Navigating a Covid-19 Recession

May 2020

See important disclosures following the presentation.

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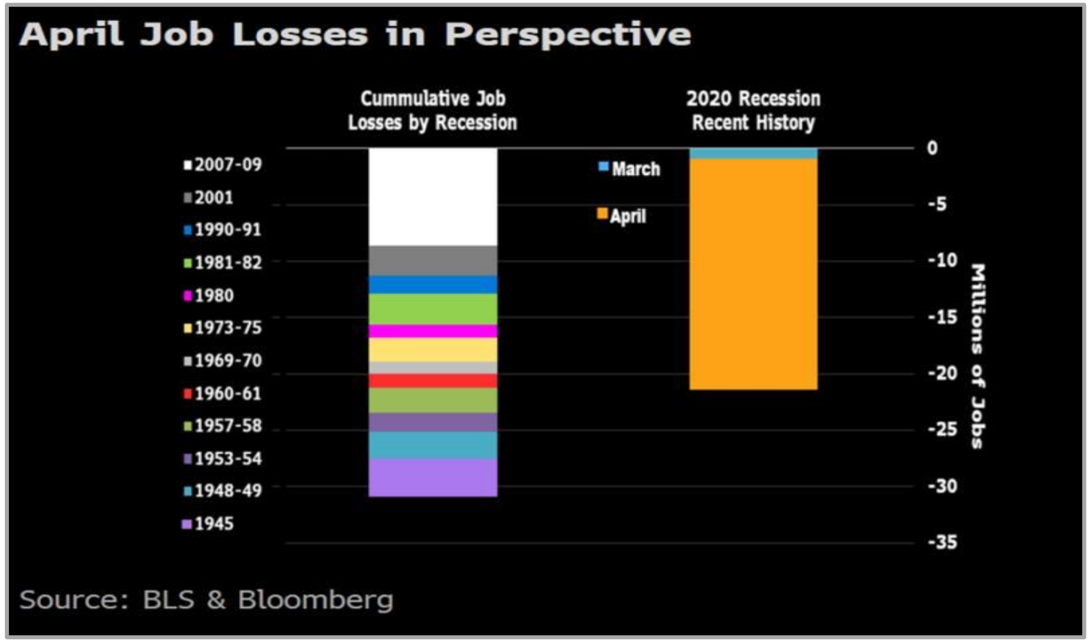
About This Chartbook

In this edition of *Evergreen Chartbook,* we will explore the devastating toll that Covid-19 has had on the US economy, the fiscal and monetary response by the Fed and the US government, our outlook going forward, and the reactions from financial markets.

Economy: US Jobs Market



- Beginning with the US labor market, the spike in US jobless claims has been unprecedented, with an average of 4.7 million weekly unemployment claims since mid-March.
- To put this number into perspective (as you can see on the chart on the right), in less than two months, we have witnessed more jobs lost than the last eight recessions combined.

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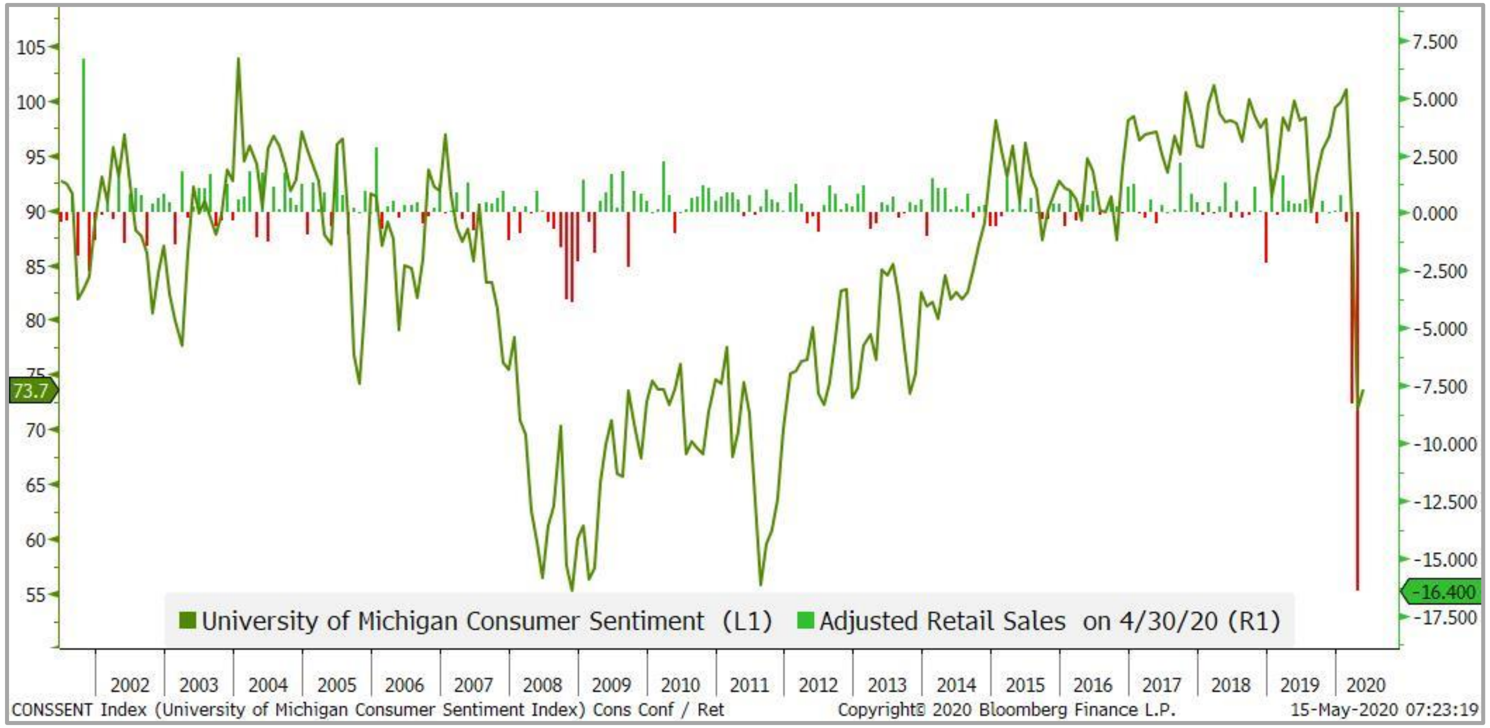
Economy: Retail Sales and Consumer Confidence



- Retail sales have followed suit by falling -16.4% in April - the biggest drop on record.
- The areas hit hardest were clothing (-78.8%), furniture (-58.7%), electronics (-60.6%), and sporting goods (-38%)
- As you'd expect, consumer confidence took a nosedive, but still remains above the cavernous depths of the financial crisis. It's possible consumers believe Covid-19's economic impact is temporary, and government relief may help buoy confidence.

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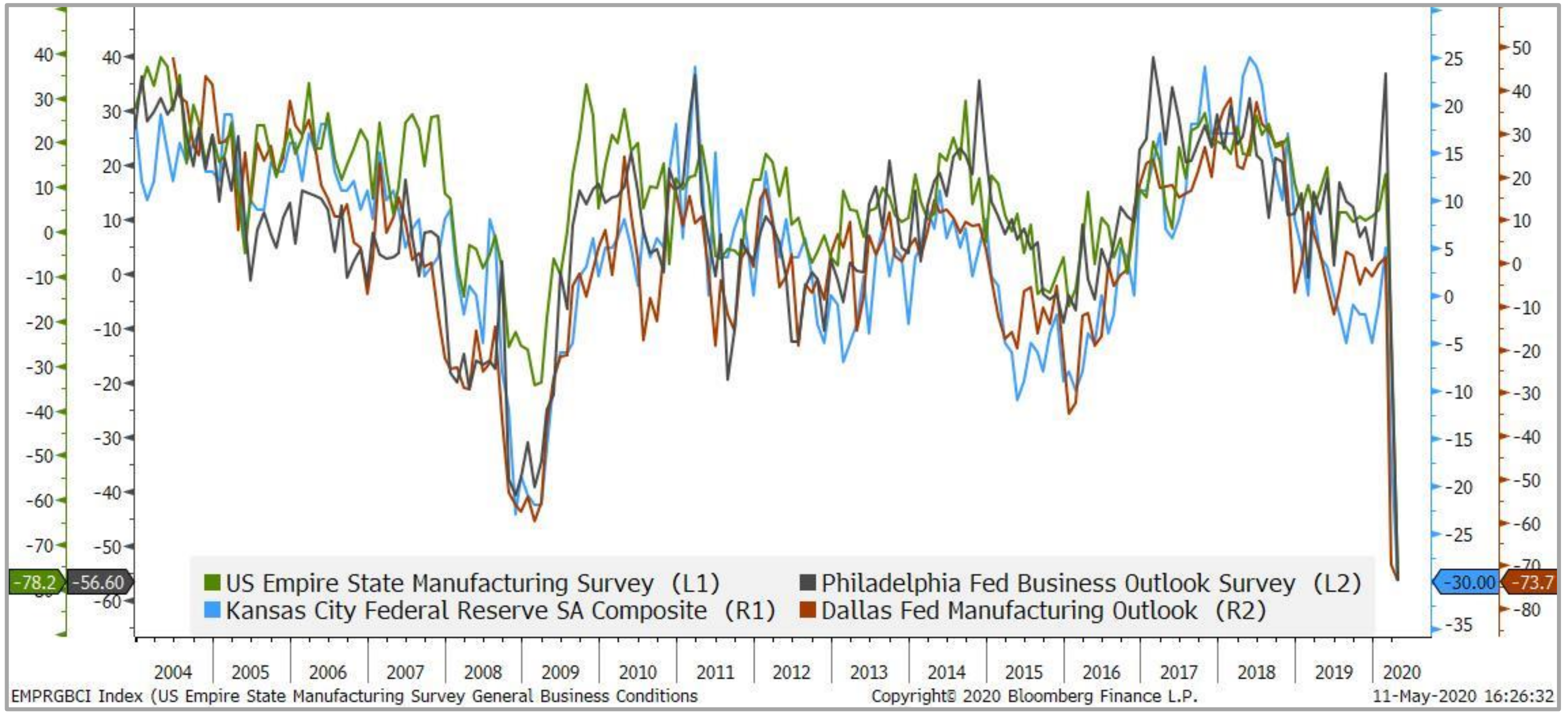
Economy: Manufacturing



- Manufacturing data, which makes up 12% of the US economy, has also been abysmal.
- The four regional manufacturing surveys in the chart above have worse readings than any point during the financial crisis.
- If you strip out inventories (excess stockpiles), industrial output is the weakest in 70 years - rivaling even the Great Depression.

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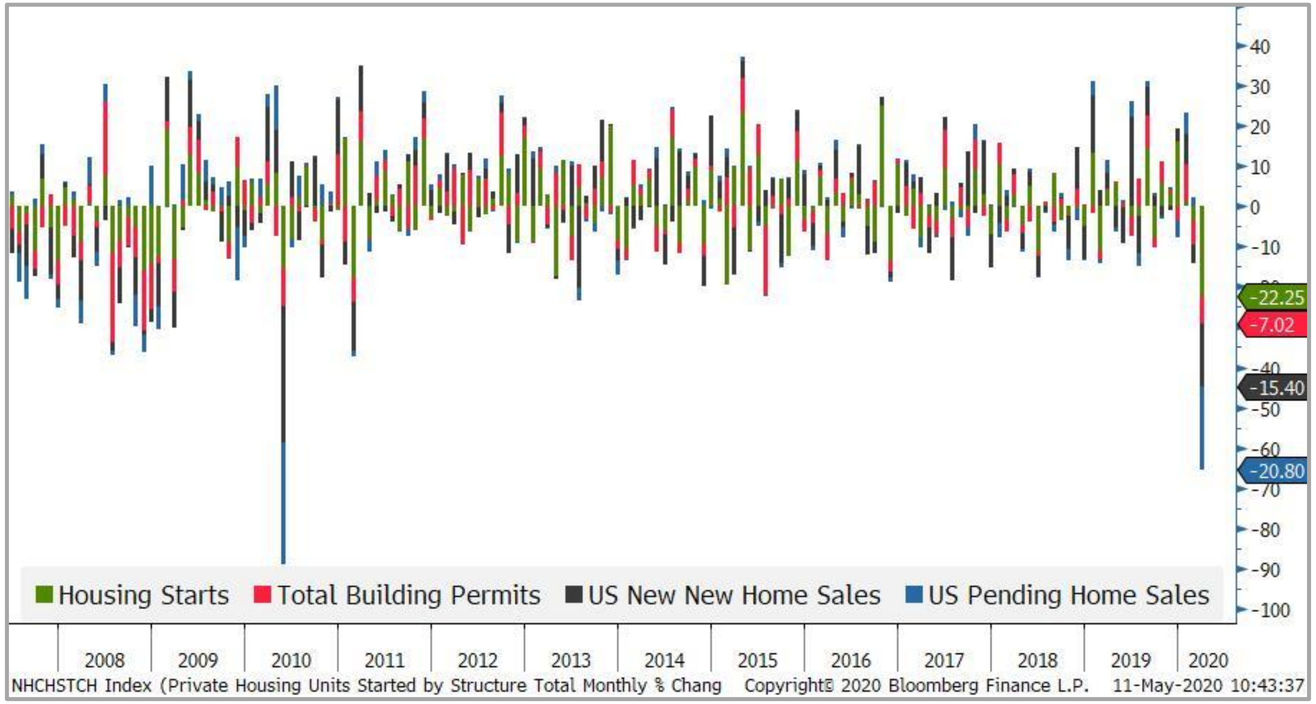
Economy: Housing Market



- In the housing market, sales activity and new construction indicators collectively combined to mark the second worst month in the last 15 years.
- Making matters worse, it's estimated that 30% of all US mortgages had either no payment or a partial payment for the first two weeks of May.
- That said, housing prices have been rather resilient, with the median listing price of $320,000 for March, up 0.6% YoY.
- It's hard for us to imagine housing prices remaining unscathed with the massive amount of delinquencies starting to emerge.

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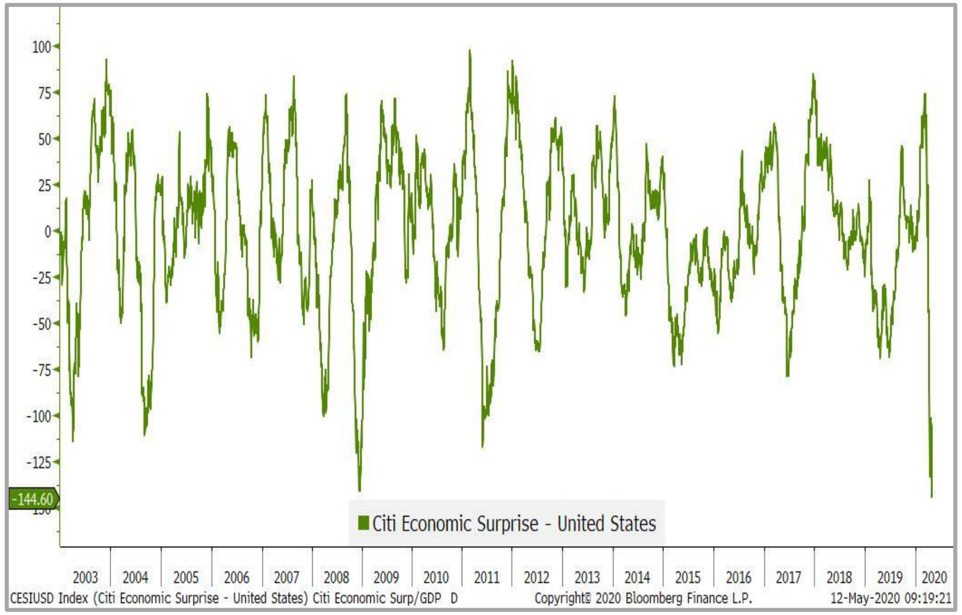
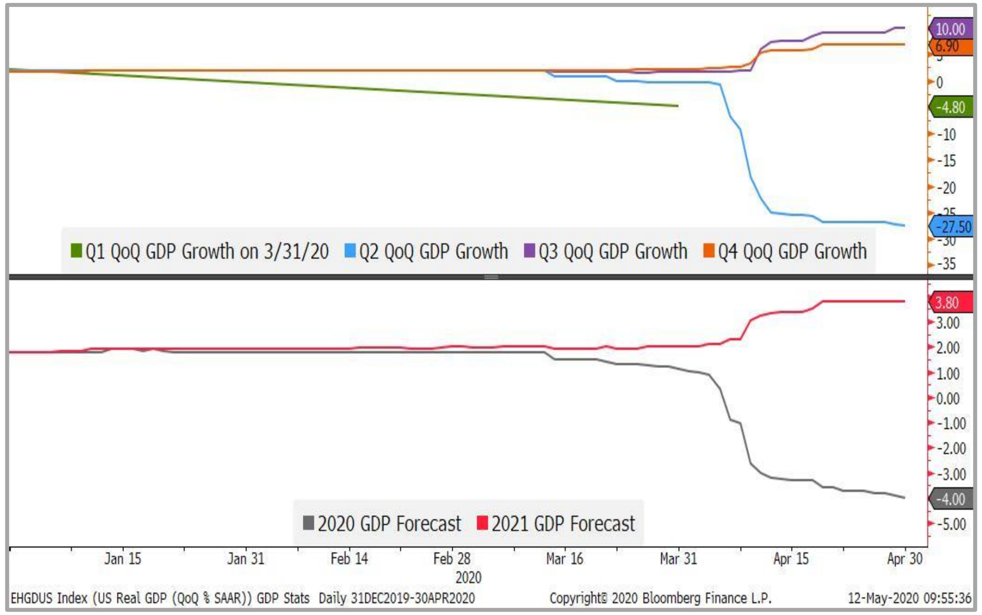
Economy: Citi Economic Surprise Index / GDP





- In terms of broad-based economic activity, the Citi Economic Surprise Index recently registered its all-time worst reading.
- Overall, Q1 GDP contracted -4.8% relative to Q4, with Q2 expected to fall -27% relative to Q1.
- Q3 and Q4 point to a rebound but are still far below Q4 of 2019. This indicates that the economy restarts but restarts slowly.
- Overall estimates now call for GDP to contract by 4% in 2020 with a 3.8% projected rebound for 2021.

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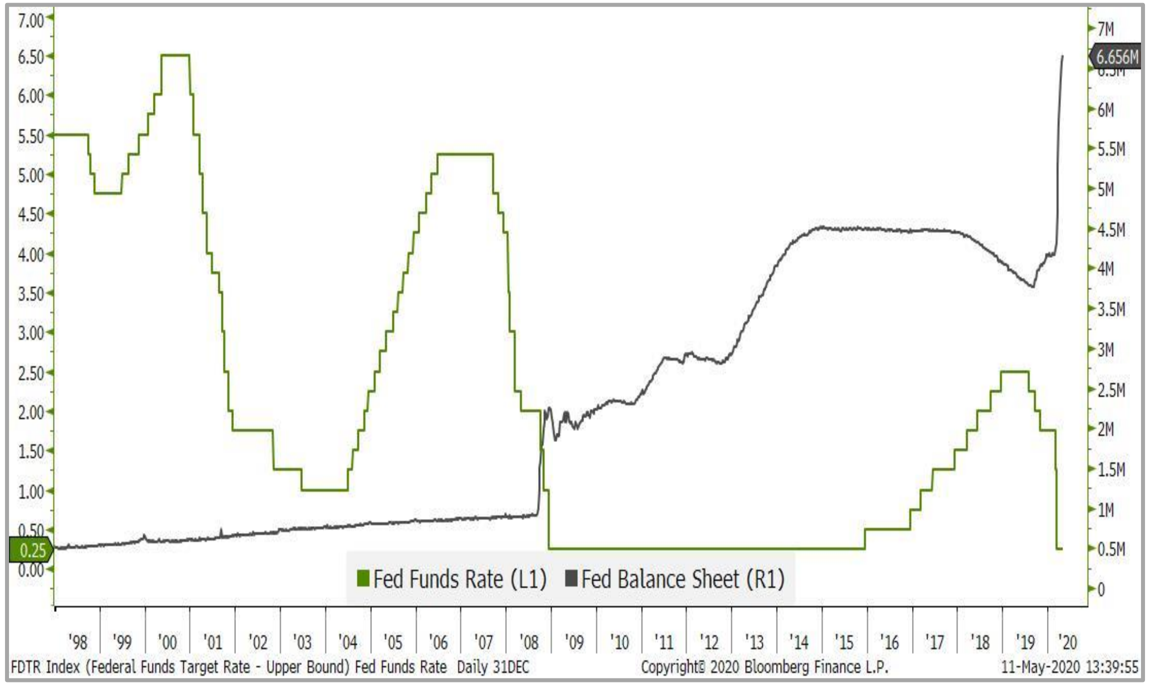
Fiscal/Monetary Response: Fed-Funds Rate, & Fed Balance Sheet



$293 Billion	One-time lump sum consumer payments ($1200 per adult and $500 per child)
$268 Billion	Increased unemployment benefits, adding $600 per week and extending to 39 weeks
$27 Billion	Grants to airlines and other essential businesses
$760 Billion	Small business loan relieve (mostly forgivable)
$150 Billion	Direct aid to state and local governments
$425 Billion	Heath-care and hospital relief funding
$517 Billion	All other spending
2.44 Trillion	**Total Liquidity Injection**

- The size and scope of the fiscal and monetary response has been equally as impressive as the economic collapse.
- The chart above shows the Fed's benchmark federal-funds rate being cut to 0.0%-0.25%, and the balance sheet increasing by just over $2.6 trillion.
- Interestingly, the balance sheet expansion roughly covers the $2.44 trillion of government stimulus programs.
- These programs work out to roughly 11% of GDP, or significantly more than the contraction in GDP itself.
- Clearly, the government is trying to alleviate the pain on consumers and businesses in the hopes of avoiding a depression-type scenario.

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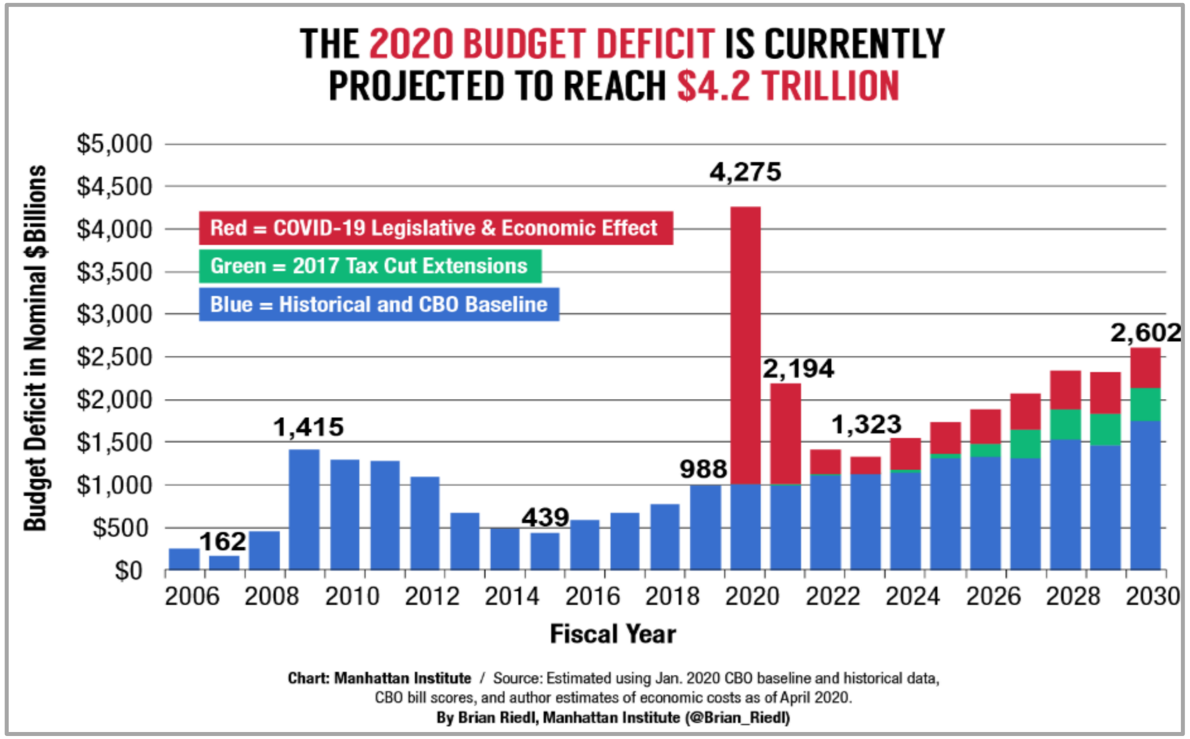
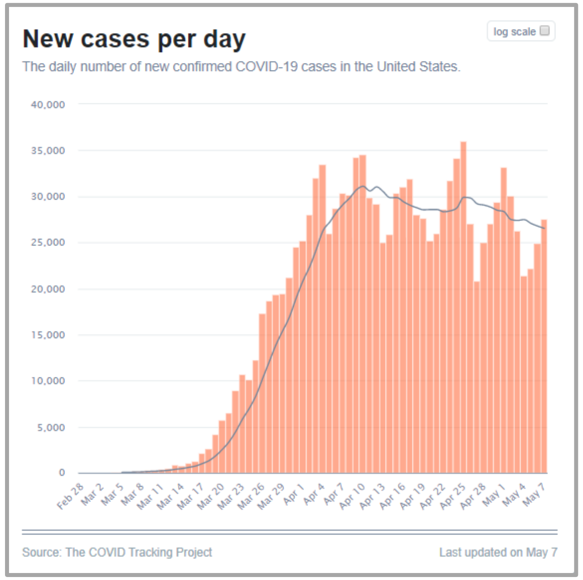
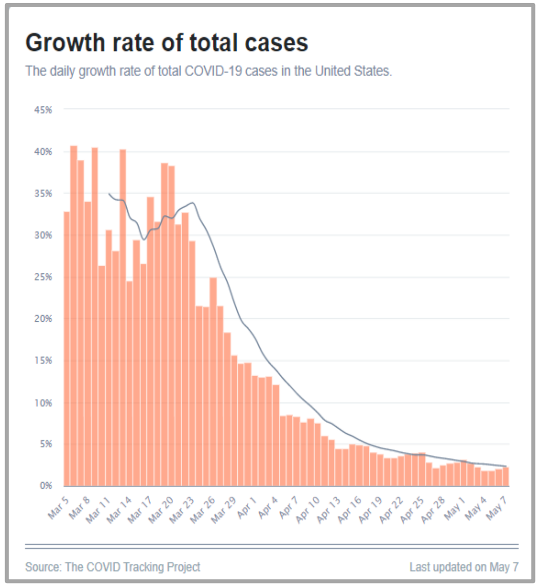
Fiscal/Monetary Response: CBO Budget Deficit

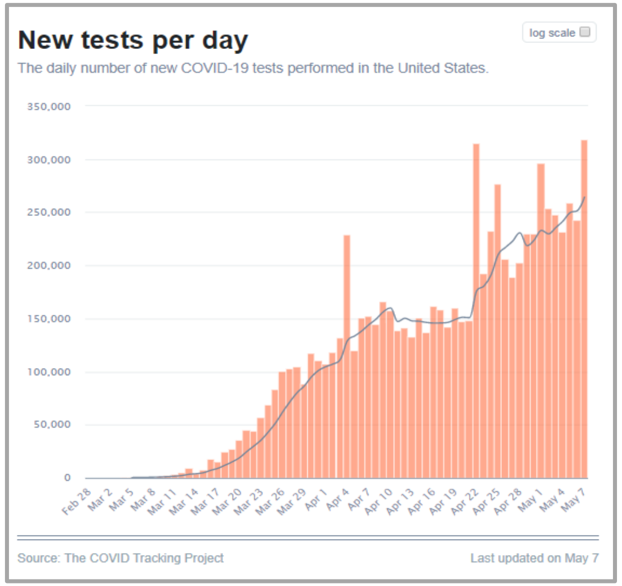


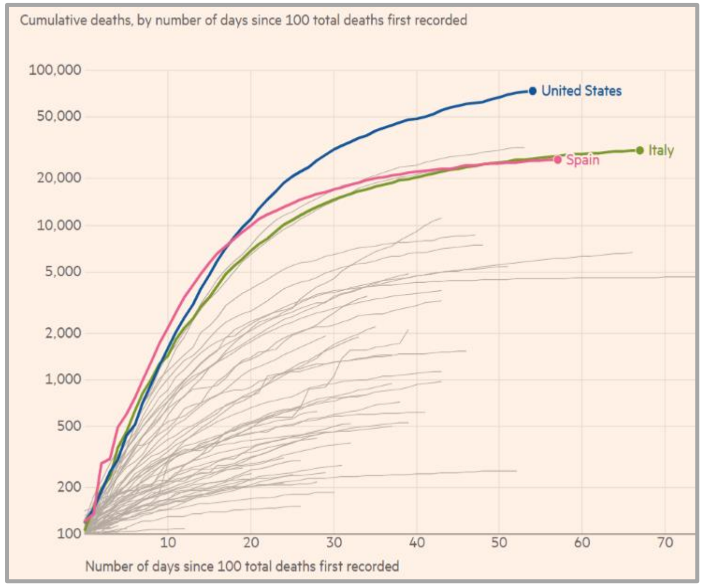
- The emergency relief intended to "bridge the gap" will have a long and lasting negative effect on our nation's debt load and budget.
- In 2020 alone, the budget deficit is expected to exceed $4.2 trillion. That's nearly 20% of overall GDP and doesn't even account for the additional $3 trillion proposal that's currently being floated in Congress for additional support.
- Needless to say, there will be significant budgetary pressure on future government spending due to the recent avalanche of emergency financial assistance.

Covid 19: New Cases Per Day and Growth Rate of Total Cases









- On the positive side, we have begun to see encouraging data in terms of flattening the Covid-19 curve in the US.
- New cases per day have flatlined and the growth rate of total cases has come down sharply.
- We have also (finally) seen a pickup in the number of tests, with the US now performing around 300,000 per day.
- The US death rate curve has also flattened, but the big risk going forward is how this number changes as we re-open our economy.

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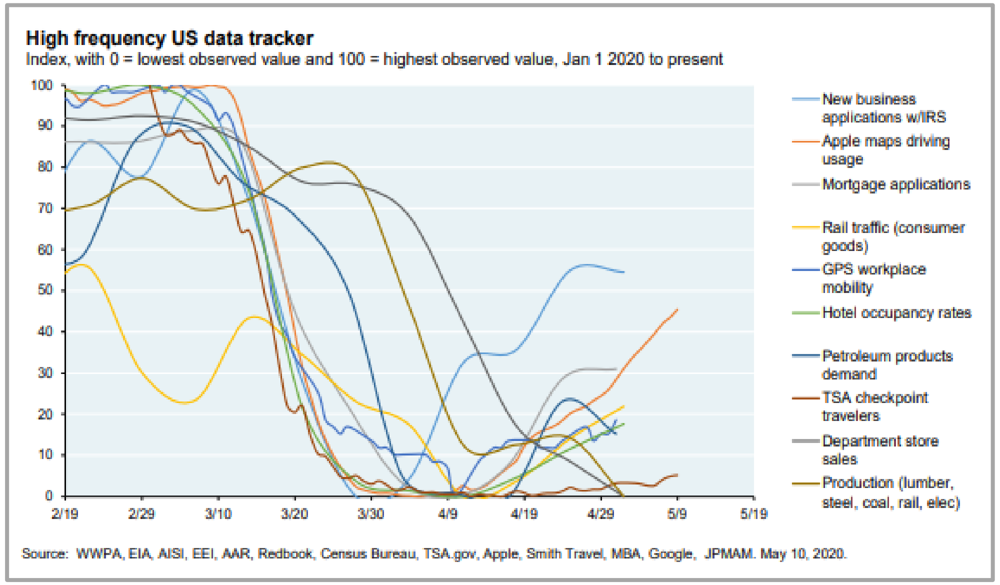
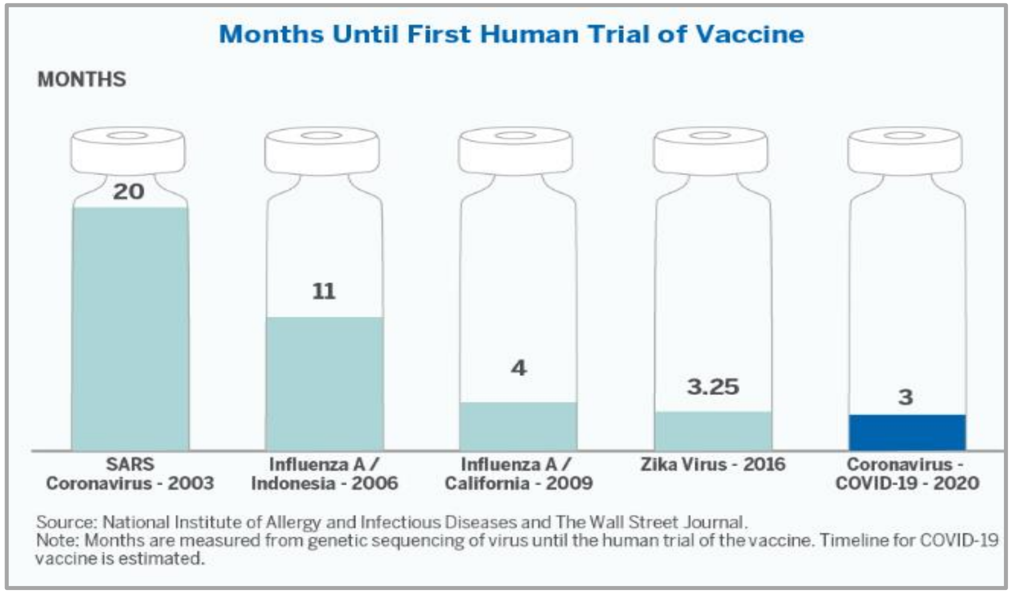
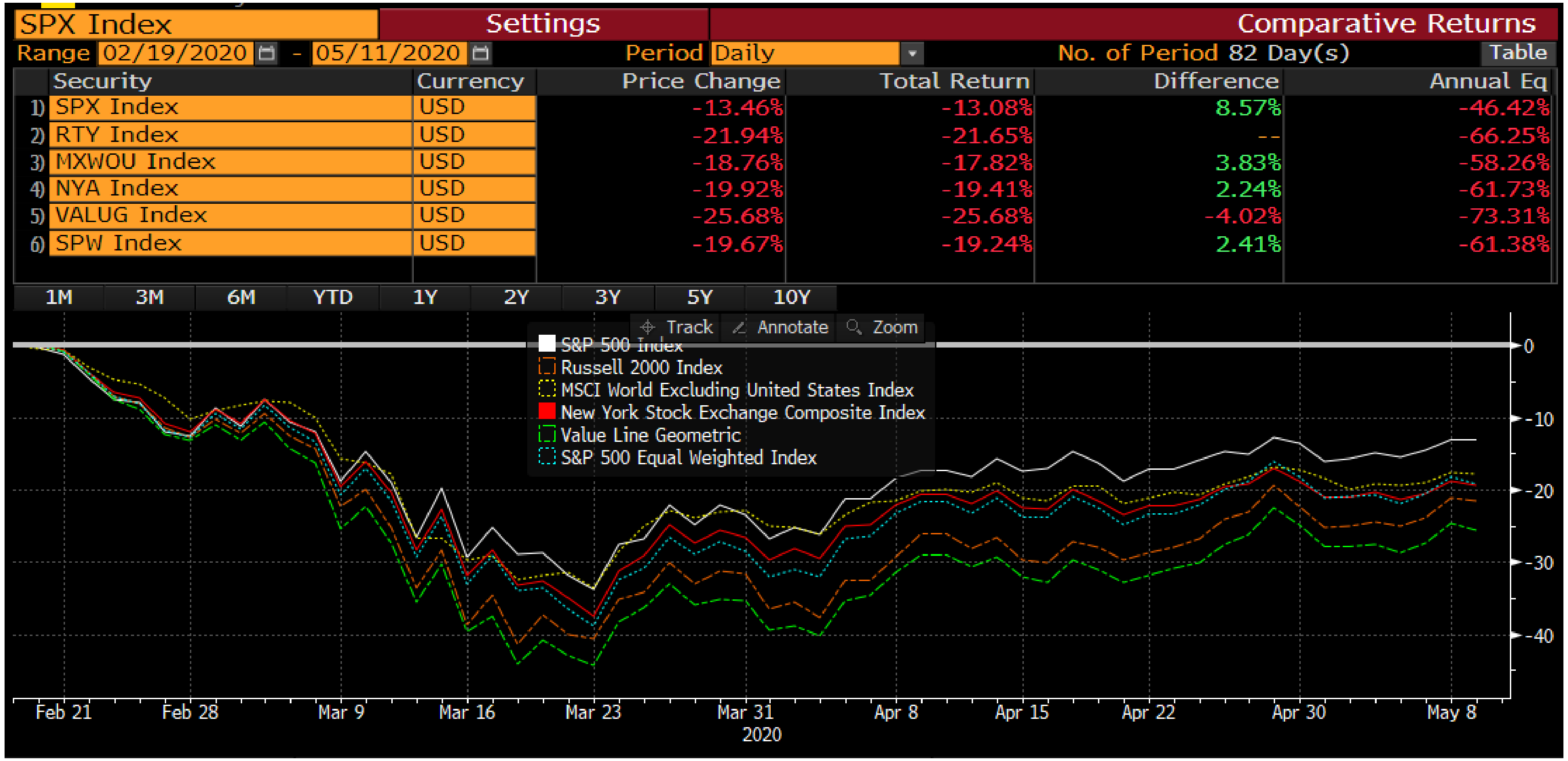
Covid 19: High Frequency Data and Vaccine





- The restart is conflicting. On one hand, you have St. Louis Fed President James Bullard predicting, “You will get business failures on a grand scale and you will be taking risks that you would go into depression” if shutdowns persist.
- On the other hand infectious disease specialist Dr. Fauci Anthony is predicting: "There is a real risk that you will trigger an outbreak you may not be able to control, which, would set you back, not only leading to some suffering and death that could be avoided, but could even set you back on the road to try to get economic recovery.“
- The good news is we have at least eight vaccines for Covid-19 currently in development, and this is the quickest response we have seen from our healthcare sector in terms of months to human trials from onset.

Equities: Drawdown and Rally



SPX Index | Settings | Comparative Returns

Range 02/19/2020 - 05/11/2020 | Period Daily | No. of Period 82 Day(s) | Table

	Security	Currency	Price Change	Total Return	Difference	Annual Eq
1)	SPX Index	USD	-13.46%	-13.08%	8.57%	-46.42%
2)	RTY Index	USD	-21.94%	-21.65%	--	-66.25%
3)	MXWOU Index	USD	-18.76%	-17.82%	3.83%	-58.26%
4)	NYA Index	USD	-19.92%	-19.41%	2.24%	-61.73%
5)	VALUG Index	USD	-25.68%	-25.68%	-4.02%	-73.31%
6)	SPW Index	USD	-19.67%	-19.24%	2.41%	-61.38%

- The market reaction was impressive on the way down and almost as impressive on the way up.
- From peak to trough, equities fell between -33% and -45%, and have since rebounded by 24-34%.
- Despite the recession we are currently living in, the S&P 500 is now only down -11% on the year.

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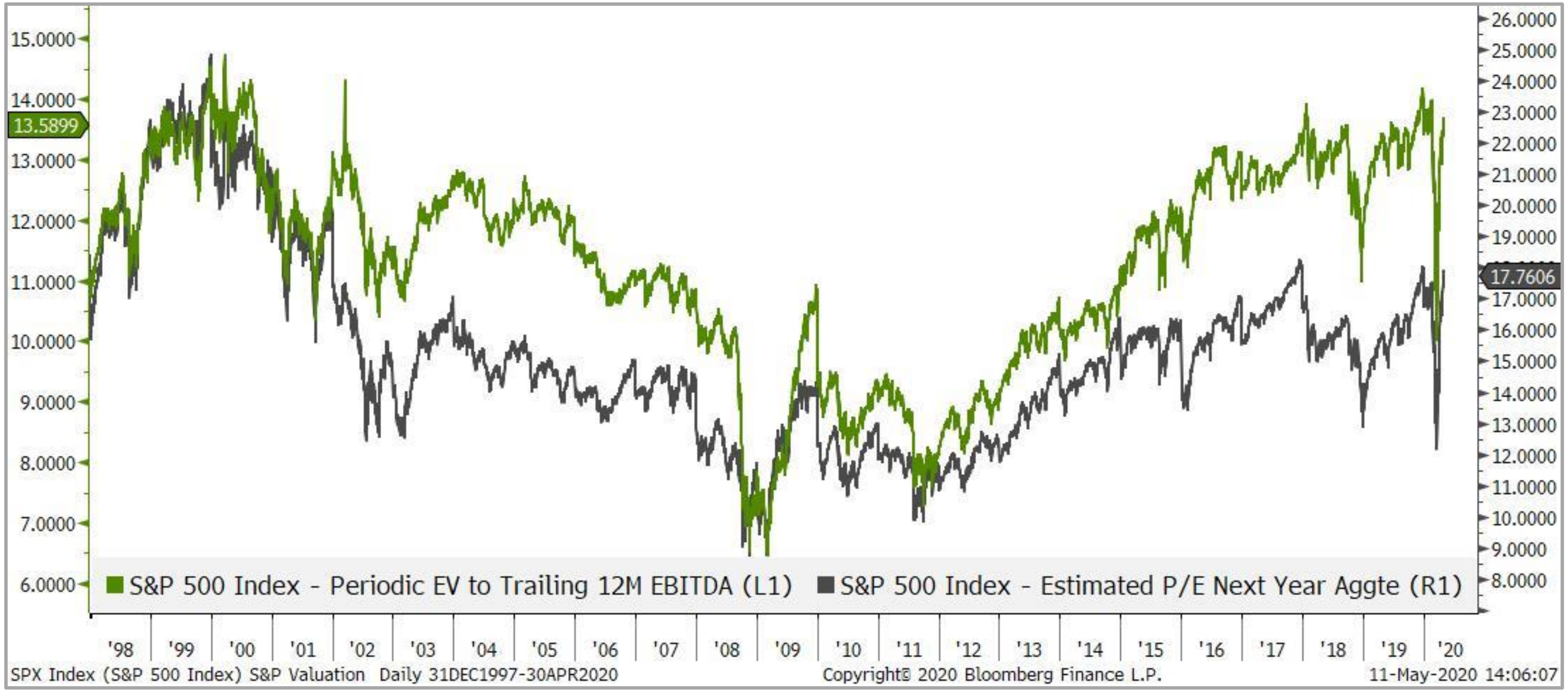
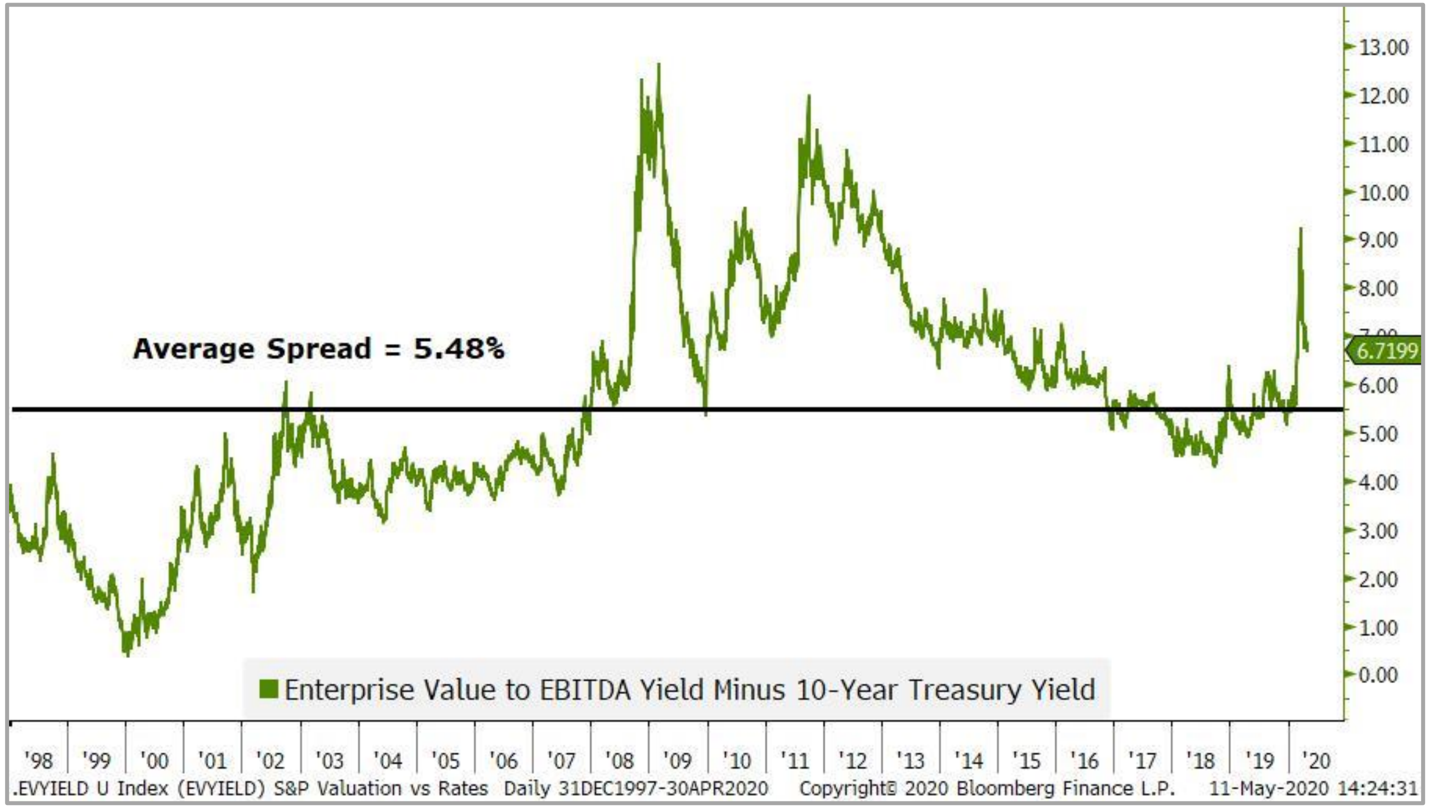
Equities: S&P 500 Valuation



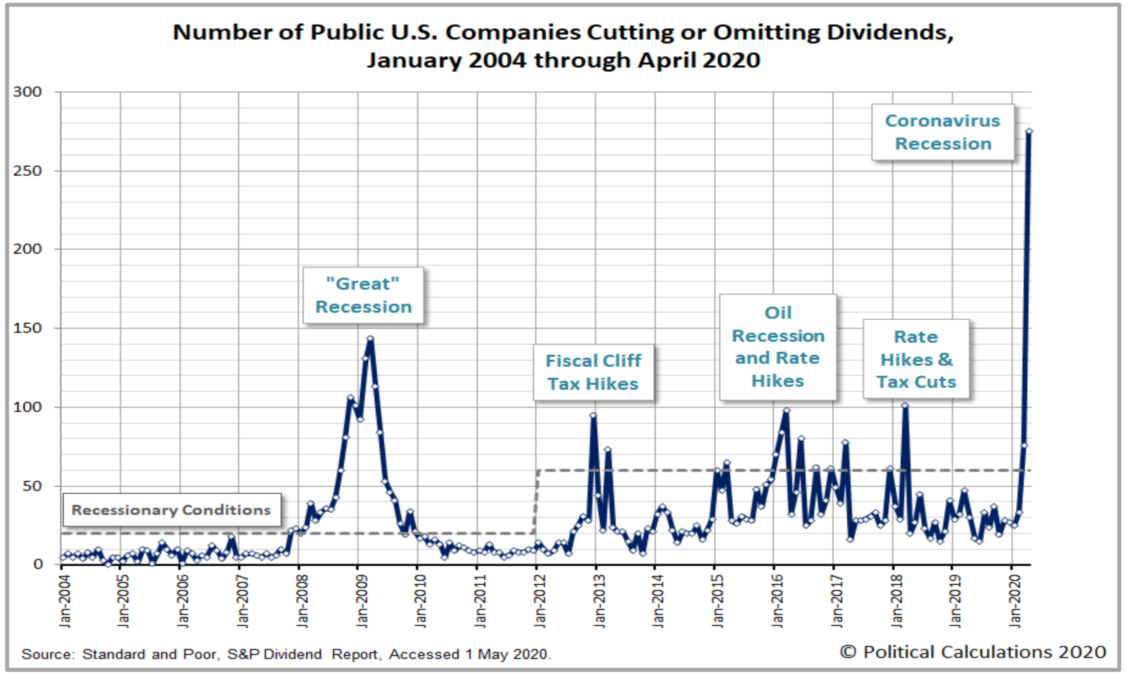
- From a valuation perspective, stocks are near the decade-high in terms of the forward P/E ratio and enterprise-value-to-EBITDA (gross cash flow) ratio.
- On these two metrics, the only times stocks have been more expensive were back in the late 90’s and a few other instances this cycle (late 2019 and early 2018).

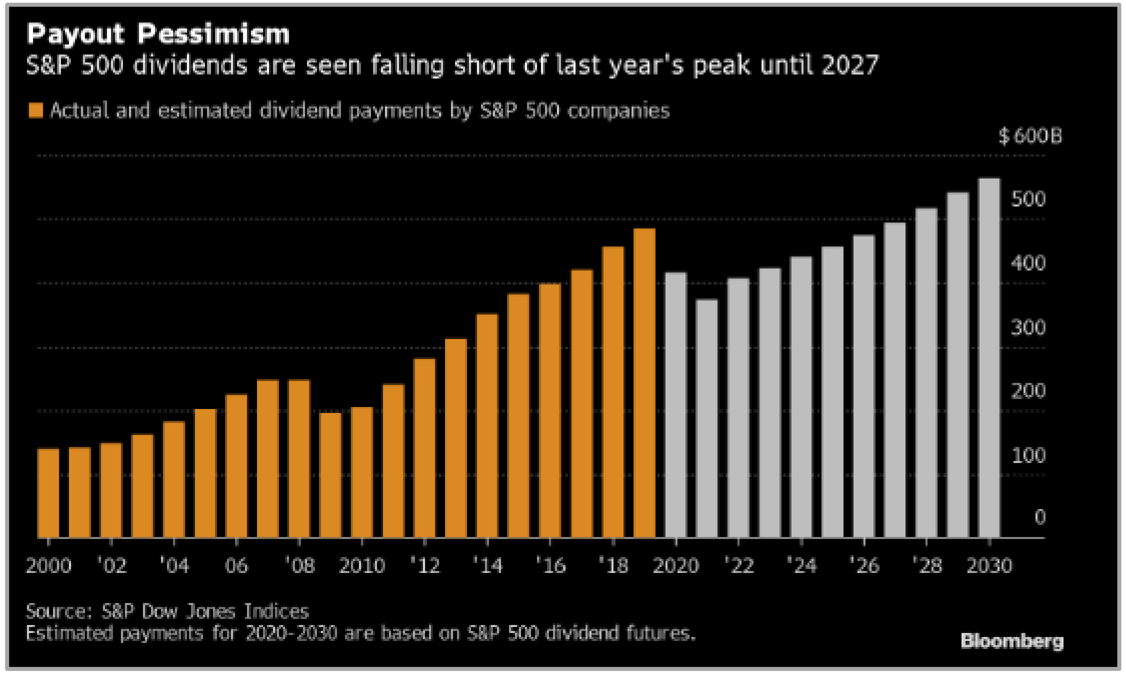
Equities: Valuation vs. Treasury Yields



- But if you compare stock valuations to interest rates, the valuation actually looks slightly attractive relative to history.
- The chart above takes the cash flow (EBITDA) yield (1 divided by the EV/EBITDA ratio) and subtracts the 10-year Treasury.
- However, it is fair to note that the reason rates are so low is due a chronically slow-growing economy and the current COVID crisis.

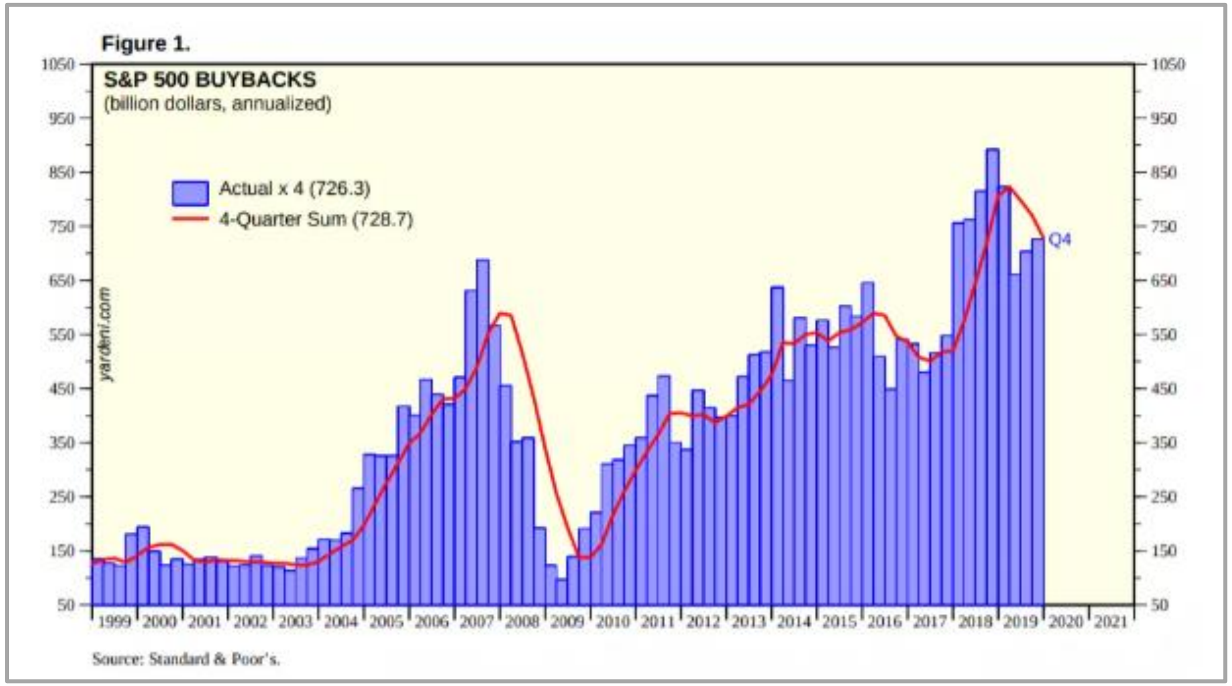
Equities: Dividends and Share Repurchases





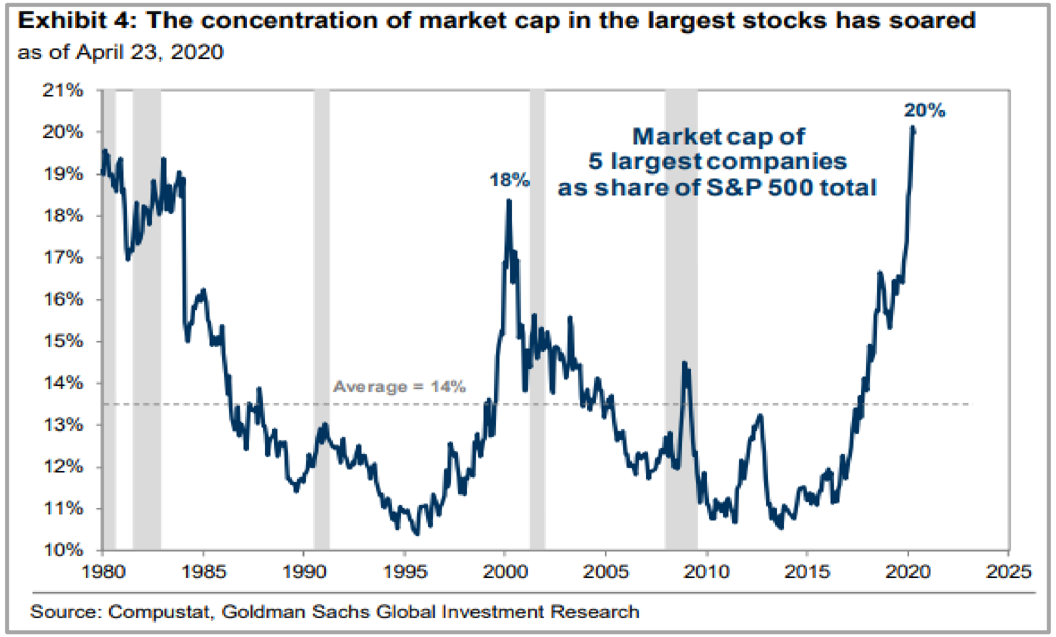
- With that said, there is severe pressure on equity fundamentals with overall earnings expected to contract by 10% YoY for the S&P 500; moreover, even that expectation may be too optimistic given the magnitude of the economic meltdown.
- This had led to a significant amount of dividend cuts, which are running at double the rate of any previous recession.
- In addition, the absolute level of dividends (using dividend futures) is not expected to reach the 2019 peak until 2028.

Equities: Dividends and Share Repurchases



- In addition, share buybacks - which exploded from 2013-2019, materially propelling and extending the longest bull market ever - have been running around 1/3 of the pace relative to the three-year average.
- Repurchases are likely to not only slow further, but also face increased regulatory pressure since many of the companies that took on more debt to buy back shares are now the same companies taking government bailouts.
- Overall, the capital return picture for stocks (buybacks plus dividends) has worsened considerably in 2020.

Equities: Narrow Leadership

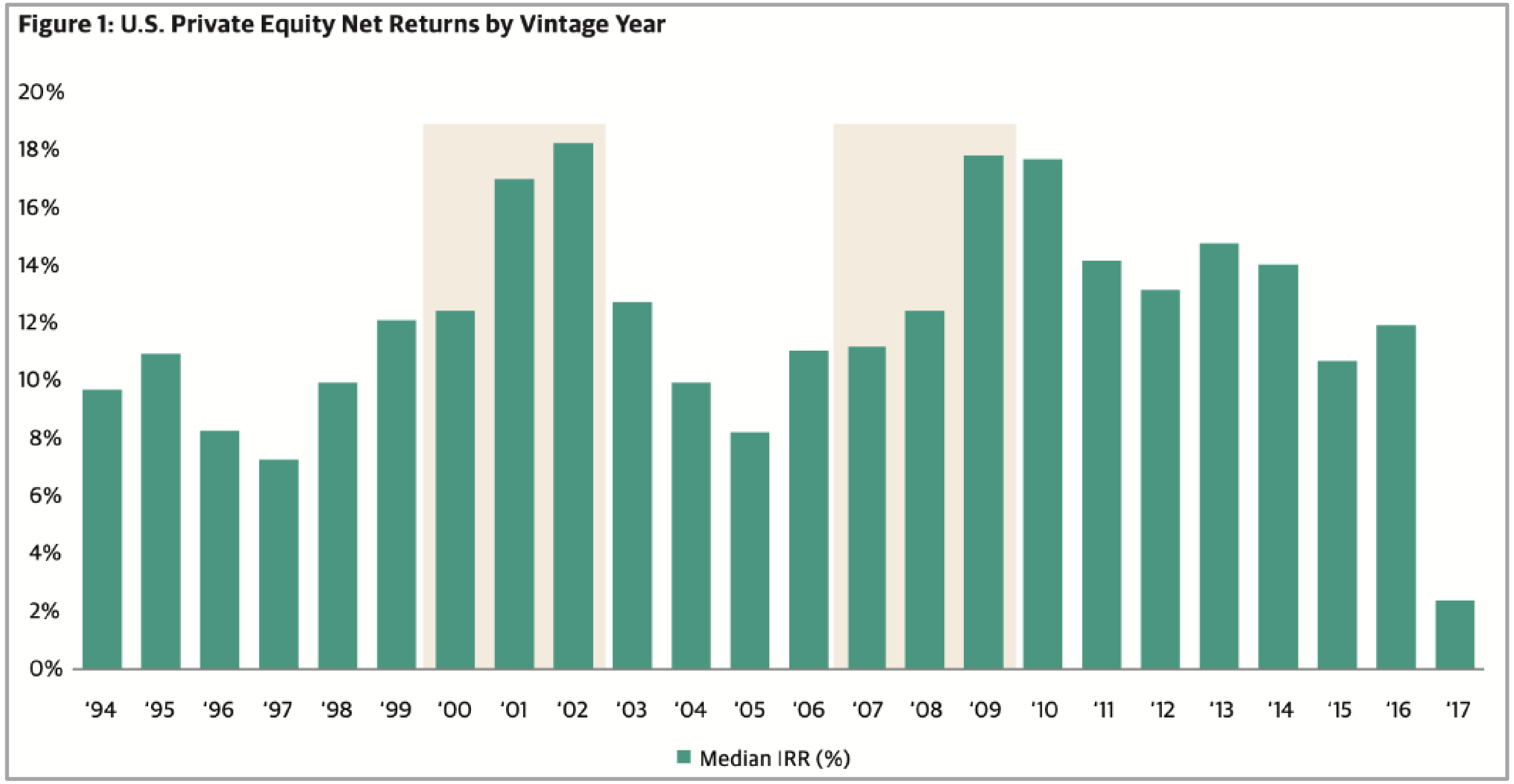


- The other notable aspect of this rally has been how pronounced the outperformance has been for the market leaders. The FAAMG (Facebook, Amazon, Apple, Microsoft, Google) group is up 10% on the year, while the remaining 495 companies are down a collective -13%.
- This group of tech titans now boasts a larger combined market cap than any other five S&P names at any point over the last 40 years.

Equities: Value vs. Growth

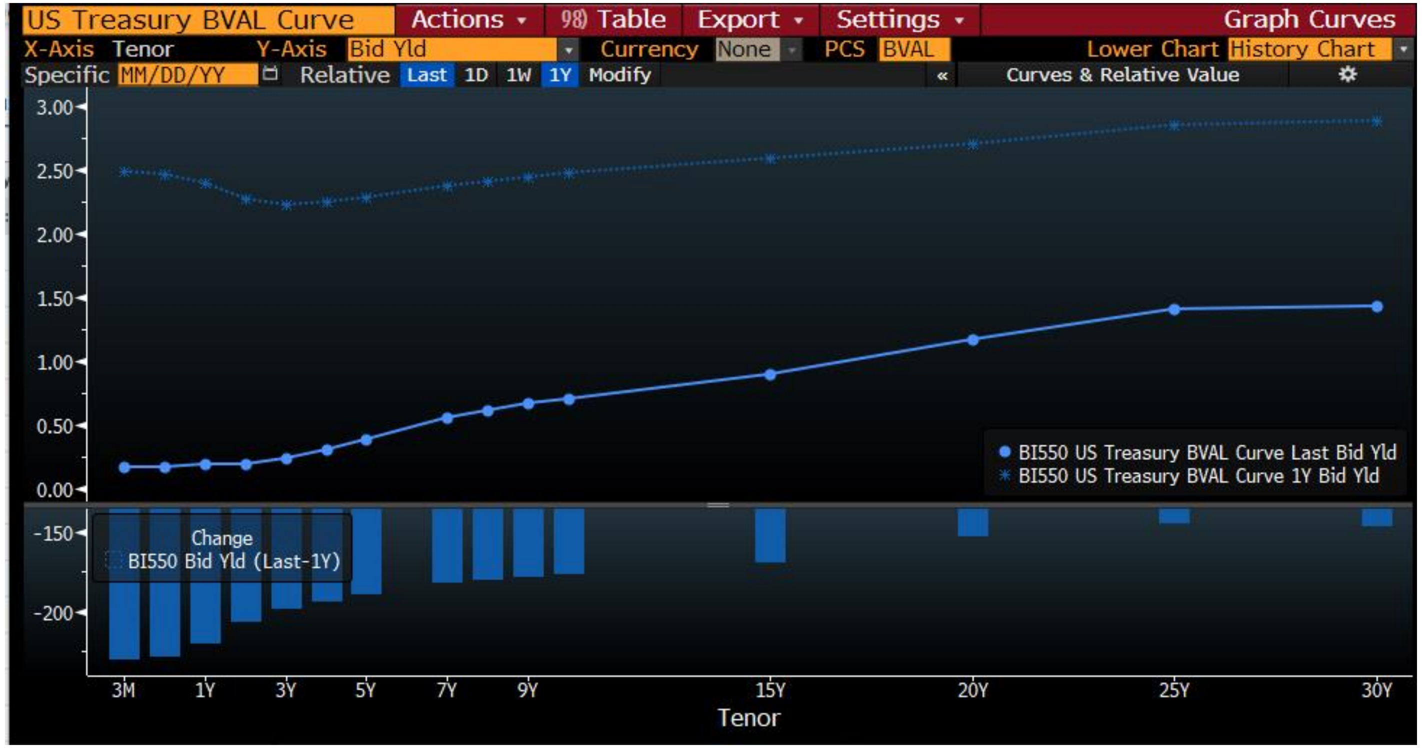
- On a similar topic, given the growth concentration of FAAMG, value stocks have seen similar underperformance versus growth stocks to what we witnessed during the tech bubble in the late 90's.
- From late 1999 to 2009, value stocks outperformed growth stocks by over 61%.
- While technology stocks look much more reasonably valued across the board today, we believe selectively increasing exposure to value (in lieu of growth) makes sense in today's environment.

Equities: Private Equity



- We also think it makes sense to begin considering a private equity sleeve.
- The best private equity (PE) vintage years tend to be those during and coming out of recessions.
- In addition, the low rate environment is conducive to the PE business model.

Income Markets: Treasury Curve vs. Last Year

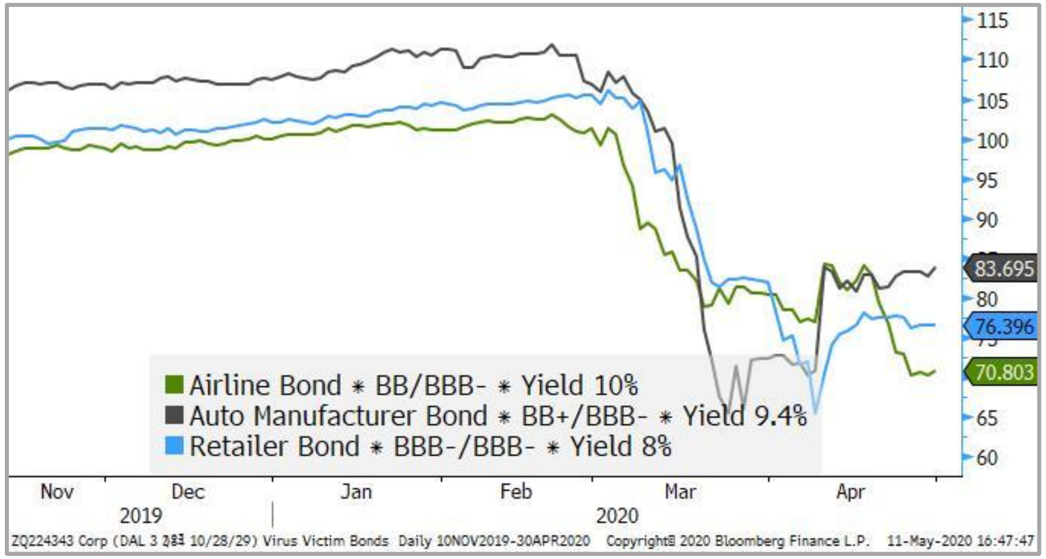


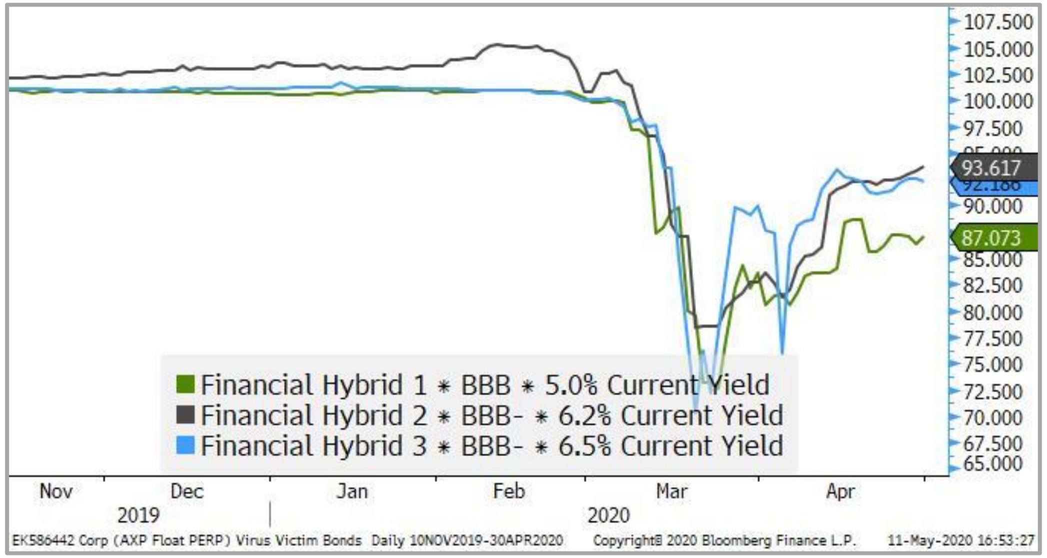
- On the bond side, the entire Treasury curve (i.e., yields at various maturity lengths) has shifted down meaningfully over the past year in a "bull flattener" (a yield-rate environment in which short-term rates are falling more quickly than long-term rates).
- Treasuries, and other high-grade bonds, were certainly a great hedge during the equity pullback.
- Today, though, they offer not only very low returns, but rather high risk given the duration, or interest rate risk, is quite high relative to the cashflow these bonds are offering.

Income Markets: Credit Spreads and Default Rates

- Fortunately, as Treasury rates collapsed, we saw credit spreads (the yield gap between government and corporate bonds) widen significantly. This divergence created a great opportunity in March to buy into both high-yield (HY) and investment-grade (IG) corporate bonds.
- Since credit spreads peaked, we have seen the IG and HY universe return 16% and 13.5%, respectively.
- With the Fed buying corporate bonds via its credit facility, we think this will be a good place to be invested over the next few years since spreads are still wide relative to the long-term average.
- With that said, default rates will continue to grind higher – even with government lending programs – so careful credit selection is crucial.

Income Markets: Bond Examples





- A few areas we like on the bond side are:
  - 1) Investment-grade virus victims (select retailer, auto manufacturer, and airline) yielding 8-10%.
  - 2) Floating or fixed-to-floating rate investment-grade financials yielding 5.0-6.5%.
  - 3) The bonds of "Fallen Angels" (companies downgraded from IG to HY) yielding 6-9%
  - 4) High-quality corporates less impacted by COVID that yield 3-5%.

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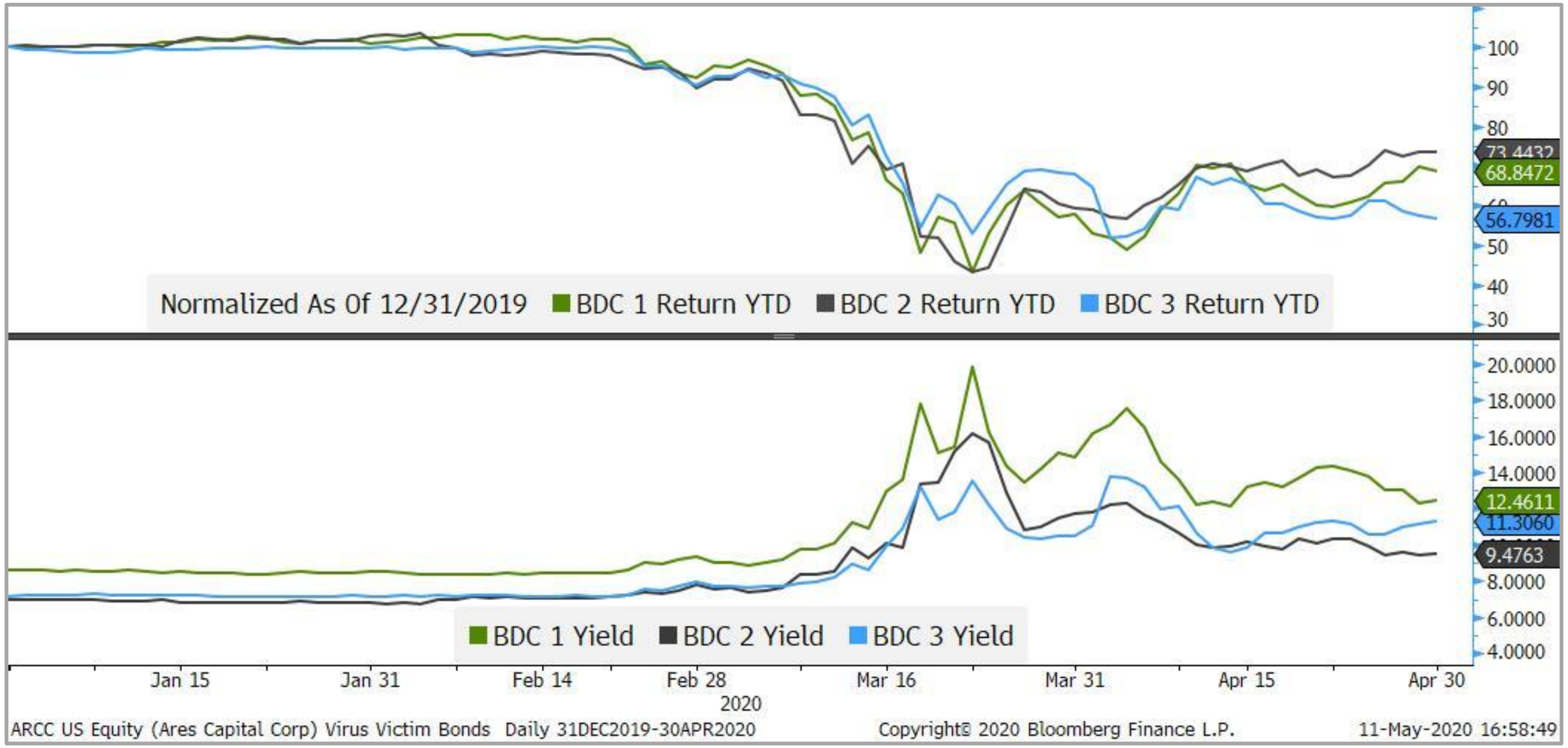
Disclosure: The yields shown for the listed security examples are average ranges of current yields we are seeing as of the day of this presentation. Specific security yields could be higher or lower than the listed ranges. These yields do not reflect the deduction of advisory fees, brokerage or other commissions, and any other expenses that a client may pay. Yields are subject to change and are not guaranteed. Please see important disclosures and Index definitions following the presentation.

Income Markets: Equity Income Areas We Like



- We also like BDC (business development companies) who essentially lend to private businesses in the US.
- Many of these companies are still down 30-50% from their highs and yield 10-13% relative to 6-9% to start the year.
- In this sector we're are focusing on the companies with the best balance sheets and operating history.

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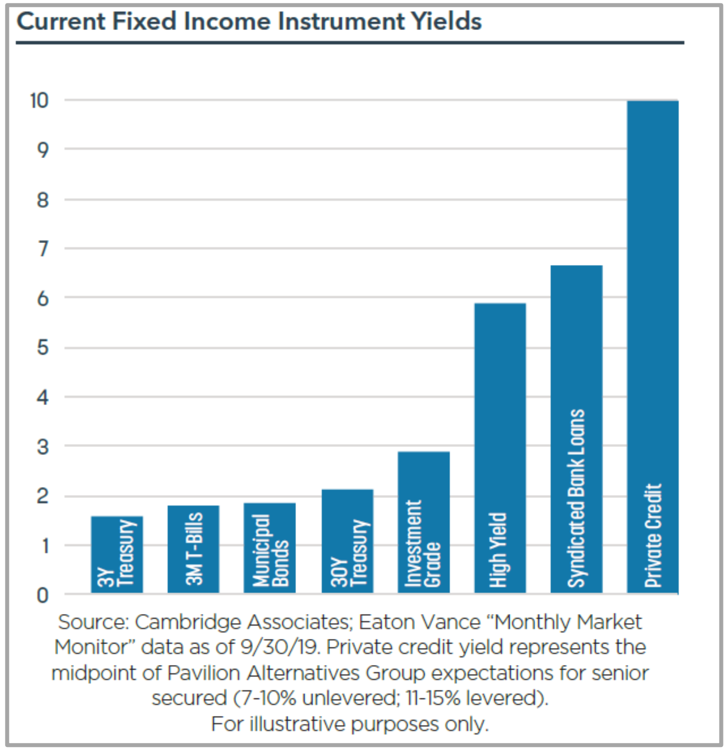
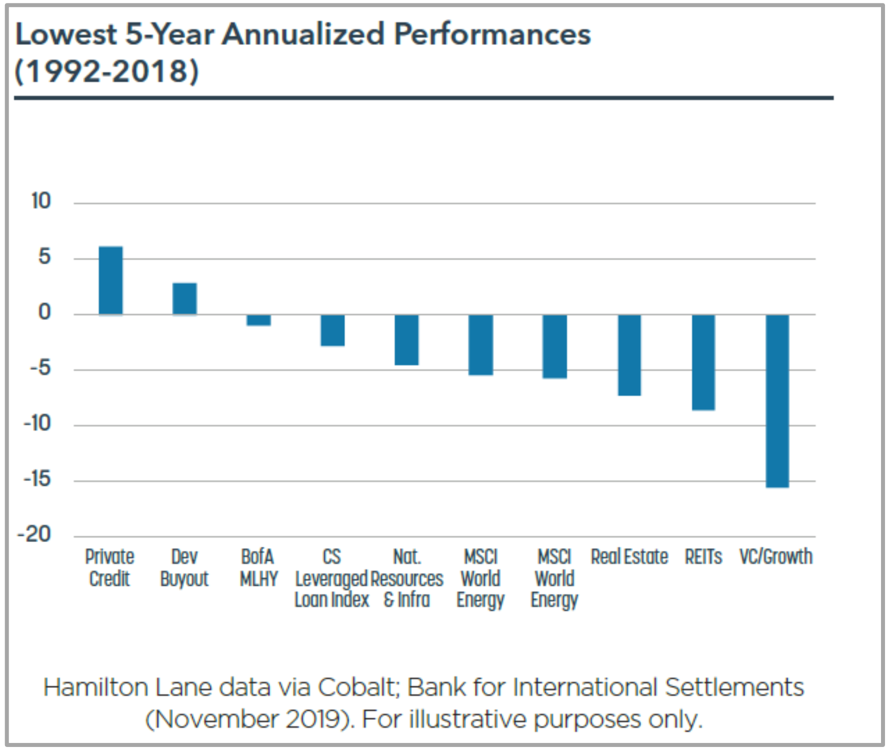
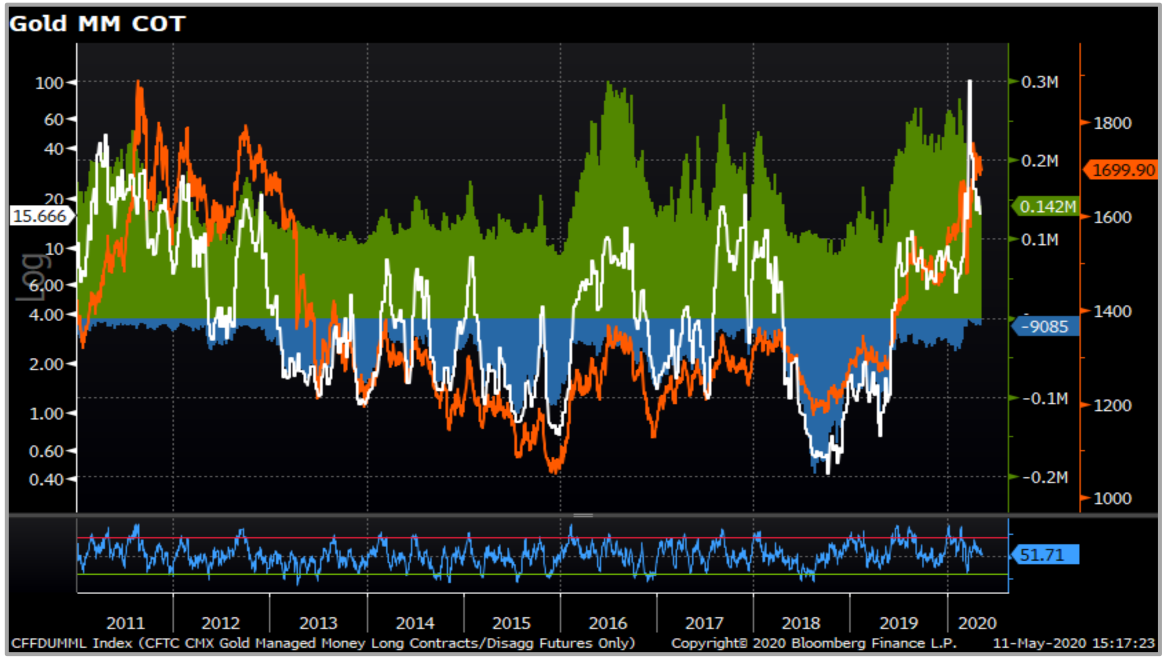
Income Markets: Private Credit





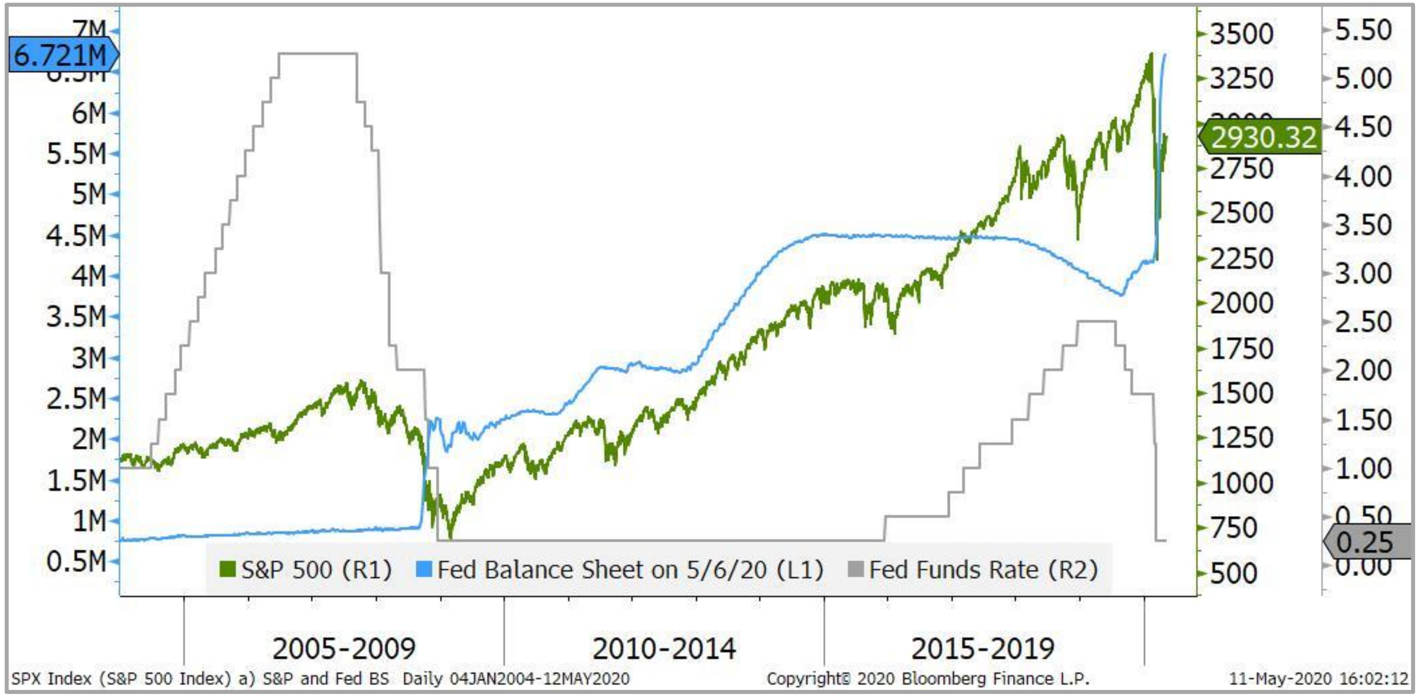
- We are also exploring private credit where in exchange for illiquidity you can generate higher cashflow.
- The private credit universe has never had a rolling 5-year negative return, which highlights the resiliency of this asset class.

Gold Miner Performance and Gold Price and Speculative Positioning



- Precious metals are also an area we have favored, which have performed exceptionally well this year.
- The price of gold has surged, and input costs (energy prices) have come down, which has been a great environment for gold miners.
- With that said, speculative positioning looks quite bullish (green line represents long positions vs. blue line, showing short positions) which could be a near-term headwind.
- The price of gold (orange line) tends to come down when there is a significantly larger amount of long positions relative to short positions.

Outlook / Conclusion Slide – Fed Balance Sheet vs. S&P 500



- The most important chart over the last decade has been the linkage between the Fed's balance sheet (blue line) and the stock market (green line).
- As you can see, the Fed's balance sheet is once again ballooning at a rapid clip, which has helped the stock market's recovery.
- Our belief is that if the market falls hard from here, the Fed and government will step back in to provide further relief.

Outlook / Conclusion Slide – Blue Chip Dividend Yield vs. Bond Yields

- It's quite interesting to look at high-quality blue chip dividend yields vs. their corresponding bond yields. (Note: these companies are all rated investment-grade.)
- When looking out over the next 10 years, our preference would be to own the stocks on the left with an average dividend yield of 4.5%, compared to the bonds on the right yielding 2.6% from the same issuers.
- We do think volatility will be elevated, though, and generally still hold a reasonable amount of cash.
- Ultimately, as volatility arises, the Fed has been quite clear they will continue to step in and provide underlying support to the corporate sector and the overall economy.

Dividend Yield	**4.55%**	**Bond Yield**	**2.57 %**
Name	Yield	Bond	Yield
JPMORGAN CHASE & CO	4.00%	JPM 2.739 10/15/30	2.52%
JOHNSON & JOHNSON	2.71%	JNJ 2.9 01/15/28	1.35%
WHIRLPOOL CORP	4.42%	WHR 4 3/4 02/26/29	3.58%
QUALCOMM INC	3.23%	QCOM 4.65 05/20/35	2.69%
CISCO SYSTEMS INC	3.33%	CSCO 5 1/2 01/15/40	2.91%
INTL BUSINESS MACHINES CORP	5.32%	IBM 3 1/2 05/15/29	2.13%
UNITED PARCEL SERVICE-CL	4.30%	UPS 2 1/2 09/01/29	2.00%
ABBVIE INC	5.37%	ABBV 4 1/2 05/14/35	3.31%
WELLS FARGO & CO	8.23%	WFC 2.879 10/30/30	2.65%

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