TFC FINANCIAL
The Financial Counselors

COMMENTARY | 1Q 2020
April 2020

OUR VIEW

Despite bold moves by governments and central banks, there were few places to hide from the market reversal.

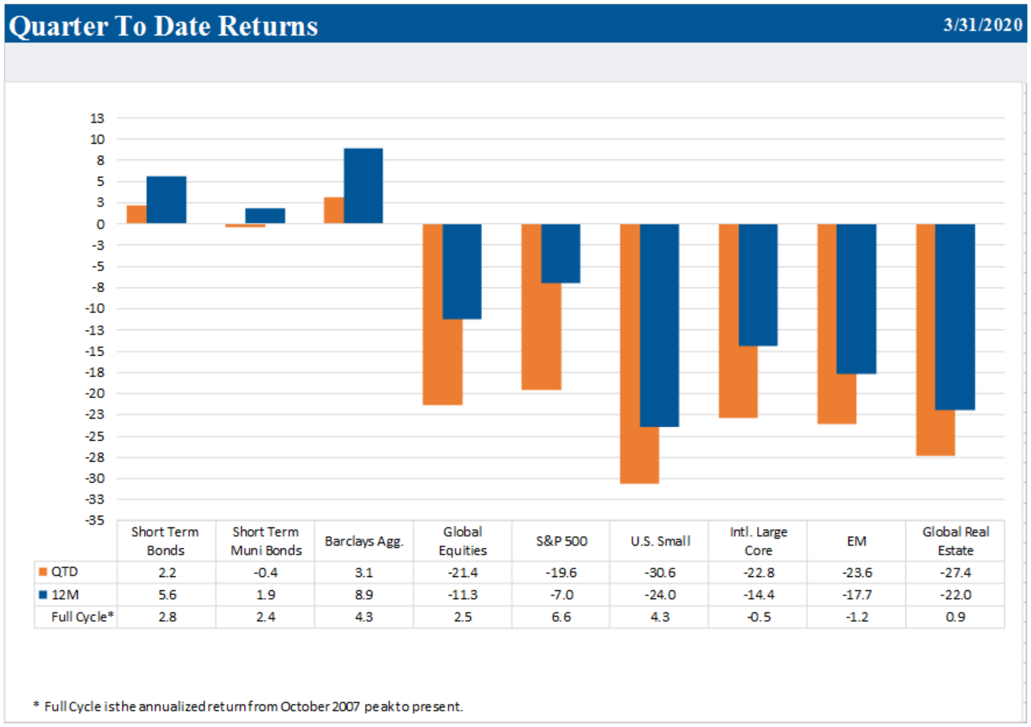
First Quarter Review

The year started with optimism about economic growth and hope that some of the left-behind segments of the market would stage a comeback in 2020. Fear replaced optimism as Covid-19 became a global pandemic. The market response to widespread illness and extreme "social distancing" measures was swift – equities transitioned from bull to bear market in record time during the first quarter. Despite bold moves by governments and central banks, there were few places to hide from the market reversal.

Global equities, as represented by the MSCI All Country World Index, fell by more than 21% in the first quarter. The S&P 500 dropped by nearly 20%. U.S. large company growth stocks were relative outperformers, but still lost more than 14%. The subset of the market considered most vulnerable in a recessionary environment – economically-sensitive companies with a lot of debt – were among the weakest performers. Consequently, U.S. large company value stocks fell by nearly 27% and U.S. small company stocks dropped by more than 30%. Developed international stocks, as measured by the MSCI EAFE Index, lost nearly 23%. Emerging markets stocks fell by a similar amount.

From a sector perspective in the U.S., technology and healthcare stocks were market leaders, while energy and financials trailed the market. Energy stocks fell by 50%, hurt by falling demand and a supply "glut" caused by the breakdown in the "OPEC +" relationship between Russia and Saudi Arabia.

Bonds were less helpful than is typically the case when equities decline. Treasury holdings and short-term, high quality bonds mostly held ground during the quarter. Investment-grade and high yield corporate bonds lost ground during the quarter, as worries mounted that an extended economic shutdown would create a dramatic increase in bond defaults. Municipal bonds had a surprisingly volatile quarter, with default concerns only a part of the picture. The highest rated municipal bonds weren't immune from market volatility, as many investors tried to sell higher quality and more liquid holdings to raise cash. Interest rate spreads between AAA 10-year municipal bonds and 10-year Treasuries widened from 81 basis points (0.81%) on March 9 to 288 basis points (2.88%) on March 23, a staggering move. Municipal bonds regained some ground by the end of the quarter.



Quarter To Date Returns 3/31/2020

	Short Term Bonds	Short Term Muni Bonds	Barclays Agg.	Global Equities	S&P 500	U.S. Small	Intl. Large Core	EM	Global Real Estate
🟧 QTD	2.2	-0.4	3.1	-21.4	-19.6	-30.6	-22.8	-23.6	-27.4
🟦 12M	5.6	1.9	8.9	-11.3	-7.0	-24.0	-14.4	-17.7	-22.0
Full Cycle*	2.8	2.4	4.3	2.5	6.6	4.3	-0.5	-1.2	0.9

* Full Cycle isthe annualized returnfrom October 2007 peakto present.

TFC client portfolios were not immune from the market downturn, declining in both absolute and relative terms. We started the year expecting some of the left-behind segments of the market to stage a recovery in 2020. Last year, the trade war derailed the recovery of value-oriented cyclical stocks. This year, the pandemic is the disruptive force. Consequently, TFC's value-oriented holdings lagged behind their growth counterparts in the first quarter. TFC's short-term bond holdings provided stability and liquidity during a turbulent quarter; TFC's credit-oriented holdings didn't fare as well but appear to be recovering with the Federal Reserve's support of the corporate bond market.

TFC's asset allocation approach is designed to provide clients with diversified equity investments across regions, economic sectors and investment styles. We are wary of "all or nothing" investment approaches, consequently TFC portfolios are "tilted" toward value but also hold an appropriate allocation to higher-quality, reasonably-priced growth stock funds. Although performance lagged behind TFC client benchmarks, the gap between TFC and benchmark performance was considerably narrower than the double-digit gap between value and growth equities.

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Portfolio Positioning

The TFC webinar on April 16 will focus on the market outlook, sharing more detail and graphics than we are able to include in this letter. In the meantime, we think it's worthwhile to share recent thoughts from Oaktree Capital's Howard Marks: "These days everyone has the same data regarding the present and the same ignorance regarding the future. Today the uncertainty is much greater than usual: the probability distribution governing future events is much wider and the tails much fatter." Of the wide variety of possible future events, two extreme scenarios are possible: a severe bear market in equities that lasts longer than currently forecasted or a rapid recovery in equities that leads the markets to new highs. Although we think the most likely outcome lies somewhere between the two extremes, in positioning portfolios we are attempting to strike a balance between the risk of losing money and the risk of missing opportunity. Consequently, our portfolio adjustments have been gradual in nature and we are not trying to "time" a market top or bottom.

Our expectations about the timing, nature and magnitude of the recovery from the pandemic led us to make changes that we think will better balance risk and return in a volatile and uncertain environment. Notably, we have reduced our holdings in small company stock funds and to funds that have significant holdings of highly cyclical/highly indebted segments of the stock market.

TFC made portfolio changes in recent years that were intended to make client portfolios more resilient in anticipation of a recession. We didn't expect a pandemic to cause an unprecedented recession by "government decree", but we did think that the economic expansion and bull market wouldn't last forever. Our decisions have been influenced by disruptive innovation, a topic discussed in our webinar earlier this year. A T. Rowe Price study estimated that more than 30% of the S&P 500 was undergoing disruption, a number that is already rising. Disruptive innovation has influenced changes in TFC's approach to value investing. Although we expect the time-tested value investment approaches of Benjamin Graham and Warren Buffett to pay off in the long run, we think that a strategy of simply buying "cheap" stocks will not be a sustainable approach to value investing. The pace of change, in large part because of technology, is such that many of today's value companies may be "cheap for a reason." It is important to identify companies that are resistant to disruption or are effectively responding to disruption. Consequently, TFC has increasingly invested in funds that go beyond simple price metrics to determine company "value."

We made additional changes in client portfolios during the first quarter. The economy seemingly shifted overnight from expansion to recession. Our expectations about the timing, nature and magnitude of the recovery from the pandemic led us to make changes that we think will better balance risk and return in a volatile and uncertain environment. Notably, we have reduced our holdings in small company stock funds and to funds that have significant holdings of highly cyclical/highly indebted segments of the stock market. Until there is a slowdown in the number of new Covid-19 cases and progress in the ability to treat victims of the outbreak, it will be hard for people to resume normal living.

In these uncertain times, it may be appropriate to prioritize liquidity and capital preservation over investment options that offer the highest but most uncertain potential returns. Portfolio additions include funds that are quality-focused-seeking companies with strong business models, balance sheets that can hold up under stress, and the ability to rebound in what is likely to be a very different world when the pandemic ends. It is important to avoid overreacting to the latest headlines, as the coming weeks (and months) are likely to be an emotional rollercoaster. In that spirit, we want to share a reminder from Artisan Partners' Portfolio Manager Dan O'Keefe: "the value of a business is the present value of all future cash flows, not just those over the next few months." That context is important as we think about the long-term outlook for markets and positioning of client portfolios to achieve lifelong financial goals. Things may get worse before they get better, but dislocations like what we're experiencing have often been buying opportunities.

As always, we welcome your comments and questions.

Sincerely,

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As an SEC-registered investment adviser, we are required to update annually in the first quarter of each calendar year our Form ADV, which includes our Form ADV Part 2A Brochure and Form ADV Part 2B Brochure Supplement. If, in connection with our annual update, we make material changes to our Brochure or Brochure Supplement since the date of our last annual update, we are required to provide (or offer to provide) our clients with copies of them.

In connection with the just completed annual update of our Form ADV, there were no material changes to our Brochure or Brochure Supplement.

By this notice, we are offering to provide you a copy of our Brochure and Brochure Supplement. You may obtain copies by sending an email to Constance Wyllie, Chief Compliance Officer and Director of Client Service & Operations, at cwyllie@tfcfinancial.com, or by calling Ms. Wyllie at 617-210-6700.

You can also find our Brochure and Brochure Supplement, as well as other information about us, through the SEC's Investment Adviser Public Disclosure (IAPD) portal: www.adviserinfo.sec.gov. You can search this site by a unique identifying number, known as a CRD number. Our firm CRD number is 105062.

Please do not hesitate to call us if you have any questions.

Notice dated March 5, 2020