# 2nd Quarter 2020

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### Market Recap

2020 has been a year of record-setting extremes. As the year began, we were extending the longest ever bull-market run, and regularly notching new all-time highs. Slow, but steady, growth was contributing to our longest ever economic expansion. Meanwhile, the coronavirus had taken hold in China, and was being exported around the globe.

For nearly two months, the U.S. economy and U.S. markets remained resilient. But confirmation of wide spread of the virus, well beyond Asia, had immediate and severe impacts. The February 19 close would be the high-water mark for U.S. markets, and the end of the bull's run. Real GDP growth, anticipated to be +2.4% during Q1, ultimately became a 5.0% real GDP contraction, marking the end of the record economic expansion.

The market's downturn was the fastest bear market in history. A series of direct interventions by the U.S. Federal Reserve was required to soothe dangerously unsteady markets. Rising hopes for rapid reopening of major world economies, based upon swift, often drastic action of multiple governments, helped arrest the market's slide. Unrivaled stimulus measures enacted by governments and central banks around the world turned the tide, and helped to keep positive momentum going throughout Q2.

Bull?
Bear?
Kangaroo?

The U.S. market's recovery, with the S&P 500® Index gaining 44.46% in the 53 trading days following the March 23 low to the new high water mark struck on June 8, is among the strongest moves off a bear market low in history. Despite a brief downturn in late June, U.S. markets remained solidly higher at quarter end. The S&P 500® Index added 20.37% for Q2, notching the largest quarterly increase since Q4 1998. Although an impressive rebound, the S&P 500® Index still reflected a year-to-date loss of -3.37% at quarter end.

Investment style, industry sector, and company-size performance were widely mixed during Q2. The gains on the largest growth stocks within the Technology and Communications sector groups — Apple, Amazon, Facebook, Microsoft, and Google — led gains by a significant margin, with an average Q2 increase of 34.47%. Small- and mid-sized company stocks outperformed as well, adding 26.56% as measured by the Russell 2500™ Index

Technology is, by far, the year-to-date sector performance leader. Along with Communications and Medical Devices, these three sectors are all meaningful overweights in our client portfolios. Small- and mid-sized company stocks are meaningful overweights as well. All contributed to outperformance of client portfolios during Q2, although small- and mid-sized company stocks remain a drag on performance year-to-date.

Trailing their U.S. counterparts, developed and emerging market stock prices jumped 16.21% during Q2, as measured by MSCI. Lake Jericho's strategy within international investments meaningfully outperformed that average, and also lead U.S. market averages, with a Q2 return of 31.10%. With a year-to-date return of -1.67%, our strategy leads both international and domestic stock averages for 2020.

Following a worrisome Q1, bond markets continued to show stress during Q2. We saw an unusually high number of rating downgrades (994), implying a lack of stability in many debt issuers. More than half of the Q2 downgrades were in the high yield segment, particularly the energy sector, both areas that we typically avoid. After increasing in late May on optimism of the U.S. economy reopening, interest rates have again fallen as reopening efforts were met with rising virus numbers. Investors were rewarded for owning high quality bonds, where we concentrate our holdings, as bond prices increase as interest rates fall.

## 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.

- The Dow Jones Industrial Average, 30 "blue-chip" U.S. companies with an industrial company bias, finished Q2 with a net total return of +18.29%, with a year-to-date loss of -8.77%.
- The S&P 500® Index, a broad, but committee selected index of 500 large-cap U.S. companies, finished Q2 with a net total return of +20.37%, with a year-to-date loss of -3.37%.
- The technology and consumer-cyclical heavy NASDAQ Composite Index finished Q2 with a total return of +30.63%, with a year-to-date return of +12.11%.
- Small- and mid-sized companies, as measured by the Russell 2500™ Index, finished Q2 with a total return of +26.56%, with a year-to-date loss of -11.05%.
- International developed markets, as measured by the MSCI World (ex-U.S.) Investable Market Index, finished Q2 with a total return of +16.21%, with a year-to-date loss of -5.11%. International emerging markets, as measured by the MSCI Emerging Markets Investable Market Index, fared better than their developed markets counterparts and finished Q2 with a total return of +18.93%, with a year-to-date loss of -10.09%.
- The Bloomberg Barclays U.S. Aggregate Bond Index, a measure of the performance of the U.S. investment grade bond market, finished Q2 with a total return of +2.90%, with a year-to-date return of 6.14%.

**The iShares Core Allocation ETF Portfolio Benchmark Series***

**Performance Comparisons For All Periods Ending June 30, 2020**

| Core Allocation Portfolio (Ticker) | Q2 2020 | YTD 2020 | 1 Year | 3 Year Total Return | 5 Year Total Return |
|---|---|---|---|---|---|
| Conservative (AOK) | 8.34% | 1.28% | 5.43% | 16.47% | 27.11% |
| Moderate (AOM) | 9.09% | -0.13% | 4.96% | 16.66% | 28.61% |
| Growth (AOR) | 12.62% | -2.59% | 3.51% | 17.22% | 31.76% |
| Aggressive (AOA) | 16.04% | -5.05% | 2.14% | 17.48% | 34.17% |

* 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

From a March 2020 Fidelity Investments report, in the year following the "trough" of all bear markets since 1929, the S&P 500® Index gained an average of about 47%. We are essentially there, and have been bouncing about that level since late-March. Coincidentally, this happens to be near the break-even point for 2020.

While a break-even year would be comforting by this point, is it sustainable? One marvels at the speed and strength of this recovery. Yet, bear market recoveries typically look just like this one; the bulk of recovery takes place within the first three months, with some volatility and modest upside movement in the nine months that follow. Although generally the exception rather than the rule, “double-dips” do occur.

Equity markets are a leading indicator of economic expectations, so the rebound in markets coincided with improving expectations for reopening the world’s economies. But there remains a meaningful disconnect between how markets are performing versus how the economy is performing.

> As markets seem content to continue a pattern of rally-reverse-rally since the end of Q2, the S&P 500® Index continues to hover near break-even for 2020.

Unemployment remains at levels once thought impossible. High levels of continuing unemployment have caused both personal income and household spending to fall sharply. Business activity and spending has fallen dramatically. Consumer credit has tightened, and both consumer and commercial mortgage delinquencies have skyrocketed. While we were starting to see an uptick in economic measures, all are well below pre-shutdown levels. Once again, surging virus numbers mean that policy makers must walk the tightrope suspended between dire health consequences and devastating economic injury. Confirmation of a double-dip in economic activity would be a catalyst for markets to once again break lower.

As for an official measure of economic activity? We will know soon enough, as on July 30 the Bureau of Economic Analysis (BEA) will release the advance estimate for Q2 GDP. Meanwhile, the International Monetary Fund (IMF), having revised their 2020 GDP forecast during Q1 from a 3.3% expansion to a 3.0% contraction, made further downward revisions during Q2. The IMF now forecasts 2020 global GDP to fall by 4.9%. The IMF’s forecast for the U.S. is now an 8.0% contraction for 2020.

My base case scenario, communicated in the Q1 Outlook, assumes a weaker, more prolonged U.S. recovery, one with some permanent GDP output loss, versus the consensus view of a more rapid recovery with no permanent GDP loss. I projected a slow and prolonged economic recovery beginning in Q1 2021.

Baring any surprises in the coming BEA release, I stand by my original projection of a deep, two-quarter recession, plus an additional quarter of improving but still negative GDP results during which, only then, containment measures can be fully scaled back. My projection was also dependent upon a second round of fiscal and monetary policy measures — now under debate in Congress — showing positive effect.

As anticipated, virus numbers have once again soared, so risk remains tilted toward containment measures being phased out more slowly than anticipated. Further, I projected that containment measures, the longer they are extended, result in meaningful, persistent changes in individual and small-business behavior. That more than 100,000 of America’s small businesses have already permanently closed certainly qualifies as meaningful.

What does that mean for markets? Again, against consensus, I projected that investment market recovery will be gradual; 6-10 months to retake the former market high was my base-case. Now five months removed, sitting about 5.5% below the former S&P 500® Index high, in a time of great uncertainty? I will stand by this projection as well, baring any great surprises, an uneventful election cycle, and meaningful advances towards a working vaccine.

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