April 13, 2020

Dear O'Brien Client,

Coronavirus. Social distancing. Containment. Pandemic. With hindsight it is remarkable that none of these words were part of our regular lexicon when 2020 began. So much has changed in such a short period that it feels almost impossible to summarize it - not only what happened last quarter, but also where we think may go from here - in just one investment letter. Nevertheless, we will give it our best shot.

To paraphrase the King of Hearts in Lewis Carroll's *Alice in Wonderland*, we will "begin at the beginning" – our outlook entering the year. Entering 2020, we anticipated a modestly positive global economic backdrop, with low odds of imminent recession as long as consumer spending and hiring held up. Against that backdrop, we felt stocks should outperform bonds, but also noted a chance for volatility to pick up if the market was unexpectedly disappointed.

The coronavirus, obviously, has significantly changed those relatively benign expectations. The pandemic has brought with it unprecedented uncertainty, both for markets and for how we interact as human beings. Prioritizing public health via social distancing and containment are the clear humanitarian priorities, but those actions have brought significant consequences for the economy and financial markets. The last quarter saw both the fastest bear market in history, as well as the start of a steep (though hopefully short) recession and a record-breaking pace of job loss.

Toward the end of the quarter, there was some stabilization in markets, but still a lot of uncertainty. While there may be more downside ahead, we do know that history shows that investors tend to overprice markets at the peak and underprice them at the trough. And when the situation eventually stabilizes troughs produce attractive long-term opportunities.

Given this, we want to share the framework we are using to look for signs that stabilization is occurring. Ultimately, society will get through the coronavirus from a healthcare standpoint and there will be a rebound for both the economy and markets. The key question is how long until we are at that point.

The table below summarizes six signposts we are watching for on that path to recovery. The signposts run the gamut of topics – from healthcare, to the economy, to sufficiently cheap markets – along with whether we think we have passed each post.

Conditions	Current Situation
Stabilization of coronavirus infection rate	Progress, but still early stages
Clarity on depth and duration of economic disruptions	Very early stages; need containment to end
Sufficiently large global stimulus	Probably sufficient if containment is short-lived
Mitigation of funding/liquidity stresses in markets	Fed actions hopefully mean past this signpost
Cheap asset markets	Some opportunities, but not yet widespread
No other Black Swan events	Contained so far

Source: Goldman Sachs, O'Brien Wealth Partners, as of 4/8/2020.

With regards to healthcare, there is widespread social distancing and tentative signs the infection rate is slowing in Europe and the U.S. Testing capabilities are improving, but are not yet widespread, and vaccine work is still ongoing. While there has been improvement from a health standpoint, we are not yet past this signpost.

From an economic standpoint, we are still in the very early stages of a recession. It is clear there will be a sharp contraction in activity and millions of workers have lost their jobs. To the extent containment measures remain widespread, we are unlikely to quickly pass this signpost.

Policy response has been impressive compared to what took place during the Global Financial Crisis (GFC), both from a magnitude and a timing standpoint. It is clear that the government and the Federal Reserve intend to do everything in their power to maintain the underlying fundamentals of our economy and the plumbing of our financial system. If containment measures are short-lived, actions already taken may be sufficient. If containment is extended beyond April, more stimulus may be needed.

During the depths of the sell-off in March, liquidity constraints became widespread across markets. The Fed stepped into higher quality bond markets to provide needed liquidity and has stated they will take additional actions if/when they are needed. Hopefully, this means we have passed this signpost.

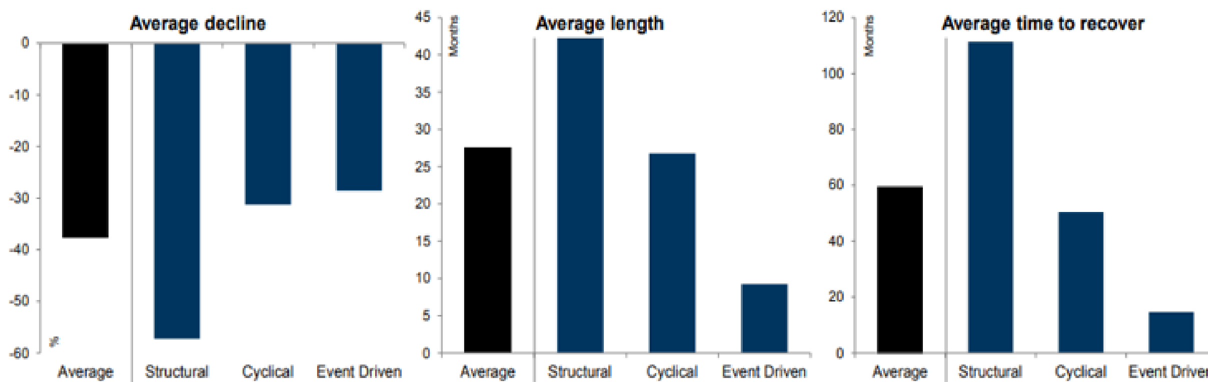
While markets have cheapened, we still see the potential for them to cheapen further given the uncertainty still surrounding some of the other signposts. Some market valuations are already historically cheap, but most are just back in line with their longer-term averages. We are actively exploring opportunities in those markets that are now historically cheap.

The last signpost has to do with not experiencing additional Black Swan – or unforeseeable extreme negative – events. When the environment is changing rapidly, the potential for other things to unexpectedly go wrong rises. So far, no other Black Swan events have occurred.

In addition to this signpost framework, we want to share with you another historical framework for gauging how this current bear market might compare to previous bear markets. Since the 1830s, the U.S. has experienced roughly 30 bear markets. Broadly speaking, these fall into three different categories:

1) Structural: triggered by structural imbalances and financial bubbles (e.g. the GFC)
2) Cyclical: typically caused by an economy going into a recession
3) Event-Driven: triggered by one-off "shocks" that do not result in recession (e.g. oil price shocks)

The current bear market started off as event-driven (the coronavirus), but containment has turned it into a cyclical bear market (there is also a recession now occurring). As shown in the charts below, both cyclical and event-driven bear markets, on average, tend to fall roughly 30% peak-to-trough. The key difference comes down to the duration of both the downturn and the time to fully recover the losses. Cyclical bear markets tend to be longer on both counts, however each bear market is unique.



Past performance is no guarantee of future results. Source: Goldman Sachs, O'Brien Wealth Partners, as of 3/9/20.

To be sure, there are still a lot of unknowns and the situation can certainly deteriorate further. We do not believe we have passed many of these signposts but we do see signs that we are moving in a positive direction. As such, we remain defensively-oriented and continue to research attractively priced assets for long-term opportunities. As we start to pass these signposts, we will look first at rebalancing portfolios back into stocks and then at reintroducing exposure to riskier, mispriced asset markets identified by our due diligence process.

Stay safe and healthy,

Your O'Brien Team

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177 Huntington Avenue, Suite 2010, Boston, MA 02115 **P** 617.547.6717 **F** 617.547.9516 **www.obrienwp.com**