viewpointe
A Horizon Trust & Investment Management Publication
HORIZON
ISSUE NO. 70, FOURTH QUARTER 2020

"Nothing is improbable until it moves into past tense." *- George Ade*

While the global coronavirus pandemic wreaked havoc on the economy and drove an unprecedented spike in unemployment, policy makers reacted with record levels of stimulus and accommodative monetary policy. This robust policy response significantly reduced the economic impact. With most of this stimulus already spent, the question remains whether more stimulus will be enacted to fill the void until the economy is strong enough to stand on its own. Unfortunately, the road ahead is uncertain in the intermediate term. Fiscal stimulus has amounted to trillions of dollars of income replacement and has significantly contributed to positive economic improvements. For the most part, the timing and scale of additional stimulus will determine the path of the U.S. economy and the direction of the markets in coming months. In this edition of Viewpointe, we discuss recent developments and provide our outlook going forward. Since much depends on the introduction of a coronavirus vaccine, in the financial planning section we provide a basic summary of how vaccines work as well as how they typically are developed.

Economic Review - Low Hanging Fruit

For most of us it is hard to think of a more trying time than what we experienced during the early months of the pandemic. The fact the U.S. economy avoided a "Depression-like" recession is a testament to policymakers' bold and timely response. The consensus expectation is the worst of the economic drag took place during the second quarter. We agree with that assessment. While the worst may be over, unfortunately, history has shown that a recovery typically accelerates quickly out of the trough and slows down once the low hanging fruit has been picked. Following this initial acceleration future gains typically become harder to come by.

While many economic indicators have significantly rebounded in percentage terms off of their second quarter lows, it is important to note that our base case does not call for the U.S. economy to get back to end of 2019 economic output levels until at least the end of 2021. We think it is important to point this out since many investors confuse the double digit percentage increases in multiple economic indicators as a sign the U.S. economy is close to being back up to pre-pandemic levels. While these increases are significant, the U.S. economy still has a long way to go to get back to where it was. To drive this point home, we feel the best method is to provide a brief mathematical example.

For illustration sake, we will assume a country's gross domestic product (total value of goods produced and services provided) for calendar year #1 was $100. Let's say that in calendar year #2 the country faced a deep recession that resulted in an economic reduction of 50%, resulting in gross domestic product of $50 (50% of $100). In year #3, the economy recovers by 50%. Is economic growth back to year #1 levels? After all, the economy dropped 50% and then gained 50%. It is not. A 50% increase on a $50 base only gets output up to $75 (50% of $50 is $25). It would, in fact, take a 100% growth rate in year #3 to get back up to year #1's $100 output level. In short, percentage growth is typically higher early on when you are coming off a very low base. These high growth rates can create the illusion that you have recovered much more than you actually have.

With that said, growth is growth and the important thing is that as a whole the U.S. economy is moving in the right direction. Ultimately, the fact that so many areas within the U.S. economy have already started to see significant improvement is remarkable. This growth largely resulted from record levels of fiscal stimulus. Fiscal stimulus in 2020 came in the form of the CARES Act. The CARES Act provided trillions of dollars of income replacement, which funded continued consumer spending. While this fiscal stimulus increased the purchase of consumer goods, such as electronics and sporting goods equipment, it was not as effective in supporting the service sector. Services include items such as meals at restaurants, stays at hotels, airline travel, attendance at concerts or shows, etc. All in all, consumers have avoided services that entail "face-to-face" contact. While some of these consumer dollars have

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migrated over to the purchase of consumer goods, the U.S. economy has nevertheless experienced a substantial decrease in consumer spending. This is significant given the fact that consumer spending makes up approximately 69% of the U.S. economy.

While the service sector recovered significantly from the second quarter lows, we expect future gains to be harder to come by until a vaccination or more effective treatment for the virus is introduced. It is important to note the recovery rate amongst service providers will vary due to permanent changes in consumer preferences. As a result, certain service providers may never recover, while others will have to forever change the way they conduct business. On the other hand, there are areas such as online retail that will likely continue to gain market share. All in all, it may take several years for the service sector to fully recover as it adjusts to the post pandemic world.

Due to the fact we expect the general economic recovery to lose speed in coming months, additional fiscal stimulus will likely be required to keep the U.S. economy on track. While we were optimistic that a new fiscal stimulus plan would be enacted by September, as we approach the end of the month, enactment of additional stimulus looks unlikely. Ultimately, the stumbling block appears to be the size of the plan. For the Republicans, they see an economy growing at nearly 30% in the third quarter, more than half the jobs recovered and a vaccine approaching. As a result, they feel a $1.3 trillion dollar plan is sufficient following the $3 trillion in stimulus already enacted. For Democrats, they see unemployment as still uncomfortably high and fear that certain areas need to be propped up sooner rather than later in the event of a second wave.

The dollar gap between the ruling parties is uncomfortably large, especially given the growing tensions surrounding the upcoming election. With that said, we fear some signs of economic deterioration may be required to force an agreement. Regardless, prior to year-end we are optimistic that additional stimulus will be enacted. Bottom line, we view the U.S. economy as extremely vulnerable and see additional stimulus as the only option to avoid negative economic consequences. Ironically, it may take some deterioration on the economic front to get Washington to act.

Fixed Income Commentary - Steady as She Goes

At their September meeting the Federal Reserve (Fed) left the Fed Funds Rate unchanged between a range of 0-.25%. More importantly, they indicated their intention to hold the rate there through at least 2023. The Fed stated their expectation to maintain this target range until labor market conditions reached levels consistent with the Committee's assessments of maximum employment. In their statement, they also shared their intention to maintain an accommodative stance until the U.S. economy achieves inflation averaging 2% over time and longer term inflation expectations remain anchored at 2%. Their statement reflected the central banks new policy framework in which they will allow inflation to overshoot their 2% target after periods of lower inflation. Simply put, the Fed appears positioned to remain extremely accommodative for quite some time to come.

The Fed's commitment to obtaining a 2% average inflation rate demonstrated their intent to not enact yield curve control, but instead to continue to foster liquidity where needed. Ultimately, the Fed appears to be signaling that it will allow longer-term yields to rise while holding short-term rates down. This strategy seems necessary to obtain the Fed's goal of full employment and 2% average inflation. Holding short-term rates low is focused on accomplishing full employment while providing room for intermediate and long-rates to drift up should assist with achieving higher inflation.

Assuming the Fed is successful, their strategy should result in a widening of the yield curve where investors are paid more yield for taking on longer maturities. One of the goals of such a policy is to encourage financial institutions to make more loans. The idea being that a steeper curve provides more attractive profit margins on the loans. A loan's rate is typically based on intermediate and long-term interest rates where the money used for the loan typically comes from bank deposits whose rates are typically tied to the shorter end of the yield curve. The difference between what a financial institution pays for deposits and what they charge for a loan is how they make money on lending. As a result, the wider the spread between the two, the more opportunity for profit.

Ultimately, the Fed plans to keep short-term interest rates low while allowing intermediate and long-term rates to drift higher. It appears it is their intention to stick with this strategy unless inflation rises above their 2% average target on a sustainable basis. Inflation, generally speaking, is a function of: (1) Expectations (consumers expect prices to go up or down) (2) Demand (increases drive prices up while decreases drive prices down) and (3) Supply (increases drive prices down while decreases drive prices up). At the present time, none of these factors are indicating that higher inflation is on the horizon.

It is important to note that monetary policy is meant to smooth out economic growth and it is not intended to change an economy's long-term trend growth rate. Simply put, monetary policy is intended to shift growth around in time. In other words, it is focused on avoiding the high peaks and the low valleys. If growth is slow, monetary policy is implemented to ease or lower interest rates. On the other hand, if growth is moving too quickly, monetary policy is implemented to slow things down by raising interest rates. With that said, inflation or deflation should not be an issue if the central bank gets it right. Dealing with inflation or deflation longer-term typically indicates some sort of monetary policy mistake.

If there is a longer-term inflation story to tell, odds are the Fed remained accommodative too long. There has been significant conversation on this front given the Fed's extremely accommodative monetary policy. While policy easing has been aggressive, such action seems appropriate in an emergency situation. A pandemic with an associated economic shutdown seems to qualify as an emergency situation. With that said, accommodative policy should always be accompanied by an exit strategy later. The risk is the Fed waits too long and prices overinflate. While at some point the Fed will be faced with the decision to change policy, we believe in the present situation that point may be several years away. As a result,

we expect the Fed to be able to hold course with their present strategy for quite some time to come.

Equity Commentary -
The Many Moods of 2020

During 2020, we have already experienced the extremes of a dramatic bear market drop and a subsequent V-shaped recovery. Equity markets dropped precipitously in the spring in response to the majority of world economies being effectively shut down by coronavirus lockdowns. Stocks were then whipsawed back almost as rapidly when investors reacted to hope of an economic recovery as economies began to reopen. While the health crisis wreaked havoc on the world economy, fortunately, much of the drag was mitigated by an unprecedented combination of accommodative monetary and fiscal policy. U.S. policymakers in particular acted aggressively to address the challenges posed by the economic shutdown. Ultimately, this policy response was effective at driving a significant recovery in economic data, which in turn helped calm investors' concerns.

Over the past few months, the S&P 500 has participated in four distinct market phases. The first phase dealt with the rapid 34% bear market sell-off that took place in reaction to the abrupt economic shutdown and ensuing recession. The second phase entailed the repair phase, which was dominated by a "whatever it takes" combination of fiscal and monetary policy. Accommodative monetary policy came in the form of the Federal Reserve's rapid reduction of the Fed Funds rate and their introduction of record amounts of quantitative easing. The fiscal policy response came in the form of the CARES Act which contained stimulus totaling approximately 47% of gross domestic product.

The third phase consists of the recovery phase where the S&P 500 soared to new all-time highs in reaction to the aggressive monetary and fiscal response combined with the reopening of much of the economy. Lastly, in September, we entered and appear to still be in the midst of a consolidation phase. During this consolidation phase, some of the earlier excesses are being shaved off as the result of profit taking and some valuation concerns. We do, however, believe this consolidation also coincides with disappointing progress on the passage of additional financial stimulus (CARES2).

With equity market fortunes largely tied to additional fiscal stimulus it seems that we are faced with four potential outcomes: (1) Congress fails to pass additional stimulus and the recovery stalls, resulting in a significant equity sell-off, (2) Congress passes a bill that is interpreted as too small and the market reacts negatively, (3) Congress passes a bill that is interpreted as sufficient to keep us on the road to recovery and the market reacts favorably, or (4) Congress passes a bill that surprises on the upside and equities rally on the news.

In conclusion, the passage of additional stimulus is hard to predict. The current political environment only complicates matters. At the present time, our base case calls for equity markets to remain range bound for the next few months. We believe the easy money has already been made. Simply put, gains going forward will be harder to come by. It is also important to note that many of the research firms we follow have cut their three year equity market return forecasts. While the S&P 500 has historically returned around 10% on an annualized basis, many forecasters are predicting annual returns closer to 5% in coming years. These forecasters are rather pessimistic due to their belief that it is unlikely that fiscal stimulus will be successful in making a seamless transition to solid economic fundamentals. If they are correct, equity investors should be prepared for some turbulence ahead. Granted there may be some opportunity in equities before the turbulence hits.

Asset Allocation -
Making up Ground

The first quarter of 2020 was extremely difficult for active managers. No one was purposefully positioned for a pandemic and the market reaction that ensued. Underperformance versus benchmark was especially pronounced in the fixed income space. Comparisons to the traditional fixed income benchmarks in this space were brutal given the fact the major fixed income benchmarks were weighted heavily in U.S. government backed bonds. U.S. bonds handily outperformed during the "flight to quality" that took place during the first quarter. The reality of the situation was that if you were not heavily invested in U.S. bonds, odds are you significantly underperformed the benchmarks that were.

Looking back, it is hard to fault fixed income managers that were invested more heavily in assets such as investment grade corporate bonds and commercial paper. After all, many of these investments at the start of the year appeared to offer superior risk adjusted reward characteristics. At the time no one was anticipating a pandemic and the flight to quality that it triggered. Fortunately, as the result of the aggressive fiscal and monetary policy response, most of the bonds that underperformed during the first quarter began to quickly recover. Our active fixed income managers have been gaining ground pretty consistently ever since. While they have not completely closed the gap, they narrowed it significantly on a year-to-date basis. After having several conference calls with their investment management teams, we are optimistic that the positive progress will continue.

While equities traded off substantially during the first quarter, benchmark comparisons were better than on the fixed income front. While U.S. mid-cap and small-cap stocks underperformed the S&P, they compared favorably to their respective benchmarks with an exception in the small-cap value space. We have been monitoring our small-cap value fund closely and have identified a potential replacement in the event it begins to once again materially underperform its peer group. Thus far, that has not been the case and the fund has been catching back up to its respective benchmark and peers. In the Large-cap space, the DoubleLine CAPE Index fund significantly underperformed the S&P 500. This underperformance resulted from the combination of sector exposure as well as the drag from the funds fixed income portfolio. Fortunately, this fund also was able to significantly close the performance gap that took shape during the first quarter.

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In conclusion, we are pleased with the progress that was made during the second and third quarters. Once our managers had an opportunity to adjust to the new investment landscape, they made significant progress on the performance front. We are hopeful that this progress will continue through the end of the year leaving us with favorable benchmark comparisons. Without a doubt this has been an extremely difficult environment to navigate for active managers.

Financial Planning - A Shot in the Arm

As the coronavirus continues to spread across the world, the quest for a vaccine continues to be widely discussed. As a result, we wanted to take this opportunity to provide some general information regarding vaccines as well as some factors that need to be considered regarding the introduction of an effective vaccine for the coronavirus.

To understand how vaccines work it helps to first develop a basic understanding of how the body fights illness. When germs enter the body, they attack and multiply. This invasion is referred to as an infection and is what leads to the underlying illness. The body fights back through the production of white blood cells. These white cells consist primarily of what are referred to as macrophages, B-lymphocytes and T- lymphocytes.

- Macrophages are white blood cells that swallow up and digest germs, as well as dead or dying cells. The macrophages leave behind remnants of the germs called antigens. The body identifies antigens as a threat and stimulates antibodies to attack them.
- B-lymphocytes are defensive white blood cells. They produce the antibodies that attack the antigens left behind by the macrophages.
- T-lymphocytes are another type of defensive white blood cell. They attack cells in the body that have already been effected by the germ.

After the infection, the immune system remembers what it learned about protecting itself from the illness. The body retains a few T-lymphocytes, referred to as memory cells. These memory cells quickly activate antibodies, if the body encounters the same illness again.

This ability to activate a timely response to a familiar illness is the basis behind a vaccine's effectiveness. Vaccines help develop immunity by imitating an infection. While this infection typically only causes mild symptoms of the illness, it does cause the immune system to produce T-lymphocytes and antibodies. Once the imitation infection goes away, the body is left with memory T-lymphocytes that remember how to fight the disease in the future.

Now that we have discussed the general idea behind how a vaccine works, it is time to discuss it in the context of the current coronavirus situation. The introduction of an effective vaccine normally requires a decade or more. While a lot of work is conducted in the lab, significant time is also spent on the human trials. The human testing typically proceeds in three phases:

- Phase 1 is a safety trial of 50 or so people to make sure that the vaccine does not have serious side effects.
- Phase 2 uses a larger sample of people and focuses on checking to make sure the vaccine's components are not broken down in the body before they can provide the intended benefit.
- Phase 3 is where thousands of people are given the vaccine and monitored as to its effectiveness in preventing serious illness upon exposure to the virus.

Phase 3 is where you determine the actual real life effectiveness of the vaccine. The primary potential outcomes include the following:

1) The inoculated do not get sick at all. (success)
2) They get sick, but have less severe symptoms. (success)
3) They get sick, but do not spread the virus. (success)
4) They do not get sick, but can spread the virus. (success)
5) The vaccine does nothing at all. (failure)
6) The vaccine actually makes them more susceptible to the virus. (failure)

Remarkably, the development of a potential coronavirus vaccine has occurred at unprecedented speed. Eight of the over 100 vaccines that are currently in development globally are already in phase 3 testing. Assuming 1 of the 8 is deemed a success, we may see the introduction of a vaccine by the end of this year.

It is important to note, however, that a successful vaccine does not instantaneously mark the end of the coronavirus. From here, we have to move on to the process of manufacturing. While large scale preparations have already been made on this front, producing doses to be administered on a global scale is no simple task. One also must consider that vaccines rarely require just one dose. Oftentimes, multiple doses as well as future boosters are required. Also, some vaccines require ingredients that have supply limitations that will require additional time to overcome. For example, there is a vaccine that utilizes the bark of a tree that grows in Chile that can only be harvested during a certain time of the year.

In conclusion, it is unlikely the first successful vaccine will be a hole in one. While ideally the dream vaccine would be a one dose vaccine delivered via a nasal inhalant that is easily manufactured which provides a 100% immunity for a lifetime, it is highly unlikely that will be the case right out of the gate. As a result, odds are we will have to settle for something that is less than ideal to get us through a period of time before better options are developed. As to time frame, our sources indicate that early vaccine options are likely to be introduced in the U.S. as soon as the end of this calendar year. Widespread distribution will largely depend on the manufacturing complexity of these options. With that said, additional options are expected to be introduced in 2021. The general expectation is that the effectiveness of the options will improve as time goes on. It is important to note, however, that humankind has only been successful in eradicating smallpox to the point that we could stop immunizations. As a result, there is a high likelihood that a coronavirus vaccination will be added to the growing list of vaccines that are administered on a routine basis. In addition, one also has to consider the risk of virus mutation which hinders the effectiveness of vaccines over time.