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Market Commentary, First Quarter 2020

By Todd Stephenson, Chief Investment Officer

"THIS AIN'T OUR FIRST RODEO"

With apologies to English teachers and with due recognition to country western singer Vern Gosdin and actress Faye Dunaway portraying Joan Crawford in the *movie Mommie Dearest,* an expression such as the above seems appropriate in times such as these.

No rodeo exists without a bull to ride or rope. A rodeo bull will perform for an average of six to ten years before being retired to stud. For eleven years we rode a record bull market in stocks. Unlike the rodeo bull that will be very satisfied after his rodeo run is over, we are not. In fact, we are anxious and concerned. While we knew that an end to the recent bull market was inevitable at some point, the cause of this abrupt ending has been a shock and naturally deepens our concern about our health, both physically and financially.

The COVID-19 virus is not our first pandemic. Unfortunately, we are now in the very midst of this health crisis and quite unsure as to how deep and how prolonged the death, suffering, and disruptions will be. Perhaps though we can take some solace in that we have endured other pandemics in the past. Some of us are old enough to have been alive during the "Asian flu" of 1957-1958 which caused almost two million deaths worldwide. Every decade or so since another widespread flu/pandemic has occurred including, "Hong-Kong", "Bird", "SARS", "Swine" and "Ebola". And while none of us were alive at the time, the "Spanish Flu" of 1917-1918 was of great and tragic consequences to the world. We should be encouraged today that with the benefit of far greater global communication and coordination along with advances in health technology and care (not withstanding some of the troubling delays in testing and needed supplies), the COVID-19 virus can and will be contained.

When the health crisis does end there will no doubt be longer term economic impacts including the probability of a deep recession, sustained job loss, and continued challenging times for most all business sectors. How this manifests itself over time in financial markets and individual investment portfolios remains to be seen. As we look back at those previous pandemics or widespread flu out-breaks we can take some solace that most resulted in only little or brief economic or market impacts. While data from 1918 is somewhat limited, what we do know is that a significant decline in short term activity occurred but recovered within a couple of years and led to what we now call "The Roaring 20s".

While the great recession of 2008-2009 was not caused by any health-related issue such as COVID-19, we can look back to our experience then as perhaps another "rodeo" that we lived through and recovered from. And to keep with the rodeo analogy a while longer, that bronco we were riding kept bucking us badly, but we held on. And after it was over, a new rodeo featured a new bull that performed spectacularly for 11 years.

The following chart really highlights the difficult quarter we experienced. While of relatively little solace, the good news is that we ended the quarter with a modest recovery from the market's low point. From the bull market peak reached on February 19th, the widely followed S&P 500 Index fell 34% to its low on March 23rd. By the end of the quarter the S&P 500 along with other indexes recovered slightly. After including the impact of dividends and market appreciation realized through February 19th, total negative quarterly total return for the S&P 500 was just under 20%.

How bad was this quarter compared to other major market corrections? The answer is not quite the worst. In the fourth quarter of 2008, during the height of the financial crisis, the S&P 500 total return was just under a negative 22%. However, in the first quarter of 2009 the total return of the S&P 500 was an additional negative 11%. While it remains to be seen how COVID-19 will continue to impact markets through the second quarter of 2020 and beyond, we should remember that during 2019 we experienced a very robust S&P 500 total return of over 31%.

There is one bright spot reflected on the asset performance chart. Total positive return for the Bloomberg Barclays US Aggregate Bond Index was 3.15% for the quarter. This benchmark index includes major segments of the US taxable bond universe. Heavily weighted to US Treasury securities, US Government Agencies and Mortgage backed securities, this index also includes investment grade corporate securities. As frequently happens during an abrupt stock market correction, there is a "Flight to Quality" whereby institutional and other investors seek out the security of US Government securities, particularly Treasuries. Demand for same will drive down yields thereby increasing price and returns. The following table illustrates the various total returns during the first quarter for the key segments represented in the US Aggregate Bond Index (all also from Bloomberg Barclays):

US Treasury Index	8.20%
US Agency Index	4.14%
US Mortgage Backed Securities Index	2.82%
US Corporate Bond Index	(3.63%)

A negative return for US Corporate Bonds also typically occurs in stock market conditions like these -- another impact of the flight to quality as the credit ratings of many corporations are potentially at risk of downgrades. When ratings downgrades are anticipated, yields will go up and price and returns will go down -- the inverse of what happens to US Treasury securities in this type of economic environment.

We generally include core bond funds in client portfolios that follow and benefit from the diversification inherent in the Bloomberg Barclays Aggregate US index. These funds primarily provide diversification to the stock market, but also among the various segments of the bond market.

In addition to core diversified fixed income funds, Phillips Financial clients may also have additional funds that specifically track investment grade corporate bonds, high-yield corporate bonds and/or municipal securities. These funds seek to create even greater diversification and additional risk adjusted after-tax returns over time. In times like these some of these funds can behave directionally with stock returns, but generally are more muted in magnitude.

Index	% Last Quarter Return 1/1/20 - 3/31/20	% Year-to-Date Return 1/1/20 - 3/31/20	% Cumulative 1 Year Avg. 4/1/19 - 3/31/20	% Cumulative 3 Year Avg. 4/1/17 - 3/31/20	% Cumulative 5 Year Avg. 4/1/15 - 3/31/20	% Cumulative 10 Year Avg. 4/1/10 - 3/31/20	% Cumulative 15 Year Avg. 4/1/05 - 3/31/20
Bloomberg Barclays US Aggregate Bond Index	**3.15%**	**3.15%**	**8.93%**	4.82%	3.36%	3.88%	4.40%
S&P 500 Index	-19.60%	-19.60%	-6.98%	**5.10%**	**6.73%**	**10.53%**	**7.58%**
S&P 500 Value Index	-25.34%	-25.34%	-12.20%	0.05%	3.45%	8.18%	5.75%
S&P Mid Cap 400 Index	-29.70%	-29.70%	-22.51%	-4.09%	0.56%	7.88%	6.97%
S&P Small Cap 600 Index	-32.64%	-32.64%	-25.89%	-5.34%	0.45%	8.06%	6.51%
S&P Small Cap 600 Value Index	**-37.37%**	**-37.37%**	**-30.64%**	**-8.62%**	-1.67%	6.37%	5.30%
MSCI EAFE Index	-22.83%	-22.83%	-14.38%	-1.82%	-0.62%	2.72%	3.06%
MSCI Emerging Markets Index	-23.60%	-23.60%	-17.69%	-1.62%	-0.37%	0.68%	5.44%
Wilshire REIT Index	-25.63%	-25.63%	-19.38%	-2.49%	-0.19%	7.67%	6.22%
Bloomberg Commodity Index	-23.29%	-23.29%	-22.31%	-8.61%	**-7.76%**	**-6.74%**	**-4.98%**

Source: Standard & Poor's, Bloomberg, Morgan Stanley Capital International, Wilshire Associates, Morningstar
Green= best performing asset class
Red = worst performing asset class

Index returns are for illustrative purposes only, and do not reflect any management fees, transaction costs or expenses. The performance of an unmanaged index is not indicative of the performance of any particular investment. It is not possible to invest directly in any index. Past performance is no guarantee of future results.

Finally, as we look back at what Phillips Financial included in its Investment Newsletter for the Fourth Quarter of 2008 there are many similarities. Most obviously, the decreases in stock market valuations were commensurate in size. And like today's market, diversification to include fixed income securities helped offset some of the damage.

In that issue from January 2009 we asked ourselves "What lessons have we learned (or relearned)?" How appropriate it is to now revisit and reconsider versions of many of those key questions:

1. Cash reserves are important to help weather downturns. A cash reserve to cover at least several months of living expenses and emergencies is probably appropriate for many people. We encourage you to consider working with your financial advisor to create or update a financial plan to help identify and provide for such contingencies.
2. Withdrawal rates from an investment portfolio need to be reasonable. People who were withdrawing funds at a sustainable rate before the market downturn have only minor adjustments to make in their withdrawal activity

at this time. Those who were taking withdrawals that were not sustainable before the downturn may need to change their spending habits significantly if they want the portfolio to last.

3. When the market is going up there is a tendency to start taking more risk by investing more aggressively. Some people are discovering they weren't as risk tolerant as they thought. Once the market begins its recovery, it will be important to carefully review the desire to invest more aggressively. Only take the amount of risk necessary to help you achieve your financial goals.
4. It is important to take profits from outperforming asset classes during good markets. Our rebalancing philosophy largely addresses this issue, but we have determined that even more diligence may be advisable with respect to taxable accounts, regardless of the tax impact.
5. Concentrated positions in one or a few stocks have played havoc with portfolios. Many people with concentrated positions have been especially hard hit with the downturn. Our philosophy of using widely diversified index-based ETFs has been verified as a prudent way to reduce the impact of specific stocks and industries experiencing significant loss in value.

COVID-19 certainly has impacted lives, day to day routines and financial returns so far this year. While we certainly don't know when this pandemic will end and our lives can return to normal, we remain confident that over the long-term, diversification should continue to provide the greatest chance of reaching your investment and retirement goals. As always, and especially during these difficult and uncertain times, your Phillips Financial advisor is available to address any questions or concerns.

Definitions and Disclosures:

Bloomberg Barclays Aggregate Bond Index. An index managed by Bloomberg to track the general performance of the domestic taxable investment grade bond market.

S&P 500 Index. An index that measures the large-capitalization sector including roughly 500 leading companies representing over 80% of the largest market capitalization in the U.S. equity markets. It is a capitalization-weighted index from a range of securities chosen by Standard & Poor's for liquidity and industry group representation.

S&P 500 Value Index. Contains those securities from the S&P 500 Index with lower-than-average sales and growth rates and that generally reflect lower price-to-earnings and price-to-book ratios.

S&P MidCap 400 Index. An index that measures the mid-capitalization sector including roughly 400 leading companies representing about 7% of the U.S. equity market. It is a capitalization-weighted index from a range of securities chosen by Standard & Poor's for liquidity and industry group representation.

S&P SmallCap 600 Index. An index that measures the small-capitalization sector including roughly 600 leading companies representing about 3% of the U.S. equity market. It is a capitalization-weighted index from a range of securities chosen by Standard & Poor's for liquidity and industry group representation.

S&P SmallCap 600 Value Index. Contains those securities from the S&P SmallCap 600 Index with lower-than-average sales and earnings growth rates and that generally reflect lower price-to-earnings and price-to-book ratios.

MSCI EAFE Index. An index developed by Morgan Stanley Capital International Inc. as an equity benchmark for performance of publicly traded securities in developed international markets.

MSCI Emerging Markets Index. An index developed by Morgan Stanley Capital International Inc. as an equity benchmark for performance of publicly traded securities in emerging markets.

Wilshire REIT Index. An index developed by Wilshire Associates to track the general performance of Real Estate Investment Trusts (REITs) traded on domestic equity markets.

Bloomberg Commodity Index. An index managed by Bloomberg to provide a diversified, economically rational and liquid benchmark for commodities as an asset class. The index is currently composed of the prices of 22 exchange traded futures contracts on physical commodities.
