opus
INVESTMENT MANAGEMENT

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JULY 2020

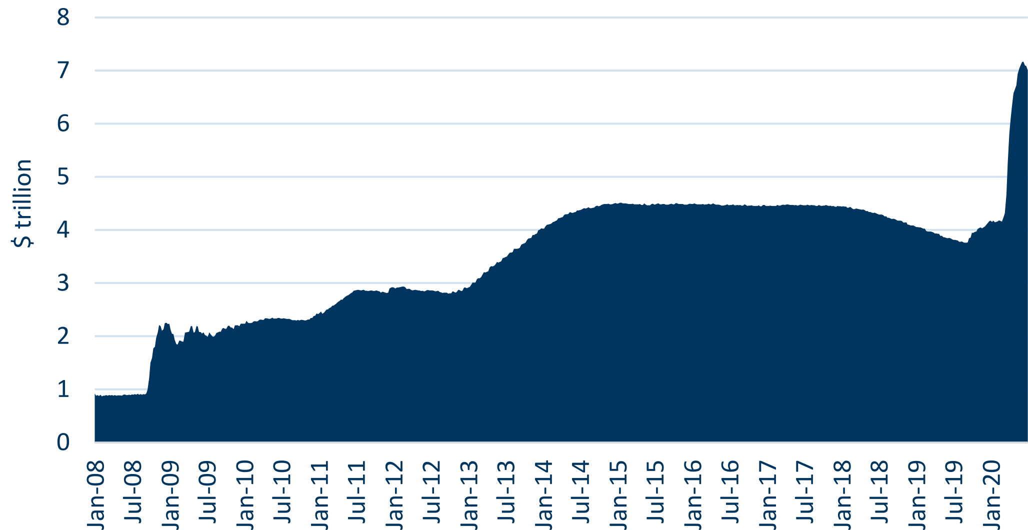
Second Quarter Commentary

Sitting in our home office chairs at the end of the first quarter, few of us would have predicted that the S&P 500 would return 20% over the next three months while the economy remained mostly shut. Investors witnessed unimaginable numbers, like the loss of almost 21 million jobs during the month of April, yet the confidence created by monetary and fiscal stimulus provided the needed boost to stabilize and lift the capital markets. With interest rates remaining low and steady, and credit risk premiums narrowing, fixed income indices performed admirably as evidenced by the Bloomberg Barclays U.S. Aggregate Bond Index returning 2.90% for the quarter. Truly astounding given the circumstances.

Economic data

We can point to a handful of reasons why valuations improved so dramatically: progress on a vaccine, the gradual reopening of states, recovering economic data, or perhaps something as simple as investors chasing momentum. In our opinion, the credit belongs to the stimulus packages provided by the Federal Reserve (Fed) and the fiscal packages passed by Congress. These measures provided stimulus checks, forgivable loan programs, unemployment benefits, aid to industries, and access to various funding mechanisms to name a few. The magnitude of the stimulus is impossible to ignore, as the Fed's balance sheet has expanded 70% since February and the budget deficit has grown $1.5 trillion. Globally, similar countermeasures are being undertaken by central banks to mitigate the economic impact of the pandemic. As we learned following the Great Financial Crisis, it's difficult to bet against those with the deepest pockets.

Exhibit 1: Federal Reserve balance sheet increased to all-time highs during the second quarter



Source: U.S. Federal Reserve

As the quarter progressed, economic data offered encouragement and optimism to many in dire need of good news. After the disastrous April jobs report, we saw a return to job creation during the months of May and June that was earlier than the consensus expected. Retail sales figures also bounced back strongly in May. For June, manufacturing survey data returned to expansionary territory with similar trends occurring globally. However, as life returns to normal with states relaxing restrictions, confirmed cases of COVID-19 are rising again, and quickly in some locations. Some states out west and in the southeast are having to reconsider their reopening schedule, even rolling-back some of the freedoms recently given. With quarterly corporate earnings ahead of us, market expectations are for a significant decline in profits, but the true focus will be on the outlook to see which segments of the economy are staging a recovery and which ones are struggling.

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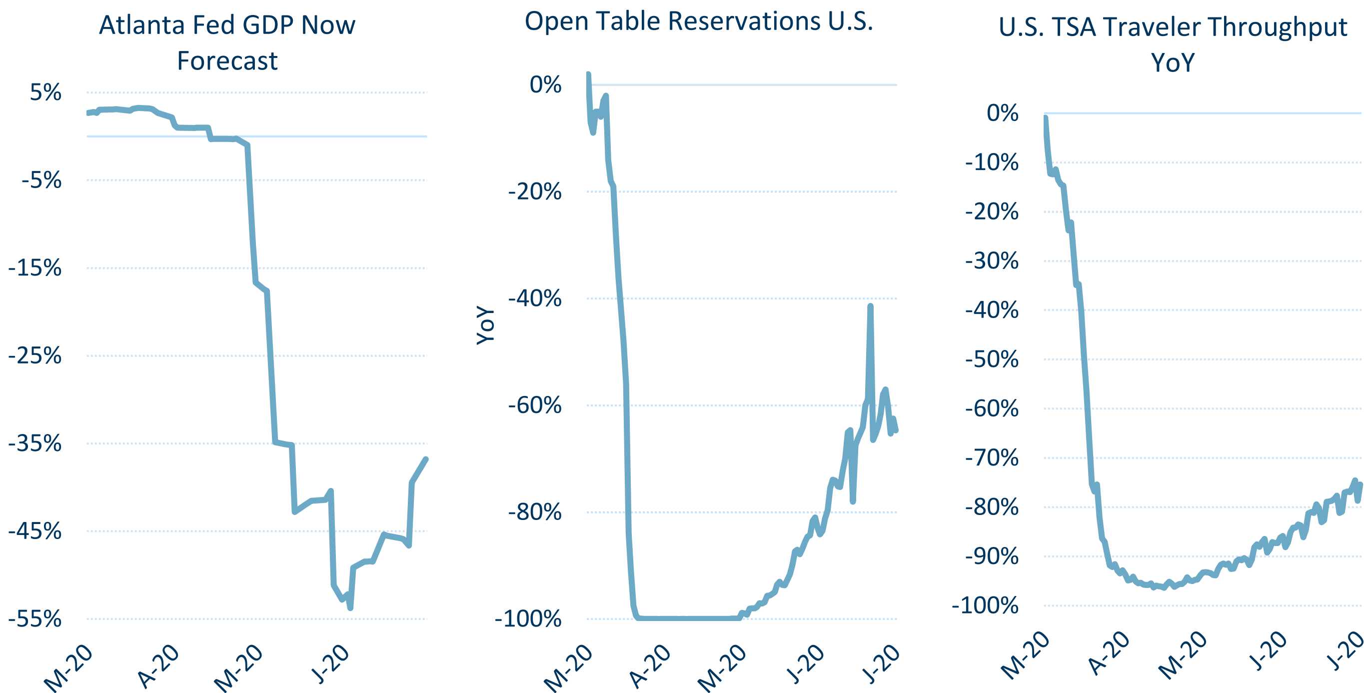
Exhibit 2: High frequency economic data improving, but a long path ahead to pre-COVID levels



Source: Opus, Bloomberg, Federal Reserve Bank of Atlanta, Open Table, Transportation Security Administration (TSA)

In the months ahead, investors will contend with a U.S. presidential election, declining trade relations with China, and the potential for a second wave of the virus. Valuations have steadily risen since March, but we expect the path forward to be choppy given the uncertainty that remains. Looking long term, with all-in yields at historic lows and the Fed committed to keeping short-term rates near zero into 2022, fixed income returns may be challenged. With rising government debt levels, growing deficits, and aging demographics, the effects of the pandemic could be long-lasting and could keep interest rates low for years to come. At Opus, we are committed to navigating your portfolio through these difficult times.

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