MARKET INSIGHTS

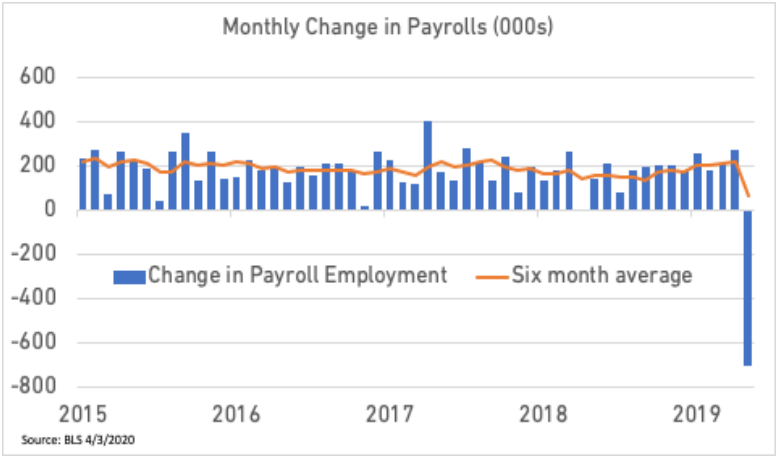
Market Insight Quarterly – Q1 2020 Review

ECONOMY

The US economy started off the year on a positive note before social distancing restrictions in response to Covid-19 led to the start of a sharp deceleration. The unemployment rate stood at a 50-year low while wage growth remained comfortably range-bound thereby not threatening profit margins. Progress on the US-China trade deal provided some clarity that buoyed business confidence late last year. Globally, growth exhibited signs of improvement early in 2020 but that changed quickly.

In early March, China's manufacturing and service purchasing managers index (PMI) data reflected the profoundly negative impact on the local economy, posting a decline almost on par to that of 2008. Covid-19 was declared a pandemic and as the first quarter came to end, similarly weak data was being reported across the globe and in the US. If that was not enough, disagreement between Organization of Petroleum Exporting Countries (OPEC) members led to a decision to boost supply and cause oil prices to decline by one-third in a single day, creating additional pressures on the energy industry.

The most recent US economic data provided the anticipated evidence that recession may have arrived. Jobless claims surged by over 3 million, nearly five times the prior peak. The Markit US Purchasing Manager's Index (PMI) data for the services sector declined to 39.1 for March, a level consistent with recession. Finally, oil prices, weighed down by global recession fears, declined for a fifth straight week and finished the quarter over 65% below where they started the year. Forecasts for second quarter US economic growth continued to decline as the quarter closed but a substantial contraction is expected.



The passage of a $2 trillion stimulus package in Congress will provide important support to businesses and workers adversely impacted by the virus. This stimulus is more than double that of 2009 in the aftermath of the financial crisis and provides noteworthy economic support. Additionally, the Federal Reserve's (Fed) response is now more robust than during the 2008 financial crisis. After announcing emergency rate cuts and a renewal of bond purchases almost two weeks ago, the Fed has continuedto be active, launching a variety of targeted lending facilities and liquidity measures to help ensure better functioning of financial markets. At the end of the first quarter, the benefits of these measures have become evident in financial markets and the sheer dollar volume of support will continue to provide benefits in the coming weeks and months.

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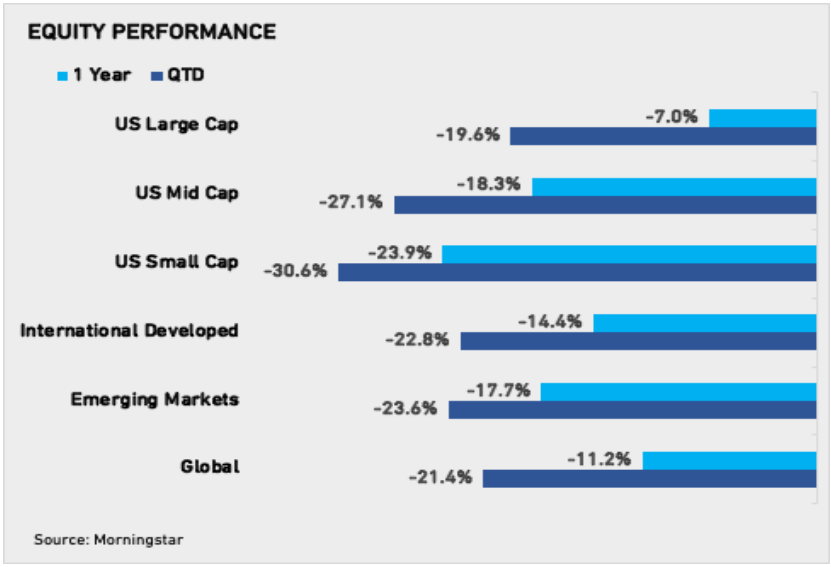
GLOBAL EQUITIES

US large cap stocks, as measured by the S&P 500 Index, fell by 20% during the first quarter of 2020 due to the growing concern the coronavirus will likely lead to a recession both in the US and globally. At one point during the quarter, US stocks had declined by more than 30% from their peak and the drop into bear market territory (defined as a decline of 20% or more from a market peak) was the fastest in history, even quicker than that of the Great Depression. As recently as February 19, the S&P 500 Index reached an all-time closing high of 3,386.15 due to the combination of better than expected US corporate earnings, a bounce back in nonfarm productivity, and various global leading indicators turning higher.



Stocks ended the quarter on a positive note, rallying by over 15%, as measured by the S&P 500 Index, from the March 23rd low as optimism that the virus might be contained within weeks rather than months combined with the fiscal and monetary stimuli already having been initiated would help the economy recover sooner rather than later.

Still the first quarter of 2020 was the worst on record for the more economically sensitive Dow Jones Industrial Average, while the broader S&P 500 Index posted its fifth weakest quarterly performance on record. Within US equities, small cap stocks as measured by the Russell 2000 Index underperformed large cap stocks which is typically the case when economic growth expectations deteriorate.

Equity market declines were widespread and global. International stocks were not spared and developed international country stocks fell by 23%, as measured by the MSCI EAFE Index. Similarly, emerging market stocks, didn't fare any better as the MSCI EM Index was down almost 24%

FIXED INCOME

US Treasury prices jumped higher and yields declined sharply during the first quarter as prospects of a slowing US economy coupled with an intense flight to safety buying boosted US Treasuries. The 10-year Treasury yield decreased by 1.2% to 0.7% from 1.9%.

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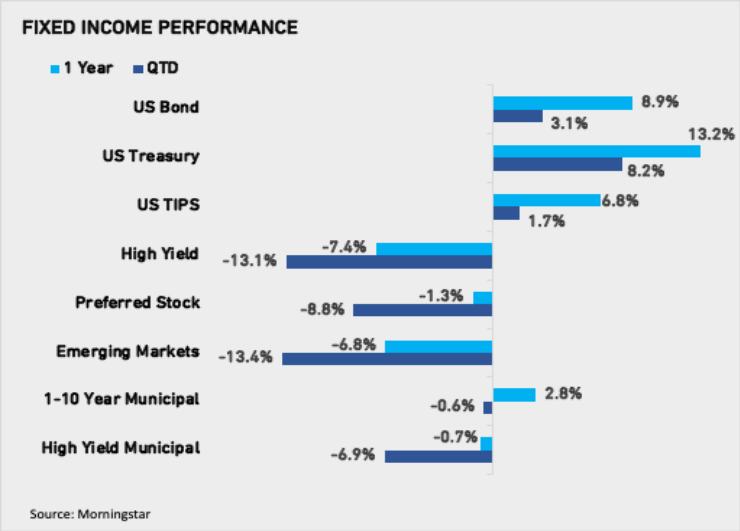
FIXED INCOME (CONT'D)

Not all segments of the high-quality bond market benefited however, and the broad bond market weakened in March, due to weakness among high-quality mortgage-backed securities and investment grade corporate bonds. Liquidity deteriorated in the middle of March as investors sought cash. Illiquidity was exacerbated by forced sellers due to mutual fund redemptions and margin calls. Investment grade bond mutual funds saw record outflows during this time. Although investment grade corporate bond prices improved late in the quarter it was not enough to offset losses for the sector.



The bond market received assistance from the Federal Reserve (Fed), which took aggressive action by bringing the Federal Funds rate down to zero from 1.5% in two reductions during the month of March and announcing a new round of bond purchases and lending facilities to boost overall liquidity.

Municipal bonds, as measured by the Bloomberg Barclays Municipal Bond Index, declined as mutual fund redemptions (like investment-grade corporate bonds) led to lower prices than implied by underlying fundamentals. Municipal bonds rebounded late in the quarter but not enough to offset mid-March weakness.

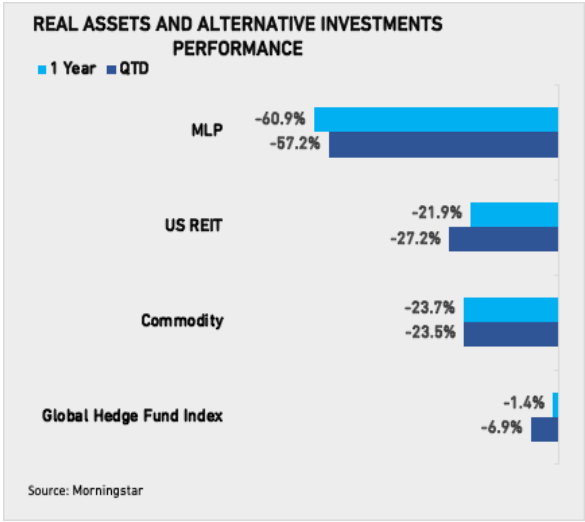
More economically sensitivity high-yield bonds, both taxable and tax-exempt lagged during the quarter as is typically the case ahead of recessions. A lack of liquidity exacerbated declines in both markets but a modest rebound late in the quarter.

ALTERNATIVE INVESTMENTS

Alternative investment strategies generally held up better than equities but still suffered declines on average. Still these strategies helped reduce overall volatility in a diversified portfolio. The broad based HFRX Global Hedge Fund Index declined by 6.9% suggesting strategies were better positioned to the volatile environment.

REAL ASSETS

Except for gold, real assets broadly weakened during the first quarter of 2020 reflecting the global economic slowdown.



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MASTER LIMITED PARTNERSHIPs (MLPs)

Master Limited Partnerships (MLPs) fell sharply as oil prices registered their worst quarterly performance on record. Oil prices suffered a one-two punch: first, a rise in supply after OPEC and non-affiliated Russia failed to reach a production cut agreement, and second, a demand shock due to the coronavirus pandemic and its impact on the global economy.

REITs

REITs underperformed broad equities during the first quarter, due largely to two factors: tightening credit conditions and the prospect of sharply weaker property fundamentals. Hotels/Gaming, Senior Housing and Retail are the sectors most affected by the coronavirus while self-storage, health care-related and industrials are less impacted.

COMMODITIES

Commodities overall declined by 24% led by the collapse in oil prices. Natural gas prices were down almost 25%. Gold, seen as a possible haven during volatile times, increased by over 3% during the quarter while copper, a more economically sensitive metal, declined by more than 20%.