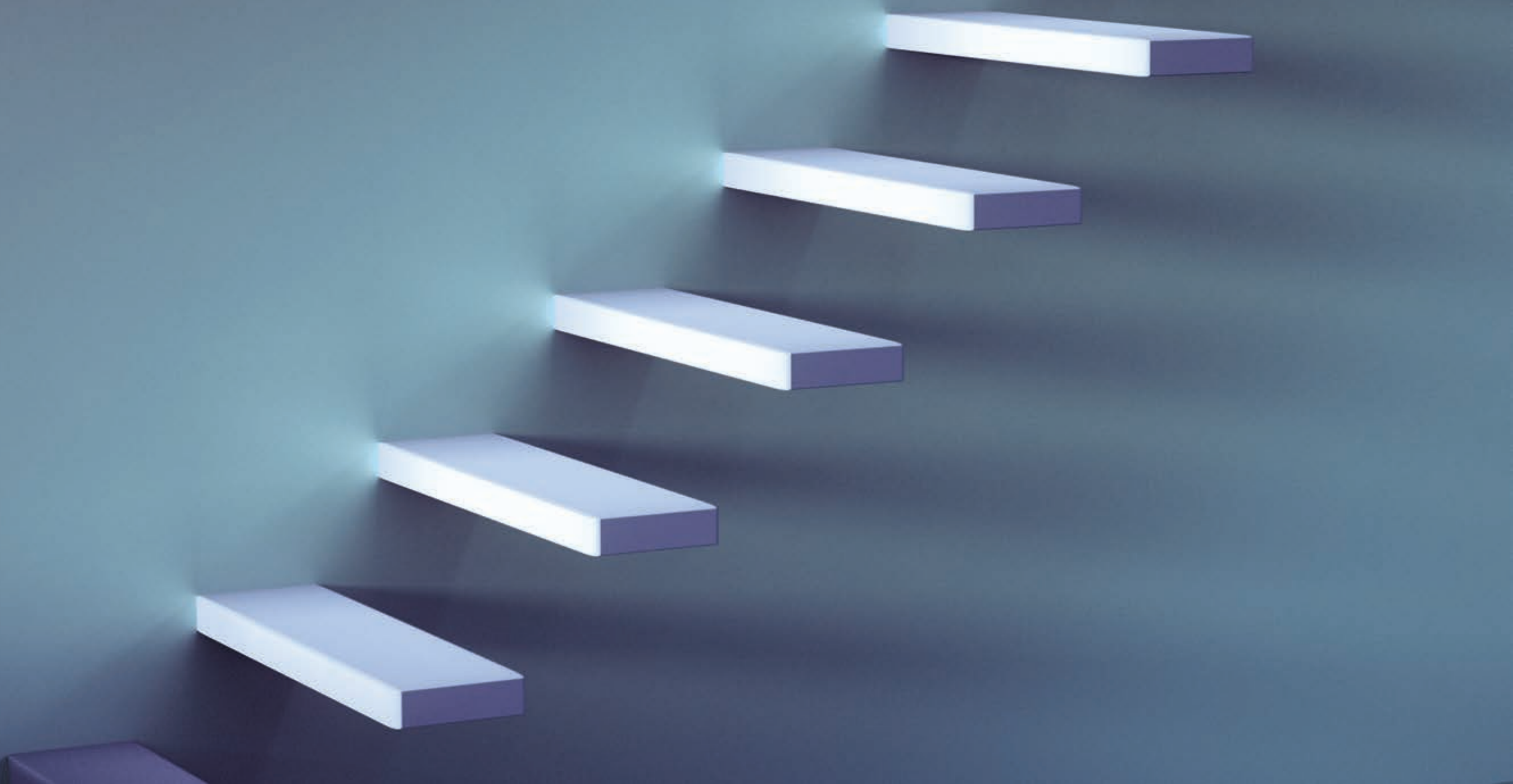
COLUMBIA THREADNEEDLE
INVESTMENTS

Looking Ahead

What bear markets and bull rebounds can teach us about how the stock market works, and how we may navigate current and future market contractions.



10% As you read the next few pages, remember this figure.

That's the approximate average annual return of the S&P 500 Index, the standard measure of stock performance in the U.S., since its 1926 inception date.[1] The key word here is average: there have been a lot of dramatic ups and downs over those 94 years that have contributed to that number. It's a testament to the power, consistency and resilience of the stock market — the rate is so robust that long-term returns for stocks have outpaced other major asset classes, like bonds and commodities, by a wide margin.[2] And for investors who have committed to staying invested for the long term, the benefits have been generous.

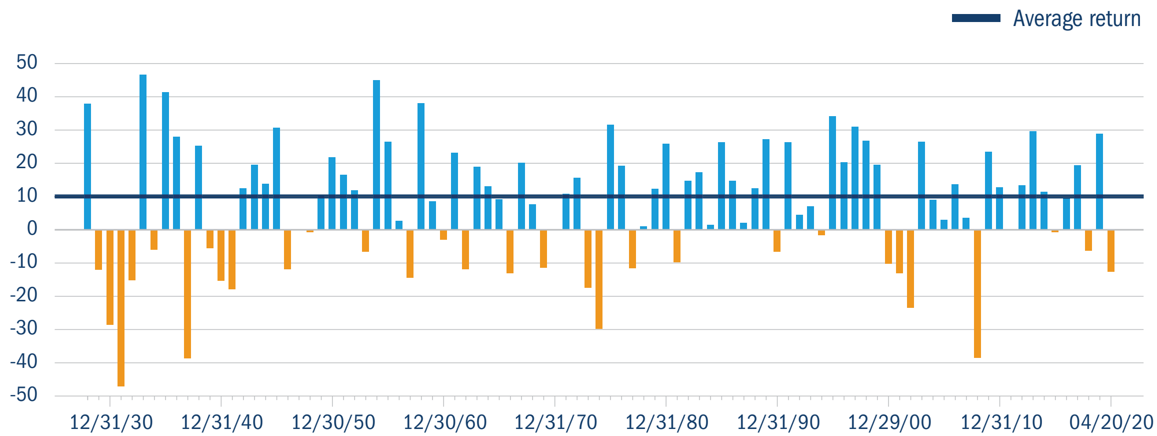
Staying invested is, of course, easier said than done.

It often requires the fortitude to stay focused on investment goals that are years away when by-the-minute bad news is coming fast, and your losses are piling up. In the midst of confidence-shattering drops in the markets, it's easy to lose sight of the fact that these types of events have occurred before, and that they can even lay the groundwork for opportunity.

The positive performance of stocks over time makes for a very attractive big picture. But when you zoom in, that picture can sometimes get ugly. Since its inception, the S&P 500 has experienced 11 instances of 20% or greater declines from an all-time high, which is generally considered to be a bear market. Each of these declines came out of a specific set of circumstances, and the duration of recovery has varied widely.

THE LONG-TERM PERFORMANCE OF STOCKS HAS BEEN IMPRESSIVE...

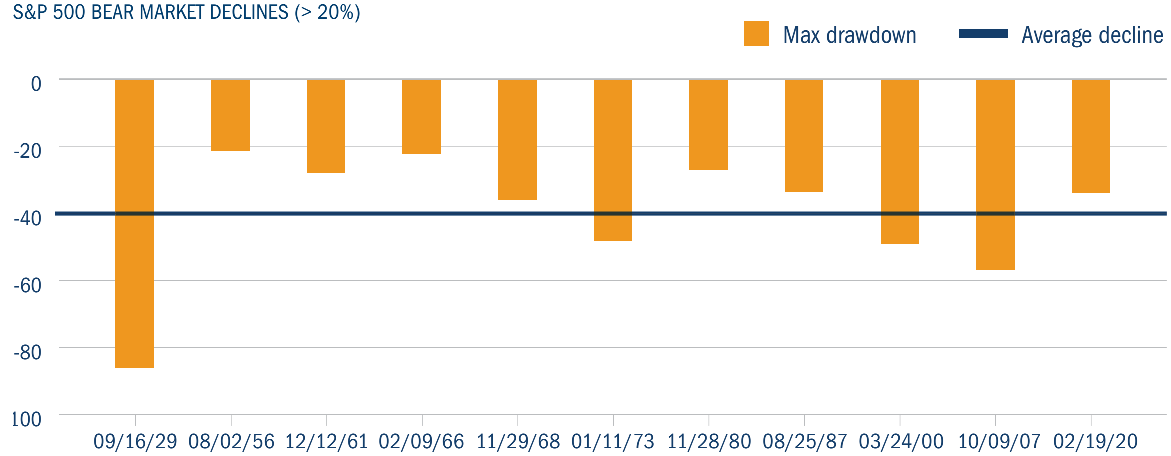
SINCE INCEPTION PERFORMANCE FOR THE S&P 500 INDEX (%)



Source: Columbia Threadneedle Investments based on S&P 500 performance data.

... BUT NOT WITHOUT PERIODS OF PAINFUL LOSSES.

S&P 500 BEAR MARKET DECLINES (> 20%)



Source: Columbia Threadneedle Investments based on S&P 500 performance data.

Past performance is not a guarantee of future results.

What have we learned from investing through bear markets?

First, that we're getting better at dealing with them. In the aftermath of each, major market participants and regulators pushed through reforms related to market structure, trading and investing rules. And as we experience a structural contraction yet again, we're benefiting from these types of reforms. Monetary policy has also evolved. Aggressive and swift action by central banks is now both common and expected — both to address the function of the market and to support investor confidence.

The second thing we learned, of course, is that we made it through. The markets recovered. The volatility (in both directions) was absorbed into the long-term, upward trend line. Investors who stayed the course felt the pain, but also benefited over the long run.

2020: Navigating a pernicious pandemic—and its aftermath.

Though many features of the current market contraction are unprecedented, these lessons help us put things in perspective and suggest a likely path forward.

The root cause of the current market contraction is COVID-19's global impact on normal business operations, governments and the financial system. It's structural in nature, driven by fundamental economic disruptions that have eroded market value and investor confidence. The severity and duration of the market downturn are yet to be determined, but our success in addressing the cause of the current slide — the ongoing spread of a global pandemic — will be, in our view, the factor that sets us on a path to recovery. Looking at it this way makes the situation relatively uncomplicated. We have only one dragon to slay, the novel coronavirus, even if it is unprecedented and formidable.

What recovery might look like

As we've noted, each decline has its own unique aspects, so the related recoveries are also unique. But based on observations and data for the most recent structural bear markets (1987, 2001–2002 and 2008–2009), we believe there are patterns that could recur — and that suggest certain strategic responses — as the markets begin to recover over the next months and years.

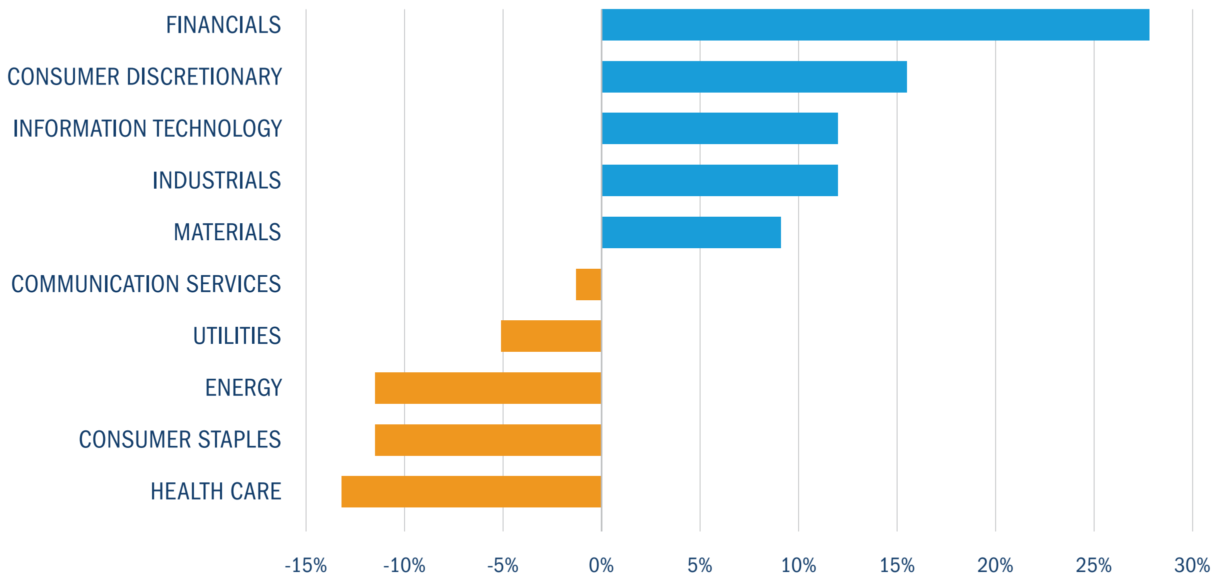
1

Defensive stocks tend to lag, while cyclical stocks tend to lead.

A large dataset supports the idea that traditional defensive sectors — consumer staples, healthcare and utilities — tend to underperform in the early stages of a recovery, while stocks with cyclical sensitivity — financials, materials and industrials companies — tend to outperform. When we look at the six-month and one-year returns after the three most recent bear markets, we can see that this pattern largely holds true.

It's important to note that in the current environment, we may see a variation on these trends. Certain healthcare stocks, which historically lagged, may be much stronger performers given the demand for testing, diagnostics, tools and products. There's also an explosion in online consumption, whether it's for groceries, education or broader retail. What started out of necessity for many may perhaps become the norm. And it will be important for investors to recognize these changes.

AVERAGE RELATIVE SECTOR PERFORMANCE 1 YEAR AFTER 1987, 2002 AND 2009 MARKET TROUGHS



Source: Columbia Threadneedle Investments. Chart reflects average relative performance of sectors within the S&P 500 for the 1 year following three market troughs, defined as 12/04/87, 10/09/02 and 03/09/09.

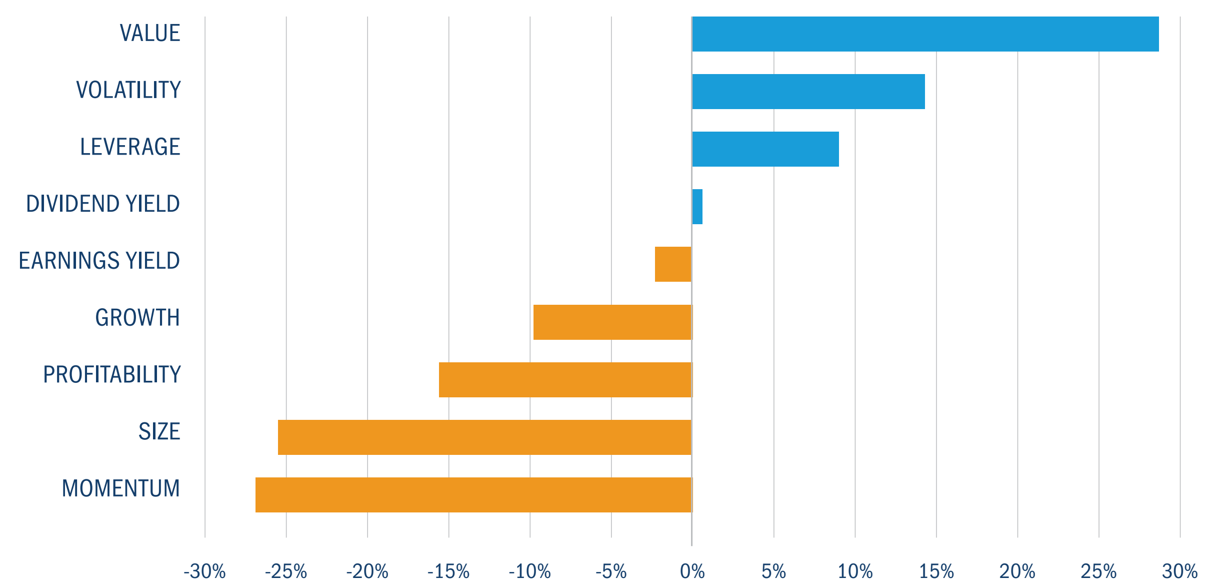
Past performance is not a guarantee of future results.

2

Cyclical and value quantitative factors may perform better than momentum and growth factors.

Factors are patterns of return that investors can isolate and seek to profit from; for example, small-cap stocks tend to outperform large caps over time. This approach is based on analyzing systematic market observations rather than the specific characteristics of individual companies or sectors. During periods of recovery from bear markets, quantitative factors that focus on cyclical and value characteristics tend to outperform. Factors that target characteristics such as rising price momentum, profitability potential and growth rates tend to underperform.

AVERAGE FACTOR PERFORMANCE 1 YEAR AFTER 1987, 2002 AND 2009 MARKET TROUGHS



Source: Columbia Threadneedle Investments based on S&P 500 data. See notes for factor definitions.

Past performance is not a guarantee of future results.

3

In the early days of a recovery, investors may avoid the sectors and industries that led the decline.

It's hard to imagine it now, but after the dot-com bubble burst, investors shied away from the tech sector for years — the memory of the pain that it inflicted on their portfolios lingered. From a behavioral perspective, this makes sense. Recency bias, the tendency for people to emphasize current reality over past experiences and future planning, can skew decisions about the risks of investing in certain companies or sectors. In the current environment, it's easy to understand why investors might avoid travel and hospitality stocks, which led the way down, because it may take longer for them to fully recover.

But for long-term investors, satisfying the urge to avoid sectors can be a strategic mistake, from both a diversification perspective and because of the potentially missed opportunities to add good long-term investments to a portfolio at attractive valuations. These missed opportunities were evident in the periods following the 1987, 2002 and 2009 market bottoms. To illustrate this, we can show the post-trough 12-month returns of the three sectors that led the downturns versus the S&P 500. In each case, the equal-weighted aggregate return of the three most "unloved" sectors outperformed the broader market.

THE SECTORS THAT LED THE DECLINE CAN TURN AROUND DRAMATICALLY DURING RECOVERY

	Start date	End date	S&P 500 return	Average return for bottom 3 sectors	Bottom 3 performing sectors
1987 Bear market	08/25/87	12/04/87	–33.5%	**–38.1%**	Consumer discretionary, information technology, financials
1987: First 1-year recovery	12/04/87	2/02/88	21.4%	**24.3%**	Return was **2.9% higher** than S&P 500 return
2000–2002 Bear market	03/24/00	10/09/02	–49.1%	**–56.3%**	Information technology, services, utilities
2002: First 1-year recovery	10/09/02	10/08/03	33.1%	**54.4%**	Return was **21.3% higher** than S&P 500 return
2007–2009 Bear market	10/08/07	03/09/09	-56.8%	**–70.7%**	Financials, real estate, industrials
2009: First 1-year recovery	03/09/09	03/09/10	68.6%	**122.0%**	Return was **53.3% higher** than S&P 500 return

Source: Columbia Threadneedle Investments based on S&P 500 performance data.

Past performance is not a guarantee of future results.

4

The winners and losers sometimes defy easy classification.

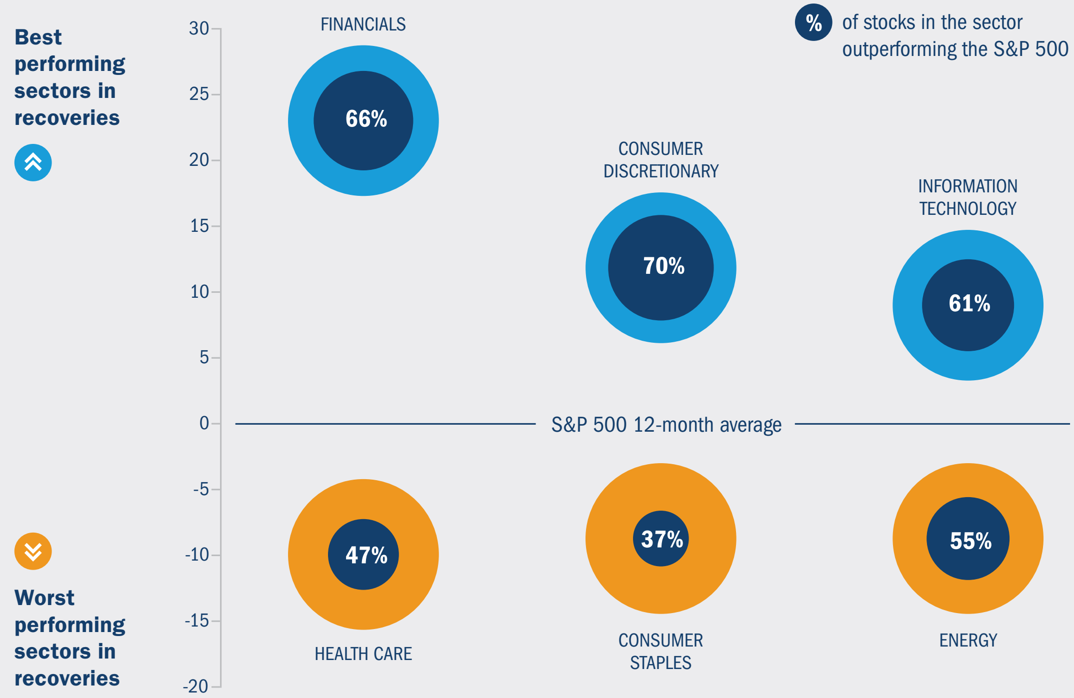
While the arguments in the three points above remain salient, taking advantage of rising markets during recovery is about more than getting the sector balance right. Aggregating returns by sector has the potential to mask the true nature of that sector's performance: it's often dominated by the outsize results of one company or a small group of businesses. When sectors outperform, it's rare that every stock in those sectors beats the market. Conversely, for sectors that underperform, not all stocks in the category lag.

This is one of the main reasons that we believe active portfolio management can make a difference during market recoveries. It's not sufficient to simply identify winning sectors, and it may be, to a certain extent, irrelevant. The best performing sectors do tend to have the highest number of stocks that exceed the performance of the S&P 500 over the same time period, but even the lowest performing sectors have a fair representation of companies that outperform the S&P 500.

Past performance is not a guarantee of future results.

OPPORTUNITY CAN VARY WITHIN SECTORS THAT OUTPERFORM AND UNDERPERFORM

AVERAGE 12-MONTH SECTOR PERFORMANCE RELATIVE TO THE S&P 500 FOLLOWING THE 1987, 2002, AND 2009 MARKET TROUGHS.



Source: Columbia Threadneedle Investments. Market troughs defined as 12/04/87, 10/09/02 and 03/09/09.

FOR THE RECOVERY PERIODS FOLLOWING THE 1987, 2001-2002 AND 2008-2009 BEAR MARKETS:

- Financials, consumer discretionary and information technology were winning sectors in aggregate. But hit rates — the percentage of stocks that outperformed — within those sectors were 66%, 70% and 61%, respectively, relative to the entire market over the 12-month post-trough period.
- Healthcare, consumer staples and energy sectors underperformed in aggregate, but hit rates within those sectors were still 47%, 37% and 55%, respectively, relative to the entire market over the 12-month post-trough period.

5

It may pay to focus on quality in fixed income.

Though observations so far have been about the behavior of stocks, fixed-income portfolio allocations also play an important part in investors' recovery strategies.

History and common sense tell us that a flight-to-safety from equities is directed to cash and high-quality bonds. But in the first phase of the current crisis, high-quality (investment-grade-rated) bonds performed surprisingly poorly, with some of the most defensive sectors performing as badly as low quality, lower rated, high-yield bonds. This was driven by a lack of market liquidity as well as concerns about underlying credit quality.

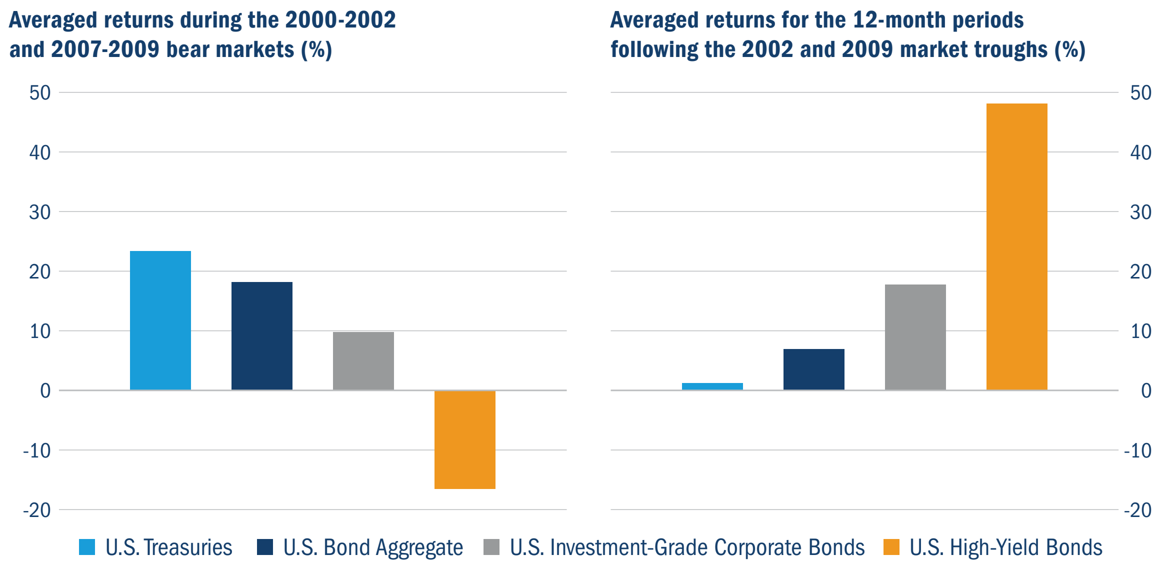
Moreover, price declines and outflows in high-quality bonds experienced early in the current crisis differ from the pattern experienced during prior market downturns.

Note that aggregate high-yield bond average returns are not available for the 1987 downturn and recovery as the market was in its very early days, so we illustrate only the 2002 and 2009 corrections and subsequent recoveries.

With this in mind, the decline in investment-grade bond prices that we have seen appears to be an aberration. In our view, high-quality bonds, especially in defensive market sectors like utilities and consumer staples, will likely revert to a more normal performance relationship relative to low-quality bonds, and then follow a path similar to previous contractions and recoveries. This is not to say all investment-grade companies and industries are immune to downgrades or worse, but the important point is our conviction that exposure to high-quality bonds can help investors mitigate downside risk in a challenging, recessionary environment.

The average historical performance of high-yield bonds in the chart below shows a similar pattern to equities during both the downturns and the recoveries. For investors with an appetite for the increased default risk, maintaining a strategic allocation to lower quality, higher yielding bonds through bear markets can also be advantageous when the markets rebound.

BOND RETURNS DURING AND AFTER TWO MAJOR MARKET CORRECTIONS



Source: Columbia Threadneedle Investments based on Bloomberg Barclays index data. Bear market periods are defined as 08/25/87-12/04/87, 03/04/00-10/09/02 and 10/09/07-03/09/09.. US Treasuries are represented by the Bloomberg Barclays U.S. Treasury Index, which measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. The US Bond Aggregate is represented by the Bloomberg Barclays U.S. Aggregate Corporate Bond Index, which consists of publicly issued, fixed-rate, nonconvertible, investment-grade debt securities. US investment grade corporate is represented by the Bloomberg Barclays U.S. Corporate Investment Grade Index, which measures the investment grade, taxable corporate bond market. US high yield is represented by the Bloomberg Barclays U.S. High Yield Corporate Bond Index, which represents the universe of fixed rate, non-investment grade debt.

What about cash?

Some investors are tempted to reallocate to cash until there is less uncertainty, but if you aren't invested, you don't get to participate when markets rebound — which can happen quickly and violently.

In the 8 years following the global financial crisis, cash returned less than 0.25% annualized. Safe, liquid … and the worst performing asset class.

Past performance is not a guarantee of future results.

6

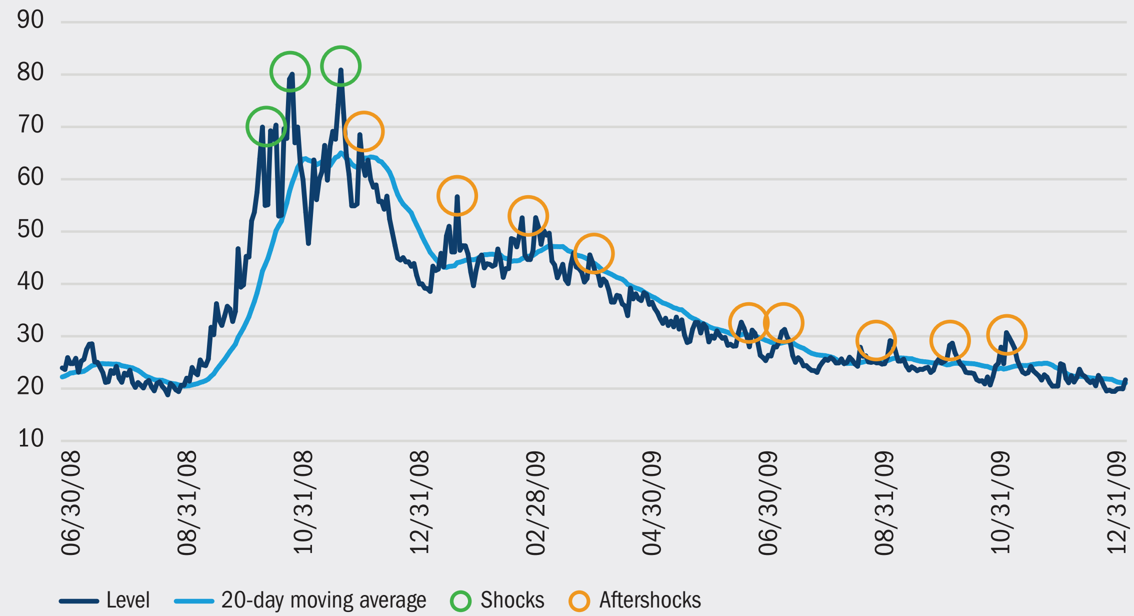
Volatility is likely to continue.

The CBOE Volatility Index (VIX) is a measure of stock market volatility. During the 2008-2009 global financial crisis, a spike in the VIX was followed by a series of "aftershocks" as it moved back toward normal levels. If we follow a similar pattern in the current environment, we could continue to see episodes of volatility — sometimes dramatic — for an extended period. Subsequent to their peak, these episodes will likely decrease in frequency and magnitude, but they can still be unnerving and costly in the short term.

Volatility during the 2008-2009 global financial crisis

A SPIKE IN MARKET VOLATILITY CAN BE FOLLOWED BY A SERIES OF AFTERSHOCKS

VIX DURING THE GLOBAL FINANCIAL CRISIS



Source: Columbia Threadneedle Investments. The CBOE Volatility Index (VIX) is a measure of equity markey volatility.

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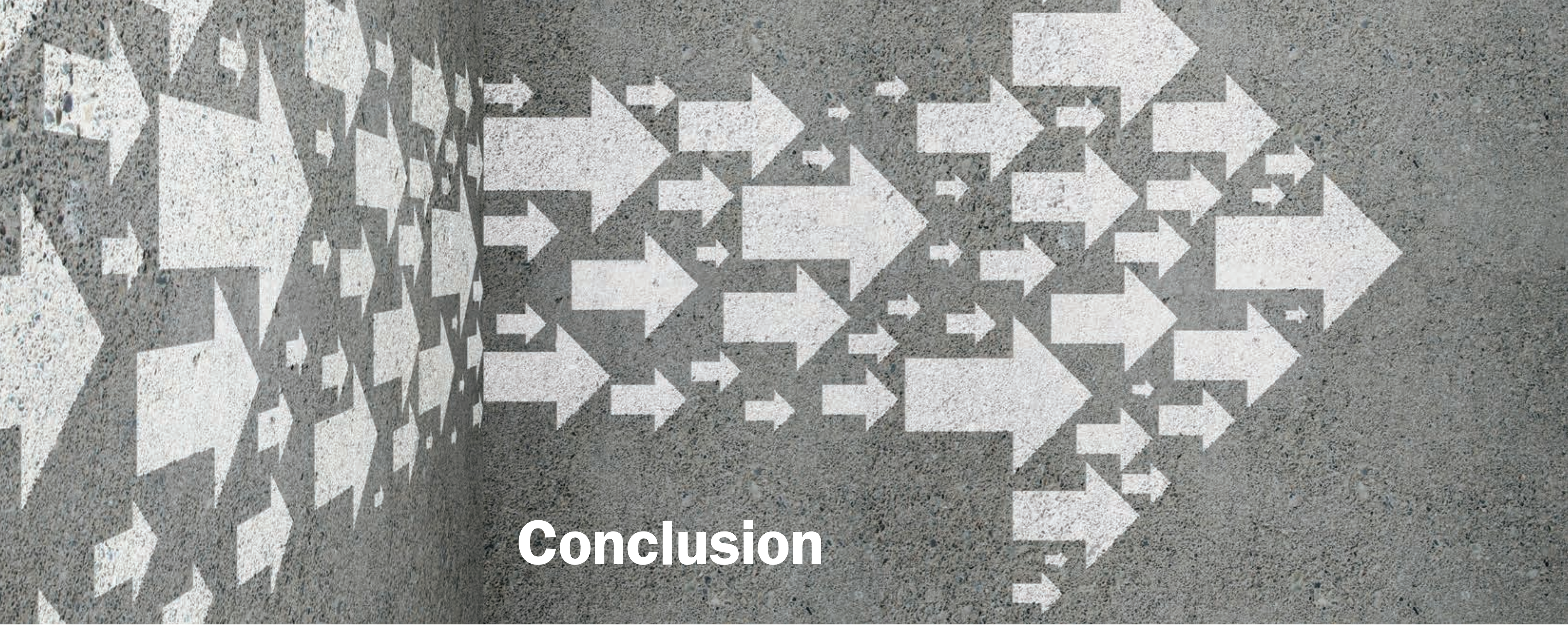

Conclusion

Each of the past 11 bear markets left an indelible mark on the economy and on investors' psyches. This one will too. It might be hard to imagine what recovery may look like, especially during what will likely be more difficult months ahead. Past performance is not a guarantee of future results, but if the markets hold true to well-established norms, bear market number 12 will pass, the lessons learned will be added to the data from the first 11, and year 95 will be added to the S&P 500 Index average.

To be sure, it can take stocks years to return to their prior highs from bear market lows, especially when a recession is part of the formula. And even then, it's unlikely that we will return to a world that's the same as it was prior to this shock. It's very likely that after the world contains the novel coronavirus, we'll see structural changes and an acceleration of trends that were already in play. The healthcare and energy industries were arguably already headed toward a fundamental transformation, and their performance over the upcoming months may look very different from prior recoveries.

Responding to these impacts and thriving through the decline and into the recovery will require intensive research at both the macro and company-by-company level into what those lasting structural changes may be and how we react to them. And while we regroup and strategize next steps, we have to be nimble, but also vigilant in adhering to our long-term, positive view of the markets — and the opportunities they will continue to provide for committed investors.

[1] Source: Columbia Threadneedle Investments. Past performance is not a guarantee of future results. Investors cannot invest directory in an index.
[2] Sources: https://www.nasdaq.com/articles/stocks-bonds-bills-inflation-returns-for-the-94-years-ending-december-2019-2019-12-09
https://www.cfainstitute.org/-/media/documents/book/rf-publication/2012/rf-v2012-n1-1-pdf.ashx
[3] Sources: https://www.nasdaq.com/articles/stocks-bonds-bills-inflation-returns-for-the-94-years-ending-december-2019-2019-12-09
https://www.cfainstitute.org/-/media/documents/book/rf-publication/2012/rf-v2012-n1-1-pdf.ashx
For the purposes of this paper bear markets are calculated as drops from all-time market highs based on total return of the S&P 500. By this calculation, the following periods have been defined as bear markets:
1987 Bear Market: 8/25/1987 – 12/4/1987 (S&P 500 return -33.5%)
2000-2002 Bear Market: 3/24/2000 – 10/9/2002 (S&P 500 return -49.1%)
2007 – 2008 Bear Market: 10/9/2007 – 3/9/2009 (S&P 500 return -56.8%)
Periods of 20% declines that are not from all-time highs are excluded from calculations, as are price declines of greater than 20%.

Factor performance is established by taking the universe of stocks in the S&P 500 and ranking those stocks based on the criteria provided below to create portfolios that are long the top 20% of securities and short the bottom 20% of securities.
Value – Book Equity/Market Cap.
Volatility – The square root of the 125-day average of a stock's absolute return divided by the cross-sectional volatility of the market.
Size – Natural log of market cap
Profitability – A Linear combination of six factors: return on equity, return on assets, cash flow to assets, cash flow to income, gross margin, sales to assets.
Momentum – A stock's cumulative return over the last 250 trading days.
Leverage – An equal-weighted average of debt-to-assets and debt-to-equity.
Growth – An equal weighted average of earnings growth rate and sales growth rate.
Dividend Yield – Trailing 12-month Dividends Paid/Market Cap.
Earnings Yield – A weighted average of realized earnings-to-price (75%) and forecasted earnings-to-priced (25%).

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