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INVESTMENT STRATEGY QUARTERLY

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Letter from the Chief Investment Officer

A Journey through the Unknown

The COVID-19 outbreak has led to unprecedented volatility and tremendous declines in wealth, but we have faith that once the pandemic is defeated, the wild swings in the financial markets will abate and prosperity will return. But what cannot be so easily recovered is the loss of a job, the loss of a business, or, worst of all, the loss of a loved one. While it is our duty to provide timely market insights, please know that now, more than ever, the health and safety of you and your families is at the forefront of our minds.

The Hubble Space Telescope celebrates its 30th anniversary in April. As the first major optical telescope soaring through space, its vitality in astronomical discoveries earned it the nickname "window on the universe." Since its launch in 1990, its discoveries have redefined our knowledge of the universe – from its estimated age (~13.7 billion years old) to the two moons circling Pluto. Its ability to capture clear, concise photographs is due to its location beyond Earth's atmosphere, where it is unencumbered by clouds and turbulence. The traveling telescope is an excellent metaphor for our investment strategy journey, as we seek to provide clear, concise views in a world of incessant change and increasing complexities. Not getting fixated on the daily headlines and approaching investments with a long-term view in mind can help avoid panic driven portfolio decisions.

The emergence of the coronavirus as a global pandemic was a 'Black Swan' event outside anyone's scope. Its discovery clouded the near-term economic outlook and created unparalleled market turbulence. As this unprecedented event unfolds, it is our responsibility to bring uncertainties into focus and provide pragmatic, insightful views to assist you in navigating your portfolio during this historically challenging time.

When it comes to the economy – **Houston, we have a temporary problem**. The COVID-19 outbreak and its negative economic impact are difficult to discern given the inability to determine the number of people infected, the transmission rate, and the longevity of the spread. But one thing remains clear – consumer spending is collapsing at a record pace due to the necessity for social distancing – the avoidance of restaurants, movie theaters, tourism and spectator events. Already, more than 46,000 US retail stores have shut their doors, major league sports have suspended their seasons, and over 515 million students have been impacted by school closings worldwide. With consumer spending, which represents 70% of the US economy, contracting rapidly and likely remaining constrained for the next few months, a temporary virus-induced recession seems unavoidable. With spending in an **interim black hole**, our Healthcare Policy Analyst, Chris Meekins, assigns a 40% and 80% probability to the US starting to "turn the corner," or realizing the true scope of the health crisis and resuming our normal activities, by Memorial Day and the Fourth of July, respectively. If this proves prescient, the US economy would likely experience a robust rebound during the second half of the year, especially if policymakers continue to exhibit a "by any means necessary" approach to defeat this virus.

Mitigating this downside risk to the economy is the **beaming up** of policymaker response. The Federal Reserve (Fed) has been and will remain proactive. Even after implementing two inter-meeting interest rate cuts – action only taken **once in a blue moon** – to reduce interest rates to zero and once again employing massive trillion dollar facilities, the Fed is still exploring ways to make sure the **gravity of the situation** does not cause the lending markets to function inefficiently. But the Fed is not alone, evidenced by the **all hands on deck** effort by central banks around the world similarly easing in a synchronized fashion. Over the last six months, almost 80% of central banks have eased policy rates – the highest level since the Great Recession. In fact, the average policy rate amongst the four largest central banks (the Fed, the European Central Bank, the Bank of England, and the Bank of Japan) has fallen into negative territory and set a new historic low. While these measures cannot cure the health crisis, they should help boost confidence and support a rebound in growth over the medium to longer term.

Congress and the Trump administration have executed several phases of their fiscal stimulus **mission**. While the health and welfare of citizens is at the forefront of any president's mind, President Trump has a heightened incentive to keep the economy **shining bright** to maximize his chances of a successful re-election campaign. Combined, the record-setting stimulus packages will put more than $2 trillion into the hands of consumers, small businesses and distressed industries (e.g., airlines) in hopes of easing the

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economic impact of the virus. If the economy continues to struggle, we do not rule out additional phases of fiscal stimulus.

With fear driving demand for US Treasuries, yields moving higher will continue to exhibit a **failure to launch** scenario. Uncertainty surrounding the duration and magnitude of the virus fueled a **flight to safety** mission that pushed the entire yield curve below 1% for the first time ever. If volatility subsides and the economy not only stabilizes but resumes its upward trajectory in the second half of the year, we'd expect the 10-year Treasury yield to remain around the 1.00% level come year end. Given the substantial energy sector and brick and mortar retailer exposure of high-yield bonds, we maintain our preference for investment-grade debt.

After the best year for equities since 2013, the 33% plus coronavirus-induced decline has brought investors **back down to earth** by ending prolonged depressed levels of volatility, heightened levels of complacency, and the second longest bull market in US history. Due to direct and indirect negative impacts from the coronavirus, Michael Gibbs, Managing Director of Equity Portfolio & Technical Strategy, lowered our 2020 earnings estimate to $155 with reductions weighted to first half 2020 results. Based on our expectation of a rebound in the latter half of the year, our 19.5x trailing multiple is unchanged, resulting in a revised 2020 S&P 500 price target of 3,023 (from 3,350). Once fears subside and the benefits of global monetary easing are felt, attractive valuations should entice investors back to the equity markets. Therefore, we remain long-term constructive on global equities, specifically US equities, and prefer cyclically-oriented sectors over defensives. The Information Technology sector should not be a **falling star**, as its secular growth story remains positive with the anticipated rollout of 5(G) later this year.

Although a long-term positive for the global economy, oil prices have fallen to levels not seen since **many moons ago**. The emergence of the oil price war between Saudi Arabia and Russia, compounding the dramatic fall-off in global demand (estimated to be worse than the 2008 and 2009 declines combined) has resulted in prices at which the global oil industry cannot sustainably function. For this reason, the price war is bound to end soon. Further support for oil is embedded in our expectation that aggressive monetary policy and a burgeoning budget deficit (~$3 trillion) will cause the dollar to modestly weaken throughout the year. Oil will likely continue to test the $20/bbl level this quarter, while lockdowns and demand disruptions are the most severe, before rebounding towards $45/bbl by year-end.

It doesn't take a rocket scientist to know volatility will be present in both the near and intermediate term. Selectivity remains of the utmost importance and just as the **take-off** and **landing** of the rocket are the most critical steps of a flight mission, buying and selling decisions are critical to the success of a portfolio. Exercise patience rather than panic, and rely upon your financial advisor and asset allocation in order to achieve your long-term investment goals.

Please be safe and stay healthy!

Lawrence V. Adam, III, CFA, CIMA®, CFP®
Chief Investment Officer, Private Client Group

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Lawrence V. Adam, III, CFA, CIMA®, CFP® – Committee President, Chief Investment Officer, Private Client Group

Chris Bailey European Strategist, Raymond James Investment Services Ltd.*

Scott J. Brown, PhD Chief Economist, Raymond James

James C. Camp, CFA Managing Director, Strategic Income, Eagle Asset Management*

Doug Drabik Managing Director, Fixed Income Research

J. Michael Gibbs Managing Director, Equity Portfolio & Technical Strategy

Kevin Giddis Chief Fixed Income Strategist, Investment Strategy

Nick Goetze Managing Director, Fixed Income Solutions

Nicholas Lacy, CFA Chief Portfolio Strategist, Asset Management Services

Joey Madere, CFA Senior Portfolio Analyst, Equity Portfolio & Technical Strategy

Ed Mills Managing Director, Washington Policy Analyst, Equity Research

Pavel Molchanov Director, Energy Analyst, Equity Research

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Giampiero Fuentes Investment Strategy Analyst, Investment Strategy

Taylor Krystkowiak Investment Strategy Analyst, Investment Strategy

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Chris Meekins, Director*, Healthcare Policy Analyst,* Equity Research

The outbreak of a novel coronavirus (COVID-19), initially in China and then around the world, creates concerns over its economic impact. According to the Centers for Disease Control (CDC), "Coronaviruses are common throughout the world. Seven different coronaviruses, that scientists know of, can infect people and make them sick. Some human coronaviruses were identified many years ago, and some have been identified recently. Human coronaviruses commonly cause mild to moderate illness in people worldwide." This newest coronavirus likely began near the city of Wuhan, China and then became widespread in an animal market in the city. The virus quickly reached epidemic levels and began to spread outside of the region. For the vast majority of patients, symptoms are mild or moderate and are similar to the common cold or influenza. For a smaller percentage, hospitalization is required and, for about 1%, death occurs. Individuals with the worst symptoms tend to be older and have other contributing factors like smoking, asthma, diabetes, and similar respiratory issues. Though many scientific questions about the virus remain unanswered and some of the information may change, it appears the reproduction rate of the virus (when mitigation measures are not taken) is two to three, meaning each infected person infects another two to three people.

As cases spread around the globe, governments had to choose how to try to limit the spread. In the US, the government put in place travel restrictions from areas most impacted by the virus, quarantined individuals returning from other nations that may be infected, funded clinical trials of new therapeutics and vaccines, and took other steps that helped to initially limit the spread. The government did make one major mistake. The CDC initially sent out faulty diagnostic tests to state and local labs and took weeks to get functional tests out. In addition, the CDC limited which individuals could actually get tested. As a result, community transmission went unnoticed for weeks and the virus went unchecked. The government eventually got tests out to key leaders, but it was too late to prevent significant spread in the US.

> Development of drugs to treat the disease and vaccines to prevent contraction of the disease has begun.

Development of drugs to treat the disease and vaccines to prevent contraction of the disease has begun. Under ideal conditions, vaccines take around two years to be developed. For therapeutics, the hope is a drug that already exists can be repurposed to treat this disease, which could be used in weeks. If an existing drug will not work, a new therapeutic will need to be developed, which likely could take two years.

The COVID-19 outbreak will likely impact the 2020 elections. At its core, the American public expects its president to be the "Protector in Chief." That usually focuses on national security (protection from war or terrorist attacks) and economic security (protection of jobs), but now it may include health security. Given the widespread outbreak, Americans who previously felt protected by the previous administration may now consider a different candidate.

> “These [stimulus] efforts won't prevent the economy from weakening, but should limit the damage and help in the eventual recovery.”

The Economic Impact

Scott J. Brown, PhD, *Chief Economist,*
Raymond James

COVID-19 is having a major impact on the US economy. Economists have had to lower their outlook for growth almost on a day-to-day basis. In his telephone conference call following the Federal Reserve's (Fed) second emergency rate cut, Chair Jerome Powell said that the Fed's economic forecasts “depend heavily on the spread of the virus, the measures taken to affect it, and how long that goes on, and that's just not something that is knowable.”

Testing for the virus has been woefully inadequate. That makes it impossible to accurately gauge how far the virus has spread and whether mitigation efforts are working. In turn, the failure to test adds considerable uncertainty to the economic outlook. While a number of states have been under lockdown, social distancing has been more sporadic in many places (for example, spring break in Florida).

Initially, the virus appeared likely to have a sharp but brief impact on China's economy. US firms would experience supply chain disruptions and a temporary loss of sales into China. As it spread to other countries, supply chain disruptions would become more significant and the outlook for global growth would be diminished. However, the spread in the US and the efforts taken against it have had a sharp, negative impact on the outlook for domestic growth and jobs.

Social distancing is the main tool to limit the spread of COVID-19 with the goal of flattening the curve, providing more time to develop treatments and a possible vaccine. Sharp declines in activity have occurred in a number of industries, including restaurants, airlines, hotels, cruise lines, sporting and spectator events, and retail. Layoffs and the loss of income will have second-round effects on consumer spending. A weaker global economy will hurt US exporters. Increased uncertainty will reduce business fixed investment. Real Gross Domestic Product could fall 5%, 10%, or more for the year as a whole (4Q20/4Q19). The unemployment rate, 3.5% in February, could rise to 10%, 15%, or 20%.

Credit problems have shown up shockingly early, threatening to amplify the economic downturn. The US Treasury market, the most liquid in the world, experienced trouble in the second week of March. The Fed has responded with two emergency rate cuts, leaving the target range for the federal funds rate at 0-0.25%. The Fed restarted large-scale asset purchases (quantitative easing) and then made that unlimited. It has encouraged banks to lend out of their capital and liquidity buffers. Day by day, the Fed has introduced an alphabet soup of credit, liquidity, and funding facilities – and will likely do more to prevent a broad collapse in credit. At no risk to US taxpayers, the Fed expanded swap lines to other central banks to relieve global strains.

Lawmakers in Washington have responded with a $2 trillion fiscal stimulus package, including increased health care spending, increased unemployment benefits, aid to damaged industries, cash and credit for small businesses, and “recovery rebate” checks for individuals. These efforts won't prevent the economy from weakening, but should limit the damage and help in the eventual recovery.

The federal budget deficit, already at $1 trillion with the economy at full employment, will rise sharply, but that is not a concern. State and local governments have balanced budget requirements. Revenue declines were a significant issue in the 2008-09 financial crisis and its recovery. The stimulus package has some relief for the states, but not nearly enough. That will have to be addressed later on.

Americans want the economy to get back to normal, but ending social distancing too soon could make things worse. Moreover, there are likely to be longer-lasting changes in consumer behavior and global trade once the virus passes.

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US Equities

J. Michael Gibbs, *Managing Director,* Equity Portfolio & Technical Strategy

Joey Madere, CFA, *Senior Portfolio Analyst,* Equity Portfolio & Technical Strategy

The market's selloff since the peak on February 19 has been historic to say the least, reaching -34% at the lows on March 23. With the global economy screeching to a halt, and the number of new COVID-19 cases increasing every day, global equities are understandably on the defensive. Admittedly, it is nearly impossible to have a great deal of confidence in economic and fundamental assumptions with the duration of the COVID-19 pandemic so uncertain and fluid at the moment. However, the economic outlook has worsened dramatically in recent weeks. The key is the spread of the virus. In our base case assumption, we look for the number of new COVID-19 cases to plateau around Memorial Day. In this scenario, we anticipate a pronounced economic slowdown at the end of the first quarter, throughout the second quarter, and lingering into the third quarter. This most likely results in a very sharp, but short recession, allowing time for the economy to start showing signs of a recovery in the fall and latter half of the year.

This base case scenario brings our S&P 500 earnings estimate for 2020 down to $155, reflecting a -4% earnings contraction for the full year. From a valuation standpoint, the S&P 500 now trades at a ~15x price-to-earnings multiple (P/E), below the long-term

average of 16.5x and 28% lower than the peak 20.7x P/E seen on February 19. On average, bear markets historically have seen P/E multiples contract by 28%. Looking forward, it is important to remember that the stock market is a forward-looking mechanism, meaning valuation multiples will start to rise long before

2020 Price Target

S&P 500	EPS ESTIMATE	P/E	PRICE
Bull Case	$167	21x	3,507
Base Case	$155	19.5x	3,023
Bear Case	$130	16x	2,080

Source: Raymond James Equity Portfolio & Technical Strategy

P/E FORWARD MULTIPLE
19.5x

2020 PRICE TARGET
3,023

economic data and corporate profits find a trough. Stocks have historically bottomed four months prior to recession end and four to six months before earnings trough. For example, the credit crisis P/E bottomed at 10x, and expanded to 17x by the time earnings troughed. For this reason, we maintain a 19.5x P/E year-end base case forecast as the market tends to discount the eventual recovery ahead of time. This results in a base case S&P 500 target of 3,023 for 2020 reduced from 3,350.[1]

Our bear case assumes a deeper recession that lingers, resulting in a 3% GDP contraction this year and $130 in S&P 500 earnings (-20% y/y earnings decline). Using a 16x P/E multiple, the result is a bear case S&P 500 target of 2,080. At this point, uncertainty regarding the ultimate economic impact and, more importantly, the magnitude of recovery by year end, leaves us with guarded confidence in our forecasts. In the coming weeks, additional information regarding the virus spread and need to keep businesses locked down should improve forecasting ability.

We believe the current volatility presents a tremendous opportunity for long-term investors. The market will react to the spread of the virus in the coming days and weeks, and for this reason we remain guarded in the short term with the number of new cases still accelerating in the US. Determining when and at what price level stocks will bottom is guesswork at this point. Instead of focusing on 'picking a bottom,' developing a strategy to execute on the inevitable recovery is a better choice. With stocks down

[1] The January 2020 ISQ outlook showed an S&P 500 price target of 3,350 for 2020 and an earnings estimate of $174 for the S&P 500.

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sharply, those with diversified portfolios and a long-term outlook can buy partial positions with some available capital now. We suggest reserving some buying power. Even if the news is challenging and equities experience additional weakness, stocks will eventually find a bottom. As the market shifts from decline to advance, allocate additional capital. As previous bull market recoveries reveal, buying at the absolute bottom is not necessary to generate sizeable returns. Bear market declines are often rapid,

Although we remain guarded in the short term, we believe the current volatility presents a tremendous opportunity for long-term investors.

Recessionary Bear Markets

MARKET TOP	MARKET BOTTOM	TOTAL MONTHS	BEAR MARKET DECLINE	MONTHS TO RETURN TO HIGH FROM BOTTOM
Jul-57	Oct-57	3	-20%	12
Jan-60	Oct-60	10	-18%	6
Dec-68	May-70	17	-36%	31
Jan-73	Oct-74	22	-48%	75
Feb-80	Apr-80	2	-21%	4
Feb-81	Aug-82	6	-24%	3
Jul-90	Oct-90	3	-21%	4
Mar-00	Oct-02	27	-49%	60
Oct-07	Mar-09	17	-59%	50
Average		***11.9***	***-33%***	***27***
Median		***10.0***	***-24%***	***12***

whereas bull markets typically last for much longer periods of time. Since 1958, the average bull market lasted approximately 41 months and advanced by 155%, whereas the average recessionary bear market retreated 33% over a mere 12 months during that same period.

The Global Impact

Chris Bailey, *European Strategist,* Raymond James Investment Services Ltd.*

At various points in the last few years, the spectre of global trade angst has overhung global financial markets. The progressive liberalisation of global trade over the past couple of generations has generally broadened choice and lowered prices for consumers and producers alike through the application of the law of comparative advantage and just-in-time delivery techniques. However, more recent years have seen a deeper debate between ‘fair trade’ and 'free trade.' This geopolitical discussion induced considerable market volatility, particularly in the third quarter of last year. Whilst January’s phase one trade deal between the US and China appeared to have pushed concerns about trade and supply chain disruption to the periphery, COVID-19 completely shattered that complacency as shown by the huge spike in volatility across global markets in February and March.

Trying to control COVID-19 via the use of quarantines and/or rigorous health checks has had a dramatic effect on day-to-day life and economic activity. You do not need to be highly schooled in the theory of the economic multiplier to envision the impact from the cancellation of a conference or the closure of a school, let alone the

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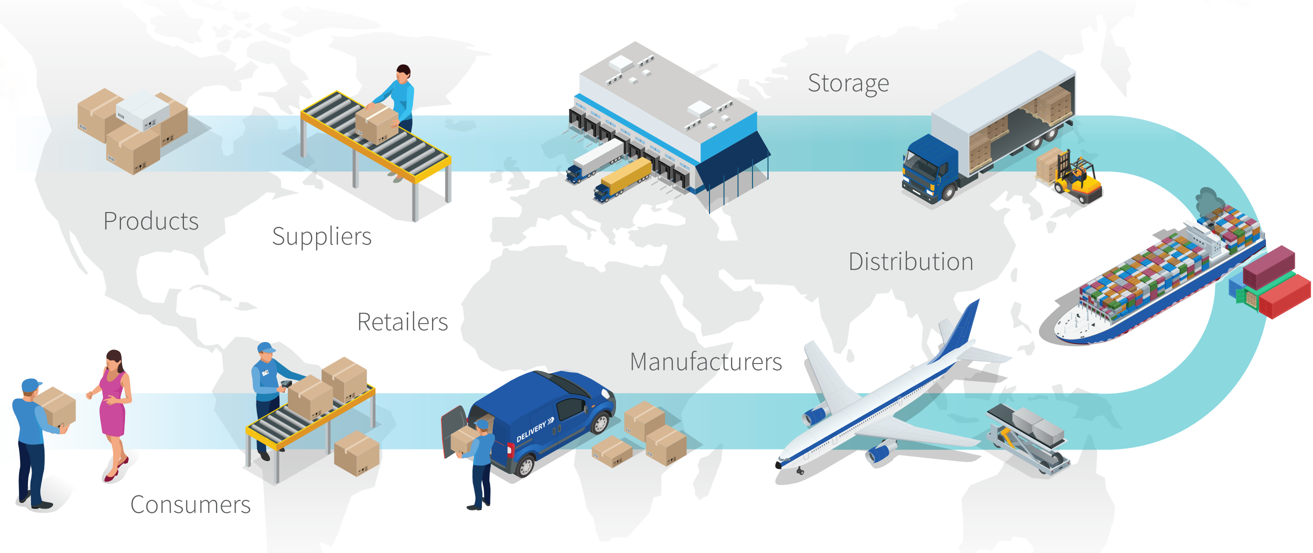
Supply Chain Disruptions

Given the increasingly globalised nature of supply chains, viral pandemics like COVID-19 can have prolonged negative knock-on effects to the economy.



impact of a moribund economy or the psychological impact of a period of widespread working from home.

On the other hand, there is the disruption of supply chains. All but the most local of businesses in the world now have extensive and deeply international supply chains, a trend that has only been magnified by digital commerce with its emphasis on price arbitrage and reliance on complex logistics. Most European or emerging market businesses are deeply dependent on international supply chains.

Putting these factors together, it is of little surprise that economic growth projections for 2020 across the world have been falling dramatically, a development generally only seen in times of economic depressions or very destructive wars. All of the ramifications are not yet known, but the extraordinary response by policymakers around the world (which, outside the US, have included the Bank of England reducing interest rates to their lowest level in over 325 years, and a raft of lending and direct worker assistance initiatives announced by other governments) reflects the severity of the COVID-19 outbreak and the need to protect economic systems.

> “All but the most local of businesses in the world now have extensive and deeply international supply chains.”

However, there is hope. Policymakers have been very proactive and countries in East Asia (including China and South Korea, which have tentatively culled their COVID-19 outbreaks to very negligible levels) have provided insights into how countries around the world can start to move beyond the impacts of the virus. Life does not naturally spring back to normal, which could risk additional outbreaks. However, the state of emergency can slowly pass. This will be a focus for Europe in April and beyond, as countries like Italy and Spain (which were at the heart of the European outbreak) attempt to return to some semblance of normality.

Keep safe. As Winston Churchill once said during a previously troubled time, "If you're going through hell, keep going."

Fixed Income

Doug Drabik, *Managing Director,*
Fixed Income Research

Kevin Giddis, *Chief Fixed Income Strategist,*
Investment Strategy

Nick Goetze, *Managing Director,*
Fixed Income Solutions

While it appears that the effect of COVID-19 on the fixed income market is changing almost every day as new cases are discovered and the course of the pandemic remains uncertain, the consistency of the bond market's response is worth noting. Each day that the virus remains uncontained, the greater the chance that the global economy will be affected to a greater degree. Early on, this was considered a regional outbreak, mostly affecting Asia and surrounding countries.

The outbreak of COVID-19 began impacting the bond market in early January, when the yield on the 10-year Treasury was approximately 2%. The general feeling was that the virus would remain an epidemic (as opposed to a pandemic) and not spread to the rest of the globe. All of that changed on Monday, February 24 when cases of the virus turned up in Italy. The theory of this being a short-term event was immediately dispelled, and the reality of a growing global outbreak spurred a rally in the US Treasury market, which has now reached near-record heights.

A wider-ranging question remains: what is the long-term impact of COVID-19? The shutdown of businesses and isolation measures have turned a medical crisis into a financial one as well.

To date, the impact has been forceful and abrupt on bonds. However, other geopolitical news has influenced market direction only to fade in time as the psychological affect ultimately proved greater than the fundamental affect.

Although these geopolitical events have influenced bonds, a consistent force in the market since the financial crisis of 2009 has been easy monetary policy around the world, which has pushed both stock and bond markets up (down in yield). Are the markets more prone to unexpected world events such as COVID-19? Or has the bond market been animated primarily by the policies of central banks? By the end of 2019, the market had all but forgotten Brexit and the phase one trade deal with China. Bonds were poised for lower prices/higher yields. The advent of COVID-19 completely derailed this trajectory. The uncertainty and fear surrounding the outbreak has driven panicked moves, triggering model-driven actions and creating a liquidity issue, which has since driven a significant gap in credit spreads. However, this is likely to normalize as fear subsides.

Source: FactSet as of 3/20/2020

> The COVID-19 outbreak has pushed yields on the 10-year Treasury note to all-time lows.

While it is very hard to make investment choices when this is happening, here are a few things for investors to keep in mind: 1) Historically these outbreaks do have a timeline. 2) The high-quality fixed income allocation needs to be maintained for liquidity and to preserve capital. 3) New fixed income allocations and/or cash flows should be filtered into lower durations. 4) Do not try to pick the bottom. Rather, position your portfolio to take advantage of when the economic cycle turns back upward.

Central banks stand by to provide the proper monetary stimulus. They have already announced the implementation of a number of 2008-era programs, which are designed to increase liquidity and restore functionality to the markets. Look for the fiscal stimulus package to follow suit. Again, preserve capital, but remain cautious using fixed income for needs beyond that. When this virus is contained (which is anyone's guess) we expect the bond market to snap back, pushing yields higher in the process (but likely well below where we were at the beginning of 2020). Having said that, each day is a challenge to the return of normal market activity.

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> "We forecast global demand down 1.5 million bpd for 2020, steeper than the declines from 2008 and 2009 (the two financial crisis years) combined."

Oil Markets

Pavel Molchanov, *Director, Energy Analyst,*
Equity Research

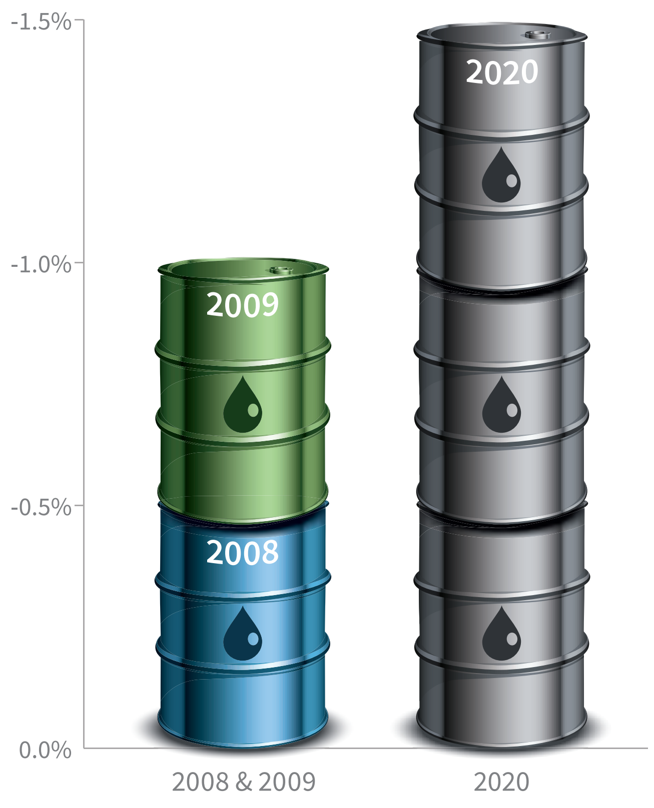
The oil market is facing an unprecedented one-two punch, but we envision recovery by 2021.

Oil's bear market dates back to February, with the clear culprit being the impact on global oil demand arising from the transportation and economic disruptions due to COVID-19. During January and February, COVID-19 had been seen as a problem largely contained within China. Throughout March, however, it became clear that the impact would be truly global in scope. As the public health situation in China shows encouraging signs of stabilization, the opposite is true practically everywhere else. As governments impose flight restrictions and other travel bans, enforce lockdowns, and require non-essential businesses to close doors, the impact on oil consumption is unlike anything in modern history. Numerous airlines are reporting over 50% flight cancellations. With 800+ million students affected by school and university closures, that means many fewer buses and cars on the roads. Countless millions of people are working from home, due to government directives or company instructions. In the second quarter of 2020, the impact of all these disruptions is likely to exceed 5 million barrels per day (bpd), or 5% of global demand. Needless to say, the timing of improvement in demand, enabled by the easing of the various restrictions, will largely be a function of medical and public health developments vis-a-vis the virus. Assuming that this second quarter figure marks the peak of impact, we forecast global demand down 1.5 million bpd for 2020, steeper than the declines from 2008 and 2009 (the two financial crisis years) combined.

Sometimes, when it rains, it pours. Such is the case with the oil price war between Saudi Arabia and Russia, which emerged suddenly and dramatically on March 7, compounding the already ultra-bearish demand backdrop. These two countries had collaborated as part of the OPEC+ coalition over the previous three years, but no longer. Saudi Arabia is vowing to increase oil production to record levels in response to Russia's refusal to cooperate with new production guidelines. This price war, to be clear, is not against US shale; this is a key contrast to the 2014-2016 price war. Saudi Arabia can see perfectly well what has been happening in the US oil industry: depressed rig counts and sharply slowing production growth, even before the dramatic events of recent weeks. The Saudi vs. Russia fight is partly economic, and it is also political. Russia will have a major constitutional referendum on April 22, arguably the most sensitive moment in domestic politics during Vladimir Putin's 20 years in power. In the run-up to the referendum, the Kremlin is stirring up nationalist fervor at home, and that translates into more intransigence than usual in foreign policy. Moreover, the Saudis and Russia have never stopped being at loggerheads over Iran and Syria. Here is the good news: assuming that Putin wins the referendum, we anticipate that Russia will become more receptive to international deal-making, opening the door to an agreement with Saudi Arabia in May/June, followed by normalization of Saudi oil production. It bears mentioning that the Saudi economy needs $70/Bbl Brent crude to balance its all-in fiscal requirements. Moreover – and this is another big distinction versus 2014-2016 – Saudi Aramco (its state-owned oil company) is now publicly traded. Does the Saudi crown prince want to deal with angry domestic investors who are seeing losses from the IPO price? Again, this factor, a key test of the royal family's credibility, did not exist four or five years ago. Russia's economy is less oil-sensitive, but it would also begin to feel real pain within months. Thus, we look at this Saudi-Russia breakup as a transitory issue.

In the short run, oil market conditions will surely be volatile. The floor during the 2014-2016 oil down cycle had been set when

Drop in Oil Demand



Source: Raymond James Equity Research as of 3/20/2020

“An oil price war between Saudi Arabia and Russia emerged suddenly and dramatically on March 7, compounding the already ultra-bearish demand backdrop.”

numerous data points began to emerge about higher-cost/lower-margin oil producers physically shutting down wells. Plenty of the world’s oil trades at hefty discounts relative to the light sweet benchmarks, so the point at which marginal cost begins to exceed marginal revenue at certain oilfields is closer than it might seem at first glance. West Texas Intermediate (WTI) crude stayed under $40/Bbl for approximately 100 days (from December 2015 through March 2016). Its absolute bottom was $26/Bbl in February 2016. This time, the degree of oversupply is much worse, so it stands to reason that the trough will also be lower. We think that WTI will test the $20/Bbl level in the second quarter of 2020 – the lowest since 1999 – averaging $25/Bbl for the quarter. After that, we forecast a V-shaped bounce to $45/Bbl in the fourth quarter and then a slower recovery to an average of $55/Bbl in 2021.

So, how is the oil industry handling this exceptionally difficult period? What practically every oil producer is currently focused on, as the first line of defense, is cutting capital spending. In many cases, they are cutting quite sharply, by 30% or even more, as compared to the initial budgets from January/February. Some reductions in corporate costs are also inevitable, and a limited number of companies will cut or suspend dividends. The main driver will be to slow drilling activity and postpone projects. By responding rapidly in this way, the large, investment-grade companies will be able to steer themselves through this period. In fact, they may even benefit - over a long-term timeframe - by taking advantage of this crisis as an opportunity to pick up cheap, distressed assets when some of the smaller players with excessive leverage end up going through bankruptcy.

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Dialing Down Expectations – What Should We Expect From the Markets Going Forward?

Nick Lacy, CFA, *Chief Portfolio Strategist,* Asset Management Services

US equities have handsomely rewarded stock investors over the past 10 years, generating a 13.6% annualized total return as measured by the S&P 500 Index. This stands in stark contrast to returns on high-quality bonds over the same time period, which only returned approximately 3.6% per year as measured by the Bloomberg Barclays US Aggregate Bond Index. However, the next 10 years will likely be very different than the last.

In order to make informed decisions when allocating assets, investors need to have a general idea of how each asset is expected to perform over a given time period. There are three broad asset classes that benefit from forecasting: stocks, bonds, and cash. Stocks tend to be the most difficult to forecast while bonds tend to be the least difficult. The best predictor of a return on a bond is the current yield on that bond, especially if it is a high-quality bond with a maturity matching the investor's time horizon. For example, if an investor bought an investment-grade bond with yield to worst of 3%, the return over that time period would roughly equal 3% per year, all else being equal.

The yield of the Bloomberg Barclays US Aggregate Bond Index has been a decent predictor of its future total returns (see figure 2). The current yield on US investment-grade bonds is around 2.0%, which can be used to gauge return expectations over the next 5-10 years. It bears mentioning that this is substantially lower than the total returns of investment-grade bonds over the last 10-20 years. Current interest rates, not only in the US but around the world, are much lower than they were before the financial crisis. With negative interest rates elsewhere around the world, this does not look like it will change any time soon.

> Dividends are fairly constant and tend to average around 2%, while earnings or sales growth may vary.

EQUITIES

Over time, equities should produce returns in line with earnings growth and dividends; however, the markets rarely do what they are supposed to do. The dividend yield on the US equity market has hovered around 2% over the last 10 years, while earnings growth has been approximately 6.5% per year since 2010. Markets should have returned 8.5% (6.5% plus the 2% dividend yield). However, the market actually returned 13.6%, over 5.1% more per year. The fact that price-to-earnings (P/E) multiples expanded substantially from 2009 to 2019 helps explain the significant difference in returns over this time period.

> “There are three broad asset classes that benefit from forecasting: stocks, bonds, and cash.”

Rolling 10-Year Returns

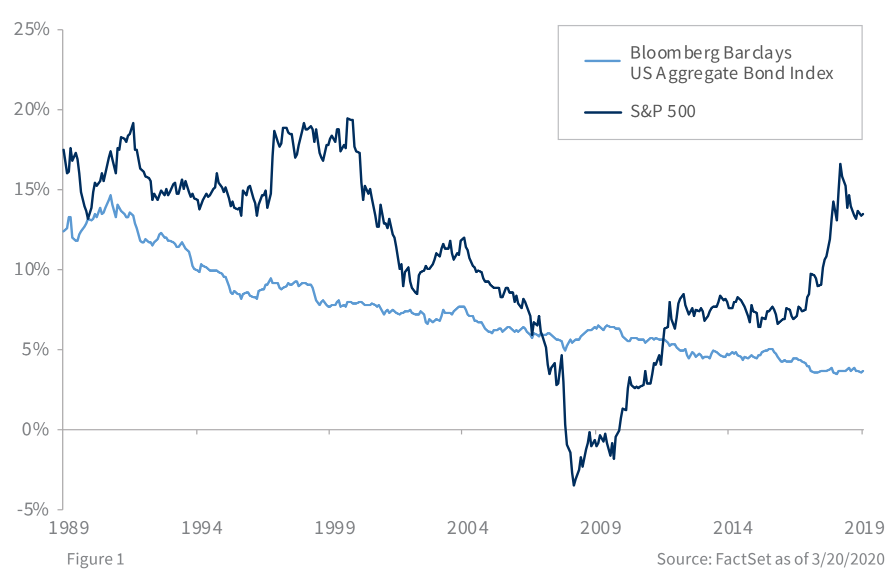

Figure 1

Source: FactSet as of 3/20/2020

Bloomberg Barclays US Aggregate Bond Index

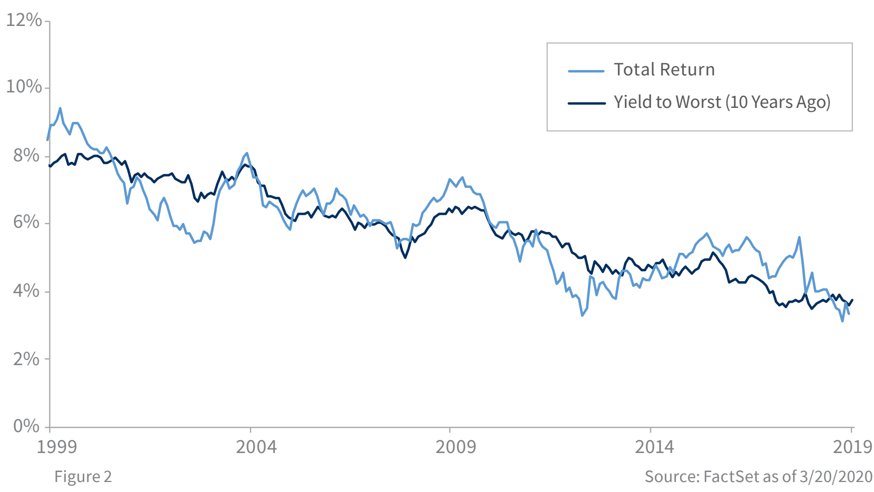

Figure 2

Source: FactSet as of 3/20/2020

What should investors expect going forward? Dividends are fairly constant and tend to average around 2%, while earnings or sales growth may vary. Research shows sales growth may be linked to economic growth and inflation, while earnings growth can be boosted by improving margins. What should we expect for economic growth over the next five years? Looking beyond 2020 and the impacts of COVID-19, consensus estimates indicate that US GDP and inflation will grow at 2% each per year, which results in a 4% sales growth estimate. How much companies earn will depend on several factors, such as borrowing and profitability. If earnings growth is exactly the same as sales growth with a 2% dividend yield, investors should expect to see returns of 6% going forward (inflation plus GDP growth plus dividends). While returns could be boosted by an expansion in P/E multiples or additional borrowing beyond the levels seen thus far, this seems unlikely.

The moral of this story is that investors should expect to see both bonds and stocks return relatively less over the next several years compared to the past 10 years due to lower yield levels, starting valuations, and economic conditions.

KEY TAKEAWAYS:

- In order to make informed decisions when allocating assets, investors need to have a general idea of how each asset is expected to perform over a given time period. The three broad asset classes that benefit from forecasting are stocks, bonds and cash.
- Current interest rates, not only in the US but around the world, are much lower than they were before the financial crisis. With negative interest rates elsewhere around the world, this does not look like it will change any time soon.
- Investors should expect to see both bonds and stocks return relatively less over the next several years compared to the past 10 years due to lower yield levels, starting valuations, and economic conditions.

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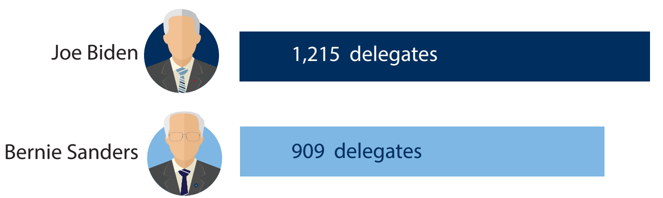
On the Ropes to Presumptive Nominee: Biden’s Historic Resurgence

Ed Mills, *Managing Director, Washington Policy Analyst,* Equity Research

A whirlwind Democratic primary appears to be nearing its conclusion with Vice President Biden emerging as the presumptive nominee (in our view) following a come-from-behind victory in South Carolina and a near-sweep in state victories through March. Biden currently leads Sanders with 1,215 delegates to Sanders’ 909, a sizeable lead (1,991 delegates are needed to clinch the nomination on the first ballot).

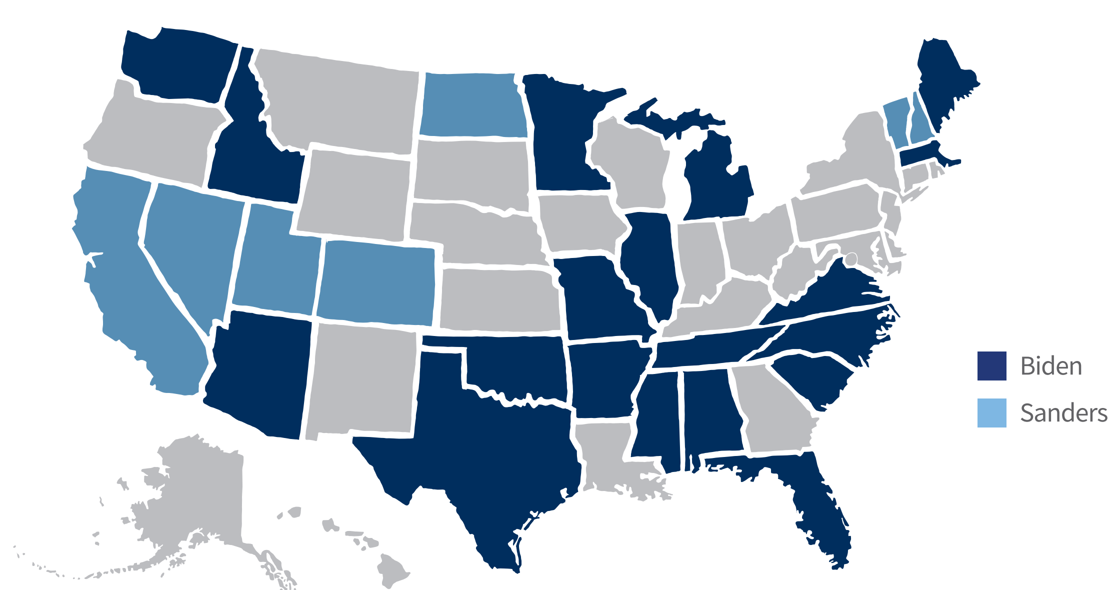


1,991 delegates are required to obtain the nomination.

The winner of either the Iowa, New Hampshire, or South Carolina primary has gone on to become the Democratic nominee since 1952. As such, there is no recent historical comparison to Biden’s resurgence to the top of the pack after finishing a distant fourth or fifth place in Iowa and New Hampshire. The last Democratic candidate to emerge as the nominee without having won Iowa or New Hampshire was Bill Clinton in 1992, but Clinton technically tied New Hampshire’s popular vote winner (Tsongas) in the delegate count. It would be easy to say that Biden was expected to win the South Carolina primary, so the results were somewhat in line with expectations. However, his margin of victory (especially following distant finishes in the early states) is extremely noteworthy. In the lead up to South Carolina, there were a series of polls that showed Senator Sanders right on Biden’s heels. Unfortunately for Sanders, he emerged from South Carolina not much better than his 2016 result, which is ultimately where his momentum stalled out again in the 2020 race.

> A female vice-presidential candidate will be on any Biden-led ticket, according to a pledge made by Biden at the last debate.

The coalescence behind Joe Biden as the clear alternative to Senator Bernie Sanders produced a much better than expected Super Tuesday result for the former Vice President. Former New York City Mayor Bloomberg picked up delegates, but massively underperformed expectations given he spent half a billion dollars on his campaign. Senator Elizabeth Warren came up short, including a



loss in her home state of Massachusetts. However, she may have been an unsung hero for the Biden campaign given that she used the last two debates to halt the rise of Bloomberg and that she likely pulled liberal voters from Sanders. From there, Democratic voters overwhelmingly pivoted toward Biden as he stacked up a series of impressive wins and expanded his delegate lead over Senator Sanders. Biden also quickly racked up endorsements from his rivals, and his coalition is now being compared to that of President Obama's in 2008. Biden's victory in Michigan was of particular note, given that it was previously won by Sanders in 2016 and ultimately helped to reinvigorate/prolong Sanders' challenge to Secretary Clinton.

The overall vote totals to date have supported the narrative that Senator Sanders is a high floor, but low ceiling candidate. Sanders won the delegate-rich state of California, his home state of Vermont, as well as Utah and Colorado. However, he fell short of the earlier delegate projections where he easily could have built an all but insurmountable lead in the delegate count. Senator Sanders consistently underperformed his 2016 vote totals, especially in Missouri and Michigan.

THE IMPACT OF COVID-19 – FLOCK TO THE FAMILIAR?

The spread of COVID-19 has upended the race in an unprecedented and uncertain way, which may still have ramifications on the Democratic convention depending on the trajectory of the outbreak. This uncertainty may have contributed to Biden's late-stage resurgence as voters may have been swayed more toward the safe and familiar choice during uncertain times. To date, nine states and Puerto Rico have postponed their primaries which leaves the race in a state of limbo, and we expect the list to grow (New York's primary is still scheduled for the end of April, potentially around the peak of the state's outbreak, per current projections).

As these primary reschedules ramp up, the Sanders campaign and Democrats could be faced with challenging logistics on how to finalize the process of selecting their nominee. The clearest path forward would be for Sanders to drop out of the race, making Biden the presumptive nominee. Alternatively, the Sanders campaign could hold out hope that the political winds change when voting resumes. We view this as unlikely, as Sanders would have to win the remaining contests by a margin of about 25 points, per election forecasters.

EARLY VEEPSTAKES

A female vice-presidential candidate will be on any Biden-led ticket, according to a pledge made by Biden at the last debate. The final selection likely hinges on the political environment that emerges in the coming months related to COVID-19. Senator Amy Klobuchar (D-MN) is seen as a 'safer, more moderate' pick. Senator Kamala Harris (D-CA) will be in the mix, but her personal attacks against Biden during the debates and the lackluster performance of her campaign are viewed as knocks against her. Stacey Abrams

of Georgia could be a pick that excites younger and African American voters. Senator Elizabeth Warren (D-MA) is also reported to be in the mix, if there is a need to have a bridge to the liberal wing of the party. Given that Biden would be the oldest elected president on inauguration day, his pick takes on additional importance which could swing the odds toward a safer pick.

PREVIEWING THE GENERAL ELECTION AND BEYOND

In our opinion, the medical, economic, and market outcome of COVID-19 will be a significant factor in the 2020 election. Should economic and health conditions continue to deteriorate, we expect a rise in expectations that Joe Biden captures the White House and a rise in the probability of an all-Democratic government. While he would swing the agenda away from the current Trump agenda (which has been received positively by the market over the past four years), Biden is generally viewed as promoting policy goals from the political mainstream and could easily push more fiscal stimulus. This would be viewed as having a neutral to positive impact on the market compared to the prospect of a Sanders presidency (which weighed on markets earlier this year). Should COVID-19 avoid the worst-case scenarios and the economy/market have a significant recovery in the latter half of the year, the momentum is likely to swing back toward President Trump. The big question will continue to be the effect of the current uncertainty on suburban voters. Incumbents are traditionally viewed as the safer choice, but Biden's familiarity may upend this calculation as we expect a "return to normalcy" to be the primary message of the Biden general election campaign.

In terms of a second term for President Trump, the initial reaction would be that this is a positive for the market should we see post-COVID-19 recovery in the second half of this year. A wave of momentum could produce down-ballot impacts that bring back an all-Republican government. Sentiment would be boosted on the continuation of the Trump deregulatory agenda and stimulus via additional corporate/individual tax cuts. However, an open question would remain as to whether the lack of any additional electoral checks would produce an unbound and bombastic President Trump on policy issues. A mitigating factor for the market here would be that second-term presidents are motivated by their legacy, and, as Trump is especially cognizant of market/economic metrics, his policy objectives should continue to support a positive environment for macro fundamentals.

Biden's strength in the South will stir a debate about the potential down-ballot impact. The Senate seats in Alabama, North Carolina, South Carolina, and the two seats in Georgia all lean Republican or are likely Republican seats at this point. We would not be surprised if these elections become more competitive. They are still a reach for Democrats, but winning any one of these would materially increase the chance of a Democratic Senate majority after the 2020 election with significant consequences for the markets from a policy perspective. An economic downturn coupled with this scenario would steer the early policy direction of a Biden presidency. We would expect to see stimulus efforts to jumpstart the economy, which could be a positive boost to infrastructure and unlocking consumer spending via debt relief (e.g., student loans, medical debt). In turn, this could benefit the housing market by increasing demand if debt relief measures spur a boom in housing demand by younger consumers who would otherwise have delayed a real estate purchase. Of course, this would be balanced by potential negatives, such as significant policy reforms targeting the Health Care, Financial, and Energy sectors. As we frequently say in Washington, developments are never as bad as you initially fear, or as good as you hope.

KEY TAKEAWAYS:

- In our opinion, the medical, economic, and market outcome of COVID-19 will be a significant factor in the 2020 election. Should economic and health conditions continue to deteriorate, we expect a rise in expectations that Joe Biden captures the White House and a rise in the probability of an all-Democratic government.
- Biden is generally viewed as promoting policy goals from the political mainstream and could easily push more fiscal stimulus. This would be viewed as having a neutral to positive impact on the market compared to the prospect of a Sanders presidency (which weighed on markets earlier this year).
- Should COVID-19 avoid the worst-case scenarios and the economy/market have a significant recovery in the latter half of the year, the momentum is likely to swing back towards President Trump.

Economic Snapshot

COVID-19 will have an uncertain impact on the US economy, but we know it's very bad in the near term. Much depends on whether the spread of the virus can be slowed, whether there will be an effective treatment, and how long extreme social distancing lasts. The Federal Reserve (Fed) has worked to ease credit strains and prevent a broader financial crisis. Fiscal stimulus won't prevent the economy from weakening, but will limit the damage and should help in the recovery. However, there are likely to be long-lasting changes to economic activity when the virus passes.

DR. SCOTT BROWN
Chief Economist

	ECONOMIC INDICATOR	COMMENTARY
FAVORABLE	THE DOLLAR	At some point, when the virus has run its course, global investors are likely to look for opportunities elsewhere, but the dollar is the safe haven in the near term.
FAVORABLE	MONETARY POLICY	The Fed has lowered short-term interest rates to effectively zero, restarted large-scale asset purchases (quantitative easing), and introduced several credit, liquidity, and funding facilities.
NEUTRAL	INFLATION	While the coronavirus has created supply issues, the reduction in global demand should put downward pressure on commodity prices. Weak domestic demand should limit consumer price inflation.
NEUTRAL	LONG-TERM INTEREST RATES	Bond yields have been somewhat unsettled, but should stabilize at relatively low levels amid the Fed's efforts to promote liquidity.
NEUTRAL	FISCAL POLICY	Fiscal stimulus should help to limit the economic damage from the virus and support the recovery. However, strains in state and local government budgets are likely to lead to spending cuts.
UNFAVORABLE	GROWTH	Efforts to mitigate the spread of COVID-19 are having a significant negative impact on many sectors of the economy.
UNFAVORABLE	EMPLOYMENT	Job losses are expected to surge sharply (the March employment data will understate the impact). The unemployment rate will head significantly higher in the next couple of months.
UNFAVORABLE	CONSUMER SPENDING	Social distancing has had a negative impact on several components of consumer spending and the ensuing loss of jobs and income will put further downward pressure on spending in the months ahead.
UNFAVORABLE	BUSINESS INVESTMENT	Increased uncertainty should reduce capital spending. The drop in oil prices will reduce energy exploration (which is capital intensive). The weaker global growth outlook is also a factor.
UNFAVORABLE	MANUFACTURING	Supply chain disruptions have broadened as the virus has spread around the world. Lower consumer spending and a drop in business investment are also factors. Global demand is weak.
UNFAVORABLE	HOUSING AND CONSTRUCTION	The housing sector was experiencing significant year-over-year improvement in early 2020. However, social distancing and the deteriorating job outlook appear to be affecting housing activity.
UNFAVORABLE	REST OF THE WORLD	The coronavirus has generated a global recession. The European economy has taken a major hit and the impact in other regions will be severe as the virus spreads.

Sector Snapshot

J. MICHAEL GIBBS
Managing Director of Equity Portfolio & Technical Strategy

This report is intended to highlight the dynamics underlying the 11 S&P 500 sectors, with a goal of providing a timely assessment to be used in developing your personal portfolio strategy. Our time horizon for the sector weightings is not meant to be short-term oriented. Our goal is to look for trends that can be sustainable for several quarters; yet given the dynamic nature of financial markets, our opinion could change as market conditions dictate.

Most investors should seek diversity to balance risk versus reward. For this reason, even the least-favored sectors may be appropriate for portfolios seeking a more balanced equity allocation. Those investors seeking a more aggressive investment style may choose to overweight the preferred sectors and entirely avoid the least favored sectors. Investors should consult their financial advisors to formulate a strategy customized to their preferences, needs, and goals.

These recommendations will be displayed as such:

Overweight: favored areas to look for ideas, as we expect relative outperformance

Equal Weight: expect in-line relative performance

Underweight: unattractive expectations relative to the other sectors; exposure might be needed for diversification

For a complete discussion of the sectors, please ask your financial advisor for a copy of *Portfolio Strategy: Sector Analysis.*

	SECTOR	S&P WEIGHT	COMMENTARY
OVERWEIGHT	INFORMATION TECHNOLOGY	24.4%	It is hard not to like this sector relative to others. Despite posting exceptional gains and moving to an elevated valuation before the market decline, the sector held up remarkably well (on a relative basis). The health crisis reiterated how many Technology subsectors offer favorable business models for the "new economy" of mobility and telecommuting.
OVERWEIGHT	HEALTH CARE	14.0%	With much uncertainty ahead, the Health Care sector offers defensive characteristics with fundamental trends more consistent than other sectors. Many subsectors will see a hiccup in business (elective surgery) as the nation fights the virus outbreak. However, pent-up demand will produce favorable results in future data. Once this period passes, lessons learned from the crisis (such as the risk of outsourcing key drug components to other countries, failing to keep health care supplies adequately stocked for dire situations, as well as the need to expand our ability to combat future virus outbreaks) will benefit the sector.
OVERWEIGHT	FINANCIALS	12.2%	We are defying the clear fundamental challenges of low interest rates and recessionary conditions by maintaining an Overweight position. Attractive valuations and strong financial positions (now vs. the credit crisis) keeps us interested. Given the magnified returns they offer on the upside, portfolio positioning in some of the hardest hit sectors may be beneficial. The record stimulus may lift the economy more rapidly than we envision today. In such a case, interest rates will move higher and carry the group with them. We remain Overweight for now while we monitor the virus outbreak and the measures taken to contain it.
OVERWEIGHT	COMMUNICATION SERVICES	10.7%	The Communication Services sector stands out in this current environment of uncertainty as an attractive risk vs. reward proposition. The need for mobility and telecommuting reinforces the attractiveness of numerous constituents in the index. The defensive dividend-paying wireless providers, as well as the fast-growing over-the-top (OTT) media providers, are in the right place at the right time. Relative strength gains during the market meltdown are evidence of the attractiveness of this sector.
EQUAL WEIGHT	INDUSTRIALS	8.9%	We downgrade Industrials given that we expect a return to growth in US manufacturing will be delayed. This is largely due to weak economic conditions stemming from the impact of the COVID-19 pandemic (business closures, etc.).
EQUAL WEIGHT	CONSUMER STAPLES	7.2%	Given the current uncertainty, we upgrade Consumer Staples in order to add some defensive characteristics to our overall sector allocation. Measures to contain COVID-19 benefit many companies in the Consumer Staples sector. Even as normality returns, consumers are likely to stick close to home for a while, adding further demand for Consumer Staples products. On a technical basis, it is a "defensive" sector that has actually provided some outperformance in this bear market so far.
EQUAL WEIGHT	CONSUMER DISCRETIONARY	9.9%	Millions of job losses and the uncertainty regarding their return cause us to remain cautious on Consumer Discretionary. If the virus peaks faster than current expectations, financial benefits from the fiscal stimulus may enhance consumption. However, this is not our base case expectation as our belief is the consumer is likely to be a saver coming out of this period.
UNDERWEIGHT	ENERGY	3.6%	Our downgrade of Energy is unavoidable given the Raymond James Energy Team's forecast for vastly oversupplied energy markets in the near term as demand drops and supply increases in part due to the Saudi/Russia price war. With Energy falling to just a 3.6% weighting in the S&P 500 index (2007 peak: 13%), a long-term opportunity is likely unfolding. However, with the near-term picture deteriorating rapidly, we feel an Underweight stance is appropriate.
UNDERWEIGHT	REAL ESTATE	3.1%	This "defensive" sector did not offer much defense during the market sell-off. With interest rates excessively low, and with the sector now offering enough beta to keep up with the overall market on the upside, we do not view the risk vs. reward favorably.
UNDERWEIGHT	UTILITIES	3.5%	With valuation elevated and an inverse relationship with interest rates, we find other areas more attractive.
UNDERWEIGHT	MATERIALS	2.5%	The deeply cyclical Materials sector likely faces challenges with economic deterioration likely.

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International investing involves special risks, including currency fluctuations, different financial accounting standards, and possible political and economic volatility. Investing in emerging and frontier markets can be riskier than investing in well-established foreign markets.

Investing in small- and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor.

There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise.

US government bonds and Treasury bills are guaranteed by the US government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. US government bonds are issued and guaranteed as to the timely payment of principal and interest by the federal government. Treasury bills are certificates reflecting short-term obligations of the US government.

While interest on municipal bonds is generally exempt from federal income tax, they may be subject to the federal alternative minimum tax, or state or local taxes. In addition, certain municipal bonds (such as Build America Bonds) are issued without a federal tax exemption, which subjects the related interest income to federal income tax. Municipal bonds may be subject to capital gains taxes if sold or redeemed at a profit.

If bonds are sold prior to maturity, the proceeds may be more or less than original cost. A credit rating of a security is not a recommendation to buy, sell or hold securities and may be subject to review, revisions, suspension, reduction or withdrawal at any time by the assigning rating agency.

Commodities and currencies are generally considered speculative because of the significant potential for investment loss. They are volatile investments and should only form a small part of a diversified portfolio. Markets for precious metals and other commodities are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Investing in REITs can be subject to declines in the value of real estate. Economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments.

High-yield bonds are not suitable for all investors. The risk of default may increase due to changes in the issuer's credit quality. Price changes may occur due to changes in interest rates and the liquidity of the bond. When appropriate, these bonds should only comprise a modest portion of your portfolio.

Beta compares volatility of a security with an index. Alpha is a measure of performance on a risk-adjusted basis.

The process of rebalancing may result in tax consequences.

Alternative investments involve specific risks that may be greater than those associated with traditional investments and may be offered only to clients who meet specific suitability requirements, including minimum net worth tests. Investors should consider the special risks with alternative investments including limited liquidity, tax considerations, incentive fee structures, potentially speculative investment strategies, and different regulatory and reporting requirements. Investors should only invest in hedge funds, managed futures, distressed credit or other similar strategies if they do not require a liquid investment and can bear the risk of substantial losses. There can be no assurance that any investment will meet its performance objectives or that substantial losses will be avoided.

The companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence.

The indexes are unmanaged and an investment cannot be made directly into them. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. The S&P 500 is an unmanaged index of 500 widely held securities. The Bloomberg Barclays U.S. Aggregate Bond Index contains approximately 8,200 fixed income issues and represents 43% of the total U.S. bond market.

The VIX is the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

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