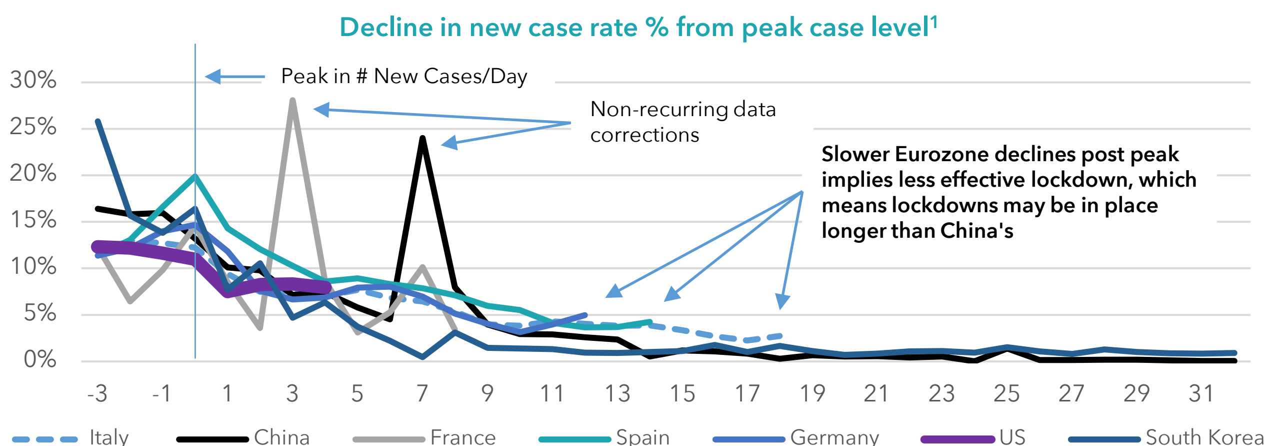
ROCKEFELLER
GLOBAL FAMILY OFFICE

Rockefeller Insights

In Focus: Seeking Certainty in an Uncertain World

Risk markets have rallied sharply over the last week as it is becoming more apparent that the social distancing efforts in place across much of the developed world have begun to slow the spread of COVID-19 and markets are looking ahead to a resumption of normal economic activity in the not too distant future. While we are encouraged by the global success in "flattening the curve", we think the market is likely to be choppy the next several weeks as investors more fully understand the path to recovery is not going to be a straight line. As we discussed in our last communication, "Darkest Before Dawn", we believe the market is looking for two things to set a bottom and determine the magnitude of the subsequent rebound: 1) signs the economy can return to growth at some level (i.e., the market needs confidence the lockdowns can be removed at some point); and 2) indications of what corporate profitability recovery will subsequently look like. While we thought the answer to the first question was clearly Q3, which is being reinforced by the recent data, the latter remains a much trickier question to answer. Looking at the graph below, the Eurozone has not had the same degree of success post lockdown in reducing transmission as China and South Korea had, due to more porous lockdowns. As a result, we expect the ability to fully restart the Eurozone economies (and the US economy by extension) will be more challenging than China's already uneven experience, which has seen multiple starts/stops at a local level as fears of renewed contagion periodically crop up.



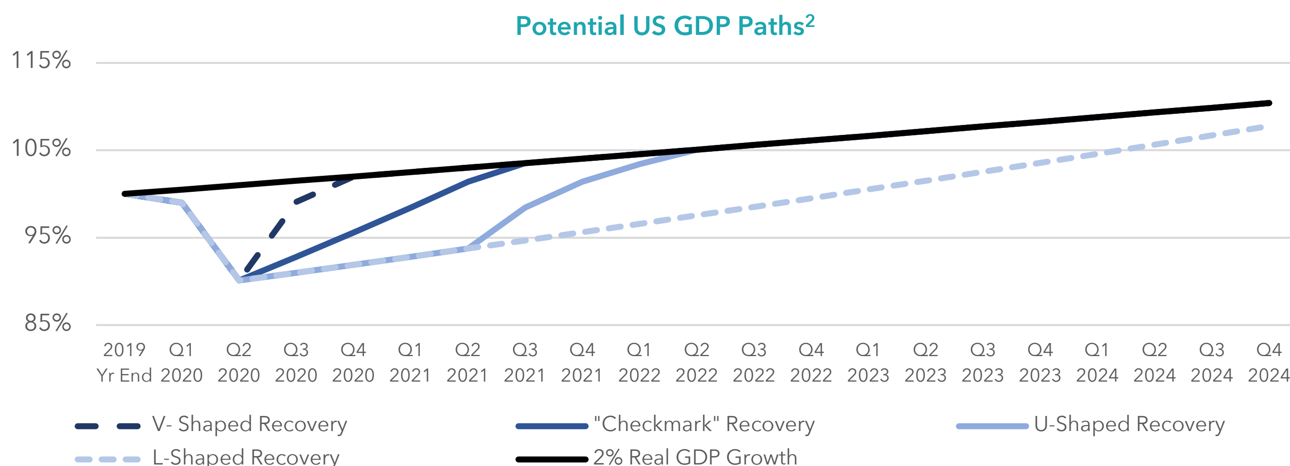
Also as seen in China's recovery, consumer confidence in going out and about will likely be pressured until vaccine or antibody tests are widespread. The longer the recovery, even with the fiscal stimulus currently in place, the more pressure corporate balance sheets will be under. We believe this will be especially true in small and medium sized businesses, which will impair those companies' ability to immediately rehire workers at a pre-COVID-19 rate. While the Federal Reserve's recent announcement to massively expand lending to small and medium sized businesses through their purchase of $600B in loans is a testament to their willingness to do whatever it takes to support the economy through this initial decline, it is unclear how many companies that were stretched from a solvency/cash flow perspective prior to COVID-19 will be able to fully resume operations post recovery. It is also unclear whether markets are fully factoring in just how bad near-term economic data will be, and likely record lows in business sentiment and activity indicators, like those we expect for the April ISM reports on business, may well give short-term pause to even the most bullish investor over the next several weeks.

[1] Source: https://www.worldometers.info/coronavirus

In Focus: Seeking Certainty in an Uncertain World

While it's difficult to pinpoint earnings levels and trajectories with any certainty at this point, taking a step back to gain a broader perspective can be helpful and reveal potential opportunities for investors willing to take a longer-term view. We believe the economic recovery can take four paths as shown below. The black line illustrates 2%/yr US GDP growth continuing indefinitely from 2019 levels (i.e., COVID-19 never happened), which is what was priced into the equity markets in early February. All recovery paths assume economic contraction of roughly 10% total GDP between Q1 and Q2 2020 versus Q4 2019 levels. Actual numbers may be higher or lower but for our purposes the shape of the recovery is more important than the precise levels.

Potential US GDP Paths[2]



The V-shaped recovery (dashed dark blue line) assumes the US (and implicitly global) economy returns to nearly full output in Q3, and completely closes the economic output gap created by the lockdowns by the end of Q4 2019. This would imply S&P 500 earnings are impaired in 2020, but enter 2021 at full run rate, so full year 2021 earnings are back in line with original pre-COVID-19 expectations by the beginning of 2021, which would imply the market would return to peak levels by then as well. ***We view this as a very unlikely scenario and estimate less than a 5% probability.***

The "Checkmark"-shaped recovery (solid dark blue line) assumes the US (and implicitly global) economy begins to rebound materially in Q3 from very depressed levels in Q2, however consumers are reluctant to fully return to former consumption levels immediately, but get progressively more confident prior to a vaccine being developed due to increased availability of COVID-19 and antibody testing. In this scenario, given the relatively quick recession and recovery, S&P 500 earnings would likely be able to return to pre-COVID trajectories in the next 18-24 months, although it is worth noting not all sectors would fully return to prior levels, e.g., there is a high likelihood of several years of earnings power impairment in the energy sector vs. pre-COVID expectations. More specifically, we would expect S&P earnings for 2020 to be impaired, 2021 earnings are also operating meaningfully below pre COVID-19 expectations due to the weaker economy in the 1H of 2021, but 2022 earnings would be on par with original projections implying US equity markets return to peak levels by the end of 2021 or shortly after. ***This is the most likely scenario in our view and we assign it a 70%-90% probability.***

[2] Source: Rockefeller Capital Management.

The U-shaped recovery (solid light blue line) assumes the initial US (and global) recovery starting in Q3 2020 is relatively slow (4% per year) due to lack of consumer confidence and reduced global trade absent a vaccine, but reaccelerates rapidly in Q3 2021 with the assumed introduction of a vaccine. Financial stresses from such a protracted slowdown would result in some loss of US economic capacity and as a result it would likely take an additional year to close the output gap. This would imply 2022 earnings are also impaired and the first full year of "normal" earnings are in 2023, with equity markets likely returning to peak levels sometime in 2023. ***This is the second most likely scenario in our view and we assign it a 5%-15% probability.***

The L-shaped recovery (dotted light blue line) assumes an anemic recovery beginning in Q3 2020, that no successful vaccine is found, that global trade is reduced for an extended period of time due to individual countries' concerns of importing the coronavirus from hotspots (likely emerging markets), and economic capacity is greatly reduced due to the financial hardships created by such a prolonged retrenchment in the economy. This is closest to the Great Depression scenario some investors are worried about and would imply earnings take a decade or more to return to prior peak levels. ***This is highly unlikely in our view (less than a 5% probability) as the reason the economic costs being incurred today to shutdown economies are being borne is that the benefit of slowing disease progression has a net positive social effect, even factoring in near-term economic pain.*** We believe the extension of lockdowns would create more economic hardships on an individual basis and societal basis than the risk of exposure to the disease, so even if lockdowns were extended indefinitely, individuals would be increasingly likely to break containment to improve their economic condition in a protracted shutdown. Breaking containment for that individual ultimately leads to immunity for that individual person (assuming they don't die), which becomes a positively reinforcing cycle as each individual decision to become exposed then increases the number of people that are immune (the immunity of the herd increases) which reduces the risk of exposure and makes the decision to break containment easier for the next individual. Since these would be individual decisions made over time, resource demands on health care would be mitigated but you would eventually see a return to a full work force.

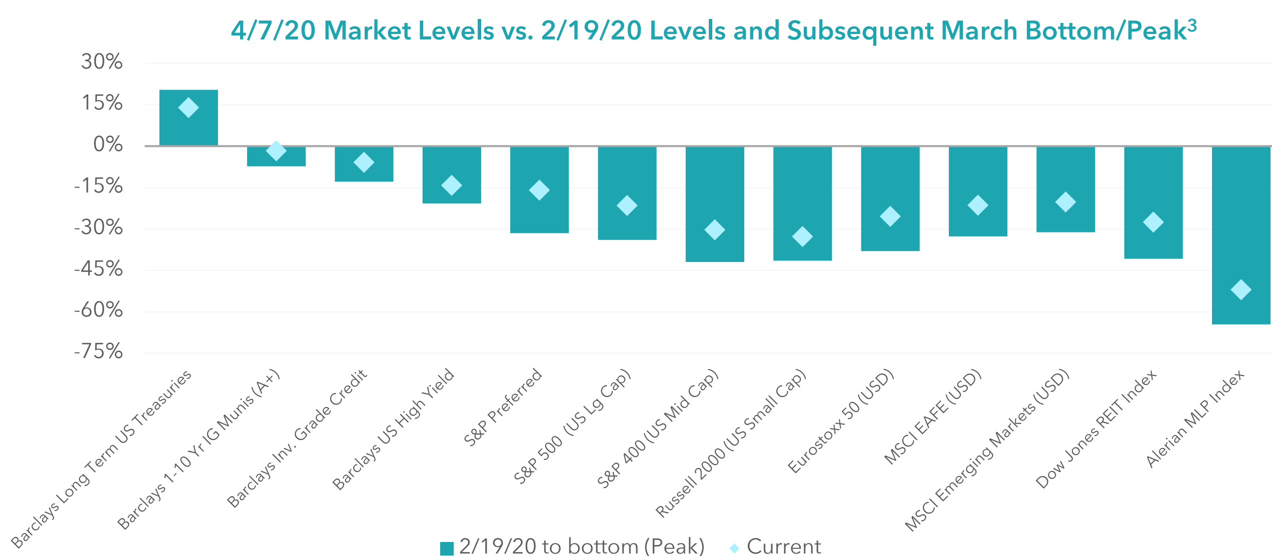
Having looked at potential economic outcomes, it becomes a little easier to rank the relative attractiveness of various assets classes based on today's levels. While the time it takes for equity earnings and GDP to recover is uncertain, some asset classes are likely to recover more quickly than others. Full recovery in the equity markets will depend on the economic paths outlined above, and some sectors or markets, e.g., Energy and MLPs, may have impaired assets that make it unlikely that stocks or bonds tied to those markets can return to prior peaks in the next several years. However, some assets with higher certainty of payments, e.g., par values and coupons, will likely recover as soon as the market becomes confident those values and payments are not impaired (e.g., investment grade fixed income and preferred stocks).

ROCKEFELLER
GLOBAL FAMILY OFFICE

Rockefeller Insights

In Focus: Seeking Certainty in an Uncertain World

Below is a chart that shows current market levels (diamond) as of 4/7/20 closing values vs. the maximum selloff for the major liquid risk asset classes compared to their 2/19/20 starting value. Many asset classes have begun to rebound, and while it is uncertain in the short term if we trade sideways or even lower as it becomes clear restarting the economy is not a trivial task, there are still attractive return opportunities left in most markets for clients willing to take a longer term time frame.



Looking at the appreciation required to return to peak index levels plus factoring in current dividend yields can give us an idea of what annualized returns for each of the markets might be depending on the ultimate path of the recovery. While this assumes current dividends remain intact (with the exception of MLPs as noted below), the bulk of the anticipated recovery is in the form of price appreciation so modest dividend reductions do not materially change the analysis. We have highlighted in blue the economic recovery path for the asset class we believe is most likely. The analysis on the next page assumes a simple return to 2/19/20 levels, but it is worth noting that current high volatility levels can create opportunities to accelerate the recovery potential for some asset classes. For example, in today's market, depending on the investor risk profile and fact pattern, investors can forgo dividends and take on some credit risk to purchase structured investments that can provide leveraged returns to the upside and similar downside exposure to investing directly in the equity market, allowing investors to potentially recoup lost price appreciation more quickly. It is also worth noting that emerging markets have sold off a little less than developed markets, however, we expect COVID-19 to have a longer impact on emerging markets economies in aggregate due to their generally less developed health care and testing capabilities, our expectations for reduced global demand for exports and the potential for developed economies to begin transitioning some critical manufacturing back onshore to improve supply chain security. As a result, we are more favorably disposed towards investments in developed economies at this point than emerging market economies.

[3] Source: Bloomberg. As of April 7, 2020.

April 2020

ROCKEFELLER
GLOBAL FAMILY OFFICE

Rockefeller Insights

In Focus: Seeking Certainty in an Uncertain World

	Barclays US HY	S&P Preferred	S&P 500 (US LC)	S&P 400 (US MC)	Russell 2000 (US SC)	Eurostoxx 50 (USD)	MSCI EAFE (USD)	MSCI Emerging Markets (USD)	Dow Jones REIT Index	Alerian MLP Index *
Appreciation to Return to peak	16.4%	18.8%	27.3%	43.3%	48.6%	34.0%	27.1%	25.3%	37.8%	56.1%
Current Yield	9.5%	6.3%	2.2%	2.3%	2.0%	4.3%	3.9%	3.2%	4.5%	10.1%
1 Yr. Ann. Return *V-Shaped*	25.9%	25.1%	29.5%	45.7%	50.6%	38.3%	31.1%	28.4%	42.3%	66.2%
2 Yr. Ann. Return *"Checkmark"*	17.4%	15.3%	15.0%	22.1%	23.9%	20.1%	16.7%	15.1%	21.9%	35.0%
3 Yr. Ann. Return *U-Shaped*	14.7%	12.2%	10.6%	15.1%	16.1%	14.6%	12.3%	10.9%	15.8%	26.1%

* Assumes MLP Index only able to recover to 75% of prior levels in stated timeframe due to asset/company impairment, current dividends assumed reduced by 50%
Source: Bloomberg. As of April 7, 2020.

From a planning perspective, the sell off in the equity markets also creates opportunities for effective wealth transfer using GRATs among other techniques. Clients that already own individual securities may want to consider creating sector dedicated GRATs to enhance the potential for successful wealth transfer. A similar exercise at the sector level for some of the more widely held sectors is outlined below.

	S&P Info. Tech.	S&P Health Care	S&P Energy **	S&P Cons. Disc.	S&P Financial	S&P Industrial
Appreciation to Return to peak	23.5%	14.7%	34.0%	27.6%	45.8%	39.4%
Current Yield	1.5%	1.8%	4.6%	1.5%	2.9%	2.6%
1 Yr. Ann. Return *V-Shaped*	25.0%	16.5%	38.6%	29.1%	48.6%	42.0%
2 Yr. Ann. Return *"Checkmark"*	12.6%	8.9%	20.3%	14.4%	23.6%	20.7%
3 Yr. Ann. Return *U-Shaped*	8.8%	6.5%	14.8%	9.9%	16.2%	14.3%

** Assumes S&P 500 Energy sector only able to recover to 80% prior levels in stated timeframe due to asset / company impairment, current dividends assumed reduced by 1/3
Source: Bloomberg. As of April 7, 2020.

From an investment perspective, portfolio construction decisions are inherently individual decisions due to differences in taxation, spending requirements, risk aversion and time horizon among other factors. Many portfolios that had large existing gains have seen those gains reduced, allowing many taxable investors the opportunity to revisit their portfolio construction with no or limited taxable consequences. While we think the market is likely choppy and potentially trades down the next several weeks, we believe any such weakness should be viewed as a buying opportunity for clients willing to take a longer-term view. Please contact your advisor to discuss your individual situation.

ROCKEFELLER
GLOBAL FAMILY OFFICE

Rockefeller Insights

In Focus: Seeking Certainty in an Uncertain World

This material was prepared by Rockefeller Capital Management solely for informational purposes only. The views expressed are those of Rockefeller Global Family Office's senior investment professionals as of a particular point in time and are subject to change without notice. Actual events or results may differ materially from those reflected or contemplated herein. The information and opinions herein should not be construed as a recommendation to buy or sell any securities, to adopt any particular investment strategy, or to constitute accounting, tax, or legal advice. The information provided herein may not be relied on for purposes of avoiding any federal tax penalties. All clients should be aware that tax treatment is subject to change by law, or retroactively, and clients should consult their tax advisors regarding any potential strategy, investment or transaction. Any planned financial transactions or arrangement that may have tax, accounting or legal implications with should be reviewed with your personal professional advisors. Forward-looking statements, including those presented herein, are inherently uncertain, as future events may differ materially from those projected, and past performance is not a guarantee of future performance. No investment strategy can guarantee a profit or avoidance of loss.

Investing involves risk, including risk of loss. Diversification and asset allocation do not ensure a profit or guarantee against loss. The asset classes discussed have varying degrees of risk. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. The indices selected by Rockefeller Capital Management to measure performance are representative of broad asset classes. Rockefeller Capital Management retains the right to change representative indices at any time. Indices are unmanaged and you cannot invest directly in an index. Indices are shown for illustrative purposes only and do not represent the performance of any specific investment.

The information and opinions presented herein have been obtained from, or are based on, sources believed by Rockefeller Capital Management to be reliable, but Rockefeller Capital Management makes no representation as to their accuracy or completeness. Although the information provided is carefully reviewed, Rockefeller Capital Management cannot be held responsible for any direct or incidental loss resulting from applying any of the information provided. This material may not be reproduced or distributed without Rockefeller Capital Management's prior written consent.

Rockefeller Capital Management is the marketing name for Rockefeller Capital Management L.P. and its affiliates. Investment advisory, asset management and fiduciary activities are performed by the following affiliates of Rockefeller Capital Management: Rockefeller & Co. LLC, Rockefeller Trust Company, N.A. and The Rockefeller Trust Company (Delaware), as the case may be.

Rockefeller Financial LLC is a broker-dealer and investment adviser dually registered with the U.S. Securities and Exchange Commission (SEC). Member Financial Industry Regulatory Authority (FINRA); Securities Investor Protection Corporation (SIPC). The registrations and memberships above in no way imply that the SEC has endorsed the entities, products or services discussed herein. Additional information is available upon request.

Products and services may be provided by various affiliates of Rockefeller Capital Management.

© 2020 Rockefeller Capital Management. All rights reserved. Does not apply to sourced material.