Monthly Investment Update

May 4, 2020

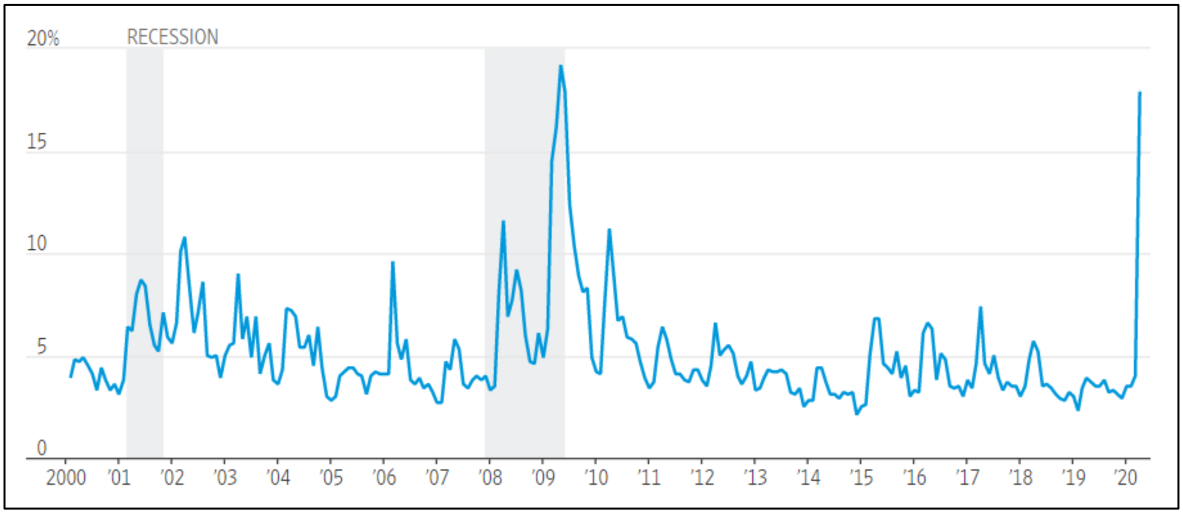
After a difficult first quarter of 2020 for investors, April provided a much-needed reprieve as markets rallied sharply. US large cap equities, as measured by the S&P 500 index, had their best month in decades returning nearly 13%[1]. Investors appeared optimistic that the significant stimulus provided by governments and central banks, lower energy prices, and evidence of potential new treatments for the COVID-19 virus could result in a swift recovery.

Unfortunately, the economic data released throughout the month was decidedly more sobering. Investors digested significant declines in first quarter year-over-year US economic output and corporate earnings, as well as the steepest job losses in US government-recorded history. Household spending and sentiment in April also marked some of their largest monthly declines ever.

Earnings

As of Friday, 55% of S&P 500 companies have reported earnings results for the first quarter with an average year-over-year decline of 14%. The quarter is on track to mark the largest decline since the third quarter of 2009 when corporate profits fell 16% from the year before[2]. Going into earnings season, analysts had been slow to update their forecasts, with the average expectation for S&P 500 earnings to decline just 7%. Second quarter earnings will likely be similarly uncertain as most companies have elected not to provide earnings guidance (only 19 companies so far), and the disagreement among analysts regarding expectations for corporate earnings over the next year has reached its highest level since 2009 (Chart 1). For 2020, analysts now expect S&P 500 earnings to decline 18%, which is a stark contrast to the average expectation of 9.2% growth that was forecast at the beginning of the year (Chart 2). If these estimates are correct, then S&P 500 earnings for 2020 will be approximately $135 per share, which means that the index trades at more than 21x this year's expected results. This price level may imply that investors are optimistic that the likely recession caused by the COVID-19 virus may be short-lived.

Chart 1: Dispersion of Analysts' Earnings Estimates for S&P 500 Companies

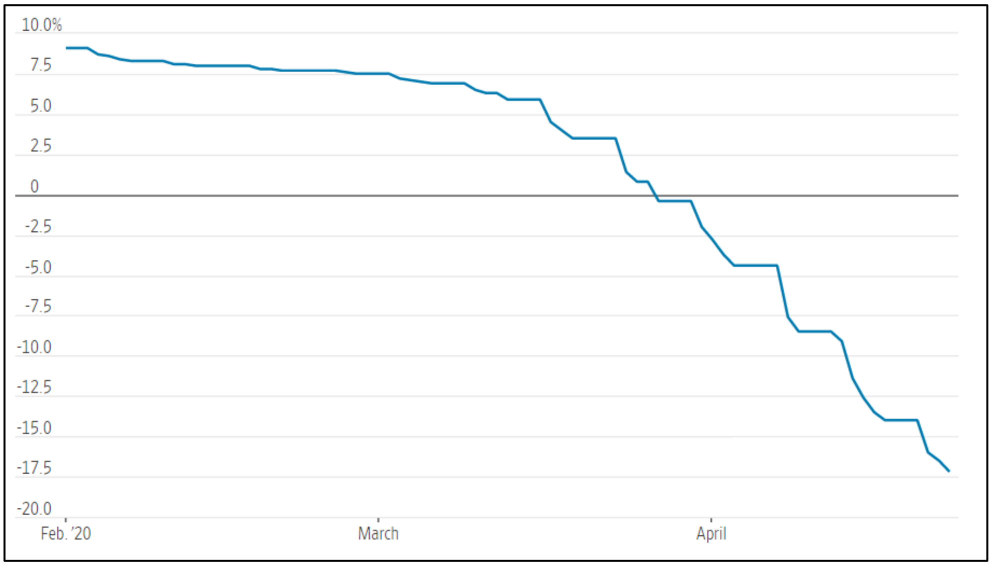


Source: FactSet, the Wall Street Journal

[1] Morningstar

[2] https://www.factset.com/hubfs/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_050120.pdf

Chart 2: Analysts' Consensus Estimate for 2020 S&P 500 Earnings Growth



Source: FactSet, the Wall Street Journal

Economy

US GDP declined 4.8% year-over-year in the first quarter[3]. Economists, on average, had been expecting a decline of just 3.5%. According to IHS Markit, first quarter GDP was expected to grow for most of the quarter until mid-March when the stay-at-home orders and business closures took hold across the country. So, it is reasonable to expect that the longer these guidelines stay in place during the second quarter, the larger the potential decline in US output. For example, as of today, IHS Markit expects that GDP could contract as much as 37% year-over-year in the second quarter as of today. Household spending activity accounts for nearly two-thirds of GDP, and its largest component, personal consumption, declined 8% in the quarter, which was steepest decline since the government began tracking the data in 1947.

Employment

On Friday, we will receive the April employment report, which will give a clearer picture of the impact that the COVID-19 virus and resulting stay-at-home orders and business closures have had on the US labor force. The April report is expected to show that the US economy lost 22 million jobs and an unemployment rate of 16.1%, which would be the highest rate since the government began tracking the data in 1948 (Chart 3). The April report will only cover the period from March 15 through April 18, during which 26.5 million people filed for unemployment benefits, but another 3.9 million applications were filed the following week, which would imply that the true unemployment rate may be north of 20%[4]. Encouragingly, many Americans who have been displaced believe that their situation is temporary. In March, 47% of those who recently lost work were on temporary layoff, up from 29% in the February report. The economy has also seen net new hiring in industries such as online retailers, pharmacies, and restaurants with delivery capacity.

[3] https://www.wsj.com/articles/first-quarter-gdp-us-growth-coronavirus-11588123665

4 https://www.wsj.com/articles/april-jobs-report-likely-to-show-highest-unemployment-rate-on-record-11588514401

Chart 3: Historical Unemployment Rate

Implications for Investors

While we are encouraged by the longer-term prospects for economic and corporate earnings growth that may result from stimulus, lower energy prices, and lower interest rates, we believe that investors may not be fully discounting the economic and psychological impact that the COVID-19 virus may ultimately cause. It is difficult to predict with accuracy when the virus will subside, when a vaccine will be widely available, or if a new wave of infections will materialize later this year.

It's also possible that households, many of which finally regained their confidence to spend just within the last few years following the global financial crisis of 2008, will quickly reduce their spending and delay large purchases and significant life events as their confidence in their future economic prospects and paycheck stability has been damaged. Given the sharp rebound in risk assets in April, particularly US equities, we remain cautious. We may experience a sharp economic recovery later this year as markets are implying today, but we do not believe that broad market prices for equity and credit are appropriately reflecting the possibility that the path to recovery may be quite volatile.

Key Economic Releases This Week

Day	Report	Period	Forecast	Previous
Tuesday	Markit Services PMI	April	-	27.0
	ISM Non-manufacturing Index	April	-	52.5
Thursday	Initial Jobless Claims	Week of 5/2	-	3.9 million
Friday	Nonfarm Payrolls	April	-	-701,000
	Unemployment Rate	April	16.1%	4.4%

Source: Marketwatch

COMPASS INVESTMENTS LLC

Asset Class Returns

Category	Representative Index	April 2020	YTD 2020	Full Year 2019
Global Equity	MSCI All-Country	10.7%	-14.8%	26.6%
US Large Cap Equity	S&P 500	12.8%	-11.8%	31.5%
US Small Cap Equity	Russell 2000	13.7%	-24.1%	25.5%
Foreign Developed Equity	MSCI EAFE	6.5%	-18.9%	22.0%
Emerging Market Equity	MSCI Emerging Markets	9.2%	-17.3%	18.4%
US High Yield Fixed Income	ICE BofAML High Yield	3.8%	-10.1%	14.4%
US Fixed Income	Barclays Aggregate Bond	1.8%	4.9%	8.7%
Cash Equivalents	ICE BofAML 3 Mo Deposit	0.3%	0.8%	2.2%

Source: Morningstar, Bloomberg, US Treasury (total returns shown gross of fees)
As of April 30, 2020

Prices & Interest Rates

Representative Index	Current (4/30/20)	Year-End 2019
S&P 500	2,869	3,231
Dow Jones Industrial Avg.	23,996	28,538
NASDAQ	8,825	8,973
Crude Oil	$15.06	$61.21
Gold	$1,695	$1,520
US Dollar	99.02	96.39
2 Year Treasury	0.20%	1.58%
10 Year Treasury	0.64%	1.92%
30 Year Treasury	1.27%	2.39%

Source: Morningstar, Bloomberg, US Treasury (total returns shown gross of fees)
As of April 30, 2020