June 15, 2020

OBSERVATIONS

- Covid-19: Resurgence of cases in Beijing, spikes in cases in a number of U.S. states as reopenings push ahead. Global cases exceed 8 million (over 2 million in U.S.).
- The Federal Reserve's economic projections show short term rates to be at the zero bound thru 2022. Real GDP to decline by -6.5% for 2020 and unemployment rate expected to be 9.3% at year end.[1]
- New home mortgage applications rose 5% week over week, + 12.7% higher than last year.[2]
- European debt frenzy: Over €1tn in debt has been issued in Europe this year, the fastest pace on record.[3]
- The World Bank estimates that 90% of global economies will experience contractions in GDP in 2020, marking the greatest synchronized downturn since 1870.[2]
- The Business Cycle Dating Committee (of the NBER) marked February 2020 as the peak of economic activity – marking the beginning of economic recession.
  - Caps a 128-month long cycle that began in June 2009 – the longest expansion since 1854.[4]
- As of 10-June, Tesla is the 30th largest company by market cap ($190bn) and is more than 2x larger than the combined automobile industry ($80.5bn in market cap and includes General Motors and Ford)[3].
- The dollar declines of the last 4 weeks (14-May thru 12-June), has contributed to international equity outperformance for the same period. U.S Large Cap is up +7.35%, while Developed International and Emerging Markets are up + 11.52% and 9.85%, respectively.[5]
- Some frothy signs:
  - Put-call ratio hit 20-year lows (indicating overconfidence).[3]
  - 104 equity capital raises ($50.3 bn) in May – marking the 2nd largest month for issuance since 1995.[6]
  - Mid-way through June, the month has seen the heaviest monthly IPO activity since May of 2019.[6]
  - Many companies going through bankruptcy have seen their stocks rise markedly as retail traders and speculators push share prices higher *(likely not to end well)*.

EXPECTATIONS

- Second wave concerns could weigh on markets, particularly given the run up in equities. With no earnings or material news on clinical trial advancements expected in the coming weeks, volatility is likely to persist.
- Given the backdrop of muted inflation expectations and economic uncertainty, rising short term rates appear clearly off the table – for the foreseeable future.

ONE MORE THOUGHT

Over the past three years the S&P 500 has returned over 10.2% percent annualized through the end of May-2020. Over the same period Emerging Markets have returned -0.15% and non-U.S. developed (MSCI EAFE) markets have returned -0.37%. The negative gap between the S&P 500 and non-U.S. equities is equally large over a five, seven, or ten-year period. Given these dismal returns for non-U.S. based equity indices, many investors are rightfully asking why they are invested in non-U.S. equites. Clearstead's answer is to utilize active management in non-US markets and seek out only the best companies in these markets. Clearstead's analysis has shown that in most cases over

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[1] *Federal Reserve economic projections released 10-June*
[2] *Mortgage Bankers Association, HousingWire*
[3] *Bloomberg LP*
[4] *National Bureau of Economic Research (NBER)*
[5] *Bloomberg LP, U.S. Large Cap = Russell 1000, Developed International = MSCI EAFE, Emerging Markets = MSCI EM, total returns from 14-May to 12-June*
[6] *Dealogic, Marketwatch*

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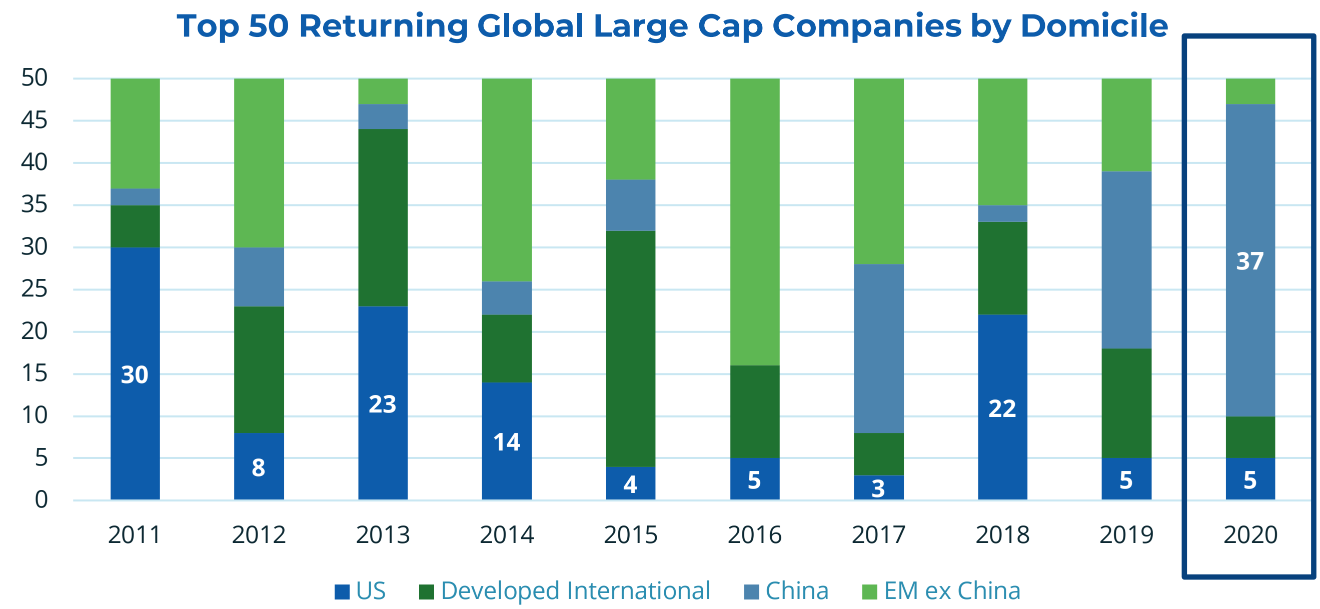
the past decade, in any given year the majority of the top 50 best returning companies are domiciled outside the U.S.—see Graphic of the Week. Similarly, our research indicates that these companies grow earnings and returns on-par with the highest returning U.S. firms[7]. However, both the MSCI EAFE index and the MSCI EM index are full of low profitability, low quality businesses. Clearly, investing in the "average" non-US equity has not been a winning strategy, but through careful selection, a U.S. investor can access a larger pool of public equities and gain exposure to firms that benefit from a non-U.S. business cycle and secular growth trends unrelated to the U.S. economy.

GRAPHIC OF THE WEEK:



Source: Clearstead, Invesco, RIMES, MSCI, 2020 data as of 4/30/2020, USD returns

In any given year of the past decade except 2011, the majority of large cap companies with the highest total return were located outside of the U.S. In 2020, nearly 75% of the top 50 returning companies YTD were domiciled in China compared to only five in the U.S.

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[7] *Clearstead - Global Equity Whitepaper; median first-quintile MSCI EAFE firm has grown earnings by 51.3% over the past 5-years compared to 43.1% for the median first-quintile S&P500 firm over the same period.*