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INVESTMENT COMMITTEE: HOUSE VIEWS

March 29, 2020

CAPTRUST

Continued bouts of high volatility in the next few months, followed by rebounding economies

- We expect all major economies to go through recession over the next two quarters, as quarantine efforts lead to massive drops in economic activity.
- Government and policy leaders will continue to scramble to backstop financial markets and businesses in an effort to stem permanent damage to the economy.
- We expect the outbreak to peak in the next two to three months, similar to the timeline in Asia.
- Given this base case, we think economic activity will recover meaningfully in the second half of the year, as economies restart and massive stimulus kicks in.

The market is currently challenged by liquidity issues, leading to high volatility

- Policymakers had no playbook for the unique challenge the virus posed, most notably the sudden economic stop from “shelter in place” and other quarantine measures.
- Liquidity quickly became a major issue as drops in revenue due to workplace stoppages quickly put a premium on cash funds, leading to deleveraging across markets.
- Trading floors and the dealer community working from remote environments exacerbated this problem as the ability to transact was impeded.
- After numerous attempts, the Fed and policymakers have unleashed unprecedented monetary, liquidity, and fiscal measures to stem these issues.
- While it will not be a straight line, we believe markets are on a path to more normal functioning, and the extreme low liquidity and high volatility should abate.

Strategic Outlook

CAPTRUST expects all major economies to enter recession in the next two quarters, followed by a rebound in economic activity and growth in the second half of the year. Our base case is for:

- The infection curve to peak in the next two to three months and begin to abate, leading to businesses restarting
- The Fed and policymakers to provide the necessary backstops for businesses and markets to prevent permanent damage to the economy
- While not a straight line, appropriate steps are taken to resolve liquidity, and volatility returns to more normal levels
- The main risk to our outlook is a second wave of the outbreak, or a return in the Fall.

Key Strategies

Sudden stop leads to opportunities

The unique nature of this crisis led to a sharp increase in volatility and decrease in liquidity, with prices overshooting to the downside (not reflective of fundamentals), especially in fixed income where we are actively looking for opportunities. We continue to favor consumer and residential areas but are also looking at high yield and investment grade corporate opportunities.

Low rates and high deficits

The combination of extremely low interest rates and increasingly high deficits is leading to even worse fundamental risk-return characteristics within the Treasury sector. We continue to favor more diversified bond exposure than the index, which provides higher yield and increasingly better fundamentals.

First-in, first-out

China's economy was the first to get hit with the outbreak, but they are also the first to exit, likely followed by Europe. The Investment Committee currently favors U.S. equities over international developed markets, but as these economies recover and with more coordinated efforts to stem the outbreak, they may present opportunities.

Dominant business models

Profitable large cap companies were already thriving in the current economy, but the nature of the crisis may accelerate disruption. Much activity was already moving online (e-learning, ecommerce, entertainment, cloud) and the virus outbreak may have accelerated those trends as consumer behavior evolves.

INVESTMENT COMMITTEE DASHBOARD

MARCH 29, 2020

Macro Policy Framework

Monetary	Fiscal	Regulatory	Trade
			

Policy backdrop is supportive, with both monetary and fiscal stimulus at historic levels, and relaxed regulation to help combat the virus. Trade remains far from resolved.

Key Themes

- We entered this crisis with an economy on sound footing, a strong banking system, and a stimulative policy backdrop.
- A “Full Stop” revenue shock from virus containment efforts has caused an unprecedented collapse of economic activity.
- GDP and economic numbers will be historically bad but difficult to anticipate; existing models were not built for this scenario.
- Policy response has been swift and significant, and the combination of the fiscal package and the Fed’s actions equate to approx. 20% of U.S. GDP (10% for Fed liquidity and 10% for fiscal).
- Fundamentals of credit still look good, however technical factors have contributed to dislocations.
- As virus impacts increase in Europe and the U.S., investor attention is on China as the “First In, First Out” of the crisis.
- We view the potential for a “second wave” in China or elsewhere, or a return in the Fall, as the largest risk to our base case.

Discretionary Portfolio Positioning

Equity	Overweight
Geography	**Overweight US, Underweight Developed Intl.**
Market Cap	Neutral
Style	Neutral (*Smart Beta)

The benchmark has trended toward growth over time – which we are monitoring.

Fixed Income	Underweight
Rates	**Underweight**
Investment Grade Credit	Neutral
High Yield	Neutral
Structured Credit	**Overweight**
EM Debt	Neutral

Historically low rates and stressed fundamentals lead us to more diversified positions within fixed income that have better risk/reward characteristics and the potential for higher income.

Commodities	Neutral

Powerful offsetting price movements could cause muted returns, with lower energy costs but higher input prices in parts of the commodities basket.

Strategic Opportunities	Neutral

We favor cash generative strategies backed by durable, hard assets that produce income and are not as reliant on price appreciation for total return.

Research Focus

- Opportunities in credit / high yield becoming interesting; looking into liquidity and opportunities
- Evaluating positioning and fulfillment outside the U.S.
- Near term outlook is lower inflation, but intermediate to long-term impacts of deficits could prove inflationary
- Consider intermediate and longer-term implications of changes in behavior and accelerated disruption (cloud, telecommuting)