SlateStone WEALTH

Balancing Your Life Goals with Financial Results

Investment Review & Outlook

April 2020

Review

This is not going to be your typical recession. Normally, certain sectors of the economy through a build-up of unwanted inventory or excess debt reach a tipping point as a function of rising interest rates. The corona virus resulted in a sudden stop in economic activity on a global scale. The sudden stop scenario means any economic data is out-of-date by the time it is published. We use economic trends to build assumptions and predictions about our financial future, now everything revolves around the unknowable path of the contagion. The economic and market outlook will be determined by medical issues, not inventory or debt levels.

We can only hope that a global lockdown will "flatten the curve" of new infections and give the medical community time to catch-up before being overwhelmed. Some of the mile-posts we will be looking for in the coming weeks/months include:

- A clear peak in the number of daily new cases across the developed world economies
- An exponential increase in the availability of test kits, both for rapid detection of new infections and for detection of the presence of anti-bodies suggesting future immunity. The development and rapid deployment of both types of test kits should be prerequisites for easing or lifting travel and social distancing restrictions.
- Successful demonstration of efficacy by one or more of the anti-viral therapies currently under review.
- Progress in developing and testing a short list of vaccine candidates.

We are still collecting the last of the earnings data from the December 2019 quarter, while earnings reports for the first quarter 2020 begin next week. But, the full impact of the economic lockdown in the US will not be revealed until we get into second quarter earnings reports which will not arrive until July.

Global Markets

Following stellar positive performance in 2019, global equity markets have demonstrated why they are considered risky assets. All sectors of the S&P 500 fell by double digits in the first quarter of 2020. On a relative scale Information Technology and Consumer Staples were the least bad. Energy and Financials generated the weakest results.

Treasury notes, with 3 to 5-year maturities generated a 5.4% return, while the aggregate return from Treasuries in the 1 to 3-year maturity range was 2.8% in the first quarter

The US Dollar, measured against a basket of freely traded currencies was volatile over the quarter, but benefited from its haven status rising 2.8%

Equity Market Performance
To 31-Mar-2020, in US Dollars

	1st Quarter 2020	12 Months 3/31/20
MSCI World Index	-21.1%	-10.4%
EMU	-26.8%	-17.9%
France	-27.6%	-17.7%
Germany	-27.0%	-17.5%
Switzerland	-11.5%	3.5%
United Kingdom	-28.8%	-23.0%
Japan	-16.8%	-6.7%
Pacific, ex Japan	-27.6%	-23.7%
EAFE	-22.8%	-14.4%
USA	-19.8%	-7.7%
Emerging Markets	-23.6%	-17.7%

Source: Morgan Stanley Capital International,
Total return, dividends less withholding tax reinvested

Data sources: Standardandpoors.com, Bloomberg, MSCI.com *Continued on page 2*

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Outlook

The consensus economic outlook data is lagging the fast-moving virus and associated lockdowns. It is obvious that we are in the early stages of a severe economic decline on a global scale.

Real GDP % over previous period, SAAR						
	4Q:19	1Q:20	2Q:20	3Q:20	4Q20	FY 2020
United States	2.1	-10.0	-25.0	11.0	7.0	-5.3
Canada	0.3	-5.5	-18.5	10.0	5.0	-3.3
Japan	-7.1	-4.0	-7.0	2.0	3.5	-3.1
China	6.0	-40.8	57.4	23.9	5.6	1.1
Euro Area	0.5	-15.0	-22.0	45.0	3.5	-3.4
United Kingdom	0.1	-10.0	-30.0	50.0	2.5	-3.7

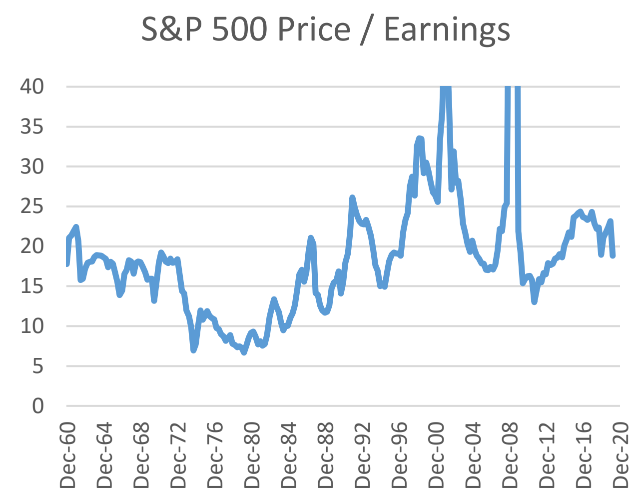
Source: JP Morgan Chase Bank NA, Economic Research, Global Data Watch, April 3, 2020

As the outlook for the global economy collapses so too does the earnings outlook. Many companies have withdrawn any form of earnings guidance as the economy went into lockdown

Standard & Poor's 500				
	Annual Earnings	%Change Y-o-Y	Price/ Earnings	Year-end Price
Dec-12	86.51	-0.5%	16.5	1426.19
Dec-13	100.20	15.8%	18.5	1848.36
Dec-14	102.31	2.1%	20.1	2058.90
Dec-15	86.53	-15.4%	23.6	2043.94
Dec-16	94.55	9.3%	23.7	2238.83
Dec-17	109.88	16.2%	24.3	2673.61
Dec-18	132.39	20.5%	18.9	2506.85
Dec-19e	139.47	5.3%	23.2	3230.78
Dec-20e	142.72	2.3%	19.6	2800

Source: Standardandpoors.com March 31,2020

While we lack confidence in the current year consensus earnings estimate, the drop in the market price / earnings ratio reflects that lack of confidence to some degree. We believe that the missing confidence will return as the economy begins to rebound in the second half of 2020. In the meantime, it is worthwhile to remember that a stock's value is a function of the discounted present value of all future earnings. While it is difficult to put a price on what that value should be at any moment it time, it will certainly rise over the long-term. The historically low level of interest rates suggests that the market's price / earnings ratio reasonably could return to former levels as the global economy regains its' footing.



We hope that the S&P 500 has already seen its' low point in late March near the 2200 level and now begins the process of testing that low. The market's volatility in both directions does not make long-term investment any easier. But if we could add to market positions near the 2400 level we would do so.

The relative strength of the technology sector during the market's collapse suggests that it should be a sector where we increase exposure once the manic volatility of the market settles a bit. We would argue that the legislative / regulatory threats related to drug pricing should be less of an issue coming out of the current crisis. Certain consumer discretionary names in retail, beyond just Amazon, should benefit with a consumer spending surge in the second-half of the year. In the Financial sector we are concerned about the threat of eliminating bank dividends to conserve capital.

On the fixed-income side, we use bonds in balanced portfolios to mitigate the risk inherent in equity investing and to provide liquidity for unanticipated expenses. Our conservative approach to bond investments in the context of credit quality remains in place. The yield curve has begun to "steepen" from very low levels, a process we suspect will continue for an extended period. As short-term bond holdings mature, we intend to roll-out into intermediate maturities with the proceeds.

Jupiter, FL
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(800) 773 9282