VWG Wealth Management 2nd Quarter Review

Executive Summary

• The S&P 500 Index rebounded from one of its worst quarters in history, rising 20.1%. For the year, the benchmark for large U.S. stocks is down 3.2%. U.S. small stocks and international stocks also improved in the second quarter, but have still declined this year.
• Massive U.S. fiscal and monetary packages of support bolstered stocks and large swaths of credit markets. International governments and central banks provided significant aid, providing a concerted global economic response to the global COVID-19 crisis.
• 'Green shoots' of revived economic activity began to appear in the U.S. and globally. U.S. employment, manufacturing and residential housing showed measurable improvement.
• Historically firm U.S. stock valuations, and viral outbreaks in 'hotspots' could put a damper on further near-term price improvements. Economists expect the path to sustained recovery will be choppy and slow. Patience will be required, and volatility should be expected. However, long-term investors cannot be too negative with extremely accommodative monetary conditions, and with a record amount of medical science resources deployed in fighting the pandemic.
• VWG recommends that investors review their long-term financial plans, maintain balanced portfolios, and allocate long-term growth capital to active managers who may benefit from periods of disruption and economic dislocations.

Review of the Markets

After suffering one of the worst quarters in history, U.S. stocks rebounded sharply in the 2nd quarter. The benchmark S&P 500 Index gained 20.1%, but is still down 3.2% this year. Noted catalysts included the $2 trillion CARES relief package enacted on March 27, extreme market negativity including large short positions and open put options, and relief from a severe liquidity squeeze in credit markets thanks to Federal Reserve intervention. The rise started slowly, concentrated in quality, non-financial mega-cap stocks. Later in the quarter the recovery

gained momentum, with participation gradually broadening to financials and beaten down travel and leisure sectors. Small U.S. stocks, as measured by the Russell 2000 Index, followed in suit, increasing by 25.5%. For the year they have fallen 13.0%.

International economies were also supported by large fiscal and monetary actions. The international equity benchmark MSCI EAFE Index, rose 15.4% in the quarter. It has dropped 11.1% for the year. The MSCI Emerging Markets Index increased 17.8% for the quarter and has lost 10.3% this year.

The U.S. Federal Reserve took further landmark actions in early April, bolstering fragile credit markets. Programs providing up to $2.3 trillion in loans to support the economy were announced, including the Main Street Lending Facility, and the Municipal Liquidity Facility. These were increased later in the quarter. The TALF (Term Asset Backed Securities Loan Facility) program was broadened, and direct purchases of corporate investment grade bonds were initiated.

These persistent actions buttressed bond prices, particularly economically vulnerable high yield bonds. The Bloomberg Barclays High Yield Bond Index recovered 8.4% in the quarter, and is down 5.4% for the year. Municipal bond prices improved at a slower rate, as concerns of stresses on state and local municipalities persisted amidst speculation of further targeted fiscal support. The S&P National Municipal Bond Index gained 2.7% for the quarter and is now up 2.3% for the year.

Crude oil strengthened in the 2nd quarter, after suffering a brief but stunning 'crash' in late April as global demand fell precipitously and storage capacity maxed out. NYMEX West Texas Intermediate Crude continuous futures contract rose 91.7% from a depressed $20.48/barrel. Year to date it has dropped 35.7%. Gold continued its rise, supported by 0% interest rates, and fears of deflation and global currency debasement. The NYMEX Gold continuous futures contract gained 12.8% for the quarter, and has increased 18.2% this year.

Unprecedented

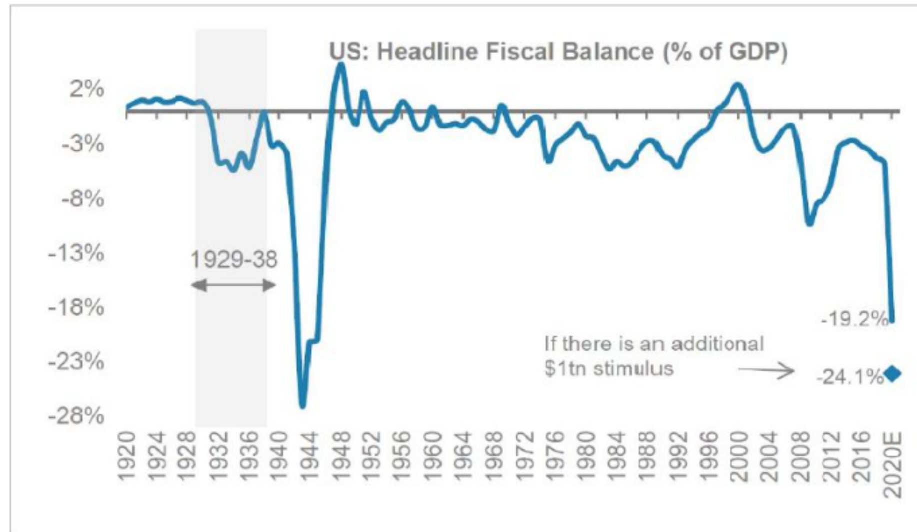
"Investing should be more like watching paint dry or watching grass grow.
If you want excitement, take $800 and go to Las Vegas."

- Paul Samuelson

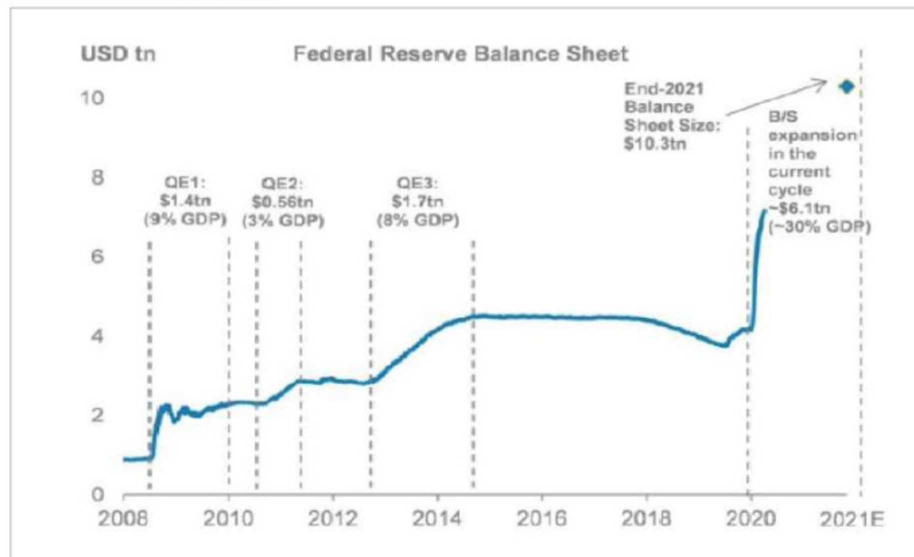
At the beginning of the year, VWG's investment views for 2020 were moderately positive. This was softened with caveats that some periodic outbreaks of volatility should be expected, and that corporate profit growth would be required to support rising stock prices. Six months later, the investment landscape, and our very lives, appear completely overturned. We all have witnessed an unprecedented use of the word 'unprecedented.' It feels like we've passed through a number of "investment" and "virology" lives. Less excitement, and a lot more paint- and grass-watching, would be welcomed.

Much has calmed down since March's perilous plunge in stock prices, and the panicked rush for liquidity that affected almost all assets. Most markets and asset types have been stabilized by the massive, coordinated efforts of global fiscal policy makers and central banks.

Fiscal Policy Response Much Greater Than During Great Depression or Global Financial Crisis



Monetary Policy Also at Unprecedented Levels and 50% Greater than Global Financial Crisis



Charts courtesy of Federal Reserve Bank of New York, Morgan Stanley & Co. Research as of June 6, 2020

Additionally, the U.S. Federal Reserve has signaled that it will continue to employ its extensive set of tools to

support the economy. The benchmark Feds fund lending rate is expected to remain at 0% until 2023 at the earliest. Fed Chair Jerome Powell stated in early June that "we're not even thinking about *thinking about* raising rates."

'Green shoots' of revived economic activity are appearing in the U.S. and globally after an almost complete shutdown of many industries and businesses. Manufacturing speaks to resumption of demand, employment, and multiplier effects. Residential housing is an excellent leading indicator of consumer demand, and a barometer of healing liquidity and credit markets.

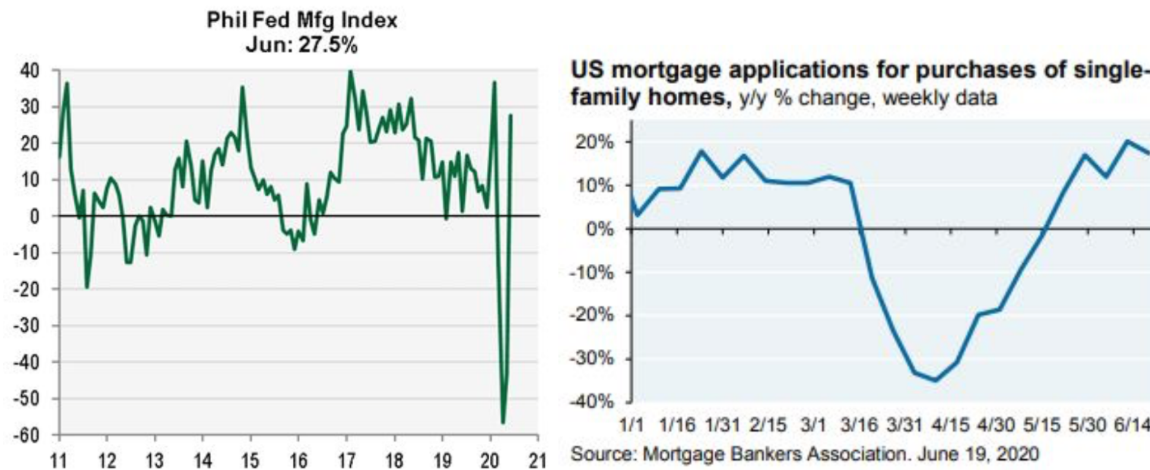
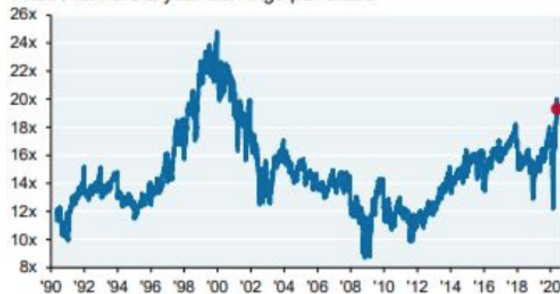
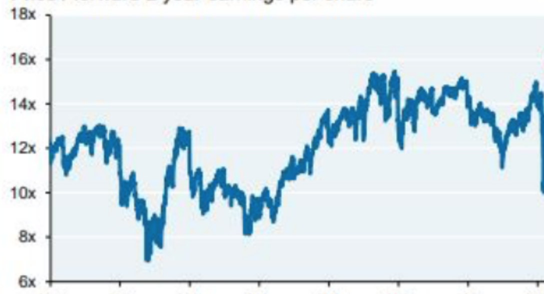


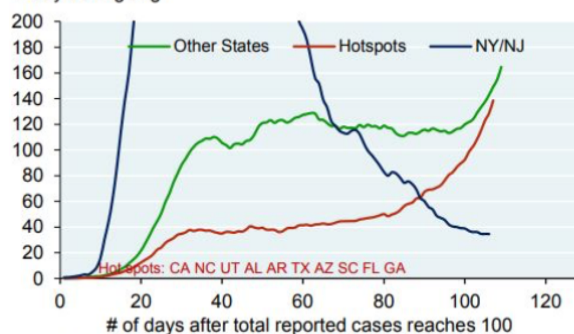
Chart courtesy of Cornerstone Macro

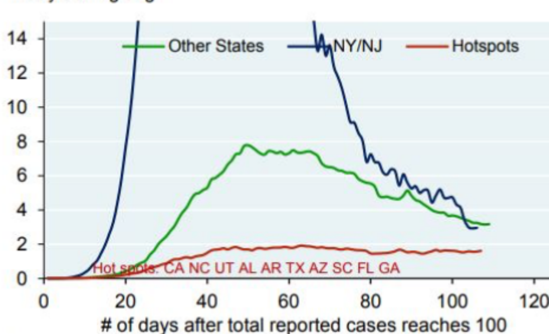
Frontrunning the rebound, U.S. and global equity prices have risen steadily since early April. The S&P 500 Index is now 5.4% higher than it was a year ago. The MSCI All Country World Index, a benchmark for global large and mid-cap stocks, is flat (0%) for the same period. Equity valuations as measured by their price-earnings ratios are historically high. This is in the face of extremely uncertain forward earnings visibility of many companies and industries, extending well into 2021.





Adding further complexity, the COVID-19 virus is still spreading. Reported infections in many U.S. 'hotspots' continue to rise. Acceleration of cases in parts of South and Central America are deeply troubling. Fortunately, U.S. deaths are not increasing in line with infections. It appears that a lot of the new U.S. 'hotspot' cases are in younger, lower-risk groups. But the return to 'normalcy' is nowhere in sight. Per Leuthold Group's chief investment strategist Jim Paulsen, "the coronavirus risk isn't going away anytime soon. We're going to have to learn to live with the virus."





Putting it together, VWG Wealth Management concludes that investors cannot be too negative. One cannot ignore the massive backstopping by policy makers and central banks, accommodative 0% interest rates, and economic activity responding from sharply low levels. Attempting to predict or time markets and investor behavior, based on news and narrative, or even a global pandemic, could be precarious.

On the other hand, we are not blindly optimistic. The U.S. and global economies have suffered a tremendous blow. Most recent data show 29.1 million U.S. workers receiving unemployment and pandemic assistance. A wave of business failures is predicted during the rest of the year. A second 'wave' of employment cuts could be coming. Peter Hooper, Deutsche Bank Global Head of Economics Research, recently stated "as business activity (in a number of industries) fails to get close to anything like 'normal,' there will be some real winnowing in corporate expenditures. We expect to see pain at higher income levels, as larger layoffs move up the pay scale." Some experts predict the U.S. unemployment rate will still be above 10% at year's end.

The road to economic healing, and ultimate sustainability sans external stimulus, will be long and bumpy. Global geopolitics, and the U.S. presidential election season, will undoubtedly offer little refuge. Volatility and uncertainty should be expected.

Portfolio Strategy and Asset Positioning

In the face of such a precarious and perplexing situation, how should investors respond, and how should their portfolios be positioned? Fortunately, the core of VWG's philosophy and process remains constant in addressing the present challenges. These consist of three essential components: planning, diversification, and investment in long-term wealth creators.

Planning. If you are concerned about your financial situation in light of the COVID-19 pandemic, or due to any significant or contemplated life changes, please work with us to review your financial plan. The plan will provide some objectivity, and will maintain focus on your long-term goals. Seeing how your plan currently works, and then evaluating it under different future conditions is extremely valuable. It can help alleviate some of your understandable near-term concerns. Breaking down your financial assets into short-term and long-term needs can also help properly frame the discussion, and keep you on track toward meeting your goals.

Diversification. VWG believes that presently, most investors' portfolios should be balanced, often with a 'barbell' type construction. An adequate allocation to cash and quality, short-term bonds, and partially capital-protected strategies should be offset with traditional equities and other investments focused on long-term capital appreciation and total return. Potential needs for cash and liquidity over the coming two years should be evaluated and addressed. Within the construct of their long-term financial plans, more conservative and concerned investors should trim some potentially volatile assets 'down to their sleeping points.'

Long-term Investment in Wealth Creators. For investments targeted for growth, VWG's core philosophy is committing capital to experienced businesses and entrepreneurial operators focused on the long-term creation of capital. These are housed in public and private strategies. The COVID-19 pandemic, and the global economic

downturn it has swiftly caused, does not change this. Uncertainty is always present in long-term investing. Perversely, it is often during periods of disruption and economic dislocations that the greatest opportunities arise. Noted serial entrepreneur and venture investor Brad Gerstner explained this in a recent "Invest Like the Best" podcast:

> ***"Far more money has been lost (in investing), betting on the end of times, trading out of one's good ideas, trying to hedge out of COVID-19, than has been made by just placing (capital) in great businesses (run by great entrepreneurs), and allowing them to compound. We aren't thinking about the next six minutes or the next six weeks, and this makes it much easier to operate during periods of duress."***

Damon Ficklin, Polen Capital's co-head of Large Growth Equity, echoed these beliefs during his recent mid-year update:

> ***"For us, the best strategy is to identify superior businesses and then holding them, not in predicting different market and economic regimes along the way, and attempting to swap in and out of them"***

Our focus is on you, your families and your loved ones

VWG's primary focus has always been, and always will be, on you and your family's long-term financial health. You can be assured of our steadiness and resolve, as we face the pandemic crisis and attempt to safely navigate through it. Along the way, we will remain vigilant to potential threats and opportunities.

Best wishes for some respite during these summer months, enjoying the outdoors and the company of friends and family (even if only via videoconference).

Regards,

VWG Wealth Management

Suzanne, Ashley, Rashmi, Kay, Lynette, Ona, Michelle, Ryan, Ryan, Susan, Marnie, Justin, Elana, Patricia, John, Rick and Jeff

Who we are

** Index Data Sourced from FactSet Research, Morningstar*

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VWG Wealth Management

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