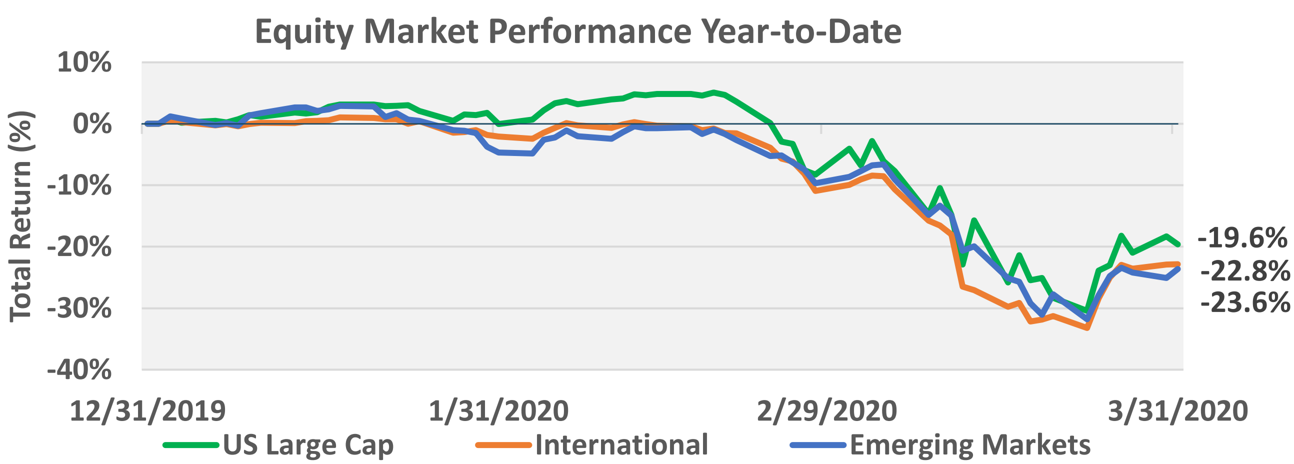
1st Quarter 2020 Commentary – Market Contagion

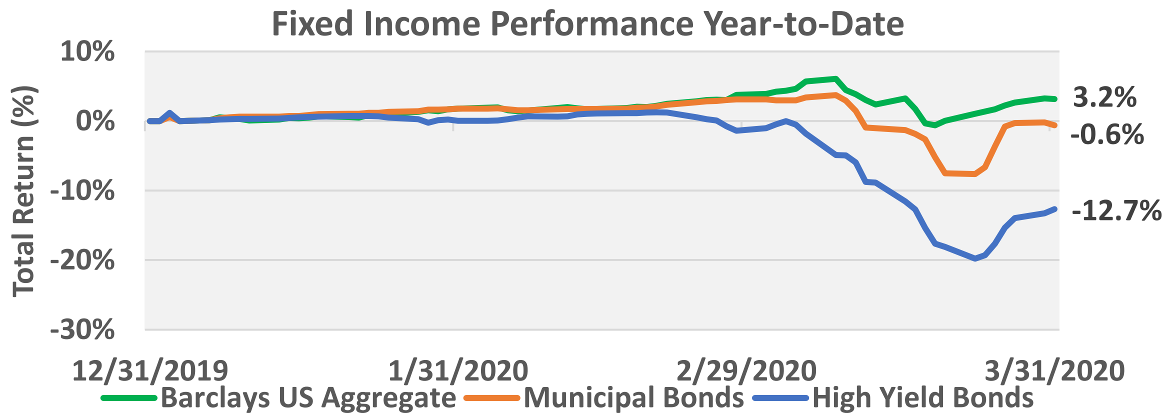
We hope that you and your families are doing as well as possible under the circumstances and staying safe.

We at Global Strategic are working remotely and finding that our heavy use of outsourcing and technology has paid an unexpected dividend. Founded in 2015, we engineered our systems and business plans from scratch based on outsourced technologies, best practices, efficiency and the ability to scale rapidly. This “anywhere, anytime” ability to work together or remotely has made our transition to the necessities of today practically seamless.

The global emergence of the Coronavirus in China late in 2019 did not attract much attention until it accelerated its impact in January. Then the spread around the world took the headlines in mid-February and financial markets around the world reacted with caution and then panic. During the first quarter of 2020, equity markets around the world were down more than 30% from their peaks until Central Banks - and the US Federal Reserve in particular -- announced a series of very powerful liquidity supports. Simultaneously, substantial US fiscal policy moves were negotiated and passed on March 23, which produced a “relief rally.”



Fixed Income markets around the world also experienced significant volatility as well. Credit spreads (yield premium over Treasuries) rose suddenly, producing price declines and higher yields, especially in the High Yield segment. As illustrated in the below chart, the Fixed Income correction lagged the Equity declines by almost a month, which is unusual.



Now what? There is no bell that rings at a market bottom but valuation metrics in both equities and non-US Government fixed income sectors have improved markedly. Every bear market is triggered by different events. Sometimes it is excesses in the consumer, other times it is a Wall Street meltdown caused by greed. In past Comments we have said that bull markets do not die of old age and that they can be ended by policy errors, excess consumer leverage, external shocks or by market overvaluation. This bear market was triggered by one of the biggest external events ever and higher than normal US equity valuations.

Howard Marks of Oaktree Capital is a keen observer of value and has been, like us, cautious. His latest comments include the statement below:

"The bottom" is the day before the recovery begins. Thus, it's absolutely impossible to know when the bottom has been reached . . . ever. [We] explicitly reject the notion of waiting for the bottom; we buy when we can access value cheap.

This concept is sound and one we fully support, but the human and economic dynamics of this virus will remain uncertain for some time and markets do not thrive under uncertainty until they think that most of the information is on the table. That is not the case at this point.

For instance, the case trajectory that New York City is experiencing has not been reflected in other large population centers. It is reasonable to assume that the impact buildup has some time to run, especially as officials are able to accumulate better data more quickly. The economic impact is just getting going and our massive government programs are in a very early phase. Forecasting is never helpful, however, we expect markets to stay volatile and plan to take advantage of opportunities.

Our clients have varying levels of risk tolerance that we must assess to be sure that we are tailoring their strategies and responses to these opportunities appropriately. For instance - when should we rebalance our portfolios to return to strategic targets? Some clients want to sit tight and take the opportunity risk of missing some of the inevitable recovery because they fear further losses. For them we are doing partial rebalancing and staying patient. For newer clients with high levels of cash, these better valuations offer more attractive entry points than a few months ago, but it is worth pointing out that valuations in the US are now just at medians while non-US segments are more opportunistically valued.

The below chart outlines our perspective on the various asset classes. We maintain our valuation metrics across these categories and we are glad to send the specific details. The biggest absolute and relative value changes are in the US from Overvalued to Neutral and in Fixed Income non-Treasury from Overvalued to Cheap. The valuation moves have been dramatic.

		Asset Class Valuation Snapshot			
	Asset Class	vs History	vs Bonds	vs Asset Class Peers	Action
Equity	US Large Cap	Neutral	Cheap	Expensive	Mkt Weight
Equity	US Small Cap	Neutral	Cheap	Expensive	Underweight
Equity	Developed Markets	Cheap	Cheap	Cheap	Mkt Weight
Equity	Emerging Markets	Cheap	Cheap	Cheap	Overweight
Fixed Income	Treasuries	Expensive		Expensive	Underweight
Fixed Income	IG Credit	Cheap		Cheap	Mkt Weight
Fixed Income	HY Credit	Cheap		Cheap	Overweight
Liquid Alts	REITs	Expensive	Cheap	Cheap vs US Stocks	Underweight
Liquid Alts	Commodities	Cheap	Note: Negative trend and excess volatility		Retain (not add)
Liquid Alts	Gold	Expensive	Note: Positive trend (policy error hedge)		No exposure

Our Investment Strategy Group has been meeting routinely to evaluate the above changes and our Policy response. First and most important for many of our clients will be to gradually rebalance back to their long-term targets but to do so very slowly, as we expect volatility to continue in response to today's uncertainties. We will be eliminating REITS and maintaining our modest overweight to US. In Fixed Income markets we are initiating a modest allocation to the high yield bond category from cash and maintaining our high credit quality within core fixed income and municipal bonds.

Thank you for your trust and confidence in us.

Donald Callaghan
Managing Partner, Chief Investment Strategist

Matt Underwood, CFA®, CAIA®
Director of Research & Portfolio Management