Research Highlight

Q1 2020 MARKET REVIEW

April 2020

OXFORD

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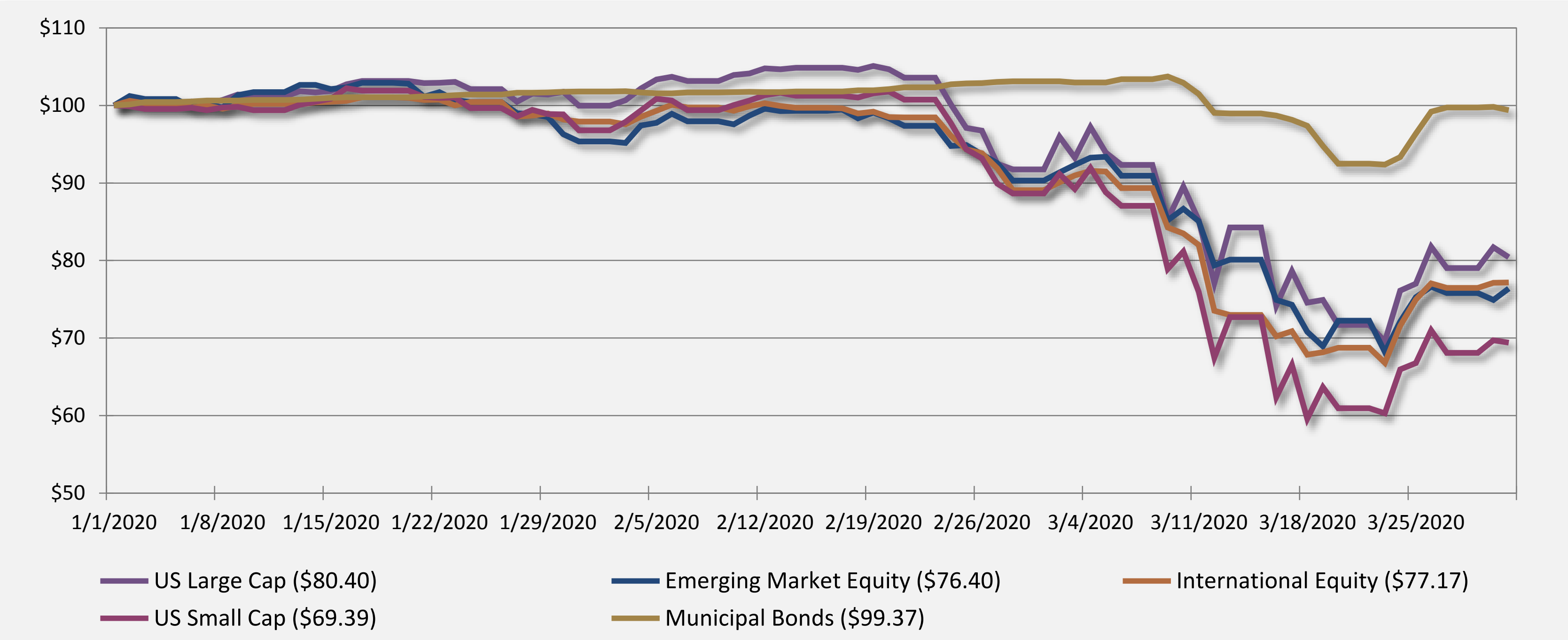
FIRST QUARTER MARKET INDEX REVIEW

GROWTH OF $100 (1/1/2020 – 3/31/2020)

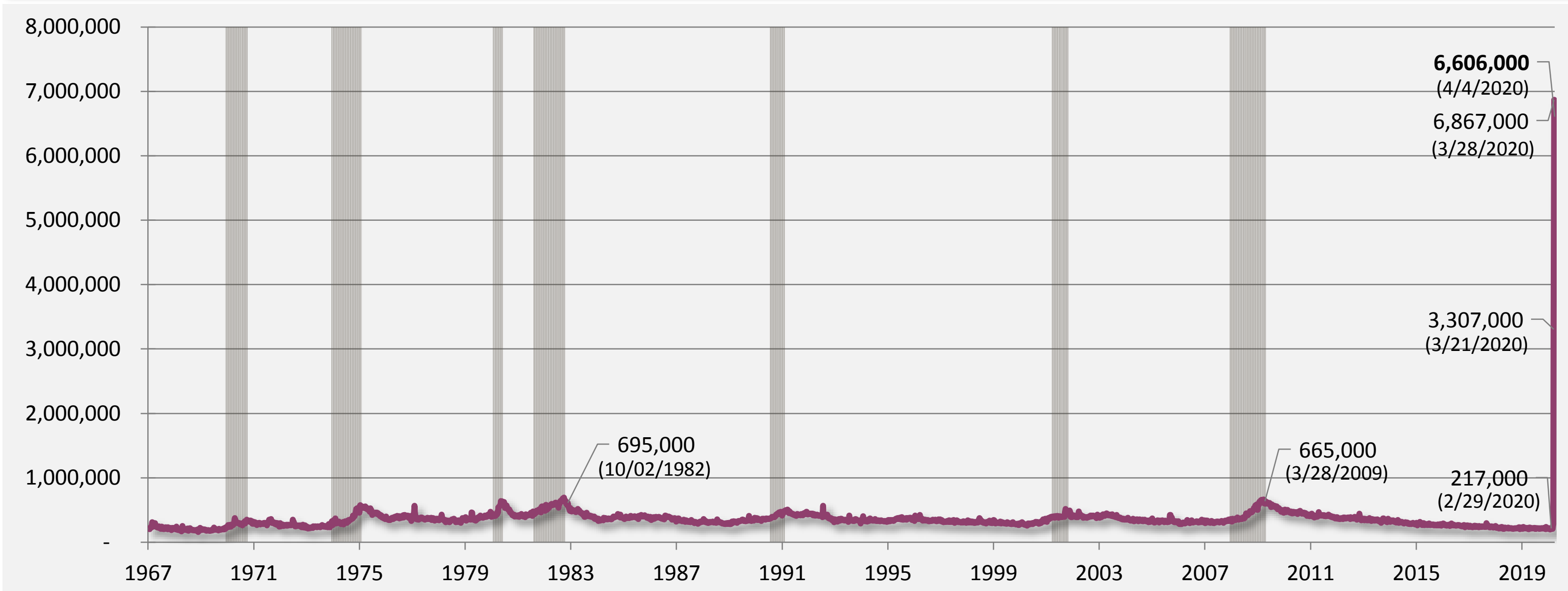


Source: Morningstar

- The year began amid a constructive economic environment, and the S&P 500 was up 5% through mid-February. As the impact of the novel coronavirus became clear there was a sharp decline in asset prices. Even high-quality municipal bonds were pressured by the liquidity crisis, falling at one point by almost 8%.
- Aggressive action by the Federal Reserve remedied a number of the liquidity gaps, and most segments of the fixed income market saw a meaningful recovery by quarter-end.
- While a rush to safer assets is typical during a crisis, it is notable that emerging market (EM) equities (-24%) only slightly underperformed the S&P 500 (-20%). This was due in part to the already low valuations for EM stocks at the start of 2020. Small cap stocks in the US fared less well, declining (-31%).
- Technology (-12%) and healthcare (-13%) were the best performing sectors, while financials (-32%) suffered amid declining interest rates. Energy (-51%) was the worst performing sector due to the plunge in oil prices.

US ECONOMY

WEEKLY INITIAL JOBLESS CLAIMS (1/1/1967 – 4/4/2020)

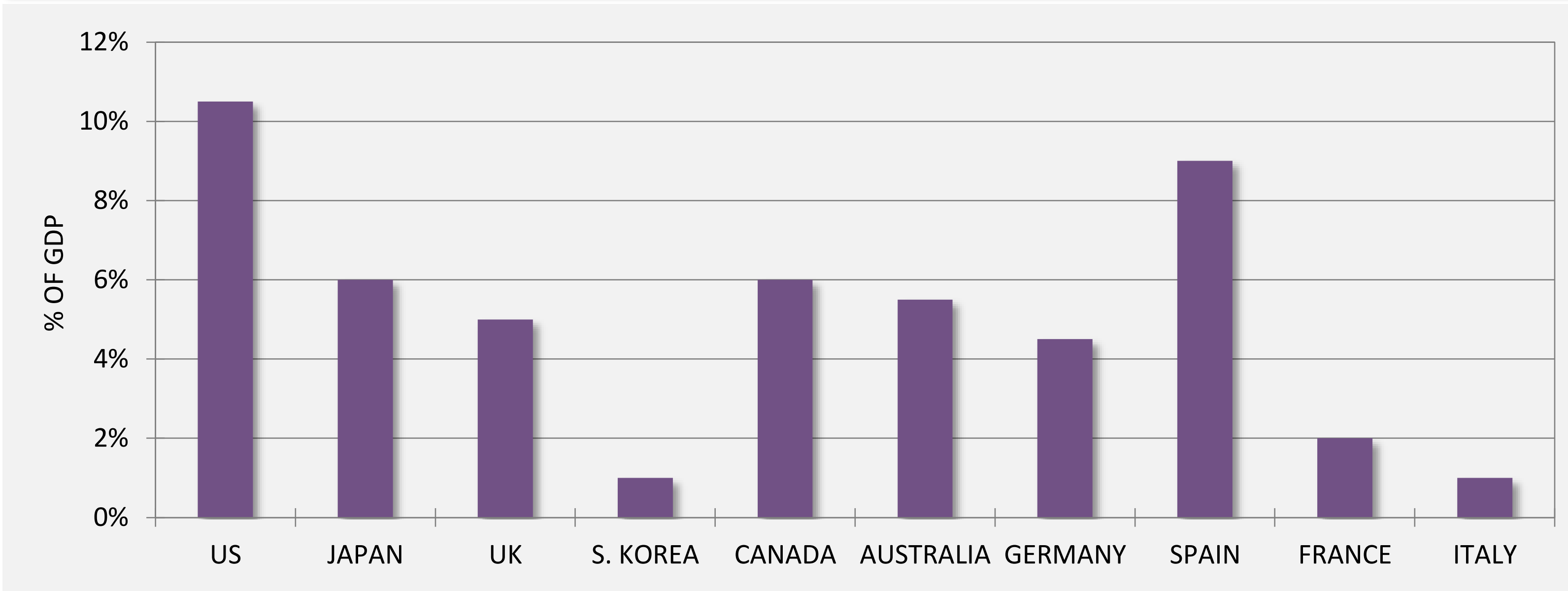


Source: Federal Reserve Bank of St. Louis

- The chart above reflects how quickly the cascade of voluntary shutdowns and government mandates impacted the labor market. The unemployment rate, which was 3.5% in February, is likely to move into the mid-teens or potentially higher as we move through the second quarter.
- The CARES act (stimulus passed by Congress) includes an additional $600 per week in Federal unemployment benefits through the end of July. State benefits vary but the average check historically is a little more than $300 per week.
- In aggregate, almost 20% of GDP is tied to areas we expect to be particularly hard hit by the crisis. This includes hotels and tourism, transportation, entertainment, restaurants and bars and retail (excluding food and beverage).
- More than 90% of the US population is under a directive to social distance, and economic activity in the coming weeks is expected to fall by record amounts. Toyota, as a barometer for the auto industry, reported a 37% decline in March sales.

GLOBAL FISCAL RESPONSE

G10 COUNTRIES – FISCAL POLICY RELIEF AS A % OF GDP (ESTIMATED)



Source: BCA Research, IMF, Financial Times

- Similar to 2008-2009, the US government has been more aggressive from a fiscal perspective than most countries in responding to this crisis. In fact, the CARES act, which is estimated to cost $2.3 trillion, is larger than all the stimulus packages passed by the US government during the 2008-2010 period.

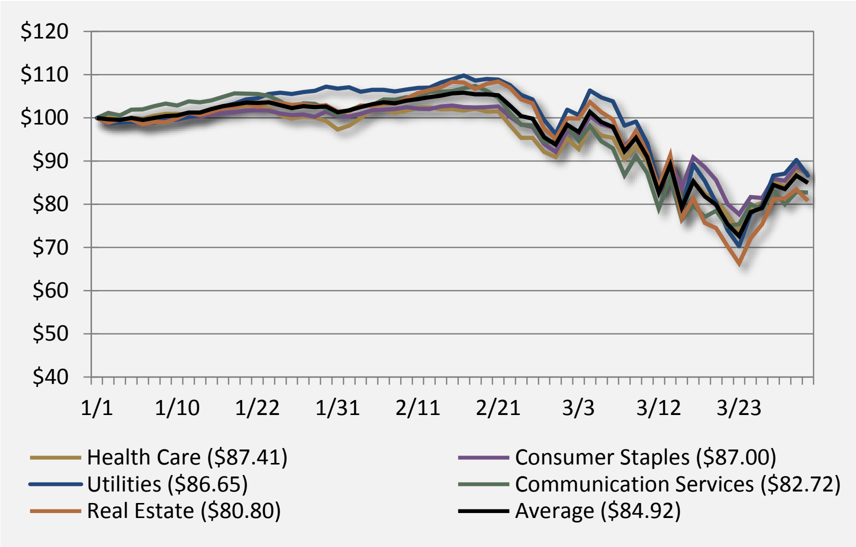
- The key components are focused on supporting individuals and small businesses; particularly as the economy is "paused" by the social distancing necessitated by the pandemic.

- Spain has been similarly aggressive in its response, with a host of policy measures that include moratoriums on some debt repayments, tax deferrals and more flexibility around its labor markets.

- Despite the modest dollar amount of South Korea's response, that country is leading the globe through its robust testing capabilities and use of geolocation tracking to manage the outbreak.

US EQUITY: DEFENSIVE VS. CYCLICAL (Q1 2020)

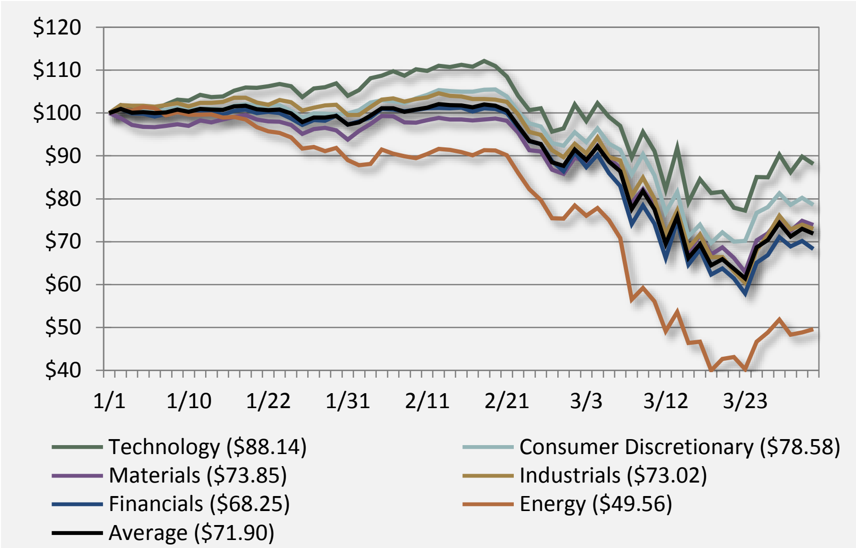
GROWTH OF $100: DEFENSIVE SECTORS



Source: Morningstar

- The significant economic contraction resulted in a flight to quality. Defensive businesses with more predictable earnings held up better than most.
- Real estate stocks declined the most due to higher debt levels and uncertainty about the duration of the downturn.
- Some consumer staples companies benefitted as families stocked up on supplies in preparation for a period of quarantine.

GROWTH OF $100: CYCLICAL SECTORS



Source: Morningstar

- Cyclical businesses were most impacted by the rapid economic decline and uncertainty regarding its duration.
- Energy stocks were impacted not only by an unprecedented demand shock, but also by a dispute between Saudi Arabia and Russia resulting in increased supply.
- Financials were the second worst performers driven by investors concerns about an increase in non-performing loans.
- In all sectors, companies with higher levels of leverage underperformed as well.

US EQUITIES: SIZE AND STYLE COMPARISON (AS OF 3/31/20)

YEAR-TO-DATE RETURN

	VALUE	BLEND	GROWTH
LARGE	-25.8%	-20.6%	-11.7%
MID	-36.1%	-27.0%	-17.1%
SMALL	-40.2%	-33.5%	-21.5%

Source: Morningstar
Based on Russell style classifications with the exception of Blend, which is based on the S&P 500.

1-YEAR RETURN

	VALUE	BLEND	GROWTH
LARGE	-17.4%	-8.0%	1.5%
MID	-30.8%	-18.5%	-7.2%
SMALL	-37.6%	-25.7%	-16.5%

Source: Morningstar
Based on Russell style classifications with the exception of Blend, which is based on the S&P 500.

- Value stocks have significantly underperformed growth stocks in recent periods. In bear markets, small cap and value stocks often decline more than the broader market. A flight to quality benefits large cap companies and growth businesses less dependent on the economic cycle.

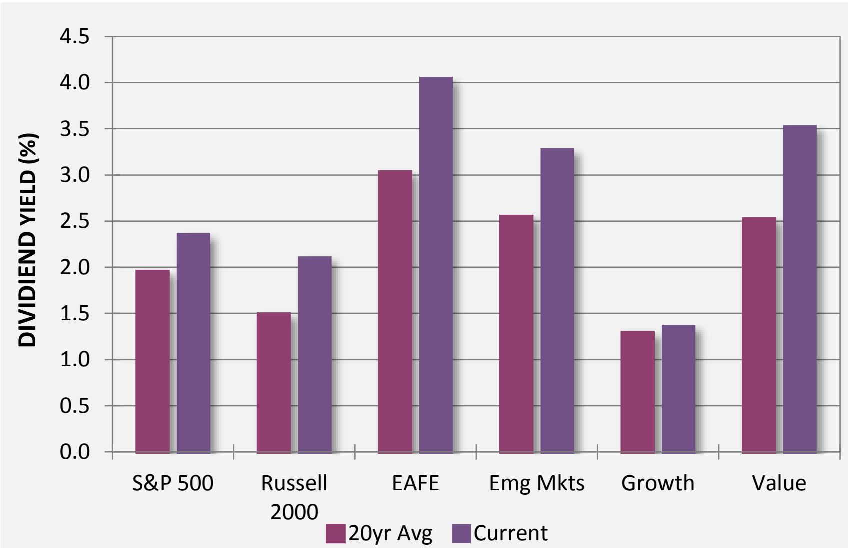
- Value stocks are more concentrated in cyclical industries. Small cap companies have lower liquidity leading to a more severe stock price impact in a market correction.

- Market pricing often significantly overshoots the true economic impact to businesses. A one-year loss in earnings equates to a modest reduction in a typical business's value. Yet, stocks have declined by substantially more. This is typical in the early stages of a bear market. Small cap and value stocks do tend to lead the market in a recovery.

- Over the long-term, value stocks outperform growth stocks largely due to the premium investors pay for growth. Today, that premium is as high as it has been in 20 years.

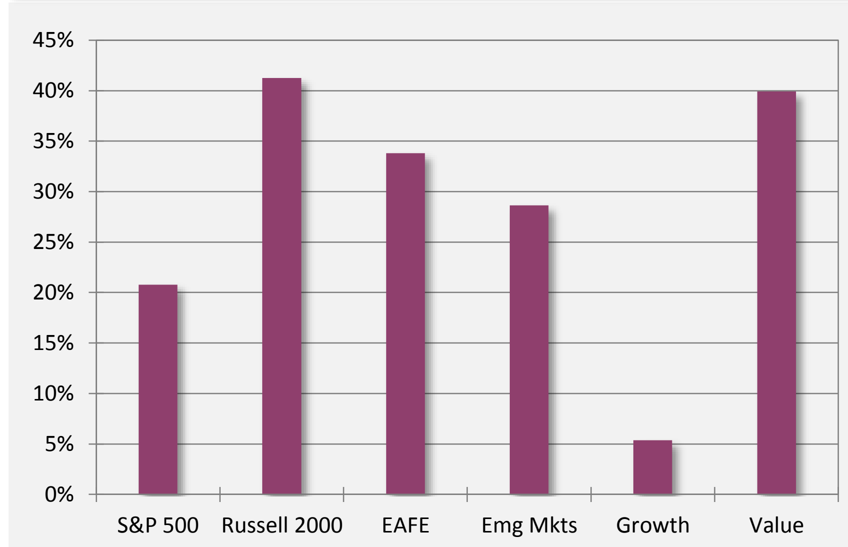
EQUITIES: DIVIDEND YIELD VALUATION (AS OF 3/31/20)

CURRENT DIVIDEND YIELD VS. 20-YEAR AVG



Source: Bloomberg

CURRENT DIVIDEND YIELD AS % OF 20-YEAR AVG

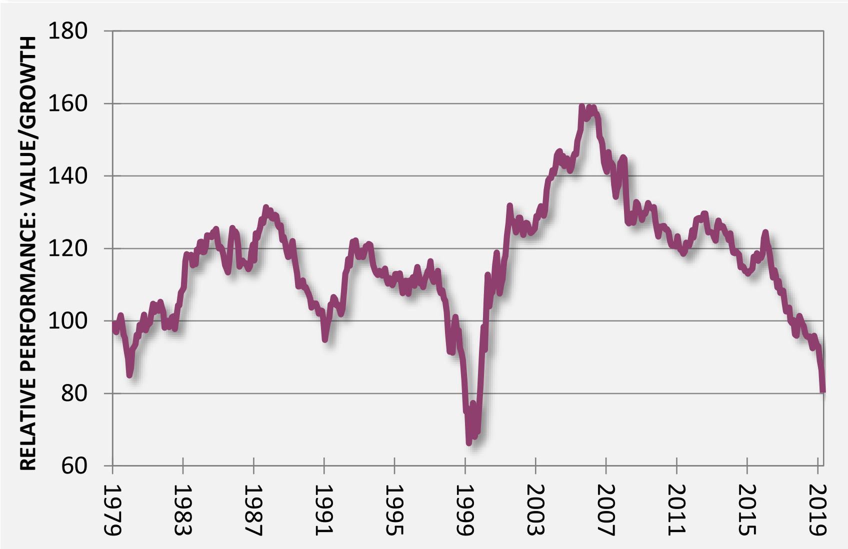


Source: Bloomberg

- Dividend yields for stocks across asset classes trade at a premium relative to their 20-year averages.
- These yields are particularly attractive with the 10-year treasury trading at 0.7%.
- The higher yields in some areas reflect investor's concerns that in an extended economic downturn dividends may need to be cut temporarily.
- Domestic growth stocks have significantly outperformed other asset classes in recent years. Growth stock valuations remain rich relative to other asset classes.
- Small cap and value stocks have suffered the most in the downturn. Their dividend yields trade 40% higher than their 20-year averages.
- International and emerging markets stocks trade at 25-35% premiums to their 20-year average.
- Starting valuation is the most important determinant of future returns. Expected returns have risen with the price declines.

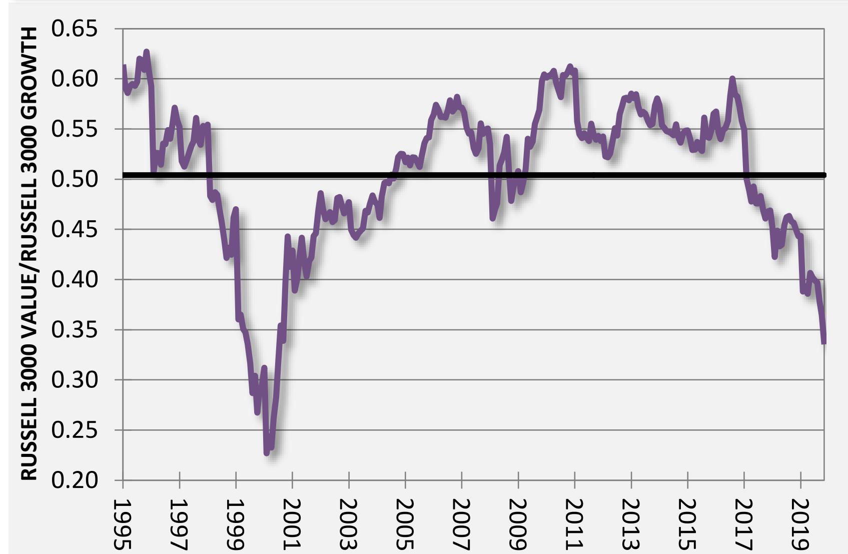
US EQUITY: GROWTH VS. VALUE (AS OF 3/31/20)

R3000 VALUE VS. GROWTH PERFORMANCE



Source: Morningstar

R3000 VALUE VS. GROWTH: VALUATION DISCOUNT



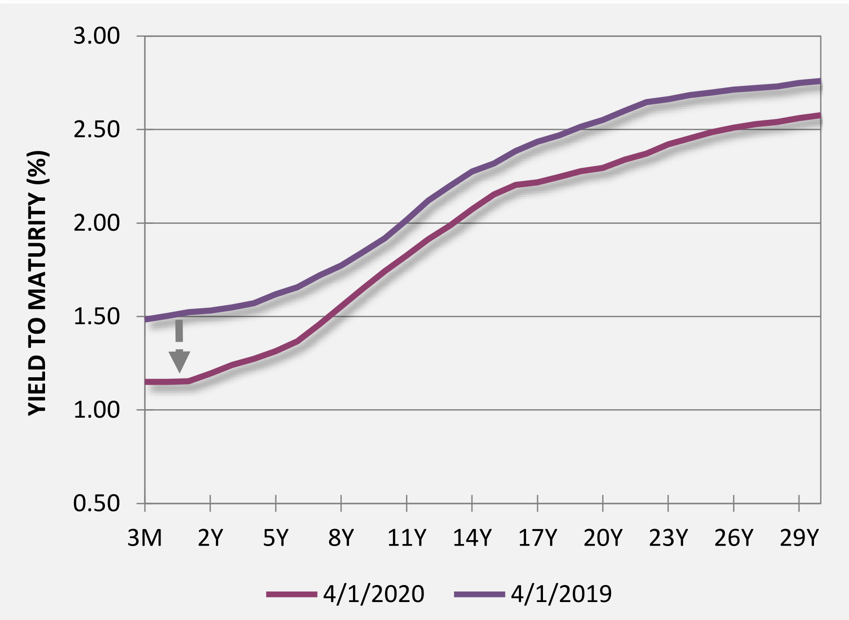
Source: Bloomberg. Note: Valuation reflects an equal weighted mix of three valuation metrics: Price/Book, Price/Sales and Dividend Yield.

- Growth stocks outperformed value stocks by 5.3% per year over the past decade. Periods such as this are not unprecedented despite the long-term outperformance observed by value stocks.
- Value stocks outperform longer-term despite their slower earnings growth rates because investors have historically overpaid for high growth businesses and over estimated the sustainability of that growth.
- The last growth rally peaked 20 years ago in March of 2000. Over the decade that followed, value outperformed growth by 6.7% per year.

- Value stocks have always traded at a discount to higher growth stocks. The level of that discount fluctuates over time. At the peak of the growth bubble in 2000, value stocks traded at 25% of growth stocks valuation.
- The current discount for value stocks is greater than any time other than the late ‘90’s technology bubble.
- Timing the reversal of this trend is impossible, but history would suggest this is a very attractive starting point for value-oriented strategies, such as Oxford’s factor-based strategy.

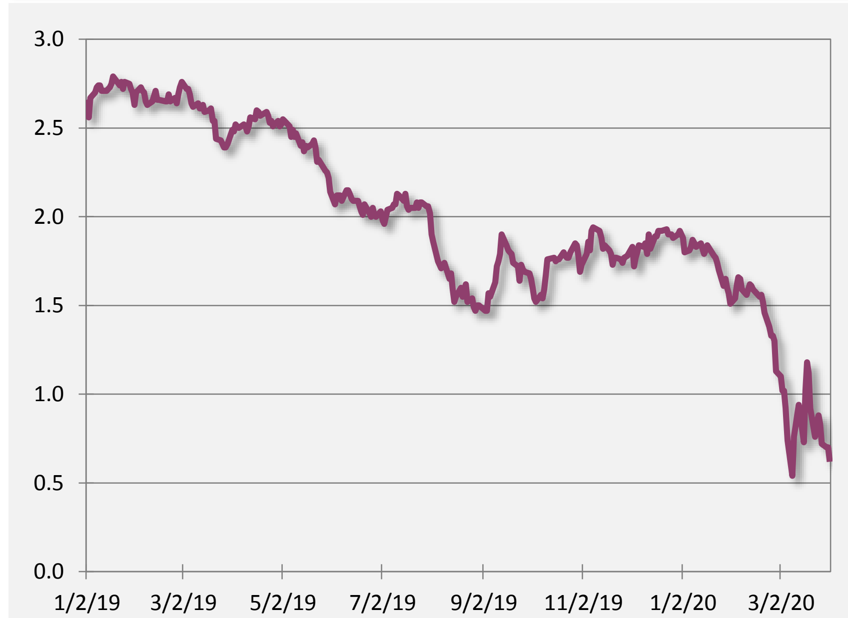
FIXED INCOME YIELDS

MUNICIPAL YIELD CURVE



Source: Federal Reserve Bank of St. Louis

10-YEAR TREASURY YIELD (AS OF 4/1/20)



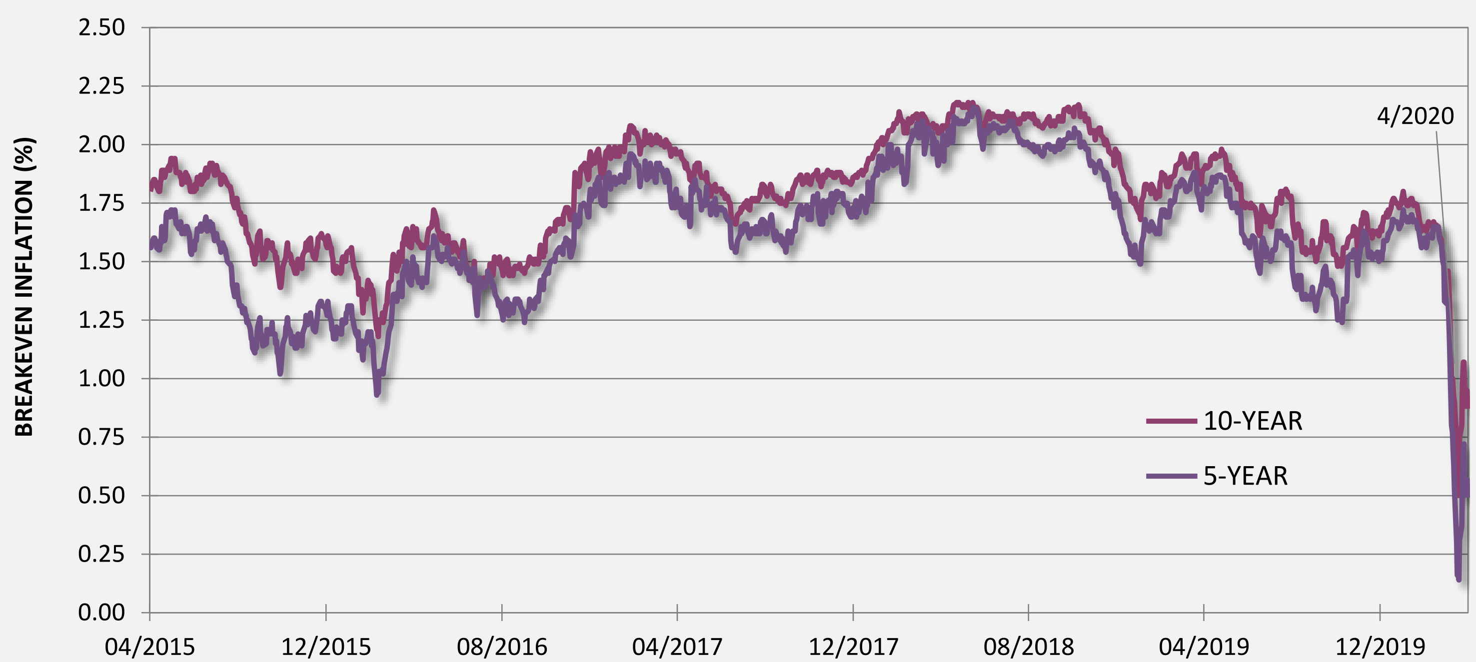
Source: Federal Reserve Bank of St. Louis

- Changes to the AAA municipal bond yield curve appear benign over the last year, as it fell slightly across maturities.
- But this market was anything but calm last month with illiquidity and forced selling sending yields sharply higher in early March, with 1-year maturities reaching yields of 2.6%.
- Since then, Fed liquidity measures have helped calm investors. While tax revenues will be challenged going forward, a majority of this sudden move in yields was technical, not credit-related, in nature.

- Despite low starting yields and staggering levels of fiscal and monetary stimulus, Treasury yields have fallen year-to-date as investors seek the safety of US debt.
- At the same time the recent peak in yields for municipal bonds occurred, investors briefly sent short-term T-bills to negative yields in late March, indicating how high the demand was for perceived safety.
- Going forward, the “risk-free rate” will create challenges for traditional asset allocations.

LOW INFLATION EXPECTATIONS

US BREAKEVEN INFLATION (5-YEAR and 10-YEAR): 4/2015 – 4/2020



Source: Federal Reserve Bank of St. Louis, BCA Research

- As the battle against the spread of the coronavirus sent the US economy into a “sudden stop,” the immediate and material decline in overall demand sent inflation expectations sharply lower.

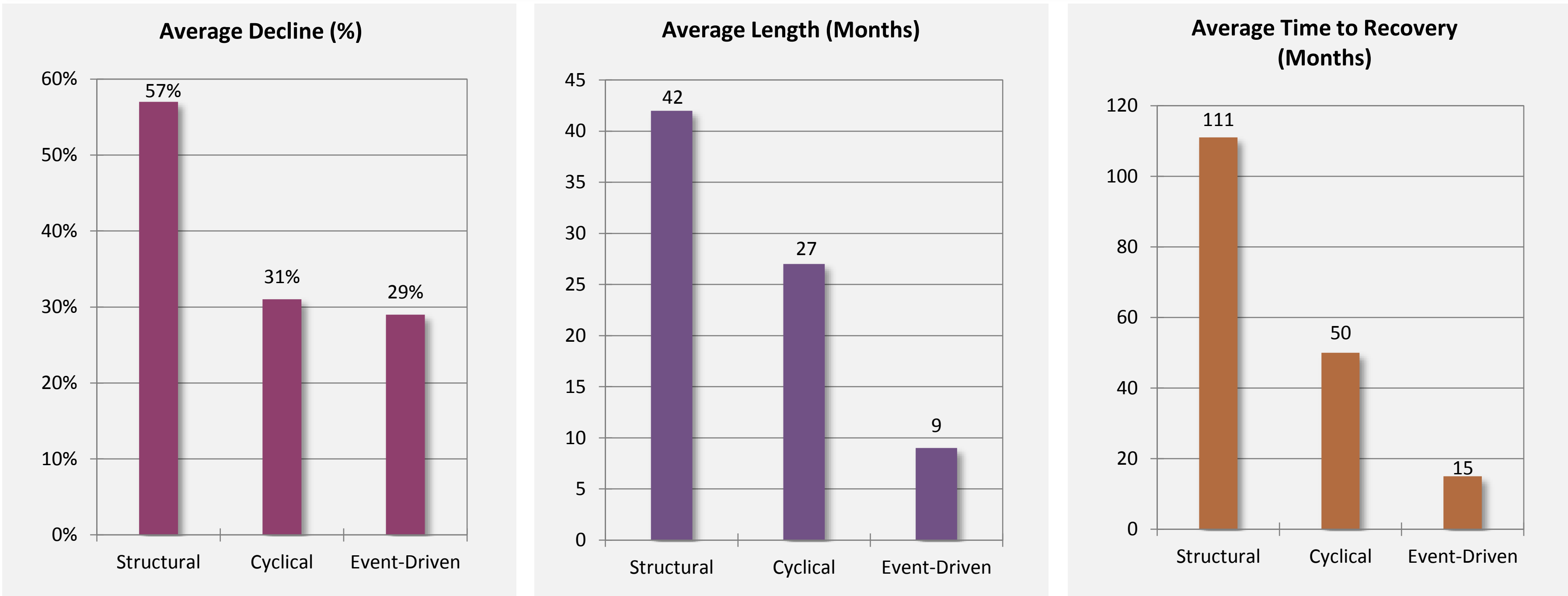
- Longer-term inflation expectations, which have typically been steady around 1.5-2.0% over the last five years, fell to nearly 0%. This implies virtually no inflationary pressure over the next 5-year and 10-year periods.

- Shorter-term breakeven inflation indicated deflation is on the horizon, with the 1-year level reaching -2.4%.

- All of these breakeven readings have started to recover as news of the fiscal spending plan specifics are moderating the extreme levels reached in late March. Still, over the intermediate term there is a case to be made that the pendulum has swung too far toward a disinflationary expectation.

US BEAR MARKETS AND RECOVERIES

BEAR MARKET SCENARIOS

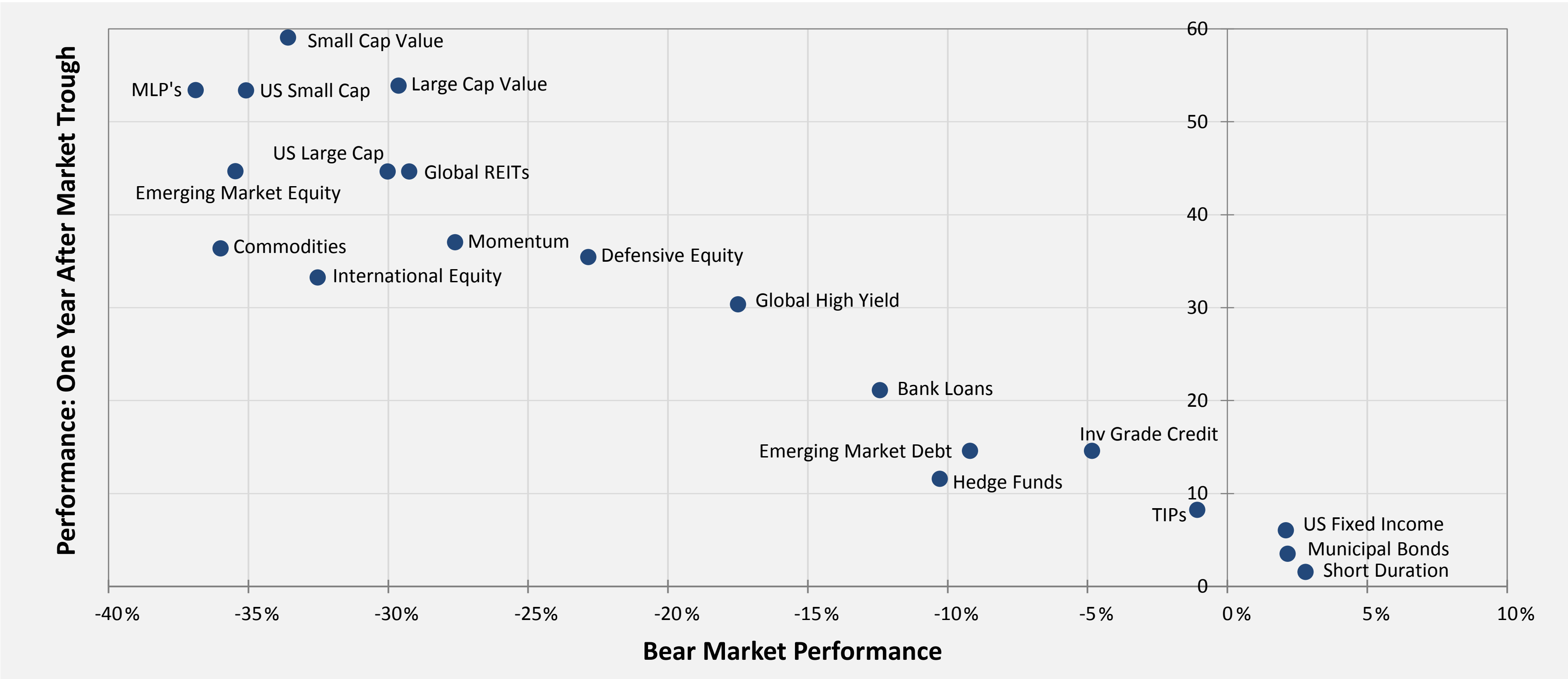


Source: Goldman Sachs Global Investment Research and GSAM

- Market declines of 20% or more, commonly recognized as a "bear market," can occur within different environments that lead to different future outcomes. Structural bear markets are most damaging, preceded by economic imbalances and a period of unusual economic strength. Cyclical bear markets are shallower and are characterized by a prior period of rising yields. Event-driven bear markets have the shortest recoveries and are most notable for the exogenous shock that led to its occurrence.
- Categorizing the current bear market is made more difficult by its self-inflicted (albeit appropriate) nature. There is still an exceptionally wide range of outcomes from here as policy stimulus attempts to fill the demand gap and prevent a deep and protracted economic downturn. In addition, we are reliant on a combination of medical progress and a change in psychology as consumers emerge from our current social distancing protocols.

PERFORMANCE BY ASSET CLASS IN MARKET CORRECTIONS

PERFORMANCE IN BEAR MARKETS AND RECOVERY PERIOD



Source: Morningstar

** We reviewed five market downturns over the past twelve years and have shown the average annualized returns in each of those downturns and then the subsequent returns in the following one-year period after the trough. The downturns highlighted are 2/21/20-3/23/20, 10/3/18-12/24/18, 5/20/15-2/11/16, 4/29/11-9/30/11 and 10/31/07-3/9/09.*

- In market corrections, small cap, value and commodity-oriented businesses typically decline the most. They also rebound the strongest in a recovery and typically begin to outperform following the market trough.

- The importance of a Safety Pod which holds high-quality bonds is most evident in market downturns, when higher yielding fixed income strategies become more correlated with risk assets due to their credit risk.

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