April 2020 Outlook

WEALTH MANAGEMENT

FNBC BANK&TRUST
WEALTH MANAGEMENT

April 2020 Outlook

Key Observations

- The COVID-19 crisis may change our lives, the economy and capital markets for years to come.
- We expect unbound economic and financial uncertainty to gradually wane later in the year, but it will not be a quick process.
- The economic pain will be felt swiftly and we think markets are likely to remain extremely volatile for the foreseeable future.

Capital Market Factors

- <u>Economic Growth:</u> For the first time in history, we are entering what will be a steep recession and we will know it with near certainty before it technically arrives. This pre-packaged recession is a different dynamic than we've ever had in our nation's history.
- <u>Monetary Policy:</u> Since the COVID-19 crisis emerged, the Federal Reserve has fired cannon after cannon and has truly become the mass buyer of last resort in an unprecedented manner. It is clear the Fed is prepared to take any and every action it can.
- <u>Fiscal:</u> Trillions of dollars of spending that were not anticipated a few weeks ago will now occur. Furthermore, trillions in tax receipts will be lost as revenues to the Treasury will shrink meaningfully. We believe we will have massive budget deficits not seen since perhaps World War II and this crisis will alter the path of debts and deficits for decades.
- <u>Inflation:</u> Near-term, demand destruction and massive unemployment increases will keep inflation modest. However, necessary fiscal and monetary policy enacted to combat COVID-19 is likely planting the seed for higher future inflation levels.
- <u>Currency:</u> Given the extreme uncertainty, it is likely the U.S. dollar will continue to serve as a global safe haven.

For additional information on forecast methodologies, please speak with your advisor. Please see slide 4 of this presentation for summary of indexes used to represent each asset class. Past performance does not indicate future performance.

APRIL 2020 – MARCH 2030 OUTLOOK

Scrap whatever assumptions you thought you had a few weeks ago.

The table below summarizes our 10-year outlook (from January to April) and you can see how our assumptions have changed in a very short period of time.

Asset Class	11/30/19 E(R)	4/1/20 E(R)	YTD Change
Cash*	1.58%	0.05%	-1.5%
TIPS	2.0%	0.9%	-1.0%
Muni Bond**	2.2%	2.7%	0.5%
Muni High Yield**	6.4%	8.3%	1.9%
US Bond	2.3%	1.6%	-0.7%
For. Dev. Bond	1.5%	0.4%	-1.2%
HY Bond	4.5%	5.2%	0.7%
EM Bond	2.9%	2.8%	-0.1%
Global Equity	7.2%	7.3%	0.1%
US Equity (AC)	5.7%	5.8%	0.1%
US Equity (LC)	5.6%	5.6%	0.1%
US Equity (MC)	5.8%	6.0%	0.2%
US Equity (SC)	5.8%	6.1%	0.3%
Int'l Dev. Equity	7.4%	7.7%	0.2%
EM Equity	9.7%	10.1%	0.4%
Real Estate	5.5%	5.1%	-0.4%
Midstream Energy	11.2%	13.5%	2.3%
Commod. Fut.	3.3%	3.3%	0.0%
HFoF Multi-Strat	6.3%	5.9%	-0.4%
Private Equity	8.7%	8.8%	0.1%

**3-month forecast*

***Tax equivalent yield based on highest marginal tax rate (37%)*

Summary of Changes to Process

- For all equity return forecasts (U.S., Intl Developed, and EM), we assume a 50 percent earnings reduction for the immediate year in CAPE and earning yields. Our historical analysis shows earnings declines of 20-40 percent during previous recessions.
- For REITs we assume a 25 percent dividend cut, which reduces the yield despite the recent sell off.
- Our CMA for Midstream Energy assumes a 1.1x distribution coverage (down from 1.4x) as midstream companies will spend some of their cash cushion. Alerian estimates a yield of 11.4 percent if there is a 50 percent distribution cut across the index.

Our Investment Themes for Remainder of 2020

1. We expect unbound economic and financial uncertainty to gradually wane.
2. The economic pain will be felt swiftly and markets are likely to remain extremely volatile for the foreseeable future.
3. Markets are moving at a torrid pace. Daily price swings have been moving at what used to be an annual pace. As a result, we anticipate revising our assumptions and Frontier Engineer™ modeling with greater frequency throughout the remainder of 2020.

For additional information on forecast methodologies, please speak with your advisor. Please see slide 4 of this presentation for summary of indexes used to represent each asset class. Past performance does not indicate future performance.

SUMMARY OF INDEXES & DEFINITIONS

INDEX DEFINITIONS

- **FTSE Treasury Bill 3 Month** measures return equivalents of yield averages and are not marked to market. It is an average of the last three three-month Treasury bill month-end rates.
- **Bloomberg Barclays Capital US Treasury Inflation Protected Securities Index** consists of Inflation-Protection securities issued by the U.S. Treasury.
- **Bloomberg Barclays Muni 5 Year Index** is the 5 year (4-6) component of the Municipal Bond index.
- **Bloomberg Barclays High Yield Municipal Bond Index** covers the universe of fixed rate, non-investment grade debt.
- **Bloomberg Barclays U.S. Aggregate Index** covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.
- **FTSE World Government Bond Index (WGBI) (Unhedged)** provides a broad benchmark for the global sovereign fixed income market by measuring the performance of fixed-rate, local currency, investment-grade sovereign debt from over 20 countries,
- **FTSE World Government Bond Index (WGBI) (Hedged)** is designed to represent the FTSE WGBI without the impact of local currency exchange rate fluctuations.
- **Bloomberg Barclays US Corporate High Yield TR USD** covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets (sovereign rating of Baa1/BBB+/BBB+ and below using the middle of Moody's, S&P, and Fitch) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included.
- **JP Morgan Government Bond Index-Emerging Market Index (GBI-EMI)** is a comprehensive, global local emerging markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure.
- **JPMorgan EMBI Global Diversified** is an unmanaged, market-capitalization weighted, total-return index tracking the traded market for U.S.-dollar-denominated Brady bonds, Eurobonds, traded loans, and local market debt instruments issued by sovereign and quasi-sovereign entities.
- **MSCI ACWI** is designed to represent performance of the full opportunity set of large- and mid-cap stocks across multiple developed and emerging markets, including cross-market tax incentives.
- **The S&P 500** is a capitalization-weighted index designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.
- **Russell 3000** is a market-cap-weighted index which consists of roughly 3,000 of the largest companies in the U.S. as determined by market capitalization. It represents nearly 98% of the investable U.S. equity market.
- **Russell Mid Cap** measures the performance of the 800 smallest companies in the Russell 1000 Index.
- **Russell 2000** consists of the 2,000 smallest U.S. companies in the Russell 3000 index.
- **MSCI EAFE** is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the US and Canada. The index covers approximately 85% of the free float-adjusted market capitalization in each country.
- **MSCI Emerging Markets** captures large and mid-cap representation across Emerging Markets countries. The index covers approximately 85% of the free-float adjusted market capitalization in each country
- **The Wilshire US Real Estate Securities Index (Wilshire US RESI)** is comprised of publicly-traded real estate equity securities and designed to offer a market-based index that is more reflective of real estate held by pension funds.
- **Alerian MLP Index** is a float adjusted, capitalization-weighted index, whose constituents represent approximately 85% of total float-adjusted market capitalization, is disseminated real-time on a price-return basis (AMZ) and on a total-return basis.
- **Bloomberg Commodity Index (BCI)** is calculated on an excess return basis and reflects commodity futures price movements. The index rebalances annually weighted 2/3 by trading volume and 1/3 by world production and weight-caps are applied at the commodity, sector and group level for diversification.
- **Treasury Inflation-Protected Securities (TIPS)** are Treasury bonds that are indexed to inflation to protect investors from the negative effects of rising prices. The principal value of TIPS rises as inflation rises.
- **HFRI Fund of Funds Composite** is an equal-weighted index consisting of over 800 constituent hedge funds, including both domestic and offshore funds.
- **Cambridge Associates U.S. Private Equity Index (67% Buyout vs. 33% Venture)** is based on data compiled from more than 1,200 institutional-quality buyout, growth equity, private equity energy, and mezzanine funds formed between 1986 and 2015.
- **HFN Hedge Fund Aggregate Average** is an equal weighted average of all hedge funds and CTA/managed futures products reporting to the HFN Database. Constituents are aggregated from each of the HFN Strategy Specific Indices.
- **Goldman Sachs Commodity Index (GSCI)** is a broadly diversified, unleveraged, long-only composite index of commodities that measures the performance of the commodity market.

Disclosures

This report is intended for the exclusive use of clients or prospective clients of FNBC BANK AND TRUST. Content is privileged and confidential. Dissemination or distribution is strictly prohibited. Information has been obtained from a variety of sources which are believed though not guaranteed to be accurate. Past performance does not indicate future performance. This paper does not represent a specific investment recommendation. Please consult with your advisor, attorney and accountant, as appropriate, regarding specific advice.

Not FDIC Insured | May Go Down In Value | Not Guaranteed By Bank | Subject To Investment Risk