March 23, 2020

IT'S ALL ABOUT POLICY RESPONSE NOW

The Federal Reserve continues to supply liquidity to the financial system. In the past week the Fed announced further policy actions that dwarf their already incredible monetary response. Here's an overview of their policy shifts:

- Unlimited QE: Asset purchases announced last week will become unlimited, essentially open-ended quantitative easing.

- CPFF: Commercial paper funding facility with the aim of supporting the flow of credit. Treasury provided $10 billion in credit protection via the exchange stabilization fund (ESF) and the Fed provided financing to a special purpose vehicle (SPV) used to give credit to a wide range of activity such as auto loans, mortgages and company operational needs.

- PDCF: Primary dealer credit facility with the aim of facilitating the availability of credit to businesses and households. The PDCF is similar to the discount window and allows for dealers to post a wider set of collateral (such as investment grade bonds, munis even stocks).

- MLFF: Money market mutual fund liquidity facility with the aim of meeting demands for redemptions by households and other investors. On March 20th they expanded this program to include municipal bonds.

- TALF: Term asset-backed securities loan facility with the aim of helping the flow of securitized products.

- Credit Market Facilities: These programs are new from the Fed and, unlike those listed above, were not used in the 2008 financial crisis. The Fed will buy corporate bonds and ETFs holding corporate bonds.
  - Primary market corporate credit facility (PMCCF) for new bond and loan issuance.
  - Secondary market corporate credit facility (SMCCF) to provide liquidity for outstanding corporate bonds.
- SME support: The Fed announced work on another program targeting small and medium-sized firms. The main street business lending program (MSBLM) would be in addition to support provided from the small business administration.

This is a monumental undertaking by the Federal Reserve to add Dollars to a system starving for Dollars. It is absolutely the correct policy action and solidifies the Fed's only crucial role - to be lender of last resort in times of financial crisis. The speed and scale at which the Fed is intervening is true truly impressive. With the Fed now supporting most fixed income markets, there should be a return to stability and less dislocations in managing bond funds.

With monetary policy firing on all cylinders, it's time for fiscal policymakers to step up. To better assess policy options in play, we had a conference call with economist Art Laffer. Here are our notes from that call:

- Origin of current crisis is not economic. The virus will end, but the economic consequences will linger and cause liquidity crisis in several industries and many companies.
- There are two serious problems: liquidity and production
- Liquidity:
  - Very solvent companies are being put at risk of fire-selling assets, turning liquidity problems to solvency problems, which is essentially incurable for years.
  - Fed and Treasury must provide cash to solvent companies with liquidity problems. A liquidity crisis cannot be allowed to become a solvency crisis.
  - Fed needs to discount freely. Companies need loan guarantees from Fed, Treasury and SBA.
- Production
  - We have a supply problem because people are quarantined and can't go to work.
  - We don't have a demand problem, so sending checks to families is not sufficient to rebound.
  - Only a restart of the supply side of the economy (production) will cause economic recovery.
  - Need to make production more attractive via a payroll tax holiday for 8-9 months for both employee and employer. This will give both employee and employer increased incentives to work and hire. For example, a worker making $50,000 year would take home $4,000 more while an employer would pay $4,000 less in taxes. This should lead to a very sharp economic reversal.

Bottom line is there policy tools available to reverse the current economic halt caused by COVID-19. We are in uncharted territory. This is the first intentional recession in history. Most recessions are caused by government economic policy mistakes. This one is being caused by an intentional government shutdown to help fight the spread of a virus.

The intentional economic shutdown has caused the largest liquidity event since World War 2. In 2008 we faced a solvency crisis in the banking system that spilled into the real economy. Today we face the opposite. In 2020 we face a real economy shutdown that is causing banking problems.

The Federal Reserve is buying the economy time by appropriately acting as lender of last resort and pumping liquidity into the system. The supply side of the American economy must now be allowed to "turn on." Fiscal policymakers need to act with the same speed and intention as the Federal Reserve. Bipartisan Congressional support this week for the Senate bill would be a solid first step.

ALLOCATOR

Fixed Income

Bonds are an asset class that does well in a deflationary policy environment (Low Growth & Strong Currency)

We have long said the Treasury bond bubble will pop again as it did from May2013-Jan2014 when long term Treasury bonds fell 18%. With voters choosing Trump's pro-growth agenda to ignite growth, we believe the this is even more likely. Treasury bond prices are at risk to fall 30-50%, and we expect any moves higher in bond prices (lower in yields) to be short-lived. Since most other bonds price off of Treasury yields, fixed income in general is a risky asset class.

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Investment Grade	LQD	9/9/2016	$119.00	$106.74	-10.3%	
Aggregate Bond	AGG	9/9/2016	$109.00	$110.03	0.9%	
Municipal	MUB	9/9/2016	$111.00	$102.30	-7.8%	
TIPS	TIP	9/9/2016	$114.00	$115.86	1.6%	
Extended Duration	EDV	9/9/2016	$128.00	$155.71	21.6%	
US Treasury 3-7 yr	IEI	9/9/2016	$124.00	$131.95	6.4%	
US Treasury 7-10 yr	IEF	9/9/2016	$109.00	$119.14	9.3%	
US Treasury 20+ yr	TLT	9/9/2016	$133.00	$159.43	19.9%	
International Total Bond	BNDX	9/9/2016	$54.40	$55.31	1.7%	
High Yield	HYG	4/12/2016	$77.00	$69.75	-9.4%	Act more like equities than bonds, benefit from improving growth

ALLOCATOR

Commodities

A change in the price of gold is a change in the value of the currency. When gold rises, the currency's value falls and vice versa. Commodities are an asset class that does well when the currency is weak. If growth is slowing while the currency weakens, there is stagflation. Own precious metals. If growth is accelerating while the currency weakens, there is an inflationary expansion. Own agriculture, industrial and energy commodities.

Commodities suffered heavy losses in the strong US Dollar environment 2012-2015. In 2016 Dollar weakness was caused by election uncertainty and commodities rallied. That weak Dollar trend was reversed by Election2016.

Gold's recent rise has been driven by a general "risk-off" stance, caused in large part by fear about coronavirus impact on global trade/supply chains coupled with Bernie Sanders' rising odds to capture the DNC nomination. We expect these fears to be transitory throughout 2020, especially since we do no believe Sanders' policy menu can win the country. At this time the move up in gold is not, in our assessment, connected to worsening domestic economic policies that would cause a flight out of Dollars. However, we cannot ignore the market based signal of gold moving to new highs.

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Gold	GLD	2/18/2020	$150.91	$140.11	-7.2%	Safe haven rush into precious metal
Silver	SLV	2/18/2020	$17.01	$11.62	-31.7%	
Energy	DBE	8/13/2014	$28.97	$8.04	-72.2%	
Oil	USO	7/30/2014	$37.00	$4.94	-86.6%	
Agriculture	DBA	9/13/2011	$32.50	$13.99	-57.0%	
Broad Comm. Index	GSG	8/5/2011	$33.00	$9.64	-70.8%	
Base Metals	DBB	6/17/2011	$23.00	$12.18	-47.0%	

ALLOCATOR

Real Estate

Real Estate is an asset class that performs well when growth is accelerating. When rising growth is coupled with a strong currency, own real estate tied to business activity (like commercial REITS). When rising growth is coupled with a weak currency, own real estate tied to commodities (farmland).

Commercial RE will be helped by improving real economic growth. RE properties leveraged to businesses & economic growth are preferred under pro-growth US policies.

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/ Loss	Policy Notes
Residential	REZ	12/21/2016	$61.00	$47.88	-21.5%	
Building/Construction	ITB	12/21/2016	$28.00	$25.42	-9.2%	
Mortgage REIT	REM	4/1/2016	$35.00	$20.01	-42.8%	
REIT	VNQ	3/7/2016	$75.50	$59.68	-21.0%	

ALLOCATOR

US Equity

We have been waiting for a 1980s/90s type of policy driven equity bull market for sixteen years. The 2014 midterm House/Senate/gubernatorial election shifts put us on the path as pro-growth candidates propelled the GOP to majorities. It was a repudiation of anti-growth economic policies and a big step toward a Reagan/Clinton type of equity bull market. Despite the voters' growth signal, Obama doubled down on his tax/spend/regulatory (EPA) agendas in 2015 causing stocks to be range bound and volatile. As 2016 began, policy uncertainty ahead of November's elections became the biggest threat to equities. The ebb and flow of the presidential political season moved markets in both directions as investors waited to learn which policy theme would prevail in November – growth vs. redistribution. Voters decisively made their choice in Election2016, and growth won. Trump's pro-growth policy agenda beat Hillary's anti-growth policy agenda in landslide fashion. Republicans retained control of the Senate, House and increased their control of governorships by three. The policy stage is now set for Trump and Congress to keep delivering pro-growth tax, regulatory and monetary policies. As they do, a bull market in U.S. equities will ignite to rival the 1980s/90s

US Equity - Cap Size

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Micro	IWC	7/11/2016	$72.00	$59.24	-17.7%	
Total Market	IWV	5/19/2016	$117.00	$132.95	13.6%	
Large	IWB	5/19/2016	$111.00	$126.17	13.7%	
Small Cap	IJR	5/19/2016	$54.00	$49.78	-7.8%	
Mid Cap	IWR	4/6/2016	$38.57	$38.10	-1.2%	

US Equity - Style

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Large Growth	IWF	7/11/2016	$101.00	$133.98	32.7%	
Small Growth	IWO	7/11/2016	$140.00	$138.53	-1.1%	
Small Value	IWN	5/19/2016	$92.00	$73.47	-20.1%	
Mid Growth	IWP	5/9/2016	$90.00	$106.75	18.6%	
Large Value	IWD	4/6/2016	$95.00	$89.15	-6.2%	
Mid Value	IWS	4/6/2016	$68.00	$56.83	-16.4%	

US Equity - Sector

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Staples	XLP	6/5/2017	$57.00	$50.40	-11.6%	
Utilities	XLU	6/5/2017	$54.00	$47.82	-11.4%	
Metals/Mining	XME	5/8/2017	$29.00	$14.54	-49.9%	Tied to commodity prices, hurt by strong Dollar
Energy	XLE	3/13/2017	$69.00	$25.86	-62.5%	Tied to commodity prices, hurt by strong Dollar
Healthcare	XLV	2/8/2017	$71.00	$79.09	11.4%	
Discretionary	XLY	11/14/2016	$79.00	$87.81	11.2%	Consumer strong w/ rising growth expectations
Financial	XLF	7/18/2016	$19.00	$18.91	-0.5%	Helped by Trump deregulation (Dodd Frank)
Materials	XLB	4/6/2016	$44.00	$40.68	-7.5%	
Industrial	XLI	3/14/2016	$52.00	$51.40	-1.2%	
Technology	XLK	3/7/2016	$41.00	$71.42	74.2%	Repatriation tax reform huge plus for tech companies

POLICY BASED INVESTING

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Foreign Equity

Country	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
China	FXI	8/5/2019	$39.86	$34.46	-13.55%	China’s currency devaluation policy is a growth killer
Hong Kong	EWH	7/6/2016	$24.08	$18.77	-22.05%	
Mexico	EWW	10/1/2018	$51.23	$27.04	-47.22%	Freer and fairer trade agreements are pro-growth for all parties involved
Canada	EWC	10/1/2018	$28.78	$18.76	-34.82%	
Denmark	EDEN	7/2/2018	$63.89	$51.08	-20.05%	European polices not improvng despite anti-austerity movements across the Euro Zone. Capital is fleeing. A zero trariff trade deal with the U.S. would reverse course and be very pro-growth for European economies.
Switzerland	EWL	7/2/2018	$32.58	$31.26	-4.05%	
Netherlands	EWN	7/2/2018	$30.51	$22.58	-25.99%	
Sweden	EWD	7/2/2018	$30.51	$21.91	-28.19%	
Eurozone	EZU	7/2/2018	$41.01	$26.49	-35.41%	
Spain	EWP	7/2/2018	$30.35	$18.33	-39.60%	
Poland	EPOL	7/2/2018	$21.78	$12.90	-40.77%	
France	EWQ	7/2/2018	$30.52	$20.47	-32.93%	
Germany	EWG	7/2/2018	$29.98	$18.25	-39.13%	
Italy	EWI	7/2/2018	$28.89	$18.55	-35.79%	
Austria	EWO	7/2/2018	$22.65	$11.58	-48.87%	
Israel	EIS	2/26/2018	$52.41	$40.00	-23.68%	
Vietnam	VNM	10/9/2017	$14.99	$10.50	-29.95%	Demographic leverage to US economic growth policies
Indonesia	EIDO	7/24/2017	$26.78	$12.90	-51.83%	Demographic leverage to US economic growth policies
Ireland	EIRL	1/26/2017	$39.00	$26.67	-31.62%	
Singapore	EWS	1/11/2017	$21.00	$15.86	-24.48%	
World Ex US	VEU	11/15/2016	$43.50	$36.60	-15.86%	Global growth reset higher after US Election2016
Norway	ENOR	8/20/2016	$20.00	$13.23	-33.85%	
UK	EWU	8/4/2016	$30.50	$20.06	-34.23%	Brexit was a vote for growth

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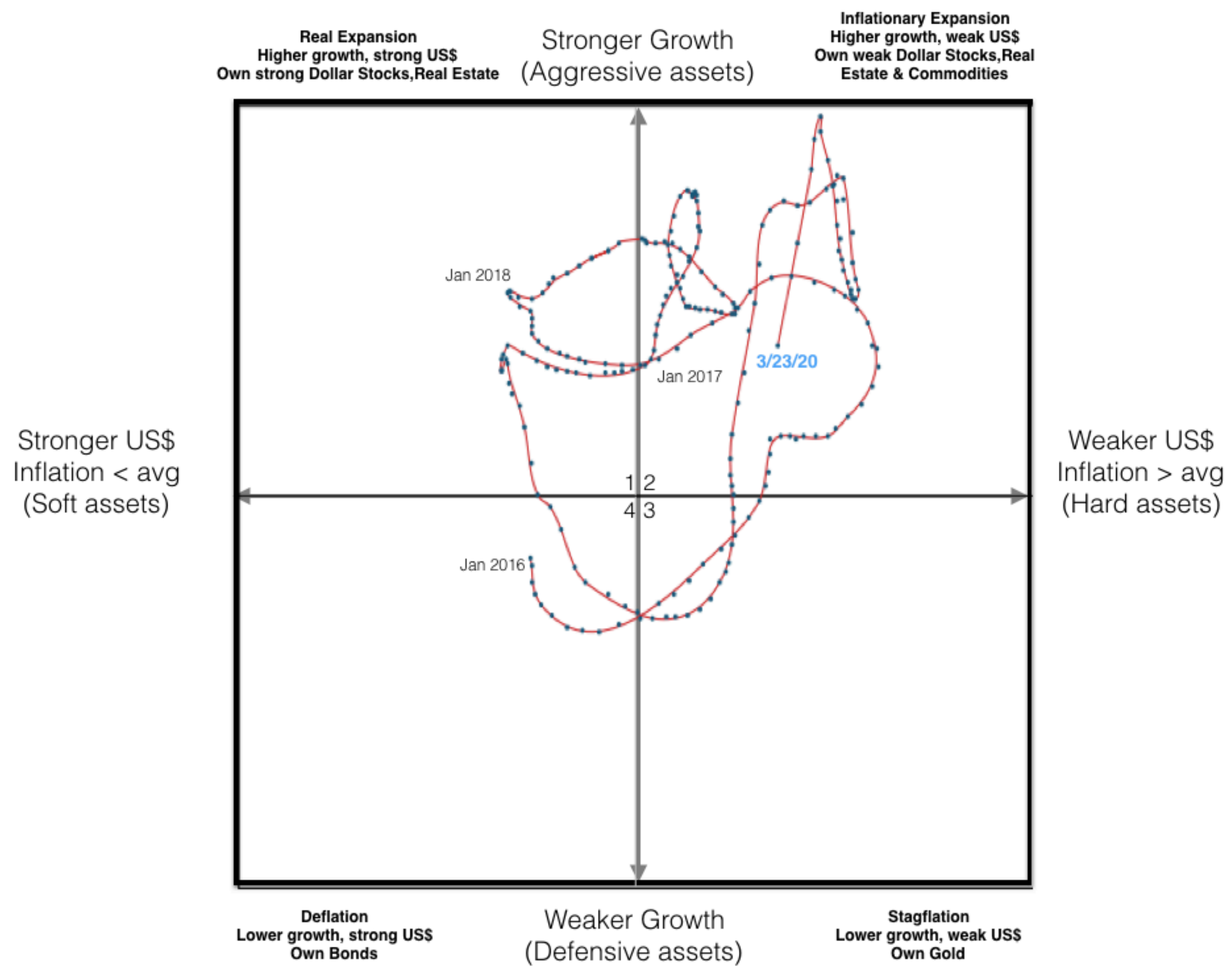
Finland	EFNL	7/26/2016	$33.00	$25.64	-22.30%	
Japan	EWJ	7/15/2016	$47.00	$45.11	-4.02%	Trade deal with U.S. is pro-growth
South Korea	EWY	7/13/2016	$52.00	$40.58	-21.96%	
Hong Kong	EWH	7/6/2016	$19.00	$18.77	-1.21%	
Frontier Mkts	FRN	7/5/2016	$10.50	$14.28	36.00%	
Peru	EPU	6/29/2016	$30.50	$21.72	-28.79%	
South Africa	EZA	6/29/2016	$51.00	$25.63	-49.75%	
India	EPI	6/27/2016	$19.00	$15.63	-17.74%	Strong Dollar emerging market, tied to US growth
Taiwan	EWT	6/21/2016	$27.00	$30.80	14.07%	
Thailand	THD	5/20/2016	$64.00	$53.91	-15.77%	
Belgium	EWK	3/16/2016	$16.50	$13.03	-21.03%	
New Zealand	ENZL	3/5/2016	$36.00	$39.30	9.17%	
Philippines	EPHE	8/5/2015	$37.00	$20.22	-45.35%	
Qatar	QAT	12/1/2014	$24.00	$15.17	-36.79%	
Malysia	EWM	10/3/2014	$41.00	$20.22	-50.68%	
Australia	EWA	9/16/2014	$22.50	$13.38	-40.53%	
Greece	GREK	7/14/2014	$20.00	$5.00	-75.00%	
Portugal	PGAL	6/4/2014	$15.00	$6.96	-53.60%	
Columbia	ICOL	6/27/2013	$21.00	$6.01	-71.38%	
Turkey	TUR	6/1/2013	$58.00	$17.81	-69.29%	
UAE	UAE	5/20/2013	$23.00	$9.30	-59.57%	
Russia	RSX	8/7/2011	$30.00	$19.97	-33.43%	Weak Dollar emerging market
Brazil	EWZ	7/14/2011	$60.00	$22.33	-62.78%	Weak Dollar emerging market
Chile	ECH	3/1/2011	$61.00	$19.00	-68.85%	
Egypt	EGPT	2/23/2004	$64.00	$17.42	-72.78%	

POLICY MAP

Growth decreased versus last week (1.68 to 1.00): Despite pro-growth tax and regulatory policy improvements since 2016, growth has tipped into negative territory over fears of a 2008-style, deflationary monetary policy mistake. The Fed must provide unlimited liquidity to prevent a solvency crisis during the first even intentional recession from shutting economy down because of a health crisis.

Value of US$ increased versus last week (1.06 to 0.93): Dollar had been stable between gold $1,300-$1,375/oz, and strengthened to $1,230/oz. giving the Fed a strong Dollar signal to pause rate hikes until economic and market data calm down. Recent Dollar weakness above $1,400 is concerning but likely has some likely temporary drivers like Coronavirus and an anti-growth DNC policy agenda post 2020.



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BOND YIELD COMPONENT ANALYSIS

Nominal Yield: 1.12% (+23%) **Inflation Expectation Component: 0.95% (+9%)** **Real Growth Component: 0.17% (325%)**

Bond market expectations for both real growth and inflation have collapsed. Before recently, the collapse in real growth had been largely caused by global bond market dynamics with negative interest rates across the globe. But now slow growth fears have come to the U.S. A domestic "shutdown" caused by COVID-19 weighs heavily on near term growth. Economic slowdown, even if it's short, makes post-2020 election policy highly uncertain. The Federal Reserve is doing what it needs to do by providing sufficient liquidity to the banking system as needed. Fiscal policy is the next policy lever to be pulled to counteract negative economic effects of a COVID-19 caused economic shutdown