2020 FIRST QUARTER COMMENTARY AND OUTLOOK

Our thoughts and prayers go out to all families who have been affected by the COVID-19 pandemic. Each of us at KLS truly appreciates the kind words and e-mails we have received from you, our valued clients, during this challenging time.

We entered 2020 following the strongest year for U.S. equities since 2013, cautiously optimistic that strong labor markets, robust consumer spending, low inflation and accommodative monetary policy would continue to drive the growth of the U.S. economy and corporate earnings. As the world began to monitor the COVID-19 outbreak, early hopes that the disease would be contained in China and the impact on the U.S. economy would not be severe were dashed as the disease spread beyond Asia to Europe and the U.S. The impact of COVID-19 on the global economy has been shockingly sudden and severe, as evidenced by the reaction of global markets and the economic data seen thus far. It is impossible to determine at this moment the duration of the decline, or how long it will be before we see a recovery. However, over the last three weeks there is optimism that the magnitude and speed of the monetary and fiscal reaction, along with the social-distancing practices being embraced by the general population, could lead to a more rapid end to the recession than some of the direst forecasts predict.

Driven by fear and the uncertainty of the public health and economic consequences of the coronavirus pandemic, the first quarter of 2020 and the ensuing few weeks have been marked by unprecedented volatility in almost all asset classes. The U.S. stock market, as represented by the S&P 500, experienced its quickest descent into a bear market in history, falling by over 20% in just 16 trading sessions. The index ultimately suffered a decline of over 33% from peak levels in February before bottoming on March 23rd. Market volatility expectations as measured by the CBOE Volatility Index (“VIX”) also ventured into unchartered territory, reaching an all-time high on March 16th, exceeding the previous record level set in November 2008. By the close of the first quarter, the S&P 500 was down 19.6%, while global equities, as represented by the MSCI All World Index, declined by 21.4%.

Index / Market	Q1 2020	2019
Dow Jones Industrial Average	-22.73%	25.34%
S&P 500	-19.60%	31.49%
S&P 400 (Mid Cap)	-29.70%	26.20%
NASDAQ	-13.95%	36.69%
Wilshire 5000	-20.70%	31.02%
Russell 2000 (Small Cap)	-30.61%	25.52%
MSCI Europe	-24.33%	23.77%
MSCI EAFE	-22.83%	22.01%
MSCI Emerging Markets	-23.60%	18.42%
MSCI All Country World	-21.37%	26.60%
MSCI All Country World ex USA	-23.36%	21.51%

The U.S. Fixed Income markets, as measured by the Barclays U.S. Aggregate Bond Index, were up 3.2% in the first quarter. However, this belies the enormous disparity in performance across sectors of the bond market. A flight to quality driven by fears of a potential economic collapse led to a surge in the price of longer dated U.S. Treasuries, as reflected by the Barclays U.S. Treasury Index's rise of 8.2%. For the first time in history, the entire yield curve temporarily fell below 1%, with short term Treasury bill yields briefly falling below 0%, the 10-year Treasury yield reaching an all-time low of 0.32%, and the 30-year Treasury yield touching a record 0.70%. Meanwhile, credit spreads spiked on pandemic-related concerns, as the U.S. Corporate Bond Index fell by 3.6% for the quarter. The municipal bond market also experienced a sharp decline and extraordinary volatility amidst larger concerns with state and local governments' ability to meet their obligations in light of the economic slowdown.

Index / Market	**Q1 2020**	**2019**
Barclays U.S. Aggregate Index	3.15%	8.72%
Barclays U.S. Corporate Bond Index	-3.6%	14.82%
Barclays U.S. Corporate High Yield Index	-12.68%	14.5%
Barclays U.S. Treasury Index	8.2%	7.12%
Barclays U.S. Municipal Bond Index	-0.63%	7.56%

The adoption of social-distancing and shelter-at-home measures across the U.S. led to nearly 10 million initial unemployment claims filed by Americans in the two weeks ending on March 28th and another 12 million in the following two weeks, eliminating within four weeks all job gains since the Great Recession. The oil price war between Saudi Arabia and Russia that began in early March has further added to the U.S.'s economic woes, as the resultant collapse in oil prices likely will lead to layoffs and debt defaults in the U.S. shale industry. While U.S. consumers generally benefit from falling gasoline prices, demand has significantly declined as people remain at home. Early economic forecasts paint a dire picture for U.S. Gross Domestic Product growth for the second quarter and possibly beyond. Similarly, G.D.P. is expected to fall drastically in China, the Eurozone and the U.K., as the world braces for a global recession in 2020.

In the face of rapidly falling markets and an impending economic crisis, unprecedented actions were taken by the Federal Reserve to provide stability to the marketplace and help avert a full-scale collapse. On March 15th, the Federal Reserve cut its benchmark interest rate to nearly zero, launched a $700 billion quantitative easing program, and established the Money Market Mutual Fund Liquidity Facility. A week later, the Fed aggressively expanded its rescue plan, announcing major steps that included unlimited monetary easing; the purchasing of U.S. Treasury securities, commercial mortgage backed securities, corporate bonds and related ETFs; establishment of lending facilities aimed at supporting credit to large employers, consumers and businesses; expanding programs that support debt issued by companies and state and local governments; and the launch of a Main Street Business Lending Program to support lending to small-and-medium sized businesses.

The Federal Government followed suit on March 27th, passing the Coronavirus Aid, Relief, and Economic Security ("CARES") Act, which contains a record $2.2 trillion in total financial relief for businesses, public institutions and individuals impacted by the coronavirus. The Act expanded unemployment benefits, provided emergency loans for small and large businesses, increased funds for hospitals and health providers, delivered aid for distressed cities and states, and authorized direct cash payments to the American people. The $349 billion Paycheck Protection Program, which aimed to keep employees in their jobs by providing small businesses low interest loans with forgiveness potential to cover key expenses such as payroll, rent and utilities, was exhausted within two weeks of its launch.

The aggressive actions by the Federal Reserve and the U.S. Government demonstrate the commitment to do whatever is necessary to stabilize the economy. Congress has been working on additional relief measures since the end of the first quarter. Similar measures have been taken in Europe, China, Japan and India in an attempt to avert an even more calamitous economic decline. The short-term reaction has been positive, as equities rebounded and credit markets have begun to stabilize. However, markets remain extremely volatile, and uncertainty continues to be the overriding theme.

Outlook

As we move through the second quarter of 2020, we will be closely monitoring a number of key issues that can help bring more clarity to the extent of the economic decline, and potentially provide signs that a recovery is underway.

Labor Markets

It remains to be seen whether the Paycheck Protection Program, or similar programs yet to come, will reach employers quickly enough to stem the tide of layoffs, or whether employees will remain in their jobs if they can receive extended unemployment benefits exceeding their normal weekly income. Clearly the most important factor in reversing the unemployment trend is containment of the virus, which would pave the way for modified business activity to resume.

Consumer Spending

For over a decade, U.S. consumer spending has proven to be the most resilient and consistent driver of the economy, accounting for two-thirds of G.D.P. over the past 10 years. Over this period, the U.S. consumer has shown strength even through stints of slowing economic growth, global trade battles, and geopolitical unrest. However, the unprecedented economic impact of the coronavirus outbreak will almost certainly lead to a sharp reduction in consumer spending as unemployment has soared, investment portfolios have declined in value, and compensation for those who have retained their jobs may be under pressure due to declines in business activity. Key factors to keep an eye on to determine U.S. consumer sentiment are recoveries in the job market and the willingness of consumers to engage in activities which do not easily lend themselves to social distancing, e.g., travel, dining out, entertainment and sporting events.

Corporate Earnings

Earnings season has begun, and first quarter 2020 results will wildly vary based on the timing of when COVID-19 disrupted a particular company's business. Many companies are reluctant to provide forward guidance in light of continuing uncertainty, but the first quarter likely will mark the beginning of an earnings recession, with profits expected to fall for at least the first two quarters of 2020. While there will clearly be an earnings decline in the coming months, the uncertainty surrounding the duration and magnitude of this decline makes it extremely challenging to assess whether stocks are fairly valued or not.

Monetary & Fiscal Policy

One of the most important lessons learned from the 2008 financial crisis was that policy responses must be large and implemented rapidly, and that it is better to err on the side of providing too much stimulus than too little. Extreme economic shocks can quickly turn into a self-reinforcing downward economic spiral if not addressed quickly, as consumers start spending less, businesses lay off workers, unemployment rises, leading to a further decline in spending, and so on. The unprecedented actions taken by the Federal Reserve and the Federal Government in March indicate that policy makers have taken this lesson to heart, and intend to do whatever it takes to avert a worst-case scenario. It will be important to assess the speed and efficiency with which stimulus to date, and future stimulus, is available to the individuals and businesses that need it most, and whether the Fed, Congress and the Executive Branch remain motivated to act swiftly should the economy continue to show weakness and signs of further decline.

Portfolio Construction

As stated above, we entered 2020 cautiously optimistic that the economic conditions, pre-pandemic, remained supportive of corporate earnings growth. As market volatility and economic decline ensued, KLS implemented a series of portfolio changes to ensure that clients had the necessary liquidity and portfolio stability to weather these extraordinary times. With that objective in mind, in mid-March we fully exited positions in money market funds that held municipal and corporate debt, moving the capital into U.S. Treasury and Government money market funds to ensure that cash equivalents are held in the most secure and liquid form.

Later in the month, we reduced clients' exposure to municipal debt, transferring bond fund proceeds to U.S. Treasury and Government money market funds. The decision to reduce the municipal bond exposure was made in response to the extraordinary volatility in the municipal bond market and the specific use of derivatives to hedge interest rate risk by the fund managers. These holdings were no longer providing the stability and diversification benefits that we would expect from our fixed income allocation. Clients continue to have some exposure to municipal bonds through investments in the Vanguard Limited and Intermediate Term Tax-Exempt funds and, for certain clients, through separately managed individual municipal bond accounts.

As the stock market fell, KLS did not rebalance into equities given the uncertainty surrounding the economic fallout of the pandemic. We did, however, reposition the exposure among equity funds. Specifically, we believe larger companies with strong balance sheets are better positioned than smaller capitalization companies to survive a sharp economic decline, while continuing to have upside potential once a recovery is underway. We also believe that growth oriented companies – particularly technology firms that can adapt to and prosper from the new economic reality resulting from the crisis – should outperform going forward.

These portfolio changes should provide clients with a portfolio that can better navigate these turbulent times, while preserving the ability to participate in the upside should equity markets continue to rally. The KLS Investment Committee remains vigilant in monitoring and evaluating economic and market conditions and we will modify client portfolios as appropriate. As always, we encourage you to reach out to your KLS Advisor to discuss KLS' perspective on the capital markets and how it pertains to your particular circumstances.

We continue to wish you and your families the very best throughout these extraordinary and challenging times.

April 22, 2020

The above commentary represents the economic and market views of our firm. We remind you, however, that each client's portfolio is managed individually. Please speak with your KLS advisor with respect to your personal circumstances and individual portfolio performance.

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