WestStar

Wealth Watch

July 2020

Over the Mountain or Into the Woods?

The second quarter of 2020 enjoyed a tremendous market rebound following the coronavirus-induced decline of the first quarter. Along with the rally came signs of economic improvement as the country began to reopen amid seeming abatement of COVID-19 spread. But where do we go from here? Have we cleared the "recession mountain" hurdle or has this recent relief merely been a pit stop as we delve deeper into the "economic woods?"

While the country contemplates ways to reopen safely while balancing the possible need for some hard-hit areas to reclose, we will explore the current state of the capital markets and the economy and ponder what might be in store for the second half of 2020.

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What You Need Know:

- The second quarter witnessed a marked rebound
- It is not uncommon for markets to recover before the underlying economy does
- Crisis-related declines often rebound within 12 months
- Unprecedented global governmental stimulative countermeasures have helped and will continue to do so
- Recovery will take time and volatility is likely to persist
- Focus on your long term investment strategy rather than near term noise

Asset Class Index Performance* Year to Date as of 6/30/20

STRONGEST

US Investment-Grade Core Bonds
6.14%

Money Market (Cash)
0.68%

International Bonds
0.61%

US Large Cap Stocks
-3.08%

Alternative Investments
-3.39%

High Yield Bonds
-3.80%

International Emerging Market Stocks
-9.67%

International Developed Market Stocks
-11.07%

US Small Cap Stocks
-12.98%

Commodities
-19.40%

Real Estate
-20.93%

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Valleys and Peaks: Market Performance

As we noted in the April edition of the Wealth Watch, while the first three months of 2020 experienced the worst S&P 500 quarterly decline since 2008 and the index's worst first quarter decline ever, historical instances of crisis event-related market declines are typically followed by strong rebounds. Such was the case in the second quarter, as the S&P 500 had its best quarter in over 20 years and the Dow Jones Industrial Average had its best quarterly performance in over 30 years. The Q2 rebound was led by small cap stocks (+25.4%) in the US Equity space, whereas emerging markets stocks led developed markets in the International Equity category (+18.2% vs. +15.1%, respectively). This "risk-on" environment was also evident in Fixed Income, with high yield bonds (+10.2%) and international bonds (+3.4%) outpacing their investment-grade counterparts (+2.9%). On a year-to-date basis bonds still lead stocks through June 30th.

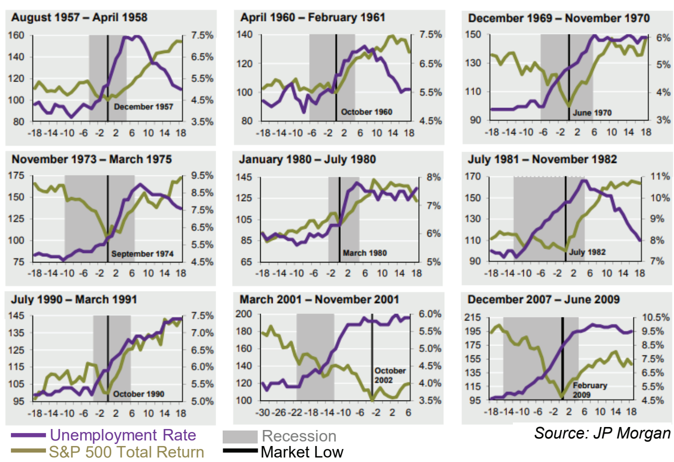
Hiking the Trail: WestStar Tactical Strategy

We had been cautious going into the first quarter and had therefore maintained a slightly defensive posture through the downturn. As the second quarter got underway we felt there were some buying opportunities for long term investors and began dipping our toe back in the river by increasing stock exposure. Research indicates that post-recession recovery rebounds are most often led by small cap stocks. As such, our most recent tactical shift included an emphasis on small cap over large cap and US over international. In Fixed Income we increased our high yield bond exposure from "underweight" to "neutral-weight." We maintained our "volatility defense" exposure via Alternative Investments as we expect volatility to persist but reduced our "inflation defense" exposure via Real Assets due to our muted inflation expectations.

Bridge Over Troubled Water: Market vs. Economy Dichotomy

How can the market be doing so well despite the economy still looking weak? This has been among the most frequent questions investors have had recently. Indeed, expectations are that second quarter real gross domestic product (GDP) will be down nearly -40% from the previous quarter and the June unemployment rate was 11.1%. Yet, as previously stated, the stock market (S&P 500) was up +20.5% in the second quarter. As we mentioned in the previous Wealth Watch, in almost every past recession going back to WWII the market has bottomed before the recession ended (see chart below). This is due to the forward-looking nature of the market which anticipates an economic turnaround in late 2020 to early 2021.

*The unemployment rate has always peaked **after** recessions end whereas the market has almost always bottomed **before** recessions end. In that sense, 2020's second quarter rebound has actually been consistent with historical market behavior surrounding economic weakness.*

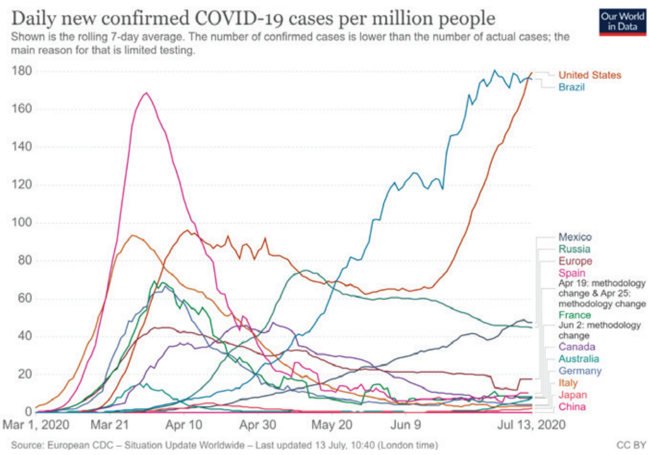


Source: JP Morgan

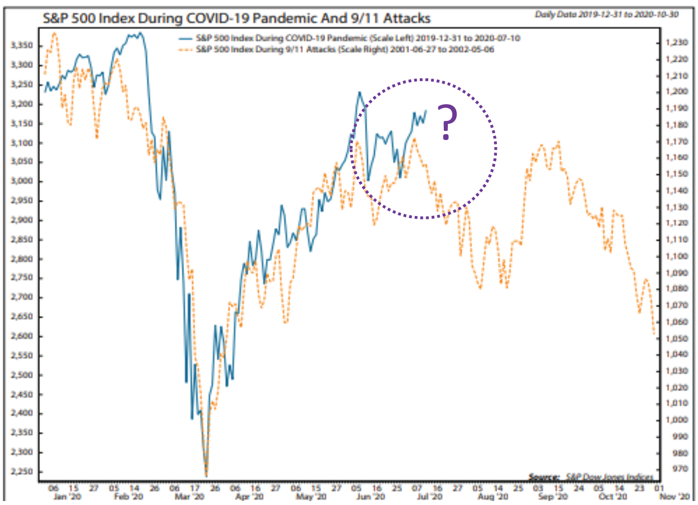
*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Devel: MSCI EAFE Index; Int'l Emerg: MSCI Emerging Markets
Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodity: Bloomberg Commodity In

Not Out of the Woods Yet: Potential Economic Impact of COVID-19 Resurgence

Though preliminary data indicates the economy showed signs of significant improvement in the second quarter, continued progress will depend on the trajectory of the spread of COVID-19. The chart to the right shows the 7-day rolling average of new confirmed cases per million people across a number of countries. It is evident that many countries have been successful in "bending the curve," yet less encouraging is the resurgence of cases in the US since mid June. Should the spread continue at its current rate, the possibility of another shutdown looms large along with the economic slowdown that would come with it. That being said, optimism is in order stemming from unprecedented monetary and fiscal countermeasures. These actions have helped ballast what otherwise may have been disastrous, yet while fast-tracked vaccines and treatment advancements show promise, the true key to sustainable recovery is a reduction in viral spread.



Winding Mountain Roads: Going Slow With Sharp Turns



When the stock market began its precipitous decline earlier this year, one of our consultants, Ned Davis Research, analyzed historical data to ascertain similar past market instances. They found a striking similarity in the market reaction to the 09/11/2001 terrorist attack. The chart at left overlays this year's market (blue line) with that of 9/11 (orange line). One might surmise that if this eerie similitude were to persist the market may be due for a correction in the second half. Yet, again, actions by the Fed following 9/11 paled in comparison to the aforementioned monumental depth and breadth of stimulus in 2020. Presently 97% of the world's central banks are in easing cycles and all indications suggest governmental countermeasures on a global scale would continue to be as, if not more, aggressive in a viral sustained spread scenario. Recovery will take time and volatility is probable, but at this point research shows a majority of economic indicators have bottomed in recent months and a "U-shaped" recovery remains likely.

Forest for the Trees…: Focus on Your Long-Term Strategy

Investors who have endured the technology downturn of the early 2000's, the global financial crisis of 2008, and the pandemic plunge of 2020 can feel understandably uneasy in regard to the markets. It is critical to remember, however, that a properly structured investment strategy based on forward-looking projections can help to smooth the ride over the bumpy mountainous roads of the market. In today's increasingly complex, more volatile markets investors should consider options beyond traditional stocks and bonds and a employ a proactive tactical strategy in order to capitalize on opportunities and defend against risks as they arise. WestStar Wealth Management remains cautiously optimistic in our tactical strategy, recognizing the unknowns that may affect future market performance. While we will remain proactive in this regard, it is important to maintain focus on longer term objectives and try to discount the distractive daily discomposure. Doing so will not only reduce anxiety but will enhance the likelihood of achieving one's goals. In summary, investors should adhere to their long-term strategy, avoid the temptation to market-time, and consider adding excess cash to their portfolios to take advantage of opportunities.

Index; Core Bond: BbgBarclays Aggregate Index; Int'l Bond: BbgBarclays Global Aggregate ex-USD Index; High Yield: BbgBarclays US Corporate High Yield Index; Cash: BofA Merrill
dex; Alternatives: Wilshire Liquid Alternatives Index

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Our team of wealth management professionals has the valuable depth of expertise you need to navigate life's events.

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