HAMILTON POINT
Investment Advisors, LLC

WHAT WE'RE WATCHING

APRIL 2020

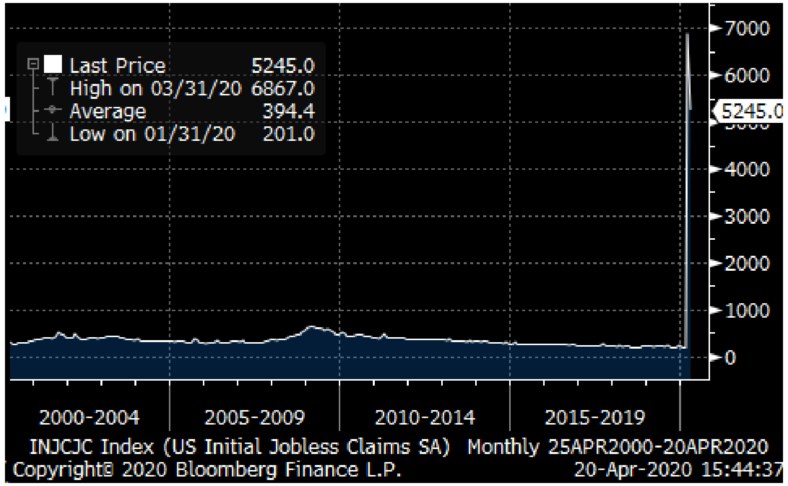
THE HIGH, THE LOW & THE SNAPBACK

- Market panic peaked in the third week of March; severe volatility hit stocks, bonds, currencies and commodities.
- Around the world, policymakers responded by rapidly deploying massive fiscal and monetary stimulus programs.
- Since then, financial assets – especially stocks – have experienced a strong rally. At the same time, the data on the real economy has deteriorated at the fastest pace since the Great Depression.
- Many investors are left wondering, "Have we come too far too fast?", or is the market telling us that the economic recovery is already underway?

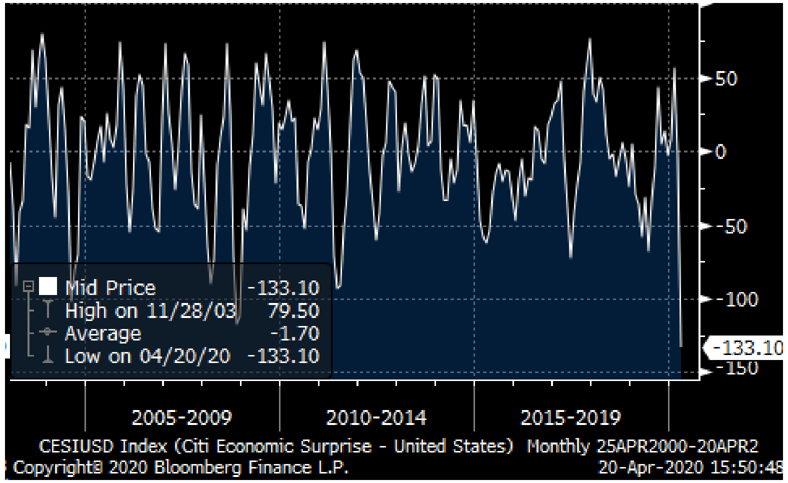
A HARD STOP IN THE U.S. ECONOMY

- There are dozens of charts like these that all lead to the same conclusion: the U.S. economy hit a hard stop in March.
- Most of the drops in economic statistics are only comparable to the Financial Crisis or the Great Depression.
- This data isn't likely to improve anytime soon. Q2 is expected to be the trough for the year, with GDP contracting at a ~50% annualized rate.

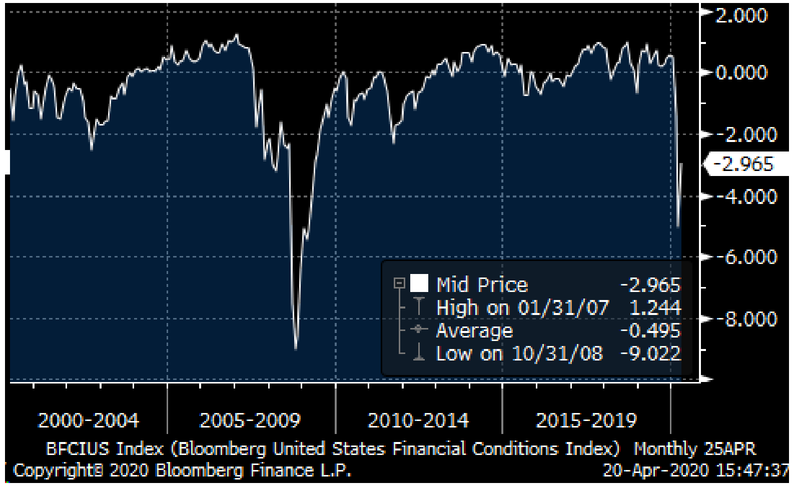
U.S. Initial Jobless Claims



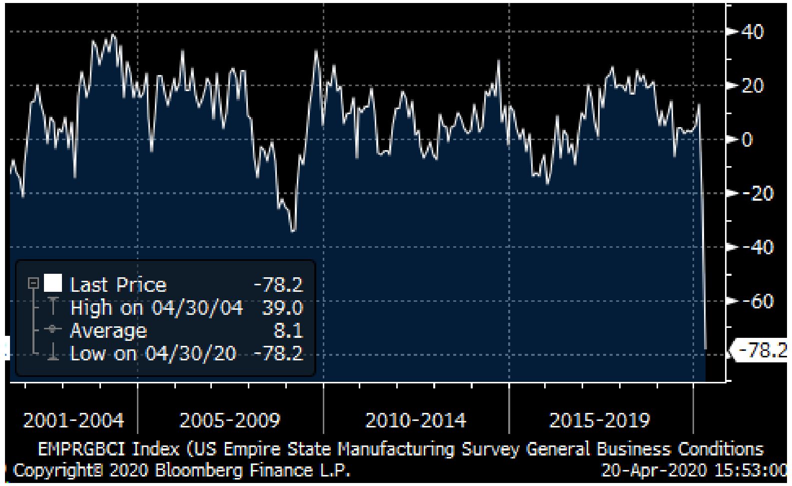
Citi U.S. Economic Surprise Index



U.S. Financial Conditions Index



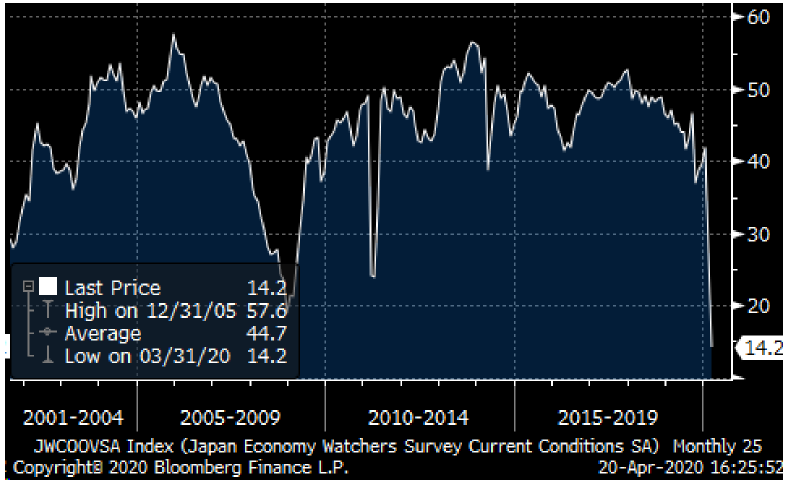
U.S. Empire Manufacturing Survey



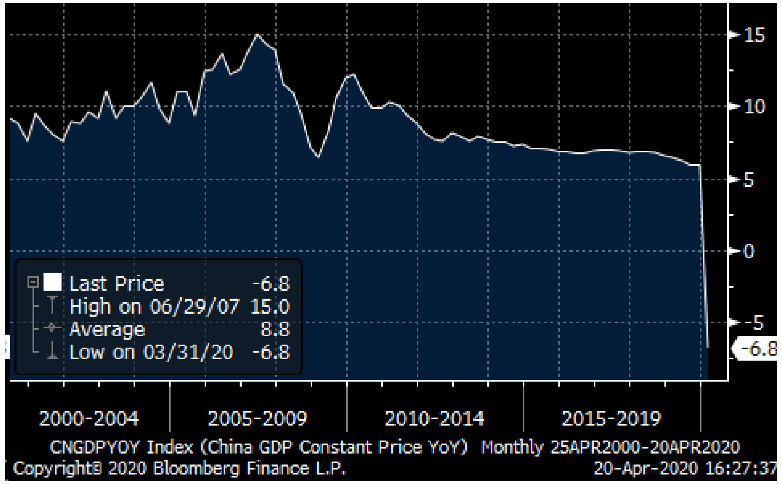
GLOBAL ECONOMY IN A FREEFALL

- The hard stop was global in nature. Broadly speaking, the harder the virus hit an area and the more open the economy, the harder the economic impact.
- Many of these areas are beginning to come back online now, so Q2 data will be important to watch in the coming months.

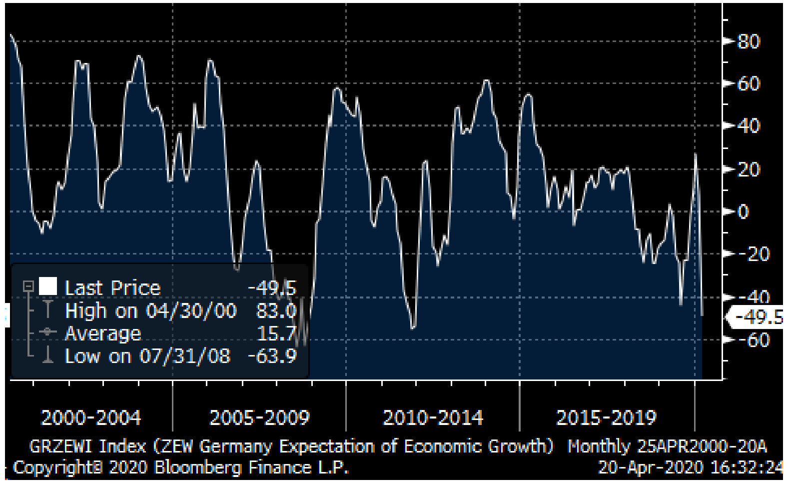
Japan Economy Watchers Survey



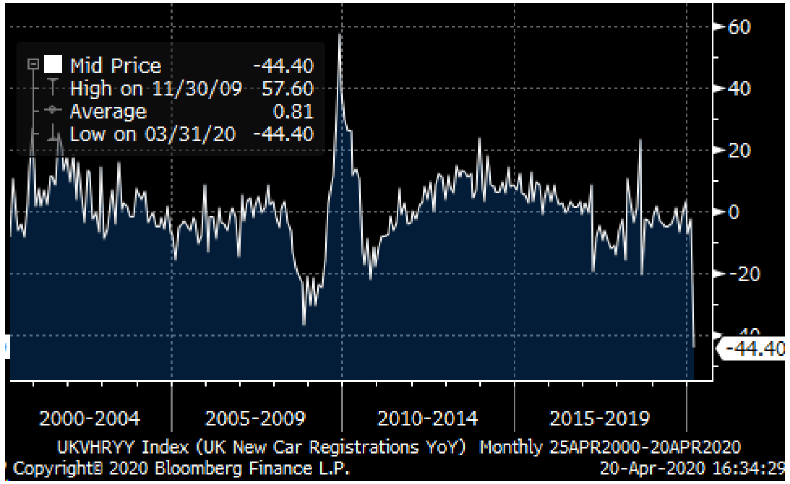
China YoY GDP % Growth



Germany Expectation Economic Growth



U.K. New Car Registrations YoY%



WHAT A SHORT, STRANGE TRIP

- Most major equity indices bottomed in late March, down roughly 25-40% on the year.
- Since then, indices have all rallied dramatically, but some differences have emerged.
- The NASDAQ is now down only 5% YTD, while the S&P 500 and the MSCI All-World are down 10-15%.
- Indices that focus on smaller, riskier companies (MSCI EM & the Russell 2000) are down 20-25%.

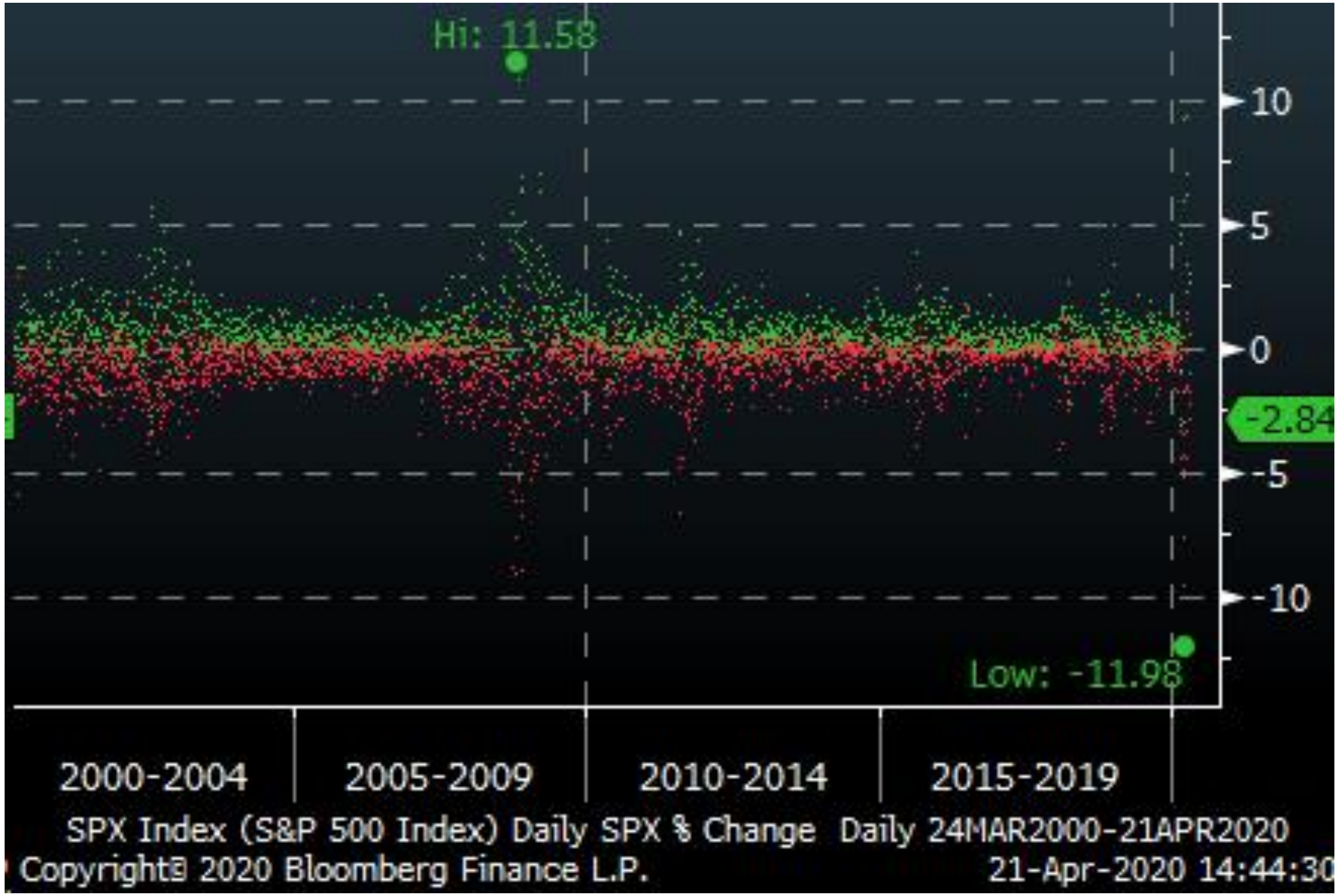
2020 Normalized Equity Index Returns

Source: Bloomberg

A REASON FOR YOUR MARKET ANXIETY

- The U.S. stock market experienced more volatility in March & April of this year than it did during the peak of the Financial Crisis.
- On March 16, 2020, the S&P 500 sank 12%, which was the largest single day move since Black Monday in 1987, and the third largest drop on record.
- Massive shifts in volatility like this cause many systematic funds to recalibrate their risk models, which often leads to a large-scale reduction in their positions (which often exacerbates the volatility).

Daily % Change in the S&P 500: Past 20 Years

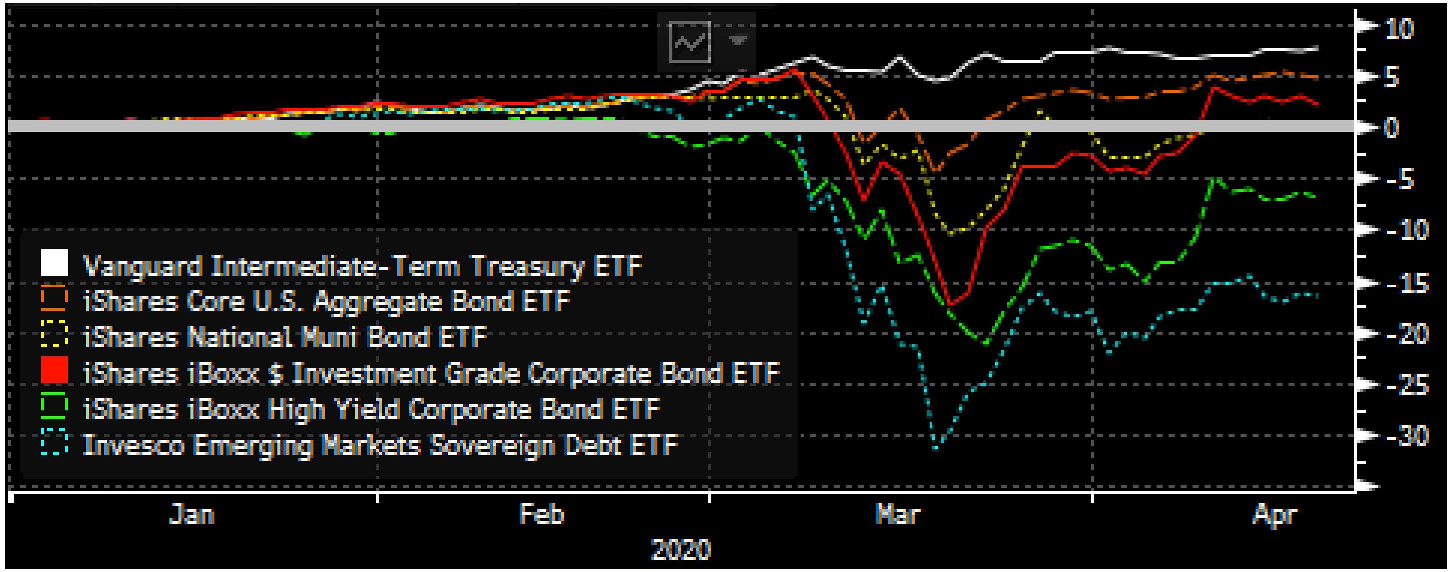


Source: Bloomberg

NOT ALL BONDS ARE THE SAME

- Treasury yields steadily traded lower to begin the year and cratered in mid-February as news of the virus spread.
- Chaotic trading occurred in many fixed income markets during late March, as the Treasury Yield curve slumped to an all-time low and credit spreads dramatically widened.
- As such, high quality assets (Treasury bonds, investment grade bonds) significantly outperformed lower quality assets (high yield, EM bonds).

2020 Normalized Fixed Income ETF Returns

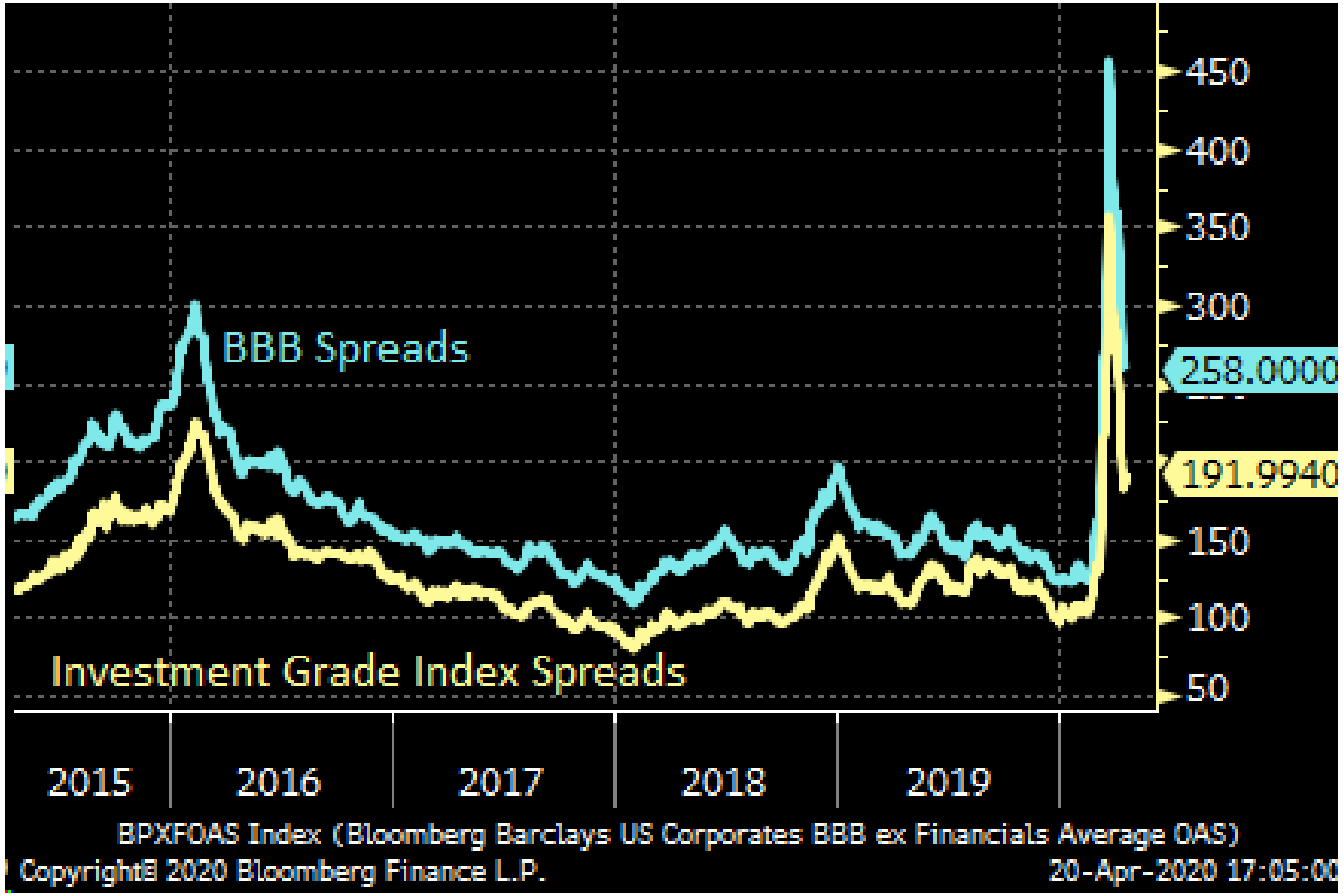


Source: Bloomberg

INVESTMENT GRADE CREDIT SPREADS

- IG credit spreads went haywire in March as large portions of the U.S. economy went offline.
- There was a quality gap that opened up at this time as well. BBB companies, which are the lowest rated investment-grade companies, saw their spreads widen 100bps* to the index.
- The spike higher in spreads represented a great opportunity for investors, but as shown, once the Fed announced they'd be buying IG bonds, spreads quickly collapsed.

U.S. Investment Grade Corporate Bond Spreads

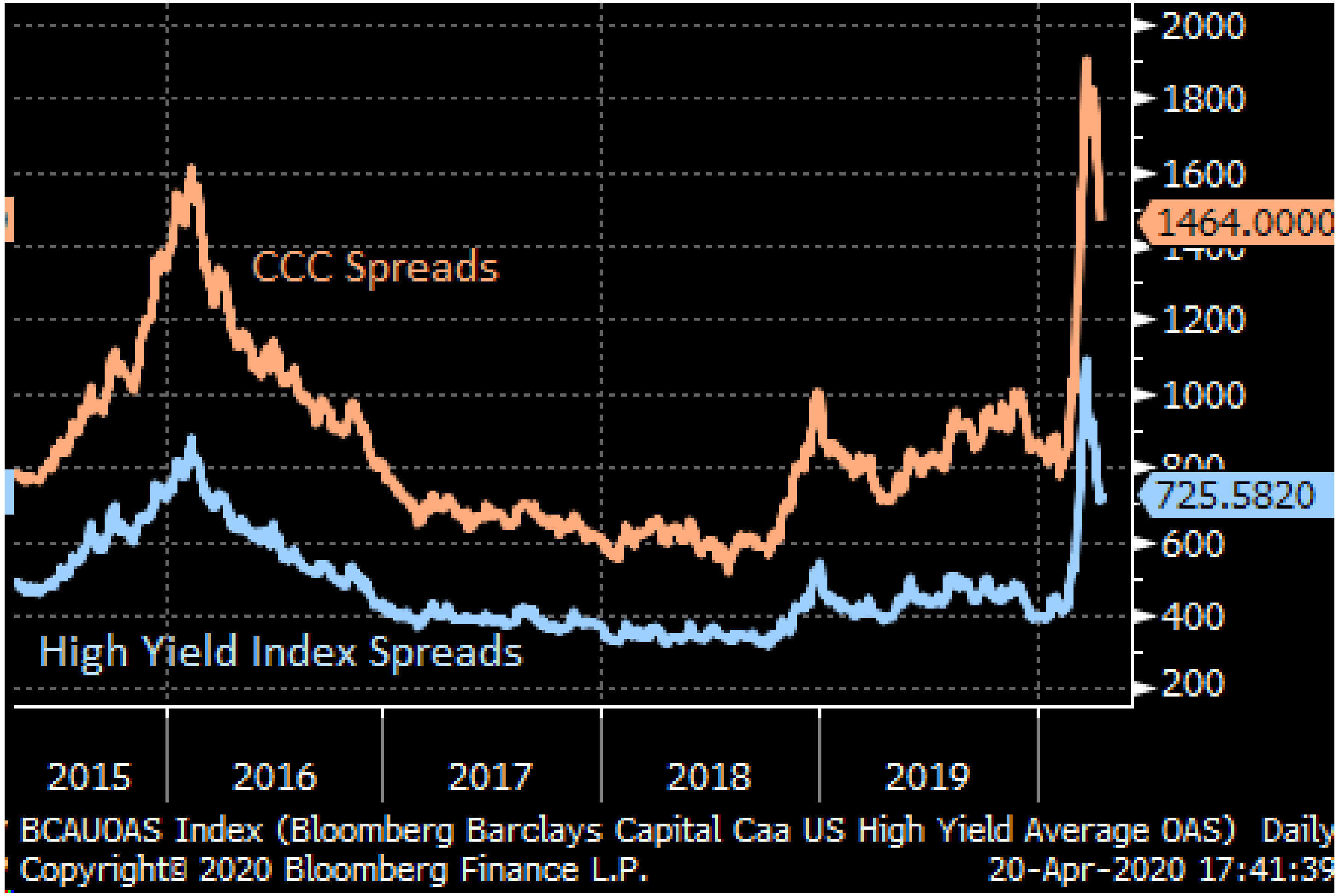


*bps = "basis points" so 100 bps is another way of saying 1.00%

HIGH YIELD CREDIT SPREADS

- HY spreads widened at a much quicker pace than investment grade spreads, since the companies have a greater dependency on well-functioning capital markets to raise capital.
- There was a massive widening in the quality gap – with the lowest rung of high yield credit (CCCs) trading ~750bps wider to the HY Index versus ~400bps to start 2020.
- We believe the backdrop will remain challenging for HY companies for years to come.

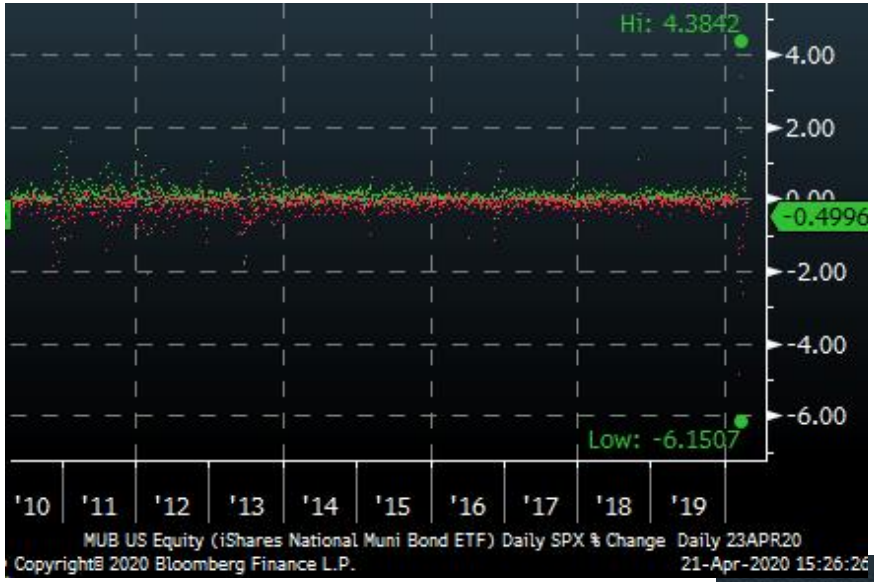
U.S. High Yield Corporate Bond Spreads



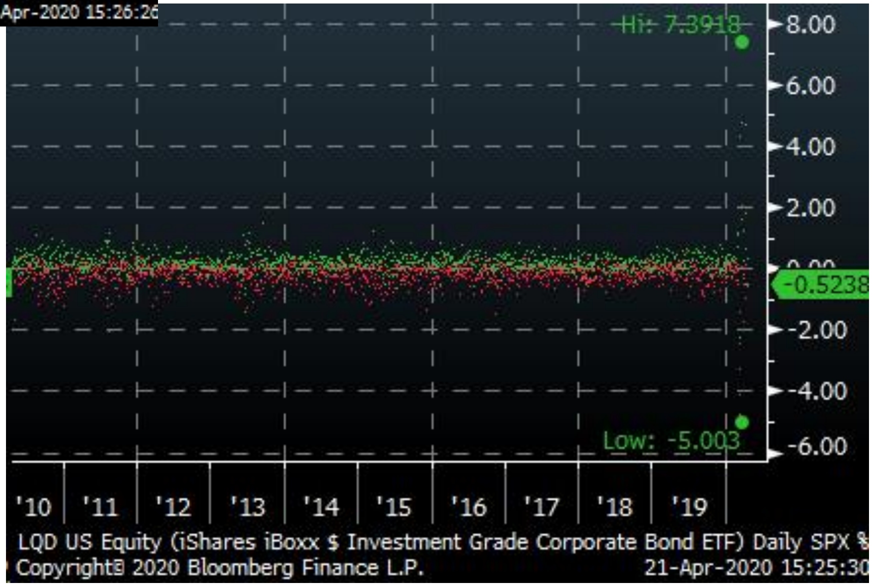
UNPRECEDENTED VOLATILITY EVEN IN "SAFE" SPOTS

- Spreads widened dramatically even in high quality assets over the past month.
- Here are the daily percentage changes in two ETFs that are widely held as high-quality fixed income investments in many individuals' and institutions' portfolios.
- These securities have experienced numerous 2%+ price declines over the past month. Those moves were virtually non-existent over the past decade.

Daily % Change in iShares National Muni Bond ETF

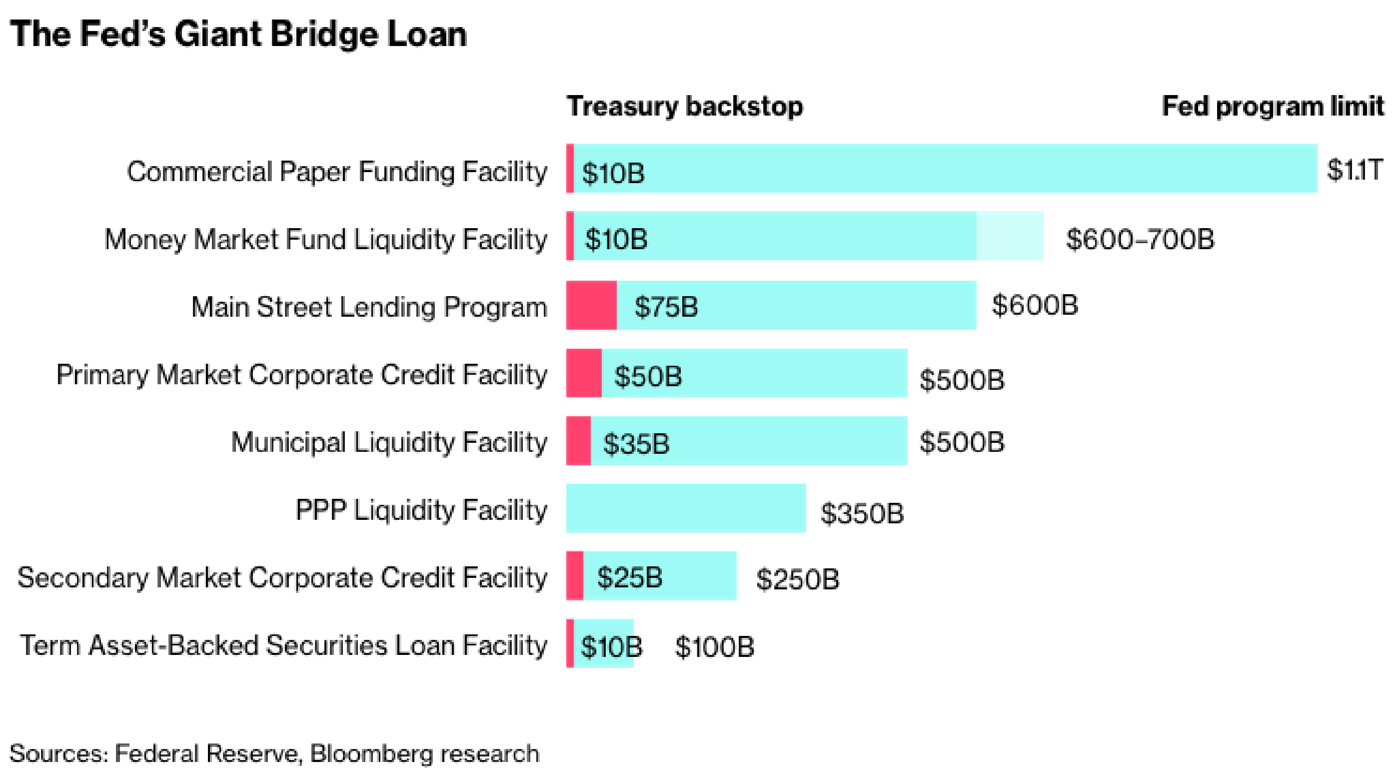


Daily % Change in iShares Investment Grade Bond ETF



THE FED HAD SEEN ENOUGH

- By mid-March, the Federal Reserve had seen enough. They began to announce stimulus programs regularly thereafter (at times it seemed daily).
- The Fed knew that tighter financial conditions would only contribute to the historic job losses that the U.S. would experience.
- Consequently, the Fed initially targeted the ”backbone” of the financial system (bank liquidity, access to commercial paper, the corporate bond market, etc.).



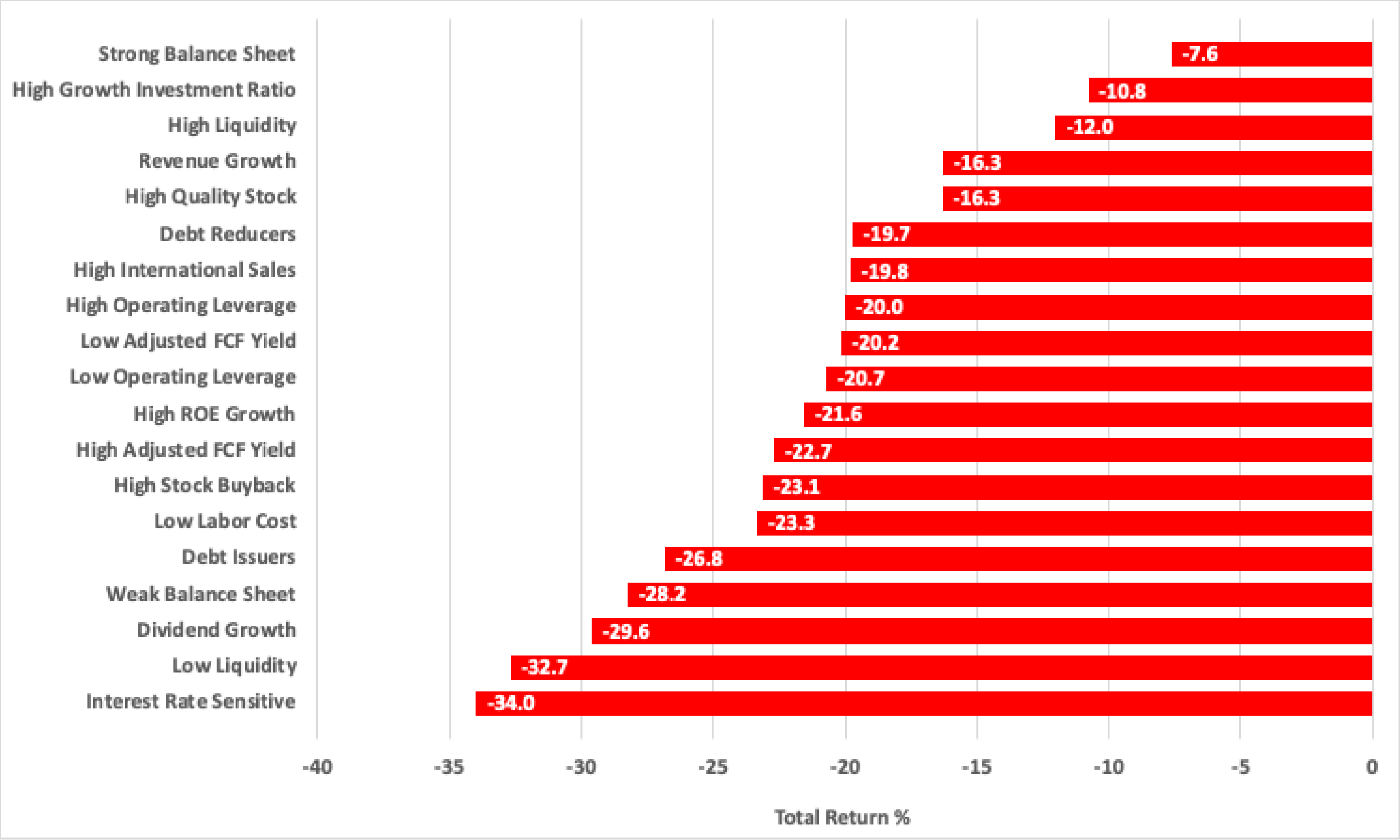
LOOKING AHEAD…

- Short-term market prognostication often seems like a fruitless endeavor - that seems particularly true now.
- Markets, generally, are *not* reflecting the present situation, but rather looking 12-18 months ahead at a minimum and trying to price in the probabilities of different scenarios in the interim.
- There are so many critical questions to be answered. A few we keep coming back to:
  - When will the U.S. develop a large-scale testing program?
  - Over what timeframe will an effective vaccine be developed, tested and widely deployed?
  - How effective will the stimulus be in helping 50% then 75% and eventually 100% of the citizenry to “re-engage” after the economy is opened?
  - What % of small businesses can survive that climate in the interim?
- If we were to make one prediction, it would be "choppy" – choppy financial markets, economic activity and return to "normal" lives should be expected due to uncertain probabilities surrounding aforementioned factors.
- Given that we have confidence in chop – we think investors would be well-advised to read the tea leaves of what the market has been rewarding these past few months (as we’ve endured a big move down and a big one up).

TRENDS HAVE EMERGED

- Goldman Sachs divides the S&P 500 into strategy baskets of 50 stocks that have the highest exposure to various factors such as quality, liquidity, fundamental characteristics, etc. *(note: individual stocks can appear in multiple baskets)*
- Examining YTD returns, one can see that: 1) dispersion is high across the factors; and 2) the market is rewarding high quality, well-financed companies and punishing those of lower quality.

YTD S&P 500 Returns by Factor Exposure

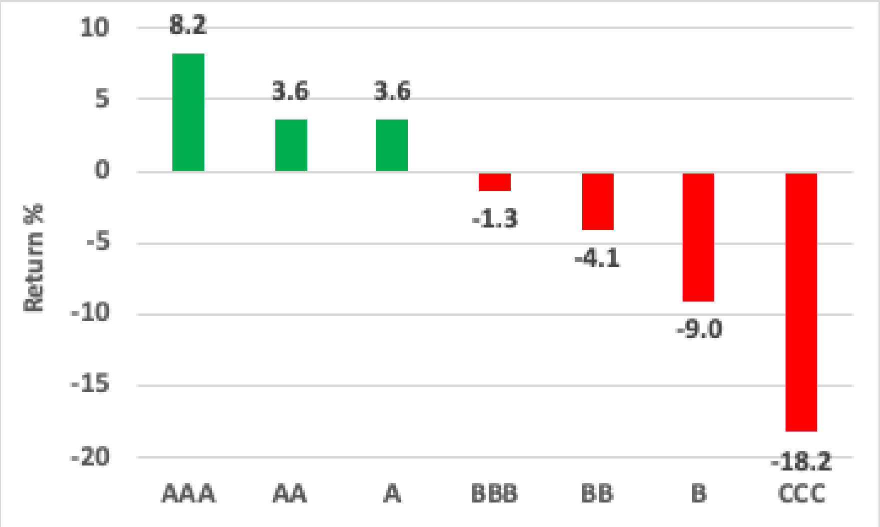


Source: Hamilton Point, Bloomberg

QUALITY WINNING IN BONDS TOO

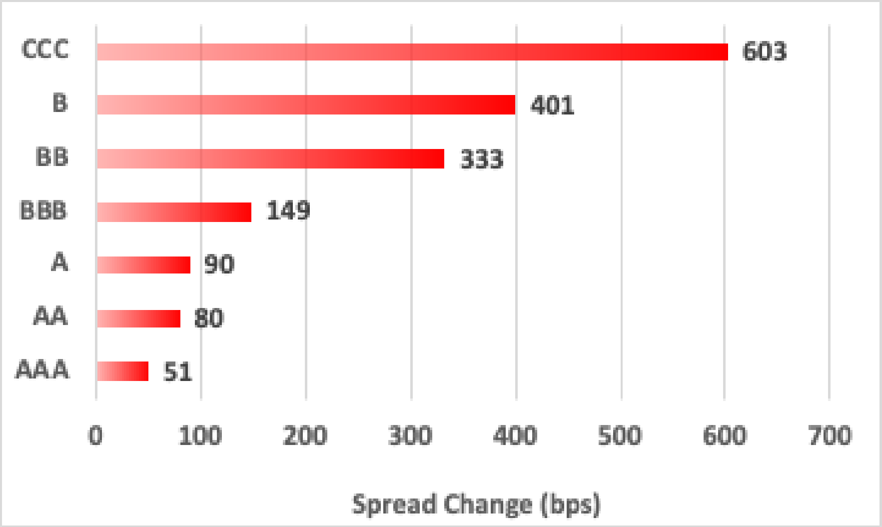
- Two factors have been driving corporate credit performance this year: 1) falling interest rates; and 2) widening credit spreads.
- Spreads have widened across all parts of the credit spectrum this year.
- However, returns have been positive in the highest quality companies because the positive effect of falling rates has more than offset the negative effect of wider spreads.
- Highly leveraged companies have been crushed as investors doubt their ability to weather the storm.

YTD Total Return in Corporate Credit



Source: Hamilton Point, Bloomberg

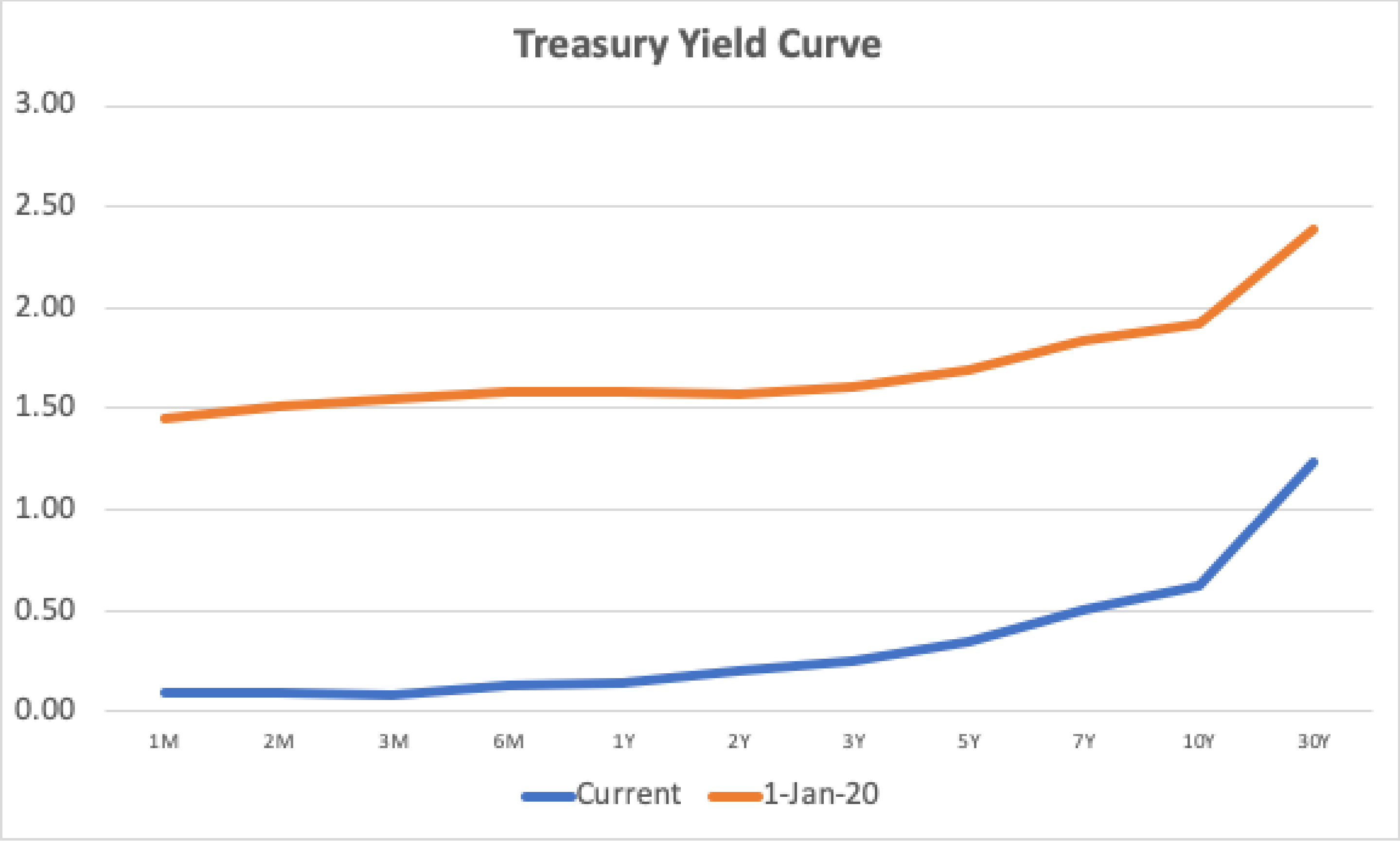
YTD Change in Corporate Credit Spreads



Source: Hamilton Point, Bloomberg

BOUNDED BY ZERO?

- The U.S. Treasury Yield Curve has dropped significantly thus far in 2020.
- On average, yields have dropped by 136bps across the curve versus beginning of the year levels.
- Based on current levels, the market does not expect the Fed to move away from its zero target for Fed funds for the next two years.



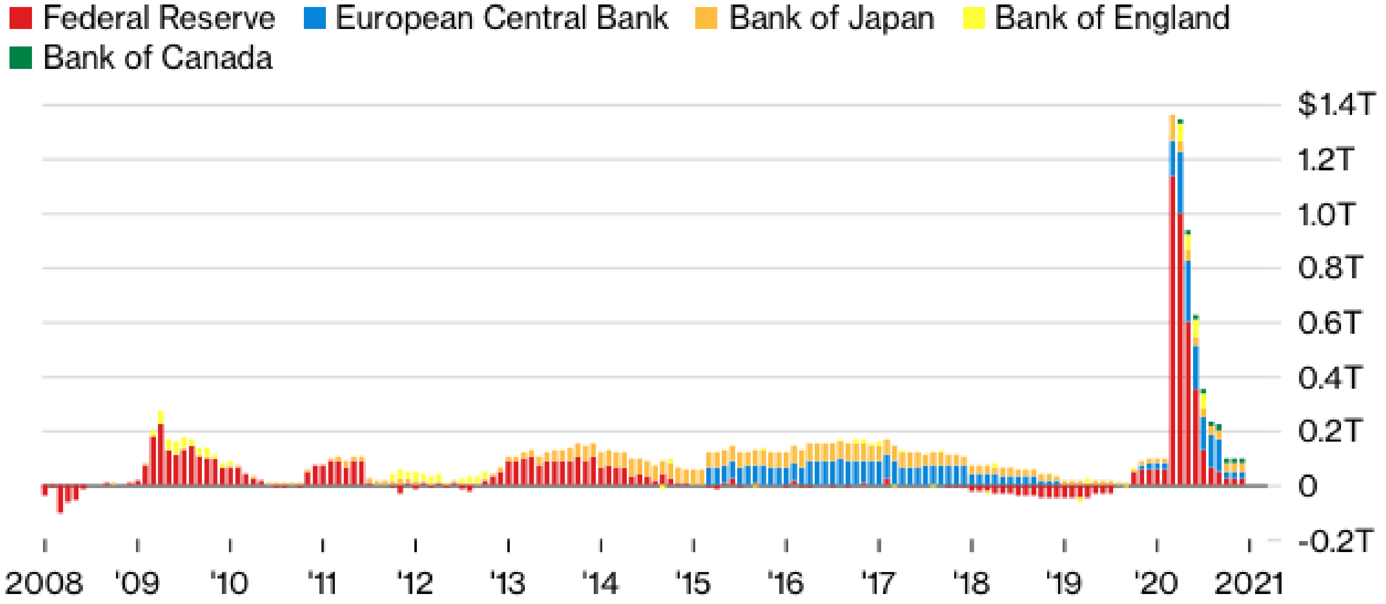
Source: Hamilton Point, Bloomberg

GLOBAL STIMULUS IS HERE

- Net asset purchases for the G-7 central banks approached $1.4 trillion in March.
- The Federal Reserve accounted for ~80% of this activity with over $1 trillion in net asset purchases.
- We expect these estimates will prove too small through the back half of 2020 – particularly with respect to the Fed, ECB and BOE.

Quantitative Easing

Net asset purchases for G-7 central banks approached $1.4 trillion in March

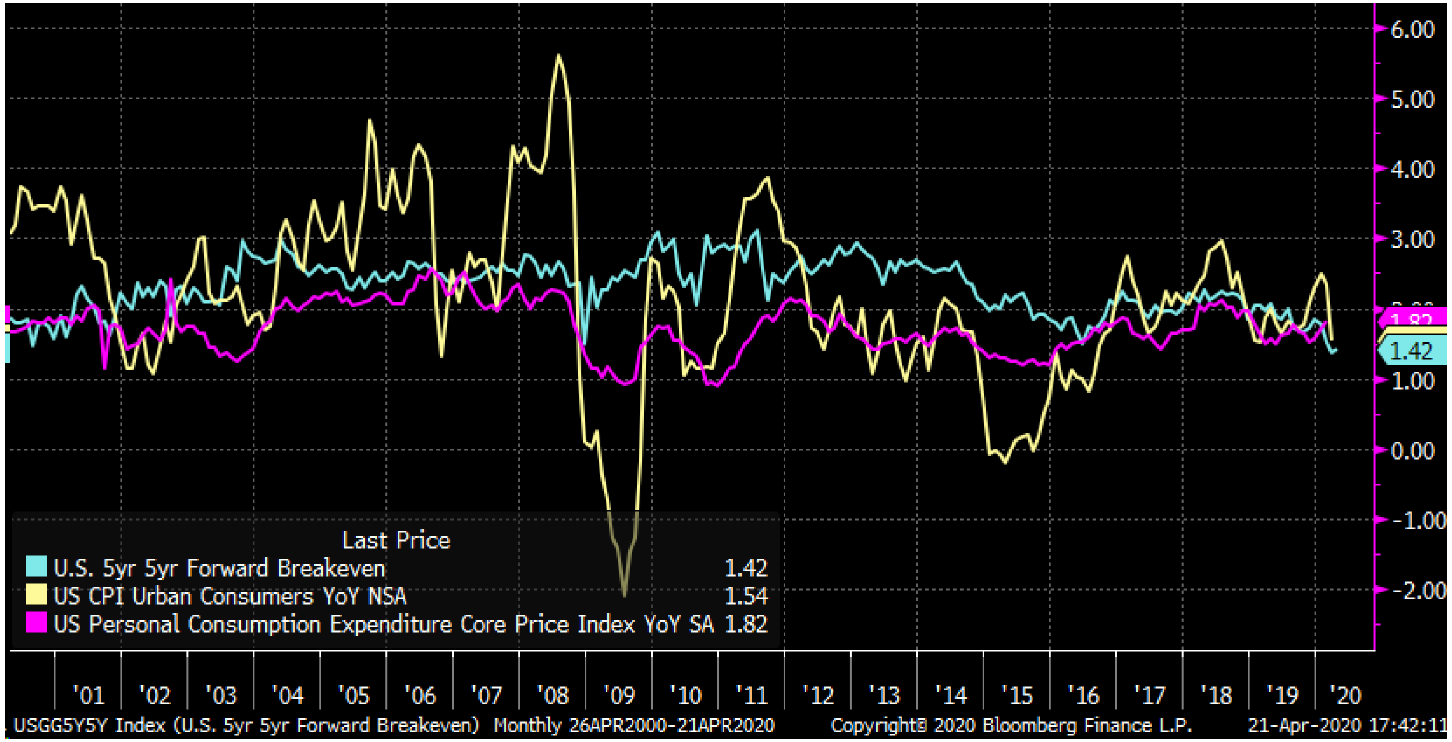


Source: Bloomberg Economics

DEFLATION A BIGGER CONCERN THAN INFLATION

- Given the global wave of fiscal and monetary stimulus hitting the markets, one may worry about future inflation implications.
- Pictured here we have 3 of the most closely watched inflation metrics: 5-year, 5-year forward breakeven rates, the CPI and the PCE Deflator*. All are firmly anchored at ~1.5%.
- Given the dramatic sell-off in oil and the pressure we're likely to see on wages and home prices, we believe the bigger short-term concern for investors is deflation.

Inflation Metrics (Breakevens, CPI, PCE Deflator): Past 20 Years



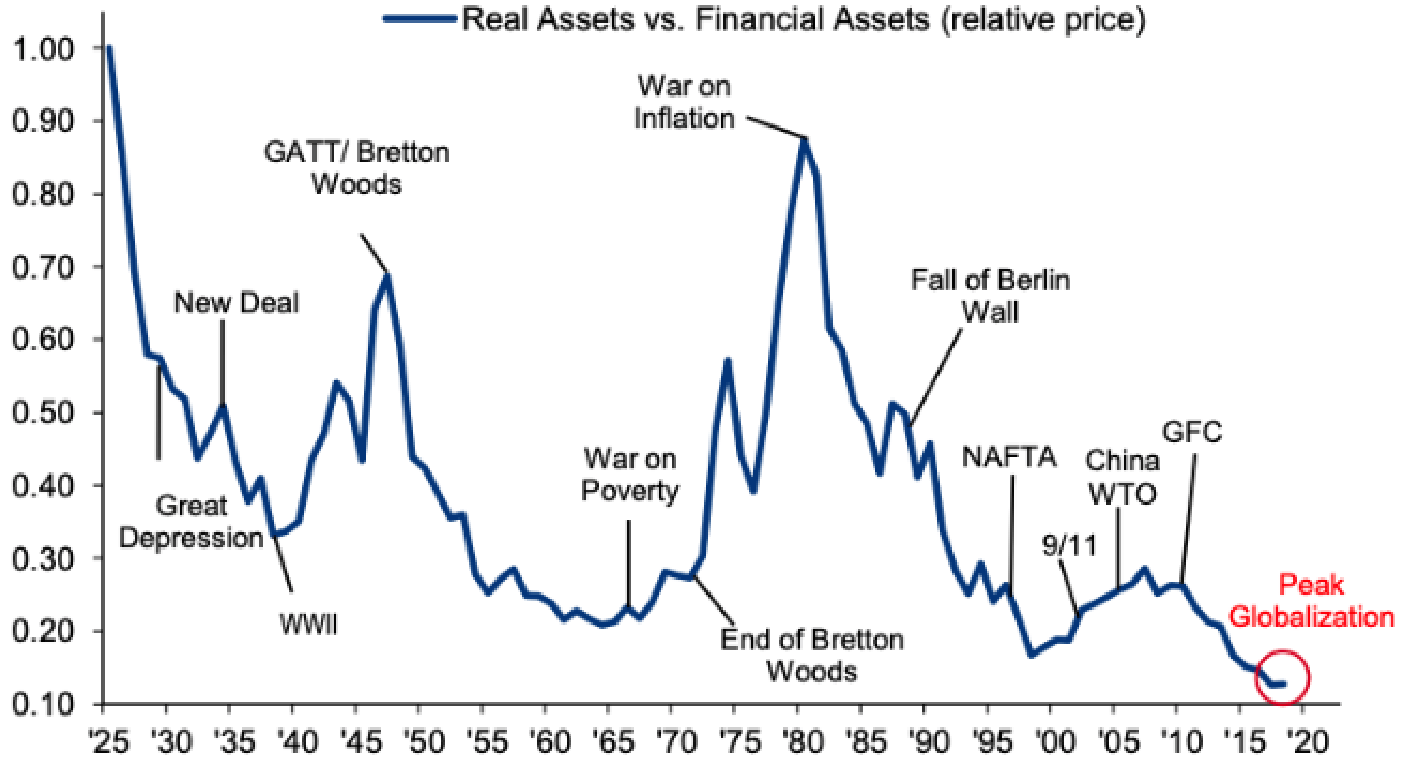
*5yr 5 yr forward breakeven: a measure of 5-year inflation expectations, beginning 5 years from today; calculation derived by comparing the yield of nominal and inflation-linked Treasury securities.

PCE Deflator is a measure of inflation based on changes in personal consumption

A REPEAT OF THE LAST DECADE?

- Given the size & form of the Fed's stimulus, we wouldn't be surprised to see a repeat of the market & "real" economy post the Great Financial Crisis (GFC).
- Financial assets responded quickly (S&P 500 bottomed March 2009) to Fed stimulus, but the "real economy" did not:
  - The unemployment rate didn't fall back below 6% until the end of 2014.
  - National home prices didn't reach pre-crisis levels until 2016.
  - Wage growth has never hit the 4% growth level it resided at pre-GFC.
- Expect the inequality debates of the past decade to intensify in the near future.

BAML's Real Asset vs. Financial Asset Index

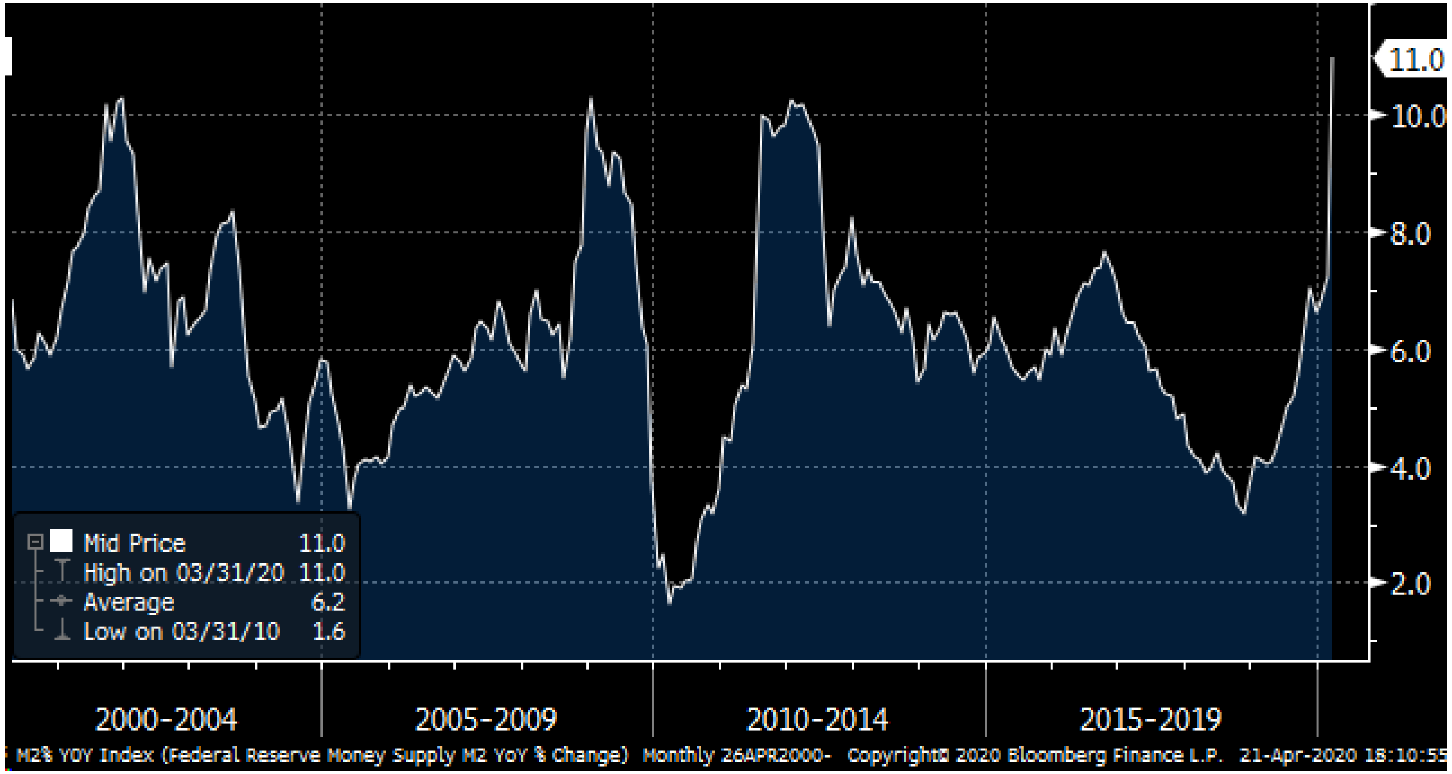


Source: BofA Merrill Lynch Global Investment Strategy, Global Financial Data, Bloomberg, USDA, Savills, Shiller, ONS, Spaenjers, Historic Auto Group. Note: Real Assets (Commodities, Real Estate, Collectibles), vs. Financials Assets (Large cap stocks, long-term Govt bonds).

WHY THE DISPARITY BETWEEN REAL DATA & STOCKS?

- Given the horrendous economic data that's published daily, many investors are wondering how the market can keep rebounding.
- If we had to pick one data point to explain this phenomena, it would be this chart. The money supply in the U.S. economy is exploding!
- M2 includes cash & checking deposits, as well as money market funds and savings deposits. Historically, there's a tight correlation between the stock market and the supply of money.

Federal Reserve Money Supply (M2) YoY %Growth



WHAT WE WORRY ABOUT

- The physical, emotional and behavioral toll of this virus on society.
- A second and third wave of the virus hitting the country.
- An inability to get aid to small businesses and the roughly 25% of Americans that we expect to be unemployed in the near future.
- A financial crisis that is born out of the current market chaos, perhaps rooted in the housing market or emerging economies.
- An extended period (i.e. years) to get the economy working back at full capacity.
- An over-leveraged world that is constrained by excessive debt in the aftermath of this crisis.

WHY WE HAVE OPTIMISM

- Scientists around the world continue to make progress in their quest for a vaccine and testing technologies, as well as treatments that could act as a "bridge" to widespread vaccine availability.
- Massive fiscal and monetary stimulus was deployed rapidly once the crisis hit the country.
- Valuations across asset classes are reasonable, assuming some version of "normal" earnings in the near future.
- Interest rates are historically low and likely to stay that way for the foreseeable future.
- The market knows at least as much as we do, and it is well off the lows.
- In the words of Warren Buffett, "For 240 years it's been a terrible mistake to bet against America, and now is no time to start."

WHAT WE THINK WE KNOW

- We have a strong bias towards quality in our portfolios. High quality appears to be a good place to be in these turbulent times.
- We've been spending time trying to avoid the blow-ups that always arise in these markets. Plenty of investments will go up and down, but blow-ups tend to go down so much that value recovery becomes near impossible.
- Market timing is a tricky game that rewards few. Maintain a sound investment allocation and rebalance when prudent to do so, which may be more often than normal given the current market volatility.
- This is a particularly good time to know what you own. Terrific investment opportunities tend to follow chaotic, gut-wrenching weeks that are filled with anxiety. Knowing what you own and why you own it will help you make a better decision during these times of stress.

CONTACT US WITH COMMENTS OR QUESTIONS

ANDREW C. BURNS
CEO & CHIEF INVESTMENT OFFICER
aburns@hamiltonpoint.com

INDUSTRY START DATE: 1978

HAMILTON COLLEGE
AB Economics

RICK WOODS, CFA, CPWA®
PRESIDENT
rwoods@hamiltonpoint.com

INDUSTRY START DATE: 1998

DUKE UNIVERSITY
AB Public Policy Studies

DUKE UNIVERSITY
MBA

NATE BYRD, CFA, CFP®
DIRECTOR
nbyrd@hamiltonpoint.com

INDUSTRY START DATE: 2006

WAKE FOREST UNIVERSITY
BS Mathematical Economics

UNIVERSITY OF NORTH CAROLINA
MBA

K.C. NELSON
DIRECTOR
knelson@hamiltonpoint.com

INDUSTRY START DATE: 1998

VANDERBILT UNIVERSITY
BA Economics

DUKE UNIVERSITY
MBA

DAVID STEPHAN, CFA
ASSISTANT VICE PRESIDENT
dstephan@hamiltonpoint.com

INDUSTRY START DATE: 2010

DUQUESNE UNIVERSITY
BS Business Administration

hamiltonpoint.com

@hamiltonpoint

Hamilton Point Investment Advisors

DISCLOSURE

The content provided herein is for informational purposes only and the opinions expressed herein are those solely of Hamilton Point. Hamilton Point reserves the right to modify its current investment strategies and techniques based on changing market dynamics or client needs. There is no assurance that any securities or strategies discussed herein will be included in or excluded from a client portfolio. It should not be assumed that any of the securities, strategies or internal studies discussed were or will prove to be profitable or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. An investment in our strategies is subject to investment risk, including but not limited to, the loss of principal and may not be suitable for all investors. This is not a recommendation to buy or sell any particular security and should not be considered financial advice. Past performance is not indicative of future results.

The visuals shown above are for illustrative purposes only and do not guarantee success or a certain level of performance.

A full description of Hamilton Point and its investment strategies and advisory fees can be found in Hamilton Point's Form ADV Part 2 which is available upon request or at the Investment Adviser Public Disclosure website. Hamilton Point is an investment adviser registered with the U.S. Securities and Exchange Commission, though such registration does not imply a certain level of skill or training. Hamilton Point's principal place of business is in the State of North Carolina. HP-20-113