Bank of New Hampshire
WEALTH MANAGEMENT

Private Banking

Quarterly Review
April 2020
"Until A Catalyst Presents Itself"

Market/Economic Update

Market analysts tend to focus on trends in economic data as their correlation with investment results creates a high probability of successful outcomes over time. This approach has proven itself time and again in each business cycle since World War II until now as the spread of the Covid-19 virus has compressed what is typically several months of deteriorating fundamentals into a few short weeks. Hindsight is always done with 20/20 vision, but a look at our January update reflects the fundamental environment at the time with the positives being a supportive Fed, a recently completed trade deal with China, strength in the technology sector and an Administration that would be careful to do no harm in an election year. The negatives we pointed out were a sluggish manufacturing sector and valuations that were stretched historically, but would likely not be problematic "until a catalyst presents itself that will restrain earnings growth." Covid-19 has been that catalyst and then some introducing us to human and economic costs that most of us have not experienced during our lives. The market reaction has been driven by the uncertainty of future earnings projections as many businesses cannot remain open and workers are being displaced during this time. Fundamental data points that are the cornerstone of investment analysis have become temporarily less relevant as we face a situation whose root is not economic, but medical in nature.

This uncertainty has not been lost on policymakers as the Federal Reserve has provided unprecedented support to keep markets functioning and Congress responded in kind by passing a $2 trillion dollar stimulus package to assist both consumers and business owners during this stressful period. These policy initiatives have not gone unrecognized by investors as markets have rallied significantly off of their March lows though further action will likely be needed as we go through the year to promote recovery. The steepness of the selloff and the downside break of the bull market trendline dating from March 2009 suggest that it may take some time for markets to return to normal, a period that is likely to be measured in months.

During this time, we can expect to see high volatility in both directions as it is impossible to know how long businesses will be functioning with limited output. Our approach in managing portfolios is centered on the need to emphasize themes that have presented strong relative performance in recent weeks through the course of the decline as these trends should continue until there is better news on the medical front. This has taken us to market segments where there will be better near term earnings visibility such as consumer staples, health care, and technology. We usually think of the tech sector as being aggressive, but in these times the need for interconnectivity and distancing is creating selective opportunities in the so called "stay at home" techs. It is important to bear in mind that market declines have always presented opportunities so we should be preparing ourselves to gradually rebalance asset allocations and to look at some of the worst performing industry groups as we go through the year.

-Charlie Mathews, CFA

Equity Markets

"A Tale of Two Quarters" would best describe our journey to the end of 2019 and into the beginning of 2020. The fourth quarter brought equity investors a happy ending with the S&P 500 finishing the year up +31%, for its best return since 2013. The best was saved for last with a strong closing push that saw 33% of the total return for the year achieved between October and December 2019.

The tale of first quarter 2020 began routinely enough with the continuation of the bull market driven on the back of a recently completed China trade deal and modest earnings growth that would be sure to continue pushing markets higher. As the S&P 500 set a new all-time high on February 19th, there were questions in the minds of most investors about the economic and market impacts from the Covid-19 virus, but the overriding expectation at that time was that it would play out along the lines of more recent diseases like SARS or the H1N1 flu virus. Our market tale quickly darkened as policymakers and investors underestimated how easy it would be spread the virus and how broad the problem would become before this was widely recognized. Once this became apparent and business closures became reality, the market reaction was relentless and abrupt as the S&P 500 dropped 35% high to low, cramming an entire bear market into a few short weeks.

Volatility continued in both directions during the coming weeks as the final five trading days produced a rally of more than 15% that left the S&P 500 down -19.60% for the quarter. Large cap U.S. stocks were again the best performing equity class, driven by a strong technology component, shown in the performance of the NASDAQ Index which was down a more modest -13.91%. Damage to the Russell 2000 Small Cap Index and the S&P 400 Midcap Index was more severe due to the exposure to consumer discretionary and financial stocks in those indices as small caps were off -30.89% and mid caps lost -30.03%. Overseas stocks were in the middle of the performance list, with the MSCI EAFE Index down -23.43% and the MSCI Emerging Markets dropping -23.87%. It was the most challenging quarter we have seen in many years since the 2008-09 bear market.

The economic uncertainty of business closures has sent corporate earnings into a swift decline and has made it difficult for analysts to make solid predictions looking out over the remainder of the year. The direction the equity market is headed will depend on how quickly the virus can be contained. There will continue to be periods of higher volatility until that uncertainty can be removed and a clearer picture of earnings can be determined. As long term investors, we believe that opportunities exist at current levels to buy high quality stocks at more attractive prices as a result of the coronavirus sell off. The process of adding to equity positions will likely play out over a period of several months to position portfolios for an eventual recovery in late 2020 or early in 2021.

—Robert Magan, CFA

Credit Markets

Credit markets experienced an increase in volatility as well during the quarter as shutdowns in business triggered concerns with regard to the sustainability of credit quality in some sectors of the corporate market to include retail, energy and certain industrial names. Liquidity has became increasingly important as fixed income investors trimmed exposure to riskier corporate credits in favor of the safety of U.S. Treasurys and money market funds. While the spread between the yield on Treasurys and short-dated lower quality bonds widened about 400 basis points over the course of the quarter, yields for higher quality, investment grade issues with similar maturities only widened about 140 basis points. This suggests an environment where investors need to be more selective and focus on situations where there is good visibility on cash flow at least for the time being until commerce begins to normalize. It is a time when it may be preferable for investors to emphasize safety over yield and focus on sectors like health care, consumer staples, and utilities where operations are continuing for the most part. The spread widening we have seen in recent weeks is similar in magnitude to what occurred during the entire 2000-2003 bear market which helps to offer some perspective on our recent experience. Overall, investment grade bonds ended up about 200 basis points wider with 3 year bonds widening 243 basis points and 30 year bonds a more modest 156 bps. While corporates had a total return of -3.9%, the flight to quality drove government securities considerably higher leaving the U.S. aggregate index with a positive +3.1% return on the quarter. The speed of the market's mid-quarter reversal illustrated the importance of building well diversified portfolios as this is the best way to prepare for unforeseen events that often prove to be the most disruptive for investors.

It was essential that global central banks rushed to support their financial systems in retaliation against the potential economic outcomes from COVID-19. The Federal Reserve cut overnight rates to zero and set vast amounts of quantitative easing in motion in an unprecedented move designed to promote liquidity during the crisis and to promote recovery down the road. As credit funds dealt with massive redemptions, the Fed initiated the purchase of investment-grade bonds and commercial mortgage products for the first time in history along with preemptively setting up money facilities for prime money market funds that also saw a significant increase in redemptions. Short term U.S. Treasury yields took a nosedive in response to the Fed cut while longer terms bonds remained at similar levels creating a modestly steeper yield curve. It is likely that policymakers will continue to look for ways to steepen the curve as we go through the year toward creating a more active credit environment that can become an engine for recovery.

While it may be early to be looking for value in the sectors most impacted by the present crisis, we must not lose sight of the fact that there will be opportunities to do this in the weeks and months ahead. This will depend on getting the virus under control and assessing the economic fall out given that there has been so much upheaval in labor markets in such a short period of time.

—Dona Murray