



Cornerstone

C A P I T A L G R O U P

Radically Practical Investing™

Quarterly Market Update and Outlook

Second Quarter 2020

Implications of COVID-19 for the U.S. Economy & Capital Markets

- The COVID-19 pandemic and the corresponding uncertainty in the financial markets necessitate a different approach to our Quarterly Market Update and Outlook. Importantly, COVID-19 is a health issue first and an economic issue second.
- Financial markets dislike uncertainty. We believe volatility will persist until the virus is contained globally or a medical solution (e.g., a vaccine) is developed.
- We recommend investors take a long-term view of the markets, and not focus on day-to-day volatility. This is a short-term shock to the system, not a structural issue as occurred in 2008. With a long-term view in mind, we are not changing our recommended asset allocation.
- The COVID-19 crisis and its disruption to our society and our prevailing modes of individual behaviors help to underscore the core tenets of impact investing: A consideration of our collective environmental and social well-being; a deep understanding of an investment's positive or negative impacts; and sound corporate governance and transparency. In Cornerstone's view, following these principles will reward the long-term investor.

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The Pandemic in a Public Health Context

The coronavirus will likely remain an acute public health crisis for the foreseeable future.

- While estimates of the number of people in the U.S. infected with COVID-19 are provided daily, the exact number is not known for a variety of reasons, including:
 - infected individuals may be asymptomatic (some health experts estimate that 60-70% of the U.S. population may become infected but remain asymptomatic);
 - large segments of the population have not been tested;
 - cases may not be reported correctly, either by individuals or health care providers/public officials (intentionally or not).
- There are two additional health challenges associated with the pandemic. The first is the increase in unhealthy behavior by U.S. consumers in these stressful times: e.g., eating badly, drinking more alcohol, consuming more tobacco. The second is a rise in mental health issues. Aside from the direct impacts of this virus — illness, loss of family and friends, loss of income — anxiety, depression and sleep deprivation also result from excessive screen time and loneliness, among other factors. Working remotely has now become acceptable, but the downside of that is reduced social interaction — a feeling of connectedness is a key element of a workplace.
- Most health and medical care experts agree that the U.S. response to the crisis was late and has been uneven. The result is that the U.S. now has the largest number of cases, far surpassing past epicenter countries such as China, Italy and Spain.
- Following concerted efforts by state governors in New York, New Jersey, California and Washington, progress has been made to make testing more widespread; to isolate anyone with a suspected or confirmed case; to impose a quarantine period on anyone who has had contact; and, most importantly, to slow the growth rate of infections.
- There is a concerted effort among national health organizations, university research labs and the pharmaceutical industry to develop a vaccine, and experimental trials are already being conducted. While there is reason for hope about a medical solution, an effective and broad-scale vaccination is estimated to be many months, or even years, away.
- “The best case is that the virus mutates and actually dies out,” said Dr. Larry Brilliant, an epidemiologist who as a young doctor was part of the fight to eradicate smallpox. ¹ Brilliant was a consultant for the movie “Contagion,” in which a virus evolved to become more deadly, but that’s the exception. “Only in movies do viruses seem to become worse,” he explained.

In sum, this crisis will continue to generate multiple health care challenges for many months to come. While it will eventually be contained by way of a combination of social distancing, a medical vaccine and nature itself, it is impossible to know how the next several quarters will unfold.

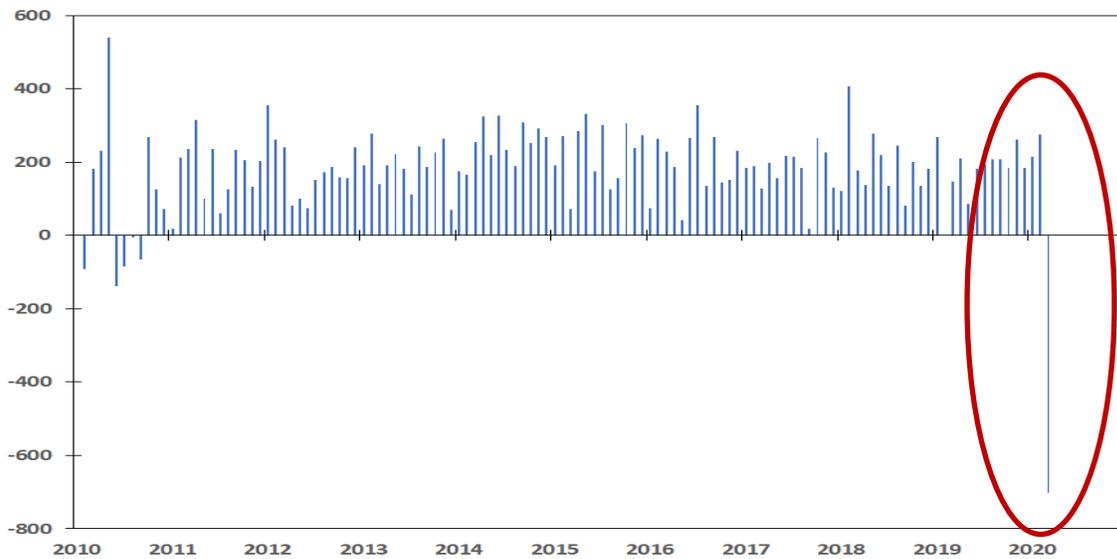
¹ <https://www.nytimes.com/2020/03/20/opinion/sunday/coronavirus-outcomes.html>

Uncertainty

Financial markets dislike uncertainty, and there is great uncertainty about the spread of the virus so far and what might happen next. Moreover, most economic data are survey-based: Industrial production, some unemployment numbers, inflation numbers, GDP and the various sentiment opinion polls are based on surveys being completed. However, in the current environment, it's likely that many of the those being surveyed will be too distracted to complete them, which will contribute to the uncertainty about the economic situation.

It's clear, however, that economic activity is in a freefall. Figure 1 shows that total nonfarm payrolls declined by 700,000 in March, after logging gains of around 200,000 in previous months.

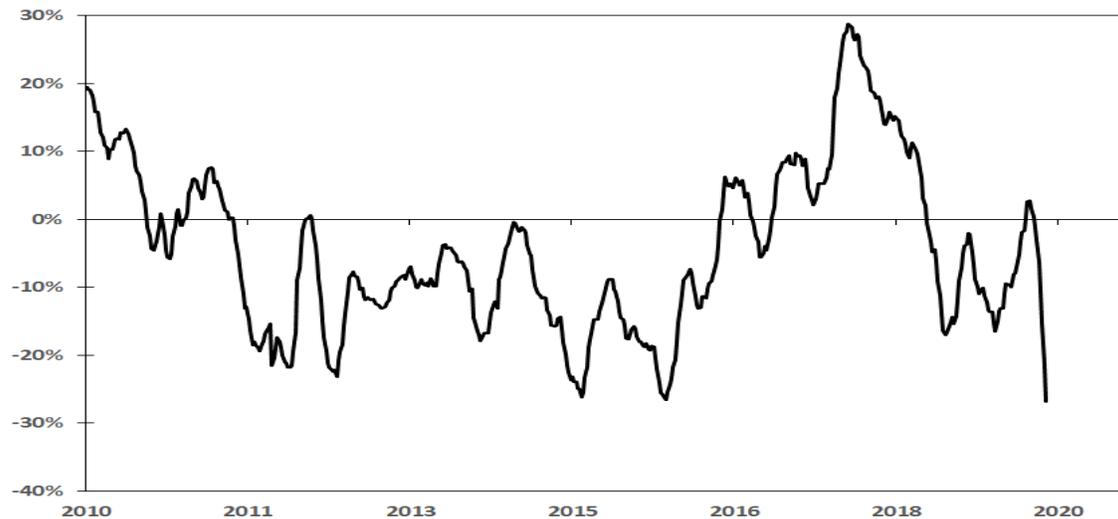
Figure 1: Total Nonfarm Payrolls: Monthly Change



Source: BLS

Similarly, Figure 2 illustrates that analysts' earnings estimates have also plunged. While it is very early to put a lot of weight on these numbers, this might suggest that corporate balance sheets might be of more relevance to investors than earnings.

Figure 2: Year-over-Year Percent Change in Net Analyst Earnings Estimate Revisions



Source: Refinitiv

The Coronavirus and the Consumer Sector

From an economic point of view, the virus has directly impacted the largest segment of the U.S. economy, namely the consumer sector, which represents 70% of GDP.

The government's efforts to slow the virus have effectively shut down the economy. This side effect is surely unwanted — but also unavoidable. While the 1918 influenza pandemic killed an estimated 675,000 Americans, the author of an academic study of the influenza pointed out² that the “the [U.S.] federal government did next to nothing [either for the economy or the healthcare system].” While there is a debate about the swiftness and scope of the U.S. response to this pandemic, the actions being taken (quarantines, lockdowns, curfews) are undoubtedly saving lives.

The Federal Reserve has taken a significant number of steps including slashing interest rates and widening their bond purchase programs, which should support fixed income markets. However, the impact of the Fed's moves may be muted in an environment where many stores are closed and consumers are postponing spending on big-ticket items in an environment of surging unemployment.

² <https://www.wbur.org/onpoint/2020/03/24/lessons-coronavirus-1918-flu-pandemic>

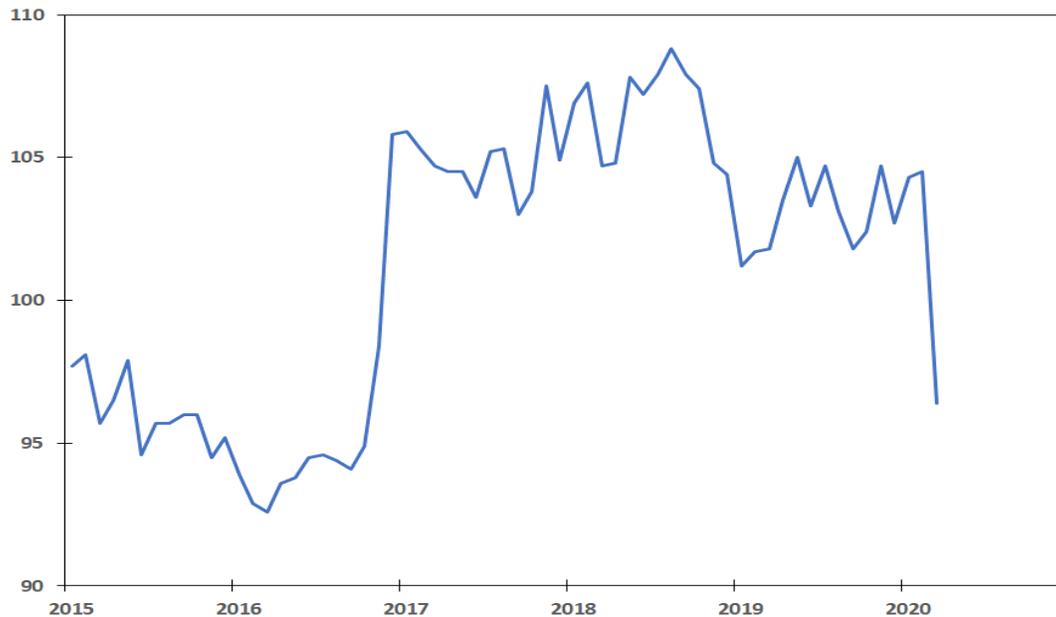
Legislative Efforts to Soften the Economic Blow

In terms of fiscal actions, the \$2.2 trillion stimulus bill called the CARES (Coronavirus Aid, Relief, and Economic Security) Act is almost three times the size of the 2009 stimulus to address the 2007–08 crisis; that package cost roughly \$800 billion.

The CARES Act targets households and businesses of all sizes. A portion of the aid to households is an expansion of unemployment insurance. Importantly however, the Act is not just focused on the unemployed but also on the employed, with the maintenance of jobs a key goal.

A particular focus is on small businesses, which employ over half of the workforce. Perhaps not surprisingly, sentiment at small businesses has come under pressure. In March, the National Federation of Independent Business Small Business Optimism Index plummeted to a multi-year low — Figure 3.

Figure 3: National Federation of Independent Business Small Business Optimism Index



Source: NFIB

(Note: While we questioned the integrity of some survey data in a previous section, the point of Figure 3 is to illustrate that small business optimism has plunged, although the extent of the drop may not be accurate.)

Worryingly, it's estimated that the average small business has only a few weeks' worth of reserves.



Market Outlook and Asset Allocation

We reiterate our view that financial markets will remain volatile until the virus is contained on a global basis or a medical solution (e.g., a vaccine) is developed. For context, we looked back at the Severe Acute Respiratory Syndrome (SARS) outbreak in Asia in 2002-04. Note how the Hong Kong stock market troughed when the rate of new infections peaked — Figure 4.

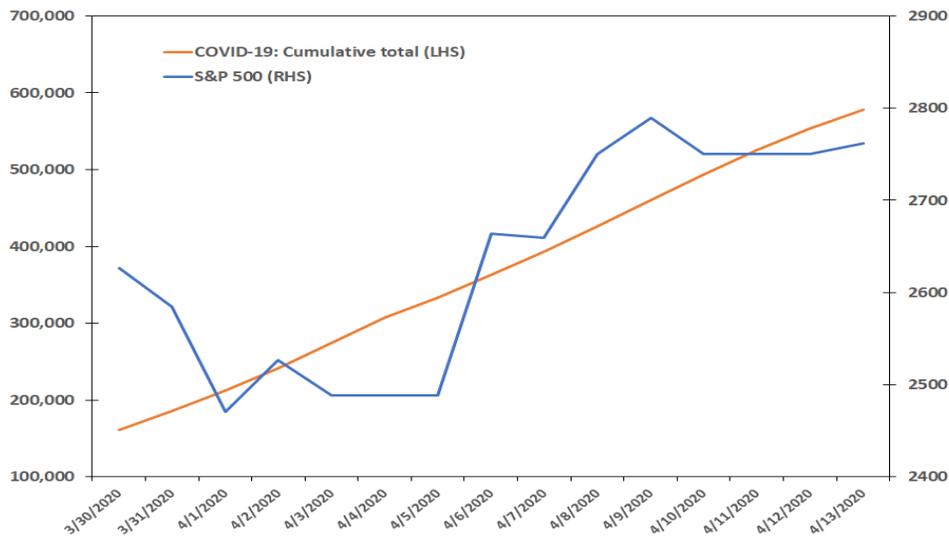
Figure 4: Hang Seng Index (LHS) and cumulative number of reported cases of SARS in Hong Kong (RHS)



Source: BNP Paribas Asset Management

Lately, the U.S. has not followed that pattern, with stocks rising even as the number of reported COVID-19 cases continues to increase. This suggests that, rightly or wrongly, investors have an optimistic view of the outlook — Figure 5.

Figure 5: Cumulative number of reported cases of COVID-19 in U.S. (LHS) and S&P 500 (RHS)



Source: CDC, Bloomberg

Importantly, this is a short-term shock to the system, not a structural issue. This is not 2008, when the entire global financial system was on the verge of collapse. This virus will eventually be contained and normal economic activity will resume. We recommend investors take a long-term view of the markets, and not focus on day-to-day volatility.

In the interest of taking a long-term view, we are not changing our recommended asset allocation. We are already overweight cash in our tactical asset allocation, and underweight international and emerging markets in both equities and fixed income, as well as alternatives (including commodities) — Figure 6.

Figure 6: Current Tactical Asset Allocation: April 1, 2020

Asset Class	Strategic Allocation (%)	Tactical Allocation %	Over / Under Weight %	Change from Last Report %
Publicly Traded Equity	60	60	0	0
US Large Cap	25	27	2	0
US Mid Cap	10	11	1	0
US Small Cap	5	6	1	0
International	15	13	-2	0
Emerging Market	5	3	-2	0
Publicly Traded Fixed Income	25	25	0	0
Short Duration	2	3	1	0
Treasuries & Agencies	3	4	1	0
Investment Grade Corporate	7	7	0	0
High Yield Corporate	3	3	0	0
International	7	6	-1	0
Emerging Market	3	2	-1	0
Alternative Assets	13	8	-5	0
Multi-Strategy Hedge	4	2	-2	0
Private Equity	3	3	0	0
Real Estate	3	3	0	0
Commodities	3	0	-3	0
Cash	2	7	5	0

Source: Cornerstone Capital Group

With the general views above as a background, we encourage clients to consider their specific situation, and contact their investment advisor for further discussion of how our expectations may apply.



What this Crisis Means for Impact Investors

The COVID-19 crisis and its disruption to our society and our prevailing modes of individual behaviors help to underscore the core tenets of impact investing:

- A consideration of our collective environmental and social well-being.
- A deep understanding of an investment’s positive or negative impacts.
- Sound corporate governance and transparency.

In Cornerstone’s view, following these principles will reward the long-term investor.

While we expect more evidence to emerge, we cite a few examples here that underscore the importance of investing with an impact lens:

- Governance in the public arena and private sector — in the form of leadership, planning, disciplined execution and adherence to safety protocols — is on full display as a differentiator in the consequences of the health crisis and its economic fallout.
- The underperformance of the fossil fuel sector, which predated this crisis, will likely continue. We can expect more investors will seek to reduce risk in their portfolios by implementing carbon-free investment strategies.
- People of color are being disproportionately impacted, both physically and economically, by the pandemic.³ Disproportionate impacts have also been recorded among poor and/or rural populations regardless of ethnicity.⁴ Demand for investments to promote greater social justice and reliable access to basic health care, nutrition and other basic services have already been heightened at the national and local levels.

ESG Fund Performance in Volatile Markets

The current market volatility and emerging economic slowdown have fueled renewed interest in the performance of investment funds that incorporate ESG analysis and/or focus on sustainable and impact investing. Cornerstone’s recent report⁵ “ESG Fund Performance in Volatile Markets” examined the performance of ESG funds in periods of extreme volatility. We encourage readers to [review our report](#).

Finally, Cornerstone Capital Group CEO Erika Karp has frequently expressed her view that sustainable investing is a proxy for quality, innovation and resilience. We would be remiss in our “Outlook” if we did not share just how pertinent her views are to the collective dilemma imposed upon us by this pandemic. When asked whether we would be *forever changed* when we emerge from this current crisis, she stated:

³ <https://www.npr.org/2020/04/09/831174878/racial-disparities-in-covid-19-impact-emerge-as-data-is-slowly-released>

⁴ <https://www.aamc.org/news-insights/new-coronavirus-affects-us-all-some-groups-may-suffer-more>

⁵ <https://cornerstonecapinc.com/esg-fund-performance-in-volatile-markets/>

We have to think about issues like distance learning, telecommuting, distributed health systems. We have to think about supply chain logistics. We have to think about surge capacity. We have to think about virtual entertainment, emergency service centralization, obviously food safety, water quality, hygiene standards. We have to think about mental health provision. We have to think more proactively and in an innovative way about investing. Going forward to attack these challenges, we remind everyone that impact and sustainable investing is just investing. But a more conscious, predictive way to invest. Impact investing is the new cornerstone of capitalism.

In every crisis, with its accompanying and often massive disruptions, there are opportunities that prove to be transformative and positive. The COVID-19 pandemic is no different, and so, in the midst of our collective challenges, we remain optimistic for long-term investors and especially those who invest for sustainability and positive societal impact.

Acknowledgements

As part of our research, we spoke with a number of experienced professionals with relevant experience in the areas of health and economics. The experts included:

- Dr. Derek Yach, a former World Health Organization (WHO) cabinet director and executive director for noncommunicable diseases and mental health. (Dr. Yach is also a founding Board member of Cornerstone Capital Group.)
- Dr. Eileen McNeely, Founder and Director of the Sustainability and Health Initiative for NetPositive Enterprise (SHINE).
- Paul Donovan, Chief Economist, UBS Global Wealth Management.

Their comments and predictions are contained in various sections throughout this report.



Market and Global Sector Performance

MARKET / INDEX PERFORMANCE

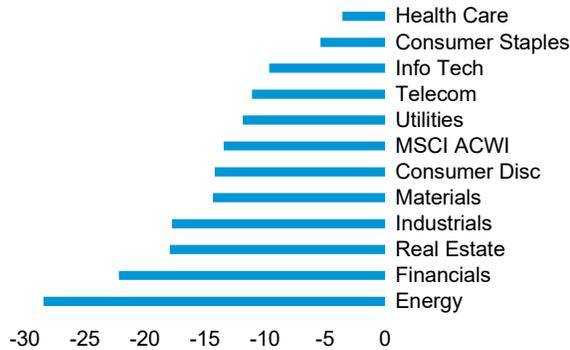
<i>As of 03/31/2020 (local currency)</i>	T1M (%)	T3M (%)	YTD (%)	2020 P/E	2020 P/B	Div. Yield
US Equity Indices						
DJIA	-13.6	-22.7	-22.7	19.2	3.5	2.7
S&P 500	-12.4	-19.6	-19.6	20.1	3.0	2.1
Nasdaq	-10.0	-13.9	-13.9	27.6	4.3	1.1
Russell 2000	-21.7	-30.6	-30.6	32.6	1.5	2.0
MSCI KLD 400 Social	-12.2	-18.4	-18.4	20.4	3.8	2.0
Global Market Indices						
MSCI World	-13.2	-20.9	-20.9	18.1	2.1	2.7
MSCI All-Country World	-16.8	-27.0	-27.0	12.9	1.2	4.2
MSCI EAFE	-13.3	-22.8	-22.8	15.1	1.3	3.7
MSCI Emerging Markets	-15.4	-23.6	-23.6	12.5	1.3	3.1
DJ Sustainability World Comp	-10.6	-18.0	-18.0	16.7	2.1	2.9
FTSE4Good Global	-12.3	-19.5	-19.5	2.2	0.2	22.3
Fixed Income						
Barclays US Aggregate	-0.6	3.1	3.1			
Commodities						
	<u>Levels</u>					
	3/31/2020	9/30/2019	3/31/2019			
WTI Crude	20.5	52.1	59.1			
ICE Brent Crude	26.4	56.8	65.1			
NYMEX Natural Gas	1.6	2.3	2.6			
Spot Gold	1577	1472	1292			
LME 3mth Copper	4951	5725	6483			
CBOT Corn	346	409	408			
ICE ECX Emission	17.7	25.0	21.9			
Currencies						
	<u>Levels</u>					
	3/31/2020	9/30/2019	3/31/2019			
EUR/USD	1.1	1.1	1.1			
USD/JPY	107.5	108.1	110.9			
GBP/USD	1.2	1.2	1.3			
AUD/JPY	65.9	73.0	78.7			
DXY Index	99.0	99.4	97.3			

Source: Bloomberg, Barclays. Equity Returns: All returns represent total return for stated period. Dividends and coupons are not included in the DAX and BOVESPA indices. Bond Returns: All returns represent total return for the stated period. Index characteristics: P/E, P/B, and Dividend Yield are based on Bloomberg consensus estimates for the stated period.

MSCI ACWI SECTOR PERFORMANCE

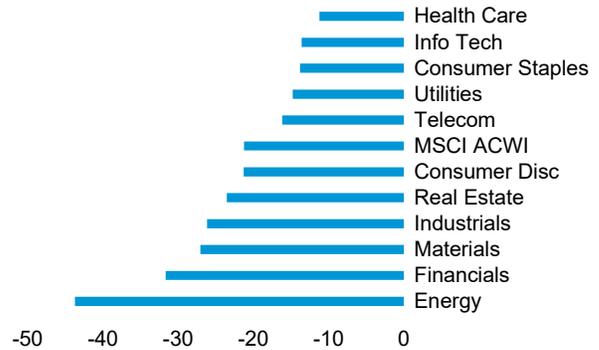
As of 3/31/2020

1 Month Price Return (%)



Source: Bloomberg. Sector returns are based on GICS methodology. MSCI ACWI is a free-float weighted equity index that includes both emerging and developed world markets.

YTD Price Return (%)



Source: Bloomberg. Sector returns are based on GICS methodology. MSCI ACWI is a free-float weighted equity index that includes both emerging and developed world markets.

US EQUITY STYLE PERFORMANCE

Style box returns are based on Russell Indices with the exception of the Large-Cap Blend box, which reflects the S&P 500 Index. All values are cumulative total return for the stated period including the reinvestment of dividends. The index used from left to right, top to bottom are: Russell 1000 Value Index, S&P 500 Index, Russell 1000 Growth Index, Russell Midcap Value Index, Russell Midcap Index, Russell Midcap Growth Index, Russell 2000 Value Index, Russell 2000 Index and Russell 2000 Growth Index.

1 Month

	Value	Blend	Growth
Large	-17.1	-12.4	-9.8
Mid	-22.7	-19.5	-14.9
Small	-24.7	-21.7	-19.1

Source: Bloomberg

Year to Date

	Value	Blend	Growth
Large	-26.7	-19.6	-14.1
Mid	-31.7	-27.1	-20.0
Small	-35.7	-30.6	-25.8

Source: Bloomberg

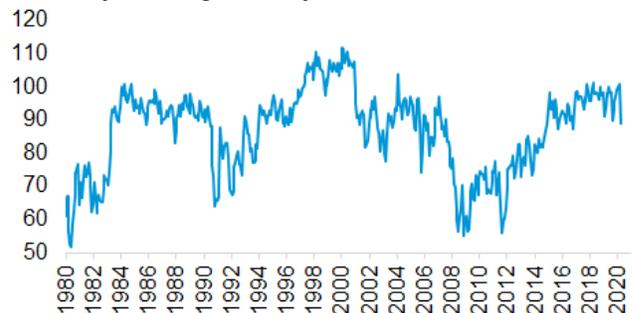
Key Economic Indicators

C&I Loan Growth (%)



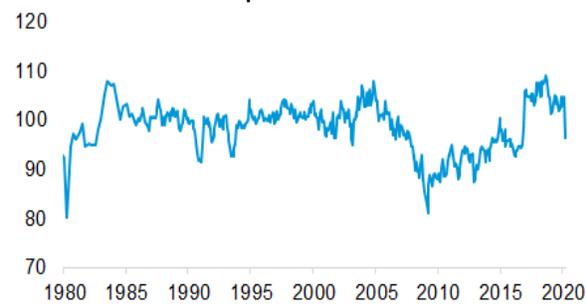
Source: Federal Reserve Bank of St. Louis

University of Michigan Survey of Consumer Sentiment



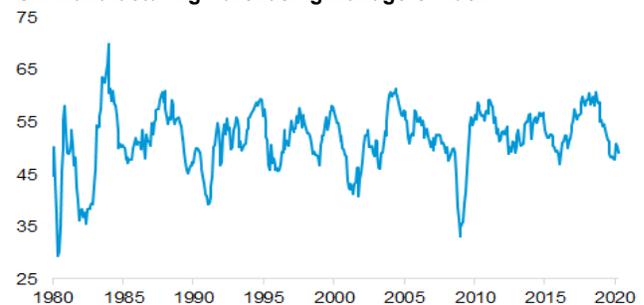
Source: Bloomberg

NFIM Small Business Optimism Index



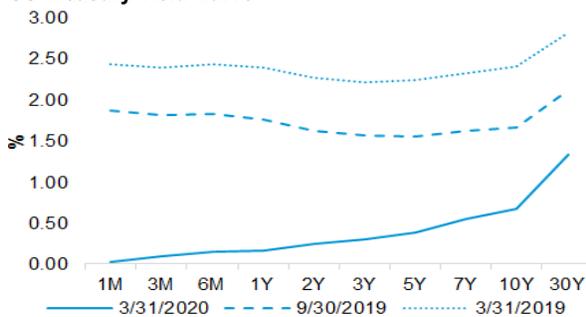
Source: Bloomberg

ISM Manufacturing Purchasing Managers Index



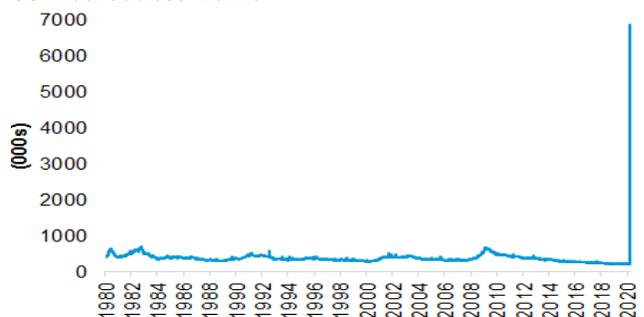
Source: Bloomberg

US Treasury Yield Curve



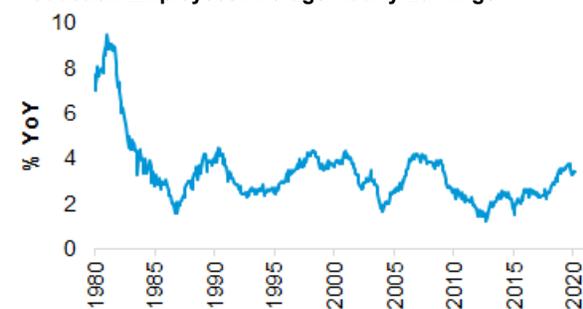
Source: Bloomberg

US Initial Jobless Claims



Source: Bloomberg

Production Employees Average Hourly Earnings



Source: Federal Reserve Bank of St. Louis

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