Sterling Advisors

REVIEW & OUTLOOK – 1Q2020

This Review & Outlook includes commentary on Sterling Advisors' three investment strategies: Large Cap Value, Large Cap Core and Intermediate Fixed Income. As a valued client, we want you to be aware of and updated on all investment options available from Sterling Advisors.

Closing Prices 3/31/2020	
DJIA	21,917.16
S&P 500 Index	2,584.59
Barclays Intermediate U.S. Govt.	2,289.59
Russell 1000 Value	980.50
Russell 1000 Growth	1,770.52
NASDAQ	8,972.60
U.S. Treasury Bond	
Current Yield 10-year Bond	0.6695%
Current Yield 30-year Bond	1.3214%

Source: Bloomberg

The Market Environment

We wake up to a world vastly different than the one that greeted us just a few months ago. The current global health crisis has changed all our daily routines and consequently brought most of our economy to a standstill. As a result, the decade-long bull market in stocks has concluded, giving way to what can only be described as an unprecedented decline in terms of speed and volatility. Large Cap U.S. stocks, represented by the S&P 500 Index, retreated 19.60% in Q1. Bonds, fueled by a flight to safety and plummeting interest rates, provided ballast during the quarter, evidenced by the Bloomberg Barclay's Aggregate Bond Index's 3.15% gain.

Major U.S. stock indices peaked on Feb. 19th as it became evident the novel coronavirus was not contained and represented a more dire public health and economic threat than previously understood. As the case count and economic disruption accelerated, the Federal Reserve cut interest rates by 0.5% on March 3rd, and again by 1% on March 15th as an emergency measure. Additionally, a far-reaching stimulus plan is being implemented to stem the economic fallout. It contains provisions such as additional unemployment insurance, small business loans, tax relief, and aid to the most impacted essential industries. It would be premature to forecast how the economy will respond to the relief package, as the duration of the crisis and extent of the economic impact is unknown. What does look unavoidable is a recessionary period due to this sudden shock to consumer demand and overall business activity. As disconcerting as this may be, we're encouraged that the Federal Reserve and the U.S. Treasury are promptly responding with all available fiscal and monetary tools.

It has undoubtedly been a difficult period of time for investors, and each of us from a health and family perspective. We understand these concerns, acting together, can create a weight of uncertainty. Our focus has been, and will be, to make sure your investments, both equities and fixed income, are of the highest quality. We're investing in businesses with the financial strength to emerge from this crisis, however long it may last, properly positioned to not only survive, but to prosper. On a personal level, we ask that you take care of yourself and your family, remembering the long-term outcome, whether it be your health or your investment account, is what matters most. That said, if your cash needs or risk tolerance have changed materially due to a change in employment status or any other hardship, these are things that should be discussed to ensure proper asset allocation.

Large Cap Value

The Large Cap Value Strategy continues to operate smoothly with our investment team working remotely since mid-March. We're meeting regularly by teleconference, and continuing to conduct our analytical process without interruption. Value stocks, in aggregate, suffered losses greater than most other styles in the first quarter. For example, the Russell 1000 Value Index shed -26.72% vs. the S&P 500 Index's -19.60% decline. Much of this disparity has to do with differences in sector weightings and investor preference for mega-cap household names with strong balance sheets. The Strategy benefitted from de-emphasizing more cyclical areas such as Energy, Transports, and Financial Services, which performed particularly poorly during the three-month period. Exposure to the Information Technology and Consumer Staples sectors increased as our investment team acted on individual opportunities that matched our somewhat more defensive macro viewpoint. Cash levels were reduced significantly as a result of these opportunistic investment changes. As always, these decisions are made at a group level, and reflect our top-down views coupled with the output from our quantitative screening process.

Several new investment themes currently expressed in the Large Cap Value Strategy include::

- More emphasis on large-cap technology issues with superior financial strength, whose products and services are ubiquitous in daily life
- Continued ownership of pharmaceutical, biotechnology and managed care companies, which continue to show attractive relative valuation, reliable dividends, and defensive characteristics appropriate for a recessionary economic period
- Reduction of holdings in the freight delivery and railroad industries due to our anticipation of lower levels of economic activity
- Reduction of financial services holdings, particularly regional banks, due to earnings headwinds that are likely to persist

The Strategy remains close to fully invested and has acted opportunistically to rotate into sectors that not only offer attractive relative valuation, but should have the ability to provide stability in a recessionary period. We're mindful of the rapidly changing economic conditions and the uncertainty created by the current public health crisis. Our goal remains to provide attractive returns while managing risk and protecting capital by avoiding unnecessary risks.

Large Cap Core

The first quarter brought unprecedented volatility as investors dealt with a whirlwind of negative news in a short time span: COVID-19 spread, Russian/Saudi energy fight, social distancing and "stay-at-home" orders from U.S. states affecting schools, businesses and restaurants, and obvious worries of a deep recession. Never before in modern history have global governments decided to shut down a good portion of the world's productive capacity. Unemployment has ticked up as layoffs and furloughs increase in numbers as plants and businesses shut down. In the U.S., the speed and the magnitude of the economic response to combat the economic slowdown has been swift and monumental. Given the crisis, our team has been communicating almost daily through these turbulent times.

Our stock selection focusing on companies with strong balance sheets, a competitive moat, pricing power and scale to weather these turbulent times has served us well. The S&P 500 Equal weight index was down 27% on the quarter, compared to the S&P 500 capital weighted index down 20%. It's clear the "average" stock did worse than the "market averages," with big technology companies performing better on a relative basis to buoy the capital weighted index. From a sector perspective, our biggest sector weights were healthcare, technology, financials and consumer staples. We sold companies where we feel the structural investment thesis has changed and continue to hold companies where essential spending drives more of the revenue. With so much volatility in the capital markets, we are constantly looking to redeploy accumulated cash to tactically add great quality companies where we feel short term sentiment is too negative and the valuation seems compelling for future growth.

Investors around the world and the U.S. are in a tough situation right now. In this modern age, it's anybody's guess if the bottom is in for the market. There are no credible earnings estimates at the moment as many companies have pulled future guidance estimates, and supply chains are impaired. Certain weaker energy, retail and mortgage companies have already started suspending or reducing dividends and stock buyback programs. Time will heal these wounds, just as it always has, but it may take longer. This is a challenging time, not just because of the coronavirus, but because the necessary policy solutions today will turn into tomorrow's problems. We continue to monitor capital market bellwethers and leading indicators to identify new market trends and minimize risk.

If earnings drive stock prices, and corporate earnings were at records levels just a few months ago, how low will those earnings come down? Do current stock market prices already discount the impact of the economic slowdown? Where the bottom is for the market and the economy is anyone's guess, and the climb back to the peak for the market and the economy will no doubt have additional volatility. We think this will be a major psychological shift for investors away from certain asset classes for a considerable amount of time in favor of what is perceived to be high quality. Investors will not want to go through the roller coaster of the last couple of months from fear of being in investments that will not be able to weather the "next" storm. We are engaging with clients and encourage open communication with us at all times as risk tolerance, financial planning goals and income needs may have changed. We will get through this slowdown and hope you and your respective families are safe and healthy.

Fixed Income

The exogenous shock unfurled by COVID-19 provided a valuable reminder of why diversification matters. In the first quarter, core US fixed income provided valuable ballast to the unexpected drawdown in US equities. As the coronavirus outbreak evolved into an official pandemic, investors sought the safe haven of US Treasuries. US Treasury yields fell dramatically to all-time lows, delivering double-digit returns in Q1 for securities dated 10 years and longer. However, many corners of the fixed income market endured an abrupt-but-brief sell-off, despite the positive US Treasury backdrop. This type of dislocation within US fixed income is extremely rare. As uncertainty grew over the virus's ultimate economic impact, a large number of investors looked to sell their high-quality, fixed income holdings – investment grade municipals and corporates were common sale candidates – to raise defensive cash positions. Even US Treasury yields spiked higher as the selling pressure overwhelmed demand, despite the US Treasury market's deep liquidity characteristics. The "liquidate at any cost" sentiment pervaded high-grade US fixed income for most of March. Investment grade corporate credit spreads (i.e., the additional yield available in investment grade corporate bonds versus a US Treasury bond with the same maturity) jumped to their highest point since the financial crisis. AAA-rated municipal bond yields hit their highest point since mid-2014. Liquidity in high-grade debt evaporated virtually overnight. The "forced sellers" were accepting dramatically lower prices to exit their positions. Those who kept a steady hand through the initial shock have been rewarded with a drastic improvement in these markets tones. Since mid-March, the US Federal Reserve has committed to an unprecedented level of support in these markets to help restore liquidity and smoother market function. As a result, investment-grade corporate credit spreads have tightened significantly and municipal bonds have enjoyed one of their most powerful rallies on record. We recognized the developments in high-quality, fixed income markets as ones driven by liquidity issues – a very different threat from a credit crisis where the near-term risk of issuer defaults spikes. Our portfolios benefited from a strong emphasis on high-quality, fixed income and a disciplined approach to security selection. We continue to express a significant bias toward high-quality, fixed income exposures to help offset any further equity volatility.

Outlook

As we shape our outlook to reflect the dramatically different set of circumstances that exist today vs. a short time ago, we feel it's imperative to acknowledge the economy has been fundamentally altered based on the coronavirus public health crisis and the changing consumer behavior it's created. As long-term investors, our focus will remain wealth creation and capital preservation through diversified portfolio management. Given the U.S. economy is mostly driven by services and consumer spending, we do anticipate the impact of the economic shutdown and demand shock will create an economic recession. Therefore, the central themes of our outlook for the remainder of 2020 are to move up in quality of equities and fixed income, focus on businesses less reliant on GDP growth, and avoid heavily indebted companies.

Given the end result of the coronavirus pandemic remains unknown in terms of its death toll and economic impact, maintaining a flexible mindset and investment outlook is important. Below are what we currently see as the most pertinent risks, and also positives, that will shape the future path of the economy and financial markets.

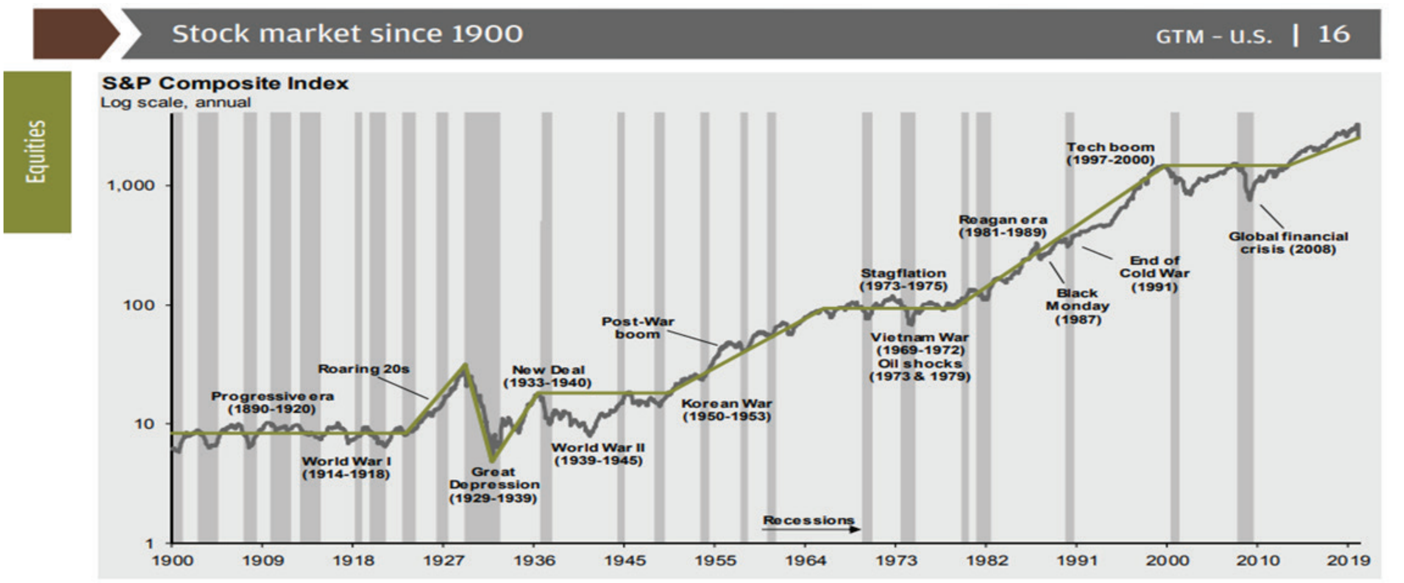
Positives

- Low interest rates
- Unprecedented fiscal and monetary stimulus
- Drastically reduced earnings expectations
- U.S. consumer's historical resilience

Risk Factors

- Unknown extent of damage to the economy
- High corporate and municipal debt level
- Rising unemployment
- Negative "wealth-effect" if falling asset prices

Based on the elevated risks and the understandable emotional response investors are feeling, we expect heightened volatility to continue until financial markets have more clarity on the impact of the coronavirus crisis. While we acknowledge the current crisis in unique in its devastating impact on public health, the following graphic may help to provide historical perspective for long-term investors about the benefits of staying the course during crisis periods.



*JP Morgan Guide to The Markets – March 31, 2020.

To summarize, our outlook is anchored in realistic expectations based on the economic shock the coronavirus crisis has created. We expect the economic data and unemployment figures to get worse before they get better, but we believe the majority of damage to asset prices has been done. The recovery will take time, patience, and all of our cooperation to help limit the spread of the virus. We ask you take care of yourself and your family, remembering the long-term outcome, whether it be your health or your investment account, is what matters most. That said, if your cash needs or risk tolerance have changed materially due to a change in employment status or any other hardship, these are things that should be discussed. As always, please feel free to contact us for any reason, and we hope that our next quarterly communication arrives under better circumstances.

Source: FactSet, Bloomberg & JP Morgan

Sterling Advisors

150 South Warner Road, Suite 200, King of Prussia, PA 19406
610-687-6800
bbtsterlingadvisors.com

Dow Jones Industrial Average: The most widely used indicator of the overall condition of the stock market, a price-weighted average of 30 actively traded blue chip stocks, primarily industrials. **NASDAQ Composite Index:** Measures all NASDAQ domestic and international based common type stocks listed on The Nasdaq Stock Market. The NASDAQ Composite is calculated under a market capitalization weighted methodology index. **Standard and Poor's 500 Index:** Capitalization-weighted index of 500 stocks, including the reinvestment of dividends and other distributions, designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. **Russell 1000 Value** Measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.