Q3 | 2020

Third Quarter Macro Overview

Since February, we've been living in historic times, as the coronavirus (COVID-19) spread around the world as a pandemic, and the global response has been to shut down businesses and ask people to stay home to slow the spread of the virus. The second quarter was a pivotal one as we turned from the shutdown to the reopening of businesses and the economy.

In April, the White House released federal guidelines for reopening the economy, and by the end of the quarter, all states had eased to varying degrees their social distancing measures. The title of one of our weekly Sight|Lines publications described the macroeconomic environment of the quarter: The Best… and the Worst. Prior to the pandemic, the unemployment rate stood at 3.5%, the best in 50 years. And in April, unemployment jumped to 14.7%, the worst since the Great Depression. Similarly, many other economic indicators posted record drops before starting to recover at the end of the quarter.

The coronavirus has had a massive impact on the economy, leading to one of the deepest recessions since the Great Depression. Unlike normal times, when business activity and corresponding economic results change incrementally, in the current environment, the change has been severe and dramatic. For example, airline travel was at one point down approximately 95% versus the previous year, and hotel revenues are expected to decline 50% this year. These are deep declines, and in our view, such dramatic shifts make it much harder to forecast the immediate change in economic activity. Given the ongoing pandemic, while it's important to understand the economy's footing in the first half of the year, without question, the focus for investors remains, where do we go from here?

The S&P 500 posted its best quarterly return since the fourth quarter of 1998, to a good degree because of the unprecedented stimulus measures and optimism that the U.S. economy will start to recover as states reopen for business. However, there is still a great deal of uncertainty going forward, and it is nearly impossible to reliably predict the inflection point. How long will it take for our economy to recover to its previous level of activity/output? How do we make up for the permanent damage being done by the shutdown? When will a vaccine become available? Will there be a resurgence of coronavirus cases? How will consumer preferences shift? Who will be the next U.S. president? On all points, no one knows for sure. So, in this environment, more so than in previous years, the "tail risks" are higher as we see a greater chance of a dramatic move in either direction. A setback in vaccine development or a continued virus resurgence could lead to a market correction (bear case, 20% probability) - or the vaccine trials could be highly successful and the virus spread will remain under control more than currently anticipated adding to investor optimism (bull case, 20% probability).

Our base case, to which we assign 60% probability, reflects what we think might happen. It acknowledges the severe impact of the coronavirus shutdown on the economy and markets and the likely regional flare-ups of cases through the end of the year, but we remain modestly optimistic about recovery in the second half of the year and into 2021.

So what does this mean for investor portfolios? Our portfolio recommendations continue to be anchored in our long-term outlook, with a focus on diversification both across and within asset classes. Our dynamic leanings are against our long-term strategic asset

allocation (SAA) and result from our short- to medium-term views. At the start of the second quarter, a general theme propagated across our leanings was the consideration of the very short-term effects of the shutdown, knowing, for example, that some smaller companies, or those in weakening financial condition, may suffer and may even go out of business. We described this concept as permanent loss. These risks still remain, but we are marginally more upbeat looking forward as the improving economic data suggests that the economy may be regaining ground, aided by continued monetary and fiscal stimulus. As a result, we are unwinding our positioning biased to more "defensive" segments of the market.

Within equity, we are adding to Non-U.S. equities relative to U.S., U.S. small cap stocks relative to large cap, and U.S. large cap value relative to large cap growth. The result being that our dynamic asset allocation now aligns to our strategic asset allocation weights (i.e. neutral). Outside the U.S., we remain neutral between developed and emerging markets equities and recommend a diversified approach to both. Within fixed income, we remain neutral between U.S. investment grade and U.S. high yield. However, within investment grade, we are removing our overweight to high quality (Aaa- A rated) corporates. We are removing our overweight to short-dated Treasury inflation-protected securities (TIPS) and increasing our duration back to that of the benchmark.

Investment Themes

The following table summarizes our thinking across various asset classes and regions.

▲ Overweight ▼ Underweight ■ Neutral

	Asset Class	Previous	Current	Comments
Equity	U.S. Equity	▲	■	U.S. equities surged after hitting a low on March 23. Our base case assumes a recovery starting in the second half of 2020 and continuing into 2021, supported by fiscal and monetary stimulus and the measured reopening of the economy. Markets, however, have priced in this scenario and the chances of a "tail risk" event going forward are higher, in our view. As a result, we have reduced our overweight to U.S. equity so that our asset allocation now aligns with our strategic asset allocation (i.e. neutral).
	U.S. Large Cap	▲	■	Smaller businesses, or those in weaker financial condition, have suffered and some have gone out of business as a result of the COVID-19 shutdowns. Risks still remain, but we are marginally more upbeat looking forward as the improving economic data suggests that the economy may be regaining ground. As a result, we are adding to U.S. small cap stocks relative to large cap and reducing our overweight to large cap stocks back to neutral.
	Large Value vs. Large Growth	▼ / ▲	■	The large cap value segment of the market has underperformed large cap growth as some of the underlying companies have weaker financial profiles and diminished cash flows. With the economy showing signs of improvement, value stocks, or those that have been beaten-down recently should start to recover. There are also still quality stocks with attractive growth profiles that have reasonable allocations. We see opportunity in both the value and growth segments and as a result we are moving back to neutral between large value and large growth.
	U.S. Small Cap	▼	■	Smaller businesses, or those in weaker financial condition, have suffered and some have gone out of business as a result of the COVID-19 shutdowns. Risks still remain, but we are marginally more upbeat looking forward as the improving economic data suggests that the economy may be regaining ground. As a result, we are adding to U.S. small cap stocks relative to large cap and reducing our overweight to large cap stocks back to neutral.
	Small Value vs. Small Growth	■	■	We recommend a diversified approach investing in both small cap value and growth.
	Non-U.S. Equity	▼	■	The reported resurgence in COVID-19 has been milder in developed markets and some emerging markets relative to the U.S., however, much of these regions had weaker economic growth and more limited monetary policy tools going into the crisis. We recommend a diversified approach to investing in U.S. and Non-U.S. equity.
	Non-U.S. Developed Markets	■	■	We are neutral within Non-U.S. equity between Developed and Emerging markets as we find the risks to be balanced between both regions.
	Europe vs. Asia	■	■	European countries were the first hot spot for the outbreak outside China. The European Central Bank (ECB) has taken simulative measures and the EU reached a deal on a 750 billion euro stimulus package, however, Europe had weaker economic growth prior to the crisis. There is the risk for some EU fragmentation once the crisis is over. Japan approved a $1 trillion stimulus package, but the country had negative GDP going into the crisis due to the increased consumption tax rate.
	Emerging Markets	■	■	Risks are balanced. A weaker dollar and the re-opening of China's economy should support emerging countries. However, weaker healthcare systems and low oil prices represent headwinds for some emerging economies. Note, within Non-U.S. equity, we are neutral between Non-U.S. Developed Markets and Emerging Markets.

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Investment Themes (continued)

The following table summarizes our thinking across various asset classes and regions.

▲ Overweight ▼ Underweight ■ Neutral

	Asset Class	Previous	Current	Comments
Fixed Income	U.S. Investment Grade	■	■	Within Fixed Income, we are neutral between U.S. Investment Grade and U.S. High Yield.
	Corporates *Government/Agency* *MBS*	▲ ▼ ▼	■	Our overweight to corporates was to higher-rated investment-grade bonds (Aaa - A). Spreads have narrowed, and we are removing our overweight in order to broaden our investments to the full spectrum of investment-grade fixed income.
	Inflation Protected	▲	■	Our overweight to inflation-protected securities was based, in part, on the opportunity presented by the market's implied inflation expectations via swaps. Since then, markets have repriced higher inflation expectations, and going forward, there is uncertainty to the pace of recovery, which should keep inflation in check in the near term.
	Duration	▼	■	While the Fed is expected to stay accommodative for the foreseeable future, interest rates are likely to move in either direction based on whether market participants see the bull or bear scenario unfolding. In the short term, rates will likely remain range bound.
	U.S. High Yield	■	■	Credit spreads widened given the economic impact from the coronavirus and the decline in oil prices as a result of the Russia-Saudi Arabia price war. Spreads have narrowed, but risks of default remains elevated. Note, within Fixed Income, we are neutral between U.S. Investment Grade and U.S. High Yield.
Alternatives	Private Assets	■	■	For investors interested in alternative investments and able to handle illiquidity, exposure to some combination of private equity, private debt, and/or private real estate can be considered as part of a diversified portfolio.
	Hedge Funds	■	■	For investors interested in alternative investments and able to handle less liquidity who have conviction about manager skill, exposure to hedge funds can be a helpful part of a diversified portfolio. This is especially true in volatile, low-return environments.

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation, or needs of individual investors. There is no guarantee that the figures or opinions forecasted in this report will be realized or achieved. Employees of Stifel, Nicolaus & Company, Incorporated or its affiliates may, at times, release written or oral commentary, technical analysis, or trading strategies that differ from the opinions expressed within.

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Led by Stifel Chief Investment Officer Michael O'Keeffe, the Stifel CIO Office is comprised of several investment professionals. The team works collaboratively with other Stifel professionals to develop macroeconomic analysis, market analysis, strategic and tactical asset allocation guidance, applied behavioral finance, and specific investment solutions for advisors and clients.

Asset Class Risk

Bonds – Bonds are subject to market, interest rate, and credit risk. Prices on bonds and other interest rate-sensitive securities will decline as interest rates rise. Municipal bonds may be subject to state and alternative minimum taxes, and capital gains taxes may apply. High yield bonds have greater credit risk than higher quality bonds. Yields and market values will fluctuate, and if sold prior to maturity, bonds may be worth more or less than the original investment.

Equities – Portfolios that emphasize stocks may involve price fluctuations as stock market conditions change. Small and mid capitalization stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies.

International/Global/Emerging Markets – There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries.

Alternative Investments – Alternative investments involve a high degree of risk, often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing tax information, are not subject to the same regulatory requirements as more traditional investments, and often charge high fees, which may erode performance. An investment is appropriate only for investors who have the capacity to absorb a loss of some or all of their investment. Alternative investments may include, but are not limited to: Real Estate Investment Trusts (REITs), Commodities, Futures, and Hedge Funds. Real Estate – When investing in real estate companies, property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance. Commodities and Futures – The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains. Hedge Funds – Investors should be aware that hedge funds often engage in leverage, short-selling, arbitrage, hedging, derivatives, and other speculative investment practices that may increase investment loss. Hedge funds can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, and often charge high fees that can erode performance. Additionally, they may involve complex tax structures and delays in distributing tax information. While hedge funds may appear similar to mutual funds, they are not necessarily subject to the same regulatory requirements as mutual funds.

Index Descriptions

The Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market. The average market capitalization is approximately $4 billion, and the median market capitalization is approximately $700 million.

The Standard & Poor's 500 Index is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.

The Standard & Poor's/TSX Composite Index is the benchmark Canadian index, representing roughly 70% of the total market capitalization on the Toronto Stock Exchange with about 250 companies included in it.

The Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 Index, which measures the performance of the 3,000 largest U.S. companies based on total market capitalization. The average market capitalization is approximately $11 billion, and the median market capitalization is approximately $3.5 billion.

The Russell 1000 Growth Index measures the performance of those Russell 1000 index companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 1000 Value Index measures the performance of those Russell 1000 index companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the broader Russell 3000 Index, which measures the performance of the 3,000 largest U.S. companies based on total market capitalization. The average market capitalization is approximately $490 million, and the median market capitalization is approximately $395 million.

The Russell 2000 Growth Index measures the performance of those Russell 2000 index companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 2000 Value Index measures the performance of those Russell 2000 index companies with lower price-to-book ratios and lower forecasted growth values.

The Russell Microcap Index is a capitalization-weighted index of 2,000 small cap and micro cap stocks, including the smallest 1,000 companies in the Russell 2000 plus 1,000 smaller U.S. based listed stocks. Over-the-counter stocks and pink sheet securities are excluded.

The MSCI World ex USA All Cap Index captures large, mid, small, and micro cap representation across 22 of 23 Developed Markets (DM) countries (excluding the United States). With 8,138 constituents, the index covers approximately 99% of the free float-adjusted market capitalization in each country.

The MSCI EAFE Index (Europe, Australasia, and the Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.

The MSCI Europe Index is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of the developed markets in Europe.

The MSCI Pacific Index captures large and mid cap representation across five Developed Markets (DM) countries in the Pacific region. With 470 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market. With 322 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

The MSCI EM (Emerging Markets) Europe, Middle East and Africa Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the emerging market countries of Europe, the Middle East, and Africa.

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related, and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and nonagency). Provided the necessary inclusion rules are met, U.S. Aggregate-eligible securities also contribute to the multicurrency Global Aggregate Index and the U.S. Universal Index, which includes high yield and emerging markets debt.

The Bloomberg Barclays U.S. Government/Credit Bond Index is a broad-based flagship benchmark that measures the non-securitized component of the U.S. Aggregate Index. It includes investment-grade, U.S. dollar-denominated, fixed-rate Treasuries, government-related, and corporate securities.

The Bloomberg Barclays U.S. Treasury Index measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. Treasury bills are excluded by the maturity constraint, but are part of a separate Short Treasury Index. STRIPS are excluded from the index because their inclusion would result in double-counting. The U.S. Treasury Index is a component of the U.S. Aggregate, U.S. Universal, Global Aggregate, and Global Treasury Indices.

The Bloomberg Barclays U.S. Treasury U.S. TIPS index includes all publicly issued, U.S. Treasury inflation-protected securities that have at least one year remaining to maturity, are rated investment grade, and have $250 million or more of outstanding face value.

The Bloomberg Barclays U.S. Municipal Index covers the U.S. dollar-denominated, long-term, tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds.

The Bloomberg Barclays U.S. Credit Index measures the investment-grade, U.S. dollar-denominated, fixed-rate, taxable corporate and government-related bond markets. It is composed of the U.S. Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals, and local authorities.

The Bloomberg Barclays U.S. Corporate High Yield Bond Index measures the U.S. dollar-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded.

The Bloomberg Barclays Global Aggregate Bond Index is a flagship measure of global investment-grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate, and securitized fixed-rate bonds from both developed and emerging markets issuers.

The Bloomberg Barclays Emerging Markets Hard Currency Aggregate Index is a flagship hard currency Emerging Markets debt benchmark that includes U.S. dollar-denominated debt from sovereign, quasi-sovereign, and corporate EM issuers.

The Wilshire U.S. REIT Index is a float-adjusted market capitalization-weighted index that measures U.S. publicly traded real estate investment trusts (REITs), excluding mortgage REITs, net-lease REITS, real estate finance companies, home builders, large landowners and sub-dividers, hybrid REITS, and companies that have more than 25% of their assets in direct mortgage investments.

The Wilshire ex U.S. Real Estate Investment Trust IndexSM (Wilshire ex U.S. REIT) measures global publicly traded real estate investment trusts, less all U.S. securities. The Wilshire ex U.S. REIT is a subset of the Wilshire ex U.S. Real Estate Securities IndexSM (Wilshire ex U.S. RESI).

The Wilshire Global REIT Index is a float-adjusted, market capitalization-weighted index that measures global publicly traded real estate investment trusts (REITs), excluding mortgage REITs, net-lease REITS, real estate finance companies, home builders, large landowners and sub-dividers, hybrid REITS, and companies that have more than 25% of their assets in direct mortgage investments.

Bloomberg Commodity Index (BCOM) is calculated on an excess return basis and reflects commodity futures price movements. The index rebalances annually weighted two-thirds by trading volume and one-third by world production, and weight-caps are applied at the commodity, sector, and group level for diversification. Roll period typically occurs from the sixth to the tenth business day based on the roll schedule.

The S&P GSCI Crude Oil Index is a sub-index of the S&P GSCI Commodity Index. The production-weighted index reflects the returns that are potentially available through an unleveraged investment in the West Texas Intermediate (WTI) crude oil futures contract.

The Wilshire Liquid Alternative IndexSM measures the collective performance of the five Wilshire Liquid Alternative strategies that make up the Wilshire Liquid Alternative Universe. The Wilshire Liquid Alternative Index (WLIQA) is designed to provide a broad measure of the liquid alternative market by combining the performance of the Wilshire Liquid Alternative Equity Hedge IndexSM (WLIQAEH), Wilshire Liquid Alternative Global Macro IndexSM (WLIQAGM), Wilshire Liquid Alternative Relative Value IndexSM (WLIQARV), Wilshire Liquid Alternative Multi-Strategy IndexSM (WLIQAMS), and Wilshire Liquid Alternative Event Driven IndexSM (WLIQAED).

Indices are unmanaged, do not reflect fees or expenses, and you cannot invest directly in an index.

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