MARKET Insights

July 2020

Season of disconnect: **The stock market and the economy**

We continue to actively invest in the time of COVID-19. Webster Bank and businesses around the world have shown great ability to adapt to the current environment. As we slowly begin to reopen, these are the key takeaways for the quarter:

- Global equities continued to rebound from the lows of March.
- There appears to be a disconnect between the economic recovery and the market recovery. GDP is forecast to contract **40%,** while the S&P 500 has rebounded over **39%** since the low of March 23, 2020.
- Long-term investors should stay the course but expect a bumpy ride as COVID-19 cases reaccelerate.

Capital markets review

The global equity markets continued to climb in the second quarter of 2020. Investors who stayed the course were rewarded. The technology sector, as measured by the NASDAQ composite, reached an all-time high during the quarter and was up 30.9%. Corporate bonds continued to rally as the Federal Reserve vowed to maintain liquidity in the market by buying corporate bonds and keeping rates low.

The quarter was marked by investor optimism as states began to reopen. Volatility remained elevated as investors digested positive and negative developments that emerged over the quarter regarding the unemployment rate, the spread of COVID-19, and the economy.

CAPITAL MARKETS

	Asset Class	Index	June 2020	Q2 2020	YTD
Equity	US Large Cap	S&P 500	1.99	20.54	-3.08
	US Small Cap	Russell 2000	3.53	25.42	-12.98
	International Developed	MSCI EAFE	3.40	14.88	-11.34
	Emerging Markets	MSCI EM	7.35	18.08	-9.78
Fixed Income	US Investment Grade	Barclays US Agg	0.63	2.90	6.14
	US Inflation-Indexed	Barclays US TIPS	1.12	4.24	6.01
	US High Yield	BBgBarc US Corp High Yield	0.98	10.18	-3.80
	EM US$ Debt	JPM Emerging Mkts Bond Global	3.51	12.26	-2.76
Alternative	Absolute Return	Credit Suisse Equity Mkt Neutral	-0.19	-1.72	-3.89

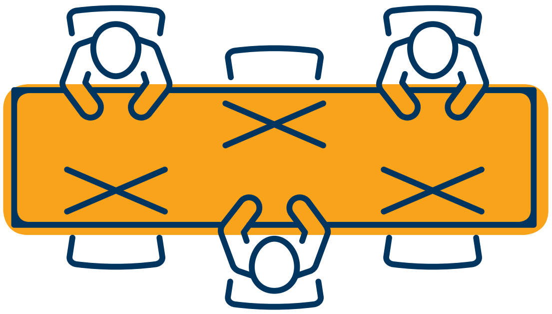
Data delayed. Earnings uncertain.

Oftentimes, we find that economic data and stock market data are out of sync. Many say the stock market is not the economy and the economy is not the stock market. At Webster, we believe the economy is not the stock market; however, economic data and market data should be used in our assessment of investment opportunities. With many companies suspending earnings guidance for the second quarter, much of the economic and corporate earnings data that we rely on is unavailable or not up to date.

Economic data is delayed and often restated. It can take months to know where the economy stands today. In normal times, these values change gradually, and we can follow the trend. The shutdown and slow restart of the economy have caused significant changes that are difficult to estimate, which should make for an interesting reporting season in Q2. Many companies have stopped providing guidance or forecasts of their current and future earnings. This information void has resulted in a wide range of potential forecasts. We expect high volatility as companies report Q2 earnings.

Will the unemployed be redeployed?

It has been estimated that as much as 80% of the newly unemployed come from service industries. In theory, service employees can be rehired more quickly than most other workers. The challenge is gauging how many jobs will become available.



Airlines, hotels, restaurants, and other entertainment venues are far from operating at full capacity. It's hard to imagine them reaching full capacity for the foreseeable future. Further, we do not know the extent of business casualties. How many restaurants and shops will never reopen? GNC, Neiman Marcus, Chuck E. Cheese, and J. Crew are a few of the firms that are in the process of bankruptcy.

Real-time data suggests gradual recovery.

The rapid U.S. stock market recovery seems to imply investors believe the economy will recover quickly. Much of the data we are analyzing does not support this view. The economy is clearly recovering, but we expect the pace to be gradual.

We have found higher frequency data to provide us with some sense of the recovery in real time. For example, the TSA provides daily data on the number of travelers that pass through security check points across the nation. On June 23, 2020, 471,421 travelers passed through TSA checkpoints. On April 14, 2020, only 87,534 passengers passed through check points. While a significant increase, the June 23, 2020, numbers are well below the previous year's 2,506,510 travelers (on the same day of the week).

OpenTable, a restaurant reservation app, is another source of real-time data. As of June 20, 2020, the number of seated diners is down **60%** nationally and **88%** in New York City versus a year ago. It is important to note that these only include restaurants that have chosen to reopen. The numbers would be higher if all restaurants were included. Not surprisingly, hotel occupancy and movie box office ticket sales also show significant year-over-year declines.

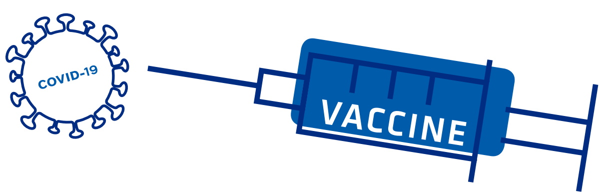
Not all industries have been hit equally hard, and there are reasons to be cautiously optimistic, despite recent evidence of a second wave of new COVID-19 cases. For all of the negative news in the retail, entertainment, and travel industries, the contribution to S&P 500 operating earnings is about 7% (*Source: JPMorgan Asset Management, Guide to the Markets, March 31, 2020*). So the impact to GDP may not be as drastic as everyday life feels in 2020. Some companies are actually thriving, and innovation is alive and well. Once the pandemic runs its course, many changes are expected. New industries will emerge. Existing industries will adapt. It is challenging in these dark times to see the light at the end of the tunnel, but some changes will be for the better.

2020 Investment themes revisited

As we typically do in our midyear review, let's take a look at the investment themes we laid out at the beginning of the year and revised as COVID-19 changed the script at the end of the first quarter:

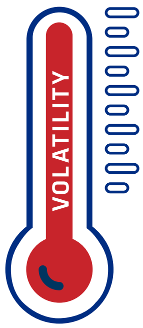
THEME 1: Recession and then Recovery

Second quarter GDP will, no doubt, be negative. Congressional Budget Office estimates are currently in the **-40%** range. After a **-5%** decline in real Q1 GDP, we will officially be in a recession. At the start of the third quarter, we now anticipate a slow recovery and then a surge. We appear to be entering this recovery



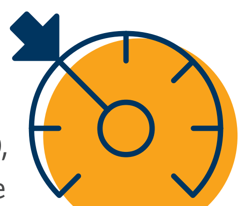
stage slowly, and with some trepidation. We cannot reliably estimate the current rate of recovery or the extent of the drop in Q2 GDP. We do not expect a full economic recovery in 2020. Many forecasters are predicting that will occur in late 2021 or early 2022. We believe that at some point, pent up consumer demand and corporate investment will accelerate the recovery, barring an acceleration of recent "second wave" conditions affecting states that were early to reopen their economies. Most importantly, a COVID-19 vaccine that is accessible to a large portion of the global population will be a necessary condition for the surge.

THEME 2: Global Pandemics Make for Volatile Markets



This theme remains largely unchanged. While we do not expect a return to the record-breaking levels of risk that we reached on March 16, 2020, as measured by the CBOE Market Volatility Index, we do expect volatility to remain above average as investors react to new information. Volatility can bring the best and worst days for the stock market. From 1900 to 2013, the best 20 trading days in the S&P occurred during the Great Depression (17 days), a few days after the 1987 market crash (one day), and during the 2008 financial crisis (two days). This is an important reason to stay the course; timing the stops and starts in this environment is likely to prove difficult.

THEME 3: Range-Bound Rates



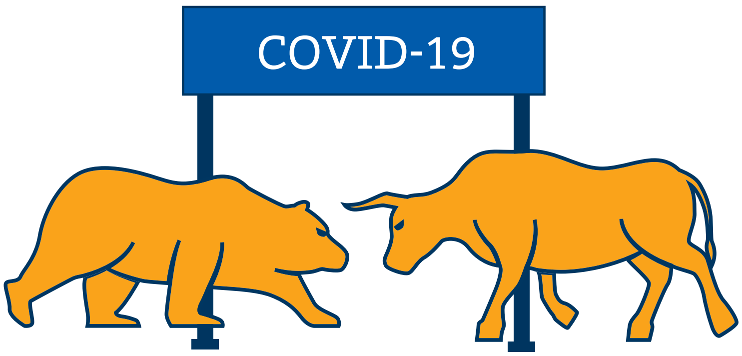
Only a small adjustment to this theme: we now expect range-bound rates to be on cruise control. On April 1, 2020, two-year Treasury yields were **0.23%** and ten-year Treasury yields were **0.62%**. On June 24, 2020, two-year Treasury yields were **0.19%** and 10-year Treasuries were **0.69%.** The Federal Reserve continues to use its entire arsenal to maintain liquidity and to keep borrowing costs low. In fact, in its latest policy meeting, the Federal Reserve indicated it sees very little chance of raising rates until at least 2022.

Portfolio adjustments

We felt well positioned entering the second quarter. We only made minor adjustments to client portfolios and largely rode the wave of the market rebound. There were opportunities in some accounts to harvest tax losses, while the large market swings caused us to rebalance many of our client portfolios back to their targets, based on each client's investment objectives. We expect to continue to prudently rebalance positions that have become overweight in Q3.

Outlook and positioning

These are truly unprecedented times. We are faced with both bearish and bullish signals emerging daily. Portfolio construction, at its core, is risk management. Our diversified approach to investing enables investors



to focus on long-term performance while mitigating short-term risk. Our portfolios were designed to weather unforeseen economic shocks. As we discussed in our last quarterly Market Insights, this shock was unique because it was caused by an exogenous event. It was not caused by underlying economic weakness or equity market fundamentals. The market decline and subsequent rebound broke several records for the speed and magnitude of price movements.

A look back as we look ahead

We have spent time over the past several months studying historical market corrections and recessions. Each of these periods in history is unique, but they all share a few important similarities: after an initial low in the "meltdown" phase, equity markets tend to rebound sharply, but retest the low once or twice due to fears of recession. Historically, this pattern is followed by a sustained bull market once stimulus has been deployed to fuel a recovery. Eventually, both the stock market and global economy recover. This is an important point as we look to help our clients achieve their long-term goals.

While the disconnect between the economic outlook and the equity market's rise will create headwinds for the global markets in Q3 and beyond, we maintain a neutral weight to equities due to the magnitude of the fiscal and monetary response already deployed by central banks around the world. They have learned from the 2008-2009 global financial crisis and responded more swiftly and with greater force in 2020.

Prepare for volatility ahead

That is not to say we are out of the woods,. We expect volatility to remain elevated as investors react to an uncertain earnings season and news of the pandemic's impact on economic recovery.

Portfolio positioning is critical during periods of market volatility, and we take an active approach to managing portfolios. We

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continually seek new investment opportunities to enhance returns and reduce risk, looking for attractively priced assets that have future growth potential. We do not chase performance or the latest investing fad.

Despite attractive valuations in the foreign equity markets, we remain underweight in foreign developed and emerging market equities and overweight in U.S. equities. The Federal Reserve's commitment to do anything and everything to support the economy and high levels of cash on the sidelines are both bullish indicators for U.S. equities as we lead up to the U.S. presidential election. History has shown that in the 23 presidential election years that have occurred from 1928 to 2016, 83% (19 out of 23) ended the year positively.

Within the U.S. equity markets, we are overweight in high-quality, large companies and technology companies that are better able to adapt to the disruption caused by the pandemic. We are underweight in fixed income and underweight in government bonds within fixed income. Yields for government bonds are not compelling at this time. We prefer corporate debt for its higher yield and upside potential as credit spreads (the yield differential between government and corporate bonds) narrow to historical levels.

RELATIVE WEIGHTINGS BASED ON OUTLOOK

	Underweight	Neutral	Overweight
Equities		✓	
Foreign Developed & Emerging Markets	✓		
U.S. Equities			✓
Fixed Income	✓		
Government Bonds	✓		
Alternative Investments			✓

We are overweight in alternative investments due to their lower correlation to traditional stocks and bonds, as well as their ability to make tactical adjustments. The asset class has proven to be a useful tool in risk management. They also have higher prospects for growth than bonds.

The global markets got sucker punched this year by the pandemic. Thankfully, the equity markets and the economy were on solid footing. The economic recovery will take some time, but long-term investors should maintain their allocations to global equities.

As always, please don't hesitate to reach out to your contacts at Webster Private Bank if you have any questions. It is a pleasure to serve you during these difficult times, and we appreciate the trust you have placed in us.

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