Vertex Planning Partners LLC

Quarterly Market Review

Q3

Third Quarter 2020

Economy

Monetary Policy

What's Happening:

In response to the government lockdowns and measures to stem the impact of the pandemic, the Federal Reserve provided unprecedented amount of support and liquidity to the financial system, lowering short term rates to zero and long term rates through the purchasing of trillions of dollars' worth of government and corporate bonds. As the economy recovered, the Fed has tapered its purchases of fixed income assets (figure 1) while indicating its intention to keep rates steady for the next couple of years, and providing flexibility around its 2% inflation target (*).

What does this mean?

The Fed has shown the willingness 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 bear market sell off into a bull market rally. As with all broad based measures, there will most likely be unintended consequences and moral hazards. As deflationary pressures are staid, it is yet to be seen if they can also support price stability without continued support while limiting excessive speculation.

Economy

Geopolitics

What's Happening:

The pandemic has shifted from draconian safety measures to ground swell of activity, both peaceful and destructive, focused on economic and social grievances faced by minorities in America and abroad. These events have saturated an already contentious political climate, with one of the most polarizing Presidential elections about to occur.

What does this mean?

The contrast between the Republican and Democratic positions seem to have never been this wide, and with the effects of COVID on the election process it may been some time before an official outcome will be decided. At stake is both an accommodative environment for corporations, small businesses and wealthy individuals, as well as the future direction of many government programs, foreign trade policy and international relationships. As we close in on Election Day, markets should remain volatile.

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). As some of the programs have expired, future bills have been held up in congress as the Presidential election looms.

What does this mean?

The impact of the shutdown, which displaced tens of millions of workers, was moderated by the additional aid given by the federal government. As some of the more generous provisions expired over the summer (such as the weekly $600 unemployment supplement), future aid will be dependent on an ever more politicized Congress to pass a bill to offset the loss of economic activity. These additional cash flows have helped stave off an even more significant drop in consumer spending as unemployment numbers have remained elevated.

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). There has been a recovery in reported unemployment, with the latest August numbers falling to around 8.5%**. The second quarter saw a sharp contraction in GDP of 34%, after a revised 5% fall in the first quarter. With a strong rebound in over the summer, third quarter GDP growth should be strong 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

In a continuation of the second quarter, equity markets made positive returns in the 3rd quarter with the S&P 500 gaining over 8.93%, MSCI EAFE returning 4.88% and MSCI Emerging Markets up 9.70%. The markets, specifically US Technology, underwent a correction beginning in September, as concerns over a second wave of the pandemic along with election concerns dampened an overbought market.

Fixed Income

Interest rates as well as credit spreads also fell for most of the quarter, provided strong returns for bonds, before seeing a slight uptick in September. Even though corporate and municipal bond defaults rates have increased steadily through the summer, yields have not been reflective of the additional risk.

Current Strategy

Reasons To Be Optimistic

History teaches us that global health emergencies are eventually transitory. Although the impact has been profound, the reaction by central banks and the federal government have been equally unprecedented. The volatility in the markets should remain for the next couple of quarters as investors digest the impacts to GDP, corporate earnings, and the election outcome, but with the amount of accommodations and low interest rates provided by the fed, and a government that is looking to backstop against the worst possible outcomes, risk assets have the environment to grow if consumer sentiment remains high. We have also witnessed an acceleration in technological innovation and adaption, which demonstrates the resiliency of the US economy.

Reasons To Be Cautious

We have little historical data in which to compare this event. Since there hasn't been a modern day parallel, it is more difficult to gain a handle on the extent of the impact, nor the long term effects. Do to the breadth of potential outcomes, it will be difficult for markets to have proper price discovery, and consequently a large amount of volatility. 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.

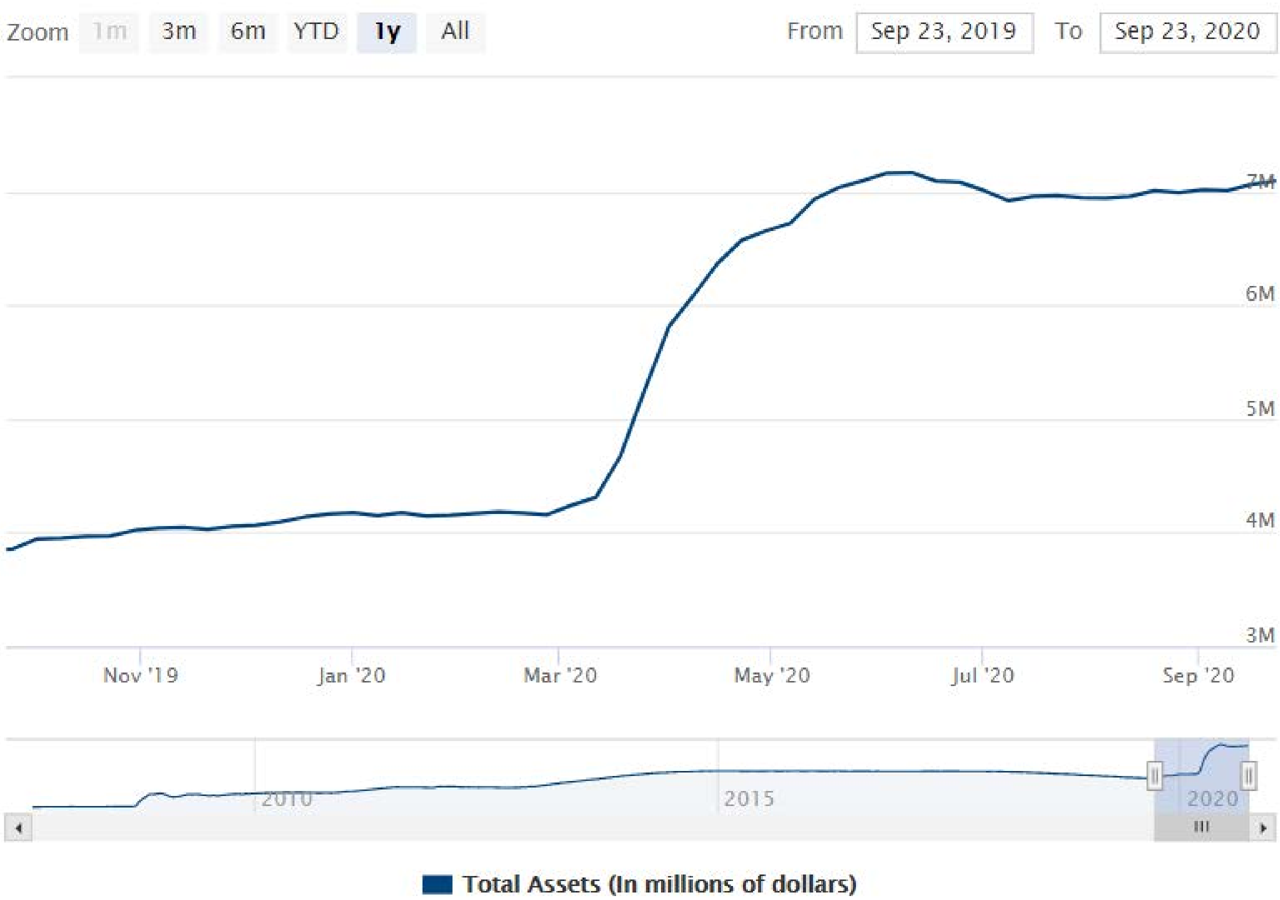
Current Strategy

For our advisory clients, during the 3rd Quarter we have made changes to our models by reducing our exposure to market capital weighted indices to overweight companies experiencing continued growth, as well as tactically adding to Technology, Medical, and Financial sectors. We also reduced our allocations to core government bonds, adding to 5 year Inflation Protected Treasuries, Investment Grade Corporate and High Yield Bonds. We reduced our allocation to a basket alternative strategies, while increasing our exposure to precious metals. These changes are in response to the low interest rate environment, along with the stimulative efforts by Central Banks of US Government to increase market liquidity and fuel the economy during the pandemic.

(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.

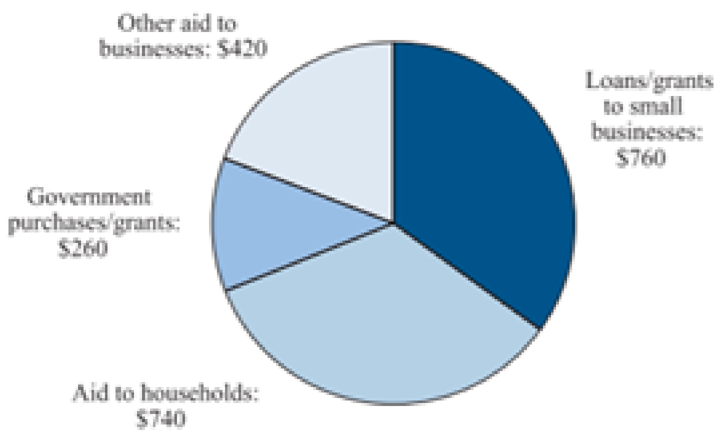
(Fig 2)

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