SGA Sustainable Growth Advisers
A VIRTUS INVESTMENT PARTNER

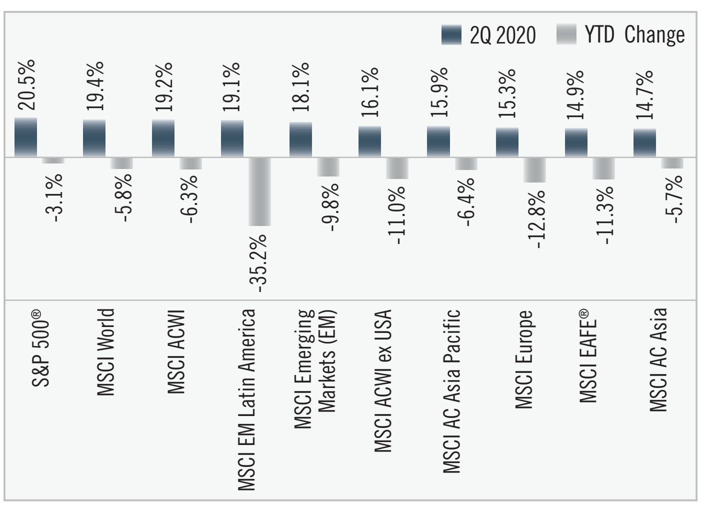
Finding Hope Amid Continued Uncertainty

MARKET REVIEW

Global equity markets posted strong returns for the second quarter with the U.S. outperforming non-U.S. developed and emerging markets. The advance was relatively narrow with companies in the information technology, consumer discretionary, and materials sectors leading. Retailers and those businesses most levered to the reopening of economies benefited the most, as did information technology and e-commerce companies that attracted increased traffic. In contrast, more defensive sectors such as utilities, consumer staples, and real estate, performed the worst.

With corporate profit growth expected to plunge in 2020, growth stocks outperformed value stocks in the quarter as investors sought businesses that could generate attractive earnings growth despite widespread economic weakness. Within the MSCI All Country World Index (ACWI), consistent with investors' more positive evolving outlook, higher beta stocks, companies with lower returns on equity, lower levels of debt, and no earnings performed best during the quarter. Globally, developed markets led by Australia, New Zealand, and Germany outperformed emerging markets despite strong performances by South Africa and Brazil. The UK and Hong Kong were among the weaker performers during the quarter, while China trailed the broader ACWI Index.

GLOBAL EQUITY MARKETS SHARPLY REBOUND



Source: MSCI, FactSet. See page 2 for index definitions.
Past performance is not indicative of future results.

GLOBAL IMPACT OF COVID-19

With continued uncertainty over the path of the COVID-19 pandemic and associated economic weakness, the International Monetary Fund (IMF) lowered its forecast for World GDP growth to -4.9% for 2020, and projected U.S. GDP to shrink by 8%. Similarly, the UK, European Union, Japan, India, Latin America, and South Africa all saw their respective GDP growth rates decline meaningfully in Q1, with further weakness expected moving forward, while China's GDP was forecast to grow by only 1%. Meanwhile, the World Bank forecast World GDP to decline by 5.2% in 2020, marking the fourth deepest recession since 1900 and the worst since World War II.

Unemployment posed a headwind to most economies in Q2 as both the manufacturing and service sectors were negatively impacted by unprecedented lockdowns. To put this into further context, 20.5 million Americans lost their jobs in the month of April, compared to 8.6 million who lost their jobs during the entire Great Financial Crisis of 2008-2009. Eurozone unemployment jumped to 7.3% in April. However, glimmers of hope began to appear later in the quarter as businesses and economies took steps to reopen. In a sign of gradual progress, U.S. unemployment unexpectedly dropped from 14.7% to 13.3% in May as 2.5 million people were added to payrolls, and in June, both the U.S. and China's PMI manufacturing indexes each rose back into expansion ranges as new orders increased.

VOLATILITY CREATES OPPORTUNITY

Following the Q1 market weakness, global equities sharply rebounded in Q2 as investors reacted to faster-than-expected business reopenings and significant stimulus from monetary authorities and governments. With the strong rebound in stock prices, the CBOE Volatility Index® (VIX®) declined 43% from elevated levels at the beginning of the quarter, but its average remained high at 34.50. In light of ongoing COVID-19 outbreaks, fluctuating state reopening plans, and persistent fears over a second wave of infections, elevated volatility in global equity markets is likely to persist. This is further underlined by the upcoming U.S. presidential and congressional elections with their important implications for future tax, regulatory, and trade policies.

From our perspective, such volatility has historically created opportunities for our approach to growth investing, and we see the current situation as no different with our portfolios well positioned to provide the predictable and sustainable revenue, earnings, and cash flow growth investors tend to seek in periods of economic uncertainty.

LOOKING AHEAD

Given the global COVID-19 pandemic, upcoming U.S. elections, widespread economic dislocations impacting consumers across the world, and uncertainty over a second wave of infections, treatments, and vaccines, we expect the path forward to be filled with wide variations of optimism and disappointment, market strength, and weakness. In the U.S., the recovery process at the national level is likely to be staggered and long as states take different paths to managing the crisis, and as testing and contact tracing continue to gradually expand. The U.S. economy faces a difficult challenge based on the speed at which the COVID-19 virus is spreading, with over 75% of U.S. GDP coming from states that have a higher transmission rate.[1]

At the same time, massive monetary stimulus is being applied to the U.S. and global economies while governments are applying significant fiscal stimulus to place a floor under economic activity and encourage growth. With monetary authorities from around the world indicating continued accommodation over the next few years, keeping interest rates near zero or below, and significant excess capacity in the economy, we see attractive opportunities for companies with long duration growth streams that also provide investors with predictability and sustainability.

SGA portfolios are well positioned to provide such predictability in cash flows and earnings over the coming years with superior profit margins, and management teams that are incentivized to perform. We continue to see tremendous opportunity for the sustainable growth businesses across our portfolios as they provide the growth and safety that investors are likely to seek in uncertain times such as these.

[1]Source: Strategas Research Partners, based on COVID-19 reproduction rate (Rt) data by state, as of 6/28/2020.

Authored by:

The SGA Investment Team

Sustainable Growth Advisers (SGA) is a growth equity firm specializing in managing high-conviction U.S., global, international, and emerging market portfolios. SGA uses a team-oriented approach and a consistent investment philosophy based on fundamental research and investing in the equities of sustainable growth companies.

Index definitions: CBOE Volatility Index (VIX) is a measure of implied volatility, based on the prices of S&P 500 Index options; a rising VIX indicates expectations for rising S&P 500 volatility, while a lower VIX indicates expectations for quieter trading. **S&P 500®** measures performance of 500 of the largest U.S. companies. **MSCI All Country (AC) Asia** measures large and mid-cap equity performance of Asia's developed and emerging markets. **MSCI AC Asia Pacific** measures large and mid-cap equity performance of developed and emerging markets countries in the Asia Pacific region. **MSCI World** measures equity performance of developed global markets. **MSCI All Country World (ACWI**) measures equity performance of developed and emerging markets. **MSCI EAFE®** measures developed foreign market equity performance, excluding the U.S. and Canada. **MSCI AC World ex U.S.** measures equity performance of developed and emerging markets, excluding the U.S. **MSCI Emerging Markets** measures equity market performance in global emerging markets. **MSCI Europe** measures equity market performance of Europe's developed markets. **MSCI EM Latin America** measures equity performance of Latin America's emerging market countries. S&P 500 and MSCI indexes are free float-adjusted market cap-weighted and calculated on a total return basis with dividends reinvested.