WestStar

Wealth Watch

April 2020

In Darkest Skies We Find Brightest Stars

In the previous edition of the Wealth Watch, we noted the "vast unknown that lies before us." Though the context was different, how true it became with the advent of the COVID-19 pandemic and the myriad ways it has fundamentally changed our way of life on a global scale. One certainty upon which we can all rely is that coordinated global collaboration will be the key to successfully recovering from this unprecedented challenge as it relates to both health and finance. While we acknowledge the near term negative impact, we are beginning to see positive developments. John F. Kennedy said:

"The Chinese use two brush strokes to write the word 'crisis.' One brush stroke stands for danger; the other for opportunity. In a crisis, be aware of the danger – but recognize the opportunity."

In this spirit, we remain cautiously optimistic and derive hope from additional words of wisdom from around the world as we explore the factors presently in play.

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Your wealth, well managed.

What You Need Know:

- Most major asset categories declined in the first quarter
- Market declines are normal and occur fairly frequently
- Crisis-related declines often rebound within 12 months
- Both medical and economic recovery will depend on effective curtailment of the spread of COVID-19 to include treatment and vaccination
- A "U-shaped" economic recovery is likely
- A bottoming process may be forming
- Current stock price levels may be attractive for long-term investors

Asset Class Index Performance* First Quarter 2020

Asset Class	Performance
US Investment-Grade Core Bonds	3.15%
Money Market (Cash)	0.66%
International Bonds	-2.68%
Alternative Investments	-8.52%
High Yield Bonds	-12.68%
US Large Cap Stocks	-19.60%
International Developed Market Stocks	-22.72%
Commodities	-23.29%
International Emerging Market Stocks	-23.57%
Real Estate	-28.34%
US Small Cap Stocks	-30.61%

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Performance

"It is better to light a candle than curse the darkness" ~ Chinese proverb

The first quarter witnessed unprecedented volatility in capital markets, with readings literally off the charts by historical standards of both normal and crisis-event markets. Headlines of "largest point decline ever" were followed by ones of "largest point increase in history," and four-figure day-to-day market swings were common. Between January and April, the best performing investment categories were safe havens such as US high-quality bonds. Bonds as a whole outperformed other major asset classes, with the worst being small cap US stocks. In terms of our performance, our investment strategies remained within our statistical range-of-return projections.

WestStar Tactical Strategy

"It's not enough to learn how to ride; you must also learn how to fall" ~ Mexican proverb

As 2019 came to an end, we were somewhat cautious about the market's prospects in 2020, for though stocks had been quite strong, they were fundamentally rather expensive. In anticipation of a market decline, we maintained a defensive posture by deemphasizing stocks. While nobody could have predicted that the sudden and severe impact of COVID-19 would be the catalyst for said decline, we did take the opportunity to rebalance our strategies. Specifically, we increased our investment-grade bond exposure (and deemphasized high yield), decreased our exposure to oil, and increased our US large cap stocks in relation to small cap stocks. The increase in bonds and decrease in high yield and oil were timely, and while our slight addition to stocks was admittedly a bit early, our emphasis on large cap over small was also well-timed.

Declines are Normal...as are Recoveries

"Fall seven times, stand up eight" ~ Japanese proverb

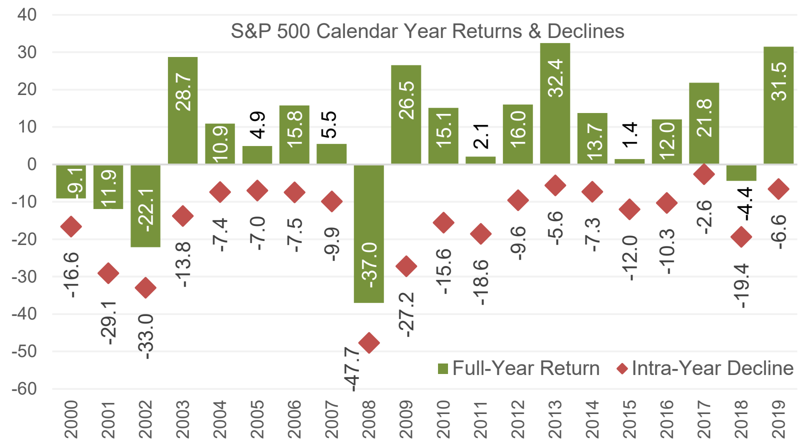
The market decline of 2020 has indeed been swift and sharp, but from a historical perspective, how does it compare to past crisis events? In collaboration with our investment consultant Ned Davis Research, we first analyzed market action surrounding past WHO-declared health emergencies (i.e., SARS, Bird Flu, Swine Flu, Ebola). We found a clear pattern of a market decline around the event followed by a rally in the ensuing 12-month period. We next expanded our analysis to examine crisis events that had a marked impact on supply chains (the 9/11 terrorist attack and the Japanese Tsunami of 2011) and found that the market pattern was similar. We then analyzed every major crisis event going back to 1907, spanning wars, terrorist attacks, financial panics, and political upheaval. The pattern was similar, as shown in the table below:

Crisis Events: 1907 - 2016	Event Date	1-Month	3-Months	6-Months	1-Year
Average Market Performance	**-6.6%**	**+3.8%**	**+5.4%**	**+9.0%**	**+14.2%**

Again we learn that a 12-month double-digit rebound is the average market response to crisis event declines of all manner. While past performance does not predict future results, we do typically see recovery following crises.

*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

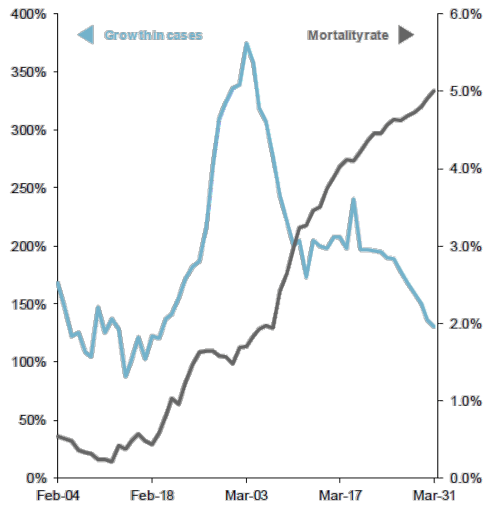
Even barring a crisis event, the stock market averages a -20% decline every 3.5 years historically. Among these "bear markets," we find the average drawdown is -26% and, if occurring during a recession, is -36%—within the realm of the 2020 to-date low point. Finally, on the chart at right, we show the past 20 calendar years and note that all experienced a decline at some point but often ended the year positive. In summary, market declines—even sharp ones—are fairly frequent and recoveries typically follow.



The Path of Recovery

"Turn your face to the sun and the shadows will fall behind you" ~ New Zealand proverb

Weekly % change in cases & mortality rate, ex-China
As of March 31, 2020



Unlike most past economic slowdowns, the current recession is caused by a completely exogenous factor. When said factor, COVID-19, abates, the recovery in both medical and economic terms will commence. Global social distancing mandates have been in place for several weeks as of this writing, and such efforts appear to be working as evidenced by the slowing growth rate of new cases reflected on the chart to the left. The economic impact will undoubtedly take more time to heal, however, as both US GDP and unemployment are expected to decline by upwards of -15% in the second quarter. Governmental fiscal and monetary countermeasures have been extraordinarily aggressive, with the CARES Act three-times as large as the stimulus measures of the financial crisis of 2008 and the Fed cutting rates to 0%, instituting unlimited quantitative easing and lending programs.. The hope is these measures will keep the economy afloat until the coronavirus crisis is curtailed. With an unprecedented globally-coordinated program to develop a vaccine and effective treatment, we may well have them by year-end. This makes a "U-shaped recovery" likely, with steep declines in output and employment in the first half, stabilization in the second half, and recovery beginning in early-2021.

The Bottoming Process is Forming

"He who always thinks it is too soon is sure to come too late" ~ German proverb

If the expectation is for more economic pain in the second quarter, is the stock market vulnerable? While we do expect volatility to persist, we also consider current levels a buying opportunity for long term investors. We frequently remind our clients that market bottoming is a process rather than a single event. Referring back to the studies mentioned above, we found that panic-selling "waterfall" market declines experience a retest of the low point in 70% of instances. During this phase, which has taken a median of two months, large cap and more defensive stocks have outperformed, whereas small cap and more aggressive stocks have led the post-retest rebound. Meanwhile, in every post-WWII recession the market has bottomed before the unemployment rate has peaked. In other words, because the market is forward-looking, stocks typically turn before the economy does. It is unlikely one can catch the exact bottom, but if the question is are current stock prices good for long-term investors, we believe the answer is yes.

Have Faith in Your Long-Term Strategy

"If you do not sow in the spring you will not reap in the autumn" – Irish proverb

It is true that in many ways, the current crisis is without precedent, and feelings of fear and consternation are to be expected in the face of such uncertainty. What we can be sure of is that, while markets will be volatile, adherence to a well-planned investment strategy is the most effective means of meeting your long-term objectives. We will continue to monitor developments and proactively seek ways to address risks and capitalize on 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

The team you can trust.

As true fiduciaries, our focus isn't on selling products to our clients. Instead, we focus on providing personalized service and real financial solutions.

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

From retirement planning and investment management to trust services and estate settlement, we can help you devise the most effective plan to meet your financial goals.

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