



VERTEX PLANNING PARTNERS
LLC

Quarterly Market Review



Q2

Second Quarter 2020

Economy

Monetary Policy



What's Happening:

In a continuation of the unprecedented response by the Federal Reserve in Q1, the Fed expanded their asset purchasing programs beyond purchasing government and short term securities to include corporate investment grade and potentially non-investment grade bonds. Following up \$1.7 trillion in asset purchases in March, there was an additional \$1.2 trillion in the second quarter (figure 1).

What does this mean?

The Fed has shown it is willing to do everything in their power to maintain credit and liquidity in the financial system. These actions have provided an immense backstop to the risk markets, subsequently transforming a market sell off into a strong rally. As with all broad based measures, there will most likely be unintended consequences and moral hazards.

Fiscal Policy



What's Happening:

The US Government has enacted a number of legislative acts in March as a response to the coronavirus pandemic, including additional funding for emergency response healthcare, culminating in the C.A.R.E Act; a \$2 trillion stimulus plan aimed at businesses and workers effected by the mandated shut down as a response to social distancing (Fig 2).

What does this mean?

The fiscal response has been nothing short of extraordinary, pushing deficit spending to levels not seen since the 1940's. With hopes of bridging the gap between shutdown and recovery, the aim of these legislative actions are to limit the negative impacts of mass layoffs and business inactivity in the service sectors (primarily travel, lodging, hospitality) and markets that depend on their cash flow (real estate, credit, etc).



Economy

Geopolitics



What's Happening:

2020 has been dominated by the spread of COVID-19 and governmental responses to “bend the curve” of infection rates by implementing drastic measures. One of the consequences has been the acceleration, or reversal, of trends such as globalization (corporations and governments rethink risks within supply chains), spending (discretionary spending on leisure and travel), activity (daily commutes, online shopping), influence (US exiting the WHO, China usurping legal control of Hong Kong citizens) and wealth inequalities.

What does this mean?

Due to the mandated change in daily habits to prevent further spread of the virus, major shifts in behavior and attitude have taken place both domestically and internationally. It might be too soon to tell if these changes are transitory or permanent, events like the BLM protests, Chinese provocation, and shifts in consumer behaviors will no doubt have profound impact on life going forward and for the next election cycle.



Economy

GDP



What's Happening:

After enjoying sub 3.5% employment, the current crisis witnessed a rapid rise in unemployment peaking at almost 15% (higher than during the Great Financial Crisis). Part of this was due to forced shutdowns and furloughed employees, as well as the government action to provide immediate unemployment benefits to those out of work. The silver lining is many of the job losses could be temporary if the economy continues to open up, and most of the jobs impacted were lower wage workers. Expectations are for a sharp contraction in Gross Domestic Product for the second quarter (possibly as much as 35% **) with a strong rebound in subsequent quarters due to reopening of the economy and the size of the government stimulus.

What does this mean?

The shutdown had major impact on transportation, entertainment and hospitality industries. As Americans focused on social distancing, many companies were forced to close their doors. The true impact may take years to define, if the effects of the pandemic linger and the drop in economic activity affects a broader segment of the economy and higher income jobs.



Markets



Equity

After reaching a low at the end of March, equity markets have subsequently rebounded with the S&P 500 gaining over 20%, MSCI EAFE returning 15.08% and emerging markets up 18.18%. Much of the gains were fueled by technology and healthcare, which benefitted from loosening credit markets, low interest rates, and a search for growth in a period of economic contraction. Although select companies have had the opportunity to grow their sales, most of the rebound in equity prices have come from multiple expansions (the price paid for each unit of earnings/sales), with the expectation that the government intervention will help accelerate economic activity in the coming years.



Fixed Income

Much akin to the equities markets, bond markets have also experienced a strong rally in prices, with interest rates reaching historic lows. The corporate bond market has been the biggest beneficiary of the Fed action, as investors rushed to purchase bonds ahead of the Fed. The liquidity in the market has provided ample opportunity for corporations to issue new bonds to shore up their cash positions. As the crisis transitions from a liquidity to a solvency issue, there may be an upcoming concern that current low rates don't properly compensate investors for potential defaults.



Current Strategy

Reasons To Be Optimistic



History teaches us that global health emergencies are eventually transitory. Although the impact has been swift and profound on economic activity, the reaction by central banks and the federal government have been equally unprecedented. Daily life may take time to heal, government intervention has provided a floor for the moment on risk assets. Volatility in the markets should remain elevated over the next couple of quarters as investors digest the impacts to GDP and corporate earnings. The Federal Reserve and European Central Banks have made extraordinary efforts to keep markets functioning, liquidity high, and subsequently prices elevated.

Reasons To Be Cautious



We have little historical data in which to compare this event, as it has both the swiftness in impact of 9-11 (although on a broader scale), as well as the depth of the Global Financial Crisis. Since there hasn't been a modern day parallel, it is more difficult to gain a handle on the extent of the impact, nor which industries are better able to rebound versus ones that might be permanently impaired. Due to the breadth of potential outcomes, it will be difficult for markets to have proper price discovery, and consequently a large amount of volatility. Also prices currently reflect a positive trajectory in economic recovery, and might not provide adequate margins of safety if there are additional setbacks due to resurgence of the virus, or potential economic shocks due to geopolitical or social events.



Current Strategy

Strategy for 2020



For our advisory clients, we continue to tilt towards lower volatility equity strategies (particularly in international assets) as well as firms with high quality balance sheets. On the asset class level, we have actively paired back our risk in bonds, real assets and equities.

Beginning in January, we have made several changes to our fixed income allocations, transitioning from higher yielding assets to government securities or higher quality corporate bonds, as well as upgrading our stock holdings from smaller companies to larger corporations with stronger balance sheets. We paired back and eventually transitioned from our equity Real Assets (Real Estate and Infrastructure), to Gold, Inflation-Protected Treasuries, and government bonds as volatility began to rise.

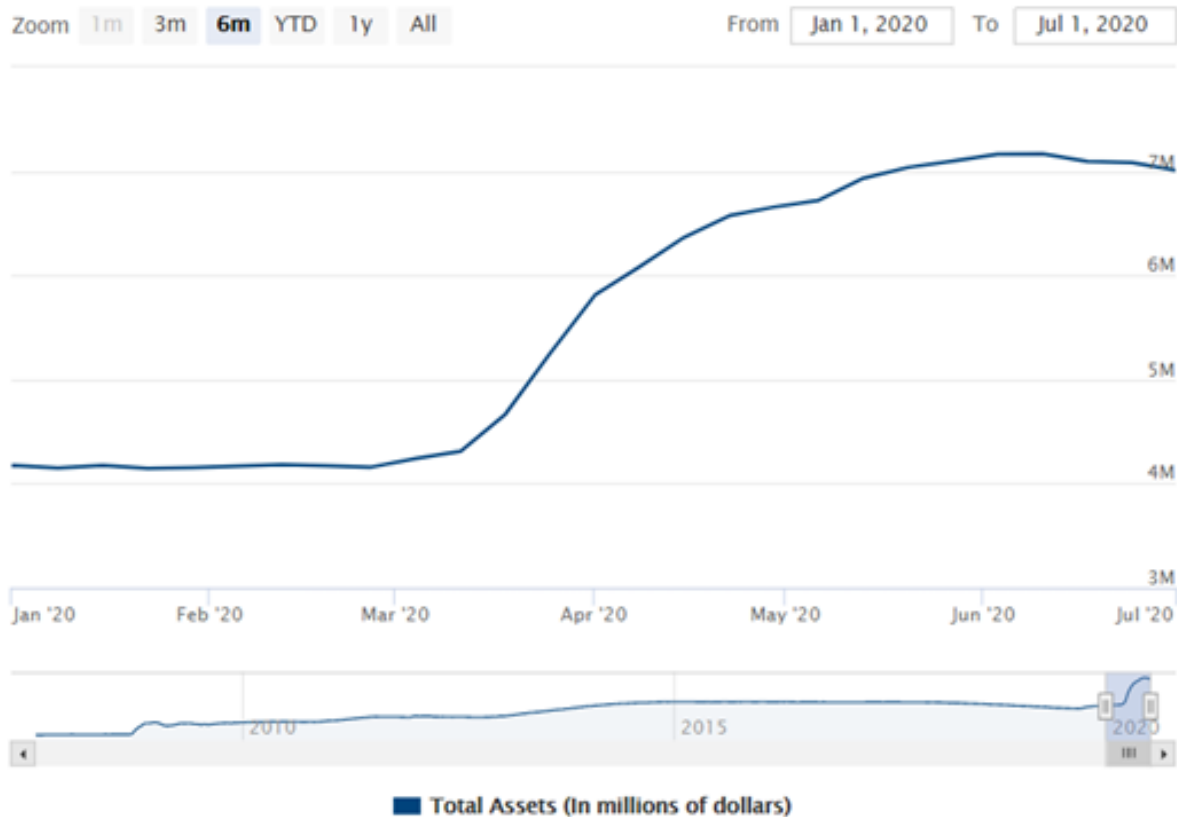
These proactive modifications were aimed at reducing the volatility within the portfolios, as well as provide a stable asset base in preparation for the second rebalance of the calendar year.



(Fig 1)

Recent balance sheet trends

The Federal Reserve's balance sheet has expanded and contracted over time. During the 2007-08 financial crisis and subsequent recession, total assets increased significantly from \$870 billion in August 2007 to \$4.5 trillion in early 2015. Then, reflecting the Federal Open Market Committee's balance sheet normalization program that took place between October 2017 and August 2019, total assets declined to under \$3.8 trillion. Beginning in September 2019, total assets started to increase.



Source: https://www.federalreserve.gov/monetarypolicy/bst_recenttrends.htm

Charts are generally updated at noon ET the day following the publication of the H.4.1, which is typically published at 4:30 ET on Thursdays.

*All Liquidity Facilities includes: Term Auction credit; primary credit; secondary credit; seasonal credit; Primary Dealer Credit Facility; Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility; Term Asset-Backed Securities Loan Facility; Commercial Paper Funding Facility; Money Market Mutual Fund Liquidity Facility; and central bank liquidity swaps.

**Support to Specific Institutions includes: Maiden Lane LLC; Maiden Lane II LLC; Maiden Lane III LLC; and support to AIG.

***Support to AIG includes: credit extended to American International Group, and preferred interests in AIA Aurora LLC and ALICO Holdings LLC.



(Fig 2)

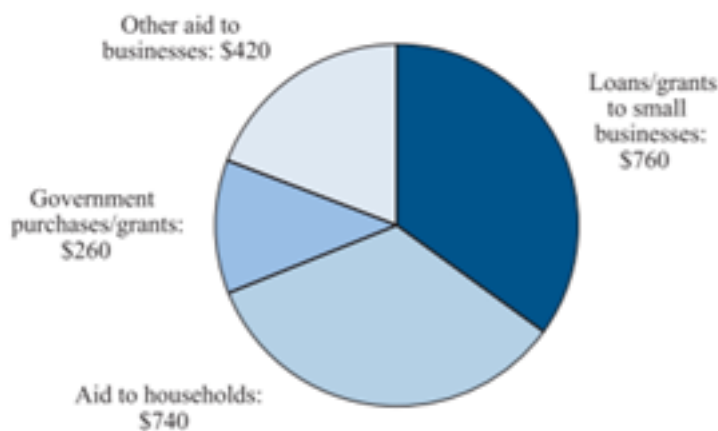
A. Fiscal support in response to COVID-19, by legislation (billions of dollars)

	Fiscal years		
	2020	2021	2020-2030
(1) Coronavirus Preparedness & Response Act	1	4	8
(2) Families First Coronavirus Response Act	134	57	192
(3) Coronavirus Aid, Relief, and Economic Security Act	1,606	448	1,721
(4) Paycheck Protection Program and Healthcare Enhancement Act	434	43	485
(5) Total	2,176	551	2,406

Note: The full title of the act in row 1 is Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020. Values are in billions of dollars. Funding for the Department of Treasury to provide loans to the airline industry and to fund lending facilities established by the Federal Reserve are not included. Fiscal support is smaller over the 2020-30 period than over the 2020-21 period mainly because of the payment of deferred payroll tax liabilities.

Source: Congressional Budget Office.

B. Fiscal support in fiscal year 2020



Note: Funding for the Department of Treasury to provide loans to the airline industry and to fund lending facilities established by the Federal Reserve are not included. Fiscal support is in billions of dollars and rounded to the nearest \$10 billion.

Source: Congressional Budget Office.

Source: <https://www.frbatlanta.org/-/media/documents/cqer/researchcq/gdpnow/RealGDPTrackingSlides.pdf>

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results.

The Standard & Poor's 500 Index is a capitalization weighted index of top 500 stocks representing all major industries. The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. All indices are unmanaged and may not be invested into directly.

The economic forecasts set forth may not develop as predicted. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price. No strategy assures success or protects against loss and there is no guarantee that their objectives will be met.

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