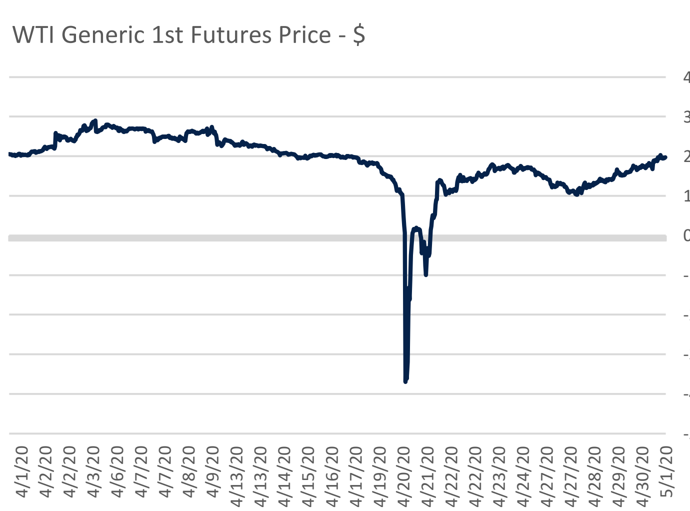
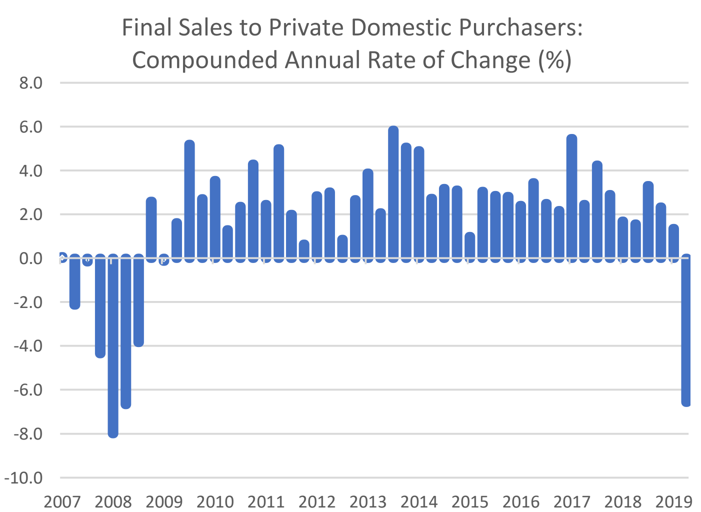
# INSIGHTS & OBSERVATIONS

## ECONOMIC, PUBLIC POLICY, AND FED DEVELOPMENTS

- The coronavirus pandemic dominated the news cycle and the markets in April. Risk assets fell into a tailspin as global cases surged to more than 3.5M by the start of May, with nearly a third in the US. The pandemic response continues to be managed locally, as cities and states grapple with the balance between maintaining a functioning economy and protecting their population. ***States such as Georgia and Florida that have led phased reopening will be closely watched test cases and their experience is likely to influence the pace of national economic recovery.***
- Record unemployment claims continue, and while the trend seems to be decelerating, total job losses over the past six weeks reached an estimated 30.3M. While some workers may have replaced jobs or dropped out of the workforce, if all jobs lost were added into the known unemployment rate, it would imply a 24% rate in the 5/8 release. We expect the official number to be slightly lower, although ***unemployment is now the highest since the Great Depression with roughly one out of five Americans at least temporarily out of work. We expect this will weigh on potential GDP for some time.***
- Turmoil in the oil markets continued in April, as ***trading in WTI oil futures went negative for the first time on 4/13. Technical factors were largely to blame***, as traders holding the active futures contracts expiring on 4/14 and unable to take physical delivery became forced sellers, pushing that contract to a low of negative $37/barrel. Technical turmoil persisted later in the month, although markets eventually calmed and WTI recovered to break $20/barrel at the start of May. Absent the same technical pressures, ***Brent traded with much less volatility, although the underlying supply and demand fundamentals remain weak for both, yet another disinflationary factor.***
- The Q1 GDP came in slightly worse than expected at -4.8%. Final sales to private domestic purchasers, a better indicator of underlying demand, contracted 6.6%, nearly equaling the lows of 2008-09. January and February were strong, however, so this is a mere preview of what lies ahead. ***Q2 estimates vary widely, but GDP is expected to contract by roughly 33% on an annualized basis***, ***a figure expected to be the largest decline in modern history.***
- The Fed's bond buying tapered significantly over the month, from an early pace of $75B/day down to a projected $8B/day at the start of May. Jerome Powell pledged to keep the benchmark Fed Funds rate near zero until the Fed "is confident that the economy has weathered recent events". ***A recent Bloomberg survey of economists indicates most expect the Fed Funds rate to remain at near zero for at least the next three years***.
- Additional detail on the Primary and Secondary Market Corporate Credit Facilities and the Municipal Liquidity Facility was also recently published, expanding the number of eligible companies and municipalities. The response to this crisis has been unprecedented, and with the initial phases behind them, ***the Fed appears to be settling in for the long haul with the intention of aggressively supporting the economy until it is strong enough to sustain a recovery.***




Source: Bloomberg



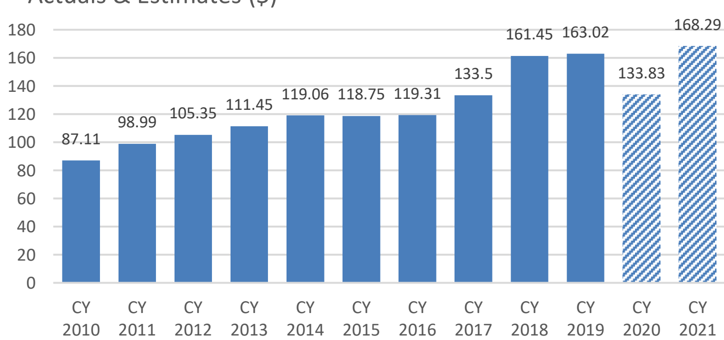

Source: Federal Reserve Bank of St. Louis

# EQUITY NEWS AND NOTES

## A LOOK AT THE MARKETS

- Once again equity investors experienced a historic month, as the S&P 500 rallied 12.8% to post its best month since 1987 and 3rd best since WWII. The market advanced despite a lack of clarity on the economy or corporate profits. ***The primary positive drivers were historic fiscal and monetary policy response, improving Coronavirus stats, and optimistic talk of reopening the economy.*** The Fed helped jumpstart equities by likely taking the worst case corporate solvency scenarios off the table and narrowing credit spreads.
- Q1 S&P 500 aggregate earnings are set to show the largest YoY decline (-13.7%) since Q3 2009. Analysts expect Q2 to reveal a YoY drop of 37%, followed by recovery beginning in the second half of the year. ***The average decline in earnings during a recession is a little over 30%, so should Q2 represent trough earnings, we are already in the neighborhood of an "average" recession's earnings impact.*** History tells us it typically takes a little over 2 years to return to peak earnings, which would put us in the second half of 2022. However, consensus estimates anticipate a return to peak EPS by the second half of 2021. Should the reopening of the economy proceed more slowly than expected, these assumptions could prove overly optimistic. ***As we look at equity valuation, we are carefully assessing the forward earnings outlook.***

S&P 500 Calendar Year Bottom-Up EPS: Actuals & Estimates ($)




Source: FactSet

- ***Declining forward earnings estimates and a rallying stock market have left the S&P 500 trading at a forward P/E multiple of 20.3x vs. a 25-year average of 16.3x.*** FactSet reports that this is the first time the S&P has traded above 20x since April of 2002. The market tends to be forward looking and, as noted, investor assumptions appear to factor in a more rapid than normal recovery in earnings. However, these are not typical conditions. A self-imposed shutdown brought the market and earnings down in record time and it is bouncing back at an equally impressive pace. But companies are likely to face margin pressures as health care, technology, and labor costs increase, and they will not enjoy the same flexibility to buy back stock. Both factors have helped drive recent EPS growth. Something to be wary of going forward.

- ***The market has recently seen well above average individual stock performance dispersion, a development we welcome as it is often a favorable environment for active managers.*** The five largest companies in the S&P 500 (MSFT, AAPL, AMZN, GOOG, and FB) have been performance leaders. Their combined market cap now represents over 20% of the S&P 500's capitalization, the largest percentage in 30 years. We believe these companies present favorable secular growth stories and they should continue to perform well over the long term, but recognize that concentration risk can lead to short-term volatility.

**Exhibit 1: Concentration of market cap in the largest stocks has surged**
as of April 30, 2020


Source: Compustat, Goldman Sachs Global Investment Research

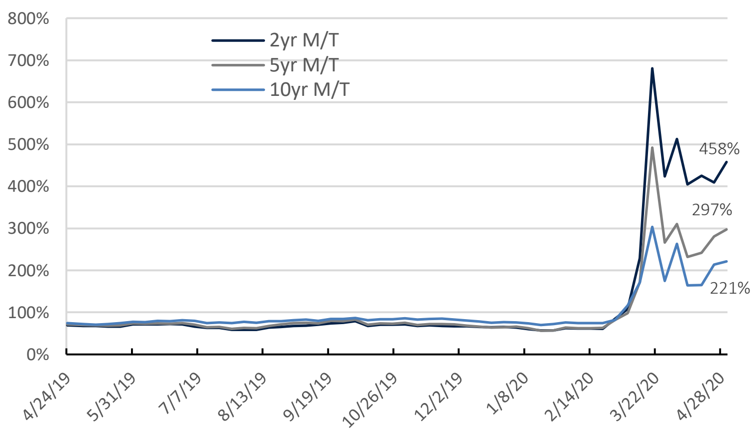
- With a push towards economic reopening, the stocks that were hit hardest during the shutdown have recently outperformed those that best weathered the storm. Energy stocks rallied nearly 30% in April, although the sector is still down over 35% YTD. Likewise, small cap stocks outperformed their large cap counterparts this past month as investors rotated into many of the laggards. By contrast, the growth style retained its large cap lead over value as a 3% gap in April widened the YTD differential to 17%. ***We continue to favor growth, particularly given today's low interest rates and slower growth environment.***

# FROM THE TRADING DESK

## MUNICIPAL MARKETS

- ***As we move further away from the initial shock of COVID-19 stay-at-home orders, the municipal market is beginning to normalize.*** New issuance was essentially put on hold through mid-April, but the last two weeks of the month each saw over $5B in new issues brought to market. Dealers are generally capital constrained, but the market has been able to absorb the deals with only modest concessions.
- Yields remain volatile as technical factors fluctuate. Municipal fund demand rebounded after experiencing heavy March and early April outflows, as net flows were relatively flat over the second half of the month. The 10Yr AAA yield ranged between 1.10% and 1.90%, ending April at 1.46%. We have seen increased curve steepness, with 2Yr to 10Yr spreads moving from 27 bps at the beginning of the month to 55 bps at month's end. ***This can be advantageous as it allows investors to realize incremental value when adding duration.***
- Sustained economic fears have caused municipals to underperform USTs and ratios remain highly elevated. ***The 2Yr ratio stood at 458%, the 5Yr ratio was 297%, and the 10Yr 221% as of 5/1, levels that suggest considerable relative value*** in swapping out USTs for municipals, particularly at shorter maturities.
- Senate Majority Leader McConnell created a flurry of headlines and a stir in the markets by suggesting that he could be in favor of states being allowed to use the bankruptcy code to restructure pension liabilities. ***Our view is that this was a bargaining tactic as Congress moves to the next phases of stimulus negotiations, not a realistic possibility.*** State bankruptcy is not currently legally permissible, and any such future consideration would face considerable political, economic and market hurdles.

Muni-Treasury Ratios Remain Elevated

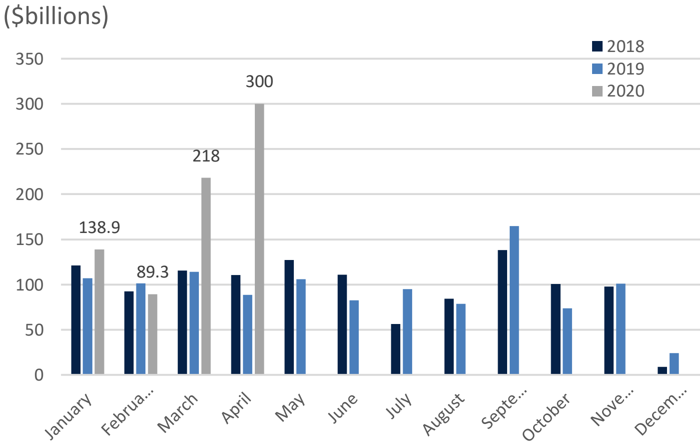



Source: Thomson Reuters

## CORPORATE BOND MARKETS

- ***In a sign of strengthening risk appetite, new issue investment grade corporate bond concessions have fallen significantly since the end of March.*** Issuers incurred an average cost of 4-5 bps in spread above their current bonds when pricing new debt during 2019, a concession which spiked to roughly 30 bps during March's market dislocation. Since that time, new issue concessions have dropped to about 14 bps and order books have been upwards of 5 times oversubscribed. Demand from investors has been revitalized, influenced considerably by unprecedented Federal Reserve support. Mutual fund investors have begun to react accordingly, with net IG inflows of $2.25B recorded during the week ended 4/29. This coupled with extremely low UST rates and a flat yield curve have made conditions ripe for issuance.
- April's $300B of issuance combined with $259B in March have fueled a YTD pace that is 85% above the same period of 2019. Boeing (Baa2/BBB-) brought a $25B 10-year deal in late April, the 6th largest in history, that was initially priced at +525 bps above comparable Treasuries. ***Strong demand pushed yields tighter and this bellwether deal closed at +450 bps, another indication that market conditions are improving.***
- Investment Grade credit spreads tightened by 68 bps during April, while lower-tiered credit tightened by just over 90 bps to 258, down 200 bps from the widest levels seen in March. Single A yields also narrowed 156 bps from March OAS highs. ***In this environment, value has once again become less readily apparent and we feel credit vigilance is imperative given our reluctance to rely on the Fed's backstop.***

U.S. Corporate Investment Grade Bond Issuance ($billions)




Source: Bloomberg Barclays

## FINANCIAL PLANNING AFTER THE SECURE AND CARES ACTS

Engaging with a trusted estate planning attorney to draft or update wills, trusts, powers of attorney and health care proxies is an essential element of financial planning. Given recent regulatory changes – including the SECURE Act and the CARES Act – a few points are worth emphasizing.

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|---|---|
| NOTARIZATION | Many states have changed their protocol on notarization for estate and other important documents and signatures, so you may not even have to go anywhere to get this done. We are happy to help you prepare by talking through the issues, engaging with your attorney, and/or reviewing documents before you sign. |
| PROTECT YOUR ESTATE FROM TAXATION | While the economic path forward may not be clear, it is reasonable to expect that the Federal government and many states will eventually be forced to consider tax and fee increases. The current federal estate tax regime is set to expire on December 31, 2025 as part of the TCJA of 2017. While the exemptions do not expire until 2026, this date is subject to change and planning to help shelter your estate assets should start far in advance. |
| ALPHABET SOUP | Only those in estate planning circles would recognize the following acronyms: CRAT, CRUT, GRAT, GRUT. Two of those strategies could make a great deal of sense today.<br>Grantor Retained Annuity Trusts (GRATs) – this is a technique that removes appreciated assets from the Grantor's estate by setting up a trust that makes annuity payments. The excess value of the trust is passed on to the next generation with the possibility of little or no use of lifetime gift exemption.<br>Charitable Lead Annuity Trusts (CLATs) - annuity payments are made to a charity for a term of years and the remainder interest is subsequently payable to a family member. A properly zeroed out CLAT may result in little to no gift tax despite significant assets being passed on to family members at the end of the trust's term.<br>We realize that estate and tax matters may be somewhat arcane to those not well versed in the subject matter. We are here to help make sense of it all and can also interface with your professional advisors. |
| SAVE YOURSELF MONEY TODAY…AND IN THE FUTURE | Re-finance your mortgage – Extremely low interest rates may present a golden opportunity to reduce monthly mortgage expenses and/or shorten mortgage term.<br>Tax extensions – With filing deadlines moving to July 15, 2020, the allowable time period for Traditional and Roth IRAs has also been extended. If you haven't already done so, we urge you to take advantage. |
| REWARD YOURSELF… AND PROBABLY YOUR KIDS | Roth conversions – Reduced account balances may present an efficient opportunity to convert a Traditional IRA to a Roth IRA. Doing so typically incurs ordinary current income taxes on the conversion balance, but you would not owe taxes on any subsequent growth. This can be compelling given future potential compounding and the new 10-year spenddown rule put into law via the SECURE Act.<br>Gifting assets - Maximizing the Federal Estate Tax Exemption by gifting investment assets is worth considering. Gifting either outright or via trust can maximize the assets you pass on to the next generation, as future gains are incurred outside of your estate. |

For questions concerning our financial planning or wealth management services, please contact:
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# APPLETON PARTNERS, INC.

## OUR HERITAGE

- Founded in 1986 and located in Boston, MA
- 100% employee owned and operated
- Collaborative, team-oriented culture marked by personnel continuity
- Professional staff of 54 dedicated to supporting all aspects of our clients' financial lives
- Personalized, high-touch service backed by recognized asset management expertise
- Entrusted with $11.06 billion of client assets (as of 4/30/20)

## OUR DEFINING BELIEFS

- Private client services should be customized and objective-based
- Transparency and accessibility are core Appleton commitments
- Goal-oriented and risk sensitive growth, income and tax efficiency are integral to our portfolio management approach
- Our active investment strategies emphasize liquidity and flexibility
- Separate accounts are best suited to meeting specific investment objectives
- Qualitative insight and deep proprietary research can uncover attractive investment opportunities

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