ACM QUARTERLY MARKET COMMENTARY
FIRST QUARTER 2020

Capital Markets

"Unprecedented" is a word that has been used a lot to describe the events of the past two months that have included a once in a generation viral pandemic (we hope) that swept across the world and caused over 200,000 deaths (and counting), including that of more than 50,000 Americans. The outbreak forced extreme containment efforts, including "shelter in place" orders in the U.S. and other major countries, which pushed a formerly expanding global economy into an instant economic depression and killed the decade old bull market in stocks with the swiftest 30% price decline in history; U.S. Treasury Bill rates dropped from 1.5% to zero in the blink of an eye, and the yield on the ten-year U.S. Treasury fell below 1% for the first time in history; oil prices plummeted from $50 to $20 in a matter of days, and just last week the near term futures contracts temporarily fell to negative $37 as U.S. storage capacity was exhausted; twenty-six million Americans (and counting) filed for initial unemployment claims as nearly 50% of U.S business halted operations, including more than one million retail stores and 700,000 restaurants that stopped serving food in-house; discretionary travel came to a sudden halt leading to a 90% decline in airline traffic and 80% vacancy rates at U.S. hotels and resorts; in response to the economic turmoil, the Fed's swiftly expanded its balance sheet by $2.5 trillion (and counting), including the first-time ever purchases of short-term municipal debt and non-investment grade corporate debt; Congress and the U.S. Treasury initiated another $2.5 trillion in economic stimulus (and counting) that included direct stimulus payments to over 93% of U.S. taxpayers, which will be of little help in their attempts to buy out-of-stock cleaning products, hand sanitizer, surgical masks, and toilet paper, but will certainly help sustain the 30% surge in alcohol sales. I think "unprecedented" sums it up pretty well

Portfolio Update

Amid the chaos, we remained disciplined in our efforts to rebalance portfolios to allocation targets and actively harvest tax losses on a near-daily basis, while acting with conviction on tactical moves. Throughout the extreme market volatility, we did our best to put emotions aside by relying on objective indicators and staying focused on the long-term. When the panic selling in the stock market began to reach historic extremes, our contrarian spirits began to stir and we shifted to a more opportunistic mindset. On March 12th, with global stock prices the down almost 27% off their highs, we wrote to you about the recent heavy lopsided selling volume that had only seven comparable precedents since 1960, all of which led to higher stock prices over the next year with a median gain of 25%:

> "*Today could well be the low of this correction, but in all likelihood, it will not be. That said, a smart, long-term investor who is looking to add to their stock holdings when prices fall, should not try to time the bottom perfectly to the day. The risk of missing it is just too high. Instead, an investor is more likely to benefit from adding to their holdings in "chunks" along the way on certain days when the panic selling is at an extreme. We believe that today is one of those days… Now is a buying opportunity, which is not to say there may be one or two more buying*

opportunities at lower prices in the weeks or months ahead. We believe now is the time for a long-term investor to put one of those "chunks" to work in the stock market… We encourage our clients to consider their financial and emotional risk tolerance… Some clients may want to consider adding available cash to their investment accounts to increase both their stocks and bond holdings…Other clients may want to consider changing their investment policy to target a higher equity percentage. Personally, I have increased the equity targets for my accounts that have the longest time horizons from 60% to 80%. That shift will not happen all at once. It will happen in "chunks" starting with a large one tomorrow."

Indeed, global stock prices rallied sharply the next day, but then resumed their decline over the next week-and-a-half to their eventual low on March 23rd. True to form, we continued to selectively buy stocks on weakness, such that our portfolios had accumulated equity allocations that were well above neutral targets when stock prices began to rally. Due to this additional equity exposure and other strategic moves, such as buying certain bond ETFs at rare discounts to net asset values, including municipal bonds at a momentary discount of almost 8%, our portfolios, generally speaking, have outpaced their respective benchmarks during the rally over the past month.

Looking Forward

Looking forward, we believe that the market low on March 23rd, which represented a 33% decline from the February high, was likely "the bottom" of this historic correction in stock prices. This view is based not only on the apparent peaking of the pandemic and plans for a gradual "reopening of the economy", but on the character of the now 25% to 30% rally off the low. The magnitude and breadth of the recovery in stock prices, along with certain gauges of buying pressure, are consistent with other major market bottoms, as opposed to a "bear market rally". That being said, the volatility in the investment markets is surely not over in our opinion. There remains too much uncertainty for the market to digest, as the story of this pandemic continues to be written. Even as life slowly returns to normal, it remains unclear what permanent damage our economy has suffered and what other long-term causes and effects will result. We believe that any hopes for a strong V-shaped economic recovery would be overly optimistic. More jobs have been lost in this country in just two months than were created in the twelve-year economic expansion since the 2007-2008 financial crisis. Unemployment will surely remain elevated for years to come, and the rebound of consumer confidence, in turn, will be muted. The extraordinary monetary and fiscal stimulus programs to date have helped to soften the blow in the short-term, with more surely to follow, but at what long-term cost? Expect eventual payback in the form of higher taxes and reduced government benefits that will likely keep a lid on the economic recovery down the road. With all of these uncertainties, it is unrealistic to expect that stocks will continue their rapid and steady advance back to their highs without interruption.

Ultimately, we believe that stock prices will be higher a year from now, despite an uneven economic recovery, because of historically low-interest rates. As we detailed in our most recent Quarterly Valuation & Trend Report, our internal estimate for the long-term nominal return of global stocks increased to 7.8% (now probably closer to 7.0% as stock prices have continued to rally) as compared to our long-term return expectation for U.S. aggregate bonds that have fallen to 1.3% since the end of the first quarter. This spread of about 6% between projected stock and bond returns, also known as the "equity risk premium", is the largest our models have indicated since the third quarter of 2011. Given the high equity risk premium, we would expect rising stock prices to attract even more capital as holders of cash and bonds tire of a paltry 1% return. In fact, a more tepid economic recovery may be the best outcome for the stock market as it may help ensure that interest rates stay lower for longer.

The math of compound interest requires exponentially larger gains to recover from larger losses. So, while a 10% loss only requires an 11% gain to get back to even, the 33% correction in stock prices in the first quarter will require a 50% rebound from its low for the major indices to fully recover. The now 28% rally in global stock has gotten us a bit more than half the way back, but what remains will surely be more of a challenge. As such, we have recently been paring our stock market exposure modestly to levels that, generally speaking, are just a percent or two above neutral equity allocation targets. Over the next year, we would not be surprised to see one or two corrections in the 10% to 15% range, but with stocks ultimately maintaining an upward trajectory. As long as the equity risk premium remains attractive, we would expect to be buyers of these pullbacks.

COMMENTARY DISCLOSURES

All returns cited were attained from Bloomberg L.P. reporting as of 3/4/2020.

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