BOYD WATTERSON
ASSET MANAGEMENT

July 2020

Investment Outlook

Our Firm:

Boyd Watterson Asset Management, LLC is an SEC-registered investment advisory firm with $11.6 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

Like the first quarter of 2020, the coronavirus pandemic dominated global headlines in the second quarter, as central banks and national governments pulled out all the stops to provide a financial bridge to consumers and corporations and forestall an economic calamity. Simultaneously, pharmaceutical companies around the world rushed to develop potential therapeutics and a vaccine to treat and eventually contain this novel virus. Both fixed income and equity markets recovered nicely over the quarter, due largely to programs put in place by the Federal Reserve, yet the economic damage turned into a stark reality as the data began to reflect the magnitude of job losses and declines in spending, manufacturing and service sector activity. The stay-at-home orders in many parts of the U.S. were successful in slowing the spread of COVID-19 as the numbers of cases and hospitalizations slowed and/or declined over the months of April and May. Unfortunately, states' efforts to re-open their economies were met with spikes in infection rates and hospitalizations in several areas around the country. The reality is we are likely to experience these waves of infection around the country until there is an effective vaccine, which most do not expect until sometime in 2021. This experience underscores the extreme level of uncertainty regarding the path of the virus and has led to an intense debate about what the shape of the recovery will resemble. While only time will tell, we expect a relatively robust recovery in the second half of this year, yet we believe the time to return to normalized economic activity will be measured in years, not in months.

Performance for Periods Ending June 30, 2020

	QTD	YTD	1-Yr	3-Yr	5-Yr
2-Year Treasury	0.10	2.92	3.96	2.57	1.71
10-Year Treasury	0.67	12.68	14.21	7.05	4.87
Bloomberg Barclays Aggregate	2.90	6.13	8.74	5.32	4.30
Corporate Investment Grade	9.27	4.84	9.30	6.27	5.69
Corporate High Yield	9.58	-4.73	-1.07	2.95	4.58
Leveraged Loans	9.71	-4.76	-2.27	2.13	2.94
Mortgage Backed Securities	0.82	3.63	5.81	4.05	3.29
S&P 500	20.54	-3.08	7.51	10.73	10.73
MSCI EAFE	14.88	-11.35	-5.13	0.81	2.05

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

The policy responses, both fiscal and monetary, announced late in the first quarter were broadly implemented over the last three months, providing varying degrees of support to many areas of the economy and financial markets. Undoubtedly, the actions taken by the Federal Reserve were unprecedented in many respects and established a powerful backstop to the financial markets. This increased investor confidence to take on risk and paved the way for record levels of investment grade corporate bond issuance, allowing companies to build cash and refinance maturities when there was decreasing visibility on the economic horizon. Even the most stressed areas of the economy were able to access the capital markets for financing, as major airlines, cruise lines and hotel companies issued debt at a time when their revenues were severely reduced. We believe the swift action by the Fed in March, combined with their willingness to tweak these programs to maximize their usefulness along the way, has had a profound effect on investor confidence, the financial markets and the economy broadly. Furthermore, the Fed has made it clear they have the balance sheet capacity to do more if conditions warrant. Not to be overlooked, fiscal policy also played a large role in providing support to many areas of the economy, most notably through the Paycheck Protection Program and fiscal stimulus checks.

COVID-19 did not discriminate when it came to the economic impact on both consumers and corporations. Despite the severe effects of the virus taking hold late in the first quarter in the U.S., GDP registered its first decline in six years (-5.0% in Q1) and the sharpest decline since the first quarter of 2009, amid the Great Financial Crisis. Highlighting the impact on the consumer side of the economy, within this GDP report, personal consumption declined by 6.8% in Q1, its first negative reading since the fourth quarter of 2009. The chart below illustrates the negative impact the virus had on various consumer and business areas of economic activity. While March and April saw the worst of the impact, the months of May and June brought early signs of recovery as re-opening efforts got underway.

COVID-19 Economic Trends

Economic Factor	Feb 2020	Mar 2020	Apr 2020	May 2020	Jun 2020
Change in Nonfarm Payrolls	0.25M	(1.37M)	(20.79M)	2.70M	4,80M
Unemployment Rate (%)	3.5	4.4	14.7	13.3	11.1
Retail Sales Advance (M/M%)	-0.4	-8.2	-14.7	17.7	NR*
Consumer Confidence	132.6	118.8	85.7	85.9	98.1
Confidence Expectations Index	108.1	86.8	94.3	97.6	106.0
PCE Inflation (Y/Y%)	1.8	1.3	0.6	0.5	NR*
PCE Inflation – Core (Y/Y%)	1.8	1.7	1.0	1.0	NR*
ISM Manufacturing	50.1	49.1	41.5	43.1	52.6
ISM Non-Manufacturing	57.3	52.5	41.8	45.4	NR*
Capacity Utilization (%)	76.8	73.2	64	64.8	NR*
Industrial Production (M/M%)	0.1	-4.6	-12.5	1.4	NR*

Source: Bloomberg. *NR – Not released yet for June.

Economic forecasts vary widely as investors look out the next couple years, yet most agree at this point the recovery will not be V-shaped. As the table below indicates, both economists and the Federal Reserve expect 2020 to reflect the worst of the virus's economic impact with the economy gradually recovering over the next two years. Regardless of the forecast, a slow pace of employment growth, coupled with elevated levels of corporate and government debt, will result in a slower rate of long-term growth.

Economic Forecast

Economic Factor	2020	2021	2022
Change in Real GDP (%)			
Bloomberg Consensus[1]	-5.6	4.1	2.9
Federal Reserve[2]	-6.5	5.0	3.5
Unemployment Rate (%)			
Bloomberg Consensus[1]	9.4	7.5	5.7
Federal Reserve[2]	9.3	6.5	5.5
PCE Inflation - Core (Y/Y %)			
Bloomberg Consensus[1]	1.0	1.3	1.7
Federal Reserve[2]	1.0	1.5	1.7

(1)Source: Bloomberg. Data as of July 1, 2020.
(2)Source: Federal Reserve, Median Projection from June 10, 2020 SEP Release.

In response to this highly uncertain economic outlook, FOMC members made it very clear at their June policy meeting that low interest rates will be with us for a prolonged period to support the recovery. Their median projection for the overnight federal funds rate remained in the 0.00% - 0.25% range through 2022. Of particular concern, in addition to the growth/unemployment outlook, is the decline in inflation that has followed both the collapse in consumer demand and oil prices resulting from the coronavirus outbreak. In further support to the Fed's dual mandate of maximum employment and price stability, FOMC participants stated their purchases of Treasury and agency mortgage-backed securities would continue at their current pace for the coming months. The Fed's balance sheet has increased from approximately $4.3 trillion in mid-March to over $7 trillion currently. It has been widely speculated, but based on recent comments seems unlikely, that the Fed may utilize the concept of yield curve control, whereby the FOMC targets specific yield levels at a given maturity to further enhance their forward guidance on interest rate policy. Alternatively, Chair Powell has generally been dismissive regarding the potential for the FOMC to embark on a negative interest rate policy, as such is the case in Europe currently.

Looking forward, we believe the economic uncertainty will result in heightened market volatility and may require additional monetary and fiscal policy action. With therapeutics and vaccines in development, we are now witnessing the challenges in re-opening the economy with several U.S. states experiencing spikes in COVID-19 infection rates as bars, restaurants, beaches, and other non-essential businesses open for business. It is critical to avoid numerous economic starts and stops in order to lessen the fear of the consumer and to facilitate economic growth. The impact of potential changes in consumer behavior during this period cannot be understated, and it remains to be seen to what degree some of this may be permanent. How long will large gatherings be avoided, when will leisure/air travel normalize and restaurants be back to full capacity, and what will all levels of education look like this coming academic year? Against this backdrop and with the absence of greater visibility on future revenues and demand, businesses will likely be slow to bring workers back.

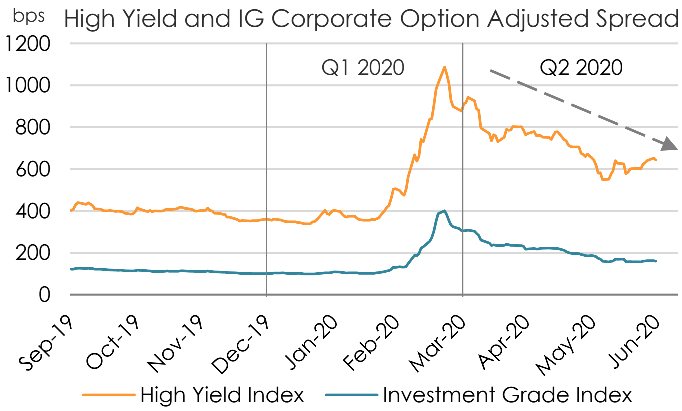
Will business travel normalize, or will technology replace some portion of that permanently, and how many people currently working from home will find themselves doing so on a more permanent basis? Until such a time as the virus appears to be under control, this inter-play of consumer behavior and the way corporations adjust to it will drive the trajectory of the recovery.

Away from the COVID-19 impact, several other areas of risk remain on our radar screen, including the upcoming presidential election, trade relations with both China and Europe, moves toward de-globalization, as well as the recent civil protests around the country. We are increasingly focused on the election as a change in administrations could have material consequences for corporate and personal taxes, regulation, and various social programs, all of which could drive market volatility.

Fixed Income

The Treasury market traded in a narrow range as interest rates responded to actions taken by the Fed and the latest headlines on the spread of the coronavirus. The ten-year Treasury ended the second quarter roughly where it began, moving one basis point lower to yield 0.66%. Spread sectors reacted positively to the Fed supported programs, which instilled confidence in the markets and helped to reduce volatility. While the Fed's unprecedented support for the markets ultimately carried the day, predicting the longer-term fundamental picture remains challenging.

Records are made to be broken and such was the case for corporate bond issuance during the quarter. New issuance in investment grade corporate bonds peaked in April, topping $285 billion. While new issue supply has tapered, the total for the quarter was a staggering $696 billion, bringing the year-to-date total to more than $1.1 trillion, easily set to beat the $1.3 trillion record issuance for all of 2017. For high yield, the year-to-date issuance now totals $210 billion, of which $139 billion came in the second quarter. The Fed responded to the risk-off sentiment that dramatically raised borrowing costs for corporations by implementing two programs: The Primary Market Corp Credit Facility (PMCCF) and the Secondary Market Corp Credit Facility (SMCCF). The key to these programs is that they allow the Fed to directly purchase individual investment grade corporate bonds, as well as investment grade and high yield ETFs (in the SMCCF). Chairman Powell stated that the programs are intended to ensure functioning secondary markets and allow companies continued access to the capital markets. While the actual market value of Fed purchases to date are small (approximately $8.7 billion), the notion of a Fed balance sheet backstop helped both investment grade and high yield spreads collapse dramatically. While we are no longer at recessionary spread levels, we are still wide of long-term averages. With this spread compression, total returns for the quarter displayed a dramatic turnaround. The U.S. Corporate High Yield Index returned 10.2% during the past three months while the U.S. Corporate Investment Grade Index returned 8.9%. Many corporations have issued debt to manage liquidity through this phase of the COVID-19 crisis, increasing leverage at the same time. That being the case, we are on track for a record year of downgrades. The BBB category for investment grade (IG) continues to grow and represents the largest percentage of the IG corporate bond benchmark. By some estimates, fallen angel issuers (those that were recently downgraded from investment grade) may top $200 billion for the year.



Source: ICE/Merrill Lynch.

In the securitized sectors, the reincarnation of the TALF program helped bring ABS spreads tighter. In fact, the improvement of that sector (nearly 150 basis points of tightening) rendered investment benefits of the Fed supported TALF program to be an economic breakeven. The Fed has continued to support the residential mortgage market with daily purchases of agency collateral. For perspective, at the end of March, the Fed was buying $41 billion of MBS per day. During the month of June, total purchases were down closer to $6 billion per day, a further sign that market liquidity is being restored.

Finally, the Fed continues to support the Treasury market by expanding their balance sheet with shorter maturity purchases. Chairman Powell's statement about "not even thinking about thinking about raising rates" sends the strongest forward guidance to date. On the supply side, the Treasury announced the addition of a 20-year maturity bond to their regular auction cycle. With this addition, in conjunction with an anticipated increase in the auction size of 30-year paper, the Treasury curve steepened during the quarter.

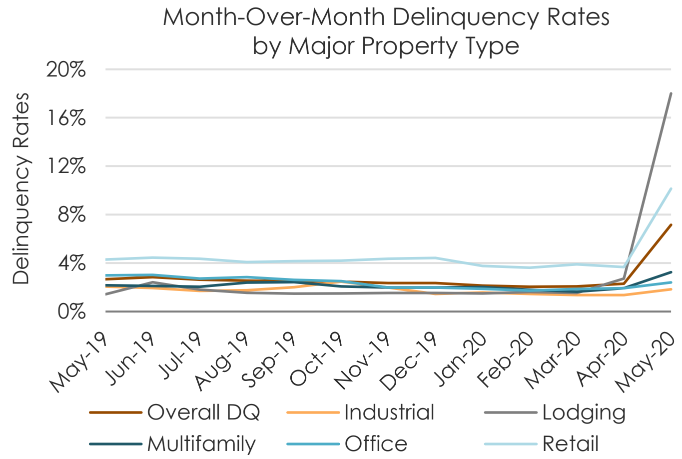
Our portfolio positioning continues to reflect an overweight to corporate credit and a slightly long duration position, which is consistent with how we began 2020. We were very active in the new issue corporate bond market in late March through April, which allowed us to take advantage of the significant widening of credit spreads that occurred at the onset of the virus outbreak. While credit spreads have recouped a large portion of the spread widening, we believe the Fed support in this sector coupled with the attractiveness of yields in the U.S. relative to other developed markets will support valuations in the short-run. Given the uncertain economic backdrop, we are emphasizing security selection and avoiding some sectors we believe will be laggards in the recovery.

Real Estate

The coronavirus pandemic has impacted most parts of the economy in one way or another and the commercial real estate sector is one of the most impacted. However, thanks to government stimulus, banks with strong balance sheets, and a fairly rapid snapback as the economy has re-opened, the commercial real estate market has held up better than was initially feared. Still, the sector has been very much a case of haves and have-nots, with office, industrial and multi-family properties faring reasonably well and hotel and retail owners (malls in particular) being decimated.

The sector that has fared the best and has the most optimistic outlook has been industrial real estate. The growth in online commerce and expected future onshoring of supply chains is expected to be a boon to industrial. This sector has actually seen its loan delinquencies decrease during the pandemic and rent collections have hovered in the high 90s as a percentage of expected rent, which is in-line with normal collections. Office real estate also has faired well thus far, as office users have been less impacted by the pandemic than other areas and rent collections have been in the mid-90 percent range. However, the outlook for office real estate is murky, with issues regarding teleworking, dense downtown locations, public transportation, and elevators in high-rise buildings all swirling around the sector as long as the pandemic continues. It remains to be seen if these issues will lead to increased teleworking, a move to suburban offices, or will simply lead to more distancing within offices, which could increase demand for leased space. Multi-family rent collections have surpassed expectations and occupancies have remained high, but there is concern that as government stimulus checks and increased unemployment insurance payments disappear in July, there will be an increase in defaults and vacancies.

The situation in the hotel and retail sectors is significantly worse. More than 20 percent of all hotel CMBS loans are delinquent as occupancy levels dropped during the second quarter to all-time lows. Downtown locations dependent on business travelers and conference business have been particularly impacted and are not expected to recover for some time. Vacation destinations have fared somewhat better yet are still operating far below normal occupancies and rates, and we expect to see many distressed opportunities in the hotel sector. Many hotels will close and may never reopen. In the retail sector, the pandemic has accelerated bankruptcies for tenants who were already facing dire financial straits. For malls, department stores may be a thing of the past as closures and bankruptcies mount, which can trigger co-tenancy clauses with in-line retailers and create a cascading effect of declining rents and occupancies. While the short-term outlook for hotels is very poor, there is a light at the end of the tunnel. The same cannot be said for the retail space, which may be facing an existential crisis as shopping has accelerated its move online.



Source: Trepp.

We believe Boyd Watterson's two primary government real estate strategies have weathered the crisis extremely well. Rent collections have exceeded 99% on average in Q2 and there is little expectation of that declining. Rather than seeing declining valuations as is expected in most asset classes, Boyd is actually expecting to see valuations increase at the end of Q2.

Equities

The equity markets staged a significant come-back in the second quarter after experiencing a dismal first quarter. The S&P 500 was down nearly 20% in the first quarter and down 34% from its peak in February of this year due to the emergence of COVID-19. The equity markets declined in anticipation of the U.S. economy heading into a quick and deep recession. However, the decline was short-lived as stocks rebounded nearly as fast and severe as the downdraft. The quick rebound was mainly prompted due to the Fed's decisive action to quickly cut interest rates and announce several programs that were designed to support the credit markets and improve liquidity in all domestic markets. Equities enjoyed a substantial comeback despite very little visibility into forward looking revenue and profit estimates. The expectation was that the Fed would be successful in stabilizing the fixed income markets and the impact from COVID-19 would be temporary. As a result, the S&P 500 ended the second quarter up 20.5% and only down a modest 3.1% year to date.

Going forward, we believe the equity markets will need to see continued progress in the reopening of the economy and will look for companies to return to profitability in order to take valuations higher. Potential headwinds to the market are plentiful as the elections in November, trade tensions with China and Europe, civil unrest domestically and globally, and a second wave of virus infections in the fall and winter all will weigh on the market. With that said, low interest rates, high dividend yields, an improving economy, a high level of cash on the sidelines, and a lack of other attractive investment options should keep investors interested in equities.