

Q3 2020 LOOK AHEAD

Disclaimer

Certain information in this presentation constitutes forward-looking statements. Due to various risks, uncertainties, and assumptions made in our analysis, actual events or results or actual performance of the markets covered by this presentation may differ materially from those described. The information herein reflects our current views only, is subject to change, and is not intended to be promissory or relied upon by the reader. There can be no certainty that events will turn out as presented. Data are from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented. Past performance is not a guarantee of future results.

Consumer Strength

Figure 3 -- Benefit Replacement Rates Across the Earnings Distribution

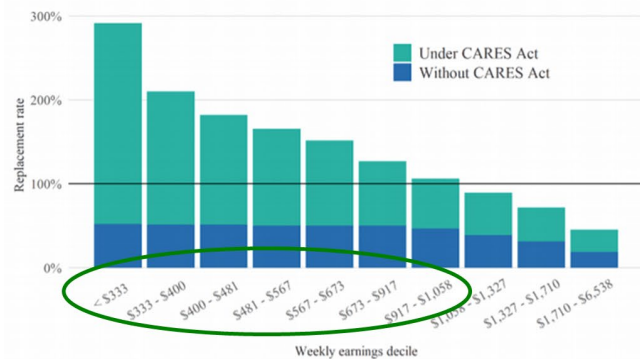
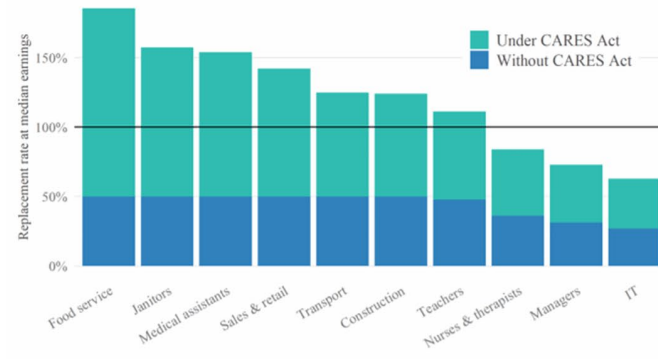


Figure 4 -- Benefit Replacement Rates for Common Occupations



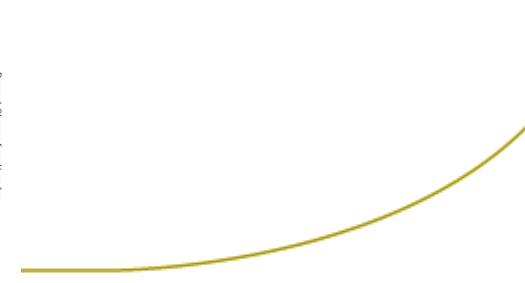
FRED -- Average Hourly Earnings of All Employees, Total Private



FRED -- Household Debt Service Payments as a Percent of Disposable Personal Income



FRED -- Real Disposable Personal Income



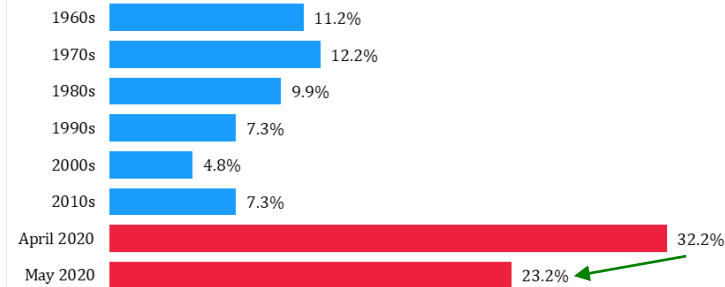
Data Sources: [University of Chicago](#), [Federal Reserve Bank of St. Louis](#)
Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

A World of Cash

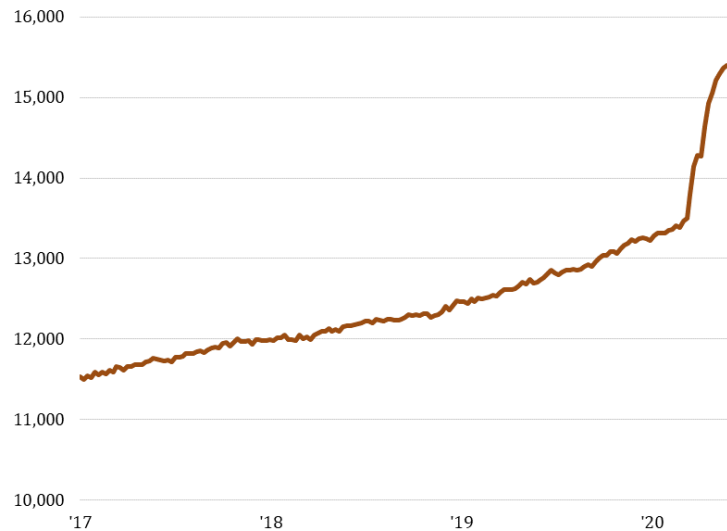
Emptying the Tank

Rainy Day?

Savings rate as a % of disposable income

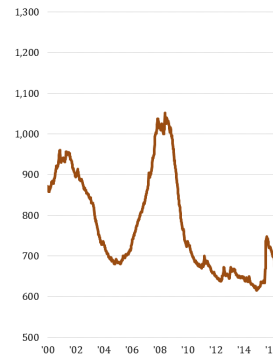


U.S. Bank Deposits (US\$ Billions)

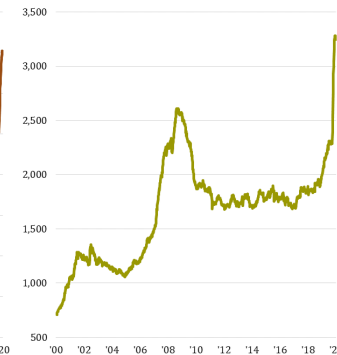


U.S. Bank Deposits are sitting at over \$15 trillion, another record high amount

Money Market Funds: Retail (US\$ Billions)



Money Market Funds: Institutional (US\$ Billions)



Retail & Institutional Money Funds have shattered any measurable past record, topping \$4.4 trillion through the second week of June

- ❑ The definitive question is: Will the U.S. consumer and businesses spend down to maintain their lifestyles and supply chains?
- ❑ If spending habits do return to normal levels, it could add approximately \$3 trillion to GDP (or 15%) and more than make up for the forced suspension of our economy

Data Source: [Federal Reserve Bank of St. Louis](https://www.frbstlouis.org/)

Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

Animal Spirits

Consumption

Corporate
Earnings
Growth

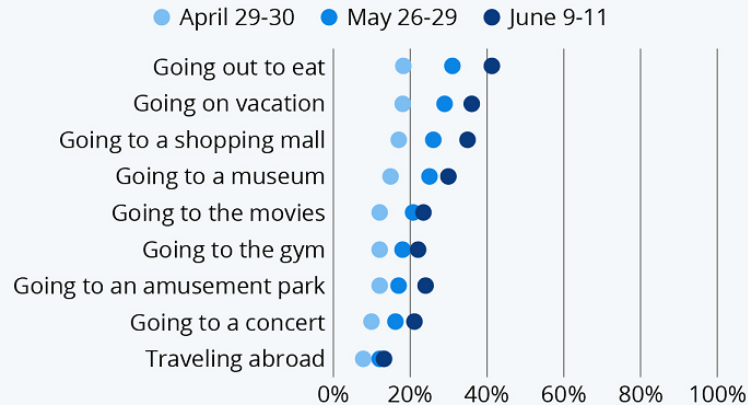
Jobs

Wages

Consumption

Consumers Are Gradually Restoring a Sense of Safety

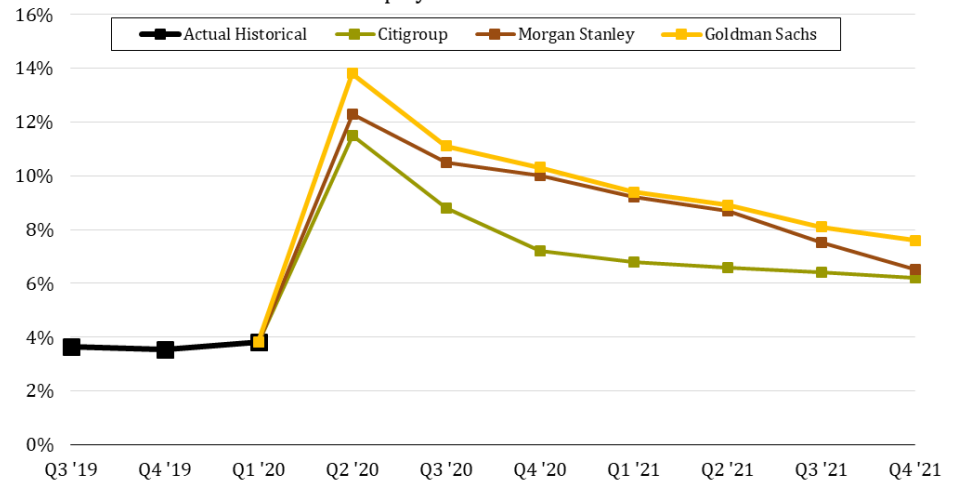
% of U.S. adults who said they're currently comfortable doing the following



Based on polls among at least 1,501 U.S. adults for each data range
Source: Morning Consult

What a Potential Jobs Recovery Might Look Like

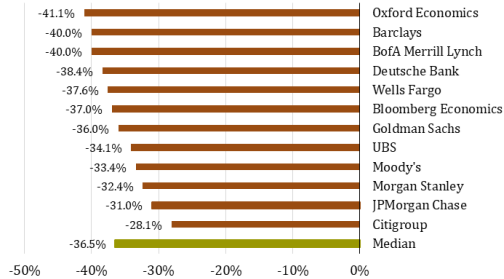
Unemployment Rate Forecasts



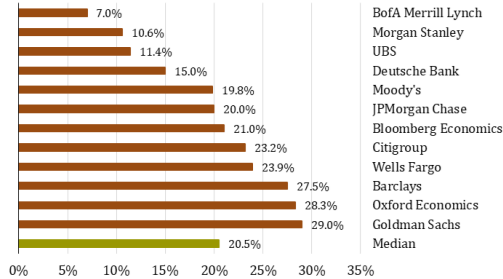
□ Consumption will continue to drive the recovery in jobs, wages, and corporate earnings

A Quick Recession

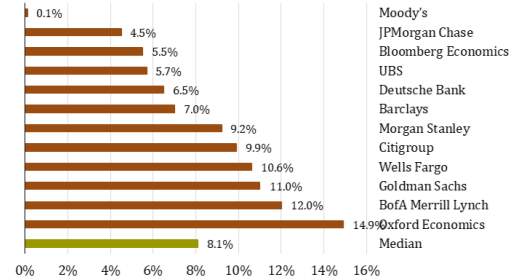
U.S. Q2 GDP Forecasts



U.S. Q3 GDP Forecasts

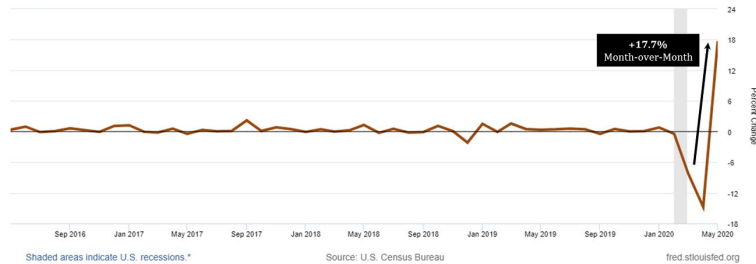


U.S. Q4 GDP Forecasts



Areas on the Mend

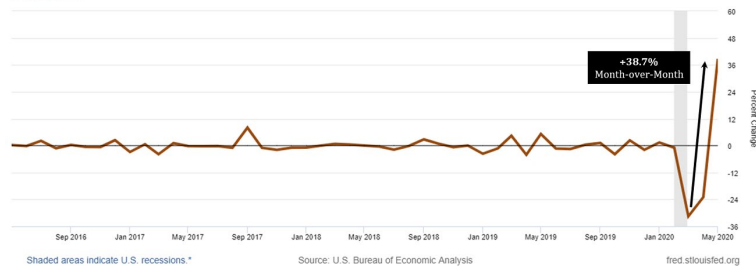
FRED Advance Retail Sales: Retail and Food Services, Total



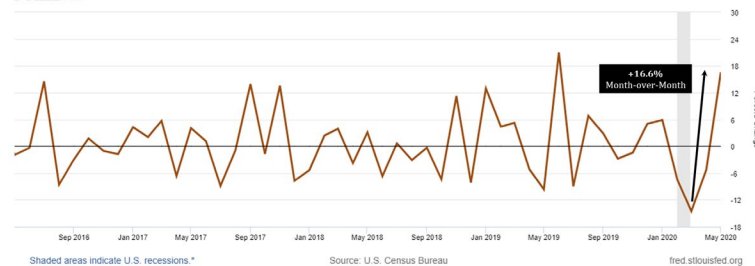
FRED Advance Retail Sales: Food Services and Drinking Places



FRED Total Vehicle Sales

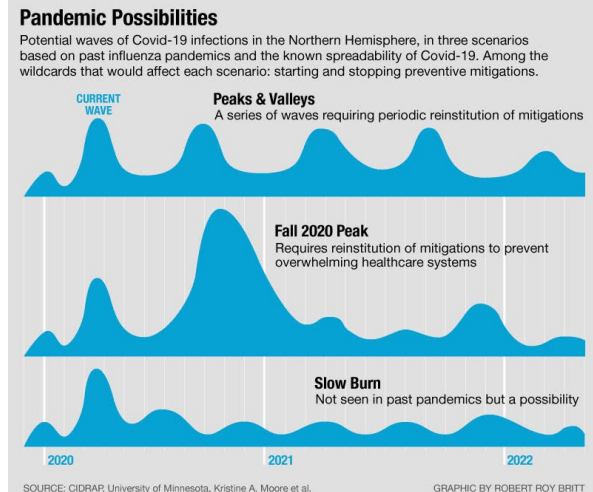
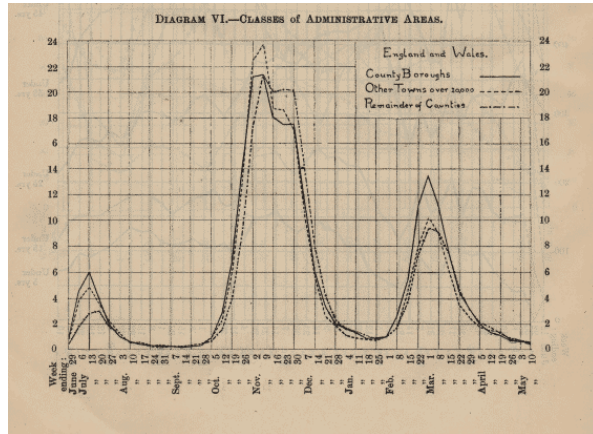


FRED New One Family Houses Sold: United States

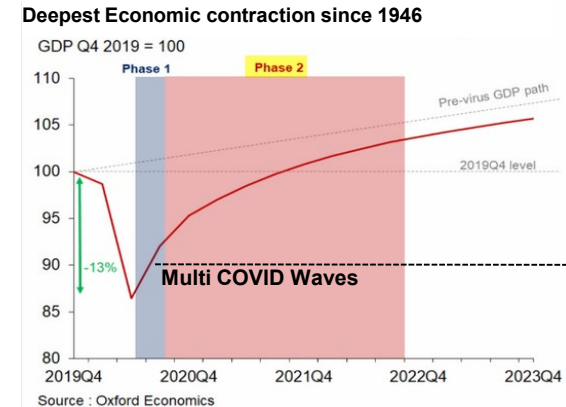


The 90% Economy

No mass economic shutdown, but rolling restrictions



A 90% Economy will likely be a byproduct of the surge in outbreaks at each level of opening up



A second wave will put a ceiling on the economic recovery, likely creating a pullback, which is quite normal

Pullbacks Are Normal After Major Lows Are In Place

S&P 500 Index Drawdowns After Rally Off Lows

Major Bear Market Low	Initial Rally Off Lows	Length of Rally (Days)	First Drawdown
October 1957	7.0%	26	-5.5%
June 1962	14.3%	40	-10.5%
May 1970	13.3%	6	-9.3%
October 1974	20.8%	25	-13.6%
August 1982	23.7%	31	-5.0%
October 1987	14.9%	2	-14.7%
October 1990	13.4%	39	-7.4%
October 2002	24.2%	36	-17.3%
March 2009	43.4%	67	-9.1%
March 2020	44.5%	53*	?
Average	21.9%	30	-10.3%
Median	17.9%	31	-9.3%

Source: LPL Research, Strategas 05/11/2020

* Current rally is still active

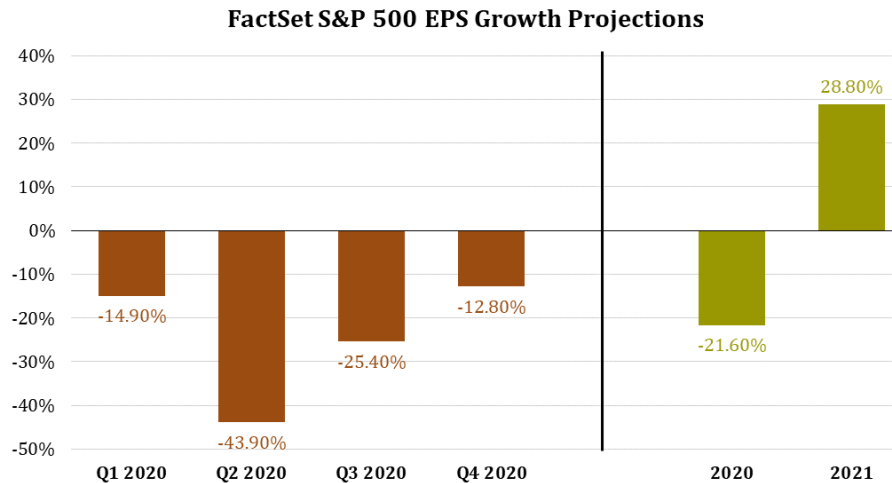
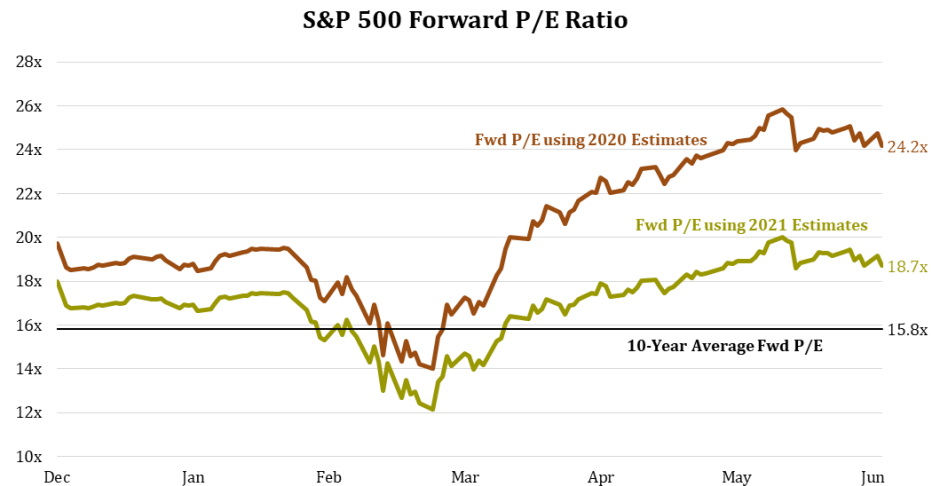
Data Sources: [University of Essex](#), [University of Minnesota](#), [Oxford Economics](#), [LPL Research](#)

Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

Does the “E” Matter in 2020?

A Race for Survival to 2021

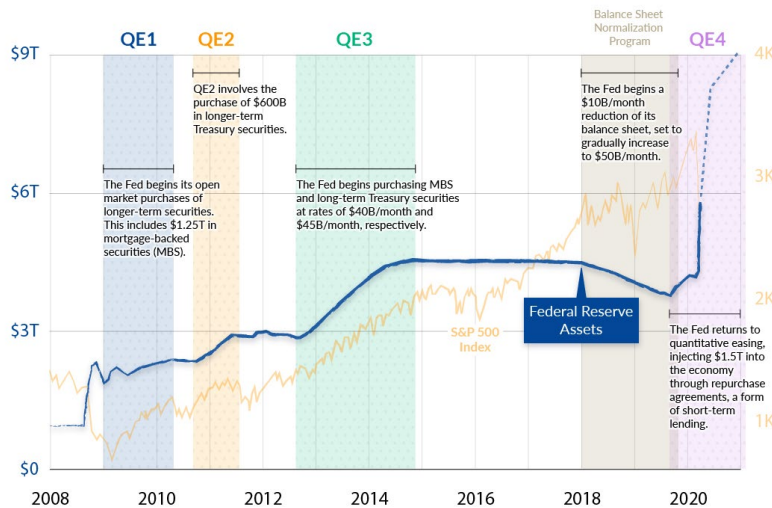
- ❑ Investors have discounted a 2020 earnings depression



- ❑ They have also likely discounted a 2021 earnings recovery

Stimulus – The U.S. Economic Safety Net

TOTAL ASSETS OF THE U.S. FEDERAL RESERVE



Sources: Federal Reserve, CNBC
 Projected future assets based on BoFA Global Research

- ❑ Moral hazard – while distinctive – is the new normal for the Fed and Congress
- ❑ Any significant threat to consumption will be met with more monetary and fiscal policy
- ❑ Potential threats include:
 - ❑ Job losses
 - ❑ Wage contractions
 - ❑ Equity markets retesting the March lows
 - ❑ Credit market bottlenecks
 - ❑ Widespread COVID shutdowns

Federal Spending in Response to Coronavirus

Amount (\$ bn)	Measure
\$293	One-time recovery rebates checks amounting to \$1,200 per adult and \$500 per child up to certain income limits
\$268	Boost to unemployment benefits, adding \$600 per week to every check until July 31st, expanding program to cover contractors and self-employed and extending program from 26 weeks to 39 weeks
\$27	Grants to airlines and businesses deemed important for national security. Non-forgivable loans through Fed are excluded as they are assumed to be repaid
\$760	Small business relief, mostly "forgivable loans" for spending on payroll, rent and utilities
\$150	Direct aid to state and local governments
\$425	Health-related spending
\$517	Other spending and tax breaks
\$2.441 trillion	~11.8% of GDP

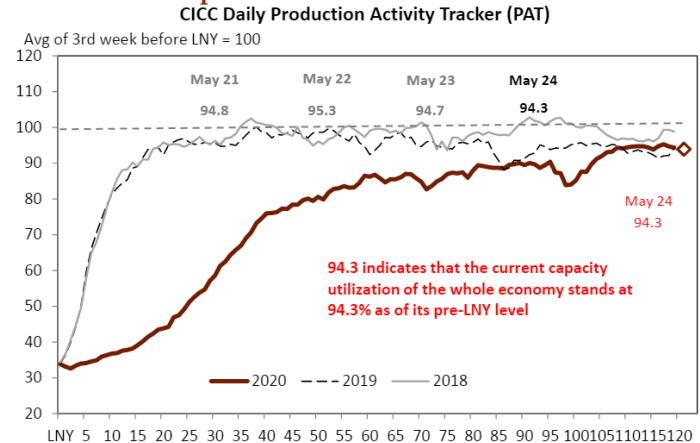
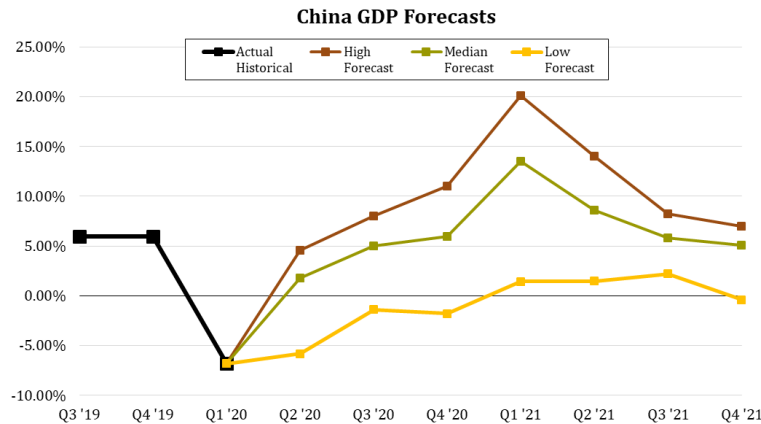
Goldman Sachs Expectations for Future Stimulus

	FY2020	FY2021	FY2022	FY2023	CY2020	CY2021	CY2022	CY2023
Phase 4 (GS Expectations)								
State fiscal aid	100	100	-	-	200	50	-	-
Unemployment insurance: broadened eligibility	-	15	16	13	-	19	15	13
Unemployment insurance: extended duration	-	80	95	94	-	104	95	94
Unemployment insurance: extra \$300/wk through Dec. 2020	57	58	-	-	115	-	-	-
Payments to individuals	270	150	-	-	270	-	-	-
Additional business support	-	-	-	-	200	-	-	-
Additional federal spending	-	150	200	-	-	150	75	-
Infrastructure	-	25	35	40	-	25	35	40
Total	427	578	346	147	785	348	220	147
Total, enacted and expected (\$bn)	2691	1053	222	-4	3381	331	85	165
Total, enacted and expected (% of GDP)	13.0	4.9	1.0	0.0	16.5	1.5	0.4	0.7

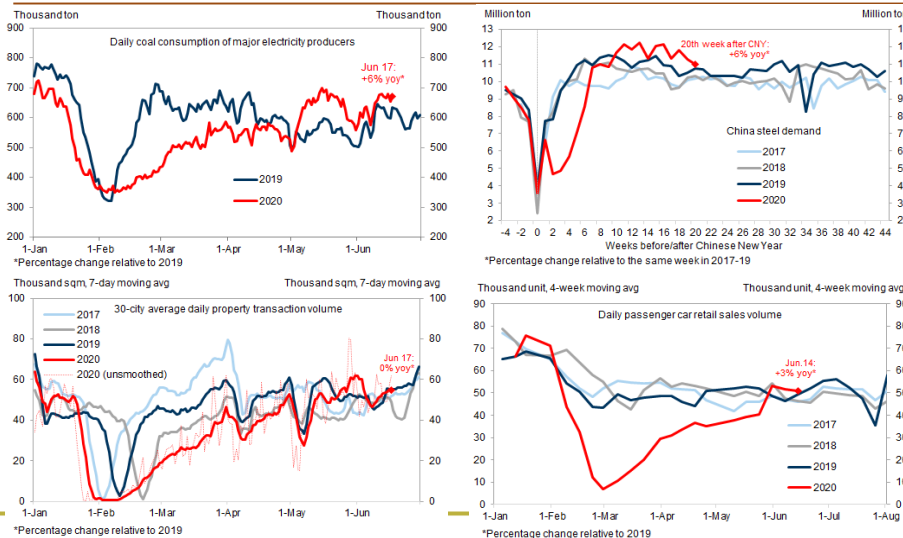
* We have adjusted CBO's initial estimate to assume a greater portion of funds paid in 2020

Emerging Markets – A Focus on China

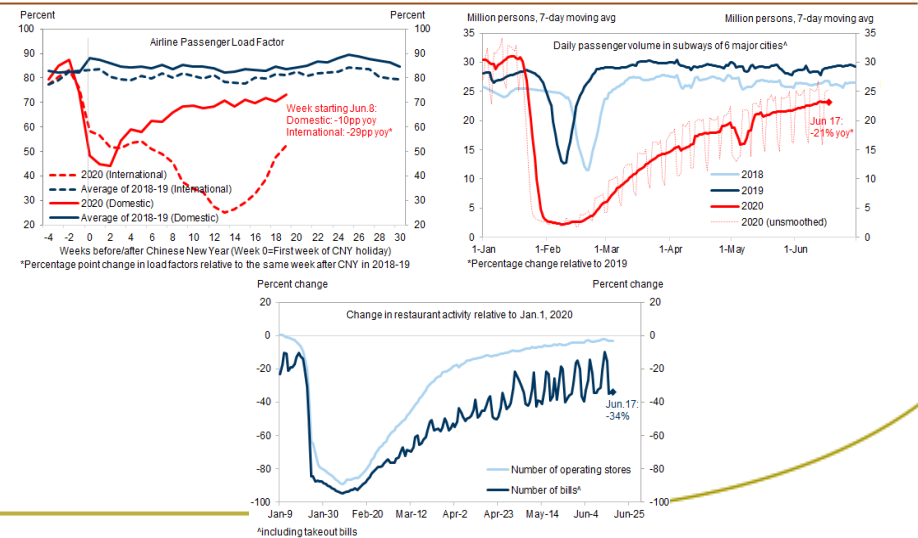
Chinese economic recovery has been V-shaped thus far



What's Back to Normal



What's Not Back To Normal



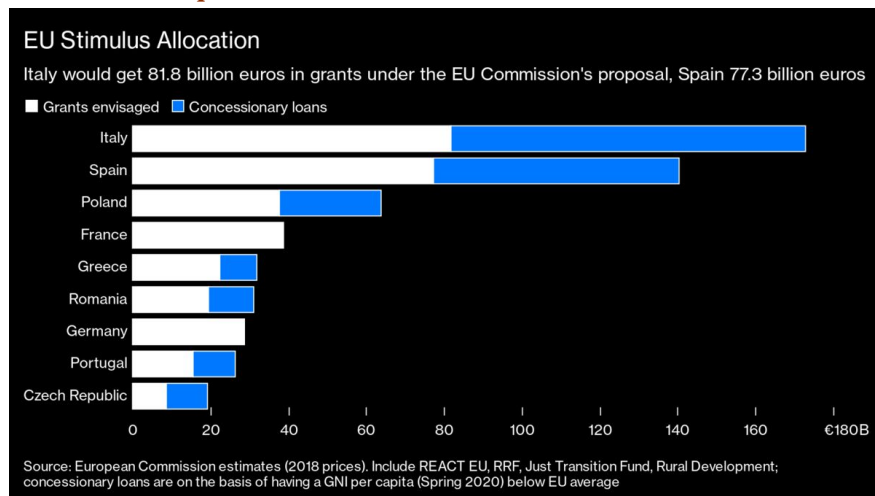
Data Sources: Bloomberg, CICC, Goldman Sachs

Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

Developed Markets – Focus on EU

Monetary Union to Fiscal Union?

European Union Stimulus Plan Details



- ❑ Proposed package value of €750 billion (\$853 billion)
- ❑ Goal is to distribute €500 billion euros in grants and €250 billion in loans to countries and sectors hit hardest by COVID-19
- ❑ Distribution would be set to begin in January 2021 and last through December 2024
- ❑ Largest fiscal stimulus in Europe (far larger than post-World War II)
- ❑ Proposed package would need unanimous support from all 27 members.

Three Main Problems

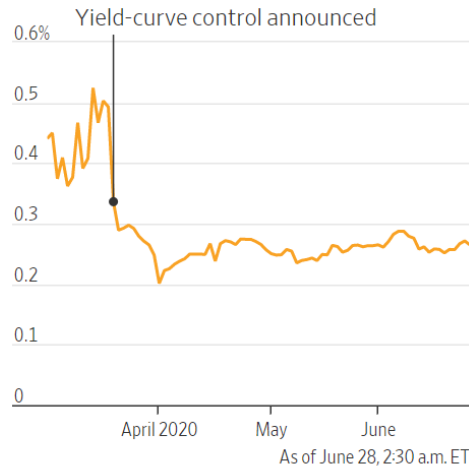
- ❑ **Some nations do not agree with the idea**
 - ❑ The commissioner has never tapped markets in such large proportion
 - ❑ Four countries not in support (Austria, Netherlands, Denmark, and Sweden)
 - ❑ Many citizens worry that their tax contributions will be used in other countries
- ❑ **How to calculate the distribution of funds**
 - ❑ Any method of calculation would be met with resistance by one or more members.
- ❑ **The 27 countries must discuss the plan**
 - ❑ Leaders must decide how they will monitor funds
 - ❑ Some do not want to agree because countries like the Czech Republic and Hungary have been accused of misusing EU money
 - ❑ Finding a way for 27 different countries looking out for themselves to come to an agreement is challenging
- ❑ **The European Fund is unlikely to pass in its current format**

Interest Rates = Much Lower for Much Longer

Global Interest Rates Forecasts: 10-Year Gov Yield %

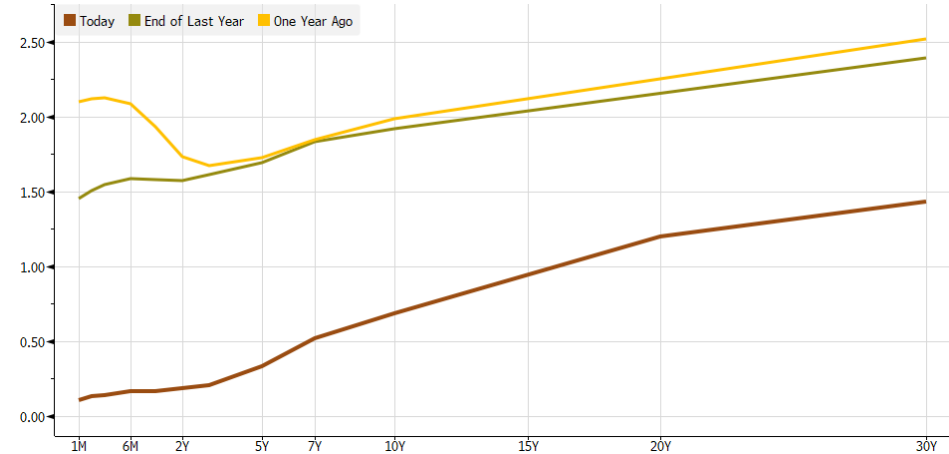
Country	2017	2018	2019	Forecast	
				2020	2021
Australia	2.63	2.32	1.37	0.87	1.07
Brazil	10.26	9.23	6.79	7.25	6.00
China	3.90	3.31	3.14	2.70	2.88
Germany	0.42	0.24	-0.19	-0.38	-0.14
Italy	2.01	2.74	1.41	1.29	1.20
Japan	0.05	0.00	-0.01	-0.02	0.02
Switzerland	-0.18	-0.28	-0.50	-0.46	-0.36
United Kingdom	1.19	1.27	0.82	0.38	0.70
United States	2.41	2.69	1.92	0.94	1.34

Australia's three-year government bond yield



Source: Tullett Prebon

U.S. Yield Curve

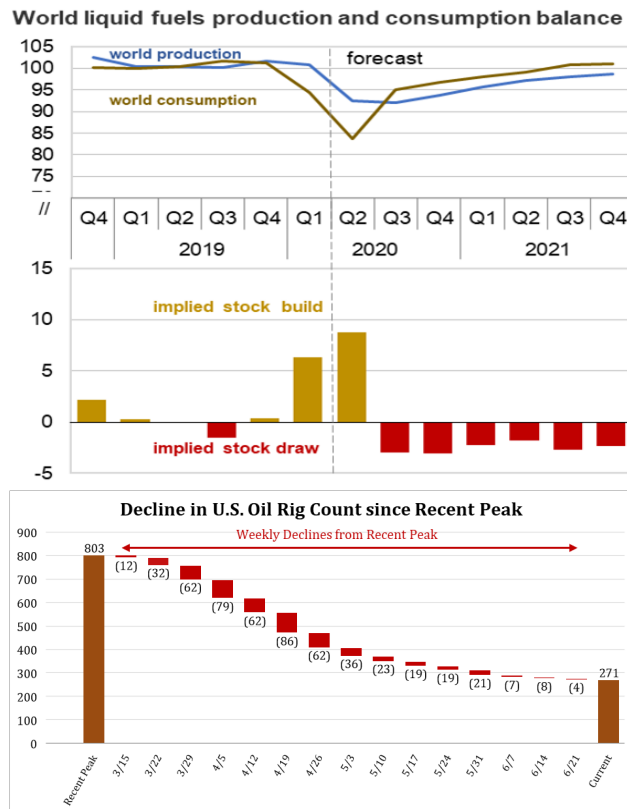


Fed Yield Curve Management

- ❑ Yield curve control has appeared likely since last year to emerge from the Fed's framework review as the key new addition to its toolkit
- ❑ Analysts expect the Fed's version to cap front-end rather than back-end rates
- ❑ Under the current environment, this tool would probably not add much beyond providing the market with certainty, as St. Louis Fed President Bullard noted at the end of May, unless the controls extended far out the curve, offering implicit guidance at a very distant horizon

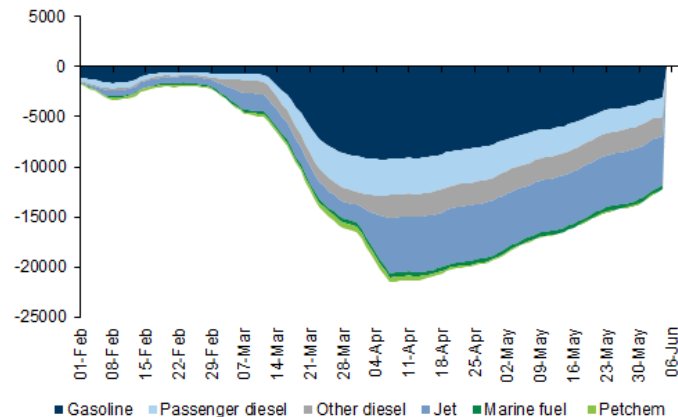
Special Note on Energy

Supply Constraints on Oil



- ❑ Production is expected to increase through the summer as shut-in wells are brought back online
 - ❑ Both North American shale and Libyan shut-in production are currently restarting

Demand Returning



Projected Outlook for Major Oil Consuming Countries

Country	% of World Consumption	Consumption Growth (Mil. barrels per day)			Projected 2-Yr Growth Rate
		2019	2020	2021	
China	15%	0.5	-0.9	1.7	5.5%
United States	20%	0.0	-2.4	1.4	-4.9%
India	5%	0.1	-0.2	0.5	6.5%

- ❑ Demand continues to recover, but remains well below normal levels
- ❑ China has continued its V-shaped recovery, with implied demand increasing although some of this can be attributed to large stockpiling
- ❑ Expectations are for oil to remain between \$35 and \$50/bbl through the midpoint of 2021

Data Sources: [U.S. Energy Information Administration](#), [Baker Hughes](#), [Goldman Sachs](#)

Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

The Policy of Politics

- ❑ Since 1944, if the S&P 500 rose in price from July 31 through October 31 of a presidential election year, the incumbent party was re-elected 80% of the time. This was the case in 2012 when President Barack Obama was re-elected. If the market is down during the period, the incumbent party lost the White House 86% of the time.

President	Start	End	DJIA Percent Change (%)	
			Percent Change (%)	Annualized Return (%)
T. Roosevelt	9/14/1901	3/4/1909	21.6	2.7
Taft	3/4/1909	3/4/1913	-1.3	-0.3
Wilson	3/4/1913	3/4/1921	-6.9	-0.9
Harding	3/4/1921	8/2/1923	17.4	6.9
Coolidge	8/2/1923	3/4/1929	255.9	25.5
Hoover	3/4/1929	3/4/1933	-82.8	-35.6
FDR	3/4/1933	4/12/1945	194.4	9.3
Truman	4/12/1945	1/20/1953	81.7	8.0
Eisenhower	1/20/1953	1/20/1961	120.3	10.4
JFK	1/20/1961	11/22/1963	12.2	4.1
Johnson	11/22/1963	1/20/1969	30.9	5.3
Nixon	1/20/1969	8/9/1974	-16.5	-3.2
Ford	8/9/1974	1/20/1977	23.4	8.9
Carter	1/20/1977	1/20/1981	-0.9	-0.2
Reagan	1/20/1981	1/20/1989	135.1	11.3
Bush I	1/20/1989	1/20/1993	45.0	9.7
Clinton	1/20/1993	1/20/2001	226.6	15.9
Bush II	1/20/2001	1/20/2009	-24.9	-3.5
Obama	1/20/2009	1/20/2017	149.4	12.1
Trump	1/20/2017	12/31/2019	54.3	15.9
Average			61.7	5.1
Average Republican			45.6	4.1
Average Democratic			85.9	6.7

- ❑ Trump administration will do whatever it takes to try and support equity prices.
- ❑ The president is hyper focused on the stock market, he has tweeted about the economy/stock market 120 times since the beginning of 2020

Election Policy & Politics

- Bipartisan approach to spending
- Limited fiscal constraints
- Anti-China rhetoric tests limits on trade, but likely little in the way of action
- Tax Policy and deficit reduction not addressed until 2022
- Billionaire tax used as political football during campaign season
- Ongoing rhetoric on multi-nationalism, the U.S. bureaucracy, and law and order

Mean Reversion Dashboard

Style Current P/E as a % of 20-Yr Avg. P/E

	Value	Blend	Growth
Large	124.1%	135.0%	147.6%
Mid	124.4%	140.5%	161.0%
Small	141.3%	192.7%	279.0%

Regional Fwd. P/E as a % of 10-Yr Avg. Fwd. P/E

ACWI	EAFE Index	EM Index	United States	Germany	United Kingdom	China	Brazil	India	Russia
133.7%	130.2%	126.7%	136.7%	139.9%	121.4%	132.0%	141.6%	130.5%	146.3%

Sector Fwd. P/E as a % of 20-Yr Avg. P/E

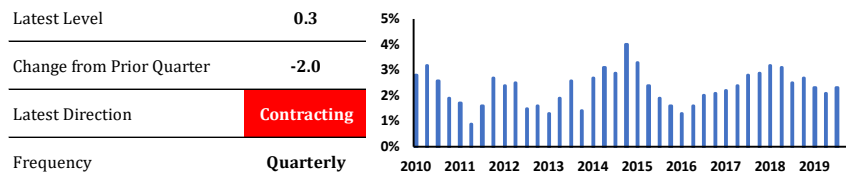
Energy	Materials	Industrials	Consumer Discretionary	Consumer Staples	Health Care	Financials	Technology	Telecom	Utilities	Real Estate
515.2%	129.4%	146.6%	198.0%	112.4%	98.8%	109.9%	146.3%	124.1%	113.9%	111.9%

Data Source: Bloomberg

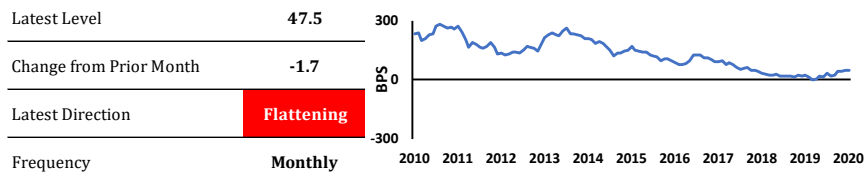
Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

Economic Dashboard

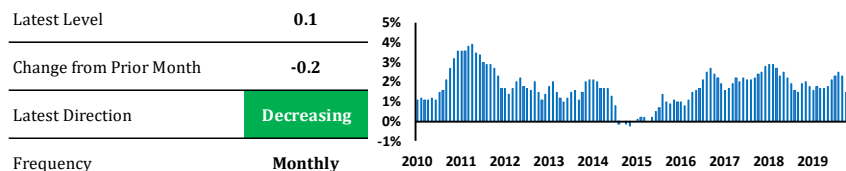
U.S. GDP Growth as of 3/31/2020



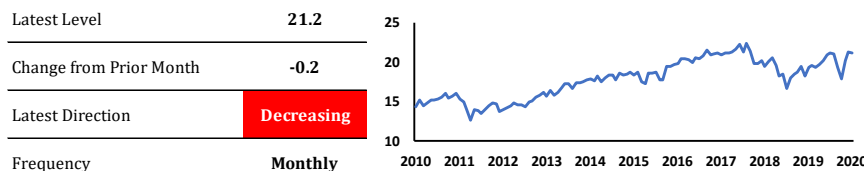
U.S. Treasury Spread 2-Yr vs. 10-Yr Spread as of 6/30/2020



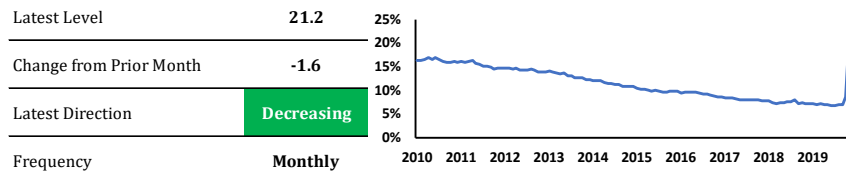
U.S. Inflation as of 5/31/2020



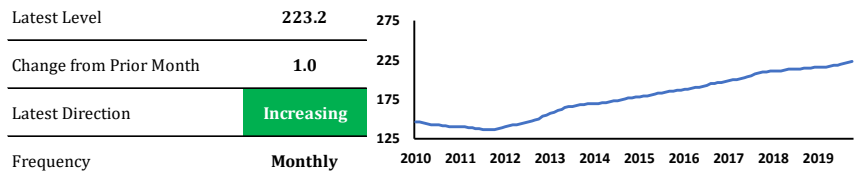
S&P 500 Trailing P/E Ratio as of 6/30/2020



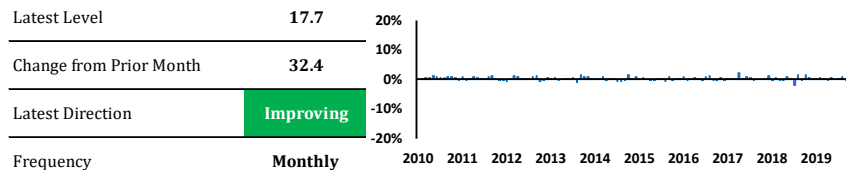
U.S. U-6 Unemployment Rate as of 5/31/2020



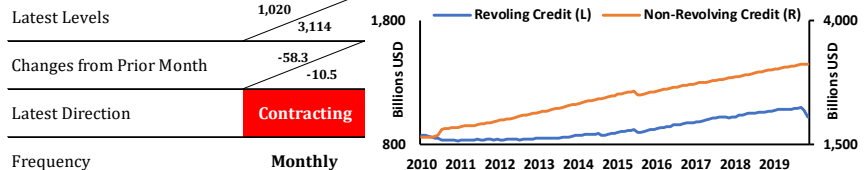
Schiller Home Value Index as of 3/31/2020



Retail Sales as of 5/31/2020



Credit: Revolving / Non-Revolver as of 4/30/2020



Our View and Recommendations

Our View

- ❑ Trump administration will use all tools necessary with no regard to deficits in order to mitigate the short-term damage of COVID-19
- ❑ Extreme volatility will persist until such time as corporate cash flows can be approximated
- ❑ China will continue to lead the world out of this economic crisis by having the best testing, tracing, and COVID management systems
- ❑ Equity valuations may be susceptible to any 2021 earnings revisions and threats to 2020 COVID rolling restrictions that limit the recovery in GDP to below 80%
- ❑ Interest rates will remain much lower (near zero) for much longer, perhaps for many years to come, to compensate for any threat of deflation
- ❑ Congress will pass a fifth round of stimulus before the August recess to support the broader economy as well as those needing an additional bridge to economic recovery

Recommendations

- ❑ Rebalance Rebalance Rebalance. Focus on using multiple time periods to rebalance portfolios back to targets
- ❑ Review planning and spending to align with revised capital market and portfolio return expectations
- ❑ Increase exposure to China as a diversifier to both the United States and general Emerging Markets exposure
- ❑ Rebalance back to target weights in Small Cap and Mid Cap as they represent better valuations
- ❑ Stress test portfolios against the COVID lows to determine your willingness to ride out the likely storms to the economy and U.S. equity prices

Strategy Update

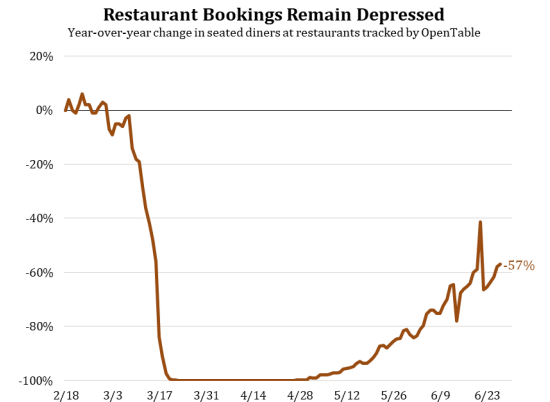
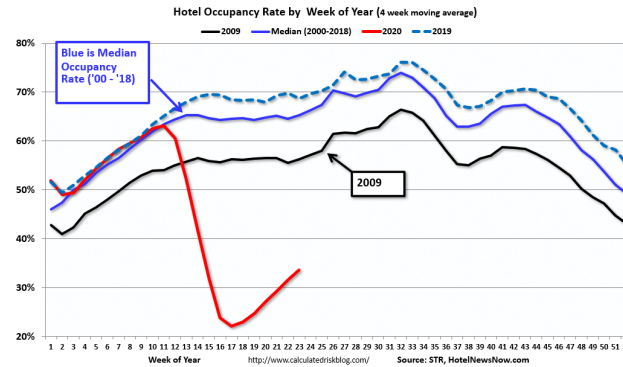
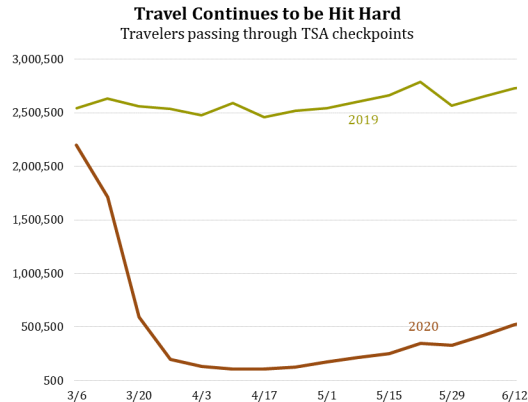
- ❑ Review of upcoming policy changes from leading Washington, DC lobbyists
- ❑ Discussion with Arthur Laffer—best known as a member of Reagan's Economic Policy Advisory Board and creator of the Laffer Curve—to help review long term implications from debt and inflation

Bruises & Scars

The impact of the economic shutdown will certainly leave bruises and scars on our economy

Likely Bruises

Hotel Occupancy Rates



Potential Scars

- Credit downgrade of the United States
- Higher taxes
- Structural shifts in commercial real estate usage
- Migration patterns to smaller urban centers

Data Sources: [Transportation Security Administration](#), [STR Inc.](#), [OpenTable](#)

Data is from sources deemed to be reliable. No representation or warranties either expressed or implied are made as to the accuracy of the information presented.

THANK YOU

tphillips@phillipsandco.com

Data Sources

Consumer Strength | Slide 3

- ❑ https://bfi.uchicago.edu/wp-content/uploads/BFI_WP_202062-1.pdf
- ❑ <https://fred.stlouisfed.org/series/CES0500000003>
- ❑ <https://fred.stlouisfed.org/series/TDSP>
- ❑ <https://fred.stlouisfed.org/series/DSPIC96>

A World of Cash | Slide 4

- ❑ <https://fred.stlouisfed.org/series/PSAVERT>
- ❑ <https://fred.stlouisfed.org/series/WRMFSL>
- ❑ <https://fred.stlouisfed.org/series/WIMFNS>
- ❑ <https://fred.stlouisfed.org/series/DPSACBW027SBOG>

Animal Spirits | Slide 5

- ❑ <https://www.statista.com/chart/22054/readiness-to-return-to-normal-after-coronavirus/>

A Quick Recession | Slide 6

- ❑ <https://fred.stlouisfed.org/series/RRSFS>
- ❑ <https://fred.stlouisfed.org/series/RSFSDP>
- ❑ <https://fred.stlouisfed.org/series/TOTALSA>
- ❑ <https://fred.stlouisfed.org/series/HSN1F>

The 90% Economy | Slide 7

- ❑ http://www.histpop.org/resources/pngs/0558/00200/00042_24bit_20.png
- ❑ <https://www.cidrap.umn.edu/covid-19>
- ❑ <https://www.oxfordeconomics.com/my-oxford/publications/555478>
- ❑ <https://lplresearch.com/2020/06/12/is-this-the-start-of-a-new-bear-market/>

Does the “E” Matter in 2020? | Slide 8

- ❑ [https://www.factset.com/hubfs/Resources Section/Research Desk/Earnings Insight/EarningsInsight_062620.pdf](https://www.factset.com/hubfs/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_062620.pdf)

Stimulus – The U.S. Economic Safety Net | Slide 9

- ❑ <https://www.visualcapitalist.com/the-feds-balance-sheet-the-other-exponential-curve/>
- ❑ <https://am.jpmorgan.com/us/en/asset-management/gim/adv/insights/guide-to-the-markets>
- ❑ <https://research.gs.com/>

Emerging Markets – A Focus on China | Slide 10

- ❑ <https://research.cicc.com/>
- ❑ <https://research.gs.com/>

Developed Markets – Focus on EU | Slide 11

- ❑ <https://www.europarl.europa.eu/news/en/headlines/economy/20200513ST079012/covid-19-the-eu-plan-for-the-economic-recovery>

Interest Rates = Much Lower for Much Longer | Slide 12

- ❑ <https://www.wsj.com/articles/fed-looks-down-under-for-rate-strategy-11593352810>

Special Note on Energy | Slide 13

- ❑ <https://www.eia.gov/outlooks/steo/data.php>
- ❑ <https://rigcount.bakerhughes.com/rig-count-overview>
- ❑ <https://research.gs.com/>

The Policy of Politics | Slide 14

- ❑ <https://www.bloomberg.com/quote/INDU:IND>

Bruises & Scars | Slide 18

- ❑ <https://www.tsa.gov/coronavirus/passenger-throughput>
- ❑ <https://str.com/data-insights-blog/coronavirus-hotel-industry-data-news>
- ❑ <https://www.opentable.com/state-of-industry>