MONTH IN REVIEW

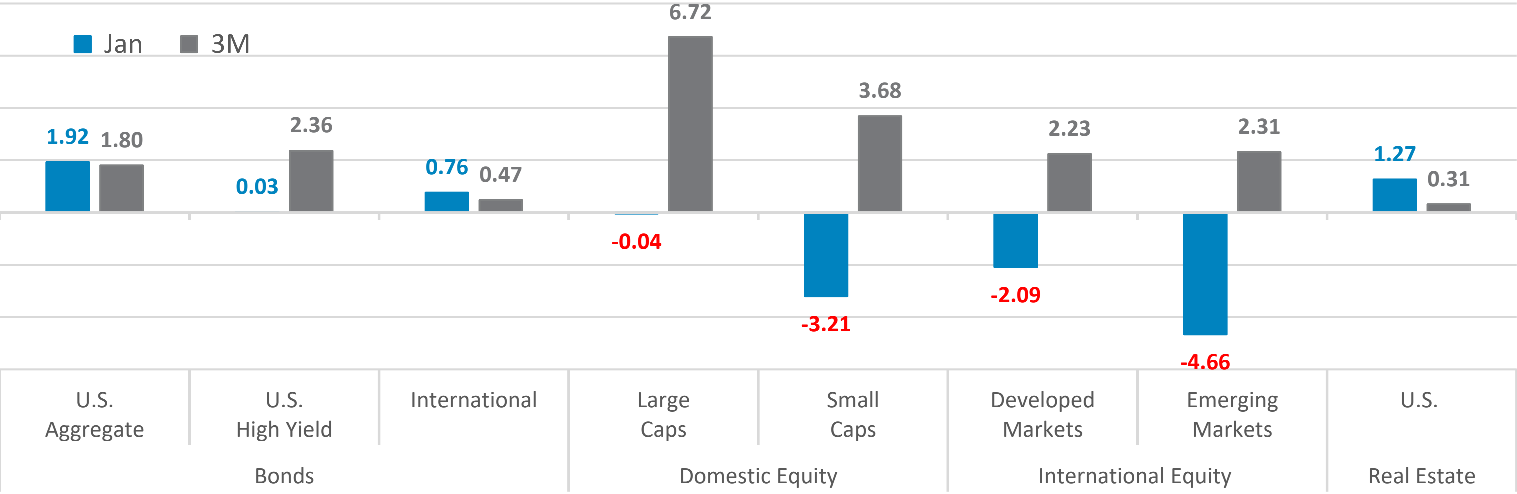
January 2020

Quick Takes

- **Tale of two markets.** January was a contrast of two halves. Nine of the first 12 trading days were positive and the index was up +3.1% through January 17th. But it managed just 4 positive days in the last nine trading days, with two days down more than -1.5% each, and finished down -0.04% (total return).
- **Return of volatility.** For the first three weeks of the month the Cboe Volatility Index (VIX) was 14 or less. But with the coronavirus scare it averaged 16.6 the last week of January and closed the month at its highest level, 18.8, since October 8, 2019.
- **Coronavirus contagion.** The primary catalyst for the stark market reversal in the back half of January was all about the coronavirus epidemic, emanating from Wuhan, China. By January 23, the reported death toll neared 20, with more than 500 infections, and Wuhan was placed under quarantine.
- **Bottom third, but not that bad.** The S&P 500's January loss of -0.04% (total return) ranks in the bottom 34% of monthly returns over the trailing 40 years. But for basically being bottom third historically, and flat, it wasn't that bad of a result. The average 40-year monthly total return was +1.0%.

Asset Class Performance

After a stellar 2019, global equities got off to a quick start in 2020 before coronavirus concerns and volatility took over in the back half of January. Headlines reporting the alarmingly quick rise in coronavirus deaths and infections in China wore on markets and by January 30 the World Health Organization declared coronavirus a global emergency.



Source: Bloomberg, as of January 31, 2020. Asset-class performance is presented by using total returns for an index proxy that best represents the respective broad asset class. U.S. Bonds (Barclays U.S. Aggregate Bond TR), U.S. High Yield (Barclays U.S. HY 2% Issuer-Capped TR), International Bonds (Barclays Global Aggregate ex USD TR), Large Caps (S&P 500 TR), Small Caps (Russell 2000 TR), Developed Markets (MSCI EAFE NR USD), Emerging Markets (MSCI EM NR USD), Real Estate (FTSE NAREIT All Equity REITS TR).

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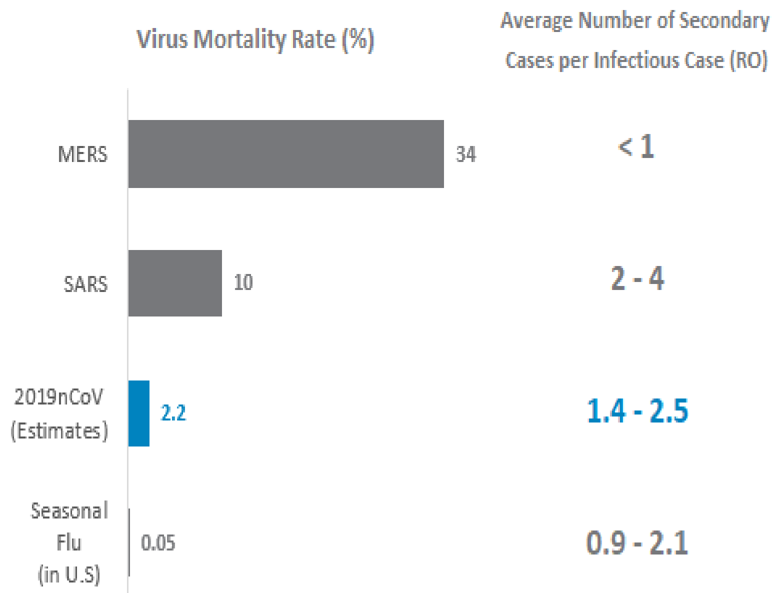
Coronavirus threatens the synchronized global turnaround

As we have been documenting over the last several months, the U.S. and global manufacturing indices had finally turned up after nearly two years of steady deterioration. The JPMorgan global manufacturing PMI had returned to expansionary territory in November and the IMF had just forecasted that the global economy is poised for a modest rebound in 2020. However, the 2019 Novel Coronavirus (2019nCoV) outbreak that emerged in Wuhan China, and is now spreading globally, is certain to be a near term drag on global economic activity. The challenge will be gauging just how big an impact the outbreak will have, because authorities still don't have a firm grasp at just how fast and wide the contagion is spreading.

The 2019nCoV outbreak creates uncertainty but looking at past viral outbreaks shows sharp shocks to economic output that last 1 to 3 months. As shown in the table to the right, compared to past viruses, 2019nCoV appears less lethal and less contagious, though data are still preliminary estimates. China is the second largest economy in the world and makes up 17% of global GDP.

Coronavirus relative to past viral outbreaks

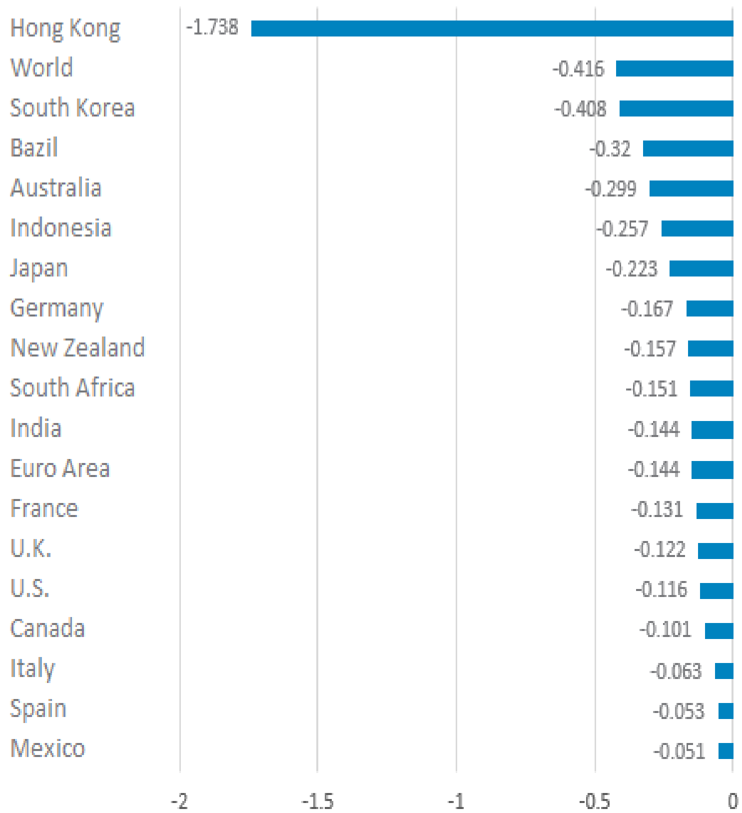
Mortality rates and secondary cases per infectious case



Source: World Health Organization and Goldman Sachs Asset Management. As of January 23, 2020.

Global Impact in a Contained Scenario

Percentage point decline in year-on-year growth from Q1 2020



Source: Bloomberg Economics.

Provinces that account for nearly 70% of Chinese GDP have shut down as part of the efforts to contain the outbreak. Travel restrictions are preventing, or limiting, movement of more than 48 million people. The city of Wuhan, the epicenter of the virus, is a major manufacturing hub, that has essentially shut down resulting in the closure of the world's largest car-parts maker, Germany's Robert Bosch GmbH. Honda and Nissan, have also closed their auto parts facilities in Wuhan. Nike has closed about half of its company-owned stores in China, Starbucks has closed about 2,000 of its cafes, and Apple says its supply chain will be affected. In the chart to the left, Bloomberg Economics attempts to forecast the potential decline in economic growth that may result in a *contained* scenario. Hundreds of manufacturers have had their global supply chains severed or disrupted, but by far Hong Kong faces the biggest hit with an estimated -1.7 percentage point drop in growth for Q1-2020.

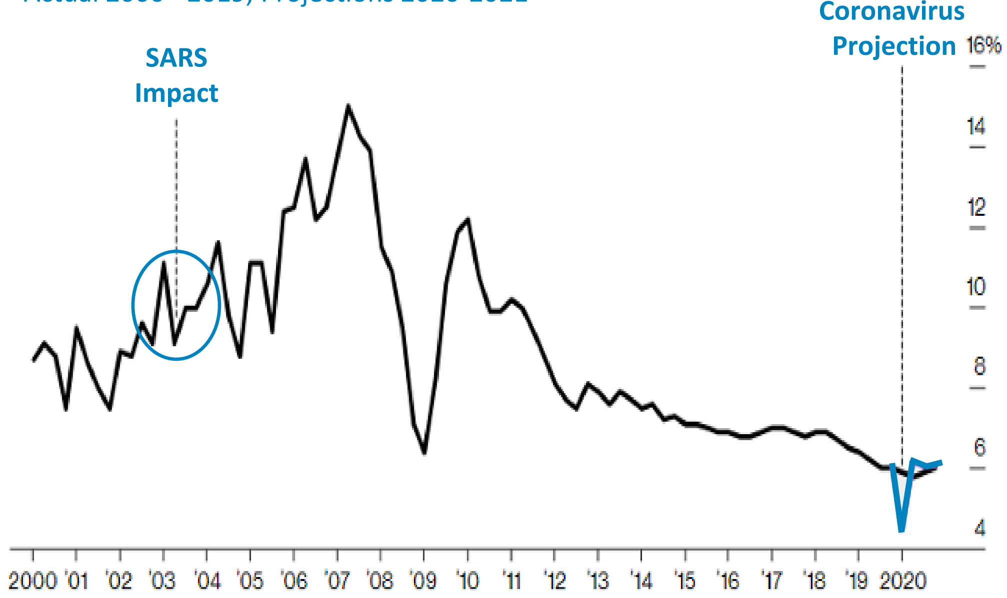
Bottom Line: While policy makers and company executives say it's too soon to assess the full impact of the coronavirus outbreak, it's becoming increasingly clear the impact will be global. What happens next will depend on how quickly the virus can be contained and supply chains reinstated.

The U.S. is enjoying the longest economic expansion ever, will coronavirus threaten it?

The U.S. is beginning its 128th straight month of economic expansion, the longest on record (data since 1854). But in January investors began to worry that the coronavirus from China could threaten that record. After the initial surprise of the coronavirus took a toll on investor sentiment, and global risk assets, in the last two weeks of January, investors have begun to look past the contagion. In the first few days of February, as this edition was going to publication, investors seemed to have been comforted by the World Health Organization's assessment that the peak of the viral outbreak will occur in Q1, with containment and recovery beginning in the following quarters. Strong economic data and better-than-expected earnings helped refocus market participants on the strong underpinnings of the economy and that market stability will be adequate to absorb the near-term growth hit that coronavirus will impose. Moreover global central banks stand ready with accommodative monetary policies to help offset the negative impact of the virus.

China Year-over-Year GDP

Actual 2000 –2019, Projections 2020-2021



Source: NBS, Bloomberg Economics.

Many economist and market strategists are forecasting that the economic impact of the coronavirus will be V-shaped. For example, the chart above shows Bloomberg Economics' projected impact of the coronavirus on China's GDP, which looks similar in magnitude to the early 2000's SARS outbreak. Mohammed El-Erian, chief economic advisor at Allianz SE, wonders in a recent Bloomberg Opinion column if a U- or L-shaped recovery should be considered. In other words, is a sharp deceleration followed by a sharp rebound, a V-recovery, too hopeful? He points to the fact that this shock impacts both demand and supply; manufacturing and services; and disrupts both internal and external Chinese trade. V-shaped arguments point to the fact that the rate of infection has likely peaked; cases outside of China are still limited; vaccines are quickly being developed and deployed; and central banks will inject significant liquidity to support economic recovery. If all those things hold true, they should be enough to insulate against the negative impact to global growth. However, El-Erian notes that the economy in China was already tenuous following the U.S.-China trade disputes, as well as the economic slowdown from other important trade partners (such as Europe). Ultimately it is too early to conclude what shape the recovery will take and more time and data is needed. This uncertainty will place greater importance on the fledgling worldwide manufacturing recovery. Domestically, the U.S. consumer has withstood many threats to the economy and will play an increasingly larger role in counteracting weakness abroad from the coronavirus. Looking forward, it is highly probable that the Fed will give inflation even more leeway before they consider any monetary policy that is even remotely close to tightening. Listed to the left are some of the characteristics that define the current state of the U.S. economy. The strength of those pillars will need to persistent to ensure a quick, transitory impact from the coronavirus disruption.

Bottom Line: The U.S. economy has been remarkably resilient since the financial crisis resulting in the longest economic expansion in history. Many bricks in the wall of worry have been removed, and most are forecasting this will be too.

State of the U.S. Economy

- ✓ S&P 500, Dow, Nasdaq: at all-time highs
- ✓ Home Prices: at all-time high
- ✓ Unemployment: at/near 50-yr low (3.5%)
- ✓ Economic expansion: longest in history (128 months now)
- ✓ Jobs growth: longest in history (112 months)
- ✓ Consumer Confidence: near highest level in two decades
- ✓ Business Sentiment: near historical highs.
- ✓ Monetary Policy: Fed expected to deliver a fourth cut by Sept., expanding the balance sheet.

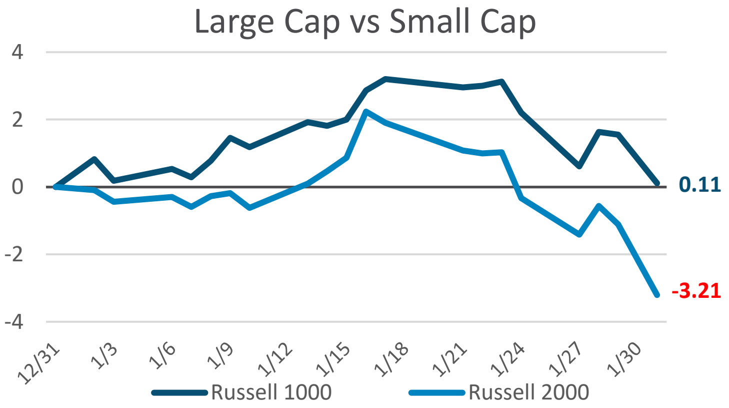
January 2020

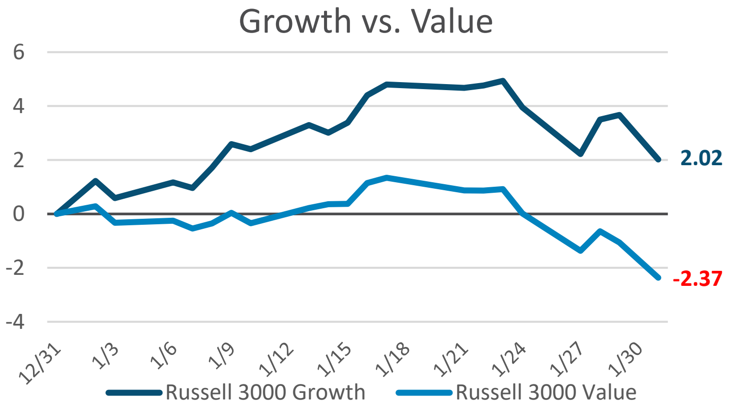
Equity Themes

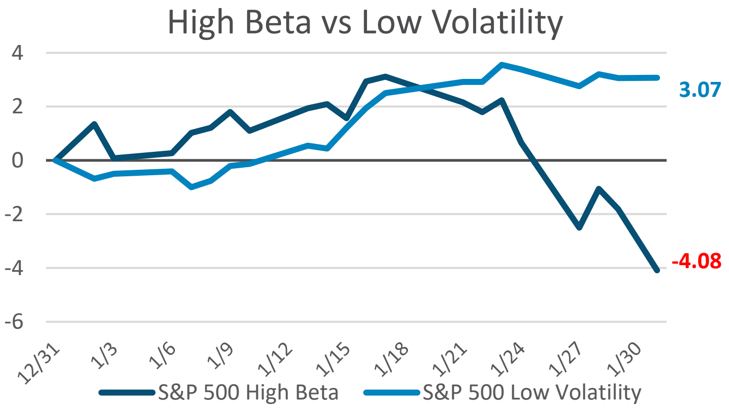
MONTH IN REVIEW

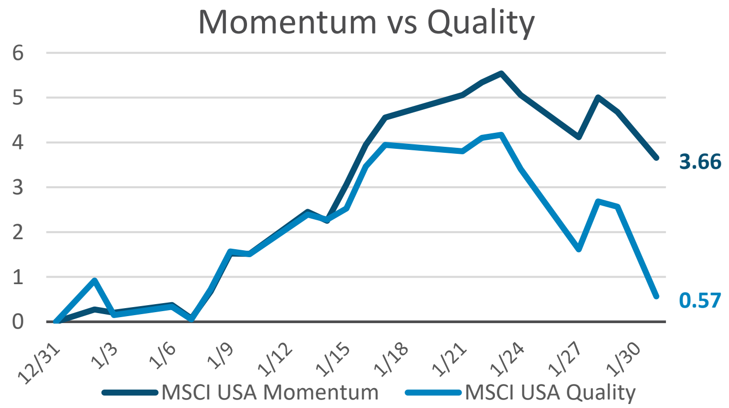
What Worked, What Didn't

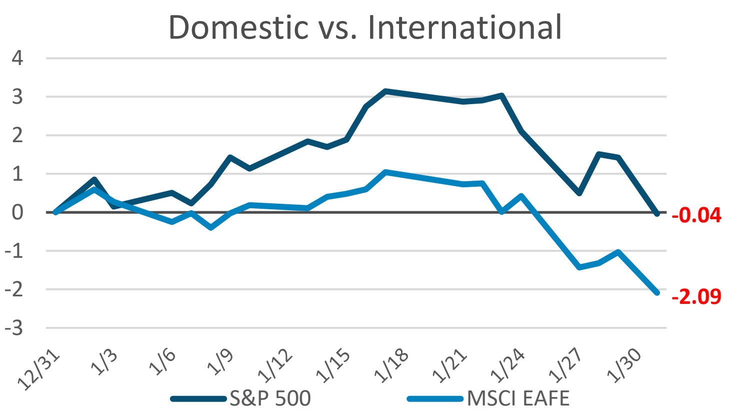
- **Small Cap Head Fake.** Entering December Small Caps had just capped three months of outperformance and finally broke their downtrend relative to Large Caps. December was essentially a draw between the two, but it all went south for Small Caps in January. Small caps fell -3.2% while Large Caps eked out a gain, the biggest monthly gap since March 2019.
- **High Beta, low return.** High Beta stocks led Low Volatility stocks until January 21, but then gave it all back plus a bunch in the last 8 trading days of the month. High Beta went from being +3.1% on January 17 to being -4.1% by the end of the month. It was the worst underperformance versus Low Volatility since the August 2019 market sell-off.
- **Coronavirus takes toll on Emerging Markets.** The coronavirus and late January risk-off selling took a toll on Emerging Markets. They were up +2.9% through January 17th but sold off hard through the end of the month to finish -4.7%.

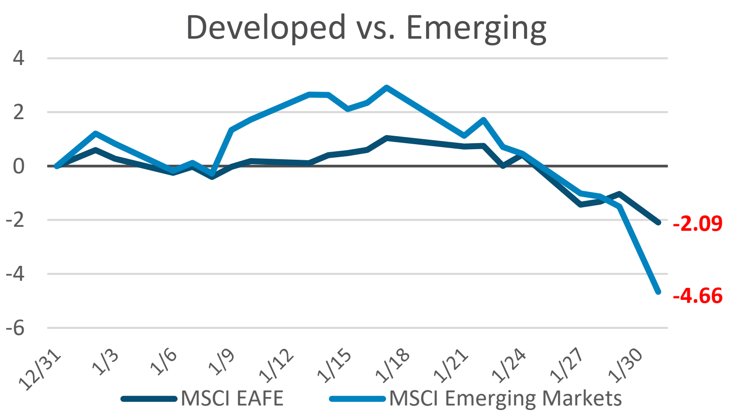












Source: Bloomberg.

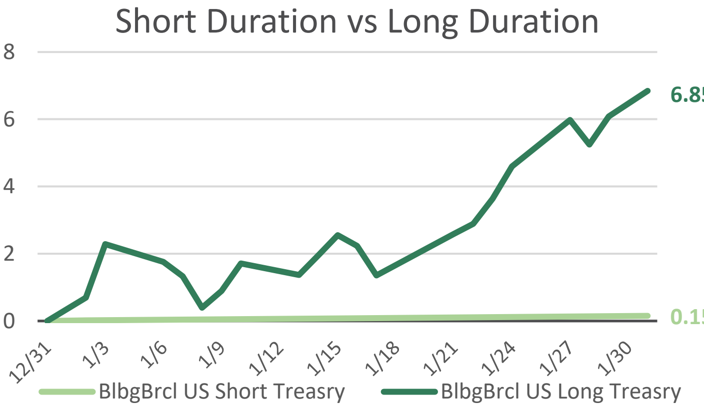
January 2020

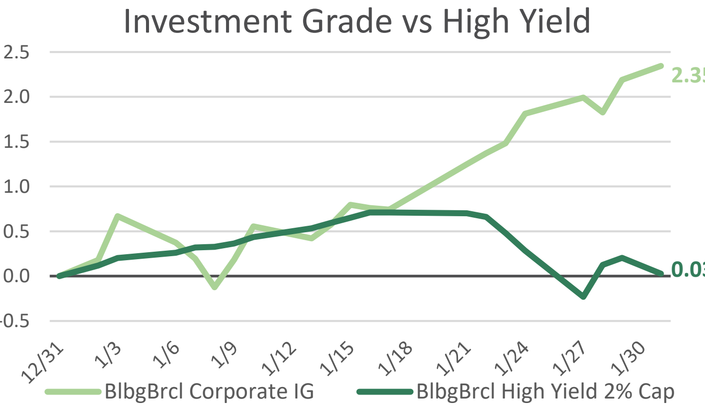
Bond Themes

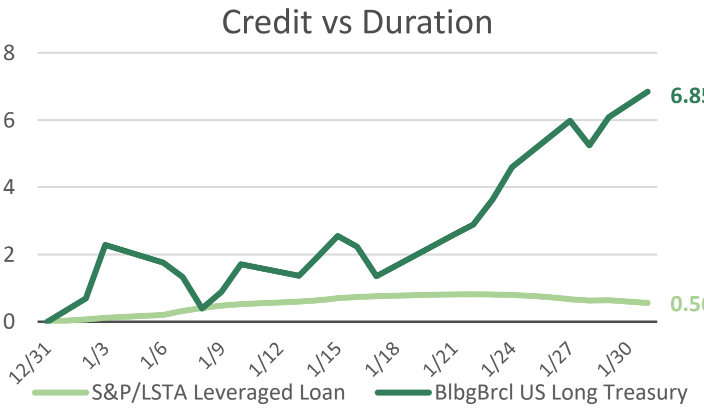
MONTH IN REVIEW

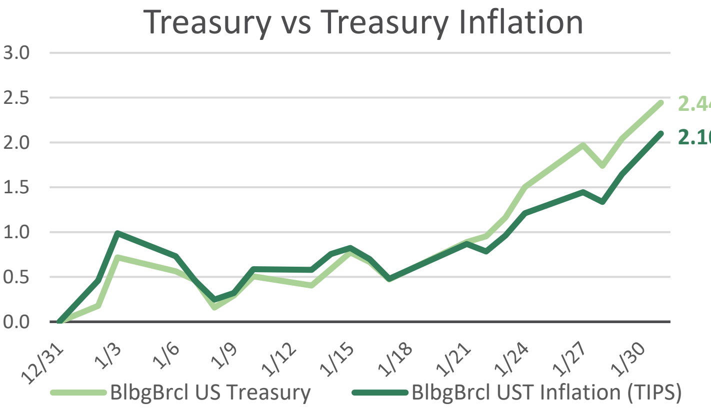
What Worked, What Didn't

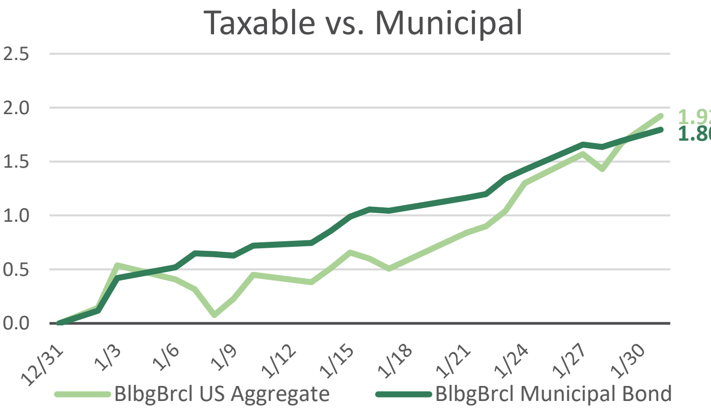
- **Yields decline, curve flattens/inverts.** January ended with Treasury yields lower, bond prices higher, and the yield curve flatter and even inverted again. The 3-month Treasury yield ended the month at 1.55% while the benchmark 10-year Treasury yield was at 1.52%. The Fed unanimously voted to keep rates unchanged at 1.50%-1.75% in January.
- **Long but not wrong.** Many investment strategist came into 2020 looking for bond yields to drift higher as prospects for better economic data improved. But the coronavirus virus outbreak made that scenario less likely. Investors sought safety and the decline in yields helped long duration treasuries to their highest monthly return, +6.9%, since August 2019.
- **One and done.** After international bonds outperformed their U.S. counterparts in December, U.S. bonds reasserted their dominance in January. U.S. bonds have bettered international bonds in 18 of the last 22 months.

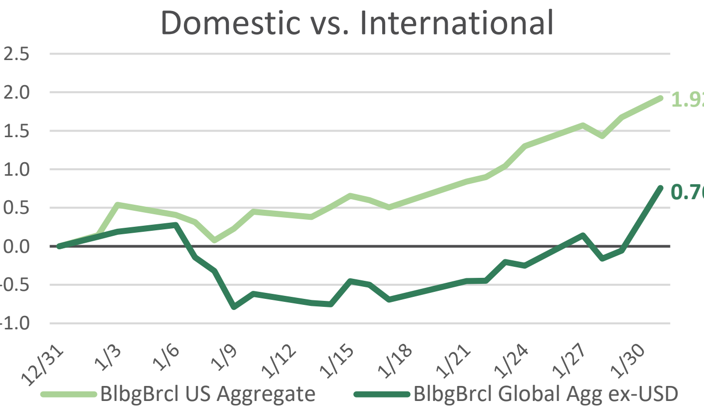












Source: Bloomberg.

January 2020
Asset Class Performance

MONTH IN REVIEW

The Importance of Diversification. From period to period there is no certainty what investment will be the best, or worst, performer. Diversification mitigates the risk of relying on any single investment and offers a host of long-term benefits, such as less portfolio volatility, improved risk-adjusted returns, and more effective compounding.

	Jan-02	Jan-03	Jan-06	Jan-07	Jan-08	Jan-09	Jan-10	Jan-13	Jan-14	Jan-15	Jan-16	Jan-17	Jan-21	Jan-22	Jan-23	Jan-24	Jan-27	Jan-28	Jan-29	Jan-30	Jan-31	Jan
High	EM 2.03	RE 0.72	LCG 0.64	MCG -0.02	LCG 0.83	MCG 0.85	RE 0.87	EM 1.56	SCG 0.53	RE 0.89	SCG 1.43	EM 0.57	RE 1.02	EM 0.82	RE 0.60	USB 0.18	USB 0.31	LCG 1.25	EM 0.48	LCV 0.46	IBD 0.33	LCG 2.26
	LCG 1.38	USB 0.29	MCG 0.39	EM -0.07	SCG 0.59	LCG 0.82	EM 0.53	RE 1.07	MCV 0.28	SCG 0.70	SCV 1.24	LCG 0.39	IBD 0.39	MCG 0.21	MCV 0.30	IBD -0.06	IBD -0.06	MCG 1.18	USB 0.23	IBD 0.33	USB 0.30	USB 2.03
	MCG 1.03	IBD -0.03	IEQ 0.39	HYB -0.09	EM 0.58	EM 0.67	USB 0.17	LCG 0.91	LCV 0.16	IBD 0.65	MCV 1.04	IEQ 0.30	USB 0.28	IEQ 0.20	MCG 0.19	RE -0.23	RE -0.48	SCG 1.05	LCG 0.22	MCV 0.27	HYB -0.41	RE 1.60
	IEQ 1.01	HYB -0.10	SCG 0.36	USB -0.11	MCG 0.49	LCV 0.44	HYB 0.03	MCG 0.78	SCV 0.16	LCG 0.40	MCG 1.00	MCV 0.20	LCG -0.05	HYB 0.18	LCG 0.17	HYB -0.42	HYB -0.67	IEQ 0.94	IBD 0.03	SCV 0.20	60/40 -0.98	MCG 0.90
	60/40 0.56	SCV -0.28	60/40 0.12	SCG -0.18	IEQ 0.29	SCG 0.36	60/40 -0.06	MCV 0.74	IEQ 0.10	MCG 0.30	LCG 0.93	LCV 0.19	MCG -0.15	SCG 0.12	USB 0.13	60/40 -0.43	SCG -0.93	HYB 0.86	60/40 0.02	MCG 0.20	RE -1.21	HYB -0.47
	HYB 0.42	MCV -0.36	IBD 0.09	MCV -0.19	RE 0.24	60/40 0.28	MCV -0.14	SCV 0.74	USB 0.09	SCV 0.19	RE 0.74	RE 0.12	HYB -0.22	60/40 0.11	SCV 0.07	IEQ -0.43	60/40 -1.05	EM 0.84	IEQ 0.01	LCG 0.19	MCV -1.63	60/40 -0.63
	LCV 0.40	MCG -0.40	LCV 0.09	LCG -0.21	LCV 0.21	HYB 0.26	LCG -0.18	SCG 0.70	60/40 0.00	USB 0.15	LCV 0.73	60/40 0.10	60/40 -0.31	IBD 0.09	LCV 0.04	EM -0.80	SCV -1.27	MCV 0.83	HYB -0.06	RE 0.13	IEQ -1.69	IBD -0.85
	USB 0.28	60/40 -0.43	RE 0.09	60/40 -0.23	60/40 0.19	MCV 0.26	IBD -0.21	LCV 0.57	IBD 0.00	MCV 0.14	EM 0.63	MCG 0.01	MCV -0.40	LCG 0.07	SCG -0.02	MCG -0.87	LCV -1.40	LCV 0.80	RE -0.31	HYB 0.10	LCG -1.75	SCG -1.04
	SCG 0.16	SCG -0.50	MCV 0.03	IEQ -0.27	HYB 0.09	IEQ 0.23	MCG -0.30	IEQ 0.52	HYB -0.01	60/40 0.13	60/40 0.43	IBD 0.00	LCV -0.42	USB 0.05	60/40 -0.06	LCV -0.89	MCV -1.48	60/40 0.55	MCG -0.34	USB 0.01	LCV -1.77	MCV -1.94
	SCV -0.11	LCV -0.67	SCV 0.02	LCV -0.30	SCV 0.05	USB 0.11	SCG -0.31	60/40 0.44	MCG -0.05	HYB 0.02	IEQ 0.42	HYB -0.08	SCG -0.70	LCV 0.04	IEQ -0.24	LCG -0.90	MCG -1.53	SCV 0.47	MCV -0.36	60/40 -0.01	MCG -2.01	LCV -2.14
	MCV -0.21	LCG -0.72	USB -0.08	IBD -0.44	MCV 0.04	RE 0.05	IEQ -0.37	HYB 0.00	LCG -0.35	LCV 0.02	HYB 0.03	USB -0.11	IEQ -0.80	SCV -0.20	HYB -0.31	MCV -1.05	LCG -1.72	RE 0.43	SCG -0.41	IEQ -0.09	SCG -2.02	IEQ -2.82
	IBD -0.38	IEQ -1.24	HYB -0.10	SCV -0.51	USB -0.12	IBD -0.15	LCV -0.38	USB -0.06	RE -0.38	IEQ 0.00	USB 0.00	SCV -0.33	SCV -0.92	MCV -0.22	IBD -0.56	SCV -1.35	IEQ -2.07	USB -0.09	LCV -0.43	SCG -0.20	EM -2.02	SCV -5.24
Low	RE -1.11	EM -1.86	EM -0.24	RE -1.01	IBD -0.15	SCV -0.24	SCV -0.54	IBD -0.24	EM -0.56	EM -0.78	IBD -0.35	SCG -0.37	EM -2.53	RE -0.57	EM -1.03	SCG -1.35	EM -3.45	IBD -0.12	SCV -0.68	EM -1.49	SCV -2.05	EM -6.15

Legend

- 60/40 Allocation (60/40)
- Large Growth (LCG)
- Large Value (LCV)
- Mid Growth (MCG)
- Mid Value (MCV)
- Small Growth (SCG)
- Small Value (SCV)
- Intl Equity (IEQ)
- Emg Markets (EM)
- U.S. Bonds (USB)
- High Yield Bond (HYB)
- Intl Bonds (IBD)
- Real Estate (RE)

Source: Bloomberg. Asset-class performance is presented by using market returns from an exchange-traded fund (ETF) proxy that best represents its respective broad asset class. Returns shown are net of fund fees for and do not necessarily represent performance of specific mutual funds and/or exchange-traded funds recommended by the Prime Capital Investment Advisors. The performance of those funds may be substantially different than the performance of the broad asset classes and to proxy ETFs represented here. U.S. Bonds (iShares Core U.S. Aggregate Bond ETF); High-Yield Bond (iShares iBoxx $ High Yield Corporate Bond ETF); Intl Bonds (SPDR® Bloomberg Barclays International Corporate Bond ETF); Large Growth (iShares Russell 1000 Growth ETF); Large Value (iShares Russell 1000 Value ETF); Mid Growth (iShares Russell Mid-Cap Growth ETF); Mid Value (iShares Russell Mid-Cap Value ETF); Small Growth (iShares Russell 2000 Growth ETF); Small Value (iShares Russell 2000 Value ETF); Intl Equity (iShares MSCI EAFE ETF); Emg Markets (iShares MSCI Emerging Markets ETF); and Real Estate (iShares U.S. Real Estate ETF). The return displayed as "Allocation" is a weighted average of the ETF proxies shown as represented by: 30% U.S. Bonds, 5% International Bonds, 5% High Yield Bonds, 10% Large Growth, 10% Large Value, 4% Mid Growth, 4% Mid Value, 2% Small Growth, 2% Small Value, 18% International Stock, 7% Emerging Markets, 3% Real Estate.

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