1st Quarter 2020

Market Recap
Performance Review
and Near-term Outlook

Market Recap

If any historical sequence of unfolding events exist that could have resulted in more difference between two quarterly investment reviews, I am unaware of what those might be. Our Q4 2019 Market Recap was a celebration of the historic economic expansion and bull market run. This Q1 2020 Market Recap is its eulogy.

Early Q1 was a continuation of 2019's themes; accommodative monetary policy, record low unemployment, and subdued but improving forecasts for both global economic growth and corporate earnings. The International Monetary Fund (IMF) had forecast an improved 2020 global gross domestic product expansion of 3.3%.

With improving expectations as a strong tailwind, global markets were determined to climb higher. In the US, on a year-to-date basis, the S&P 500® Index added 4.8% through the February 19 close to reach a new all-time high, 37.1% above the Christmas Eve low struck during the Q4 2018 downturn. Meanwhile, the coronavirus was taking hold in China, exported around the globe, and volatility was taking hold of international markets.

For two months, the US economy and US markets remained resilient. Officials and pundits alike discussed the virus in terms of the impact on China, and what effect China's economic fall-out might have on the global economy. Whether wishful thinking, or naive comfort, those two months of whistling past the expansion's graveyard allowed the corona virus threat to escalate from a regional concern to a worldwide health crisis.

22 Days

The February 19 close would prove to be the cycle high-water mark for US markets. Twenty-two trading days then was all it took for the S&P 500® Index to fall 30% from that high — the fastest drop of that magnitude in history. The second, third and fourth fastest 30% pullbacks — 23, 24, and 31 trading days — occurred during the Great Depression era in 1934, 1931 and 1929, respectively. It took a few more trading days for the S&P 500® Index to tumble the full 36% from the February 19 high to the new trading cycle low struck on March 23. The Dow Jones Industrial Average would drop 38.5% from its 2020 high. The small-company Russell 2000 Index would drop 42.1% from its 2020 high. The IMF subsequently revised their 2020 global gross domestic product forecast from a 3.3% expansion to a 3.0% contraction.

Lake Jericho managed portfolios, and advised strategies, lean heavily into long-term global growth themes, or factors sensitive to economic cycles. As economic growth turned into contraction, our portfolios were impacted more dramatically than the broad market indexes imply. Recognizing that the market's first reaction is typically an over-reaction, as predetermined market thresholds were breached, we methodically increased cash holdings by liquidating non-core positions. As markets neared what we considered, with high likelihood, the cycle floor, we rebalanced what had become outsized bond allocations back to long-term target allocations. With those proceeds, and the previously accumulated cash, we began aggressively reinvesting in core portfolio positions.

Just as the downturn was the fastest on record, an abrupt reversal among the fastest on record began March 24. In one trading session, the S&P 500® Index regained 9.4%. A head-spinner, no doubt, but eclipsed by the Dow's same-day climb of 11.37%, the best one-day performance for the Dow since 1931. The final few trading sessions of Q1 added additional and much needed relief, setting positive market records along the way.

U.S. stocks, as measured by the Russell 3000 Index — a measure of the largest 3,000 U.S. companies, and considered a proxy for the complete U.S. stock universe — finished Q1 2020 with a total return of -20.90%. Although a disappointing set-back, the late-quarter rebound avoided a potential -36% setback that looked highly likely as late as mid-March.

Performance Review

Lake Jericho client portfolios are, most typically, balanced, globally diversified strategies that incorporate varying combinations of multiple asset types. Each asset type, and geographic location, will have a meaningful impact upon returns. Reviewing the benchmark returns below, you see where, and how, Lake Jericho managed or advised portfolio returns were impacted.

Within the table below, we present the iShares (by Blackrock) Core Allocation ETF Portfolio Series benchmarks. Lake Jericho provides this information for a relative performance comparison against independent, balanced, globally diversified strategies managed to similar risk profiles. As iShares information is publicly available, and return data is available within the Interactive Brokers Portfolio Analyst benchmark database, Lake Jericho clients can easily incorporate the data points into their own analysis.

- The Dow Jones Industrial Average, 30 "blue-chip" U.S. companies with an industrial company bias, finished Q1 with a total return of -22.73%.
- The S&P 500® Index, a broad index of the 500 largest U.S. companies, finished Q1 with a total return of -19.60%.
- The technology and consumer-cyclical heavy NASDAQ Composite Index finished Q1 with a total return of -13.95%.
- Small- and mid-sized companies, as measured by the Russell 2500™ Index, finished Q1 with a total return of -29.72%.
- International developed markets, as measured by the MSCI World (ex-U.S.) Investable Market Index, finished Q1 with a total return of -24.00%.
- International emerging markets, as measured by the MSCI Emerging Markets Investable Market Index, finished Q1 with a total return of -24.41%..
- The Bloomberg Barclays U.S. Aggregate Bond Index, a broad measure of the performance of the U.S. investment grade bond market, finished Q1 with a total return of 3.15%.

The iShares Core Allocation ETF Portfolio Benchmark Series*

Performance Comparisons For All Periods Ending March 31, 2020

Core Allocation Portfolio (Ticker)	Q1 2020	YTD 2020	1 Year	3 Year Total Return	5 Year Total Return
Conservative (AOK)	-6.52%	-6.52%	0.37%	10.18%	15.55%
Moderate (AOM)	-8.45%	-8.45%	-0.80%	9.79%	16.28%
Growth (AOR)	-13.50%	-13.50%	-4.95%	7.27%	15.52%
Aggressive (AOA)	-18.17%	-18.17%	-8.99%	4.75%	14.50%

* The iShares Core Allocation ETF Portfolio series is designed to meet the needs of investors who would like to maintain fixed target levels of exposure through a portfolio diversified across domestic, international, and emerging market equities, bonds, and other instruments. The Core Conservative Allocation Strategy seeks approximately 30% exposure to global equity markets. The Core Moderate Allocation Strategy seeks approximately 40% exposure to global equity markets.. The Core Growth Allocation Strategy seeks approximately 60% exposure to global equity markets. The Core Aggressive Allocation Strategy seeks approximately 80% exposure to global equity markets. Presented here is the iShares Core Allocation ETF Portfolio Benchmark performance, constructed with no management fees, and with no transaction costs, while Lake Jericho portfolio performance is actual performance, net of all fees, including investment management, administration, and transaction expenses.

Near-term Outlook

As markets have continued to rally since the end of Q1, the S&P 500® Index is now closer to its February 19 all-time high than it is to the March 23 low. The continued relief is comforting, but perhaps not entirely sustainable. With so much uncertainty, what are investors to think?

In uncertain times, I look to what I know, if not what I can prove, to guide me. It is prudent to remember that since 1928, through 24 bear markets and 14 economic recessions, markets have reclaimed, on average, prior all-time highs in about two years. If we limit that analysis to more recent downturns, the average time to recovery is less than 16 months. While uncertainty may persist for some time, it will pass. It always has.

It is also prudent to remember that the stock market is not the economy. Smart investors understand that investment decisions must incorporate separate views on these two distinctly different influences. Historically, the stock market and the US economy were tightly, inextricably linked. Globalization, the shift to a technology and service-based economy, and the growth of private equity markets have all served to weaken the immediacy of that link. Though still meaningful, and in the long-run most impactful, it is now important to clearly differentiate between our near-term expectations for the US economy and investment decisions made for portfolios with long-term investment horizons.

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While one might rightly fear that the worst is yet to come for the US economy, the stock market remains a leading indicator of the economy. It is reasonable to believe the worst for markets has passed, and also believe that the worst is yet to come for the US economy. In fact, that is the consensus view. Debate now centers on recession versus depression, and the potential shape of eventual recovery.

In recent weeks, I identified five potential paths for global economic recovery over the next two years. Confident that the five paths expose the outer bounds of reasonable outcomes, each is anchored to a meaningfully different set of assumptions about the course of the virus near-term, ongoing containment measures as a result, policy responses, healthcare interventions, and varying extents to which the experience permanently affects individual behavior and corporate activity.

My base case scenario assumes that a weaker, more prolonged recovery, one with some permanent GDP output loss, is most probable given current data versus the consensus view of a more rapid recovery with no permanent GDP loss. This base case scenario is the scenario in which I am now framing investment decisions.

I project a deep, two-quarter recession, plus an additional quarter of improving but still negative GDP results during which containment measures are fully scaled back, and additional fiscal and monetary policy measures show some effect. Risk remains tilted toward containment measures being phased out more slowly than anticipated. Particularly so in densely populated areas that drive economic growth. Further, I project that containment measures, the longer they are extended, result in meaningful, persistent changes in individual and small-business behavior. I model a slow and prolonged recovery beginning in Q1 2021.

Versus consensus, I forecast a permanent loss of GDP output, equivalent to not less than one full year of trend global GDP growth, due largely to the knock-on effects of oil markets, the need to restructure much of the US energy sector, and the resulting loan-loss hit to the banking sector. This single sector influence was sufficient to delay my market recovery timetable by six months. Again, against consensus, I project that investment market recovery will be much more gradual than the initial February-March correction; 6-10 months to retake the former market high is my base-case.

As always, I am available at any time, any day of the week, to discuss anything within this Outlook, or specific portfolio performance questions. Until then, be well. Enjoy your coming weekend, and thank you!

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