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Reiner Financial Group's Investment

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First Quarter 2020

First Quarter 2020 Key Takeaways

The first quarter of 2020 has been an unprecedented period in U.S. financial market history across numerous dimensions. We just witnessed the fastest 30% decline from a recent high on record for the S&P 500 (in only 30 days). We have experienced historic volatility. And U.S. Treasury yields recently dropped to all-time lows.

Larger-cap U.S. stocks fell 20% this quarter, having rebounded a bit from their historic drop. Smaller-cap U.S. stocks have done even worse, falling 31%. Developed international stocks and emerging-market stocks both dropped around 24%. Much of the differential between U.S. and foreign stock market returns has been due to the appreciation of the U.S. dollar, which has risen roughly 2.5% year to date.

In the fixed-income markets, core bonds gained just over 3%, once again playing their key role as portfolio ballast against sharp, shorter-term stock market declines. Yields have been extremely volatile as well—shooting up on some days when stocks were also sharply selling off. The 10-year yield ended the quarter at 0.70%, down from 1.92% at year-end.

Turning to the credit markets, floating-rate loans and high-yield bonds took it on the chin. Both dropped around 13%. But investment-grade corporate bonds were far from immune, losing over 4%.

Our allocations to lower-risk fixed-income and diversified alternative strategies have offset some of the equity losses. Treasuries and managed futures in particular have been areas of positive returns during the quarter. But even this level of diversification has not been able to completely counter a steep and quick equity downturn.

The near-term economic damage from the United States' and other countries' response to the coronavirus outbreak now looks almost certain to be severe. GDP is expected to sharply contract, potentially by historic proportions, and unemployment is expected to rise to levels never seen before.

The depth and duration of the recession (and the speed of the recovery) depend on the effectiveness of our medical and policy responses. A medical resolution is a "known unknown." But the Federal Reserve and other major central banks seem to be all-in to support markets. At the same time, governments around the globe understand something massive needs to be done quickly on the fiscal policy side.

Yet when stock prices—or any asset's prices—*drop*, forward-looking returns *rise*. Our outlook for U.S. stock returns improved with their cheaper valuations. So, in mid-March we began taking advantage of this bear market by adding a small allocation back to U.S. stocks at better prices. As markets have dropped further, we have assessed the next point at which we'd want to add back another increment to U.S. stocks.

While the news may sound dark and hopeless at times, remember that this too shall pass. The world has faced many challenges and economic downturns and has always come out the other side. We are all facing unique risks and unknowns today, but we will bet on our resilience.

First Quarter 2020 Investment Letter

We are living through an extraordinary period in history that none of us will ever forget. The impact on our families, communities, and country has been profound. While several weeks ago we had reason for cautious optimism that the coronavirus might be largely contained to China, it is now obvious that is not the case. The United States and world are now facing the dual threats of a health crisis and an economic crisis. Both need to be fought with monumental government policy responses and individual behavioral changes.

We've frequently said that recessions and bear markets are inevitable phases within recurring economic and financial market cycles. We've also said there is *always* the risk of an unexpected "external shock" to the markets and economy (e.g., a geopolitical conflict or natural disaster). Investors need to be prepared for both to happen, but their precise timing is consistently unpredictable.

It's one thing to say it and another to actually live it. But we will get through this crisis period. Things will improve and recover. Most importantly, we sincerely hope you and yours are able to remain healthy and manage well through this challenging period.

First Quarter 2020 Market Update

The first quarter of 2020 has proven to be unprecedented for financial markets. U.S. stocks fell into a 20% bear market in the shortest time ever. They continued to drop and declined 30% in a record 30 days! Volatility, as measured by the VIX, reached its all-time high on March 16. Oil's 25% drop on March 9 was its biggest one-day drop since the 1991 Gulf War. Finally, 10-year and 30-year Treasury bond yields fell to all-time lows of 0.54% and 0.99%, respectively!

Larger-cap U.S. stocks fell 20% this quarter, having rebounded a bit from their historic drop. Smaller-cap U.S. stocks did even worse, falling 31%. Foreign stocks also suffered significant drawdowns, as developed international stocks and emerging-market stocks both dropped around 24%.

In the fixed-income markets, core bonds gained just over 3%, once again playing their key role as portfolio ballast against sharp, shorter-term stock market declines. The 10-year Treasury yield is currently at 0.70%, down from 1.92% at year-end. In contrast, higher-risk floating-rate loans and high-yield bonds suffered outsized losses, both dropping around 13%. Investment-grade corporate bonds were far from immune, losing over 4%.

Finally, a bright spot in the quarter, trend-following managed futures strategies produced some of the strongest returns, with gains in the mid- to upper single digits, depending on the strategy.

Update on the Macro Outlook

We entered the year with an outlook for a moderate rebound in the global economy (especially outside the United States) on the back of reduced U.S.-China trade tensions and extensive global central bank monetary accommodation. Our base case now is that the U.S. economy is headed into recession in the second quarter. It is likely to be a severe one, with a sharp contraction in GDP and an unprecedented rise in unemployment.

The near-term economic damage from the United States' and other countries' response to the virus now looks almost certain to be severe (barring some unexpected major medical breakthrough in the near future). While we do not forecast economic data, the current Wall Street first quarter and second quarter GDP forecasts are for annualized declines in the range of 9% to 34%.

The depth and duration of the recession—and the strength and timing of the ensuing recovery—depend on two key variables:

- 1) The effectiveness of our medical response and social policy efforts in flattening the curve
- 2) And the speed and effectiveness of our fiscal, monetary, and regulatory policy response

One lesson learned from the 2008 global financial crisis is that a policy response needs to be significant and executed quickly. Governments need to make a credible commitment to “do whatever it takes” to support the economy and prevent a negative spiral from taking hold. The Federal Reserve and other major central banks seem to have gone all-in to support the fluid functioning of credit, lending, and financial markets, and their critical role as the “plumbing” of the real economy. At the same time, governments around the globe understand something massive needs to be done quickly on the fiscal policy side. On March 27, Congress passed, and the president signed into law, a \$2 trillion stimulus package. Similar support measures are being debated or implemented around the world. Discussions continue about additional steps to take in support of markets and the economy.

Portfolio Positioning

When you diversify across asset classes and consider a variety of potential scenarios, there will always be leaders and laggards in your portfolio. Some positions, like U.S. stocks, work well in strong up environments like we experienced last decade, while we have incorporated others that benefit portfolios during tougher times like the start to the 2020s. Put together, they build resiliency and protect a portfolio from betting on a single outcome, which can be a disastrous financial result if the opposite happens.

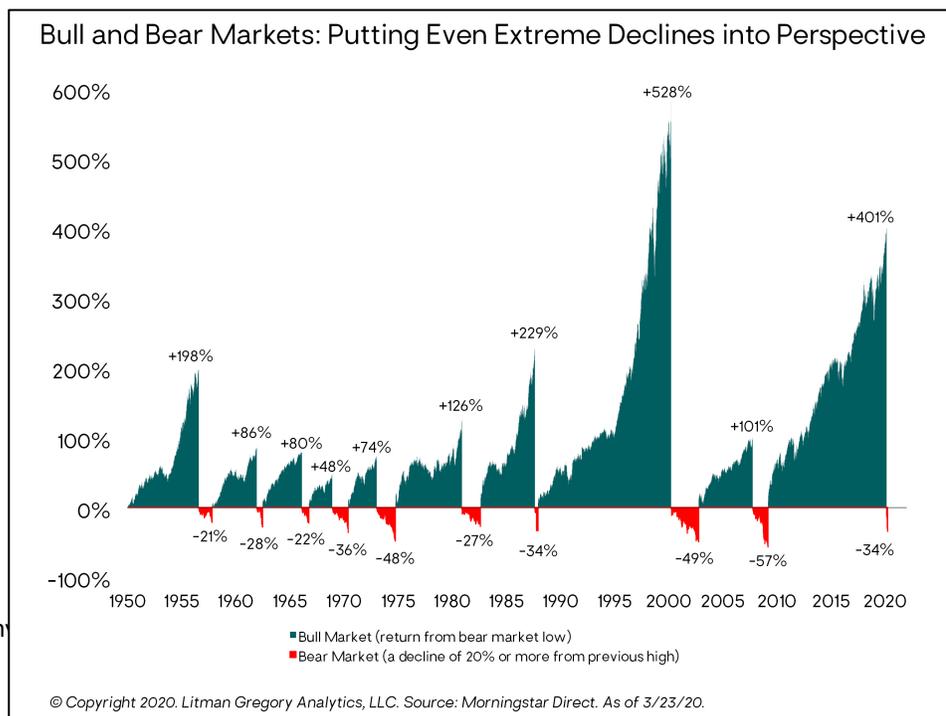
Our portfolio allocations to core fixed-income and alternative strategies performed well as stock markets sold off, delivering strong absolute returns and significantly outperforming U.S. stocks. These allocations helped to offset some of the decline in stocks and should continue to do so if the selloff continues.

Following the U.S. stock market’s 20% decline in mid-March, we added a modest amount back to our U.S. stock exposure. We continue to assess the point at which we’d further increase our exposure to U.S. stocks. However, given the still-negative trajectory of the virus in the United States, we have increased the margin of safety we want to see before doing so. As our expected returns analysis stands, we’d look to buy more around the 2100 price level on the S&P 500. From that level, our base-case five-year expected return for U.S. stocks would be in the 9% to 12% range, annualized. (The market closed at 2585 on March 31.) A return in that range is in line or somewhat better than the long-term average for U.S. stocks. We believe that’s sufficient compensation to justify a full or neutral allocation to equities overall. If there are additional market declines and valuations become even more attractive, we plan to increase our equity allocation to an overweight once stocks offer the likelihood of *above-average* returns.

Closing Thoughts

During these historic times, it is paramount to stay disciplined and recognize when emotion rears its head in investment decision making. If we invest based on emotion, we are very likely to exit the market *after* it has already dropped meaningfully, locking in losses. By the time the discomfort and worry are gone, the market will *already* be much higher. That is not a recipe for long-term

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investment success. Global markets have endured severe challenges and economic downturns in the past and have always weathered the storm. Attempting to time the market's tops and bottoms is a fool's errand; however, incrementally adjusting portfolio allocations in response to changes in asset class valuations, expected returns, and risks can be highly rewarding to long-term investors.

The time to be adding to stocks and other *long-term growth* assets is when prices are low and markets—and most of us personally—are gripped by fear and uncertainty rather than complacency, optimism, or greed. It may seem like the market could just keep dropping with no bottom in sight. But that is exactly where research, analysis, patience, experience, and having a disciplined investment process come most into play.

The precipitating event for the recent volatility is something none of us have experienced before: a global pandemic and an extreme societal response. One in two Americans now live under lockdown (and maybe more by the time you read this). Our medical infrastructure could be overwhelmed. We are probably already in a global recession. Facing this dual medical and economic crisis, the situation is probably likely to get worse before it gets better. We would love to be wrong. But it *will* get better.

The future is uncertain but our investment playbook remains the same: diversify; balance long-term returns with short-term risks; buy low into fear, sell high into greed. Stay the course.

-Reiner Financial Group 04/15/2020

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