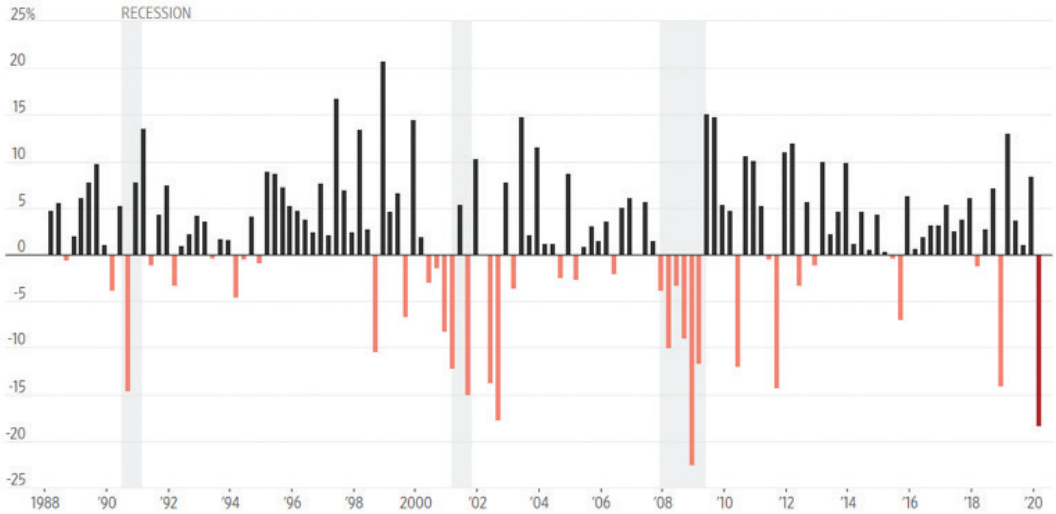
OCEAN PARK
ASSET MANAGEMENT

# Risk Matters. Defense Matters. Discipline Matters.

It wasn't what anyone expected or predicted at the start of 2020: One of the worst quarterly returns for the S&P 500 in over three decades (see chart below) and the worst first quarter for the Dow since 1987.

**S&P 500 quarterly change**




Note: As of 11:30 a.m. ET
Source: FactSet

## RISK MATTERS:
### A BRIEF EXAMINATION OF Q1 2020

To say markets can be treacherous is an understatement. The selling became indiscriminate during March as investors scrambled to dump assets from stocks, commodities, emerging markets debt in frantic fear of a massive global economic downturn.

- Institutional investors questioned every bond market, essentially crippling liquidity before the Federal Reserve Bank ("the Fed") stepped in to address the deterioration, curbing the worst fears.
    - The Fed became a "buyer of last resort" establishing emergency intervention facilities to provide flow of credit to businesses, consumers, employees and municipalities.
    - The Fed also removed its cap on purchasing Treasuries, essentially buying as much as needed to keep the markets flowing. This includes buying TIPs, an inflation strip of bonds, at a higher level than ever before.
- The Nikkei, representing the Japanese stock market, clocked its worst quarter since the 2008 recession.
- The stocks of emerging markets countries crumpled 30-40% over worries about how countries from India to Chile to Poland would manage through the health crisis.
- Bonds of emerging markets countries reflected much higher risk of default and lost at least 20% of their values and more.
- Fear of cratering demand coupled with a Middle East price war sent oil prices plunging to an 18-year low. As an example, WTI crude oil fell 75%, from over $60 a barrel at the start of 2020 to under $15 a barrel recently.
- In a panicked rush for safety, investors snapped up U.S. Treasury bonds. The longer the maturity, the greater the price gains and 20+ year Treasury bonds soared up 20% on the quarter. Even 7-10 year paper jumped up 10%.
- The 10-year Treasury fell from 1.92% to a record low 0.54%, before recovering to close the quarter at 0.70%. The historic lows are epic: the last record was 1.34%.
- High yield corporate bond spreads blew out to a peak of +1087, nearly +700 bps wider than they had been at the end of February. Widely watched high yield corporate bond ETFs and actively managed mutual funds dropped as much as 20% from peak to trough during the quarter.

# DEFENSE MATTERS:
## IMPLEMENTING A DEFENSIVE STRATEGY

It can be gratifying to play offense in the investment markets, but defense is a critical element of a good strategy also – no one wants to take a "round trip" when the cycle changes.

The next two charts demonstrate the benefit of a disciplined participation in one investment holding as it played out from buy to sell.

**A Sample High Yield Corporate Bond Fund**

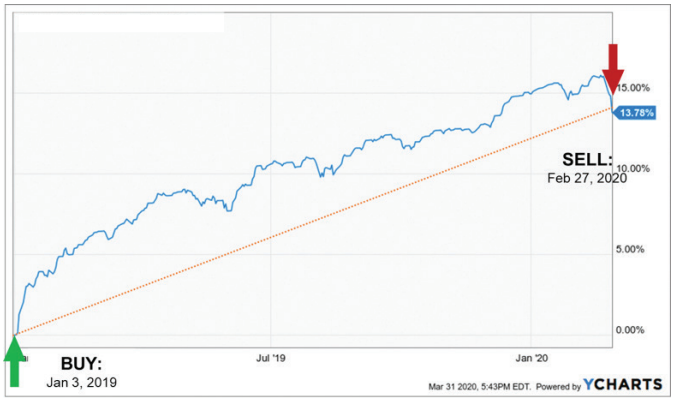



Chart A illustrates an investment in the high yield corporate bond asset class. A Buy signal, as defined by our long-proven rules in place, guided us to purchase on January 3, 2019, as indicated by the green arrow. The bumpy trend to the upside lasted until mid-February 2020. The fund then turned down and continued falling until it reached a Sell signal (again as defined by our rules-based trailing-stop discipline). The sale occurred on February 27, 2020, closing out a +13.8% gain.

**A Sample High Yield Corporate Bond Fund**

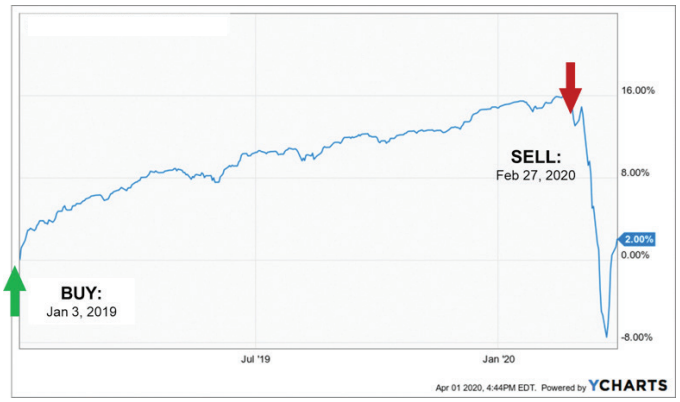



Chart B illustrates the same fund through the end of the first quarter. After the Sell signal, this fund declined over 18%, erasing all gains from the prior 14 months.

Understanding risk and applying that knowledge to investment strategies in the form of disciplined buy and sell rules can limit drawdowns.

# DISCIPLINE MATTERS:
## MEETING EXPECTATIONS

The far-reaching market action during first quarter of 2020 underscores how much a rules-based defensive discipline matters. By the end of February all common stock fund holdings and nearly all high yield corporate bond fund holdings were sold. The risk reduction progressed at a speedy clip in early March as Sell signals occurred across any remaining high yield corporate bond funds, all preferred stock funds, all emerging markets debt funds and all municipal bond funds. Some of the proceeds from these sales were invested in intermediate and long-term Treasury bond funds and back into recovered municipal bond funds. The rest is held in cash (money market funds).

Even the normally sleepy municipal bond asset class saw a lot of action during the month of March. At the height of the market fear, investors questioned the liquidity of the municipal bond asset class, resulting in a decline that triggered sell signals for all holdings. However, the muni market settled down enough to give a few new Buy signals in March.

Market turmoil can strain the advisor/client relationship. Have a process and understand that **RISK MATTERS, DEFENSE MATTERS,** and **DISCIPLINE MATTERS.**

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The **S&P 500 Index** is a market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenues are based in the US; it's often used as a proxy for the U.S. stock market. One cannot invest directly in an index or category and unmanaged index or category returns do not reflect any fees, expenses, or sales charges.