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iCapital

INVESTMENT COMMITTEE MARKET COMMENTARY

IN THIS ISSUE

iCapital

Greetings,

As we write to all of you, we hope this commentary finds you and your family healthy and safe in these unprecedented times. Our sincere blessings are with all of you. It is difficult to articulate the speed of how things have changed throughout the world in less than 30-days. How profoundly different we all feel with many unknowns and adjusting to life at home.

We entered the year with a strong stock market, record low unemployment and a solid economic outlook for growth. Market risks and uncertainty were centered around trade negotiations with China, continued growth in the US and abroad and the possible political ramifications of a presidential impeachment. We were all aware of the growing federal deficit and wondered what unknowns could derail the outlook and dramatically change economic forecasts.

A quarter later, an unforeseen and unparalleled demand disaster has taken over economic projections and changed the world economy. We will always remember 2020 as the year of the pandemic that changed each of us. The word corona will no longer conjure thoughts of "finding your beach", it will render memories of self-sacrifice as the world was put on pause as the coronavirus ravaged our society.

What we do know, is the second quarter economic outlook is bleak. We enter the quarter transitioning from a pre-virus economy to, hopefully, by the end of the quarter a post-virus one. The third quarter will be where we will know if social distancing measures will start allowing our economy to re-open and help us define a path to recovery. Until that begins to take shape we have prepared a quarterly overview to understand the financial impacts of the coronavirus and other market concerns.

With deep gratitude from all of us at iCapital,

Katie Umile, CEO

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INVESTMENT INSIGHTS *{as of April 7, 2020}*

From iCapital Investment Committee Chief Market Strategist, Dr. Ahmad Etebari

Contagion in the World Economy

The COVID-19 pandemic continues to weigh heavily on the world economy, causing mass shutdowns and widespread disruptions. It is wreaking havoc on the travel industry, potentially bankrupting airline and cruise-ship companies, shutting down large events, closing schools, quarantining large groups of people, testing our healthcare capabilities, and forcing businesses to lay off workers. At the same time, we have witnessed a collapse in oil prices, which is bound to curb investments in the oil and gas industry, leading to further layoffs.

Forward-looking economic forecasts now look intensely bleak — a stark change from the economic environment entering the year. From January to the end of March we have gone from record low unemployment, booming consumer confidence and strong manufacturing to expectations of massive drawbacks in GDP and employment. The latest jobs reports gave us our first taste of data we can expect from the pandemic, with a reported 3.3 million and a further 6.6 million new jobless claims in back-to-back weeks, for a metric that had never topped 700,000 claims in a week. The full economic impact will not be fully understood for some time and the data has not been able to reflect how severe the impact is to the economy. However, we do know the effect will be extreme no matter where the trajectory of the virus continues from here. With that being said, we can look at how markets have been affected in the quarter so far.

A Market Scorecard

Coming off the heels of a strong year, global markets took investors on a wild ride during the quarter. Sweeping concerns over the economic impacts of the virus caused vast selloffs in virtually every major asset class with the exception of US Treasuries and gold. Investors flocked to cash and safe-haven assets, leaving both domestic and international equities in the dust.

The S&P 500 and the Dow lost 20% and 23%, respectively, recording their worst first-quarter performances ever. The Nasdaq did better, losing only 14%. International equities and U.S. real estate had losses in the range of 20%-30% each. But, the hardest hit asset was oil, as U.S. West Texas Intermediate Oil (WTI) posted its largest quarterly loss ever at 65.5%.

The pain varied across sectors. Consumer staples, tech and health care suffered the least, while energy (particularly, oil and gas exploration) suffered the biggest loss (-76%), followed by travel service (-67%) mortgage REITs (-64%), and airlines (-58%). As for investment style, small-cap and value did far worse than large-cap and growth, respectively.

In terms of volatility, March was the worst month of the quarter experiencing wilder market swings than in any month in 1929, 1987 and 2008. March also had the highest VIX (CBOE Volatility Index) level ever recorded in the 27-year history of the metric and saw some of the biggest daily losses and gains ever in history.

U.S. Policy Response, a Positive

In late March, the Federal Government passed a historic fiscal stimulus package totaling $2 trillion as it tries to cope with the economic fallout from COVID-19. The package contains rebate checks that will be received by most workers, cheap loans to businesses, more generous unemployment benefits for those who have been laid off and financial support for industries that have been disproportionately affected by the virus. The bill is the largest fiscal stimulus package in modern history and will help combat some of the economic burden COVID-19 has placed on people and their businesses.

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The Federal Reserve is also providing massive monetary stimulus to the markets, standing ready to do "whatever it takes" to keep the rates low and support the markets. The Federal Reserve actions have already helped to stabilize the financial markets, paving the way for a more effective implementation of the government fiscal policies. That said, this is currently a Band-Aid to the much larger overarching problem of containing the virus. The economy cannot fully recover or even begin to recover until the virus has been overcome and people are allowed to return to their normal lives, spending and churning the gears of the economy again. While this package can be seen as a concern given the U.S. debt load, realistically it should not be that extensive of a burden in the short run. The U.S. will continue to roll over its debt as it has always done historically and if the package can mitigate the damage and get the economy back on track faster, the result will be overwhelmingly positive.

U.S. Treasuries Deliver as Expected

Few, if any, sectors in financial markets were spared from the sudden collapse of the economic outlook and liquidity towards the end of the quarter. Fear of recession from a widespread COVID-19 outbreak forced investors globally to sell risky fixed income products in their portfolios and, in exchange, demand safe-haven assets, such as those offered in the U.S. Treasury market. U.S. Treasuries were one of the fixed income sectors to deliver a positive return in Q1, up on the average around 10%.

While delivering a positive return, Treasuries experienced unprecedented volatility. The yield on the 10-year Treasury bond has compressed from a high of 1.88% at the beginning of January to 0.63% today. A move of this magnitude does not reflect the volatility profile of a "sleepy" government bond. While typically less volatile than equities, the liquidity crunch that occurred in the middle of March wrenched the typical investor's 60/40 portfolio, driving volatility in Treasuries to the highest levels since the 2008 financial crisis. Volatility in the US rates markets seem to have stabilized since the Federal Reserve intervened and committed to buy unlimited amounts of Treasuries across the yield curve.

Not All Bonds Are Created Equal

Other "risky" US fixed income sectors have experienced historically rapid increases in yields. High quality sectors, such as municipal bonds and investment grade corporates, were down about 3% and 4%, respectively. The underperformance of these high-quality bonds is largely due to the collapse in market liquidity.

High yield bonds and leveraged loans massively underperformed the broader fixed-income market, with returns of about -14% and -13.5%, on a combination of higher liquidity risk and more importantly, significantly higher risk of default.

Unfortunately, the Fed "put" does not extend to these fixed income sectors. At the end of March, the yields on high yield bonds are still 9% higher than the yields on risk-free U.S. Treasury bonds, and the yields on high yield energy bonds were 20% higher than U.S. Treasury bonds. This dispersion in yields reflects the severe disruption in future cash flows that many highly-levered corporations face.

Oil Plunges but Consumers Unable to Take Advantage

A price war that began with the breakdown of Saudi-Russian collaboration early March has driven crude oil prices below $25/barrel to their lowest levels this century. This is bad news for oil companies, particularly those whose assets include higher-cost wells as they face dwindling cash flow. Particularly vulnerable are independent exploration and production firms with more limited access to capital than the industry's majors. This will likely lead to oil-sector bankruptcies and significant layoffs in the United States, where many producers need prices above $50/barrel to stay profitable.

Normally, as oil prices would fall, consumers would spend less at the pump, companies' shipping costs would fall, and airlines would pay less for their fuel — and all of this would stimulate demand, helping to balance the oil market. But unlike past supply-driven price shocks, this one comes against the backdrop of a simultaneous and historic demand shock. With economic activity already plummeting due to the COVID-19 pandemic, the demand response to the oil price crash is nowhere to be found. High airfares have nothing to do with the fall in air travel this year, so passing along fuel savings to customers will not help airlines sell more tickets. With Saudi Arabia and the UAE accelerating new production capacity additions in spite of anemic demand, the oil supply glut may even exceed available storage capacity by the middle of 2020. This will force a shut-in of production capacity if it happens, with nowhere for oil to go.

A quick production decline from higher-cost wells driven out of operation by the price war, coupled with a potential prompt return to coordination by Russia and Saudi Arabia that might emerge from an OPEC+ meeting this week, could eventually lead supply to fall back below demand this year. However, the glut of oil in storage will likely keep oil prices depressed well into next year at earliest. It will take a long time for a world emerging from the rubble of COVID-19 to absorb the leftover oil from this price war, and this will mean a slow recovery for smaller US oil producers.

Currency Markets Move "Risk-Off"

Currency markets have been the "leading" asset class in pricing in the painful global recession that is about to occur. As COVID-19 went truly "global" in March, investors forged a new consensus centered around the fact that no person nor country would be spared in its path. This consensus resulted in a widespread preference for safe-haven currencies, with an outsized demand for the U.S. dollar. At the end of the quarter, the DXY (dollar spot index) was up about 5% from recent trough levels on March 9, while the BBDXY (Bloomberg dollar spot) was already well past 2017 highs. On the other hand, commodity-based currencies (think RUB, AUD, BRL) were down 10–35%.

Innovation A Source or Resilience

This bear market has painted a widely different picture for different areas of the equity market based on the effects the virus will have on a given industry. Cyclical stocks such as travel and leisure, automobiles and construction have been hurt especially hard while industries more tied to secular growth in technology have outperformed the averages. These areas of the market, consisting of subindustries such as software and internet retail, have a larger exposure to innovation either in creating new industries or taking clients from legacy players in each industry. This gives them the ability to continue growing during difficult market conditions. Where the virus takes the economy from here could largely dictate how innovative and secular growth companies can separate themselves from the pack. These companies will most likely continue to command a premium in the marketplace while the economy remains in contraction.

Try to See the Big Picture

While there is no doubt that this has been a difficult quarter for investors, it is important to remember that the financial markets have already reflected a lot of uncertainty revolving around COVID-19. That is not to say that markets cannot fall further, they can, but with the losses already baked in across most asset classes, the question on everyone's mind is, "where do markets go from here?" Any sagacious investor knows that no one has a crystal ball and trying to time or predict the market's short-term performance is a foolish proposition. What we do know is that historically markets have gone up over time. Take a step back and realize that this has been an abnormal quarter, so trying to see normalcy in this quarter can be misleading. The stock market was on an almost 11-year bull run and the run was going to come to an end eventually. That the bull run came to an end so abruptly was unsettling to many, but we have a strong enough faith in humanity that we believe this pandemic will eventually pass, and that markets will function again under more normal circumstances.

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THE MARKETS

Thoughts on the Recent Market Performance

The world's economies and stock markets have been rocked by the spread of COVID-19. Investors' fears prompted a major sell-off in February and March, plunging stocks well below their 2019 closing marks. Nevertheless, 2020 started off in a positive way. Following a strong 2019, stocks were slow to move forward as investors cashed in some of their 2019 gains. But by mid-January, each of the benchmark indexes were safely ahead of their 2019 closing marks. However, concerns over the COVID-19 outbreak in China quelled investor optimism. By the end of January, only the small caps of the Nasdaq remained ahead of their prior year's pace, as each of the remaining indexes listed here fell into the red.

February started off as January ended, with investors more inclined to sell rather than buy equities. However, word of China's plans to cut tariffs on some U.S. imports sent stocks higher during the second week of the month. The Nasdaq was more than 6% over its 2019 year-end value while both the S&P 500 and the Dow also pushed ahead. But by the third week of February, the impact of the virus was becoming evident with news of a widespread outbreak in South Korea. Selling accelerated the following week as outbreaks were reported in Iran and Italy. As more cases were reported in the United States, investors feared that containment of the virus was not likely and rushed to cash in stocks. By the end of February, each of the indexes lost significant value led by the Dow, which fell more than 10% for the month.

March 2020 will surely go down as one of the most turbulent months. COVID-19 continued to spread worldwide. In the United States, confirmed cases and, unfortunately, deaths spiraled. Fear became the motivating factor in our daily lives — fear of catching the virus, fear of the illness affecting our loved ones, fear of losing our jobs, fear of economic failure, and fear of losing our money. With respect to the stock market, this fear manifested itself in a major sell-off for most of the month. After falling sharply during the last week of February, stocks rebounded marginally to open the month. But that push was short-lived as stocks plummeted dramatically mid-March, despite the announcement of new actions and legislation by the Federal Reserve, Congress, and the President. On March 20, each of the benchmark indexes listed here posted double-digit losses. Year to date, the major indexes were more than 20% behind their 2019 closing values. The passage of the CARES Act at the end of the month helped ease investors' concerns enough to move back to stocks. The end of the month saw each of the benchmark indexes post major gains, with the Dow marking its best single day since 1938. However, the spike in index values was not nearly enough to offset the major losses sustained throughout the month. March saw the Dow fall almost 14%, the S&P 500 drop over 12%, the Nasdaq lose 10%, the Global Dow give back close to 15%, and the small caps of the Russell 2000 plunge nearly 22%.

The first quarter of 2020 closed with each of the benchmark indexes securely in the red compared to their 2019 year-end values. The Russell 2000 again suffered the largest three-month fall, closing the quarter down nearly 31%. The Dow suffered its worst quarter since 1987, while the broader-based S&P 500 hasn't seen a quarterly decline this bad since 2008. The Nasdaq fell more than 14%, marking its worst quarter since 2018. The Global Dow fell over 24% for the quarter.

By the close of trading on March 31, the price of crude oil (WTI) had sunk to $20.35 per barrel, well below the February 28 price of $45.19 per barrel. The national average retail regular gasoline price was $2.120 per gallon on March 23, down from the February 24 selling price of $2.466 and $0.503 less than a year ago. The price of gold finished March at $1,591.20, slightly higher than its February closing value of $1,585.80.

Market Performance

Market/Index	2019 Close	As of 3/31	Month Change	Quarter Change	YTD Change
DJIA..................	28,538.44	21,917.16	-13.74%	-23.20%	-23.20%
NASDAQ..............	8,972.60	7,700.10	-10.12%	-14.18%	-14.18%
S&P 500...............	3,230.78	2,584.59	-12.51%	-20.00%	-20.00%
Russell 2000	1,668.47	1,153.10	-21.90%	-30.89%	-30.89%
Global Dow	3,251.24	2,469.53	-14.84%	-24.04%	-24.04%
Fed. Funds	1.50%-1.75%	0.00%-0.25%	-150 bps	-150 bps	-150 bps
10-year Treasuries	1.91%	0.69%	-43 bps	-122 bps	-122 bps

Chart reflects price changes, not total return. Because it does not include dividends or splits, it should not be used to benchmark performance of specific investments.

***NOTES:**

The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks.

The S&P 500 is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy.

The NASDAQ Composite Index is a market-value weighted index of all common stocks listed on the NASDAQ stock exchange.

The Russell 2000 is a market-cap weighted index composed of 2,000 U.S. small-cap common stocks.

The Global Dow is an equally weighted index of 150 widely traded blue-chip common stocks worldwide. The U.S. Dollar Index is a geometrically weighted index of the value of the U.S. dollar relative to six foreign currencies. Market indices listed are unmanaged and are not available for direct investment.

Latest Economic Reports

- **Employment:** Employment rose by 273,000 in February after adding 225,000 new jobs in January. In 2019, job growth averaged 178,000 per month. Notable job gains occurred in health care and social assistance, food services and drinking places, government, construction, professional and technical services, and financial activities. The unemployment rate dropped 0.01 percentage point to 3.5% for the month as the number of unemployed persons dropped by close to 100,000 to 5.8 million. In February, average hourly earnings for all employees rose by $0.09 to $28.52. Average hourly earnings increased by 3.0% over the last 12 months ended in February. The average workweek rose by 0.1 hour to 34.4 hours in February. The labor participation rate for February was 63.4%, the same as in the previous month. The employment-population ratio was 61.1% last month (61.2% in January).

- **FOMC/interest rates:** The Federal Open Market Committee held several emergency meetings in March, dropping the target range for the federal funds rate 150 basis points to 0.00%–0.25%. To further combat the economic impact of COVID-19, the Committee proffered a number of new and drastic measures. Among the actions taken by the Fed are unlimited bond buying including the purchase of corporate bonds; $300 billion in new financing; and the establishment of two new facilities, the Term Asset-Backed Securities Loan Facility to enable the issuance of asset-backed securities, and a Main Street Business Lending Program to support lending to eligible small and medium-sized businesses.

- **GDP/budget:** According to the third and final estimate for the fourth-quarter gross domestic product, the economy accelerated at an annualized rate of 2.1%, the same rate as in the third quarter. Consumer spending grew at a rate of 1.8% (3.2% in the third quarter), fixed investment fell 0.6% in the fourth quarter (-0.8% in the third quarter), and nonresidential fixed investment dropped 2.4% in the fourth quarter, compared to a 2.3% decline in the prior quarter. Consumer prices advanced at a rate of 1.4% in the fourth quarter, comparable to the third quarter (1.3%).

Last February saw a budget deficit of $235 billion. Through the first five months of the 2020 fiscal year, the deficit sits at $624.5 billion, 14.8% greater than the deficit over the same period last fiscal year.

Last February saw a budget deficit of $235 billion. Through the first five months of the 2020 fiscal year, the deficit sits at $624.5 billion, 14.8% greater than the deficit over the same period last fiscal year. Compared to the same period last year, government spending climbed 9.2%, far exceeding receipts, which rose 7.0%. In February, the largest expenditures were for Social Security ($91 billion), income security ($91 billion), national defense ($55 billion), and Medicare ($52 billion). On the income side of the ledger, social insurance and retirement accounted for $100 billion and individual income taxes totaled $70 billion.

- **Inflation/consumer spending:** According to the Personal Income and Outlays report for February, personal income rose 0.6% for the month, the same advance as in the previous month. Disposable, or after-tax, income increased 0.5% after increasing 0.6% in January. Consumer spending rose 0.2% in February for the second consecutive month. Price inflation remained low, however, as consumer prices inched ahead 0.1% for the third month in a row. Over the last 12 months, consumer prices are up 1.8%.

The Consumer Price Index inched ahead 0.1% in February, the same increase as in January. Year to date, consumer prices are up 2.3%. Increases in prices for shelter (which makes up the largest portion of overall consumer costs) climbed 0.3% in February following the same 0.3% increase in January. Energy prices dropped 2.0% in February after falling 0.7% in January. Gas prices plummeted 3.4% while fuel oil prices decreased 8.5%.

Prices producers receive for goods and services fell 0.6% after advancing 0.5% in January. The index has increased 1.3% since last February. Producer prices less foods, energy, and trade services inched down 0.1% in February following a 0.5% increase in January. Since February 2019, prices less foods, energy, and trade services moved up 1.4%. In February, producer prices for goods fell 0.9%, the largest decline since moving down 1.1% in September 2015. Over 60% of the February decrease in goods prices is tied to a 3.6% drop in energy prices.

- **Housing:** After falling 1.3% in January, existing home sales jumped 6.5% in February. Year over year, existing home sales are up 7.2% (9.6% for the 12 months ended in January). The median sales price for existing homes was $270,100 in February, compared to $266,300 in January. Existing home prices were up 8.0% from February 2019. Total housing inventory at the end of February was 1.47 million, an increase from the January rate of 1.42 million units for sale. Following a strong January, sales of new single-family homes decreased in February, falling 4.4% below January's totals. Sales are 14.3% above the February 2019 estimate. The median sales price of new houses sold in February was $345,900 ($348,200 in January). The average sales price was $403,800 in February ($402,300 in January). Available inventory, at a 5.0-month supply, was slightly lower than January's 5.1-month supply.

- **Manufacturing:** For the first time in three months, industrial production increased, climbing 0.6% in February after falling 0.5% the previous month. Manufacturing output edged up 0.1% last month but is still 0.4% below its level of a year earlier. Total industrial production was unchanged from a year earlier. New orders for durable goods climbed 1.2% in February following a 0.1% increase in January. New orders have advanced four out of the last five months. For the year, new orders for durable goods are up 0.4%. New orders for transportation equipment drove the increase, vaulting 4.6% in February. However, excluding transportation, new orders fell 0.6%. New orders for capital goods (manufactured assets used by businesses to produce consumer goods) jumped ahead 4.1% in February, driven primarily by a jump in new orders for defense capital goods, which soared 25.7%. Orders for nondefense capital goods inched up 0.5%.

- **Imports and exports:** Import prices fell 0.5% in February after inching up 0.1% in January. February's drop in import prices was the largest decrease since a similar decrease last August. Since February 2019, import prices have fallen 1.2%. Fuel imports plunged 7.7% in February, the largest monthly decline since prices receded 7.8% in June 2019. Excluding fuel, import prices actually increased 0.3% in February. Prices for exports dropped 1.1% last month after advancing 0.6% in January. This is the largest monthly decrease in export prices since December 2015. Prices for exports decreased 1.3% on a 12-month basis from February 2019.

  The international trade in goods deficit was $59.9 billion in February, down from $65.5 billion in January. Exports of goods for February increased 0.5% to $136.5 billion. Imports of goods dropped 2.6% to $196.4 billion.

  The latest information on international trade in goods and services, out March 6, is for January and shows that the goods and services trade deficit shrank to $45.3 billion, $3.3 billion less than the December trade gap. January exports were $208.6 billion, $0.9 billion less than December exports. January imports were $253.9 billion, $4.2 billion lower than December imports.

- **International markets:** The spread of COVID-19 sent world markets and economies tumbling. With over 110 countries and territories reporting cases of the virus, major institutions and banks have cut their forecasts for the global economy. Several nations, led by China, have ordered certain areas locked down, restricting movements of millions of people and suspending business operations. China's gross domestic product is expected to plunge to 4.9% this year, slower than earlier forecasts of 5.7% annual growth. Year to date, the STOXX Europe 600 Index fell almost 23%, Germany's DAX slipped over 24%, France's CAC 40 lost 24%, Italy's FTSE MIB Index dropped 26%, the UK's FSTE 100 Index has given back close to 23%, and Japan's NIKKEI 225 is down 21%.

- **Consumer confidence:** Not surprisingly, the Conference Board Consumer Confidence Index® declined sharply in March. The index fell to 120.0 from February's 132.6. The Present Situation Index — based on consumers' assessment of current business and labor market conditions — decreased from 169.3 to 167.7. However, the Expectations Index, which is based on consumers' short-term outlook for income, business, and labor market conditions, fell from 108.1 to 88.2.

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OUTLOOK

Eye on the Month Ahead

Individuals' health is of primary importance as the world continues to battle the effects of COVID-19. Of secondary, but great importance, is the impact of this pandemic on the world's economies and markets. April will, hopefully, begin to point toward recovery of both personal and economic health. The impact of the CARES Act should begin to be felt by individuals and businesses next month.

*NOTES

Data sources: Economic: Based on data from U.S. Bureau of Labor Statistics (unemployment, inflation); U.S. Department of Commerce (GDP, corporate profits, retail sales, housing); S&P/Case-Shiller 20-City Composite Index (home prices); Institute for Supply Management (manufacturing/services). Performance: Based on data reported in WSJ Market Data Center (indexes); U.S. Treasury (Treasury yields); U.S. Energy Information Administration/Bloomberg.com Market Data (oil spot price, WTI Cushing, OK); www.goldprice.org (spot gold/silver); Oanda/FX Street (currency exchange rates). News items are based on reports from multiple commonly available international news sources (i.e. wire services) and are independently verified when necessary with secondary sources such as government agencies, corporate press releases, or trade organizations. All information is based on sources deemed reliable, but no warranty or guarantee is made as to its accuracy or completeness. Neither the information nor any opinion expressed herein constitutes a solicitation for the purchase or sale of any securities, and should not be relied on as financial advice. Past performance is no guarantee of future results. All investing involves risk, including the potential loss of principal, and there can be no guarantee that any investing strategy will be successful.

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