GREYCOURT

Dear Friends of Greycourt: March 30, 2020

Since mid-February, policy makers have pursued an increasingly coordinated shutdown of global economic activity to impede the spread of COVID-19. The economic impact has been clear and negative, while the jury is still out regarding the effectiveness of health policies. Predictably, stocks and other risk assets have plunged by as much as 40% from recent highs, while safe-haven investments such as U.S. Treasuries have soared in value, driving current yields well under 1%.

To put the current fall in context, there have been nine notable bear markets in the United States since the Great Depression (a bear market being defined as a 20% or greater decline in prices from the prior peak value). The worst drawdown was 86% (September 1929 - June 1932) and the shallowest was 27% (November 1980 - August 1982). The median stock market drawdown for these bear periods was 36%: in other words, the current decline is average in depth—so far—but has occurred with extraordinary speed.

Our job at Greycourt is to assess this dynamic situation as objectively as possible, identify the key drivers, likely potential outcomes, and then offer specific investment recommendations that are consistent with our clients' long-term allocation strategies and the maintenance of thoughtful diversification. With great humility, we undertake our advisory role, acknowledging that we're doing so in the face of heightened uncertainty (for example, the VIX reached a record high of 82.69 on March 16th).

We don't know just yet how health policies will impact the transmission or severity of the virus, nor are we sure massive stimulus efforts will sustain the US economy until the virus is contained. We do know that people are getting sick and dying, that we're in a sharp recession, and that the efficacy of health and economic policies over time will determine the shape of recession recovery and future asset returns.

The simple diagram below illustrates four recession and recovery scenarios we believe are possible going forward:

		Economic Policy Outcome: Effective	Economic Policy Outcome: Ineffective
Health Policy Outcome	Effective	**V Shape** **Recovery Q4 2020**	U Shape Recovery 2021
	Ineffective	U-L Shape Prolonged Recession 2021	L Shape Prolonged Recession Q4 2020

In a V-shaped recovery, health and stimulus policies prove effective. Their joint success allows businesses to get back to work in 10-12 weeks. As a result, the recession is not as deep as feared, the recovery is rapid and stock prices recover quickly – typically posting low double-digit returns (from current index levels) over the next three years. By contrast, an L-shaped recovery, the worst and least likely outcome in our view, implies that the economy is overwhelmed and imposes long-lasting structural damage to the world economy from which it would take many years to recover (think the Great Depression).

Falling in between are the U-Shape (most likely) and U-L Shape recoveries. For both cases, the recession is steep and drags late into the 3rd quarter. Despite the deeper and longer recession in the U-shaped scenario, we expect a reversal in the recession during 2020 leading to modest, positive 3-year returns for stocks. In the U-L scenario, the economy is helped by massive stimulus; nonetheless, the failure to contain the virus, perhaps through additional mutation, lead to an L Shape outcome.

If the U Shape Recovery is realized, as we expect, the long-term challenges of near-zero percent interest rates, weakened central banks, and substantial global indebtedness that faced economies and markets before the virus will remain as serious drags on long-term returns. The coordinated all-in monetary and fiscal policies taken to combat the economic impact of the virus will continue well beyond the virus as techniques such as debt monetization are put to the long-term test.

What we invest in now depends on our forecast of the likely path of recovery and our confidence in that forecast. It is our view that the government's health and economic responses will only be partially successful. We expect a recession to peak in the second quarter with economic growth contracting by 25% or more. Recovery should follow, likely beginning in the 3rd quarter, but ongoing and long-lasting structural problems of high debt and hyper-low interest rates will dampen the magnitude of longer-term stock returns.

As a result, we recommend relying on your long-term asset allocation strategy for financial and emotional support. Currently, we suggest one or more of the following actions:

- Aggressively harvest tax-losses positions; replace sold positions with like exposures.
- If underweight to equity targets, consider slowly adding to low cost, tax-efficient passive strategies, funding from cash or lower volatility hedge positions. At the margin, we would focus on the hardest-hit sectors and industries with companies that have low net debt ratios and material pre-crisis operating margins.
- Diversify fixed income beyond traditional municipals to include exposure to US Treasuries and to other investment grade taxable securities to enhance safety and liquidity.
- Begin to slowly invest in distressed and credit-related strategies like high yield debt, distressed debt, or structured credit.

Please don't hesitate to contact your advisor if you have questions about our market views or would like to discuss how they may apply to your portfolio.

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