BOYD WATTERSON
ASSET MANAGEMENT

April 2020

Investment Outlook

Our Firm:

Boyd Watterson Asset Management, LLC is an SEC-registered investment advisory firm with approximately $11.1 billion of assets under management.[1] Over the last 90+ years, Boyd Watterson and its predecessor companies have successfully managed a broad range of fixed income and real estate strategies for institutions and individuals alike.

With a focus on the management of money and a dedication to the satisfaction of our clients' expectations, we offer the benefits of a boutique firm but with the resources usually attributable to a much larger asset management firm.

[1]Including gross real estate assets under management and advisory-only unified managed accounts. SEC registration does not constitute an endorsement of the Firm by the SEC nor does it indicate that the Firm has a particular level of skill or ability.

Please visit our website, *www.boydwatterson.com*, for information about Boyd Watterson's investment strategies, insights, philosophy and people.

Check Out Our Blog:
www.boydwatterson.com/blog

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The Macro View

Many came into the New Year with a sense of optimism given the U.S./China 'phase one' trade agreement in December, the Federal Reserve having eased monetary policy several times in the second half of 2019 and while growth expectations were relatively modest looking into 2020, recession fears had faded. The emergence of the coronavirus (COVID-19) in China and its subsequent spread throughout the world rapidly changed the outlook on virtually everything. Efforts to contain the spread of this virus varied from country to country, but the health consequences and economic effects were immediate and severe, impacting the lives of billions of people globally. Numerous large economies have effectively closed to non-essential services, and healthcare systems around the world are overwhelmed, all of which is transferring most, if not all, of the near-term financial burden and solutions to global central banks and governments. What began as a public health crisis quickly morphed into an economic and financial crisis, on an unprecedented level.

From an economic perspective, much of the domestic data over January and February remained broadly supportive of our growth outlook, recognizing much of this data is backward looking. Consumer confidence increased, payroll growth strengthened, and manufacturing and services PMIs remained in expansionary territory. Additionally, major stock market indices reached record highs in February and credit spreads remained relatively tight. This all changed in the month of March as madness ensued and major declines in the stock market and severe stress in the credit and funding markets were reminiscent of the experiences felt during the 2008 financial crisis. To make matters worse, investors' first glimpse of the anticipated plunge in economic data was revealed in late March. The weekly jobless claims report showed a greater than tenfold increase over the prior week to nearly 3.3 million and the University of Michigan index of consumer sentiment registered its largest monthly drop since 2008. Economic data over the coming weeks will undoubtedly be some of the worst witnessed in many years (or history) and, at the very least, a mild recession now appears inevitable. In fact, some economists are forecasting double-digit declines in GDP for the second quarter.

Performance for Periods Ending March 31, 2020

	QTD	1-Yr	3-Yr	5-Yr
2-Year Treasury	2.81	5.38	2.58	1.71
10-Year Treasury	11.93	18.25	7.27	4.08
Bloomberg Barclays Aggregate	3.15	8.93	4.82	3.36
Corporate Investment Grade	-4.05	4.37	4.00	3.27
Corporate High Yield	-13.06	-7.40	0.57	2.68
Leveraged Loans	-13.19	-9.15	-0.73	1.21
Mortgage Backed Securities	2.79	7.06	4.08	2.96
S&P 500	-19.60	-6.98	5.10	6.73
MSCI EAFE	-22.83	-14.38	-1.82	-0.62

Source: Interactive Data, Credit Suisse, Bank of America/Merrill Lynch/Bloomberg.

As the near-term economic outlook shifts from expansion to contraction, it's important to note there are generally three types of recessions; some are event-driven, while others result from a cyclical shock or a structural shock. In our opinion, the likely economic contraction resulting from the COVID-19 crisis would qualify as an event-driven economic recession, similar to the 1918 flu pandemic. The COVID-19 crisis is both a supply shock that began in late January when China effectively closed its economy, disrupting supply chains globally, as well as a demand shock as many consumers have been mandated to work from home and in some cases, ordered to stay at home aside from performing essential services. Compounding this economic stress is the breakdown of OPEC+, which has resulted in an all-out oil price war between Russia and Saudi Arabia. The resulting sharp decline in oil prices that followed has once again brought into question the viability of smaller producers in the U.S. energy complex, not to mention the volatility associated with the likelihood of credit downgrades and potential losses to the financial sector that lends to this industry.

The broader question now relates to how long the current closures and social distancing mandates will be necessary to mitigate the spread of the virus and then, once economies begin to slowly reopen, how long it takes to reach full capacity both in terms of supply and demand. Fortunately, the monetary and fiscal policy responses have been rapid and massive in scale.

The Federal Reserve stepped in first, in early March, with a 50 basis point reduction in their key overnight lending rate and quickly followed with an additional 100 basis point reduction, both of which were intermeeting moves, the first for the Fed since the 2008 financial crisis. This brought the federal funds rate back down to the zero bound, a range of 0.00%-0.25%. The rapid deterioration in economic conditions and resulting spike in volatility in financial markets caused the Fed to dust off its full policy playbook utilized during the Great Recession. In conjunction with the massive rate cut on March 15th, the Fed began to expand its balance sheet once again with renewed large-scale purchases of U.S. Treasuries and agency mortgage-backed securities. Furthermore, they enacted their section 13(3) authority to establish liquidity and financing programs for the commercial paper market, for money market mutual funds, primary dealers, the asset-backed securities market and new programs to support the primary and secondary markets for corporate bonds. In some cases, these were coordinated actions with other global central banks as similar actions were taken in their countries. We applaud the Fed's aggressive action to employ the full extent of their balance sheet in support of the liquidity needs of financial institutions and markets to facilitate the flow of credit to households and businesses throughout the U.S. economy. By late March, the Fed's balance had already reached nearly $5 trillion, larger than the peak during the 2008 crisis. Fortunately, there is no limit to the size of the Federal Reserve's balance sheet, a powerful backstop in times of crisis.

Despite the political tension in Washington, Congress and the Trump Administration have been active in their efforts to support our citizens and our economy through various fiscal programs. The Families First Coronavirus Response Act was passed to provide paid sick leave, free virus testing and to expand food assistance and unemployment benefits. The Treasury and IRS extended income tax payment due dates for certain individuals and corporations for 90 days to free up additional liquidity to the economy. Just as the quarter was ending, Congress approved, and President Trump signed the CARES Act to provide fiscal stimulus and financial support that will impact numerous areas of our economy. This $2+ trillion economic relief package is the largest ever passed through Congress, equating to nearly 10% of annual GDP. Importantly, the CARES Act provides direct cash payments to millions of households, temporarily suspends payments on federal student loans, increases unemployment insurance benefit amounts and expands eligible workers, provides funding for forgivable bridge loans to small businesses, includes emergency loans to distressed businesses, provides additional funding for hospital and healthcare assistance and contains various provisions for tax relief. We believe this is likely the first of what could be two or three total targeted stimulus plans. Future needs will largely depend on the government and healthcare sectors' efforts to contain the spread of COVID-19.

Given the severity of this unforeseen health crisis, the unfortunate reality remains that it was necessary to intentionally reduce economic activity through restrictions on non-essential activity and social distancing. As a result, there was little alternative to fiscal policy to provide the initial bridge financing to get Americans through the worst of it. The objective is to facilitate the transition back to a normal state of economic activity while minimizing the long-term financial damage to the U.S. economy and maximizing the support to our healthcare system and well-being of our citizens.

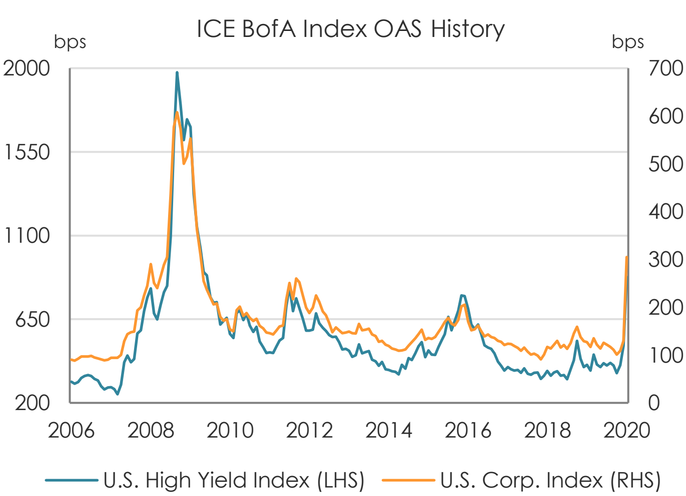
While it remains impossible to determine when life and economic activity will normalize, we remain somewhat cautious on what the recovery will look like, at least as it relates to how quickly economic activity will fully recover. Supply chains will need to be put back together both in terms of production ramping up and the transportation of goods to end users. Social and consumption habits will be more interesting to observe as an event like COVID-19 that creates dislocations of this magnitude risks changes in behavior that may be more than temporary. While we strongly believe in the resiliency of American consumers and corporations, the unprecedented nature of this crisis leaves us with more questions than answers as we close the door on the first quarter of 2020.

Fixed Income

It is hard to put into words, much less into historical perspective, what has transpired in the fixed income markets throughout the first quarter of 2020. Coming off a strong 2019 with solid total and excess return performance across all fixed income sectors, we began 2020 with a cautiously optimistic view. We expected positive, albeit lower, total returns than 2019 with Fed policy likely on hold. We also anticipated an uptick in volatility with the coming election cycle and lingering trade issues. We got both, but not for the reasons we expected.

January and February proceeded normally with some follow through from the fourth quarter of 2019. Risk premiums remained on the tighter side of this cycle across most non-government sectors of the fixed income market. Treasuries rallied as the yield curve flattened, led by demand from investors in pursuit of higher yields offered by longer maturity bonds. The short end remained anchored, having led the way lower in the Fall with the Fed having eased monetary policy several times. To some, given the seeming relative calm in the markets, the persistent rally in Treasuries during the same period that stocks were performing well foreshadowed concern that a flight to quality rally was on the horizon. Very quickly in March the landscape changed dramatically with the market's acknowledgement that COVID-19 was now a global health problem and an intensifying economic problem. As equities tumbled, outflows from fixed income mutual funds and ETFs gained steam while inflows to government money market funds spiked. The ensuing flight to quality drove Treasury yields to new historic lows and credit spreads significantly wider. The yield curve steepened led by short Treasury bill yields moving lower, briefly into negative territory in some cases. Volatility spiked and liquidity deteriorated rapidly as forced buyers (duration hedgers) and sellers (cash needs/fear) collided in the market. As mentioned previously, the Fed stepped into the market aggressively as the "lender of last resort," with the goal of providing much-needed liquidity and hopefully, calming the fears of investors.

For perspective, the ICE BofA U.S. Corporate Index experienced spread widening during the first quarter from a low option-adjusted-spread of 99 basis points to a peak of 401 basis points, closing the quarter at 305 basis points. The last time we experienced anything close to this was during the 2008-2009 Great Recession, however this time around it unfolded much faster. What investors experienced in the corporate bond sector also occurred to varying degrees in all other spread sectors. Fortunately, credit spreads have partially recovered (narrowed) as we close out the quarter. We believe the modest recoveries in risk premiums at this juncture are more reflective of investors' perception of quality and liquidity than an outright willingness to add risk.



Source: ICE Data Services entity ("ICE"). Month-end data as of March 31, 2020.

By late March, with spreads having gapped significantly wider, the new issue corporate market came to life as many high-quality, investment grade issuers were able to tap the markets. In our opinion, corporate management teams and treasurers are shoring up liquidity by strategically drawing lines of credit or accessing the corporate bond market. This will allow companies to navigate the coming months as the financial impact from the virus affects their ability to generate positive cash flow. Additionally, in our experience, companies have many levers to support liquidity in these environments, including reduction of capital expenditures, halting share repurchases and cutting or eliminating dividends. We believe the many programs the federal government has put in place should help support investment grade corporate liquidity in the near term. Interestingly, high-grade corporate bond issuance set a record in March, topping $250 billion, with many of the issuers rated single-A or high BBB and tended to be in the more 'defensive' economic sectors. The previous record for monthly issuance was $178 billion in May 2016.

The mortgage market also experienced substantial spread widening as Treasury yields fell sharply, leading to significant underperformance of the sector. Difficulty hedging and managing mortgage-backed positions on dealer trading desks along with limited balance sheet room made selling mortgages in March exceedingly difficult. Similarly, asset-backed securities collateralized by consumer receivables (auto loans and credit cards, etc.) also saw significant spread widening and limited investor appetite given the unknown severity that this crisis will have on employment and consumer finances in the near term. Fortunately, two of the Fed's recently announced programs are specifically targeted at these two areas of the structured finance market and were successfully utilized during the 2008 financial crisis to improve both issuance and liquidity in this corner of the market.

We entered 2020 having gradually de-risked our portfolios throughout 2019 with the goal of having dry powder for the uptick in volatility we expected this year. We also maintained a slightly longer duration relative to our benchmark as a hedge against spread widening. As a result, during March, we participated in some of the high-quality corporate new issues to capture some of the wider, more attractive spread levels being offered due to the repricing in the market. New issues came with significant concessions to the secondary market allowing us to purchase high-quality names at very attractive levels. Importantly, with the slew of unconventional monetary policy initiatives announced in March and fiscal support coming in April, the fixed income market's overall liquidity and trading are beginning to see improvement.

Most broad sector valuations still appear attractive relative to only a couple of months ago, but investors will continue to be faced with the tough task of evaluating and investing in an environment of significant economic uncertainty over the coming weeks and months. Within this weakening economic environment, we anticipate an increase in credit downgrades and defaults in the corporate sector. As a result, security selection and fundamental credit research will be critically important as we evaluate further additions to our portfolios. Liquidity will remain a top priority in our portfolios during this challenging period yet, given the more attractive risk premiums in the fixed income market, we will also look to balance the risk-reward opportunities. We believe history has shown that when there is fear, panic and chaos in the financial markets, there is often opportunity for disciplined investors as well.

Real Estate

There has been a dramatic change in the outlook for commercial real estate since the end of 2019. The COVID-19 outbreak has negatively impacted the economy and is expected to negatively impact the real estate sector. No sector of the market is immune, but the impact is much more severe for some than others.

Hotels, casinos and co-working spaces were immediately feeling the impact the most due to their short-term leases, which are essentially day-to-day or month-to-month. There will be many defaults in these areas and lenders will likely try to work out deals with landlords rather than foreclose. Retail landlords are expected to be battered in both the near-term and long-term, as many malls and shopping centers have had to close and there is the expectation that few tenants will be paying rent during this period. There are also likely to be many more bankruptcies in this already troubled space, which could mean massive losses in the coming quarter(s) for investors with retail exposure. Student housing is also a concern, as many students vacated their apartments due to schools closing for the rest of the year, leaving remaining lease payments in doubt. Senior housing facilities have been hit hard by the virus and the fear is that there is more to come, which will also adversely impact future leasing at these properties. Multi-family assets could be negatively impacted by the many layoffs, particularly in Class B and C buildings where the tenants tend to be more financially stretched.

While no sector is completely safe, office and industrial assets with long term leases to strong tenants will likely manage this period with less damage. Lower quality credit tenancy in these asset classes will pose a greater risk. There has been a surge in warehouse demand as more and more people turn to online shopping for their spending habits and distribution needs increase as a result, which bodes well for the industrial sector. Self-storage and medical office are generally considered areas of relative safety as well.

Deal flow is expected to dramatically slow down as the secured debt market comes to a near-halt. The only deals being closed today are those that were agreed to before the crisis and where financing was already in place. The CMBS market is largely shut down; life companies are facing wide bond spreads, and banks are looking to preserve liquidity and are being highly selective about sponsors and deals as spreads have widened 75-100 bps. The unsecured market remains open for larger borrowers, but spreads have widened in that market as well by 30-40 bps.

We believe Boyd Watterson's two primary government real estate strategies are well positioned to weather the current economic storm. There is long-term stability in leasing to federal, state and local governments and risk of missed or deferred rental payments is not a major concern in the near-term. Boyd is not expecting to see material changes in the value of its government leased properties in the near-term.

Equities

The equity markets started off 2020 with a continuation of the 2019 bull market. 2018 was a negative year as the Fed raised rates, creating uncertainty for domestic growth and corporate profits. When the Federal Reserve reversed course in early 2019, the bull market was back on. Valuations seemed heavy by the end of 2019, but cash flow generation was strong, and the market was willing to go along. The returns from other assets classes didn't seem to be as appetizing. The S&P 500 peaked in the second week of February 2020 with a close at 3,380. However, when COVID-19 health scare started to filter into the market and economy in early March, there suddenly was indiscriminate selling and the market fell approximately 35% from its peak. Consequently, fundamentals started to matter as investors paid closer attention to balance sheet strength. The market rallied off the lows but couldn't recover what had been lost. One of the hardest hit sectors has been the banking industry. However, as we go into this downturn, the banks have never been in better shape with most banks being overcapitalized. JP Morgan, for example, one of the better managed banks, is down more than 30% as we closed the quarter. Thus, the market still has some uncertainty as to the strength of the balance sheet of one of the best managed companies. We will be watching JP Morgan and the sector for some clues as to how quickly the economy can stabilize and start to grow again. The banks will be key in distributing the small business stimulus from Washington. Listening to their comments will be extremely helpful. As we look forward beyond COVID-19 and the current lagging economy, we expect goods and services production to normalize. Eventually, the economy will recover to near capacity and market participants will realize that the fed funds rate again is near zero. The reality of a good economy and a lower risk-free rate should once again make the case to own equities. The sooner the economy can get back on track, the sooner equities can recover what was lost and possibly rally to new highs. We would hope that this will be the case within the next 18-24 months.