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MARKET REVIEW
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SMB Trust Services

MARKET BRIEF

CORONAVIRUS: ECONOMIC AND FINANCIAL MARKET IMPLICATIONS

The outbreak of the respiratory illness caused by coronavirus has put health authorities on high alert and unsettled financial markets. As of February 13, over 60,000 cases have been confirmed and the number of deaths has surpassed 1,300, according to the World Health Organization. The virus is believed to have originated in late December in a large wildlife food market in Wuhan, China. The situation remains fluid with new cases being reported each day.

Measures are being taken globally in an attempt to halt the spread of the virus. Chinese authorities have suspended flights and public transportation in multiple cities, impacting over 50 million Chinese citizens. Other countries have instituted travel bans to and from mainland China. Some Chinese businesses and factories plan to remain closed from late January until mid-February. Meanwhile, U.S. companies including Starbucks, Nike, Disney, McDonald's, and Apple have temporarily closed their operations in China. Concerns that these preventative measures will likely disrupt global supply chains have led many economists to project a temporary slowdown in global economic growth.

ECONOMIC IMPLICATIONS

In an attempt to gauge coronavirus's potential economic impact, many economists have cited the 2002-2003 Severe Acute Respiratory Syndrome (SARS) outbreak as a historical comparison. Similar to coronavirus, SARS is believed to have originated in a wildlife food market in China and spread to over 20 countries. SARS affected around 8,100 people over the course of a few months and caused more than 770 deaths. The SARS fallout reduced China's economic growth to an annualized rate of 9.1% in the second quarter of 2003 from 11.1% in the first quarter. With the SARS outbreak contained within a couple of months, China's economic growth quickly recovered to 10.0% in the third quarter.

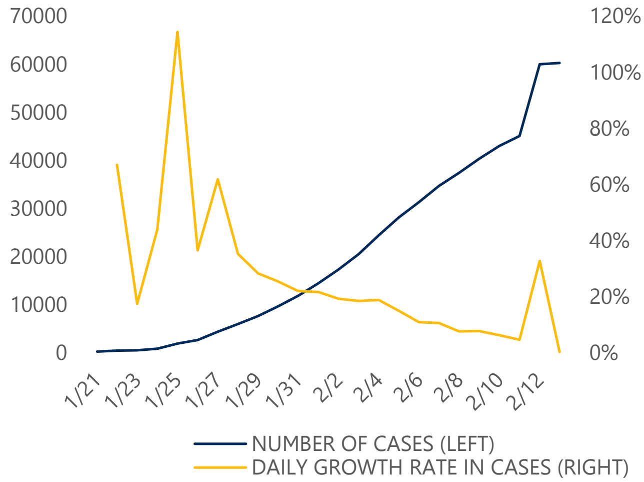
Economists project the coronavirus outbreak could reduce 2020 global economic growth by 0.2% to 0.3%. Prior to the outbreak, the International Monetary Fund (IMF) projected global economic growth would accelerate to 3.3% this year from 2.9% in 2019. If estimates for the disease's economic drag are accurate, global growth may still be slightly better this year than in 2019. Bloomberg economists forecast coronavirus will reduce China's economic growth to 4.5% in the first quarter, 1.5% lower than their pre-outbreak forecast of 6.0%. Bloomberg expects global economic growth will rebound within one to two quarters, and China's economy will expand by 5.7% this year, down from 6.1% in 2019.

FINANCIAL MARKETS IMPLICATIONS

History shows that diseases threatening to reach pandemic levels can produce volatile market reactions including panic driven sell-offs followed by quick V-shaped rebounds. For instance, during the SARS outbreak the S&P 500 declined 13.3% from January 14, 2003 through March 11, 2003. By May 5, 2003, the S&P 500 had recovered all of those losses. Up to this point, the stock market's response to coronavirus has been far more moderate. The S&P 500's drawdown from January 17 through January 31 was 3.1%, and the index subsequently rebounded 3.2% in the first week of February as coronavirus fears began to ease. Although the broad market has avoided steep losses thus far, we would expect shares of companies in the global airline, casino, hotel, cruiseship and

CORONAVIRUS OUTBREAK

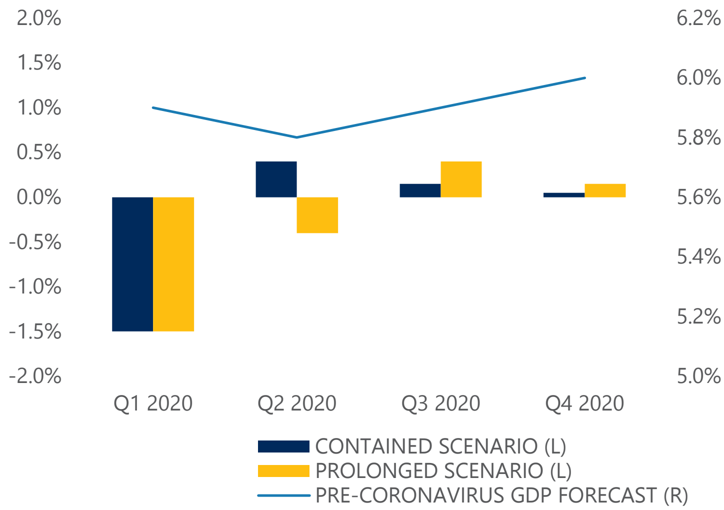
NUMBER OF CASES AND DAILY GROWTH RATE



Source: World Health Organization (WHO)

CORONAVIRUS IMPACT ON CHINA'S ECONOMY

QUARTERLY CHANGE IN CHINA'S GDP FORECAST



Source: Bloomberg

Past performance does not guarantee future results.

travel agency businesses to remain under pressure for up to several months.

Other asset classes that are more sensitive to China's economy, including commodities, are taking longer to recover compared to the quick rebound seen in stocks and bond yields. The prospect of a weaker global economy in the near-term and associated weaker demand from China for oil and industrial metals led to sharp declines in commodity prices. The price of crude oil plunged 20% to a three-year low of $49.61 per barrel in early February from above $60 per barrel in the first week of January. The travel ban in China is estimated to have reduced Chinese oil consumption by 20% and 3% globally. China is the largest importer of crude oil from many of the world's largest producers including Saudi Arabia. Industrial metals also fell over 10% into correction territory. China's share of industrial metals' global demand has risen in the last couple of decades to 50%-60% today from 10%-20% in 2002.

Despite the pain in many commodity markets, we observe several potential reasons for stabilization in equity markets. The daily growth rate in the number of cases has dramatically fallen from over 50% earlier in the outbreak to below 8%. The slowing growth rate in cases could be a sign the virus has been largely contained. While the virus has spread to over 20 countries, the number of cases outside China is relatively low at 249, or 0.6% of total cases. In addition, many of the cases outside China affected people who traveled to China recently along with their family members who have been in close contact with them. The first weekend of February was a critical time to get an indication whether the preventative measures were working. February 6 marked two weeks since the city of Wuhan was quarantined, and two weeks is also the virus' incubation period. The slowing daily growth rate in cases suggests the spread of the virus may have reached a turning point, and we could continue to see fewer new cases each day. One risk is a second wave of contagion around mid-February triggered by infected people traveling for the Lunar New Year celebration in late January which may have aided the spread of the disease.

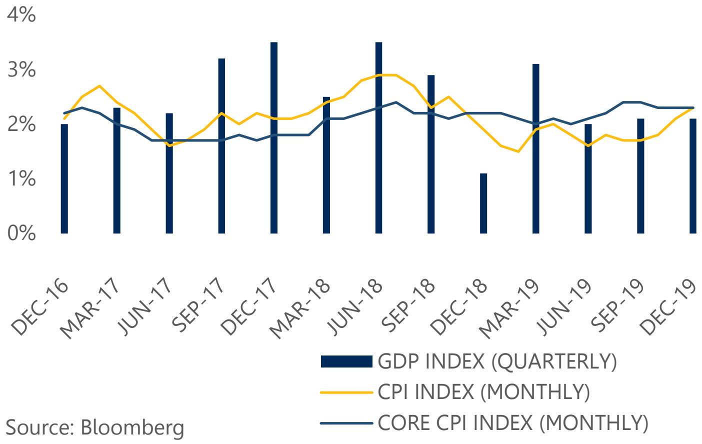
Another factor that likely helped stabilize markets was the hope that China's stimulus response may offset part of the virus' economic drag. In the first week of February, China's central bank lowered short-term interest rates and injected a few hundred billion dollars of liquidity into the economy via reverse repurchase agreements.

CONCLUSIONS AND INVESTMENT IMPLICATIONS

Deadly diseases including coronavirus and SARS are significant global health issues, yet their impact on the global economy and financial markets is typically short-lived. Often, the immediate market response overstates the long-term risks to the global economy. While it is too early to determine the full impact of the coronavirus, a recent decline in the rate of contagion and a significant liquidity injection from the People's Bank of China are encouraging developments. Given the extensive travel restrictions, quarantines and curfews throughout large parts of central China, most experts expect a moderate slowdown in Chinese GDP growth in the first half of 2020. We expect the broad U.S. equity market to continue navigating coronavirus concerns as the first quarter unfolds. Energy and industrial commodity prices and areas of the domestic equity market most closely tied to global travel could, however, remain under pressure for several months.

ECONOMY

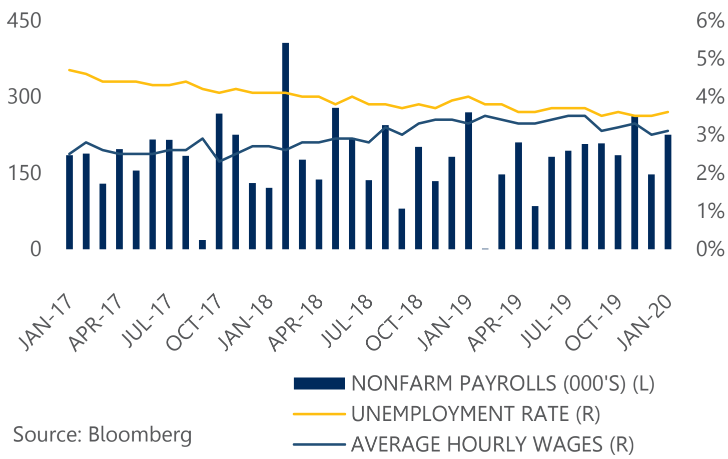
GDP AND CONSUMER PRICES
DECEMBER 2016 THROUGH DECEMBER 2019



Source: Bloomberg

- The U.S. economy grew 2.1% in the fourth quarter, matching the third quarter's growth rate. A historic decline in imports and steady export growth offset weaker consumer spending of 1.8%. Tariffs from the trade war with China appear to have contributed to imports' 8.7% decline which was the largest quarterly decline in over 10 years.
- For the full year, the U.S. economy grew 2.3%, below the 2.9% and 2.4% increase in 2018 and 2017, respectively.
- Underlying U.S. consumer prices, measured by the core Consumer Price Index (CPI) which excludes the volatile food and energy components, rose 0.1% in December. In the 12 months through December, the core CPI increased 2.3%.

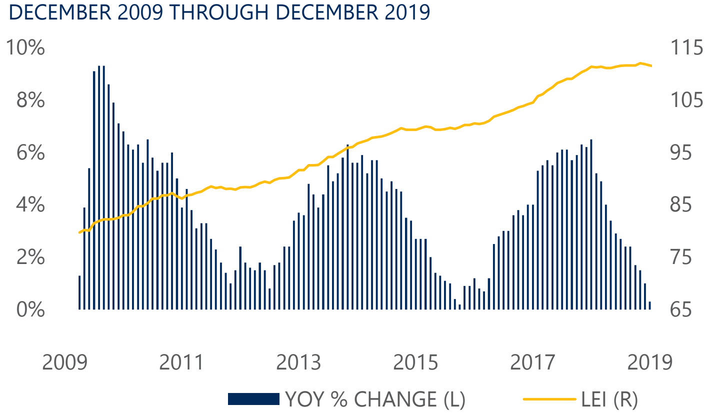
LABOR MARKET
JANUARY 2017 THROUGH JANUARY 2020



Source: Bloomberg

- The U.S. labor market started 2020 on a strong note by adding 225,000 jobs, easily topping the Bloomberg consensus estimate of 165,000. Warmer January weather helped the construction industry add 44,000 new jobs. The monthly rise in construction employment far surpassed the industry's 2019 monthly average job additions of 12,000.
- The education and health services industries led the employment report with a combined 72,000 new jobs in January compared to 22,000 in December.
- The labor force participation rate climbed to 63.4%, the highest level since 2013. The unemployment rate ticked up to 3.6% from 3.5%. Average hourly wages increased 0.2% from December which was less than the 0.3% expected, but year-over-year wage growth was more than expected at 3.1%.

LEADING ECONOMIC INDICATORS
DECEMBER 2009 THROUGH DECEMBER 2019



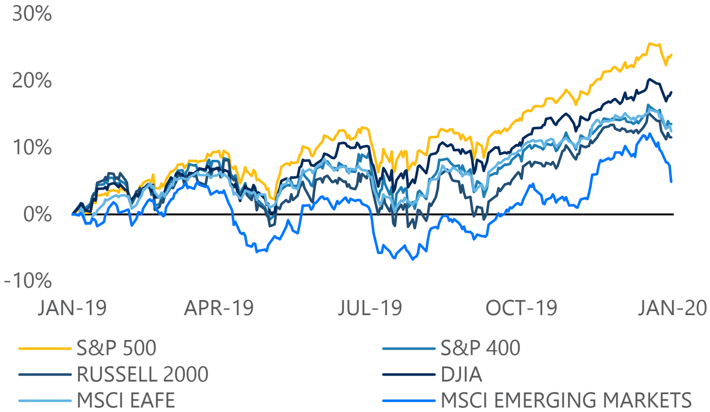
Source: Bloomberg

- The U.S. Conference Board Leading Economic Index (LEI) declined 0.3% in December following a slight increase of 0.1% in November. December's reading was the fourth decline in the LEI index over the last five months.
- Weakness among the index's 10 components has become more widespread. The largest detractors in December were an unexpected spike in jobless claims and a decline in building permits. Both detractors are believed to be temporary, as jobless claims have since fallen and low interest rates could encourage a rebound in permits.
- Economic growth slowed in the second half of 2019, but looser financial conditions and consumers' optimistic outlook for the economy should support growth of about 2% through early 2020, the Conference Board said.

EQUITY

TRAILING 12-MONTH EQUITY RETURNS

PRICE APPRECIATION, JANUARY 2019 THROUGH JANUARY 2020

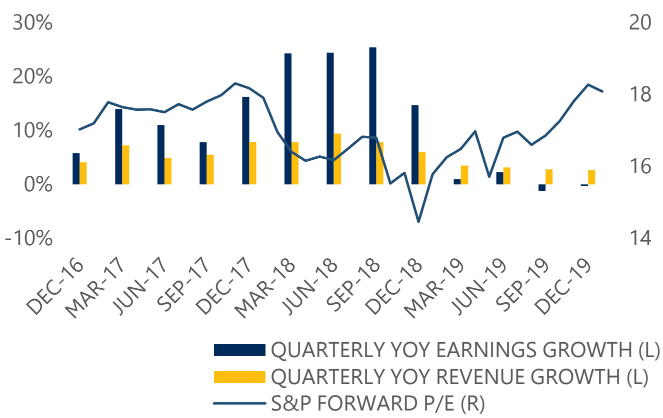


Source: Bloomberg

- Global equities' stellar performance in 2019 was briefly carried over into the new decade as the S&P 500 rose 3.1% in the first half of January before losing all its gains in the second half of the month amid coronavirus fears. The U.S. and China signed a phase on trade agreement on January 15 and suspended new tariffs, signaling an easing of trade tensions.
- The coronavirus outbreak interrupted one of the stock market's calmest periods in the last five decades. The S&P 500 did not move more than 1.0% in either direction since mid-October, its sixth longest streak since 1969 and third longest since 1995.
- Emerging markets were the most affected by the virus outbreak, as the MSCI Emerging Markets index fell 4.7%.

S&P 500 YOY EARNINGS & REVENUE GROWTH

BY QUARTER, DECEMBER 2016 THROUGH JANUARY 2020

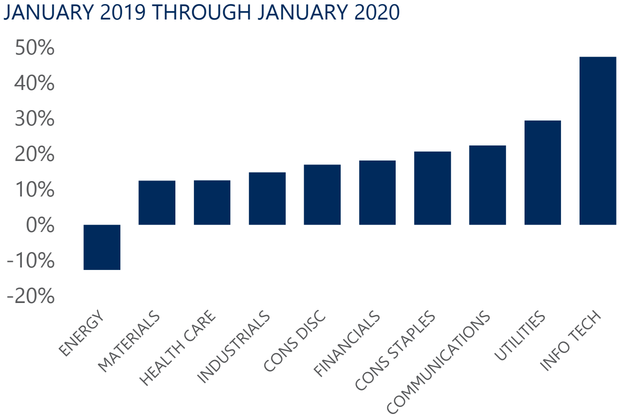


Source: Bloomberg

- About half of S&P 500 companies have reported fourth quarter earnings. Earnings are on track for 0.3% decline which is better than the original analysts' consensus estimate for a 1.3% decline. Revenue growth of 2.6% is slightly ahead of analysts' estimates for 2.3% growth.
- The technology and consumer discretionary sectors are the largest drivers of the S&P 500's better-than-expected growth with both sectors posting growth rates more than 5.0% above analysts' estimates. Excluding energy's 42.3% earnings decline, the S&P 500 is on track for 2.9% earnings growth.
- The fourth quarter's earnings growth forecast has been improving as companies report results above expectations, suggesting the index might avoid an earnings recession if the trend persists.

S&P 500 SECTORS 12-MONTH PRICE RETURNS

JANUARY 2019 THROUGH JANUARY 2020



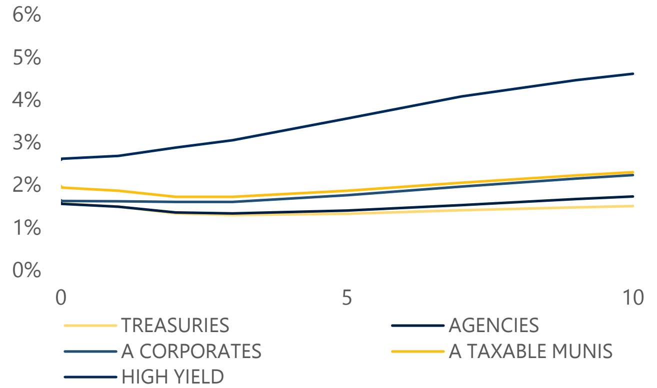
Source: Bloomberg

- The 10-year U.S. Treasury bond yield's return to near a multi-year low drove the 6.7% monthly gain in the interest rate sensitive utilities sector. Real estate also benefitted from lower rates and posted a 1.4% return.
- The technology sector's 3.9% January gain was a distant second behind utilities, but technology remained the best sector over the last year by a wide margin. Better-than-feared earnings growth propelled the technology sector in January. The sector is on pace for 4.8% growth versus analysts' forecast for a 1.0% decline.
- Energy and materials were the biggest sector laggards in January with losses of 11.1% and 6.2%, respectively. The prices of crude oil and industrial metals have declined amid expectations for reduced demand from China due to the coronavirus.

FIXED INCOME

CURRENT YIELD CURVES

YIELD CURVES AS OF JANUARY 2020

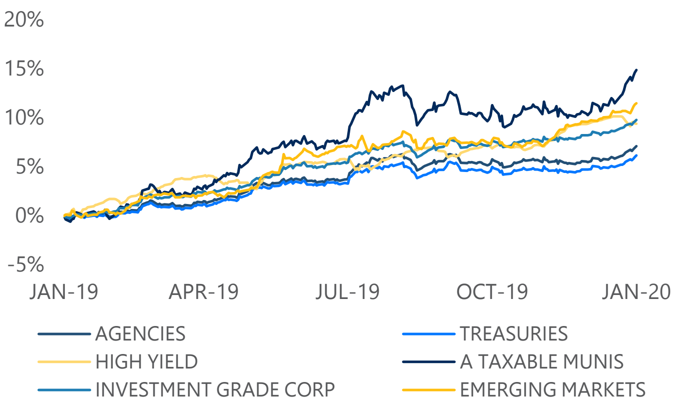


Source: Bloomberg

- The medium-to-long part of the Treasury curve decreased materially in January as investors feared the possibility of weaker global economic growth due to the coronavirus outbreak. Meanwhile, the short end of the curve remained mostly unchanged as the Federal Reserve elected to keep the interest rate unchanged.
- The U.S Treasury yield curve ended the month inverted as the three-month Treasury bill closed the month yielding more than the 10-year Treasury note.
- Single A-rated corporate bonds began to show significant spread versus Treasuries starting two years out. High quality government agency bonds began to show significant spread versus Treasuries starting five years out.

12-MONTH RETURNS, TAXABLE BOND SEGMENTS

JANUARY 2019 THROUGH JANUARY 2020

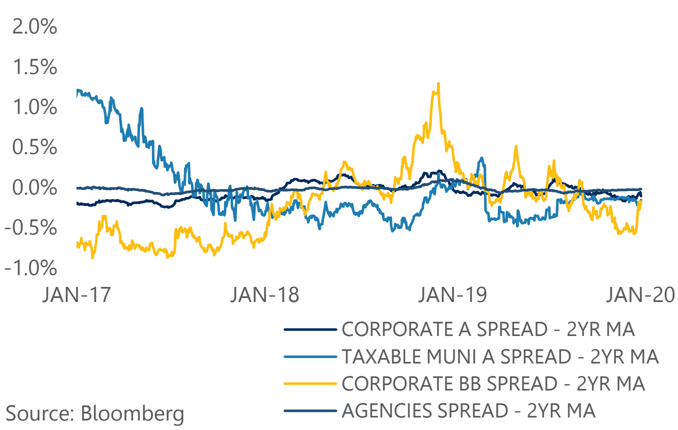


Source: Bloomberg

- Each of the fixed income sectors shown in the accompanying chart generated a healthy price return above 6.0% in the past 12 months as yields have continued to decline over the period.
- Each of the fixed income sectors has maintained a positive rolling one-year price return since March 5, 2019.
- Single A-rated taxable municipals posted the best one-year return of 14.9%, while Treasuries recorded the weakest performance of 6.2%.

SPREAD VS. TREASURY LESS 2-YR MOVING AVG

JANUARY 2017 THROUGH JANUARY 2020



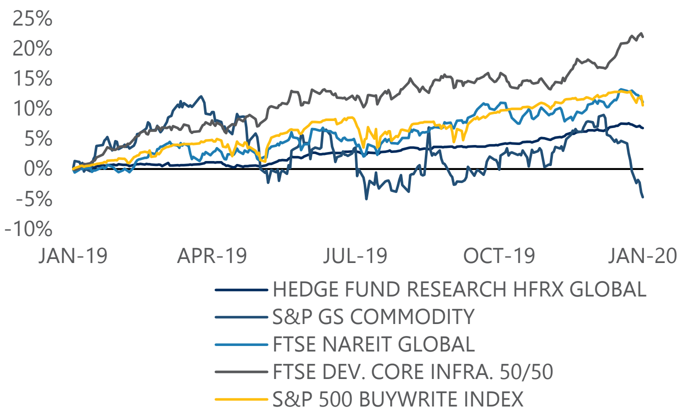
Source: Bloomberg

- The two fixed income sectors with corporate credit exposure shown in the accompanying chart, Corporate A and Corporate BB, saw their spreads widen during the month, signaling that investors view corporate credit as becoming riskier.
- Single A-rated taxable municipal bonds were the only fixed income sector in the accompanying chart that experienced spread tightening during the month.
- Spreads for all of the fixed income sectors shown in the accompanying chart are currently below their two-year average spread.

ALTERNATIVES

ALTERNATIVES, 12-MONTH RETURNS

JANUARY 2019 THROUGH JANUARY 2020



Source: Bloomberg

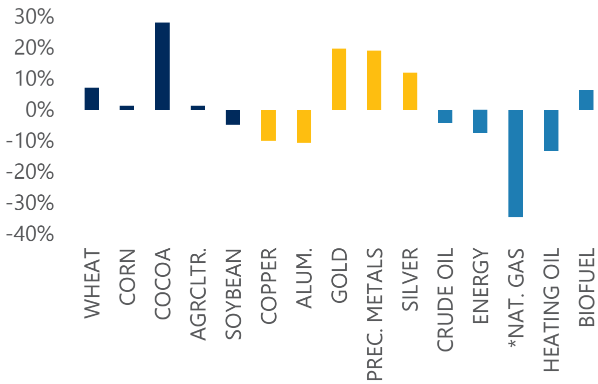
- A glaring 13.6% performance gap materialized in January between the global infrastructure and the broad commodities asset classes.

- Most energy and industrial metal commodity prices were weighed down by concerns about how hard the global economy would be hit by the coronavirus. A 15.6% decline in U.S. oil prices to under $52 per barrel more than offset a 4.7% gain in gold prices during the month.

- The global infrastructure asset class benefited in January from an environment favoring equity securities with above average dividend yields and defensive characteristics. Over the 12-month period ending January 31, the global infrastructure index shown in the chart at left outperformed the MSCI ACWI Index by 3.0%.

COMMODITIES, 12-MONTH SPOT RETURNS

JANUARY 2019 THROUGH JANUARY 2020



Source: Bloomberg

- U.S. crude oil prices entered bear market territory in the first days of February following a rapid 20% decline from an eight-month closing high of $63.27 per barrel on January 6.

- Travel restrictions, curfews and quarantines across large swathes of China in response to the coronavirus have caused market participants to anticipate a significant reduction in oil demand in coming months. China, the world's second largest economy, is the largest buyer of crude oil exports from several major oil-producing nations including Saudi Arabia.

- After a nearly 30% rise over the twelve-month period ending January 31, global cocoa prices are expected to remain elevated amid slowing production growth in Ivory Coast and steady worldwide demand.

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