Opus CAPITAL MANAGEMENT

Coronavirus Correction

Quick Look

- Most recessions are caused by financial events, but COVID-19 has proven to be the rare occasion in which our economic and market declines were the result of a non-financial event.
- U.S. stocks fell 20% during the quarter. Its 34% drawdown from the February 19th peak made it one of the five largest drawdowns since World War II.
- Bonds gained 3.2%, despite a brief dislocation in prices and declines in credit.
- The variability of equity returns on one-year time periods is likely far wider than many investors realize. While the average annualized return is 10%, stocks have returned between 8% and 12% just three times over the last 50 calendar years.
- Upcoming economic data will be dreadful, but the market already knows this, and has priced in the expectation of recessionary level readings.
- Historically, markets find a bottom on average four months before a recession ends.
- One silver lining for investors is that drawdowns are typically accompanied by above-average forward investment returns.
- While we are all excited to resume normal activities, patience will likely be required before we climb back to previous market (and account) highs. The good news is that we do eventually get there.

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About Opus Capital Management

Opus Capital is an evidenced-based investment advisory firm driven by our overriding mission to help people. We believe the marriage of comprehensive financial planning + statistically proven investment principals creates the clearest roadmap to long-term success.

We are independent and transparent in all aspects of investment management decision making and financial planning. We selectively partner with like-minded individuals and families, endowments, foundations, and 401(k) plans in 28 states.

Quarterly Investment Letter, Q1 2020

We closed the quarter in the eye of the storm of COVID-19, which has morphed into the largest health crisis of most of our lifetimes. Most recessions are caused by financial events, but the coronavirus has proven to be the rare occasion in which economic and market declines were the result of a non-financial event. For purposes of this letter, we will focus on the financial aspects of the crisis and leave the health crisis to those more qualified.

Let's get the ugly statistics out of the way. U.S. stocks reached a 34% drawdown from their February 19th peak, already making this one of the five largest drawdowns since World War II. The coronavirus drawdown was the fastest 20% and 30% declines on record, reaching both within a 30-day time period. We saw two of the worst daily declines in post-War history for the S&P 500 Index, trailing only the Black Monday crash of 1987. The final tally for Q1 was a -20% decline in the S&P 500 Index, qualifying as one of the five worst quarters since 1940. Small caps crashed 31%, while international and emerging markets lost 23% on average.

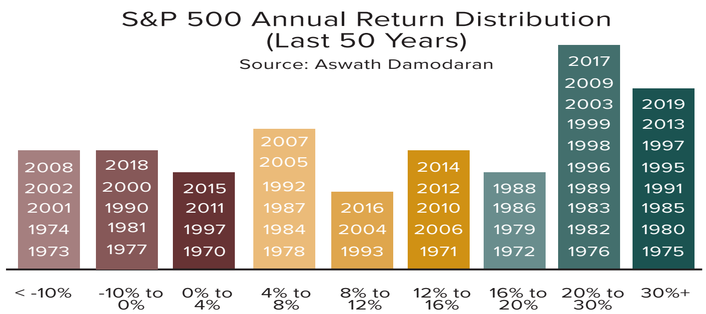
Bonds had their own wild ride. Treasurys reached all-time lows along every point on the Yield Curve, with the 10-year falling from 1.92% at quarter-start to 0.67% at quarter-end. In mid-March, a panic rush to cash caused a brief dislocation in prices for mortgage-back securities, corporates, municipals, and other spread assets until the Fed came in to backstop the high-quality bond market. In the end, bonds (as measured by the Bloomberg Barclays Index) gained 3.2%, but it wasn't without its hiccups.

Our guess is that all readers have had more than their fill of gloom over the past month, so our preference would be to turn the recap to more forward-thinking matters. Admittedly, we find little value in predicting when the market will bottom, or exactly how deep the recession will be. Both of these are unknown as we enter April, and while monetary and fiscal stimulus will help, we likely cannot begin to be answer these questions at least until we see new cases of the virus peak, both in the U.S. and globally.

Rather, as we enter the second quarter let us turn the page to focus on the behavioral elements of investing, specifically as it relates to navigating drawdowns in order to achieve long-term investment goals.

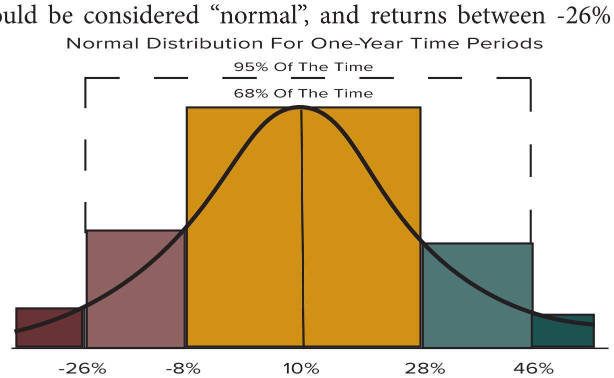
Markets Fluctuate More Than We Think

Since the S&P Composite Index's inception in 1926, stocks have averaged an annualized return of 10%. Many investors are anchored to the 10% bogey for stocks, and grade calendar year returns above or below 10% as "good" or "bad" years. But did you know that in the last 50 calendar years, stocks have returned between 8% and 12% just three times?



In the chart above, returns are broken into annual distribution buckets. Gold returns are considered normal returns, acknowledging that most investors consider the 4-8% bucket as somewhat disappointing. Returns in the green are considered good to great (farthest right), while returns in the crimson are considered bad to horrific (farthest left). While this chart provides a fairly accurate picture of how investors disseminate return distributions, the flatness of the visual reveals an underestimation of what should be considered "normal returns."

Over the past decade, U.S. stocks' standard deviation measurement has been just 11%, well below the historical 18% and perhaps masking the actual volatility potential of equities. Assuming normal distribution, any returns between -8% and 28% should be considered "normal", and returns between -26% and



U.S. EQUITY RETURNS (%)

As of 03/31/20	Q1 2020	1-Year	3-Year	5-Year	10-Year
S&P 500	-19.6	-7.0	5.1	6.7	10.5
Russell 1000 (Large Cap) Growth	-14.1	0.9	11.3	10.4	13.0
Russell 1000 (Large Cap) Value	-26.7	-17.2	-2.2	1.9	7.7
Russell 2000	-30.6	-24.0	-4.6	-0.3	6.9
Russell 2000 (Small Cap) Growth	-25.8	-18.6	0.1	1.7	8.9
Russell 2000 (Small Cap) Value	-35.7	-29.6	-9.5	-2.4	4.8

Source: Morningstar

Continued from page 2 . . .

46% should be considered in play. The variability of equity returns on one-year time periods is likely far wider than many investors realize.

In reality, there are few investors that have the willingness to stomach return fluctuations of such extremes. Investors in or near retirement stage likely do not have the ability to assume such volatility, even if they have the willingness. This is where the inclusion of bonds play such a vital part of a balanced investing portfolio. While all-time low yields currently compromise their future return potential, the ability of bonds to tamp down the volatility of equity market return distributions is worth its weight in gold for investors lacking the ability and/or willingness to digest the violence of normal market swings. Importantly, the variability of equity markets narrows dramatically when viewed more appropriately through a ten-year time period. Over the last 50 years, stock returns have been between -1% to 18% over any 10-year rolling return period.

Drawdowns Take Time But Do Recover

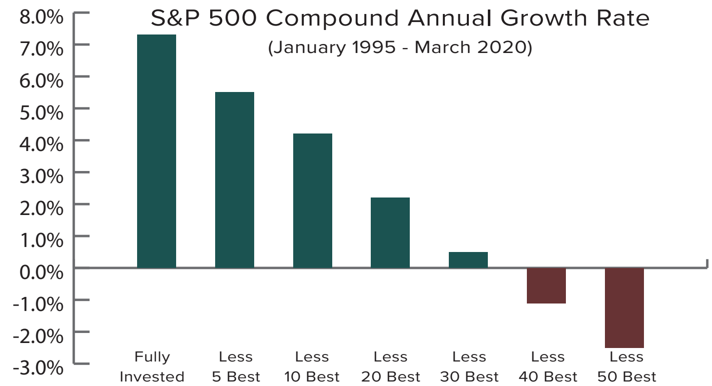
While we are all excited to resume normal activities, patience will likely be required before we climb back to previous market (and account) highs. Historically speaking, bear market recessions have an average drawdown of 37% from their peak. Once the bottom is finally reached, it takes on average 30 months to reach new all-time highs. In general, the steeper the drawdown, the longer it takes to reset new highs, as it accounts for the simple mathematical fact that every percentage loss requires an even larger percentage gain to get back to even. Our 34% drawdown will require a 51% gain to set a new market high. In 2008, a 56% drawdown took 49 months until new highs were reestablished in April 2013, which was a 134% gain off of the 2009 market bottom. The good news is that we do eventually get there.

Bear Market Recoveries
Largest S&P 500 Index Declines Since WWII

Peak	Bottom	Bear Mkt Length	% Decline	Recovery Length	Recession?
Oct-07	Mar-09	17 Months	-56%	49 Months	Yes
Mar-00	Oct-02	31 Months	-49%	56 Months	Yes
Jan-73	Oct-74	21 Months	-48%	69 Months	Yes
Dec-68	May-70	17 Months	-36%	21 Months	Yes
Feb-20	?	?	-34%	?	?
Average All Bear Mkts		12 Months	-30%	20 Months	
Average Bears w/ Recession		18 Months	-37%	30 Months	
Average Bears w/out Recession		7 Months	-24%	10 Months	

Source: LPL

Our recency bias has us accustomed to seeing markets at all-time highs, but that is atypical as stocks historically are at all-time highs only 30% of the time. The other 70% of the time, investors are trying to recapture previous highs. 20% of the time, markets are in a bear market drawdown of 20% or greater (our current plight), which is likely a far higher percentage of the time than many investors realize.



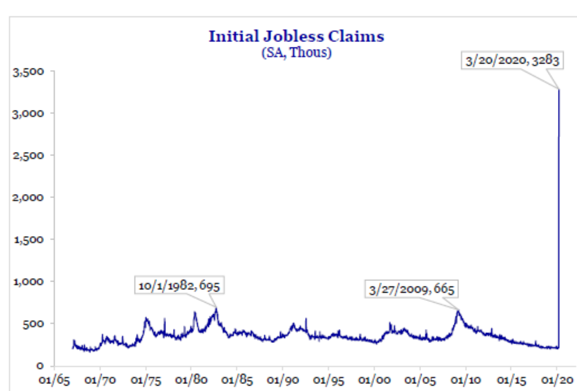
Source: Strategas

Importantly, the only way to reclaim lost returns is to stay in the market. Per the chart above, just missing the best five days of the past 25 years has resulted in an annualized return drag of 2%. Taking this further, if you missed the best 50 days of the past 25 years, your returns were essentially flat. The paradox for investors is that the highest daily return days often occur during bear markets. As an example, March's overall misery also included two of the Dow's highest daily returns in history (9% returns on March 13 and March 24).

Additionally, bear markets are noted for their nauseating levels of volatility. In March, the S&P 500 traded in a range of greater than 3% in 16 of the 22 trading days. Comparatively, we did not see more than 16 days of 3% or greater in any of the last eight years. 2008 and 2009 combined for 117 days in which the S&P 500 traded in a range of greater than 3%. These volatility spikes are the norm for bear markets, so expect daily swings with some magnitude to be around for a while.

Markets Will Lead Economic Data

The upcoming economic data will be dreadful, but the market already knows this, and has priced in the expectation of recessionary level readings. Our first glimpse of this was the final week of March's initial jobless claims, which reached a record 3.3M new unemployment claims. U.S. stocks rallied 6% that day despite the report.



Source: Strategas

Given the speed of the coronavirus impact, monthly economic data is incredibly lagging. As of this writing, our most recent monthly payrolls report still showed we added 300,000 new jobs the previous month. Once these reports are updated for March, they will simply be affirmation of what we already know; that our economy has halted. Economists will eventually label this current time period as a recession, and by the time they do, stocks will have likely already bottomed. Historically, markets find a bottom on average four months before a recession ends.

Economic Recessions & Market Bottoms

Recession Start	Recession End	Recession Length In Months	Market Bottom	Conclusion
Aug '29	Mar '33	43	6/1/1932	9 Months Before
May '37	Jun '38	13	3/31/1938	3 Months Before
Feb '45	Oct '45	8	3/26/1945	7 Months Before
Nov '48	Oct '49	11	6/13/1949	4 Months Before
Jul '53	May '54	10	9/14/1953	8 Months Before
Aug '57	Apr '58	7	10/22/1957	6 Months Before
Apr '60	Feb '61	9	10/25/1960	4 Months Before
Dec '69	Nov '70	10	5/26/1970	6 Months Before
Nov '73	Mar '75	16	10/3/1974	5 Months Before
Jan '80	Jul '80	6	3/27/1980	4 Months Before
Jul '81	Nov '82	15	8/12/1982	3 Months Before
Jul '90	Mar '91	8	10/11/1990	5 Months Before
Mar '01	Nov '01	7	10/9/2002	11 Months After
Dec '07	Jun '09	17	3/9/2009	3 Months Before
	Average	13 Months	Average	4 Months Before

Source: Strategas

In our Q3 2018 letter, we wrote about how paradoxically, the best of times economically are typically not the best of times for future returns. As an example, forward returns are markedly better when the unemployment rate is high than when it is low. This can be explained by 1) the notion that markets lead data and 2) the recognition of the economic cycle. Emotionally, it feels particularly cruel how this most recent economic cycle has ended, but an end was inevitable, just as an eventual recovery will be.

Future Returns After Drawdown Events

One silver lining for investors is that drawdowns are typically accompanied by above-average forward investment returns. Our first example is a look back on the worst quarters in S&P 500 Index history, dating back to 1940. These quarters provided one-year forward returns of 28% and three-year cumulative returns of 60%, benefiting from the early stages of recovery.

S&P 500 Since 1940			Forward Performance		
Year	Quarter	Performance	1 Year	3 Years	5 Years
1962	Q2	-20.6%	31.2%	69.2%	94.8%
1974	Q3	-25.2%	38.1%	72.7%	117.5%
1987	Q4	-22.6%	16.8%	48.8%	109.0%
2008	Q4	-21.9%	26.5%	48.6%	128.2%
Average		-22.6%	28.1%	59.8%	112.4%

Source: AWOCS

INTERNATIONAL RETURNS (%)

As of 03/31/20	Q1 2020	1-Year	3-Year	5-Year	10-Year
Int'l Developed ex US	-22.8	-14.4	-1.8	-0.6	2.7
Emerging Markets	-23.6	-17.7	-1.6	-0.4	0.7

Source: Morningstar

As another example, in looking at data back to 1950, stocks achieve higher one-year forward returns with each step down in drawdown impact. Per the chart below, one-year forward returns see a meaningful jump once they reach a 30% drawdown threshold. The same can be said at 40% and 50% levels. The caveats here are that 1) 3-month and 6-month data is more mixed, and 2) the market bottom is still to be determined.

Percent From High	1 Year Forward Return
0% to 5%	8.3%
5% to 10%	7.1%
10% to 15%	7.1%
15% to 20%	9.3%
20% to 25%	9.5%
25% to 30%	8.4%
30% to 35%	13.7%
35% to 40%	14.0%
40% to 45%	23.8%
45% to 50%	34.8%
50%+	53.1%

Source: Irrelevant Investor

A lot of the data above is predicated on a market bottom, and that will not be known for some time. As we stated earlier this month, we can simply go off the evidence that over the long-term, purchases at this level of drawdown have become highly profitable investment lots. To paraphrase famous investor Howard Marks, a time to buy is easier to recognize than the time to buy. Rules-based rebalancing and dollar-cost averaging in new cash are effective ways to invest in this spirit.

Rather than fixating on total portfolio value, we would encourage investors to think of their portfolios in terms of buckets. First, the bucket that covers either the next 6-12 months of spending (for retirees) or six months of emergency savings (accumulators) should remain in cash, as liquidity is crucial in times of distress. For retirees, a bucket of at least five years of spending needs is likely invested in high-quality bonds, which are an invaluable source of funds while equities are in drawdown. Finally, there is a risk-bucket that can capitalize on the high odds of above-average forward returns from long time-horizon assets, without concern of near-term liquidity needs.

In both smooth and challenging markets, we appreciate your confidence in our firm and value your partnership. Now more than ever, please contact us with any questions or needs. Be well and we hope that our collective, societal efforts of social distancing will soon prove to have helped flatten the curve.

FIXED INCOME RETURNS (%)

As of 03/31/20	Q1 2020	1-Year	3-Year	5-Year	10-Year
Aggregate Bond	3.2	8.9	4.8	3.4	3.9
Muni	-3.4	0.6	2.4	2.0	3.2
Int'l Bonds	-5.3	-1.3	1.1	0.9	1.5
High-Yield	-13.7	-8.9	-0.6	1.4	4.4
Short-Term	-2.2	0.8	1.5	1.4	1.8
90-Day T-Bill	0.3	1.8	1.8	1.2	0.6

Source: Morningstar

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