April 20, 2020
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Lockdown-omics

Todd Asset Management Q1 2020 US Market Commentary

	1Q 2020	1 Year	3 Year*	5 Year*	7 Year*	10 Year*
S&P 500	-19.6	-7.0	5.1	6.7	9.6	10.5
Russell 1000 Value	-26.7	-17.2	-2.2	1.9	5.6	7.7

* *Annualized Total Returns.*

What started out as a decent quarter with the economy growing, people getting jobs and investors making money, turned into the fastest decline on record of almost 34% over 22 trading days between February 19 and March 23. Everyone became familiar with a new term- a Lockdown. As we are seeing the effects of the Coronavirus lockdown related screeching halt of economic activity, we start thinking about the concept of lockdown-omics, i.e. estimating how bad the contraction in activity is going to be. Make no mistake, the economic activity is collapsing. Markets recognized this with their recent decline. They appear to be starting to discount some recovery in activity, despite the fact that we have not seen the full extent of the damage that's been caused. We think the sharpest deceleration of activity on record will probably lead to a sharp recovery later on this year. We may be talking about Recovery-omics before long.

- Equity markets, interest rates and commodity prices, experienced a collapse in response to the COVID-19 outbreak and we have also started what appears to be the fastest, deepest recession to ever hit our economy. Think of it as an "Instant recession", as the government aggressively responded to the health threat by ordering large parts of the economy to shut down.

- Normally, recessions take years to develop. Consumers overconsume or businesses over-invest in real estate or technology. Usually, there is some financial foolishness involved featuring banks, investment banks and too many loans. Recovery times depend on the extent of overleverage that needs to be paid off.

- That's not the situation today. Consumers globally were in better shape going into this instant recession. This recession will hurt their incomes, so some recovery period will be needed. Banks had clean balance sheets, which is important because they finance the upcoming recoveries. The banks are generally in good positions to lend.

- Markets have rallied off the March 23 bottom as Governments and Central Banks started to aggressively respond to the economic pain being caused by the shutdowns. Consumer income relief and business loans being used to backstop world economies.

- We expect a short but likely record breaking decline in economic activity followed by a sharp recovery as the economies of the world re-open after the coronavirus crisis.

Bear Markets often have similar patterns in terms of how deep they are, and which groups lead recoveries. We present a synopsis of how deep bear markets get and what happens during bear markets in our report titled "Coronavirus Bear Market, is it done yet?" available at www.toddasset.com under the insights tab. Some of the highlights to look for:

- Since 1950, peak to trough declines for bear markets averaged -25% during recessions and less in panics. Bear market declines of 50% or more only occurred during long term secular bear markets (think 15 years of a sideways tracking market, like the 1970s and 2000's episodes) associated with rectifying economic excesses. We believe we are in a secular bull market, so the current cyclical bear market should not results in that type of decline. The current decline puts this episode on par with the 1987 crash, which was the worst of the cyclical bear markets in secular bull phases.

- ***Following bottoms of recession related bear markets- 1 year returns from the date of the market bottom average over 38% for the S&P 500.*** The recoveries to be accompanied by:

    - <u>Early cycle rotation</u>- towards economically sensitive areas that suffered during the recession relates bear market, but recover afterwards.

    - <u>Leadership Changes</u>- Laggards tend to become leaders and vice versa. The worst groups in this decline were Energy, Financial, Real Estate, Material, and Industrial stocks. Most of these will likely be leadership of the recovery phase.

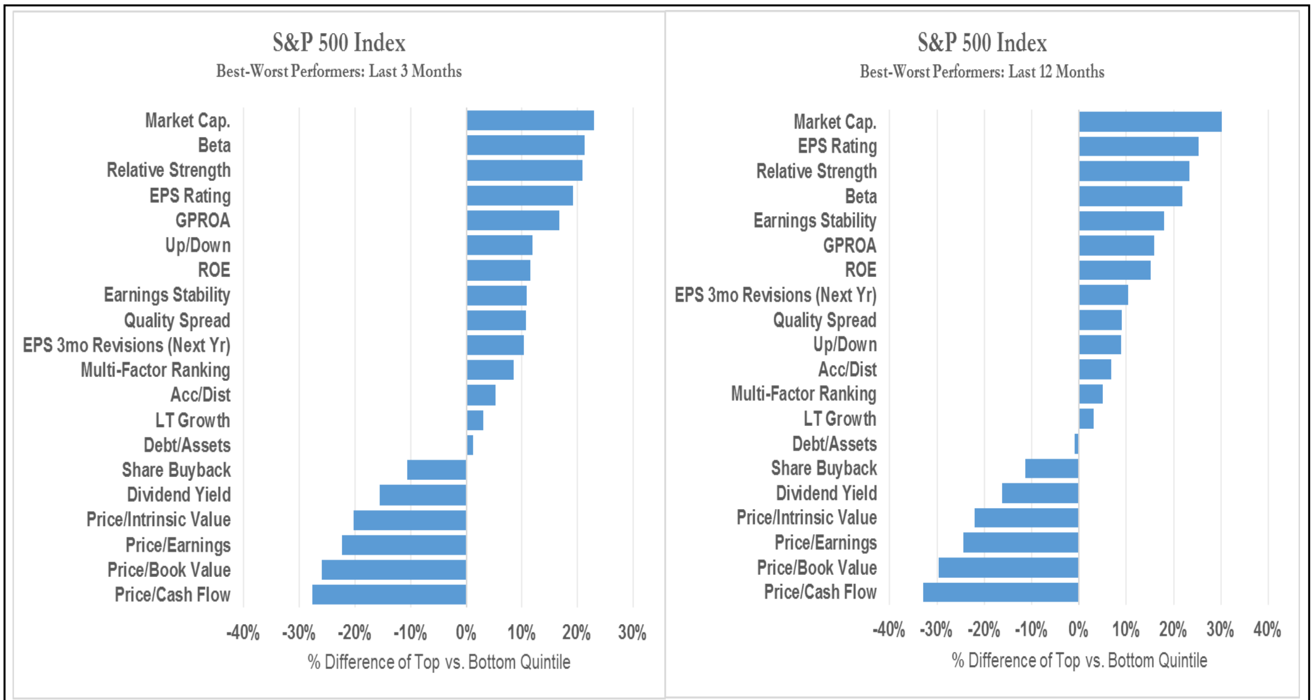
    - <u>Regime changes-</u> Rotation in styles usually occurs. We are overdue for a value cycle.

To see a recovery, we need progress on three fronts to occur. First, illiquidity cannot become insolvency. Many good companies have been shuttered for good reason but only temporarily. This is why central banks are saying "Whatever it takes." Central banks have moved aggressively to address this. Second, fiscal policy needs to provide a buffer, with probably $10 Trillion needed globally. Politicians are also saying "Whatever it takes"… The US, Europe, China, Canada, Australia and Japan (among others) have all implemented aggressive measures. Remember though, currently announced programs are generally relief, not stimulus. All of the actions to this point are to "weather the storm." Watch for more programs to recover from the storm. Lastly, we need Medical progress. Testing, treatment and prevention. That takes time.

For now, it's a question of patience. Bear Markets sometimes need to retest lows, though we suspect this bear is different as it has not occurred naturally. We saw the first low at -34% from the peak for the S&P 500, but the worst economic news is still ahead of us. This could cause that retest, because the economic numbers will be really ugly. Comparisons are likely to be drawn to the Great Depression, as unemployment surges temporarily and the economy shrinks. Realize it is not the

Great Depression, because this time (unlike during the depression) we are providing ample liquidity, fiscal stimulus, a social safety net and relaxing regulations to ensure a recovery from what we think will be a "V" or narrow "U" shaped decline and recovery.

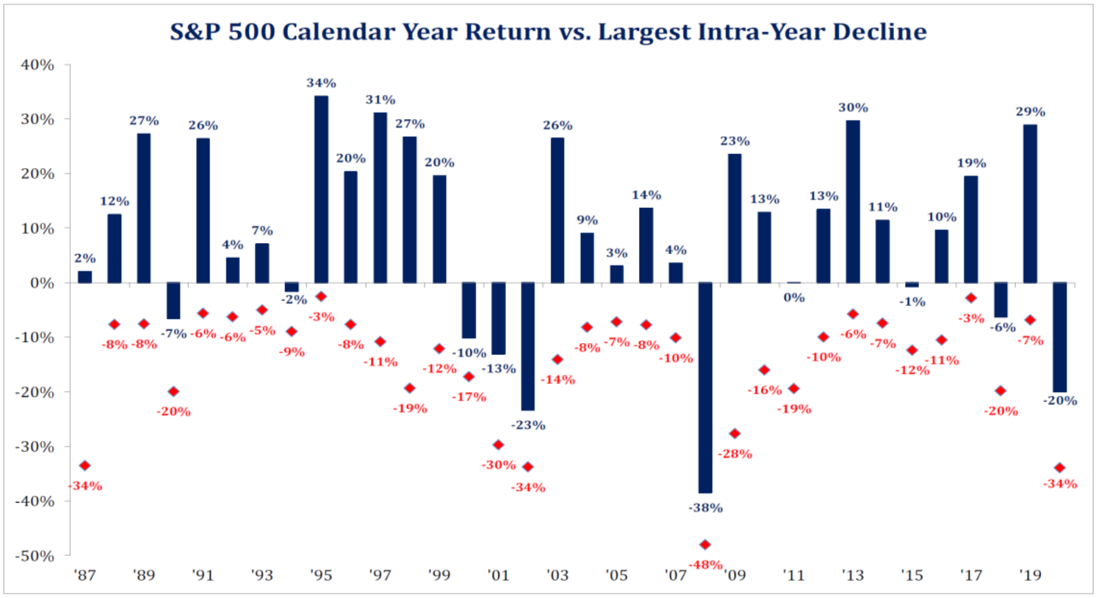
Factor performance



Source: Bloomberg, William O'Neill + Co. and Todd Asset Management

Like we have seen in many of our recent letters, Value has overwhelmingly been out of favor during the past 3 months and over the prior year as well. Large cap higher quality growth has been in demand. Traditionally, bear markets lead to leadership changes, which we believe should result in a value cycle unfolding.

S&P Intra-year drawdown only exceeded by the 2008 Great Financial Crisis



Source: Strategas

- At 3-31-20, the intra-year maximum drawdown was -34% (red dot) while YTD performance was -20% (blue bar). Down 34% matches internet bubble burst and 1987 crash intra-year drawdowns.
- This drawdown matches the worst since 1987 aside from the Global Financial Crisis.

Markets Usually Bottom before Recessions End

Economic Recessions & Market Bottoms

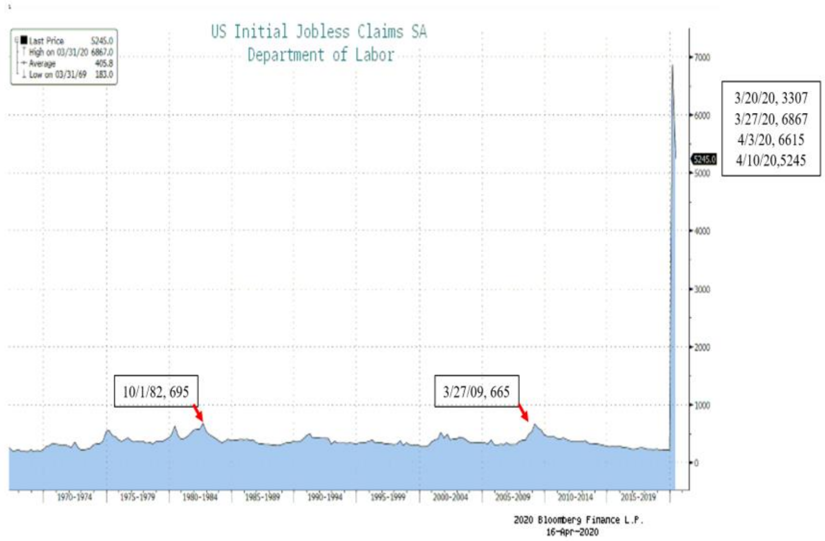
Recession Start	Recession End	Recession Length In Months	Market Bottom	Conclusion
Aug '29	Mar '33	43	6/1/1932	9 Months Before
May '37	Jun '38	13	3/31/1938	3 Months Before
Feb '45	Oct '45	8	3/26/1945	7 Months Before
Nov '48	Oct '49	11	6/13/1949	4 Months Before
Jul '53	May '54	10	9/14/1953	8 Months Before
Aug '57	Apr '58	7	10/22/1957	6 Months Before
Apr '60	Feb '61	9	10/25/1960	4 Months Before
Dec '69	Nov '70	10	5/26/1970	6 Months Before
Nov '73	Mar '75	16	10/3/1974	5 Months Before
Jan '80	Jul '80	6	3/27/1980	4 Months Before
Jul '81	Nov '82	15	8/12/1982	3 Months Before
Jul '90	Mar '91	8	10/11/1990	5 Months Before
Mar '01	Nov '01	7	10/9/2002	11 Months After
Dec '07	Jun '09	17	3/9/2009	3 Months Before
	Average	13 Months	Average	4 Months Before

- Markets usually bottom in anticipation of recessions bottoming.
- Given the amount of fiscal and monetary stimulus in play, an economic rebound is likely.

Source: Strategas

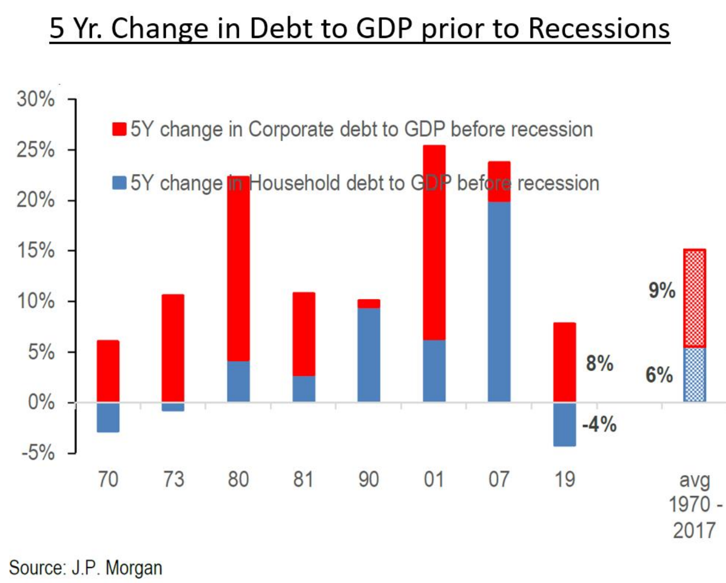
Coronavirus Shutdown Prompts "Instant Recession"

- Over 22 Million Unemployment claims have been filed in just 4 weeks!
- We could see the unemployment rate exceed 10.5% next month, the worst since 1982.
- This indicates a record breaking slowdown is likely, and a recession is here.



Source: TAM, Bloomberg

No "Seeds were Sown" for this recession.

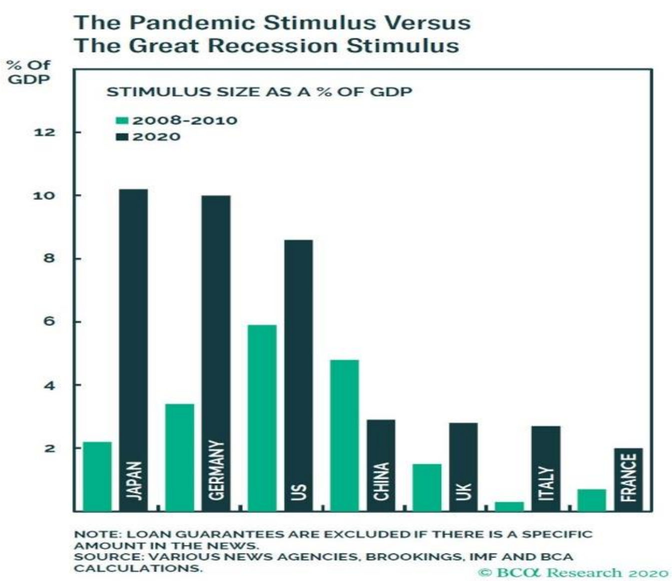


- The "Seeds" of recessions usually include excessive debt.
- This one's different: unsustainable debt has not built up in corporation or households.
- This should result in a shorter recession than otherwise.

The Deepest Recession since WWII is probably followed by the Sharpest Recovery

Source: Haver Analytics, IMF, Morgan Stanley Research forecasts. Note: Global real GDP includes economies under MS Research coverage and the growth rate is the PPP-based GDP weighed average.

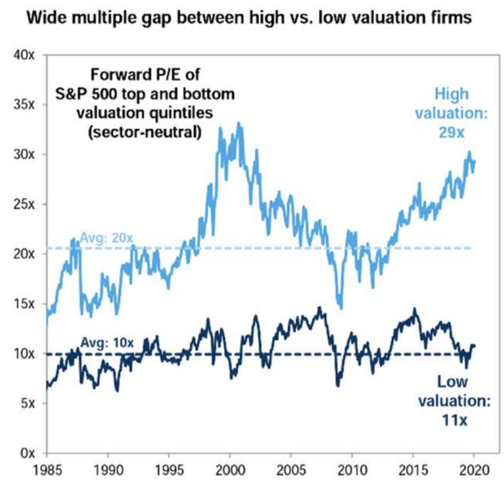
Stimulus- Go Big Early

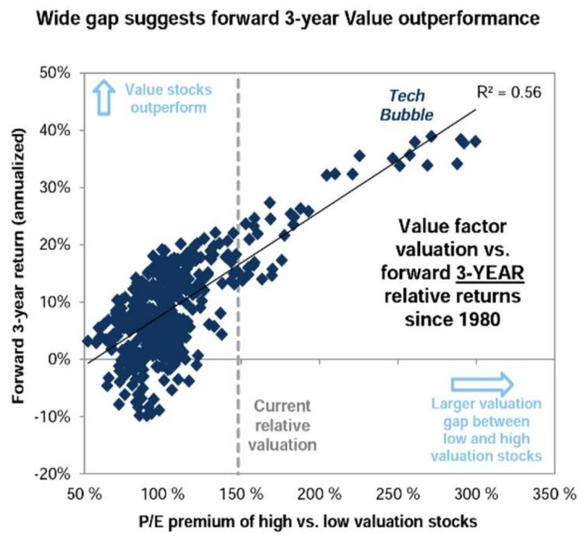


NOTE: LOAN GUARANTEES ARE EXCLUDED IF THERE IS A SPECIFIC AMOUNT IN THE NEWS.
SOURCE: VARIOUS NEWS AGENCIES, BROOKINGS, IMF AND BCA CALCULATIONS.

- Governments/Central banks learned to "Go Big Early" with stimulus and intervention.
- Consider the size of this stimulus vs during the global financial crisis, and then realize we have not seen the worst of the economic reports yet.

High Premium Usually Precedes Value Cycle





Source: Strategas

- The chart to the left tracks the spread between the most expensive 100 stocks in the S&P versus the bottom. The Chart to the right tracks the forward 3-year performance of value versus growth (vertical axis) to the current premium of growth over value.
- From the current valuation levels (growth at 160% premium on a P/E basis), value stocks have generally gone on to nicely outperform growth over the following 3 years.
- Bear markets usually result in a change of leadership.

Summary

We have experienced a fast and deep bear market as the government mandated economic shutdown will likely lead to record breaking economic declines. Fortunately, governments and central banks have stepped up forcefully and quickly to relieve some of the stresses that will result from mass unemployment and business closures. Not all of the stresses will be alleviated, and we expect that further stimulus programs will be undertaken by governments worldwide. Markets have reacted with strong rallies off of depressed levels, even without having seen most of the negative economic reports arising from the lockdown. Our sense is that now some patience is needed as markets probably need to get some economic information, and clarity on when economies will reopen. We believe economies should start to recover sometime in the third quarter (between July and September) which should mean that the March 23 low is probably the bottom of the market. Given the extraordinary amount of government support globally for the economy, visibility for growth should improve once the economy is reopened. If that is the case, then the recovery should have further to go before year end, and will likely have new value oriented leadership.

Even in a Coronavirus lockdown, we are here to support you. We are available via email or phone and welcome your calls. If you have any questions, please feel free to contact any of us for further information.

As always, if you need any additional information, please feel free to contact any of us.

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04/20/20
S&P 500 – 2823
Russell 1000 Value – 1052

Refer to the following page for more information on the commentary presented. This is pertinent to this letter and should not be reproduced or duplicated without this disclosure.

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Russell 1000 Value Index is a widely recognized index of market activity based on the aggregate performance of common stocks from the Russell 1000 Index, with lower price-to-book ratios and lower forecasted growth values. The performance data was supplied by Frank Russell Trust Company.