

ECONOMIC & MARKET INSIGHTS

First Quarter 2020

EXECUTIVE SUMMARY

The longest economic and stock market expansion in history has come to a sudden end. Coronavirus (COVID-19), the long-feared "black swan event", has upended the capital markets, business activity and our daily lives. Since mid-February, equities and other risk-oriented investments experienced unparalleled price swings. Forced selling by leveraged funds and investors panicked by the recent events receiving media coverage 24-hours a day, sent all but the very safest investments spiraling downward. The spike in stock market volatility was unprecedented. Circuit breakers temporarily halted trading in U.S. stocks, liquidity dried up in the bond markets and money market funds struggled to meet redemptions. A dispute between Saudi Arabia and Russia over oil production also spooked markets, sending energy prices tumbling.

The global economy and stock markets appeared to be on solid footing prior to the coronavirus outbreak. However, there were some warning signs of economic fragility. Global trade and manufacturing had slowed and corporate leverage had risen while earnings growth stagnated. Today, much of the world is quarantined, shutting down schools, factories and small businesses, creating both supply and demand shocks unprecedented in scope and depth. Governments worldwide have stepped up efforts to stabilize economies through stimulative monetary policies and increased spending. The U.S. Federal Reserve reduced rates to zero and injected liquidity into the financing and bond markets. Congress has moved forward with an emergency spending and tax cut package that will benefit consumers and businesses. With interest rates already at very low levels, governments are being forced to explore new types of asset purchase and spending programs.

The coronavirus has derailed global economic growth and weakened the financial positions of consumers and corporations. In the capital markets, low yields on government debt limit future fixed income returns. Market volatility will take time to subside. However, the equity markets will eventually settle at a place where equity valuations are reasonable as the outlook for corporate earnings stabilizes. The huge fiscal and monetary stimulus from governments will provide a buffer worldwide. Large scale shifts from bonds to stocks as portfolios are rebalanced, coupled with opportunistic investors pursuing bargains, will provide a tailwind for the stock markets.

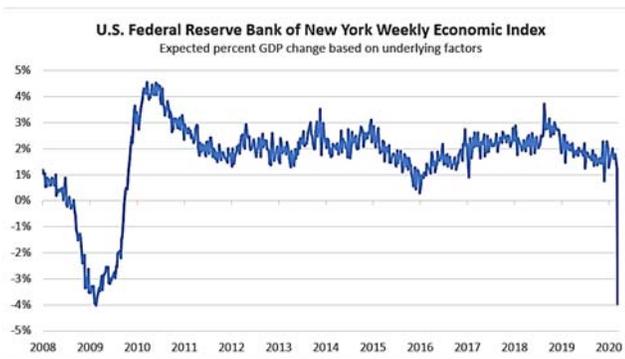
The duration and magnitude of the current crisis is unknowable until the durability of the pathogen is clearer and there is a timeline for the widespread use of better treatment options and a vaccine. We are living through a historically stressful time with the health of our families and our livelihoods at risk. Rest assured, we continue to closely monitor investment portfolios in light of these challenges with a long-term view. We urge investors not to make significant changes to portfolios based on emotions as timing decisions almost always hurt long term returns.

ECONOMIC INSIGHTS

One of the most enduring economic expansions in history took a dramatic turn over the first quarter of 2020. The shift was almost entirely due to the rapid spread and subsequent containment effort of the novel coronavirus. Before the outbreak, much of the global economy was on track for a positive, albeit slowing, pace of expansion. After the virus, there are many uncertainties pertaining to global growth for which data released over the coming weeks will provide important insights.

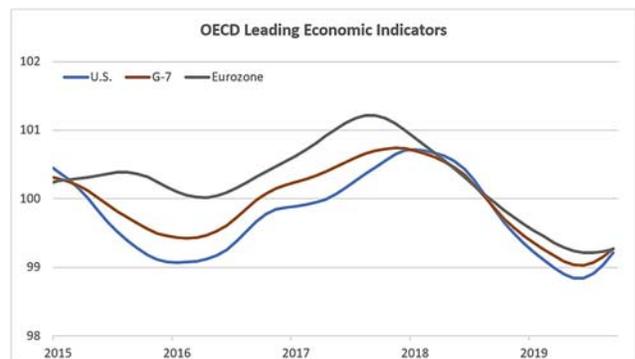
So far, the coronavirus' impact on the economy has been far reaching. Global supply chains have been disrupted with uncertain timelines for coming back online. Demand for core commodities, such as oil, has fallen dramatically. This has only been further exacerbated by a price war between Russia and Saudi Arabia. Consumption has been impacted from many angles as new health-focused social norms (like social distancing) have brought select industries (such as travel and hospitality) to a virtual standstill. Layoffs and furloughs within these hardest hit sectors have already started and the unemployment rate is rising rapidly.

While these scenarios depict a grim picture of the world, many of the disruptions are likely temporary in nature and are creating extensive pent-up demand. Once the health crisis is contained, its foreseeable that the recovery in growth could be sharp.



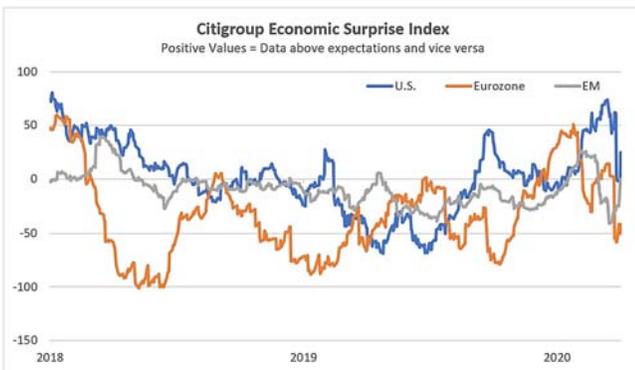
Federal Reserve Bank of New York

The Weekly Economic Index measures the expected change in GDP incorporating a number of factors such as unemployment claims and gasoline sales. Recent readings have fallen to lows not since reached during the 2008 Financial Crisis. This reflects the abrupt halt in economic activity in many areas of the country.



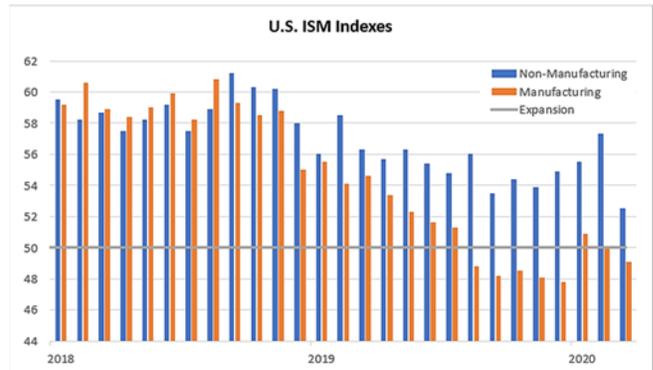
Organization for Economic Cooperation and Development

Following a period of lower readings, leading economic indicators (LEIs) had stabilized and started to improve at the end of 2019. While this was an encouraging sign coming into 2020, the effects of the coronavirus are likely to push future readings meaningfully lower, thwarting any recovery in the short to medium-term.



Citigroup

The impact of the coronavirus is already showing up in economic surprise indices. This reflects a variety of economic readings that are coming in well below prior forecasts. Such readings are likely to be volatile in the coming weeks as the economy fully digests the effects of the shutdown.

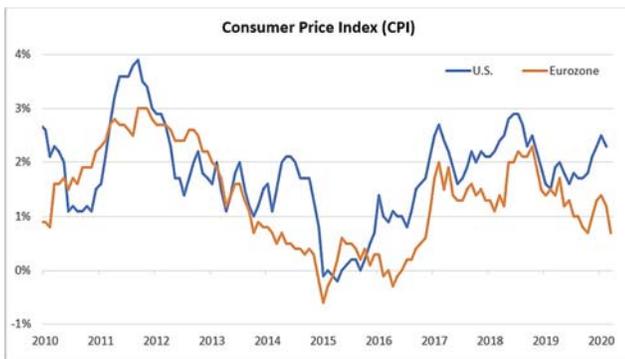


Institute for Supply Management

Manufacturing data fell from barely in expansion territory (50.1) in February, to contraction territory (49.1) in March. Manufacturing activity has seen a steep decline in new orders and production stemming from the coronavirus. Non-manufacturing (services) data was trending higher but came down, although it remains in expansion territory.

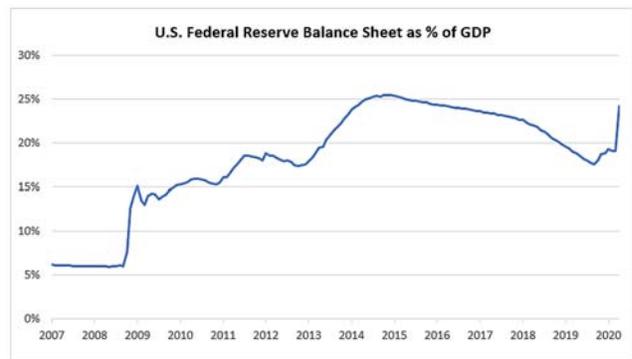
Having learned from previous financial crises, many global central banks have acted swiftly to enact record breaking stimulus packages. These efforts were primarily focused on ensuring adequate financial liquidity and 'bridging the gap' of unemployment as jobless numbers around the world ballooned. In the U.S., legislators across the aisle came together to pass the \$2 trillion CARES (Coronavirus Aid, Relief, and Economic Security) Act. The multi-faceted Act is unprecedented for its size and scope and includes new relief methods such as mailing checks to Americans with earned incomes below certain thresholds. Despite its size, there are already discussions for additional follow-on efforts.

So far, the effect of the coronavirus on different areas of the economy has been varied. Inflation will likely be lower in the short-term, although its uncertain how it will trend longer-term. Prices for consumer expenditures like gas have come down dramatically, while prices for other items, such as groceries and personal care items, have risen. Growing unemployment is also likely to lessen wage pressures, which had risen over the past several years. The effect on corporate profits, on the other hand, appears more apparent. Most analysts and economists are predicting a dramatic decline in earnings over the second quarter reflecting the large fall-off in business activity and consumer spending. Additionally, the U.S. Dollar has seen heightened volatility and demand reflecting its status as the global reserve currency. This U.S. Dollar strength is persistent even against an unprecedented amount of stimulus and growing domestic unemployment.



U.S. Bureau of Labor Statistics

Recent inflation numbers have come down marginally. The longer-term impact of the coronavirus on inflation is somewhat unknown. Prices for a variety of consumer goods is on the rise but is partially offset by falling wages and oil prices. Massive amounts of monetary policy could cause inflationary pressures down the road.



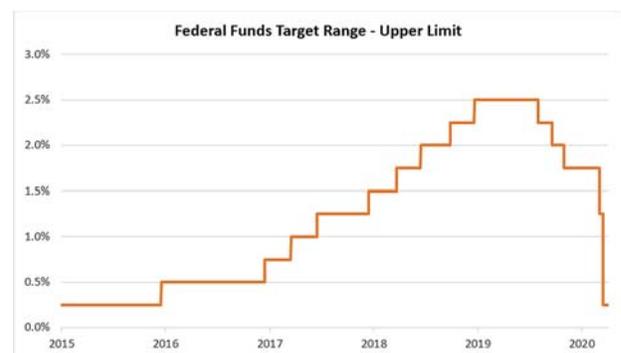
Bloomberg

Recent monetary policy moves from the Federal Reserve have translated to the expansion of its balance sheet to a record \$5.86 trillion. Notably, this figure is well above levels reached during the 2008 timeframe in terms of a percentage of GDP.



U.S. Federal Reserve and Bloomberg

The U.S. Dollar rose recently as investors took shelter in what's still considered the core global reserve currency. While its value relative to other major currencies has risen, price movement has been volatile and is likely to remain this way as new policy and economic data is released.



St. Louis Federal Reserve

Following 'mid-cycle' adjustment cuts last year, the Federal Reserve moved swiftly and aggressively to help offset the impact of the coronavirus by cutting rates to near zero. The Fed has also stepped up asset purchases to provide liquidity and help stabilize fixed income markets.

EMPLOYMENT AND THE CONSUMER

Entering 2020, the unemployment picture in the U.S. was sustained near its lowest level in roughly 50 years. This dramatically and quickly changed given the broad decline in economic activity and extensive amount of social distancing being exercised worldwide to combat COVID-19. Workers find themselves in one of two camps — those people who can work remotely and those people who need to work with other people. The former group are more likely to retain their jobs, as long as economic demand warrants it, but the latter group are at higher risk of losing work time and pay. Since this market downturn is expected to be short-term in nature (less than a year), some companies may even consider "labor hoarding", or keeping some people on the payroll as a more affordable solution than finding new employees once the economy rebounds. Given all of this, it is still very likely there will be a sharp increase in unemployment figures, which may be more evident in the April report (to be released in early May). As a warning for what may come, the highest weekly initial jobless claims of all-time were released covering the last two weeks of March totaling 10 million people, or 3.8% of the entire U.S. working-age population.

COVID-19 has already made its presence known within the consumer sector, as anyone who has been confronted with an empty grocery store shelf of a commonly accessible good can attest to. Online sales for some affordable items have increased, only to be abruptly met with decreased sales of some brick-and-mortar expensive items. More essential spending like consumer staples and utilities have weathered the downturn better than others. Existing consumer spending levels may be constricted even further as the potential economic downturn deepens. However, the largest factor in determining how the consumer has reacted already and will continue to react is the level and duration of unemployment.



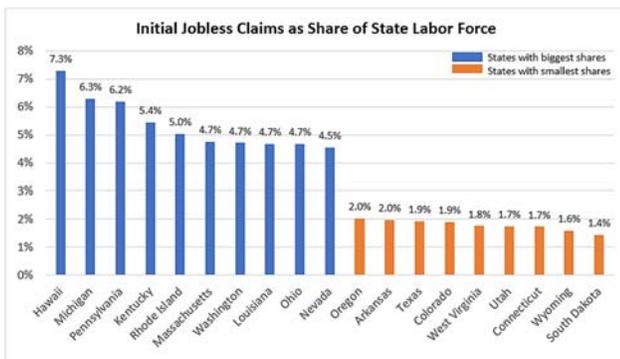
Labor Department

After remaining slightly above 200,000 for at least the past year, initial weekly jobless claims have skyrocketed into the millions for the last two weeks. A stark reminder of the impact the virus is having on overall employment.



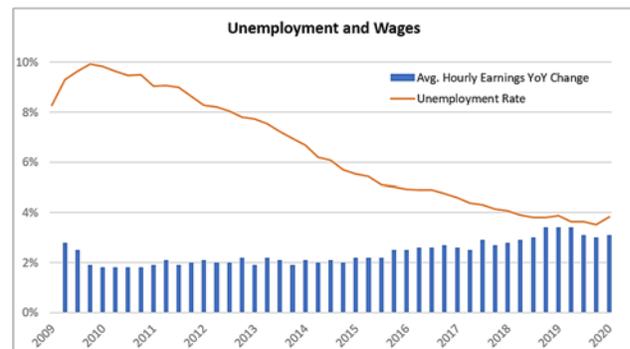
Conference Board

The broad level of consumer confidence wavered quite a bit during the last three years, and took a sharp nosedive in March, as investor's fears manifested themselves over ongoing virus concerns.



WSJ analysis of Labor Department Data

Jobless claims were more widespread in states with impacted revenue streams - Hawaii for tourism and Michigan for automobile manufacturers. Likewise, those states with less impacted revenue streams fared better.



U.S. Bureau of Labor Statistics

After 10 consecutive years of a declining unemployment rate, March's figure slightly increased indicative of the COVID-19 impacts. This rate is expected to drastically increase soon as more data is factored in, and will be possibly much more pronounced in April's report.

RESIDENTIAL AND COMMERCIAL REAL ESTATE

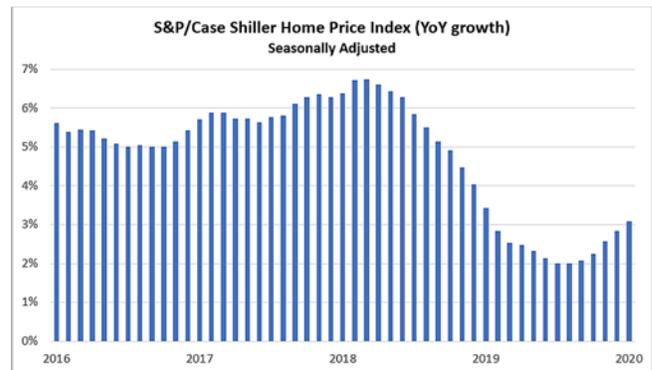
The U.S. housing market had been on an upswing coming into 2020, supported by lower mortgage rates, a strong labor market and healthy home builder activity. The coronavirus has thrown a wrench in what could have been a strong year for residential real estate. The Federal Reserve's actions to stabilize the sector have had a rocky start and mortgage rates have been volatile. Mortgage providers could not handle the upsurge in loan applications that followed the Fed's rate cuts. In addition, the Fed's purchase of mortgage backed securities (MBS) and the resulting fall in rates was larger than expected, making it difficult for mortgage providers to effectively hedge against the risk of rate changes. As the unemployment rate rises and incomes fall, mortgage payments will become more uncertain and defaults could rise significantly. Home builder activity also shows signs of a decline which will dampen new homes sales in the coming months. That said, lower mortgage rates and improved affordability may help the housing market to rebound once the health crisis has passed.

Commercial real estate has been shaken by the quarantines and business closures imposed by governments in the wake of the coronavirus outbreak. Valuations were high in some real estate sectors, but operating income and debt levels were healthy. Going forward, operating income will be impacted by a decline in rental income as tenants miss payments, although the recently enacted CARES Act should help to support tenants. Real estate funds, which have recently experienced large inflows of capital, may hold back on further acquisitions until the current health crisis has passed and some have even backed out of existing deals. Infrastructure, which tends to be less economically sensitive than other sectors, has been more stable. Public REITs have been unusually volatile as long-term interest rates have moved up and down.



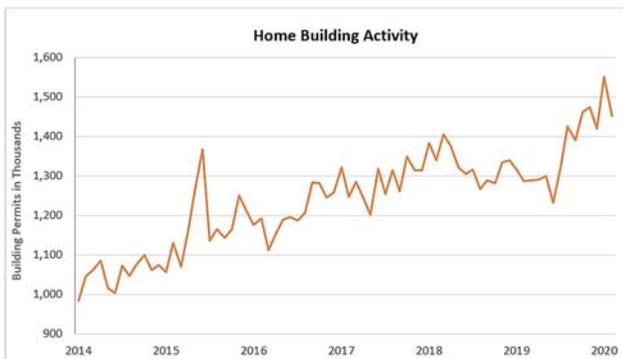
Mortgage Bankers Association

Despite Fed interest rate cuts, mortgage rates were volatile in the first quarter. A refinancing wave and limited buyer demand for MBS kept mortgage rates elevated until Fed purchases brought rates back down.



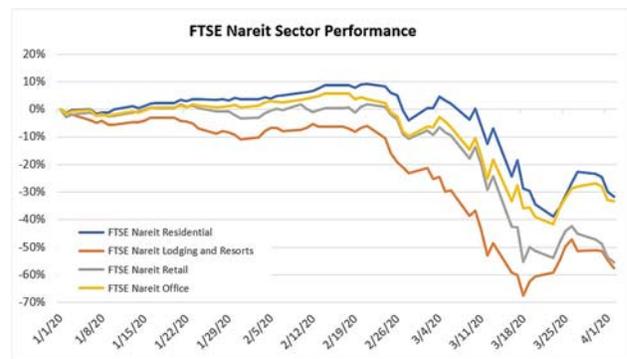
S&P/Case Shiller

Although U.S. home price gains have recently accelerated, the coronavirus is expected to stifle sales activity and curb prices. Lower mortgage rates and improved affordability may help the housing market to eventually rebound.



U.S. Bureau of the Census, U.S. Department of Housing and Urban Development

Mild weather over the winter was a positive for builders, but the coronavirus clouds the 2020 outlook. New permits slumped in February after reaching a 13-year high. Housing starts fell due to a weak multi-family sector.



Nareit

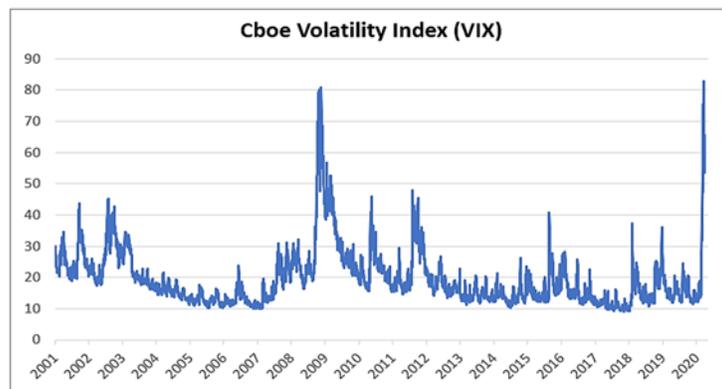
Public REITs have been devastated by the coronavirus outbreak. Operating income will be impacted by a sharp decline in rental income as tenants miss payments. Some REITs have cut or eliminated dividend payments.

MARKET INSIGHTS

EQUITY MARKETS

The first quarter marked the worst period for stocks since the depths of the 2008 financial crisis. While the magnitude of the decline has so far been less severe, the pace was unprecedented with the S&P 500 Index falling more than 30% in just over a month from its all-time peak. Most prevalent during this tumultuous time is the unprecedented level of volatility. Over the last several weeks, there have been many of the largest percentage moves ever recorded for markets. The Cboe Volatility Exchange Index or more commonly known as the VIX, a barometer for market volatility (and fear), touched its highest level since 2008. The equity market downturn was also widespread, as most major developed and emerging market indices entered bear market territory.

Within the U.S., larger and more defensive stocks generally outperformed in a relative context. Larger-caps were aided by more durable business models and better capitalized balance sheets. Growth held a firm grip outperforming value as many of the worst performing sectors (energy, financials, industrials) are larger constituents in value-oriented indices. Interestingly, however, value has tended to shine coming out of previous bear markets. Airlines and cruise line stocks were notably negatively impacted as their demand levels fell upwards of 90% throughout March. Sectors that fared better during this crisis include essential items needed to survive (consumer staples and utilities) and information technology, a basic necessity to many during the vast social distancing efforts.



Bloomberg

The VIX reached levels not seen since the 2008 Global Financial Crisis. While it hit exceedingly high levels, it typically does not remain elevated for long periods of time.

FIXED INCOME AND ALTERNATIVE MARKETS

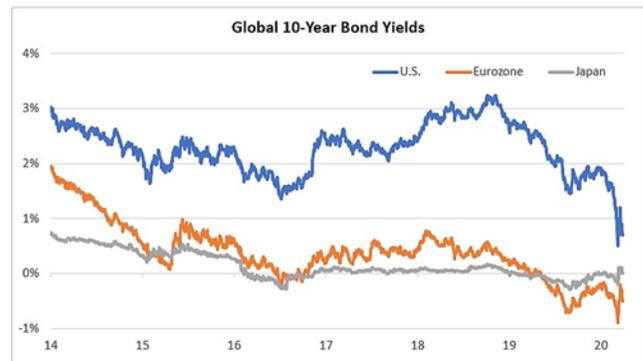
The sudden and dramatic shift into the safest assets made U.S. government securities the only place to be during the first quarter. Virtually all other bond sectors experienced losses as higher credit spreads, a drought in bond market liquidity and technical selling caused a challenging environment for fixed income investors. Hedge funds overall declined much less than equities, but most strategies, including those with low market exposure such as market neutral and arbitrage, posted losses. Commodities remained highly volatile, led by the energy sector, which was hampered by a power struggle between Russia and Saudi Arabia to control the supply of oil. Oil prices staged a rebound at quarter-end on hopes that the two countries would reach an agreement. Fears of a global recession and a slowdown in demand caused most commodities to plunge in value. Even gold, a popular safe-haven asset, was volatile due to periods of technical selling.

Although the sharp drop in interest rates was a positive for Treasuries, Treasury Inflation-Protected Securities (TIPS), and government mortgage-backed securities, prices hereto were volatile. 10-year Treasury rates dropped to an historic low of 0.4% and remained below 1% at quarter-end. TIPS yields declined as longer-term inflation expectations fell virtually to zero. In the credit markets, spreads spiked to recessionary levels, causing bond prices to fall. During recessions, credit fundamentals often deteriorate and default rates rise, particularly for highly leveraged companies. A huge technical sell-off in corporate and municipal bonds as investors piled assets into cash, contributed to the spike in bond yields (and fall in prices). Market liquidity was very poor and at times trading came to a virtual standstill, although the dislocations had abated by quarter-end. Emerging market debt was further hampered by the sharp rise in the U.S. dollar.



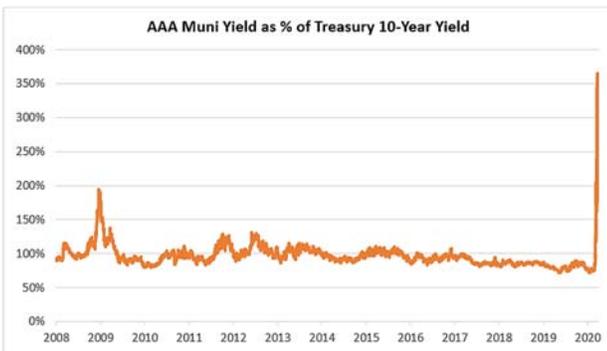
Barclays Capital

After a four-year decline, high yield spreads shot upward as the coronavirus crisis unfurled. Rising corporate leverage and a large weighting in the volatile energy sector led high yield to be underperform for the quarter.



Bloomberg

Sovereign yields were volatile during the quarter. Yields sharply declined as interest rate cuts took effect, boosting prices. But widespread selling by investors to raise cash intermittently caused rates to spike.



Bloomberg

A massive sell-off took place as investors scrambled to raise cash and grew fearful the coronavirus response and a recession would impair municipal finances. Municipal yields skyrocketed to unheard of levels before retreating.



U.S. Energy Information Administration

After a strong 2019, oil prices plummeted, at times reaching \$20 a barrel. The sharp reversal was triggered by falling demand, fears of a global recession and an uptick in supply following a dispute between Russia and OPEC.

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