1919 INVESTMENT COUNSEL
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April 2020

Investment Review and Outlook

***"It would be foolish to disguise the gravity of the hour.
It would be still more foolish to lose heart and courage."***

-Winston Churchill, 1940

KEY TAKEAWAYS

- We believe extraordinary monetary and fiscal stimulus coupled with lower interest rates, lower oil prices and low inflation will support a meaningful economic recovery once the virus abates or is contained. We do not foresee a depression.
- We expect elevated market volatility to continue until the public health crisis wanes, with Q2 economic data reflecting the challenging recessionary period we have entered. It is entirely likely that recent market lows will be retested as part of a bottoming and eventual recovery process.

When we last updated you via this quarterly Investment Review and Outlook, COVID-19 had barely made the news in the US. Now, in such a short period of time, it has taken over every aspect of our lives. This is a difficult time for all of us as we worry about the health and well-being of our families, friends, clients and co-workers, as well as the impact on our country and the rest of the world.

The healthcare emergency that we face is serious, its path and severity difficult to predict. However, with social distancing, the heroic work of many healthcare workers, and the diligent efforts of the scientific research community, we believe this global pandemic will eventually reach a more manageable point.

Although this has been especially difficult from an economic and market perspective, it may be helpful to keep in mind that investors have weathered a number of difficult financial periods in the past, including the tragedy of 9/11 and the Great Financial Crisis of 2007-2009, among others.

As always, and in particular during this challenging time, we are here to listen to your concerns, provide thoughtful investment advice, and work towards your financial goals. We will get through this together. We hope you find the following insights helpful.

THE ECONOMY

The Economic Impact Of A Virus-Induced Crisis

As we witness the impact of the economic fallout from business closures and social distancing, it is important to note that although a recession has begun in the US, it is not one rooted in a financial crisis but rather a recession fueled by a global health crisis.

In fact, although it may be difficult to recall now, the US was in the 11th year of a historic bull market until the coronavirus crisis hit. Just a few weeks ago, low unemployment and low interest rates buoyed consumer spending, and investor confidence was high. The economy was on strong footing, with growing wages and solid business profitability.

Now, in the heart of the coronavirus crisis, with many businesses closed and workers laid off or furloughed as a social distancing and health-safety precaution, governments and central bankers around the world have adopted wide-ranging fiscal and monetary programs to counteract some of the financial impacts on their citizens and businesses.

Federal Reserve Actions And The CARES Act Seek To Provide Relief

Federal Reserve Chairman, Jerome Powell, announced that the Fed will take whatever actions are necessary to restore stability to the financial markets.

> ***"When it comes to this lending, we're not going to run out of ammunition, that doesn't happen. We still have policy room in other dimensions to support the economy." Fed Chairman Powell***

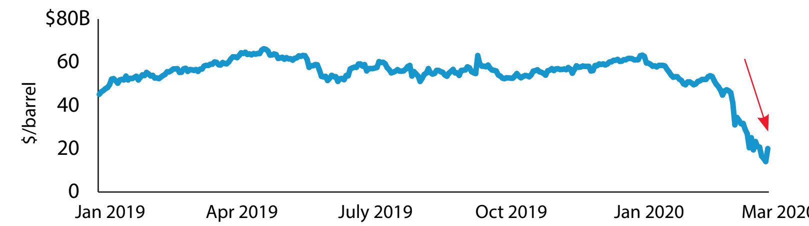
As a result, the Fed has provided significant liquidity to enable banks to lend to and support consumers and companies, including lowering the Fed Funds rate to near zero and buying corporate bonds and other assets to free up frozen credit markets.

In fact, the Fed and the Treasury have, over time, developed a proactive playbook with which to address economic disruptions, including the 2007-2009 financial crisis. This has enabled the rapid deployment of various forms of liquidity and credit support to facilitate markets running smoothly. In addition, the historic $2 trillion CARES Act will provide significant fiscal stimulus that equates to nearly 10% of US GDP. To put this amount in perspective, $2 trillion is nearly half of 2018 collected tax revenue.

Oil Market War Fuels Further Stock Market Volatility

Stock market volatility during the first quarter was further compounded by an all-out price war between Russia and Saudi Arabia over the appropriate balance between oil supply and demand. Both nations threatened to boost oil production as they failed to agree on how to cut supply in response to a drop in demand resulting from the impact of the coronavirus. The glut in supply and falling oil prices that have resulted also are having a significant operating impact on the highly-leveraged US shale industry.

Oil Price War Impacts West Texas Intermediate



Source: Factset

A Recession But Not A Depression

We fully expect volatility in the market to continue until the public health crisis wanes through containment and treatment. We also expect employment data and other forthcoming economic data to reflect the challenging recessionary time we have just entered. However, we do not anticipate a global depression (like the 1930s) due to the rapid and aggressive monetary and fiscal policy actions that have been implemented. The severity of the 1930s Great Depression was significantly compounded by specific policy mistakes, including tight monetary policy, protectionism, and the fact that banks were allowed to fail without government support, none of which is occurring now.

Rather, when we reach a period when the number of COVID-19 cases flattens and we slowly get back to normal, the question will become how quickly the economy will snap back. Bear in mind that when that time comes, the consumer, by virtue of our heavily consumer-driven economy, will be the beneficiary of lower interest rates, lower oil prices, financial stimulus and low inflation. We believe all of these factors bode well for a meaningful economic recovery and a new cycle of expansion and growth. Accordingly, we expect to see supply chains reinvigorated, inventories accumulated, and pent-up consumer demand unleashed and met.

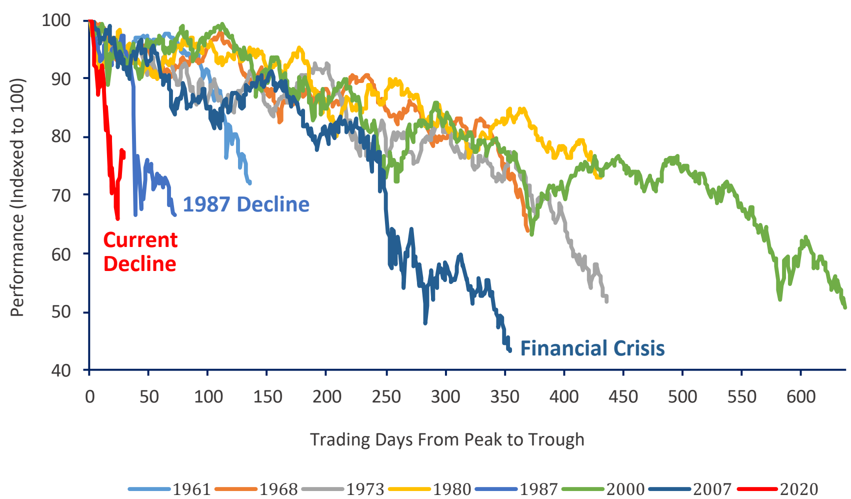
EQUITIES

Expect Market Volatility To Continue

As news about the virus continues to unfold, we expect volatility in the stock market to continue. To put in context the striking volatility we recently have experienced, between 1982 and 2019, the average number of days each year with market moves greater than +/- 3% was 10 days. There have already been 22 days with moves of that magnitude in the first quarter of 2020.

As the chart below shows, the magnitude and speed of the current stock market decline, as compared with other market drawdowns, has been unsettling for many investors. However, it is important to note that we have experienced such declines before; they just have occurred over a longer time period. Nonetheless, markets always have recovered.

Magnitude & Duration of Major S&P Declines Since 1950



Source: Strategas

The growth rate of new coronavirus infections is the dominant factor driving uncertainty and risk-avoidance in the equity market. This rapid expansion of uncertainty and fear surrounding the coronavirus led to the fastest bear market in history. The S&P 500 declined by -20% for the quarter ended March 31, 2020 closing the day at 2,470, in stark comparison to its all-time high close of 3,386 on February 19, 2020. However, this market decline should be considered in the context of the powerful rally we have experienced over the last 10 years. The stock market is now back to the level first reached in late 2017.

Corporate Profits Decline As Prices Drop

Expectations for 2020 corporate profits have dropped by as much as one-third compared to 2019 and may continue to fall as more information becomes available. In the coming weeks many companies will be commenting on what they are seeing as result of Q1 disruptions which will be very helpful in gauging the impact on earnings. Price declines in stocks have been highly-correlated across sectors such as Consumer Discretionary, indicating panic selling and the impact of passive and quantitative strategies on the stock market. Stock prices are the result of earnings expectations (fundamental) and investor confidence (sentiment), both of which have been significantly reduced. Until companies provide updated guidance, the volatility almost certainly will continue as markets react to headlines with limited information.

Encouraging Signs

However, what has been encouraging to note is that the indiscriminate selling of almost any asset has abated, and the sharp rise in equity correlations has subsided. When equity correlations are at extremely high levels, it means that stocks are being sold to a degree that has no bearing on how much or how little the underlying business will be impacted by the current economic situation. Rather it's a behavioral response fueled by investor fear.

Another positive sign worthy of note in the equity market is that the number of stocks registering new 52-week lows has declined. In addition, from a dividend perspective, companies with strong balance sheets and free cash flow should have no trouble paying dividends as planned.

Looking Forward To A New Business Cycle

We expect the biggest challenge will come in Q2 2020, following a weak and volatile Q1. As the coronavirus infection curve flattens over time and becomes more manageable, we hope to see the beginning of a recovery and economic expansion take hold. It likely will take some time for the economy to heal after the sudden shock of the economic shutdown.

As we look forward to the transition from a recession to the beginning of a new business cycle, we expect early-cycle stock leadership to be driven by cyclical, value and small-cap stocks. Once we believe the new cycle is imminent, cyclical companies in sectors such as Consumer Discretionary should become more attractive relative to more defensive sectors such as Utilities.

As in the past, we will continue to invest in high-quality companies with strong balance sheets, competitive products and services and large addressable markets. Some of these companies may include innovative healthcare and technology companies providing many of the solutions used in addressing the coronavirus crisis and operating in this "new, social-distanced normal." Investors likely will be rewarded by owning innovative, growing businesses like these in the next business cycle.

FIXED INCOME

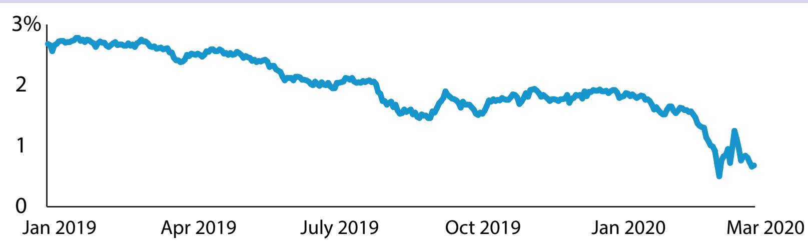
A Challenging Fixed Income Market

In the fixed income markets, the first two months of the year produced strong returns as the Bloomberg Barclays Aggregate Index posted a return of 3.76%. All components of the index generated positive results. However, as March began and the coronavirus epidemic collided with the oil price war, an unraveling of the fixed income markets began, as investors rushed to safety. The Bloomberg Barclays Aggregate Index lost a little ground and finished with a +3.15% return as of March 31, 2020.

Volatility Prevailed

As a reflection of the volatility in the fixed income markets that took place in March, we saw the 10-year Treasury yield fall below 1%, bottoming at an intraday low of 0.33%, an all-time low yield. A few days later, the 10-year Treasury retraced its footing with the yield rising to 1.27% (when bond prices fall, yields rise). These kinds of swings are not considered normal for the Treasury market.

10-Year Treasury Yield Over Time



Source: Factset

For several weeks in March, trading and liquidity continued to be challenging. Investors wanting to sell certain fixed income securities had to sell what they could, not necessarily what they wanted. However, towards the end of the quarter, the markets started to re-open, and investment-grade new issuance met plenty of demand, with attractive pricing. Corporate bond spreads improved broadly to +353 bps, although still wide relative to historical averages.

The Fed Takes Further Action

Two days after lowering rates to zero in mid-March, the Fed announced the establishment of the Commercial Paper Funding Facility (CPFF) to support the normal functioning of the short-term market, which is vital to financing everyday business. The Fed announced various additional facilities to support fixed income market functioning, including programs aimed at Treasuries, agencies, municipals, corporates and some asset-backed securities. However, several areas of the market are still not functioning normally, in particular the mortgage-backed security (MBS) market. It may take some time for the Fed's numerous programs to work their way through the system, but we do believe that they will eventually produce the desired results.

Selective Investing

In this environment, we are focusing on high-quality securities in the short-to-intermediate end of the curve, as volatility should be expected for the foreseeable future. The 10-year Treasury yield remains below 1% and the 30-year Treasury remains well below 2%, indicating a continued demand for safe-haven investments. Our expectation is for a lower-for-longer interest rate environment as we move forward through the remainder of the year.

Insight On Municipals

Municipal bond funds experienced record outflows of $41 billion in March. This follows what had been a record 12-month streak of inflows prior to the coronavirus outbreak. The sell-off in mid-March was the worst in four decades. Following the $2 trillion stimulus bill, yields declined by over 1% across the curve, despite the outflows, resulting in the biggest one-day rally since 1993. Besides the unprecedented stimulus provided by the

CARES Act, state "rainy day funds" are at their highest levels since 2000, which will help them weather the coronavirus storm. Certain states already have tapped those funds, including Maryland and California.

Upgrades Still Exceed Downgrades

With a strong economy prior to the coronavirus crisis, credit ratings of municipal issuers continued to improve as upgrades (the most since 1989) exceeded downgrades for the fifth straight year. However, we believe non-essential revenue-backed bonds may be at risk moving forward as usage revenue streams are impacted by the shutdown. Before we meaningfully commit additional funds to that market, we need to see improvement on the health front so that revenues derived from discretionary entities (hotels, convention centers, stadiums) can resume.

The Federal Aid Available To Municipalities

When it comes to investing in municipal bonds we will focus our efforts on the beneficiaries of Federal aid, which are state and local governments, as well as essential service authorities such as water and sewer. According to The Tax Foundation, aid programs include $150 billion for state and city government pandemic expenses, $100 billion for health care providers, $25 billion in transit infrastructure grants, $14 billion to higher education institutions for virus-related closure/disruption costs, $10 billion to the FAA for support of airports, $50 billion to airlines, $8 billion to air cargo carriers and $3 billion to states based on the needs of schools at all levels impacted by the pandemic.

CONCLUSION

We understand this is a difficult time. Certainly, the world will change afterwards as a result. From an investment standpoint, change often includes the possibility of innovation and new businesses. We do expect the extreme market volatility to continue in the near term, and we will keep you updated as important new developments arise.

As always, we encourage you to continue to focus on your long-term goals, keep perspective and seek our help. For over 100 years, 1919 Investment Counsel has worked with our clients to navigate difficult periods in our nation's history. ■

The views expressed are subject to change. Any data cited herein have been obtained from sources believed to be reliable. The accuracy and completeness of data cannot be guaranteed.