LPL RESEARCH
GLOBAL PORTFOLIO STRATEGY

April 2020

A BRIDGE TO THE OTHER SIDE

LPL Research's monthly global review and look forward

Investment Takeaways

We continue to follow our *Road to Recovery Playbook* to determine where we are in the stock market's bottoming process. We believe the proces is well underway, and we anticipate having visibility into a peak in COVID-19 cases soon—our key to stocks establishing a durable bottom. Bold fiscal and monetary stimulus will help bridge the economy to the other side, though the recent bounce has left the near-term risk-reward less attractive.

- We believe **stocks** may be approaching a near-term low. Our bear case has the S&P 500 Index potentially hitting 2,200 before recovering in the second half of the year as the COVID-19 containment efforts bear fruit and economic activity can resume.* **Equities View: Overweight**
- Our year-end 2020 fair value target on the **S&P 500** of 3,150–3,200, based on a price-to-earnings (P/E) ratio of about 18 and the S&P 500 reaching normalized earnings potential in 2021 at around a $175 per share run rate, depends on the pandemic peaking in the United States in April and economic activity beginning a gradual recovery to something close to pre-crisis trends by year-end.*
- We favor **large cap stocks** for their greater potential resilience during the recession and recommend balanced exposure between the growth and value styles in equity allocations where suitable.
- China has led the way out of the global crisis and supported **emerging market** equities, which remain attractively valued relative to **developed markets** and should return to pre-crisis economic growth rates before Europe, Japan, or possibly the United States.
- The Federal Reserve's (Fed) comprehensive response to the crisis, including a near zero policy rate and open-ended bond purchases, may limit any upward movement in **yields**.
Fixed Income View: Underweight
- We favor a blend of **high-quality intermediate bonds** with a modest underweight to **US Treasuries** and an emphasis on short-to-intermediate maturities.
- While valuations from riskier bond sectors have become very attractive, we think there may be more opportunities in equities. We have downgraded our view of high-yield bonds to negative, but we believe they may still have value for more income-oriented investors who can tolerate the added risk.

Key changes from March's report: Downgraded high-yield bonds from neutral to negative; upgraded communications services to positive; downgraded consumer discretionary and real estate to negative.

Our Asset Class & Sector Choices

Equity Asset Classes	Equity Sectors	Fixed Income	Alternative Asset Classes
Emerging Markets Equities Large Cap Equities	Communication Services Financials Healthcare Industrials Technology	Mortgage-Backed Securities	Event Driven

Data as of April 7, 2020

*As noted in our *Weekly Market Commentary* dated 03/17/2020, our year-end fair value target for the S&P 500 of 3,150–3,200 is based on a trailing price-to-earnings ratio (P/E) of about 18 and S&P 500 earnings per share forecast for 2021 of $175.

2020 Market Forecasts

Covid-19 Creates Significant Earnings and Interest Rate Uncertainty

	Previous Forecast	Base Case	Bear Case
10-Year Treasury Yield	2-2–25%	1.25–1.75%	0–0.5%
S&P 500 Earnings per Share	$175	$158–162	$138–142
S&P 500 Fair Value	3,200–3,300	3,150–3,200	2,200 or lower

Source: LPL Research, Bloomberg 03/31/2020

All indexes are unmanaged and cannot be invested into directly.

Past performance is no guarantee of future results.

2020 Economic Forecasts

Covid-19 Creates May Have Sparked a Global Recession

	Previous Forecast	Base Case	Bear Case
U.S.	2.0%	1.25–1.75%	0–0.5%
Developed ex-U.S.	1.3%	0.75–1%	-0.25–0.25%
Emerging Markets	4.3%	3.75–4%	2.75–3.25%
Global	3.5%	2.5–2.75%	1.5-2%

Source: LPL Research, Bloomberg 03/31/2020

The economic forecasts may not develop as predicted.

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Equities Asset Classes: Favor US Large Caps and Emerging Markets

As the US economy enters recession and the war against COVID-19 continues, we favor large cap stocks with better balance sheets and greater earnings stability, though small caps may outperform in a market recovery once the bear market ends. In the near term, growth stocks appear better positioned than value, but value may get support in an economic rebound this summer, buoyed by attractive valuations. We believe the United States remains well positioned for economic recovery, but China is leading the way out of the global economic crisis, which we expect to support emerging market equities.

	Asset Class	Neg	Neutral	Pos	Rationale
Market Cap	Large Caps			●	We favor US **large caps** over their small cap counterparts as the US economy enters recession and financial conditions may tighten further. In comparison, large companies offer better balance sheets and greater earnings stability, in our view, though small cap stocks historically have led performance coming out of a recession, which may warrant a more positive short-term view once stocks bottom.
	Small Caps	●			
Style	Growth		●		We maintain a balanced view of growth and value, though with a slight preference for growth in the very short term as the bottoming process continues. Relative valuations may help support **value** stocks as economic growth potentially begins to ramp up this summer. Currently, with the US economy in recession, the ability to grow earnings without much help from the economy and relatively stronger balance sheets favor **growth**. Growth companies may be in a better position to get through to the other side of this crisis stronger and take advantage of market opportunities.
	Value		●		
Region	United States		●		Among developed markets, we remain US focused. We believe the US economy, bolstered by massive fiscal and monetary stimulus, is better positioned to recover from the COVID-19 pandemic in the second half of the year than Europe or Japan. Earnings growth for the next couple of quarters will be significantly impaired by the lockdowns and social distancing. We would anticipate US earnings outpacing that of Europe and Japan in 2021 as the economic recovery potentially gains steam.
	Developed International	●			In **Europe** in an eventual post-crisis economic recovery, fiscal deficits and populism may continue to weigh on sentiment, spending, and investment. Evidence of stabilizing growth earlier this year now seems like a distant memory, though progress to contain the COVID-19 pandemic in the hardest-hit areas of Italy and Spain has been encouraging. In **Japan**, structural reforms have had limited success, and the consumer tax hike in October 2019 contributed to a sharp economic contraction in the fourth quarter. A return to growth may come later this year, but Japan's economy and "Japan, Inc." both came into the outbreak weaker than its global peers.
	Emerging Markets			●	**China** has led the way out of the global crisis and supported emerging market equities, which remain attractively valued relative to developed markets and should return to pre-crisis economic growth rates before Europe, Japan, or the United States.

Equities Sectors: Favor Cyclicals for the Rebound

We have made several changes to our sector views for April, although we maintain our preference for economically sensitive (cyclical) areas of the equity market. We believe communication services, healthcare, and technology are best positioned for the near term as the bottoming process continues, while we would expect financials and industrials to be among the leaders when the economy begins to restart after the virus is contained.

	Sector	Neg	Neutral	Pos	S&P 500 Weight(%)	Rationale
Cyclical	Materials		●		2.6	China is holding up relatively well amid the global pandemic, but pressure on commodity prices due to the global demand shock is significant.
Cyclical	Energy	●			2.9	Global price war and pandemic drove oil to 2002 levels. We urge caution as corporate defaults are likely to pick up despite expected supply cuts.
Cyclical	Industrials			●	8.1	Pickup in capital expenditures (capex) has been delayed. We see the sector as a strong second-half rebound candidate, supported by fiscal stimulus and potential infrastructure spending.
Cyclical	Communication Services		▶	●	10.5	Several industries benefit from stay-at-home orders. Earnings outlook is relatively healthy and valuations are fair. Regulatory risk for internet companies remains.
Cyclical	Consumer Discretionary	●	◀		9.8	Excluding e-commerce, this is one of the most challenged sectors in the services-led recession. Fiscal stimulus and lower energy and interest costs provide a partial offset.
Cyclical	Technology			●	25.0	Among best earnings outlooks of all equity sectors, it's supported by productivity enhancements via mobile, cloud, automation, and artificial intelligence (AI). Strong relative performer in 2020.
Cyclical	Financials			●	11.4	Difficult environment with near-record-low Treasury yields, the fed funds rate at zero, and the US economy in recession. But valuations are attractive. Strong bounce-back candidate.
Defensive	Utilities	●			3.6	Possible short-term outperformer until a durable bear market low is established, but valuations are high, and we expect interest rates to rise in an economic rebound.
Defensive	Healthcare			●	15.2	The pandemic strengthens an already bullish case, based on a strong healthcare spending outlook, favorable demographics, and steady earnings growth with high visibility.
Defensive	Consumer Staples	●			7.7	Valuations are high, but staples are among the best positioned sectors to ride out a recession with attractive yields and resilient revenue streams.
Defensive	Real Estate	●	◀		3.2	Fundamentals have deteriorated, particularly for the retail groups, and for office as well. There are pockets of strength in the healthcare, technology, and industrial segments.

Investing in real estate/REITs involves special risks such as potential illiquidity and may not be suitable for all investors. There is no assurance that the investment objectives of this program will be attained.

Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

Fixed Income and Alternative Investments: Limit Rate Sensitivity

We suggest a blend of high-quality intermediate bonds in tactical portfolios. We expect modestly higher long-term rates in 2020 as economic activity is restarted in the second half of the year. Compensation for longer-maturity bonds remains unattractive, in our view. We still see incremental value in corporate bonds and mortgage-backed securities (MBS) over Treasuries, but risks specific to each individual bond sector temper our views. We favor municipals bonds as a high-quality option for taxable accounts. Supply dynamics still look attractive, and valuations relative to Treasuries are historically attractive. Economic risks are elevated, and we are biased toward higher quality issuers. We maintain a constructive view of the event-driven space going forward.

		Low Medium High	Rationale
Fixed Income Positioning	Credit Quality		Valuations are attractive, but uncertainty merits some caution.
		Short Intermediate Long	
	Duration		We prefer below-benchmark interest-rate sensitivity due to historically low longer-maturity Treasury yields and prospects of a second-half economic rebound.
		Neg. Neutral Pos	
Sectors	U.S. Treasuries		Yield spreads to international sovereigns remain elevated but have narrowed. Valuations have become very expensive on COVID-19-related demand.
	MBS		Diversifying source of yield among high-quality options. Fed bond buying provides some added supports. Refinancing activity due to lower mortgage rates may weigh on returns.
	Investment-Grade Corporates		Risks are elevated due to economic uncertainty, but valuations have become very attractive. Some support from the Fed.
	Preferred Stocks		Higher credit quality among the riskier fixed income options. Bank fundamentals firm prior to pandemic, but distributions optional and at increased risk.
	High-Yield Corporates		Valuations are very attractive, but we believe equities have more upside, and high-quality options may be better diversifiers. More attractive for income-oriented investors.
	Bank Loans		Weaker investor protections and the end of rate hikes have reduced attractiveness, especially during a period of economic stress.
	Foreign Bonds		Rich valuations, interest-rate risk, and potential currency volatility are among negatives.
	Emerging Markets Debt		Dovish central banks improve the valuation picture but may be vulnerable to COVID-19-related risk. Positive bias for second half of 2020.

Yield spread is the difference between yields on differing debt instruments, calculated by deducting the yield of one instrument from another. The higher the yield spread, the greater the difference between the yields offered by each instrument. The spread can be measured between debt instruments of differing maturities, credit ratings, and risk. **Bank loans** are loans issued by below investment-grade companies for short-term funding purposes with higher yield than short-term debt and involve risk. For the purposes of this publication, **intermediate-term bonds** have maturities between 3 and 10 years, and short-term bonds are those with maturities of less than 3 years.

All bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. **Corporate bonds** are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate, and credit risk, as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features. Investing in **foreign and emerging market debt (EMD)** securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards. **High-yield/junk bonds** are not investment-grade securities, involve substantial risks, and generally should be part of the diversified portfolio of sophisticated investors. **Municipal bonds** are subject to availability, price, and market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Interest income may be subject to the alternative minimum tax. Federally tax-free but other state and local taxes may apply. **Mortgage-backed securities (MBS)** are subject to credit, default, prepayment risk that acts much like call risk when you get your principal back sooner than the stated maturity, extension risk, the opposite of prepayment risk, market and interest rate risk.

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Commodities and Currencies

We continue to favor **precious metals**, which are benefiting from safe-haven buying, lower interest rates, and massive stimulus from the Fed. Potential further weakness in the **US dollar** is another possible positive catalyst for precious metals, particularly the gold commodity. Our neutral **industrial metals** view reflects near-term global recession risk; however, China appears to be leading the global economy out of this crisis and may help provide near-term support for the industrial metal complex. Our **crude oil** outlook remains negative on substantial excess supply as the Saudi-led global price war continues, and the pandemic remains a significant drag on global demand.

Alternative Investments

While the **event-driven** industry experienced a significant widening of deal spreads during the month, we maintain a constructive view of the space going forward. Mid-month, during the worst of the sell-off, the median deal spread widened to over 12% from 4%, as indiscriminate selling of announced deal targets led to losses. Fortunately, we have yet to see any type of meaningful increase in deal breaks, which has led to an attractive opportunity set at current spread levels. While significant risks remain, strong managers have looked to mitigate broader economic uncertainty by shortening the average time deals are closing within their portfolios and by focusing on fundamentally sound transactions.

A Look Back at the Prior Month

Economy: March Data Mainly Reflects Pre-Outbreak Climate

Most economic data released in March was stale and reflected the generally healthy US economy in February. However, the timelier data released late in the month, particularly jobs data, began to reflect the significant hit to economic activity as much of the country was effectively put on lockdown.

- **Conference Board's Leading Economic Index (LEI)** rose 0.7% year over year in February, but only 0.1% month over month. Though the index signaled economic growth in February, the impact of the lockdowns and social-distancing efforts will not be evident until the March report.
- **Payrolls and Labor.** Nonfarm payrolls fell 701,000 in March, breaking the record 113-month streak of monthly gains. That data was collected mid-month and didn't reflect the surge in the timelier weekly jobless claims data, which surged an unprecedented 9.9 million over the two-week period ending March 28 and likely pushed the unemployment rate above 10%.

- **Inflation.** The sharp slowdown in global economic growth and related depressed commodities prices put more downward pressure on inflation in March, although it is not reflected in the latest inflation data, which was for February. The core Consumer Price Index (CPI), which excludes food and energy prices, increased 2.4% year over year, up slightly from the prior month's 2.3% reading. On the wholesale side, the core Producer Price Index (PPI), excluding food and energy, increased 1.4% year over year in February, down from 1.7% in January. Prices for core personal consumption expenditures (PCE), the Fed's preferred inflation gauge, edged higher to 1.7% year over year in February.
- **US Manufacturing**. The domestic manufacturing sector slowed less than expected in March, as the Institute for Supply Management's (ISM) Purchasing Managers' Index (PMI) dipped one point to 49.1. Supplier delivery times lengthened due to supply chain pressures, while the new orders and employment components of the report fell to recessionary levels on intensifying COVID-19 impact.
- **US Consumer.** The Conference Board's Consumer Confidence Index dropped sharply in March to mid-2017 levels, but it exceeded expectations for a steeper decline. The most recent retail sales data reflected a 0.5% monthly drop in February, which reflected minimal store closures and social-distancing restrictions. The measure of retail sales' contribution that is more closely mapped to gross domestic product (GDP) was unchanged in both January and February, but it is expected to fall sharply in March, when more stay-at-home orders took effect.
- **US Business.** Data on capital investment in February has become largely irrelevant given the sharp reduction in economic activity in March. That said, bookings for all durable goods rose 1.2% in February, core capital goods orders excluding aircraft and military hardware fell 0.8%, and orders excluding all transportation fell 0.6%. The pandemic will undoubtedly drive durable goods orders sharply lower in March (report due April 24).
- **Federal Reserve.** The Fed announced several unprecedented actions in March to support the economy and markets through the ongoing crisis. The central bank cut rates to zero; announced it will do as much quantitative easing, i.e., bond purchases, as is needed; and provided significant emergency funding across a number of segments of the credit markets. It even expanded its potential securities purchases to include individual corporate bonds and exchange-traded funds (ETF).
- **Fiscal Policy.** The policy response from the US government has also been significant and unprecedented. A roughly $2 trillion fiscal plan stimulus package was passed by Congress. Plan highlights include direct payments to individuals and expanded unemployment benefits to help those impacted by the layoffs, loans to distressed companies in some of the hardest-hit industries, small business loans, a three-month delay in the April 15 tax deadline, aid to the stressed healthcare system, and help to plug budget gaps for state and local governments.

Equities: Virus Drove Stocks Sharply Lower

The **S&P 500 Index** entered a bear market in March as the COVID-19 outbreak spread rapidly around the globe and containment efforts brought significant economic activity to a halt. From its February 19 record high, the index fell 34% through the March 23 low, before ending the month with a strong rally. The move from an all-time high to a 20% or greater decline—the standard definition of a bear market—was the fastest in history. In the last full week of the month, the Dow Industrials staged a 21% three-day rally and the S&P 500 registered its best weekly gain in more than 90 years.

Style/Capitalization

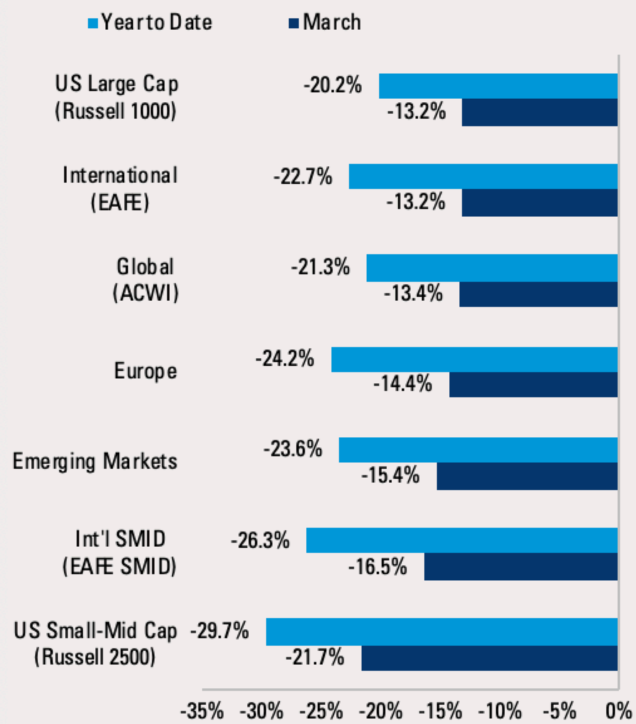
Large cap stocks held up much better than their small cap counterparts in March as investors and traders favored the stronger relative financial positions generally enjoyed by larger companies. Small cap stocks also have tended to be more economically sensitive and typically lag large caps during economic contractions. Growth stocks held up better than their value counterparts in March, with growth supported by healthcare's leadership and value dragged down by outsized declines in energy and financials.

Global Equities

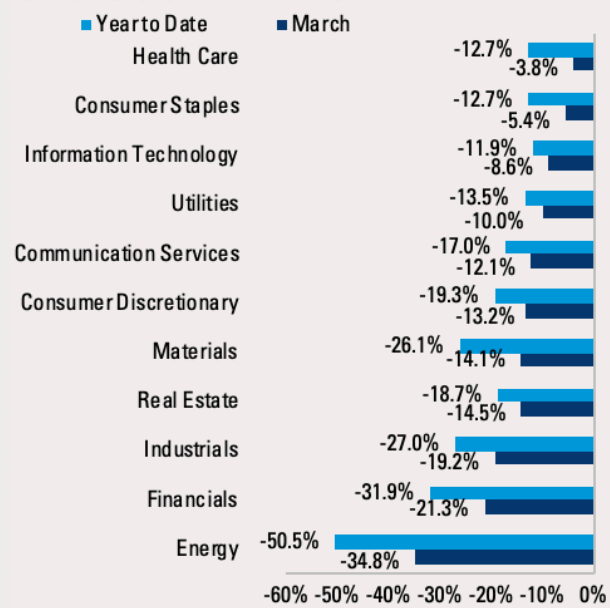
Globally, equities suffered slightly larger declines as global pandemic spread rapidly throughout much of the developed and emerging world. Emerging markets lagged despite China's resilience, while among developed markets, Japan held up relatively well. A strong US dollar weighed on dollar-based international returns.

International developed equities slid 13.3% for the month**,** based on the MSCI EAFE Index. Based on the MSCI EAFE country

GLOBAL INDEX PERFORMANCE



S&P 500 SECTOR PERFORMANCE



Source: FactSet 03/31/20

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Stock investing involves risk, including loss of principal. Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

indexes, **Australia**, **France**, and the **United Kingdom (UK)** underperformed, while stocks in **Japan** and **Switzerland** suffered limited losses. **Emerging markets** equities slid 15.4%, based on the MSCI Emerging Markets Index, led by China as its economy has restarted. Brazil and India lagged.

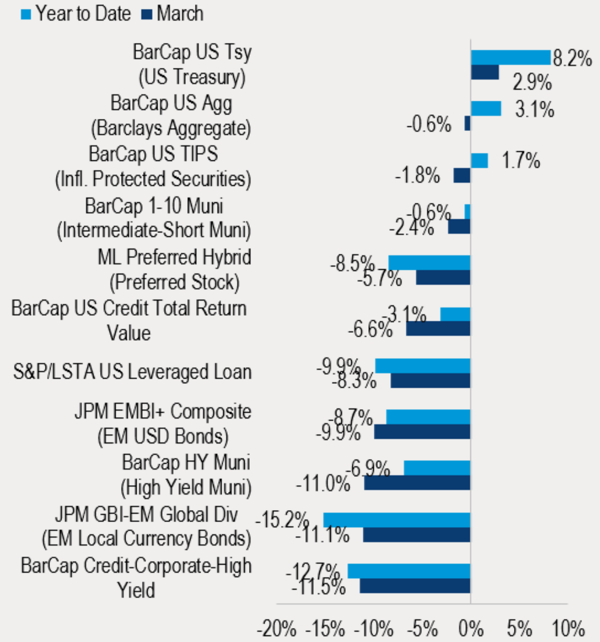
Fixed Income, Currencies, and Commodities

US Treasury **yields** fell sharply in March as the US economy entered recession and the Fed enacted massive stimulus. The 10-year Treasury yield slid 43 basis points (0.43%) to end March near a record low of 0.70%.

A safe-haven rally in fixed income bolstered **Treasuries**, as shown in the Fixed Income Performance Table. The **Bloomberg Barclays US Aggregate Bond Index** (Agg) lost 0.59% on corporate bond weakness. Lower-quality bond sectors struggled, particularly high yield, emerging markets debt, and bank loans. **MBS** produced a positive return for the month.

Commodities broadly suffered similar declines as stocks in March, but the gap between winners and losers was sizable. **Gold** rose about 2% on safe-haven demand and Fed stimulus (source: Bloomberg Gold Commodity Index), while **oil** prices were cut more than half due to the Saudi-Russia price war and the global demand shock from COVID-19.

FIXED INCOME PERFORMANCE



US Treasury Yields

Security	2/29/2020	3/31/2020	Change in Yield
3 Month	1.27	0.11	-1.16
2 Year	0.86	0.23	-0.63
5 Year	0.89	0.37	-0.52
10 Year	1.13	0.70	-0.43
30 Year	1.65	1.35	-0.30

AAA Municipal Yields

Security	2/29/2020	3/31/2020	Change in Yield
2 Year	0.76	1.27	0.51
5 Year	0.80	1.31	0.51
10 Year	1.09	1.62	0.53
20 Year	1.52	2.08	0.56
30 Year	1.65	2.21	0.56

Source: FactSet 03/31/20
Indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results.
Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise, and bonds are subjec t to availability and change in price.

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Stock investing involves risk including loss of principal. Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies. Value investments can perform differently from the market as a whole and can remain undervalued by the market for long periods of time. The prices of small and mid-cap stocks are generally more volatile than large cap stocks. Bonds are subject to market and interest rate risk if sold prior to maturity.

Bond values will decline as interest rates rise and bonds are subject to availability and change in price. Corporate bonds are considered higher risk than government bonds. Municipal bonds are subject to availability and change in price. Interest income may be subject to the alternative minimum tax. Municipal bonds are federally tax-free but other state and local taxes may apply. If sold prior to maturity, capital gains tax could apply. U.S. Treasuries may be considered “safe haven” investments but do carry some degree of risk including interest rate, credit, and market risk. Bond yields are subject to change. Certain call or special redemption features may exist which could impact yield.

Mortgage backed securities are subject to credit, default, prepayment, extension, market and interest rate risk.

Credit Quality is one of the principal criteria for judging the investment quality of a bond or bond mutual fund. Credit ratings are published rankings based on detailed financial analyses by a credit bureau specifically as it relates the bond issue’s ability to meet debt obligations. The highest rating is AAA, and the lowest is D. Securities with credit ratings of BBB and above are considered investment grade. Duration is a measure of the sensitivity of the price (the value of principal) of a fixed-income investment to a change in interest rates. It is expressed as a number of years.

Alternative investments may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor’s portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, geopolitical events, and regulatory developments. The fast price swings in commodities and currencies will result in significant volatility in an investor’s holdings.

Investing in foreign and emerging markets securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks. All information is believed to be from reliable sources; however, LPL Financial makes no representation as to its completeness or accuracy.

US Treasuries may be considered “safe haven” investments but do carry some degree of risk including interest rate, credit, and market risk. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

For a list of descriptions of the indexes referenced in this publication, please visit our website at [lplresearch.com/definitions.](lplresearch.com/definitions)

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