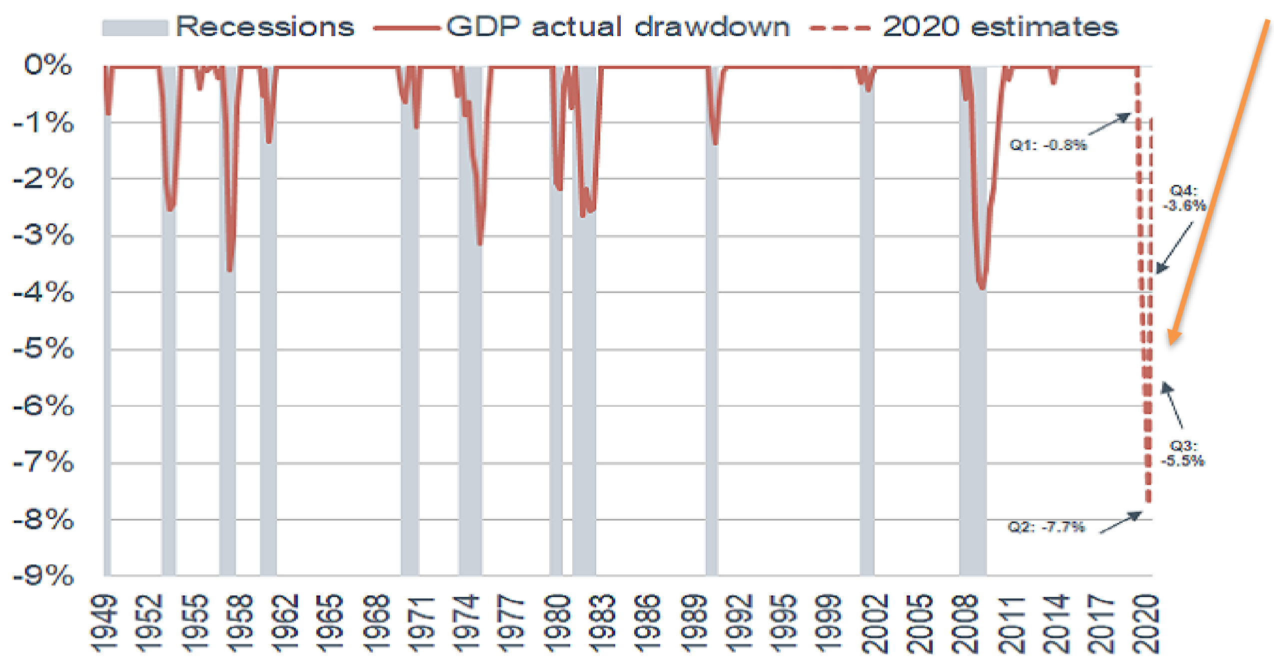
May 2020

Two Very Different Trajectories: Bullish Market / Bearish Economy

Historical records continue to be broken both in the speed and magnitude of change of the financial markets and the US economy. After falling from all-time highs in February to bear market territory in March, US stocks staged a warp speed rally in April which some are now calling a 'new bull market'. Meanwhile, the US economy has not only fallen off a cliff but has plunged into a deep canyon with little visibility as to how and when it will return to normal. It appears Wall Street is focusing on the other side of the canyon, while Mainstreet is struggling to just find a path that leads upward. In both cases, certainty and clarity are surely absent. The good news is that both monetary and fiscal stimulus has also moved at warp speed, providing huge stimulus like never before, adding over $5.5 trillion or 26% of GDP in just 45 days! Is this stimulus enough to make the economy whole again? Certainly not. Will it get the economy in a position to move forward? Maybe, hopefully. The tentative stability of the markets and fragility of our economy make for exceptional challenges AND opportunity. I am confident our Country will figure it out, but the new normal will likely be quite different.

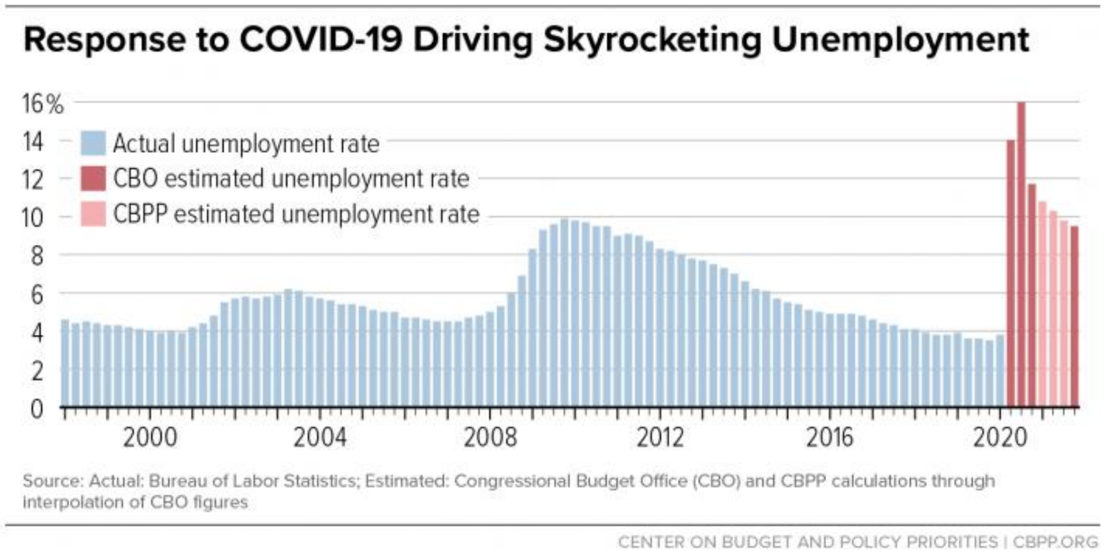
View the Damage and Response: Sometimes visualizing change can have more meaning than just numbers. The charts below provide a glimpse of the enormity of the situation at hand and perspective of how the current situation compares to previous shocks.

Economic Growth will contract; Forecast range from -9% to -50% in 2Qtr.
According to Schwab, *'The prospective shape of the post-virus recovery—whether it looks like a V, U, W or any other letter—has been a topic of debate among economists and investors. We think the most apt letter may be a Y, given that parts of the economy were already weak before the crisis, including manufacturing and business investment. As businesses start to reopen, the initial resumption in activity may cause a short-term surge in growth, but it might be difficult to sustain over the long term (hence the Y shape).* The chart below shows the GDP drawdowns since 1949 with the current decline being the largest by at least double.

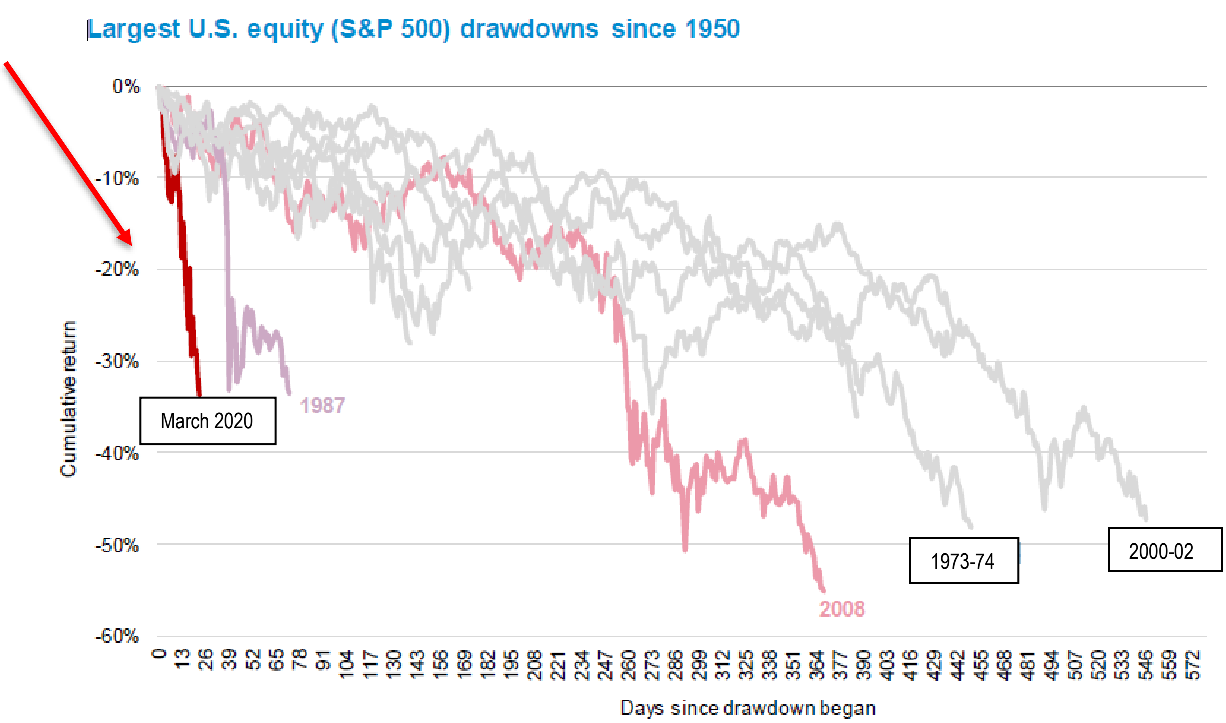


Source: Charles Schwab

Skyrocketing Unemployed: Yet another record. After reaching record low unemployment in February of 3.1%, the rate has skyrocketed to 16% with over 28 million people filing claims. This compares to 'only' 8.3 million claims filed during the '08-09 Great Recession. **The CBO projects the unemployment rate will average 10.1% for 2021 and would be the highest annual unemployment rate since the 1930's.**

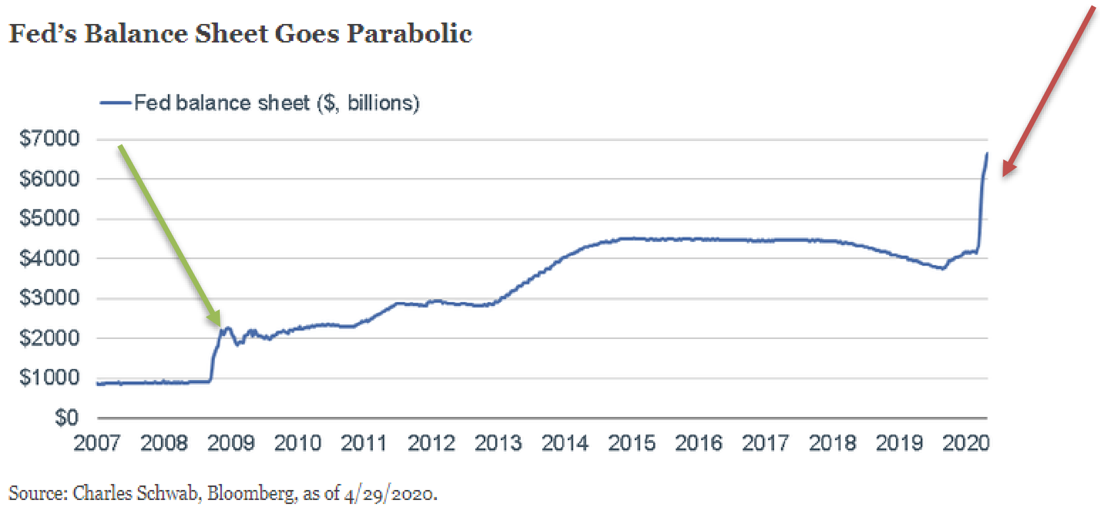


Speed of Market Reaction: The market selloff was the fastest since 1929. In comparison, the chart below shows the depth of the decline of the previous four selloffs occurring in 2008, 2000, 1987, and 1973. Notice in every instance, the initial decline was followed by another leg down. Today, with the recent strong rally, the S&P index sits only about 15% off its all-time high, which says the market is expecting a 'V' shape recovery.



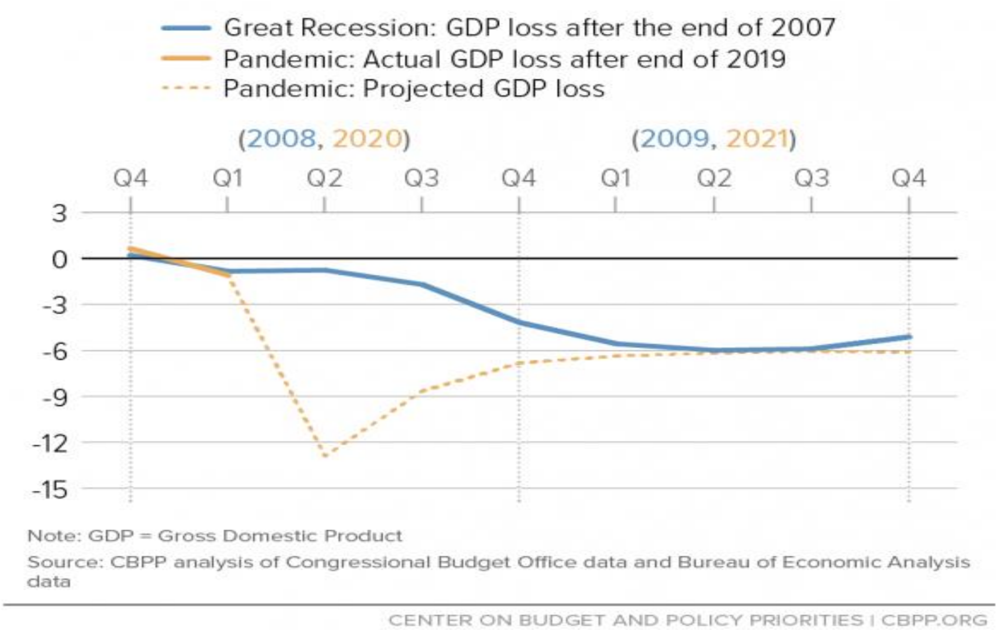
Federal Reserve to the Rescue: Make no mistake, without the Federal Reserve's aggressive actions, the financial markets would not only have fallen much further, but the entire World markets would have nearly stopped functioning. It is a scary thought, but I bring it to point, to emphasize the critical and essential role of the US

Central Bank which is to ensure and provide liquidity to the financial system. And that is exactly what they have done. The Fed's rapid and aggressive action absorbed the panic selling, which at one point was over $70 billion a day. Since mid-March, the Fed has purchased nearly $3 trillion of US Treasury bonds and other various securities. In addition, it provided credit facilities to ten different entities including Small Businesses, Municipalities, Money Market Funds, Primary and Secondary Market Dealers. It is these aggressive actions that have put a floor under the market and brought back confidence, at least on Wall Street. The chart below shows the size of the Fed's Balance sheet (assets they hold). Notice how much larger and faster they have acted as compared to the 2007-09 market sell-off.



Congress Did the Impossible: They moved together at record speed! One of the few bright spots about the Covid-19 virus is that it has brought the Country and Congress together, at least for a while. The $2.9 trillion package passed by Congress is by no means perfect or complete, but it has filled some of the financial gap. More assistance will be needed as the gap is huge.

Huge Output Gap: According to the Congressional Budget Office (CBO) the expected cumulative fall in output of GDP from 2Q20 thru 2021 is estimated to be a -13.6%. which is over twice the decline experienced during the 2008-09 Great Recession. The chart below compares the drop in GDP after 2007 bubble burst (Blue line) as compared the expected drop now from the Covid-19 economic shut down (Orange line). Again, the speed and magnitude of decline is setting new history records.



Much more to the Story… the charts above give just a glimpse of the damage and rescue efforts now in play. Though there are similarities to previous economic downturns, the Covid-19 shock is far more difficult because it is still being understood and is not contained. This makes quantifying the economic damage a moving target and stimulus initiatives hit or miss, trying to just plug some of the big holes. Until the situation truly stabilizes, we have only just begun to assess the total human, financial, and economic impact.

Stock Market, a Market of Stocks: The strong will get stronger; the weak will die. With all the uncertainty, there is both more risk and more opportunity when it comes to investing. The business environment is also changing at record speed and it is becoming clear that strong (well capitalized and adaptable businesses) will get stronger and the weak (highly leveraged and static businesses) will die. No doubt about it, the economy and businesses will be operating differently going forward and those businesses that can adapt will thrive, even in a poor economy. What this means is <u>that many of the traditional 'safe-haven' Value companies will shrink or dissolve while the aggressive Growth companies will thrive.</u> We are seeing this scenario play out in the stock market. The performance void between Value and Growth and Large & Small Cap is huge, over 20% and 30% respectively. And even within these sectors there is a huge gap in performance to the point where some people are now calling the stock market a 'market of stocks'. Careful selection of stocks makes all the difference in both risk and return.

Bond Market Wild Ride: Though much of the market headlines focused on the stock market, the bond market sell-off was just as dramatic or even more so. Bonds are supposed to be a place of shelter in market selloffs, but that has not been the case in this environment. Credit spreads widened in every sector of the bond market, causing even high-quality bonds to fall sharply. But thanks to the Fed's buying program, many of the bond sectors have recovered. Again, careful attention to capitalization and leverage is key to a solid performing bond portfolio.

Investment Strategy: Allocation to stocks and bonds is at the 'Neutral' point in the portfolios; however there have been several changes to holdings. On the stock side, the allocation shifted away from "Value" and into "Growth"; exposure increased to Mutual funds rather than ETF's to capture specific stock exposure. On the Bond side, high quality investment grade is the main holding, supplemented with some High Yield funds that provide good interest income in an exceptionally low rate environment. **The portfolio strategy is working very well in current volatile market environment**.

It is definitely a challenging time, but I am optimistic. Every facet of the Country is at work to not only get through this event, but to be stronger and better. It will happen.

These are my thoughts. I am happy to discuss the market in more detail. It is changing EVERY day! Please contact me with your questions and concerns.

Stay safe, stay well, and focus on the good.
Best Regards,
Barbara

Barbara HS Huff, CEO
New Albany Investment Management
614-216-6139
bhuff@newalbanyinvestment.com