GALLIARD
Capital Management, Inc.

WELLS FARGO STABLE VALUE FUND W INVESTMENT REVIEW

Second Quarter 2020

The Wells Fargo Stable Value Fund W (the Fund) is 100% invested in the Wells Fargo Stable Return Fund G.

WELLS FARGO STABLE RETURN FUND G FACTS

- Fund Inception Date: October 1, 1985
- Fund Advisor: Galliard Capital Management, Inc.
- Fund Trustee: Wells Fargo Bank, N.A.
- Valuation Frequency: Daily
- Fund is 100% benefit responsive
    - Plan sponsor withdrawal with 12 month notice

INVESTMENT OBJECTIVE

The Fund seeks safety of principal and consistency of returns while attempting to maintain minimal volatility. The Fund is designed for investors seeking more income than money market funds without the price fluctuation of stock or bond funds.

INVESTMENT STRATEGY

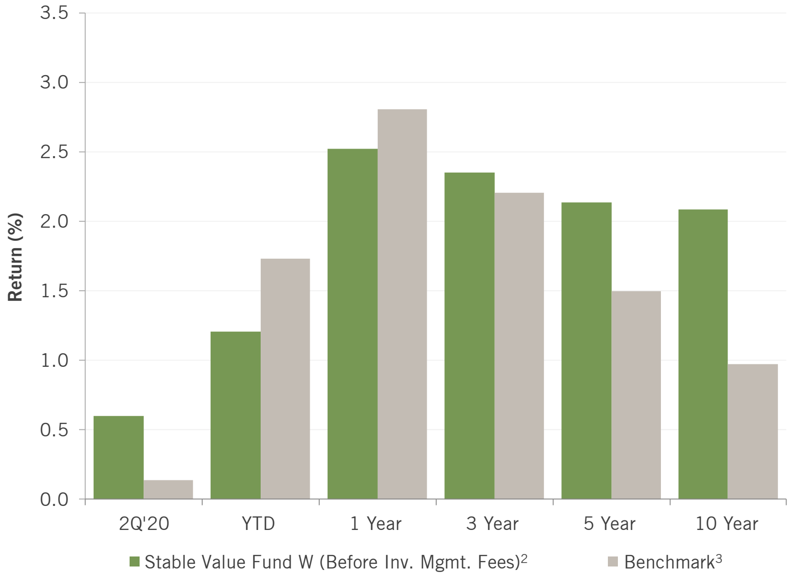
The Fund's underlying fixed income strategy is managed in a conservative style that utilizes a disciplined value investing process to build a high quality portfolio with broad diversification and an emphasis on risk control. Our core investment philosophy is to build a portfolio of realizable yield through bottom-up, fundamental research, utilizing a team-based approach to portfolio management. Galliard's fixed income portfolios emphasize high quality spread sectors, diversification across sectors and issuers to reduce risk, neutral duration positioning, and a laddered portfolio structure for ample natural liquidity.

The majority of the Fund's assets will be invested in fixed income portfolios that are wrapped by stable value contracts which allow fund participants to transact at book value. The Fund will hold cash in order to maintain sufficient liquidity, and may also invest in traditional GICs. The Fund utilizes high credit quality stable value contract issuers, with an emphasis on diversification.

INVESTMENT RISK

As is true of any form of investment, there is the risk of principal loss or underperformance relative to benchmarks or other investment options. Underperformance or principal loss may be the result of many factors. Please refer to the Fund's Disclosure Booklet for information regarding risk factors.

INVESTMENT PERFORMANCE[1] (as of 06/30/20)



Annualized Performance	2Q'20	YTD	1 Year	3 Year	5 Year	10 Year
Stable Value Fund W (Before Inv. Mgmt. Fees)[2]	0.60	1.20	2.52	2.35	2.13	2.08
Benchmark[3]	0.13	1.73	2.81	2.21	1.50	0.97
FTSE 3 Month Treasury Bill	0.14	0.52	1.56	1.72	1.15	0.61
Value Added (Before Inv. Mgmt. Fees)	0.46	(0.53)	(0.29)	0.14	0.63	1.12

Wells Fargo Stable Value Fund W reflects all annual fund operating expenses before investment management fees. Please consult the fact sheet provided by your plan administrator for the performance of your investment.

1: Returns for periods less than one year are not annualized.
2: In order to illustrate historical performance of the Fund, Fund W's returns have been linked with the historical returns of Wells Fargo Stable Return Fund G and the resulting amount is reported as "before investment management fees." Returns designated as being "before investment management fees" include all income, realized and unrealized capital gains and losses and all annual fund operating expenses. Returns may have been impacted by the effect of compounding and have been rounded to the nearest basis point. These returns also include all non-Wells Fargo subadvisor fees, audit and valuation fees. Returns designated as "before investment management fees" do not reflect the maximum 0.35% fee which may be charged by Galliard for management of each client's account. For example, if the maximum advisory fee of 0.35% were deducted quarterly from each account, a ten year annualized total return of 2.08% as of June 30, 2020 would have been reduced by 0.35% to 1.73%. More detailed information regarding the impact of the maximum investment management fees can be found on page 6. Fees which may be charged to each client for investment management are described in Galliard Capital Management's Form ADV Part 2. See disclosures on page 6 for additional information.
3: 50% FTSE 3 Month Treasury Bill, 50% ICE BofA 1-3 Year U.S. Treasury Index. While prior to 2007, the benchmark was 50% 90 Day T-Bill plus 50% ICE BofA 1-3 Year Treasury Index, the historical returns above are that of the current blended benchmark. While it is believed that the benchmark used here represents an appropriate point of comparison for the Fund referenced above, prospective investors should be aware that the volatility of the above referenced benchmark or index may be substantially different from that of the Fund; and holdings in the Fund may differ significantly from the benchmark or index if the investment guidelines and criteria are different than the Fund.

FUND POSITIONING

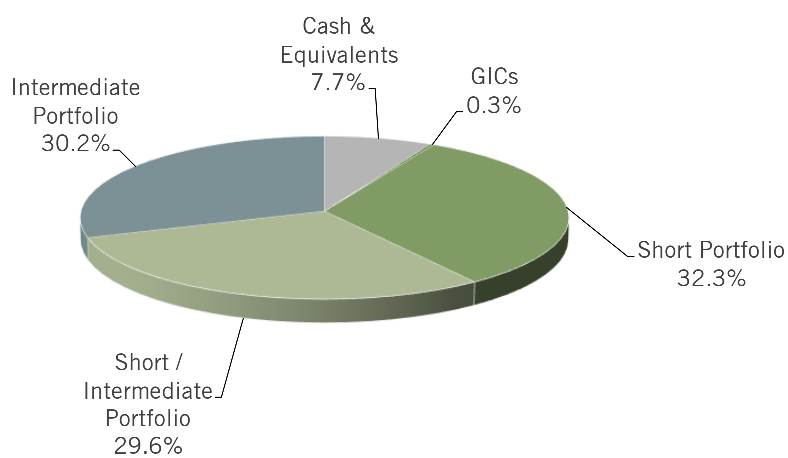
- The Fund's investment strategy remained unchanged during the quarter. We continue to emphasize actively managed portfolios of diversified, high quality fixed income securities, wrapped under security backed investment contracts
- In the current market environment, we are managing the Fund's duration toward the low end of its target range, while maintaining the Fund's cash allocation
- Sector allocations remain broadly diversified across the bond market
- The Fund's blended yield before investment management fees decreased during the quarter to 2.39%

FUND CHARACTERISTICS as of June 30, 2020

Total Assets	$26,043,601,800
Blended Yield (Before Inv. Mgmt. Fees)[1]	2.39%
Market to Book Value Ratio	104.3%
Effective Duration	2.48
Number of Contract Issuers	9
Number of Underlying Issues	3,178
Annualized Turnover as of 12/31/19[2]	49.7%

1: Blended Yield before investment management fees has been reduced by the amount of book value investment contract fees and all annual fund operating expenses. The blended yield net of Galliard investment management fees will vary by client depending on unique fee schedules. The maximum investment management fee by which the yield could be reduced is 0.35%.
2: Please refer to the Fund's Disclosure Booklet for more information regarding methodology of turnover calculation.

STRATEGY DIVERSIFICATION[1]



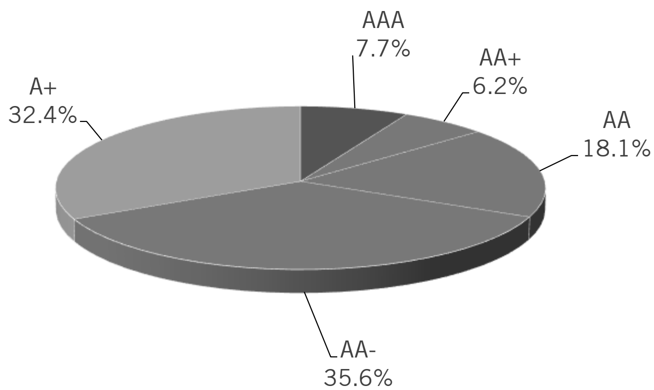
1: Totals may not add to 100% due to rounding.

WELLS FARGO STABLE RETURN FUND G HOLDINGS

Issuer	% of Portfolio	Moody's Rating	S&P Rating	Contract Type[1]
Prudential Ins. Co. of America	14.4%	Aa3	AA-	SBIC
Transamerica Premier Life Ins. Co.	14.2%	A1	A+	SBIC
Royal Bank of Canada	14.1%	Aa2	AA-	SBIC
American General Life Ins. Co.	14.1%	A2	A+	SBIC
Metropolitan Life Ins. Co.	12.3%	Aa3	AA-	SBIC
Pacific Life Ins. Co.	8.6%	A1	AA-	SBIC
Massachusetts Mutual Life Ins. Co.	6.2%	Aa3	AA+	SBIC
Nationwide Life Ins. Co.	4.1%	A1	A+	SBIC
State Street Bank and Trust Co.	4.0%	Aa2	AA-	SBIC
Metropolitan Life Ins. Co.	0.3%	Aa3	AA-	GIC
Cash/Equivalents				
Short Term Investment Fund	7.7%	Aaa	AAA	---
TOTAL	**100.0%**	**Aa3**[2]	**AA-**[2]	**---**

1: GIC = Guaranteed Investment Contract. SBIC = Security Backed Investment Contract.
2: The Weighted Average Quality of the portfolio has NOT been assessed by a nationally recognized statistical rating organization. The Weighted Average Quality shown represents an average quality of the contracts and cash held by the portfolio as rated by S&P and Moody's.

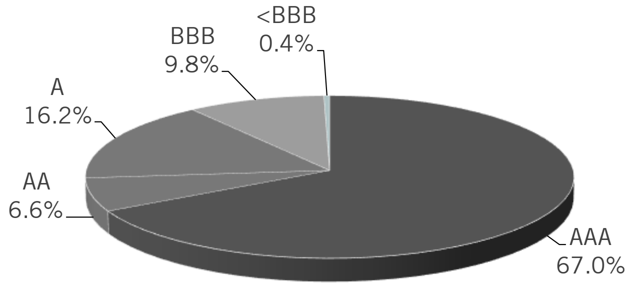
CONTRACT QUALITY DISTRIBUTION[1]



1: The quality distribution shown represents the distribution of the contract issuers' Composite Ratings, as rated by S&P, Moody's and Fitch. If Moody's, S&P and Fitch all provide a credit rating, the composite rating is the median of the three agency ratings. If only two agencies provide ratings, the composite is the more conservative rating. If only one agency provides a rating, the composite rating reflects that agency's rating.

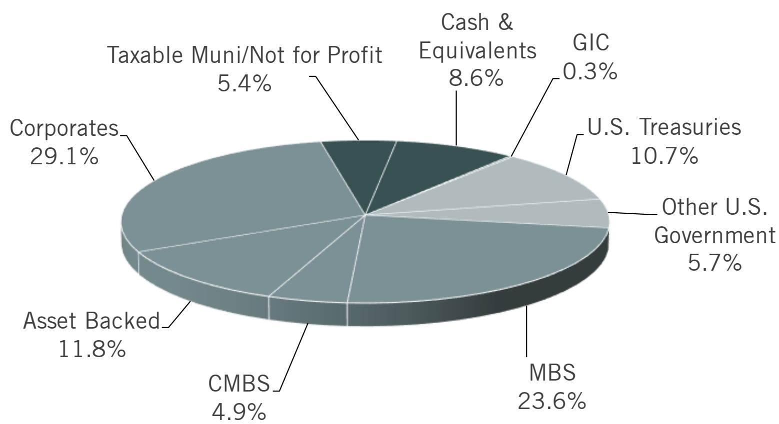
Totals may not add to 100% due to rounding.

UNDERLYING FIXED INCOME CREDIT QUALITY[1]

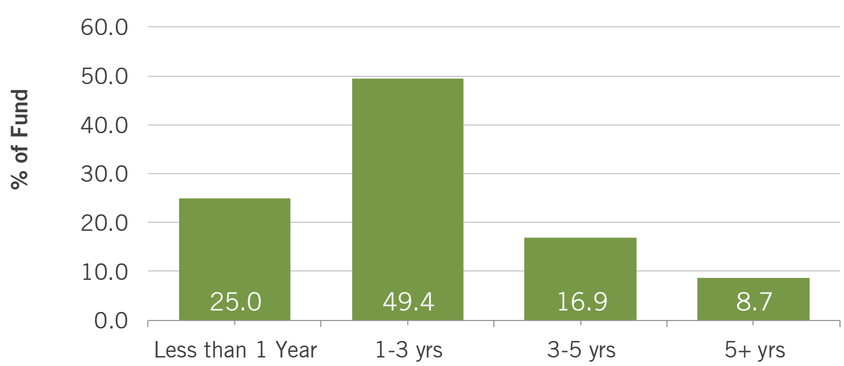


1: The quality distribution shown represents the distribution of the individual holdings' Composite Ratings, as rated by S&P, Moody's and Fitch. If Moody's, S&P and Fitch all provide a credit rating, the composite rating is the median of the three agency ratings. If only two agencies provide ratings, the composite is the more conservative rating. If only one agency provides a rating, the composite rating reflects that agency's rating.

UNDERLYING FIXED INCOME ASSET ALLOCATION



UNDERLYING DURATION DISTRIBUTION



Totals may not add to 100% due to rounding.

ANNUAL PERFORMANCE[1]

	2019	2018	2017	2016	2015	2014	2013	2012	2011
Stable Value Fund W (Before Inv. Mgmt. Fees)	2.55	2.27	1.95	1.82	1.70	1.55	1.75	2.08	2.45
Stable Value Fund W (After Maximum Fees)	2.19	1.91	1.59	1.47	1.35	1.20	1.40	1.72	2.09
Benchmark[2]	2.90	1.72	0.63	0.58	0.29	0.33	0.20	0.25	0.81
Consumer Price Index[3]	2.29	1.67	2.11	2.07	0.73	0.76	1.51	1.74	2.96
FTSE 3 Month Treasury Bill	2.25	1.86	0.84	0.27	0.03	0.03	0.05	0.07	0.08

QUARTERLY PERFORMANCE[1]

	FIRST QUARTER		SECOND QUARTER		THIRD QUARTER		FOURTH QUARTER	
YEAR	Before Inv. Mgt. Fees	After Max. Fees	Before Inv. Mgt. Fees	After Max. Fees	Before Inv. Mgt. Fees	After Max. Fees	Before Inv. Mgt. Fees	After Max. Fees
2010	0.75	0.66	0.79	0.70	0.76	0.66	0.74	0.66
2011	0.63	0.54	0.62	0.54	0.61	0.50	0.57	0.49
2012	0.54	0.46	0.52	0.43	0.51	0.41	0.49	0.41
2013	0.47	0.38	0.47	0.38	0.42	0.32	0.39	0.31
2014	0.36	0.27	0.38	0.29	0.39	0.29	0.41	0.32
2015	0.40	0.32	0.43	0.34	0.42	0.32	0.44	0.35
2016	0.42	0.33	0.45	0.36	0.47	0.39	0.47	0.38
2017	0.45	0.36	0.47	0.39	0.50	0.41	0.52	0.43
2018	0.52	0.44	0.55	0.47	0.57	0.48	0.60	0.51
2019	0.60	0.51	0.63	0.54	0.65	0.56	0.65	0.56
2020	0.60	0.52	0.60	0.51				

1: Returns for periods less than one year are not annualized
2: 50% FTSE 3-Month Treasury Bill, 50% ICE BofA 1-3 Year U.S. Treasury Index. While prior to 2007, the benchmark was 50% 90 Day T-Bill plus 50% ICE BofA 1-3 Year Treasury Index, the historical returns above are that of the current blended benchmark. While it is believed that the benchmark used here represents an appropriate point of comparison for the Fund referenced above, prospective investors should be aware that the volatility of the above referenced benchmark or index may be substantially different from that of the Fund; and holdings in the Fund may differ significantly from the benchmark or index if the investment guidelines and criteria are different than the Fund.
3: Consumer Price Index as reported on 07/02/2020.

Wells Fargo Stable Value Fund W is 100% invested in the Wells Fargo Stable Return Fund G. The Wells Fargo Stable Return Fund G is a collective trust fund for which Wells Fargo Bank, N.A. is investment manager and trustee. Galliard Capital Management, a wholly-owned subsidiary of Wells Fargo Asset Management Holdings, LLC, serves as advisor to the Wells Fargo Stable Return Fund G. While the Wells Fargo Stable Return Fund G has been in existence since 1985, Fund W has only been available with the applicable trustee fee of 3 bps since February 2, 2015. In order to illustrate historical performance of the Fund, Fund W's returns have been linked with the historical returns of Wells Fargo Stable Return Fund G and the resulting amount is reported as "before investment management fees." Returns designated as being "before investment management fees" include all income, realized and unrealized capital gains and losses and all annual fund operating expenses. Returns may have been impacted by the effect of compounding and have been rounded to the nearest basis point. These returns also include all non-Wells Fargo subadvisor fees, audit and valuation fees. Returns designated as "before investment management fees" do not reflect the maximum 0.35% fee which may be charged by Galliard for management of each client's account. Fees which may be charged to each client for investment management are described in Galliard Capital Management's Form ADV Part 2.
The Fund is not insured by the FDIC, Federal Reserve Bank, nor guaranteed by Wells Fargo or any affiliate, including Galliard Capital Management. Past performance is not an indication of how the investment will perform in the future. FOR INSTITUTIONAL INVESTOR USE ONLY.

TOTAL ANNUAL FUND OPERATING EXPENSES

Total Annual Fund Operating Expenses are deducted directly from the Fund's net asset value and reduce the investment option's rate of return. Total Annual Fund Operating Expenses will be reflected daily in the Fund's net asset value.

Expenses	Expense Ratio (as of 06/30/20)	Per $1000
Acquired Fund Fees[1]	0.166%	$1.66
-Investment Contract Fees[2]	0.157%	$1.57
-Other Acquired Fund Fees and Non-Affiliated Investment Management Fees paid to Non-Affiliated Investment Advisors[3]	0.009%	$0.09
Other Expenses	0.030%	$0.30
-Administrative Expense	None	None
-Audit, Valuation and 5500 fees	0.000%	$0.00
-Trustee Fees	0.030%	$0.30
12b-1 Distribution Fee	None	None
Total Annual Fund Operating Expenses[4]	**0.196%**	**$1.96**

Investment Management Fees paid to Galliard^	up to 0.35%	up to $3.50
Total Annual Fund Expenses (after maximum investment management fee)	up to 0.546%	up to $5.46

WELLS FARGO STABLE VALUE FUND W

NOTICE: Effective 7/1/20 the maximum Investment Management Fee paid to Galliard Capital Management ("Investment Advisor") for assets in the Wells Fargo Stable Value Fund will be reduced from 0.35% to 0.20%. As a result, the estimated Total Annual Fund Expenses (after maximum investment management fee) for the Fund as 7/1/20 will be reduced to 0.396%[5].

1: These are fees borne indirectly by the Fund when it acquires an interest in another fund which pays its own separate fees
2: These are fees paid to create and maintain the investment used by a stable value fund
3: Includes audit fees for the cost of producing a report by a qualified auditor
4: Total Annual Fund Operating Expenses are reflected daily in the Fund's net asset value (NAV)
5: Estimated total fund expense ratio calculation (after maximum investment management fee) is based on the actual 6/30/20 expense ratio net of the maximum Galliard Investment Management Fee after reductions. Total Expense Ratios vary based on actual fund operating expenses.

^Galliard Investment Management Fees

The Wells Fargo Stable Value Fund W is offered for direct investment by certain institutions such as retirement plans and employee benefit trusts. The Fund itself does not accrue an investment management fee. The Fund and a series of other stable value collective investment funds managed and trusteed by Wells Fargo purchase interests in the Wells Fargo Stable Return Fund G and may accrue investment management fees. The Fund may also be offered through certain financial intermediaries that may charge their customers other fees.

An investment management fee may be paid directly at the Plan level or by the Plan Sponsor. The maximum 0.35% fee which may be charged by Galliard for the management of each client's account is reflected above. Fees which may be charged to each client for investment management are described above and in Galliard Capital Management's Form ADV Part 2.

Please refer to your plan administrator for specific information on the fee arrangement with Galliard for your Plan.

SECOND QUARTER 2020 – GLOBAL PANDEMIC PEAK? OR TIP OF THE ICEBERG?

As the COVID-19 pandemic evolved over the last several months, the world watched with bated breath for signs of peaking infection rates. At the same time, epidemiological terms like R0, asymptomatic spread, and aerosol transmission have entered the mainstream lexicon. With over 10 million reported cases and over 500,000 deaths worldwide, it is hard to take solace in smaller daily reported numbers. Nevertheless, with many regions reporting slowing growth rates, there is optimism that perhaps a peak has been reached and better days lie ahead. Caution is warranted, however, as many of the world's top epidemiologists warn that we have a long way to go.

Since the initial outbreak, the economic outlook has closely tracked the evolution of the virus. Early on, the math of exponential growth in infections sparked unprecedented economic projections and plummeting financial markets; however, Government restrictions put in place to control the spread of COVID-19 proved effective in "flattening the curve." Renewed confidence led many authorities to relax restrictions in order to restart economic activity. Regardless, questions remain about the public's willingness to resume pre-COVID-19 activity levels amid growing concerns of additional outbreaks. As we write this summary, a number of states have recently reinstated previously removed restrictions as a result of resurgent infection rates. On the positive side, consensus is forming that another total economic shutdown can be avoided with some restrictions remaining in place to combat regional infection spikes. Going forward, a delicate balance between economic welfare and health concerns will need to be struck while the global health system continues to learn the best way to deal with the disease.

First quarter GDP growth came in at -5% q/q annualized, despite COVID-19 shutdowns not taking full effect until the end of March. Heading into the unknown, economists' initial forecasts called for GDP to be down by 40% or more in the second quarter with unemployment reaching 20%. Recent economic data has surprised to the upside, prompting updated 2Q GDP estimates in the -20% to -30% q/q annualized range; still making this most severe economic downturn since the Great Depression. Looking ahead, forecasts are calling for a strong recovery with +20% q/q annualized GDP growth in the back half of the year. Should expectations be met, 2020 full year GDP is expected to be -6% to -8%.

GOVERNMENT AND CENTRAL BANK RESPONSE

At the end of March, Congress passed the CARES Act, a $2 trillion pandemic relief stimulus package designed to relieve cash flow stresses at the consumer and business levels. The stimulus was wide ranging and included checks for qualifying families (technically these are advanced tax credits against 2020 personal income), Paycheck Protection Program (PPP) loans from the SBA to assist small businesses in retaining employees, and the Main Street Lending Program (administered by the Federal Reserve) targeting eligible businesses as well as states and municipalities. Additionally, the Government implemented temporary changes to unemployment benefits, including relaxed eligibility requirements and expanded benefit amounts. At present, Congress is debating the $3 trillion HEROES Act that passed a house vote in mid-May. In the meantime, the PPP loan application deadline has been extended (initially ended on July 1) and it is expected that the temporary unemployment benefit changes will also get extended past the current expiration on July 31st.

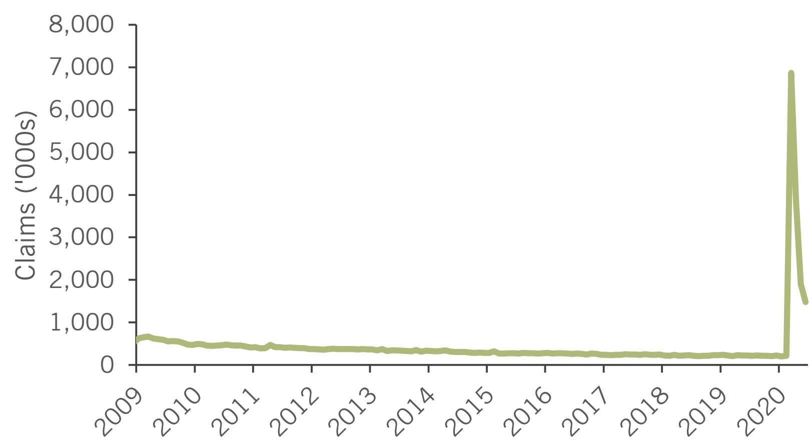
Since cutting its policy rate to zero and enacting unlimited QE in March, the Federal Reserve has purchased ~$1.7 trillion in Treasury securities and ~$780 billion in Agency MBS (gross of paydowns). For perspective, it took three rounds of quantitative easing spread out over four years following the global financial crisis (GFC) for the Fed to grow its holdings of Treasury and Agency MBS (net of paydowns) by an equivalent amount as it has over the last three months! The Fed's balance sheet stands at $7.131 trillion (most recently published figure), almost $3 trillion larger year-to-date. As expected, the Fed kept rates unchanged at its June meeting while published forecasts (dot plot) indicate that officials almost universally agree that policy rates will remain near zero for at least the next several years. Although the Fed continues to reject the idea of negative policy rates, futures markets are currently pricing in the probability of an additional policy rate cut into negative territory by early 2021. Rather, Fed officials have suggested using "yield curve control" as an additional policy tool if needed. Opinions differ on the efficacy of these uncommon monetary policies, with the current debate focused on the difference between strengthened forward guidance and yield curve control.

Recall that the Fed also initiated a number of credit facilities, ranging from money markets and asset securitizations to municipal and corporate bonds, designed to ease system-wide liquidity stress and facilitate functioning capital markets. To date, these programs have largely gone unused relative to their capacity. It seems the Fed's signal that it will do "whatever it takes" to restore market functioning to pre-COVID levels was enough in and of itself. Furthermore, the Fed's QE purchases of Treasury and Agency MBS have had the desired outcome, with proceeds driving demand in riskier investments. For example, the primary markets for corporate bonds and ABS were open for business well ahead of any applicable Fed facility involvement. As evidence of this, US High Grade corporate issuance was almost $700 billion in 2Q and year-to-date supply of nearly $1.2 trillion has already surpassed full year supply in 2019![1] Yet with all that activity, both the Primary Market Corporate Credit Facility (PMCCF) and the Secondary Market Corporate Credit Facility (SMCCF) have lent a combined $41 billion out of a possible $750 billion program size. As for asset securitizations, spread levels for on-the-run ABS are approaching pre-COVID-19 levels and are well inside of Term Asset Backed Loan Facility (TALF) funding. As are result, TALF subscription has been practically zero. Regardless of their utilization, these programs remain in place and could provide a necessary backstop should markets unravel again.

WHAT DO THE DATA MEAN?

After the global economy shut down in late March and early April, the change in economic output, whether measured in absolute numbers or in percentage terms, was historic. We highlighted three months ago that the speed and severity of the destruction was unprecedented, rendering previously existing data trends meaningless. Now that a corner has been turned, it is important to recognize that upside recovery numbers will be equally historic. Already, we have witnessed dramatic turnarounds in job creation, retail sales, pending home sales, etc. prompting headlines of the largest month-over-month changes in history!

FIGURE 1 INITIAL JOBLESS CLAIMS[2]



Here, we caution against exuberance. The baseline has changed and, as a result, deciphering the relative health of the economy is strenuous. As the universally taught example illustrates, a 50% drop followed by a 50% increase still leaves us 25% short of where we began. The historic rally in equity markets and spread products only adds to the confusion. Our intent is not to throw cold water on the positive tone and subsequent momentum. Rather, we consider an event like a global pandemic to be an extreme event that raises a number of questions. Prudence in interpreting data is more important than ever.

After alarming increases in unemployment claims at the end of March and early April triggered unemployment rate forecasts of 20% or more, the labor market has staged a comeback, beating expectations in subsequent months. The April jobs report was horrific, with nearly 21 million jobs lost; however, May and June saw the creation of 2.7 million and 4.8 million jobs respectively. While not enough to make up for previously reported job losses, May and June job creation was impressive relative to expectations of -7.5 million and +3.2 million respectively. The unemployment rate has been equally surprising. After catapulting to 14.7% in April, May came in at 13.3% versus expectations of 19.0% and June followed suit at 11.1% versus expectations of 12.5%. Undoubtedly, this appears to be an impressive turnaround; however, beating forecasts may be a reflection of forecasting ability and evidence suggests the labor market is far from healthy. Initial unemployment claims have consistently been around 1.5 million per week since the beginning of June, double the previous record for weekly initial jobless claims set way back in 1982. Additionally, continuing claims have remained at more than 19 million after peaking in May at 25 million. Recall that during the GFC in 2009, unemployment reached ~10% and it took 7+ years to return to pre-crisis levels. Unemployment is expected to be 9% by the end of this year.

1: Source: J.P. Morgan
2: Source: Bloomberg

With the turnaround in the unemployment trend came a turnaround in consumer spending. Personal consumption cratered in April, falling 12.6% m/m but then sharply increased by 8.2% m/m in May. In similar fashion, retail sales fell by 14.7% m/m in April before increasing by 17.7% m/m in May. Updated surveys of consumer sentiment signal the positive momentum may be here to stay. After falling all the way to 71.8 in April, the University of Michigan Consumer Sentiment Index bounced back to 78.1 by the end of June. Clearly, these numbers reflect the positive effect of Government stimulus. Referring back to the ongoing Government debate regarding additional stimulus, it seems likely that additional rounds of stimulus and an extension of unemployment benefit changes will be necessary should unemployment claims remain elevated.

Measures of business activity show a similar pattern. For example, the ISM Manufacturing Index and the ISM Report on New Business Orders Index rebounded into expansionary territory in June (52.6 and 56.4 respectively) following a deep contraction in April and May. Notably, these are “diffusion” indexes that do not indicate the magnitude of change. Rather, they are indicative of direction (trend), and whether relatively more or relatively fewer survey respondents are expanding or contracting. While still tremendously useful in signaling a trend, the numbers in and of themselves should not be confused as absolute. That is, a diffusion index measure of 56 today does not mean business activity is the same as it was with a measure of 56 four months ago. The baseline has shifted considerably, and business activity is trending and expanding from there. Confirming this idea are other measures, like industrial production and capacity utilization. According to the Federal Reserve’s most recent release in June, industrial production is 15.3% lower y/y at a level that is only 92.6% of base year 2012. Capacity utilization, at 64.8%, is 12% lower than in February, 15% below the long-run average, and almost 2% below the low point during the GFC. To be clear, the change in trend is a positive story, but these are additional examples of the difficulty in interpreting data when large changes occur. Business activity, along with labor, is far from being out of the woods. On the inflation front, both headline and core CPI were basically zero m/m in May after falling considerably in April, while y/y numbers fell to 0.1% and 1.2% respectively. Meanwhile, the Fed’s preferred measure of inflation, the PCE Core Index fell to 1.0% y/y in May. Much to the Fed’s chagrin, core inflation will likely remain well below its stated target of 2.0% for the foreseeable future. Market measures of inflation confirm subdued inflation expectations with 5-year and 10-year breakeven inflation rates ending the quarter at 1.17% and 1.34% respectively. The Fed’s policy actions have thus far convinced the market that deflation can be avoided. Nevertheless, underwhelming inflation only serves to strengthen the Fed’s resolve to keep rates lower for longer. Financial repression, penalizing savers to the benefit of borrowers, will be the order of the day.

Fueled by low mortgage rates and supported by payment forbearance, the housing market has proven resilient even in the face of unprecedented unemployment. Primary 30-year mortgage rates ended the quarter at an all-time low of 3.13%; however, this still seems high relative to historically low Treasury rates. Measured through February 2020, the spread between the 30-year primary mortgage rate and the 10-year Treasury rate averaged ~170 bps for the previous ten-year period. Since the beginning of March, that spread has averaged 257 bps and currently stands at 244 bps. Clearly, there is additional room for primary mortgage rates to compress further should interest rates stay low. Conventional wisdom suggests that as mortgage underwriting capacity opens up (currently overrun with forbearance applications), competitive pressures will eventually drive the primary mortgage rate lower.

FIGURE 2 ISM MANUFACTURING AND NON-MANUFACTURING[1]

1: Source: Bloomberg

Although many measures of housing activity are lower year-over-year, month-over-month numbers in May optimistically suggest a floor has already been reached. For example, new home sales posted a 16.6% m/m increase in May following three months of declines while pending home sales posted a 44.3% m/m increase in May, marking the largest m/m increase in the series history, following two months of 20% declines. Thus far, delinquencies and defaults have been relatively well behaved, supported by ongoing payment forbearance programs designed to relieve borrower cash flow stress during the pandemic. Furthermore, housing supply remains constrained allowing for tight supply-demand fundamentals to continue. Consequently, the S&P CoreLogic Case-Shiller 20 City Home Price Index was 3.98% higher y/y in April, marking the biggest increase since December 2018. Nevertheless, there is considerable uncertainty around the interplay between prolonged high unemployment and the eventual expiration of the aforementioned forbearance programs. The housing market could still prove difficult should forbearance recipients eventually turn into defaults.

LOOKING AHEAD

In summary, we are optimistic that the economy has reached a bottom and will continue to progress in the second half of the year. The coronavirus will evolve, with ebbing and flowing infection rates being combated with regional restrictions that move in tandem. Economic measures, including GDP, will likely increase at an elevated rate due to base effects; however, we are cognizant that an event of this magnitude could have a long tail with unintended consequences and that forecasts beyond the relevant range have proven inaccurate. A “U” shaped recovery seems most likely with the possibility for some rough patches along the way resulting in something more like a “W” shaped recovery. The Fed will remain committed to providing easy financial conditions and the Government will likely provide additional rounds of stimulus to keep consumers afloat. Liquidity has improved dramatically as a result of Fed intervention, and some asset valuations appear to fully reflect easy financing conditions and Government stimulus, perhaps limiting the upside. As a result, we continue to advocate for investors to remain patient and maintain a heightened focus on downside risk.