ADKINS SEALE CAPITAL MANAGEMENT, LLC
Investment Commentary
April 1, 2020

Dear Clients:
Today is certainly no time for April Fool's Day foolishness as the "fight" against COVID 19 rages on across the world, our nation, and our home state. We have warned of the inevitable "Black Swan" event that would disrupt the optimistic pricing of financial assets following the bottom of the "Great Recession of 2007-2008" but we, like most others, did not see the pandemic threat coming our way. In comparison to the "giant meteor collision with earth" scenario mentioned in our previous commentary, this pandemic is likely not to have the scale of global deaths, climate change, or lasting disruption of economic activity as would be the case from the giant meteor collision. Nonetheless, the cost of this pandemic in terms of lives lost and economic disruption is real as evidenced by near constant coverage in today's 24/7 news media. So what should investors and their investment advisors do in the face of this event and for the period until life's heretofore daily activities can be restored?

First, we think everyone should take a step back and acknowledge that the "end of the world" does not happen very often and that the challenges we face today do not comport with an "end of times" scenario. Our view on financial asset pricing has, for some time, been that prices were far ahead of fundamental valuation and thus subject to significant downward re-valuation. The 24% price decline in the S&P 500 Index as of quarter end from the recent high on February 19, 2020 is disconcerting but needs to be evaluated in proper context. Even with the price declines for the current quarter, the trailing three and five year annualized total returns with dividends for the S&P 500 Index are 5.1% and 6.7%, respectively; the 31.5% return for 2019 made this result possible. The distress from the current "shutdown" of major parts of the US economy will continue until the healthcare threat from the virus subsides. The good news is that the American people have responded aggressively with a can-do attitude to cope and with the approval of unprecedented fiscal and monetary policy actions to dampen the costs of this disruption.

On the other side of the coin are the concerns about the adverse consequences of massive debt issuance fed by historically low interest rates and the unprecedented money creation by the US Federal Reserve Bank and other central banks around the world. We applaud the Fed's injecting much needed liquidity and clearing guarantees into the money markets to maintain confidence in critical market functions. We hope this infusion is maintained only as long as needed to bridge the impact of the virus. We are less sanguine about the Fed's decision to lower short term interest rates to near zero. Short term and longer duration interest rates play a critical role in encouraging efficient capital allocation among competing uses, including the financing of government expenditures, as well as in contributing to sustainable pricing of assets such as stocks where returns are derived from uncertain future profitability. Higher short term interest rates to a level necessary to preserve the purchasing power of the US dollar would lend support to more stable payments to beneficiaries of retirement plans and endowments in addition to braking excess price speculation in stocks, real estate, and commodities.

Since the onset of the virus crisis, bond yields for corporate and municipal borrowers have spiked materially in recognition of the potentially higher default risk due to reduced revenues. The large stimulus package passed the final week of March hopefully will provide sufficient relief to bridge the revenue shortfall brought on by the sheltering in place and social distancing guidelines. We think the restoration of positive credit and duration yield premiums are positive and should enhance the signals from the shape of the yield curve and width of credit and duration spreads about the future direction of both stocks and bonds. We are most concerned with the proposition that the US economy and related asset markets cannot function where market participants require **ZERO** net of inflation interest rates. Investors and their advisors should remain focused on maintaining sufficient liquid reserves until bond yields provide reasonable returns for duration and credit risks. Higher bond yields will also improve the forward return outlook for stocks but not without some continued near term price weakness for stocks.

Investment Market Returns as of March 31, 2020

For the first quarter and trailing twelve month period, the broad US stock market experienced negative total returns of -20.9% and -9.24%, respectively. The threat of a significant disruption in corporate profits caused stock prices to be repriced lower. With the pandemic being global, comparable returns for non-US stock markets were also lower as the broad non-US stock index recorded negative returns of -23.4% and -15.6%, respectively. Concomitant with the increase in perceived risk, returns on stocks for smaller companies were more negative as reflected by the performance of the Russell 2000 US Small Cap Index which registered total negative returns of -30.6% and -24.6% for the two periods. There was simply no place to hide with equity investing during the first quarter and no one should be surprised to see that situation continue for some time. However, investors must not lose sight of the long term nature of investing in stocks. For instance, the annualized returns over the fifteen year period ended March 31, 2020 for the S&P 500 Index, the Russell 2000 US Small Cap Index, and the MSCI-AWCI ex US NR (usd) Index were 7.6%, 5.7%, and 3.4%, respectively, including the return destroying experiences of 2008 and the current quarter.

The fixed income markets (bonds) reflected extreme divergence in the current quarter as strong demand for government issued securities with near-microscopic yields pushed prices up, while prices for corporate and municipal bonds fell across the board. The broad US taxable investment grade bond index generated total returns of 3.2% and 8.9%, respectively, for the recent quarter and trailing twelve months. The return on intermediate term, investment grade corporate notes registered a negative return of -3.9% for the quarter but still managed a positive 4.0% return for the twelve months. Comparable returns for investment grade municipal bonds were a negative -0.6% and 3.9%, respectively. The real pain was felt in the US high yield (low credit quality) bond market which experienced severe price declines after year end 2019, resulting in negative total returns of -12.7% for the quarter and -6.9% for the trailing full year. The difficult medicine being administered in the credit markets will likely produce positive results over the next few quarters as relative risk becomes priced more efficiently.

Cash returns are now near zero and may even become negative as the markets cope with the malign effects of the COVID 19 virus. The other asset protecting strategies such as hedged equities, tactical asset allocation, precious metals, and commodities have performed unevenly over the past twelve months but with mostly less downside than the current losses on traditional equities. The relative attractiveness of these assets will probably decline as stocks and bonds reprice to higher future returns.

Our Look Forward

We are encouraged by the prospect for higher “future” returns from stocks and bonds resulting from the decline in prices. Until the pandemic disruption is ended, our allocations will lean to capital preservation but with an eye to increasing equity and duration exposures as opportunities present. In times such as these, maintaining a consistent investment approach and adequate liquidity with a disciplined distribution policy should produce positive outcomes over the long term.

In Closing

We look forward to visiting with each of you about your investment results and expectations for the future and to make sure your portfolios are aligned with your specific circumstances. We greatly appreciate the opportunity to serve as your investment adviser and pledge our best efforts to meet your expectations.

P. Michael Adkins, CFA
mikeadkins@ascm-llc.com

J. Richard Seale, CFA
dickseale@ascm-llc.com

Jay K. Binderim, CFA
jaybinderim@ascm-llc.com