Steve Keck

From: Kelly Sullivan <Kelly.Sullivan@neamgroup.com>
Sent: Friday, March 20, 2020 3:48 PM
To: Alie Causey
Cc: Steve Keck; Alton Cogert
Subject: [EXTERNAL] Market Update

Hi Alie –

It has been an interesting week in the markets, so I wanted to send you a quick update with our thoughts on the economy and your portfolio below.

Please let me know if you have any questions or if you would like to get on a call and discuss.

Thanks and stay healthy.

Best,
Kelly

Economy & Capital Markets

- Market volatility has spiked to unprecedented levels over the last few weeks on an escalation of the COVID-19 pandemic and an oil price war between Saudi Arabia and Russia. After hitting all-time highs on February 19th, equities are down over 30% from those highs. Rates markets have also been volatile with the 10-year Treasury hitting an all-time low last Monday of 0.31% and with the entire curve trading below 1% at one point for the first time. More recently, the Treasury yield curve has steepened, and rates have backed up with the 10-year currently yielding 0.89%.

- The Fed has stepped in to quell markets and made a number of moves over the last two weeks to support the smooth functioning of markets and to provide liquidity, including:
  - -150 bps in emergency cuts to the Fed funds rate (-50bps on 3/3, -100bps on 3/15) bringing it to a range of 0-0.25%
  - $1.5T increase in repo liquidity
  - Launched QE4 with $700B of Treasury and Agency MBS purchases, $500B and $200B, respectively
  - Opened the discount window for banks to borrow for 90 days
  - Cut reserve requirements for banks
  - Launched crisis-era facilities – Commercial Paper Funding Facility (CPFF), Private Dealer Credit Facility (PDCF), Money Market Mutual Fund Liquidity Facility (MMLF) – to provide ample liquidity to ensure the smooth functioning of markets
- The Fed has done a lot, but monetary policy is not a vaccine; there is a limit to what it can do. So, there is a need now to see progress on the fiscal policy front. We are getting a glimpse at the potential fiscal stimulus package the White House is working on ($1T package providing assistance to small businesses and direct payments to individuals), but markets need to see more details before they price in the intended benefits of such stimulus measures.

- Spreads have moved materially wider across asset classes amid the volatility and liquidity is challenged at best with selling broad based across all markets.

Portfolio

- The portfolio, while not immune to weakness in the capital markets, is well positioned. Agency MBS (3.8% of the portfolio) could be used as sources of liquidity, if needed, but keep in mind that Agency MBS has been quite volatile over the last couple of weeks and, while they are generally liquid now, there could be days where liquidity in this sector dries up.
- In terms of the risks we currently see in the portfolio, we would highlight the exposure to energy. In total, LICOA has $2.4mm in energy names which makes up about 2.2% of the portfolio (Kinder Morgan and Noble Energy). Given the drop in oil prices, we are likely to see downgrades in this industry but we are comfortable continuing to hold these names.
- Other sectors that are likely to be most adversely impacted by the fallout from this virus are airlines, hotels, and retail/department stores. **You have no exposure to these industries in the portfolio**.

- YTD through 3/19/2020, the LICOA portfolio has returned -4.20% relative to the benchmark's return of -7.95%; so +3.75% of relative outperformance.

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