

Perspectives

A Quarterly Newsletter for Clients of Parsons Capital Management



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As the year began, optimism was high after markets posted 30%+ gains in 2019 - lengthening the bull market and economic expansion into record-setting territory. Trade frictions were fading and the primary challenge to the on-going bull market was thought to be the November election. By the end of March the bull market was dead and the economy was in recession, shut down by the government in response to Covid-19 and then buffeted by an unexpected oil price war between Russia and Saudi Arabia. The speed at which the market went from all-time highs to a bear market, 22 trading days, was the quickest in history. Along the way markets opening "limit down" and tripping circuit breakers became a near daily occurrence. Panic selling was the norm. In this negative environment, growth stocks handily outperformed value, owing to laggards like energy and banks which weighed down the value index. Stocks further down the capitalization scale were particularly hard hit as their ongoing viability was called into question. A strong 15% rally in domestic markets in the final week of the quarter was sparked by unprecedented efforts from the Federal Reserve and Federal government to prop up the economy and blunt the financial impact of the virus.

Data as of March 31, 2020	March '20	Qtr. 1 '20	YTD '20
S&P 500	-12.35%	-19.60%	-19.60%
MSCI AC World Index (incl. US)	-13.44%	-21.26%	-21.26%
MSCI EAFE (Europe, Asia, Far East)	-13.25%	-22.72%	-22.72%
MSCI EM (Emerging Markets)	-15.38%	-23.57%	-23.57%
Russell Largecap	-13.21%	-20.22%	-20.22%
Russell Largecap Growth	-9.84%	-14.10%	-14.10%
Russell Largecap Value	-17.09%	-26.73%	-26.73%
Russell Midcap	-19.49%	-27.07%	-27.07%
Russell Smallcap	-21.68%	-30.58%	-30.58%

Data compiled by Tamarac Inc.



Fixed Income Markets

The volatility that besieged equity markets also impacted the fixed income markets, as US Treasuries were the only fixed income instrument to post positive returns for the quarter with gains of 2.76% in the short end up to 21.47% for maturities 20+ years. Municipal bonds had managed a positive total return through the first two months of the year but a -3.63% total return in March resulted in a -0.63% return for the quarter. Muni bonds were particularly hard hit in the month as questions arose concerning states' abilities to meet their obligations in the face of the unfolding recession. Corporate issues were also unsurprisingly hit in March, ultimately returning -3.14% for the quarter. No sector of the fixed income market was as hard hit as the high yield market, where energy companies make up a high proportion of issuers. The index, already down through the first two months, posted a -11.73% return in March bringing the year to date figure to -13.12%.

Fed cuts rates back to 0%...

Curve moves lower, but uninverts...

Commodities crash, led lower by energy...



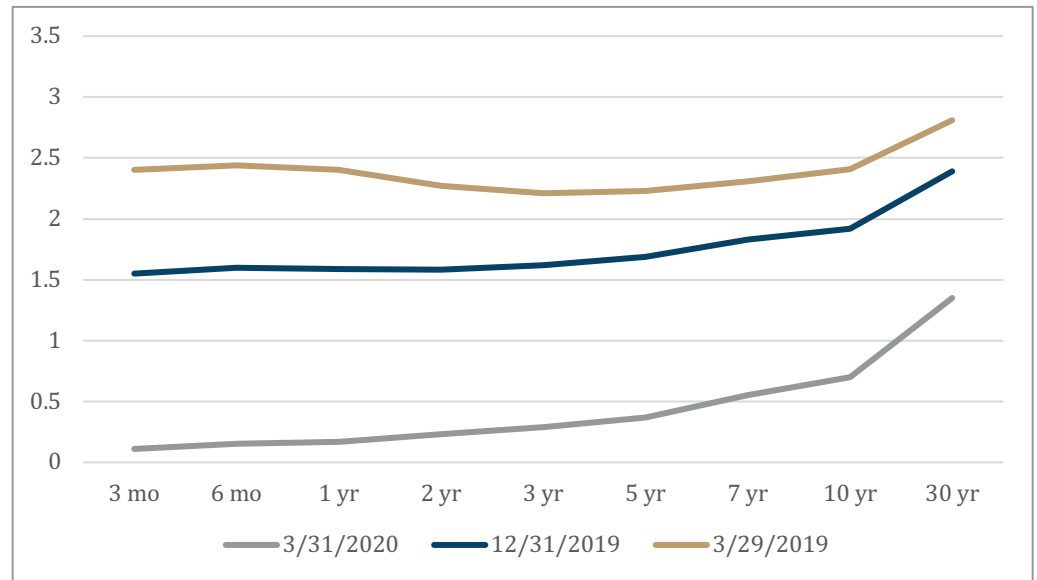
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US Treasury Yields

Two emergency rate cuts, 0.5% on March 3rd and a full percentage point on March 15th, brought the Fed funds rate to 0%, a move not taken since the Great Recession. A mid-cycle adjustment had already brought the yield curve lower throughout 2019, but the dramatic effect of the March cuts can be seen in the significantly lower curve at the end of the quarter. If there is a positive to note, it is that the curve has entirely erased its inversion and is now steeper than it has been in quite some time.



Commodities

Commodity prices unraveled in the quarter, with geopolitical issues darkening an already bleak picture due to the Covid-19 shutdown.

Nowhere was price weakness more apparent than in the energy complex. Oil prices were already falling as demand was evaporating due to economies shutting down. In the face of this demand destruction, the OPEC+ alliance disintegrated when Saudi Arabia and Russia were unable to agree to a production cut, leading the Saudis to flood the market with oil.

Gold was the lone positive standout, benefitting from a flight to safety and potentially some inflation concerns tied to the massive monetary policy measures undertaken globally.

Commodity	Qtr. 1 '20	Year to Date '20
CRB (broad index)	-34.25%	-34.25%
Oil	-66.45%	-66.45%
Gold	4.21%	4.21%



Economy began year on firm footing...

Payroll & expansion end record run...

Pockets of relative strength...

Government stimulus trying to blunt Corona impact...

Unprecedented bad numbers, but signs of stabilization...



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It's hard to believe now, but through the first two months of the year the domestic economy actually appeared to be gaining steam. While the impacts of Covid-19 were certainly being felt in some corners of the world, the US economy was humming as unemployment remained near an all-time low and trade frictions were moving toward resolution. In the span of four weeks, an economy that was tracking roughly +3% found itself in a recession.

In the US, payroll employment (seasonally adjusted) had grown every month beginning October of 2010. That impressive streak came to an end in March with a decline of -701,000 employees (data from the Bureau of Labor). Of the 701,000 decline, leisure and hospitality accounted for 459,000 - indicating just how hard hit the service sector was. After creating 22.5 million jobs from the end of the Great Recession in 2010 through February of this year, 16.8 million new unemployment claims were filed in three weeks in March.

While the devastation in the job market has been fast and immense, certain surveys and activity indicators are holding up better than expected - showing the economy hasn't completely shut down.

- The Consumer Confidence Index registered 120 at the end of March, down from 132 in February. While down, it ended the quarter at a level last seen in 2017 and a long way from the low of 25 witnessed in February 2009.
- The March readings for the manufacturing and service PMIs (Purchasing Manufacturers Index) were also much better than expected at 49.1 and 52.5, respectively. As a reminder, any reading above 50 indicates expansion.
- Housing has been another bright spot early in the year, with home sales up in January and February (latest data available) to the highest level since 2007. Housing starts and permits were also higher through February.

Of course these bright spots may prove transitory. Some of the economic data can be chalked up to the lagged effect of the shutdown and data gathering. There are some signs that the US economy is showing its resilience, however, as factories retool to produce needed medical supplies and companies learn to operate remotely.

In the face of these numerous headwinds, the Federal government has stepped up with multiple rounds of stimulus, approaching 15% of GDP. To put this in perspective stimulus measures taken in 2008-2009 were roughly 5% of GDP. While there is no doubt that the economic decline has been swift, such forceful stimulus may help to hasten the rebound once the economy is able to reopen.

While the economic situation in the US is certainly bleak, the international picture shows both how much worse it can get and also signs of recovery.

In Europe, economies across the continent were already weakening, led by Germany. In the earliest stages of Covid-19, the virus swept through the region and already weak economies began to seize up. In Italy, the service PMI reading crashed in March with a reading of 17.4, down 34.7 points, and the lowest reading for any country ever. The Italian manufacturing PMI also fell to a record low (for Italy) of 40.3 in March.

China, the first epicenter of the Covid-19 outbreak, was starting to slowly reopen their economy and see early signs of traction by the end of the first quarter. Business confidence rebounded to 52 in March from 35.7 in February, while various measures of activity also bounced higher. Manufacturing PMI rose almost 10 points to 50.1, while non-manufacturing nearly doubled to 52.3 and service PMI added nearly 20 points to register 43 in March.



*Echoes of 2008 in 1Q
sell-off...*

*Fed moved faster & more
forcefully than 2008...*

*Government pushing
stimulus at record rates...*

*Economic shutdown
clouding the near-term
outlook...*



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On February 19th the S&P 500 notched a new all-time high of 3386.15, up nearly 5% for the year. Over the following 22 trading days, the index lost 34% of its value as the full impact of Covid-19 started to become apparent. Along the way volatility spiked higher, with the VIX reaching 82.69 after beginning the year under 14. For comparison, the highest reading for the VIX during the Great Recession was 79.13. Selling was indiscriminate and panicked, and in an echo of 2008 credit markets began to freeze.

Faced with the prospect of a respiratory pandemic causing financial contagion, the Federal Reserve and Federal government dusted off the playbook developed in the Great Recession and went to work. In days, the Fed brought their borrowing rate to 0%, injected \$2 trillion into the repurchase market to keep credit moving, and restarted Quantitative Easing with \$700 billion in bond purchases. They also launched programs to backstop money market funds, commercial paper and the bonds of municipalities and corporations. They moved with alacrity and precision, addressing almost all sectors of the complicated and far flung credit markets.

In late March and early April, the Federal government passed three stimulus bills within three weeks (\$8.3 billion, \$100 billion, and \$2.2 trillion respectively) in response to the economic damage caused by shutting down the economy. Among other things, these bills provide aid to small businesses, expand paid sick leave, fund vaccine development, increase and expand unemployment benefits and provide direct payments to most Americans.

Fiscal and monetary stimulus together, already at 15% of GDP, are set to go higher. These coordinated and massive actions together with expectations for more helped to arrest the market freefall and contributed to a nearly 26% rally off the lows in late March and early April. The aggressive federal actions helped to stave off the financial worst case scenarios. Somewhat better than feared medical information has, as of this writing in mid April, perpetuated the rally.

What comes next? Forecasting has never been more difficult, because the unknowns have overwhelmed investors' ability to quantify risk and reward. First quarter earnings are coming in and so far are by and large surprisingly good, because January and February were strong. That won't last; companies are generally no longer providing guidance for the second quarter or rest of the year, since they have no idea how long and to what extent the economy will remain closed. Since consumers are the driving force of the economy, the recovery from this sudden and potentially deep recession (contraction in GDP) is uncertain both in terms of trajectory and speed.

In another era, the unprecedented federal deficits might prove inflationary. The yield curve is telling us, however, that the prevalence of global deflationary pressures like falling oil prices, technology, and aging population matter more – at least for now.

While broad market forecasts are no more than a guess at the moment, we can and are looking at companies and industries to assess likely winners and losers from the dislocations caused by the pandemic and its possible aftermath. It's a time for caution, but there will be a recovery and the world will look different, providing opportunity in the chaos.

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