Economic & Investment Strategy Outlook
Summer 2020

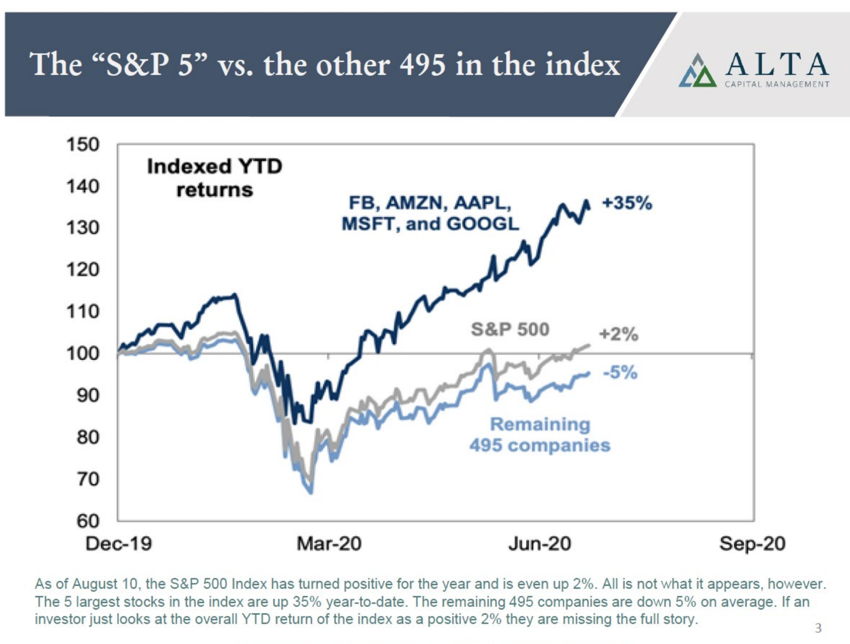
Economic Outlook

Generations are defined by timelines and shaped by shared experiences. However, there are generational events that transcend nearly every divide and change the course of history. Several easy examples come to mind such as the Civil War, Great Depression and World War II. We anticipate the COVID-19 pandemic is destined to become one of those generational events. Epidemics and pandemics are not new to the world. There are hundreds in recorded history. The most recent pandemic of a similar nature to COVID-19 was the Asian flu of 1957 – 1958, which also caused a global recession. What sets COVID-19 apart, is the all-encompassing scope and scale of the virus with accompanying disruptions, and thus the subsequent implications for investors as they navigate the worldwide effects. No outbreak in recent memory has been disruptive enough to immobilize global economies.

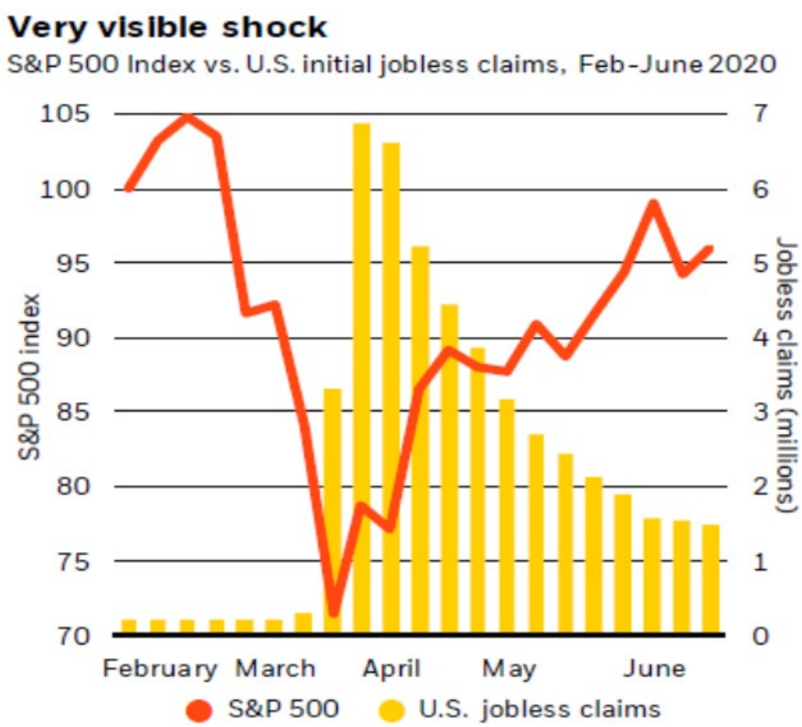
Since the world has had some time to react to and further understand the situation created by COVID-19, the Investment Strategy Committee as part of its ongoing evaluation, has outlined topics we believe will need to be monitored going forward to manage investor portfolios. These topics may affect multiple asset classes.

- **The speed at which economies, markets, and humanity have been affected and have reacted.** It is best described by Lenin who stated, "There are decades where nothing seems to happen and then there are weeks where decades happen". What we think today, may become obsolete or invalidated quickly. This is evidenced by acknowledging the change in what we knew in the beginning of the year, what we believe today, and what we foresee in the future is vast. An example is the velocity of changes in the equity markets. Barron's writes, "The stock market has had a rally for the ages." The S&P 500 bottomed on March 23, only 23 sessions after reaching a high on February 29, falling 34%. A bear market cycle normally lasts 18 to 36 months. The market then rose 51%, 99 sessions later, just short of the February record. This raises the question of whether the upturn in equities is a continued bull market or a bull market rally in a bear market.

- **The concentration of big technology stocks that have surged in price, have driven the gains in the Nasdaq and S&P 500.** This concentration group is represented by Apple, Microsoft, Amazon, Google parent Alphabet and Facebook. This group has risen 35% this year and accounts for 40% of the Nasdaq and 20% of the S&P 500. The significance of the concentration stands out with respect to the S&P 500, for which the remaining 495 companies have lost an average of 5%. This group of five stocks has boomed as investors flocked to them for their consistent earnings, strong balance sheets, and growth prospects in a pandemic economy. We have seen some recent broadening of price improvement for other stocks that have products and services conducive to the pandemic economy or are cyclical in nature. If conditions improve to create a more broad-based upturn, investors could rotate out of the group of five. Rotation among sectors is essential to a bull market.



- **Is the stock market decoupled from the economy?** Arguably, we would expect the stock market to be tied to economic activity. An old market axiom says that the stock market is a predictor of the economy and the economy is not a predictor of the stock market. The stock market is a leading indicator and is driven by earnings. Second quarter earnings have fallen predictably, clearing a low bar of expectations. Forecasting will be more difficult as more than 40% of S&P 500 companies have pulled guidance resulting from unknown impacts from the pandemic. Conflicting trends in economic indicators prevail, as stocks, housing, and retail do not reflect a recession. Is this recession different? That argument is offered as the recession was generated by the government, rapid in nature and record-breaking in terms of government response. For these reasons, is it easier for investors to foresee the recovery?



Source: BlackRock Investment Institute, with data from Refinitiv Datastream, June 2020. Notes: The yellow bars show initial claims for U.S. unemployment insurance. The S&P 500 is indexed to 100 at Jan. 31. **Past performance is no guarantee of future results.** Indexes are unmanaged and are not subject to fees. It is not possible to invest directly in an index.

- **Consumer spending represents two-thirds of our economic growth.** Government stimulus has replaced paychecks and working capital to support workers, businesses, and thus spending. We must watch the need and response for any continued stimulus and how successfully the economy is restarted while simultaneously developing vaccines and treatments. Federal Reserve Chairman Powell recently told the Senate Banking Committee that the last phase of a recovery "would require people to regain their confidence engaging in activity that requires close indoor contact or large outdoor gatherings." Looking longer term, we will need to assess if any areas of the economy lose productive capacity or are permanently scarred or damaged.

With the uncertainty in the world, we take comfort in the fact that individual investors (as represented by retirement plan participants) did not make dramatic portfolio moves despite the dynamic moves seen in the markets. Vanguard reported, "That 95% of the five million investors in 401(k) and similar retirement plans run by Vanguard Group didn't make a single trade in the first four months of the year." Similarly, T. Rowe Price reports that fewer than 3% of their retirement plan participants made any changes to their portfolios from late February through the end of March. The Investment Strategy Committee takes a similar consistent approach. While we always look for opportunities, we currently believe that patience rules the day in this period of economic and market dislocation.

Investment Strategy

Given the rationale above, the Investment Strategy Committee made minor adjustments with one asset allocation change around our neutral targets and added one new allocation position.

- Regarding COVID-19, European nations put in place robust public health measures and initiated a strong policy response. That coupled with favorable valuation and recent strong U.S. market returns prompted a 5% addition to our international position. This will move the international allocation closer to neutral. This was funded by reducing our overweight cash position by 5%.
- Seeing the potential for future inflation with stimulus funds and potential economic recovery, we initiated a 5% TIPS position. This was funded by reducing the ultra-short fund position by 2% and a further reduction in cash by 3%.
- Diversified our U.S. equity position by shifting 5% from active to passive management adding an S&P 500 index fund.

Please see our overall recommendations on the next page.

The Investment Strategy Committee

PeoplesBank Wealth Management
Relative Asset Class Recommendations
As of 07/28/20

	Unattractive	Slightly Unattractive	Neutral	Slightly Attractive	Attractive
Stocks			X		
US Large Cap				X	
US Mid/Small Cap				X	
International Developed		X			
Emerging Markets		X			
Bonds			X		
US Investment Grade			X		
Inflation Protected Securities (TIPS)				X	
High-Yield	X				
International Bonds	X				
Municipal Bonds				X	
Preferred Stocks	X				
Real Assets					
Real Estate		X			

As of 07/28/20. Recommendations subject to change at any time without notice.

Investment Process

PeoplesBank Wealth Management's asset allocation process develops both long-term (strategic) and shorter-term (tactical) recommendations. The strategic recommendations are based upon how the Investment Strategy Committee believes investment portfolios should be positioned in a generally neutral market environment over the next ten years. The tactical recommendations are meant to highlight opportunities over the next one to two years where the Committee sees either increased opportunity or risk.

The Wealth Management Investment Strategy Committee (ISC) is responsible for establishing and updating both the strategic (long-term) and tactical (short-term) asset allocation for Wealth Management's investment management and trust relationships. The committee is comprised of the senior members of the Wealth Management team. The committee is also responsible for monitoring and updating strategies, managers, and funds within client portfolios. The ISC meets monthly. If you have any questions or would like to discuss PeoplesBank Wealth Management's outlook further, please call or send an email to your relationship or investment officer.