Colorado Capital
MANAGEMENT

QUARTERLY MARKET UPDATE / JULY 2020

Economic Outlook

Overview

Due to fallout from the COVID-19 pandemic, the U.S. economy contracted at an annualized rate of 5% in the first quarter, and over 30% during the second quarter of 2020. This is the most severe decline since we began measuring GDP in 1945.

Recent improvements in hiring and retail sales point to an emerging rebound. However, economic output and employment remain far below their pre-pandemic levels. With the growth of the virus accelerating, significant uncertainty remains about the timing and strength of a future recovery. The longer the crisis lasts, the greater the risk of permanent job losses and business closures.

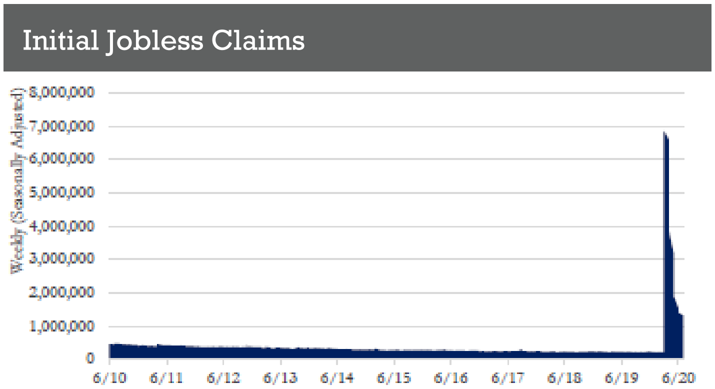
The burden of the downturn has not fallen equally on all Americans. Those least able to withstand the recession have often been affected the most. Gaps in economic well-being have widened. There has been widespread social unrest over racial and economic inequality, and police brutality.

Federal stimulus programs have helped to ease the economic pain. Congress is currently debating a a large new stimulus program to support state governments and extend enhanced unemployment benefits.

CCM Key Economic Indicators

Indicator	6.30.20	3.31.20	6.30.19
US Economy			
Quarterly GDP Growth	-32.9%	-5.0%	2.0%
Unemployment Rate	11.1%	4.4%	3.7%
U.S. CPI -Core (Inflation)	1.2%	2.1%	2.1%
Interest Rates			
Fed Funds Rate	0.00%	0.00%	2.25%
10-Year Treasury Rate	0.73%	0.87%	2.07%
Currency & Commodities			
Crude Oil (WTI)	$ 39.27	$ 20.51	$ 54.66
Gold Price	$ 1,771	$ 1,604	$ 1,358
Trade Weighted Dollar Index	120.0	121.3	115.4
Confidence			
Consumer Confidence Index	98.1	120.0	124.3
ISM Purchasing Managers Index	52.6	49.1	51.7
Stock Prices			
Dow Jones Industrial Average	21,813	21,917	26,600
S&P 500 Forward P/E ratio	21.7	15.4	16.7

Employment



Source: U.S. Employment and Training Administration

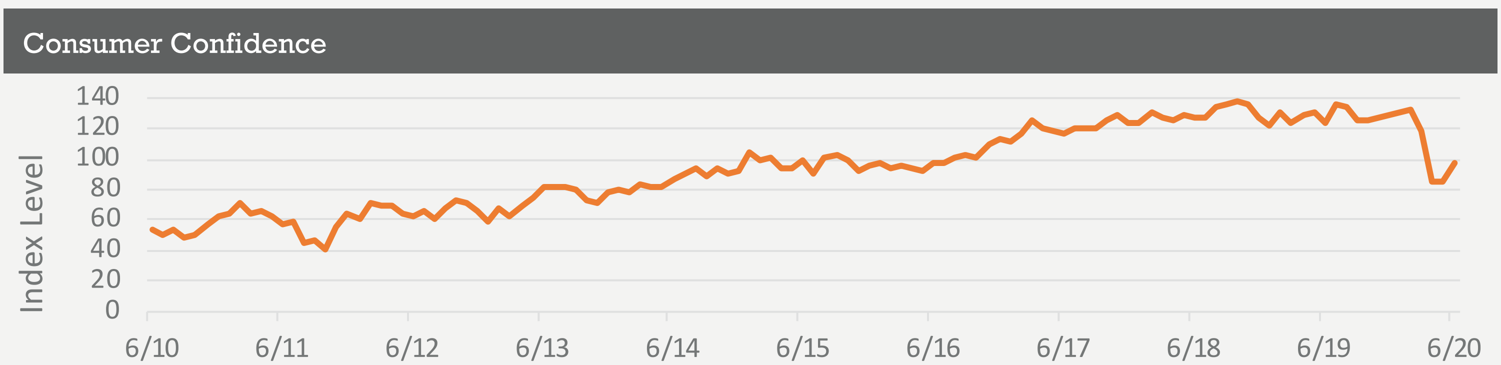
While the labor market is improving, unemployment remains at very high levels compared to historical norms. The national unemployment rate in June was 11.1%, down from 14.7% in April, but up from 3.7% a year ago.

As of late June, 19.5 million individuals filed continuing unemployment claims, while 1.5 million filed weekly first-time claims. First-time claims peaked in late March at over six million a week, compared to a weekly average of about 250,000 last year year.

Consumer Behavior

Confidence: Consumer confidence plunged in the second quarter, reaching a low of 85.9 in May (from near record high in the 130's in February), before rallying in June to 98.1. Americans cautiously returned to the marketplace in May and June, helping the economy slowly dig out from a severe recession.

Spending: Pent up demand from months of isolation, as well as the distribution of Federal stimulus checks, helped fuel an eye-popping 18% increase in seasonally adjusted retail and food-service sales in May. This record growth rate boosted hopes that a good portion of consumers are eager and able to spend despite double-digit unemployment. However, retail sales remained well below their February level. Despite the spending increase, Americans still saved more than a fifth of their disposable income in May, an exceptionally high savings rate that signals caution.



Source: The Conference Board

Inflation & Housing

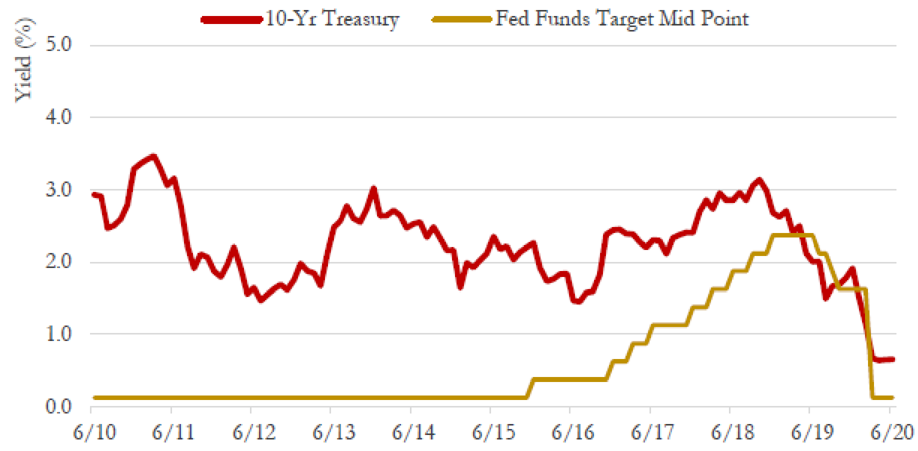
Inflation: With weak demand and large price declines for some goods and services, consumer price inflation dropped sharply to 1.2%. Indicators of longer-term inflation expectations however have been relatively steady. As the economy recovers, inflation should gradually increase, moving closer to the Fed's 2% objective.

Housing: Housing has clearly been one of the economy's bright spots. Fueled by record low interest rates, mortgage applications for home purchases are up 18.1% compared to last year. Low rates should continue to induce more renters to become buyers. Demographics should also support the housing market, as many Millennials are approaching typical home-buying age. As might be expected during the pandemic, buyer interest in suburban and rural markets is increasing at about twice the pace of interest in urban areas.

U.S. Government Policy Measures

Monetary Policy: The Federal Reserve cut overnight interest rates to near zero in March and introduced a range of emergency lending programs to purchase debts of companies, cities, and states. The Fed expects to keep short-term interest rates pegged near zero through 2022. Longer term rates are also near historical lows, with the 10-year Treasury Note ending the quarter at 0.73%, down from 2.07% a year ago, and from its long-term average of about 4.5%.

10-Yr U.S. Treasury Yield vs. Federal Funds Target Rate



Source: Federal Reserve, Bloomberg

Fiscal Policy: When Congress returns from recess, it will face a critical few-week period to consider additional fiscal stimulus. Emergency expanded unemployment benefits expire on July 31, and many states will face tough budget decisions due to sharp declines in tax revenue. It is not clear if there will be another large stimulus bill to support the economy. If a bill does come to pass, it is likely to be roughly $1 trillion in size, with the bulk of the money going towards state and local aid and stimulus to households through policies like a payroll tax cut or another round of direct household checks.

Global Economic Outlook

Following the sharpest economic decline since the Great Depression, a long uphill climb will be required to get back to pre-pandemic levels. While much uncertainty remains, global economic growth is expected to contract by an unprecedented 4.0-4.5% in 2020. In this scenario, Advanced economies (AEs) contract by 5.5% and emerging markets (EMs) excluding China by 3.5%. China's economy is anticipated to pull back by 2.5%, with the U.S. falling 6.5% from 2019 levels. The differences reflect pre-Covid variations in underlying economic growth rates, and how different countries have dealt with the crisis.

Until there is an effective vaccine, many other scenarios are possible, depending largely on the path of the virus and its overall impact. If widespread stay-at-home orders return, the emerging recovery will reverse course, and unemployment will remain elevated for longer. By extension, there would be more permanent job losses, negative wealth impacts, and business insolvencies, even with renewed stimulus measures.

When the pandemic is finally over, we expect the global economy to look quite different than it did before. Many businesses will be forever changed, and there is a high likelihood that potential GDP growth will be lower due to economic scarring. Most major economies will have additional national debt as a result of fiscal stimulus measures. This increased debt will likely also be a drag on economic growth and could result in higher taxes and/or inflation. Political leadership and policy may also undergo substantial change.

Market Commentary

Overview

As difficult as the first quarter of 2020 was for investors, the second quarter proved to be nearly as spectacular in a positive direction. Despite the severity of the COVID-19 induced recession that began to grip the economy in Q1, in Q2 markets continued to respond to the extraordinary intervention measures of the Federal government. The Federal Reserve successfully launched massive lending facilities, extended credit, purchased government-backed paper, and indicated it was also prepared to purchase corporate bonds to support and calm fixed income markets. These efforts paid off.

Additionally, Congress and the Administration provided direct financial support to households as well as small and large businesses alike to keep the economy afloat in the hope that the pandemic would recede rapidly and that an organic economic recovery would ensue. As the quarter ended, economic data was turning positive but ample uncertainty remained, especially given a surge in COVID-19 cases.

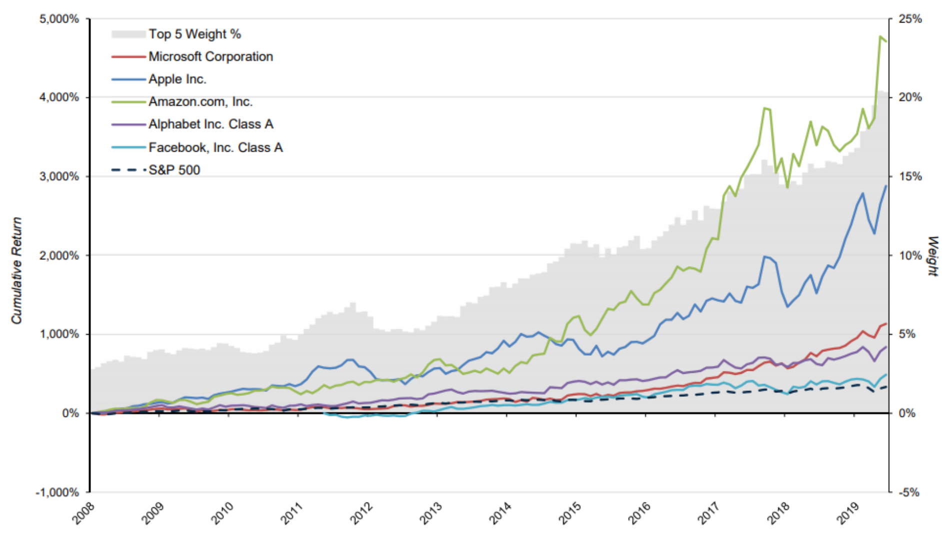
Given this environment, the U.S. benchmark S&P 500 index rose by 20.5% during the quarter. Overseas, the MSCI EAFE Index rose 14.9%, and the MSCI Emerging Markets Index rose 18.1%. Fixed income markets produced solidly positive returns with the relative certainty that interest rates would remain low for some time. The Barclays U.S. Aggregate Bond Index rose 2.9%.

U.S. Equities

The quarter began with equity volatility (the VIX "fear index") near record highs, and while it dropped by roughly half during the quarter, it remained well above its long-term average. Despite the elevated level of fear, equity markets delivered strong returns, apparently concluding that a recovery was underway, the earnings outlook was improving, and government fiscal and monetary support would continue for as long as needed.

While many companies have been unable to provide future earnings guidance in this environment and some corporate outlooks appear grim, other businesses have thrived in the social distancing economy.

S&P 500 Current Top 5 Weight and Performance—12/31/2008-5/31/2020



Sources: FactSet, S&P as of 3/25/2020. For illustrative purposes only.

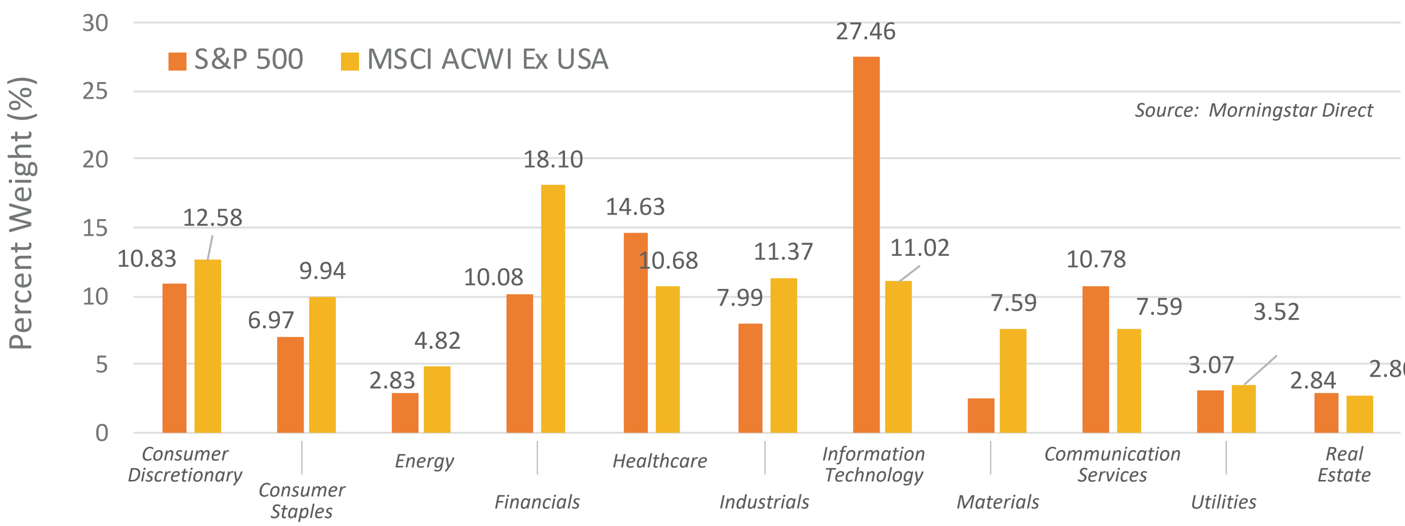
Some of the very largest tech firms and companies with strong online business models fall into this camp. Being in the right place at the right time has propelled these industry leaders to lofty valuations. Five stocks now make up 20% of the value of the S&P 500 index.

International Equities

International equities have significantly lagged US stocks, both during the nearly 11-year bull market that ended in February, and since that time. This results in foreign stocks generally trading at considerably more attractive valuation multiples than U.S. stocks. International stock markets also have very different industry weightings, with less concentrated exposure to information technology, health care and communication services.

The aggressive and cohesive national response to the pandemic in many of the major economies in Europe and Asia appears to have been far more effective than efforts in the U.S. to slow the virus. As a result, these economies can be expected to recover more quickly than the U.S. Should that happen, their stock markets and currencies should respond in kind.

Sector Exposures: S&P 500 vs. MSCI All Country World Index (Ex-USA)



Fixed Income

Fixed income markets posted strong relative returns with interventions from Central Banks and their guidance that rates will remain low for the foreseeable future. While government bonds outperformed in the first quarter, higher risk bonds excelled in the second quarter. The overall U.S. bond market is up roughly 6% so far this year, but the return is almost entirely from appreciation, as yields are extremely low (See chart on next page).

Equity Market Outlook

In the U.S., the path to economic recovery will depend on the course of coronavirus and the corresponding public health response. It is reasonable to expect the stock market to bounce around for an extended period until the economy finds firmer footing. Despite this expectation, the U.S. stock market appears to be priced for a quick economic recovery. The resulting stretched valuations will become a concern if something other than a quick economic recovery becomes reality.

The longer-term outlook appears more positive, however, as the recent slowdown was driven by government policy and not economic imbalances. Relaxing these restrictive policies should eventually lead to economic recovery.

While the pain of the economic recession has been widespread, the stock market has produced distinct winners and losers. Online retailers for example, have enjoyed growing sales, while travel and hospitality-related businesses have been pummeled.

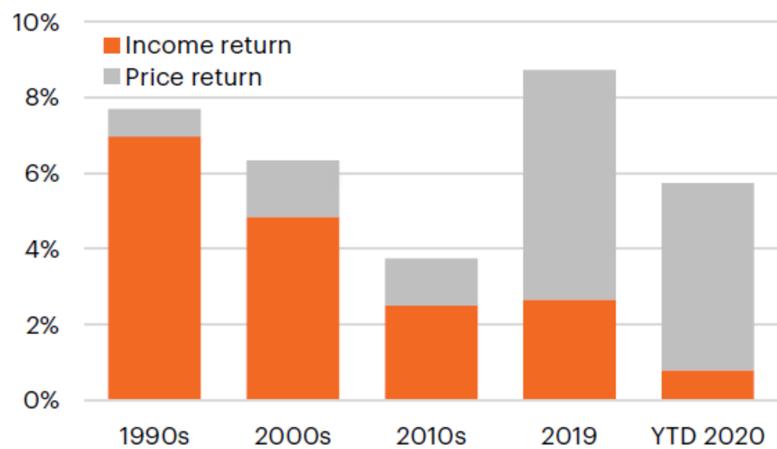
Equity markets in developed international markets appear to be moderately priced relative to the U.S. In Europe, most economies are recovering from the lockdown and, thus far, there has been little evidence of a significant second wave of infections. The outlook in Japan and the U.K. however is less attractive, primarily due to headwinds such as Brexit and structural weaknesses that existed prior to the onset of the pandemic. China's stock market appears well positioned to benefit form a global recovery and from its government stimulus package.

Fixed Income Outlook

For fixed-income investors, the environment remains relatively challenging with yields on 10-year Treasuries ending the quarter around 0.7%. Assuming the economy gets past the coronavirus driven recession and begins to expand again, these yields as a starting point for investing are unattractive. However, developed market government bonds serve a useful role as portfolio ballast against risk-off episodes and spikes of volatility.

The yield premium on corporate bonds has narrowed considerably since peaking in March. While there may be select opportunities within the high yield asset class, caution is appropriate as increased defaults are likely in the months ahead.

Barclays AGG Return Contribution



Source: Bloomberg Finance, L.P., as of June 15, 2020.

High quality fixed income should continue to play a useful role in managing overall portfolio risk. However, the prospect of an economic recovery, especially if accompanied by high government debt loads, tempers enthusiasm for the overall expected returns of fixed income investments.

Sources: Capital Market Consultants, Department of Labor, Department of Commerce, Morningstar, Bloomberg, Johns Hopkins University, JP Morgan, Realtor.com

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