THE BOSTON FAMILY OFFICE

Investment Update

Second Quarter 2020

We are pleased to report that the BFO team continues to be free of COVID-19 issues and hope the same can be said of you and yours. Offices in Boston were allowed to open about a month ago, but the city's preference is for people to work from home, if possible, and the restrictions and requirements for opening are quite onerous. For the time being most all of us are still working remotely until the balance between the risks, rewards, and compliance is more compelling.

Some of the tools that allow us to do this were available ten years ago in more rudimentary forms, but they certainly were not widely available twenty years ago. The economic consequences of the national shutdown would have been far greater if fairly large segments of the economy had not been able to shift quickly to remote work. Despite that, the consequences were dire indeed and the data that started to emerge in April paint a bleak picture, revealing an economic contraction no less astonishing in its breadth and rapidity than the 34% pullback in the S&P 500 from February 19th to March 23rd.

Equity Markets (Total Return)	2Q'20	1-Year	3-Year
Dow Jones Industrials	18.5%	-0.5%	9.1%
S&P 500	20.5%	7.5%	10.7%
S&P Mid-Cap	24.1%	-6.7%	2.4%
S&P Small-Cap	21.9%	-11.3%	0.6%
MSCI All-Country World	19.4%	2.6%	6.7%
MSCI Foreign Developed Markets	14.9%	-5.1%	0.8%
MSCI Foreign Emerging Markets	18.2%	-3.0%	2.3%
US Bond Markets (Total Return)	**2Q'20**	**1-Year**	**3-Year**
Barclays US Govt/Credit Intermediate	2.8%	7.1%	4.4%
Barclays US Govt/Credit Long	6.2%	18.9%	10.3%
BAML Municipal Intermediate	2.6%	3.6%	1.7%

The speed of both the U.S. stock market's correction in March and its rebound since then have few historical comparisons. By early June, the S&P 500 was back to roughly where it started the year, although it has traded in more of a sideways fashion since. Investors have had to balance optimism about gradual re-openings with news of reversals due to increasing confirmed cases in parts of the country. The 10-year Treasury yield stayed very low at around 0.7% throughout the quarter, but yields on cash equivalents and shorter-term Treasuries inside of five years drifted lower and these ultra-safe securities now offer minimal income. Following the Fed's intervention, the March dislocations in the markets for many other kinds of bonds have eased considerably and investment grade corporates and municipals now trade at more normal yields compared to those of Treasuries.

Perhaps the question that we are hearing most often these days is about the seeming disconnect between market performance and the state of the economy. Clearly all is not well in the latter even though there have been recent signs of early recovery. Unemployment is still in the double digits; a large percentage of the U.S. population is living under some limiting level of restrictions; and some industries are likely to operate at a small fraction of their old capacity for a while to come. Nonetheless, investors are assuming that the earnings power of most companies will not be permanently impaired and the economy will be back to normal in a year or two, regardless of the exact path of progress and setbacks along the way. Stocks are valued based on assumptions about many years' worth of future profits, so looking past a very bad year in the midst of one is not as irrational as it might seem.

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As much as we still do not know now about the course of the pandemic, we knew even less in March and there have been improvements on many fronts since then. Rapid progress is being made on vaccines and treatments and there has been success in flattening the curve in order to prevent the health care system from being overwhelmed. Also, it seems clear that another crippling national shutdown is not in the offing and that states will continue to employ the most relevant policies for their individual situations, which naturally will be different in a country this large. Most importantly, earlier in March it was as-yet unclear what the government could or would do to help offset the economic damage caused by shutting down so much of the economy. Investors now know that the Fed and Congress unleashed an unprecedented (a word that one has a hard time avoiding these days) amount of monetary and fiscal stimulus and are unlikely to turn off the spigot until the all clear sign is sounded. The Fed is projecting that rates will stay low for years, potentially using a new tactic of buying bonds at certain maturities to continually put downward pressure on yields, one of several novel ways it is injecting liquidity in to the market. These lower rates put upward pressure on stock valuations all things being equal.

The disconnect between markets and the economy might not be as large as it seems as the economic pain has been more acute for smaller companies, whereas perception of "the market's" performance is usually based on the Dow Jones Industrial Average (generally most quoted in the news) and the S&P 500 (what most professional investors pay attention to), both of which are made up of large companies that are better equipped to weather the 2020 environment. Further, the S&P 500's performance has been driven by some of the very largest companies, which were already perceived as more recession-resistant, and also happen to have been particular beneficiaries of work and shop from home trends. Although the performance of smaller companies in the second quarter alone was relatively strong (see table above), their 2020 peak-to-trough performance was significantly worse than larger companies' and came from levels well below 2018 all-time highs, whereas the S&P 500 had been at an all-time high on February 19th.

As we look forward, there are several short-to-near-term topics that will likely garner more investor attention and pose risks to stock prices. For example, the pandemic has squeezed out the typical non-stop press coverage of the upcoming election with its implications for tax and regulatory policy. The U.S.-China trade war has similarly taken a backseat but could again become a more frequent market mover. Finally, but more immediately, while Congress was unified in support of earlier support packages, there is not much bipartisan agreement on the scope and composition of a Phase 4 package, notably on the supplemental $600 per week unemployment which rolls off soon. This is not an exhaustive list and, as always, there are any number of things that could start or exacerbate a market selloff and we have now experienced two material ones in the last two years. Fortunately both were followed by sharp rebounds, and if nothing else good comes out of them, they at least afford the opportunity to reflect on how one actually feels when stocks go down as opposed to a perception of how one might react to a hypothetical scenario. We are here to help if a discussion about your asset allocation and portfolio positioning are called for based on these recent experiences and this certainly is a more favorable time to make changes than when in the throes of a market selloff.

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