Equities Rebound Following the Q1 COVID-19 Shock

The first half of 2020 brought about seemingly insurmountable challenges and unpredictability on a global scale. After stocks nosedived in the first quarter, the S&P 500® Index had its best quarter in over 20 years, returning 20.54% in the second quarter, and erasing most, but not all, of the first-quarter losses. Year to date, the S&P 500 was down 3.08% through June 30.

FIGURE 1: S&P 500® INDEX FORWARD PERFORMANCE FOLLOWING BEST 65-DAY % CHANGES

65 Trading Days Ended	65-Day % Change	+20 Days	+65 Days	+125 Days	+250 Days
1. 6/10/2009	38.8%	-6.0%	11.0%	17.5%	13.1%
2. 11/9/1982	38.7%	-0.8%	3.1%	15.9%	14.3%
3. 1/11/1999	30.2%	-3.8%	4.7%	10.7%	11.0%
4. 3/12/1975	28.6%	0.2%	8.3%	1.2%	19.9%
5. 7/16/1997	25.9%	-1.6%	2.0%	1.7%	25.7%
6. 4/17/1991	24.9%	-5.6%	-1.6%	-1.0%	3.5%
7. 6/12/2003	24.7%	0.0%	1.6%	6.2%	13.3%
8. 4/3/1987	24.0%	-3.7%	2.6%	9.0%	-14.1%
9. 1/28/1963	23.8%	-1.2%	5.6%	3.5%	16.4%
10. 12/2/1998	22.4%	5.0%	9.3%	11.0%	18.6%
6/25/2020*	36.3%	?	?	?	?
Average		-1.8%	4.7%	7.6%	12.2%
% Positive		20.0%	90.0%	90.0%	90.0%

*6/25/2020 marks 65 trading days off the 3/23/2020 low, and ranks as the S&P 500 Index's 3rd best 65-day % change relative to the top 10 comparable periods. Data is obtained from Strategas and is assumed to be reliable. **Past performance is no guarantee of future results.**

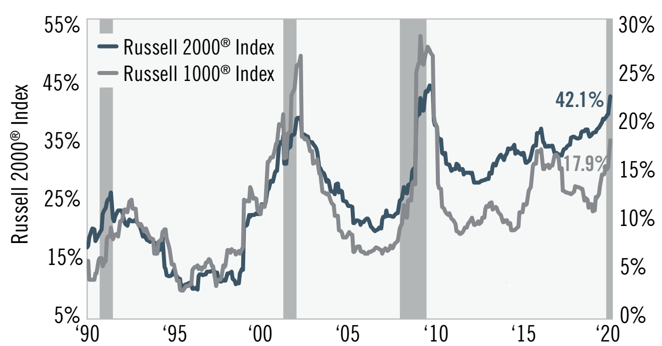
International developed market equities and U.S. small-cap stocks also rebounded strongly in the quarter, returning 14.88% and 25.42%, respectively, but they were hit harder overall in the downturn relative to the U.S. large-cap market, declining 11.34% and 12.98% year to date. Value stocks significantly underperformed growth stocks with the Russell 1000® Value Index down 16.26% and the Russell 1000® Growth Index up 9.81% in the first half of the year. Value indices contain many more businesses that have been adversely affected by COVID-19.

Interest rates declined slightly during the quarter as the 10-year U.S. Treasury yield declined from 0.68% to 0.65%, allowing the Bloomberg Barclays U.S. Aggregate Bond Index to advance 2.90% for the quarter and 6.14% for the first half of the year. High yield bonds rallied 9.61% during the quarter, cutting the year-to-date loss to 4.78%. Municipal bonds rallied 2.72%, bringing the Bloomberg Barclays U.S. Municipal Index into positive territory for the year with a return of 2.08%.

WHAT WAS BEHIND THE VOLATILITY?

We came into this recession with fairly strong business momentum driven primarily by consumer spending as manufacturing had been weak since early 2018 due to global trade and tariff disputes. Then, along came COVID-19, which became a global pandemic and essentially shut down the entire economy seemingly overnight. Businesses with high fixed costs, high levels of debt, and minimal revenue opportunities have been the hardest hit during the lockdown. Examples of these types of businesses include airlines, cruise lines, casinos, hotels, restaurants, and brick and mortar retailers, to name a few.

FIGURE 2: PERCENT OF NON-EARNERS
Russell 2000® Index vs. Russell 1000® Index



Data presented is as of June 30, 2020. Data is based on companies with available data. Data is obtained from Strategas and is assumed to be reliable. **Past performance is no guarantee of future results.**

Many companies have been forced to put their business disaster recovery plans into action and learn how to really operate in a more digital environment. Fortunately, the Federal Reserve and the U.S. government immediately recognized the economic impact of the virus. Monetary and fiscal policy reacted much faster than usual in order to cushion the economic free fall. The Fed's focus on providing much needed liquidity to the bond market has indirectly helped equities. Fiscal efforts have been focused on helping small businesses and the unemployed.

FIGURE 3: FISCAL POLICY, % OF GDP
Financial Crisis vs. COVID-19 Crisis

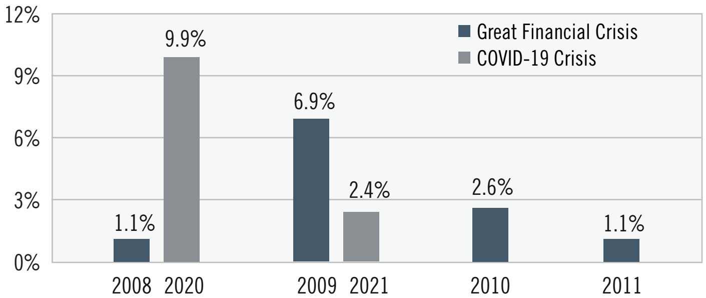
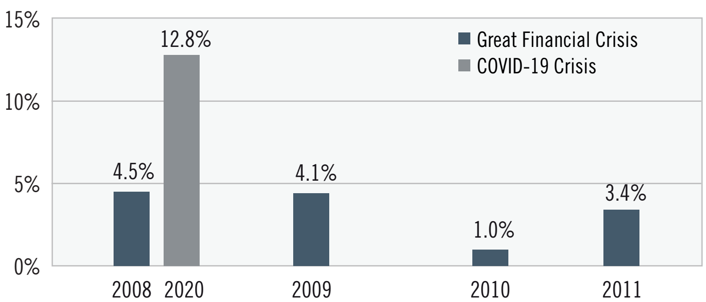


FIGURE 4: FED BALANCE SHEET GROWTH, % OF GDP
Financial Crisis vs. COVID-19 Crisis



Data presented is for the fiscal year. Data is obtained from Strategas and is assumed to be reliable. **Past performance is no guarantee of future results.**

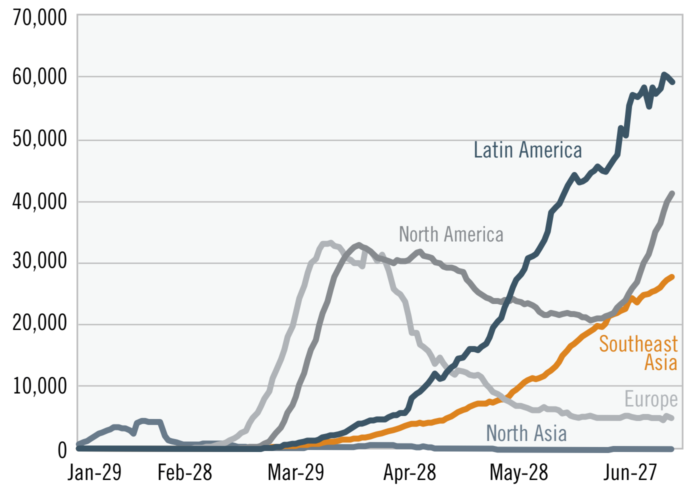
WHAT ARE THE LONG-TERM IMPLICATIONS OF THE COVID-19 HEALTH CRISIS?

One of the more important issues facing investors is how much of the change brought on by the pandemic in terms of business and consumer behavior becomes sustainable in the future. If the lockdown had been very brief, we would guess very little would change longer term. However, the longer people feel at risk, the more these changes start to become a part of everyday life. Once consumers experience services like Netflix, online shopping for groceries and apparel, online doctor visits, virtual meetings with new and existing clients, barriers to trial get very quickly removed. Many of these trend changes in our lives were occurring before the virus outbreak, but they have accelerated out of necessity. For example, demand for travel and group conferences may be greatly reduced in the future due to consumers and companies having discovered the ease of cloud videoconferencing.

IS THE STOCK MARKET ANTICIPATING A "V" SHAPED RECOVERY?

Although the market bounced back in the second quarter, we do not believe it is anticipating a robust economic recovery as many market commentators have suggested. If businesses were to get back to normal quickly, then many of the hardest hit areas in the stock market would not be 40% to 80% off of their 52-week highs set over the last year when the economy was not in a recession. Additionally, with the 10-year U.S. Treasury yield at a paltry 0.65% and the yield curve with only a slightly positive slope, this suggests a modest but not robust recovery. It is not a meaningful prediction to believe that the economy will improve from here (despite the possibility of a second wave of COVID-19 infections) because there is nowhere to go but up when activity has been shut down for several months. Asia and Europe have done a better job of controlling the virus and their economies are showing meaningful signs of improvement already.

FIGURE 5: DAILY INCREASE IN COVID-19 CASES
7-Day Moving Average



Data presented is as of June 30, 2020. Data is obtained from Johns Hopkins CSSE and J.P. Morgan Asset Management and is assumed to be reliable. North Asia countries are China, Hong Kong, Japan, South Korea and Taiwan. Southeast Asia includes Singapore, India, Indonesia, Malaysia, Pakistan, Philippines, Thailand, Bangladesh, Sri Lanka and Vietnam. North America includes Canada and U.S. Europe includes eurozone countries, Bulgaria, Croatia, Czech Republic, Denmark, Hungary, Poland, Romania, Sweden, United Kingdom, and Switzerland. Latin America countries are Chile, Brazil, Mexico, Argentina, Colombia, Peru, Venezuela, Ecuador, Panama, Paraguay, Costa Rica, Bolivia, Uruguay, El Salvador, Honduras, Cuba, Dominican Republic, Haiti, and Nicaragua.

ANY CHANGES TO KAR'S INVESTMENT STRATEGY?

All of our portfolios are focused on owning quality businesses that can prosper in good times and survive difficult periods. Interestingly, we have seen good and bad economic times in the span of six months due to the unique nature of the COVID-19 health crisis. At KAR, we search for competitively advantaged businesses with protectable moats regardless of how the stock market is behaving. We seek companies with balance sheet strength with low levels of debt, low capital intensity, and positive cash flow. Our approach has been rewarded in this recession. While there continues to be above-average uncertainty (second wave risk, election results, and economic recovery timeline) in the near term, we continue to believe our time-tested strategy of owning quality companies will continue to be rewarded over the long haul.

We thank our clients for your trust and confidence in managing your assets during these volatile and challenging times.

Authored by:

Douglas S. Foreman, CFA
Chief Investment Officer
Kayne Anderson Rudnick Investment Management, LLC

Kayne Anderson Rudnick believes that superior risk-adjusted returns may be achieved through investment in high-quality companies with market dominance, excellent management, financial strength, and consistent growth, purchased at reasonable prices.

Index definitions: Large-capitalization stocks are represented by the **S&P 500® Index**, a market capitalization-weighted index that includes 500 of the largest companies in leading industries of the U.S. economy. Growth stocks are represented by the **Russell 1000® Growth Index**, a market capitalization-weighted index of growth-oriented stocks of the 1,000 largest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. Value stocks are represented by the **Russell 1000® Value Index**, a market capitalization-weighted index of value-oriented stocks of the 1,000 largest companies in the Russell Universe. Small-capitalization stocks are represented by the **Russell 2000® Index**, a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe. Developed international markets are represented by the **MSCI® EAFE Index**, a free float-adjusted market capitalization index that measures developed foreign market equity performance, excluding the U.S. and Canada. The **Bloomberg Barclays U.S. Aggregate Bond Index** is a market value-weighted index that tracks the daily price, coupon, pay downs, and total return performance of fixed-rate, publicly placed, dollar-denominated, and non-convertible investment grade debt issues with at least $250 million par amount outstanding with at least one year to final maturity. The **ICE BofAML U.S. High Yield Index** tracks the performance of U.S. dollar denominated below-investment-grade corporate debt publicly issued in the U.S. domestic market. The **Bloomberg Barclays U.S. Municipal Index** covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prefunded bonds. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment.

The commentary is the opinion of Kayne Anderson Rudnick. This material has been prepared using sources of information generally believed to be reliable; however, its accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice or an offer of securities.

Past performance is no guarantee of future results.

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