THIRD QUARTER 2020 – TRUST & INVESTMENT MANAGEMENT'S

WEALTH MANAGEMENT UPDATE

Exchange Bank

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TRUST & INVESTMENT MANAGEMENT GROUP

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Investment Review and Outlook

By Matthew C. Kelman, *Vice President*

What a short, strange trip it's been. Any number of adjectives could be used to describe the first half of 2020: volatile, harrowing, unprecedented, extraordinary… and the global economy and financial markets would have been no exception to the list of topics that could have been described by any of those. The speed at which the COVID-19 pandemic upended nearly everything in our lives, wreaking havoc on the global economy, would have been difficult (nearly impossible) to grasp at the beginning of the year. However, as bad has the global catastrophe has been, there have been bright spots for our economic and financial futures at times, mainly coming from the official use of monetary and fiscal resources to assist in the recovery from the worst economic contraction since the Great Depression.

In equity markets, what a difference a quarter makes! Following the worst ever (post-WWII) first calendar quarter for U.S. stock markets, the most recent three months saw the best ever (post-war) second calendar quarter for domestic stocks, with double digit returns seen broadly throughout the developed world's equity markets as well as for those in emerging markets. With unprecedented amounts of monetary and fiscal stimulus flooding global markets and, by quarter-end, the re-opening of most economies after the lockdowns of March and April, risk markets saw significant rebounds. U.S. stock markets, with their heavy concentration in technology stocks levered to work-from-home and lockdown economies, outperformed their global counterparts, with growth outperforming value. The risk-on environment also allowed small-caps to outperform their large-cap peers and emerging markets to outperform their developed market counterparts outside of the U.S.

In fixed income markets, yields across most of the U.S. Treasury yield curve continued their descent in the second quarter,

MARKET PERCENTAGE TOTAL RETURNS AS OF JUNE 30, 2020

Index	Q3 2020	One Year	Five Years (annualized)	Ten Years (annualized)
Barclays U.S. Aggregate Bond Index	2.90	8.74	4.30	3.82
S&P 500 Index	20.54	7.51	10.73	13.99
Russell 2000 Index	25.42	-6.63	4.29	10.50
MSCI EAFE Index	14.88	-5.13	2.05	5.73
MSCI Emerging Markets Index	18.08	-3.39	2.86	3.27

with the short end of the curve anchored near zero thanks to the Federal Reserve's rate cuts from March of this year. Long-term rates generally fell as well though as the markets attempted to price in the actual amount of damage done to the U.S. and global economies, and as the prospects for a swift rebound in economic activity shrank with new surges in COVID-19 cases and deaths throughout the country and world. Additionally, the Fed's extraordinary purchases of securities across various parts of the fixed income credit universe allowed (forced) credit spreads tighter, in particular for traditionally safe-haven assets like municipal bonds and more highly rated corporate debt. All in all, it was a positive quarter for returns across the entire fixed income universe, with higher levels of credit risk being particularly rewarded after the first quarter's credit selloff.

Looking ahead, the unknowns related to the global pandemic will continue to weigh on economic growth to some degree, while the level of policymakers' continued responses are also TBD. As noted previously, attempting to forecast fundamental economic data far off into the future has become a guessing game by macro-economists in the current environment, with several assumptions being made regarding waves of disease, vaccine and anti-viral developments, and potential fiscal and monetary policy responses topping the lists of assumed variables. Attempting to time the markets based on economic projections is difficult in the best of times, and nearly impossible to do with any reasonable level of accuracy today. Markets can also disconnect from economic reality for long periods of time as well. As such, Exchange Bank continues to recommend building portfolios to meet your long-term goals instead of focusing on short-term market movements. If the past six months have shown us anything, it's that the value of having and sticking with a long-term plan can keep you on track to meet your goals, while making decisions based on what we think will happen in the markets in the immediate future can derail your plans long before achieving your goals.

Feel Good Story – The Gift that Keeps on Giving

By Emily Menjou, *Vice President & Personal Trust Fiduciary Manager*

GK Hardt was a local businessman who emigrated from East Prussia to America as a child. GK first went into business in Santa Rosa in 1937, and over the years became a successful auto dealer, investing his profits in local land and philanthropy. By the time he died in 2004, GK had amassed a multimillion-dollar estate. Hardt seemed to personify the American dream, and yet the story gets even better.

GK appointed his longtime business associate, Gladys Bates, and Exchange Bank as co-trustees to settle his estate after his passing. Estate settlement is one of Exchange Bank's core services that we provide for countless families in our community. GK's estate plan, however, included an unusual twist, leaving millions of dollars to charity at the choosing of his co-trustees. *(As successor trustee, we often distribute large sums of money to charity, however it is very rare for a trust to leave the beneficiary selections up to the trustee.)*

Longtime and now retired Exchange Bank Trust Officer, Linda Burille, worked with Gladys to research and thoroughly vet countless charities until decisions were ultimately made as to how GK's wealth would be divided, with a goal of making the late businessman proud. Some of the beneficiaries included Montgomery and Santa Rosa High Schools, Redwood Empire Food Bank, California Parenting Institute, 6th Street Playhouse, Petaluma Arts Council, SRJC's Shone Farm, Salvation Army, Meals on Wheels, the Earle Baum Center of the Blind, the Green Music Center and Assistance Dog Institute.

Fast forward to 2020—I recently received a heartwarming letter in the mail from Bonnie Bergin of Bergin University and the Assistance Dog Institute. Assistance Dog Institute has a singular mission to advance the human-canine partnership through research and education. In recognition of GK's generosity and a true testament to the lasting impact of his legacy, Bonnie found a way to honor GK Hardt 16 years after his passing.

Meet *Hardt*, this handsomely adorable assistance dog who will undoubtedly go on to help enrich the life of whomever he is assigned, helping to further carry on the generosity and legacy of GK Hardt.

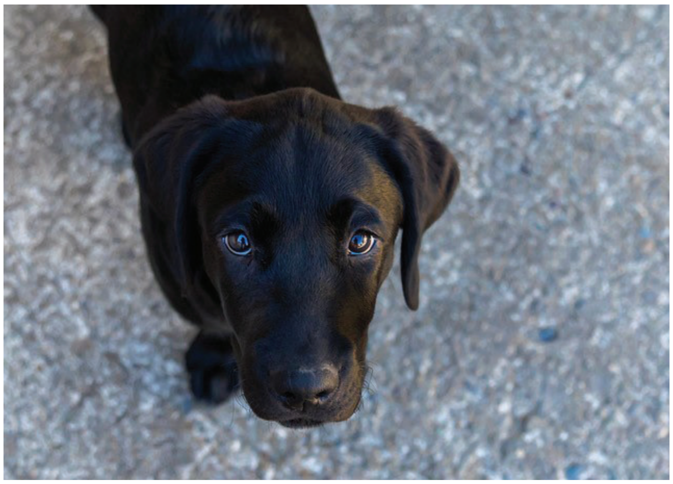

Photo credit: Sherri Rieck, Bergin University

Note about confidentiality: Protecting the privacy of our trusts is of utmost importance to Exchange Bank. All details disclosed in the above article have either been previously disclosed to the public or are being disclosed with express permission.

Recent Economic Highlights

By Argus Research Company

U.S. GDP PLUNGES 32.9% IN 2Q

The U.S. economy contracted at an astonishing 32.9% rate in 2Q20, as the nation shut down to combat the coronavirus. Here are some of the stark numbers. Personal Consumption Expenditures plummeted 35%, led by a 44% drop in spending on Services, as the country sheltered in place. Private Domestic Investment fell 49%, including a 38% plunge in Equipment, as the oil and gas industry suffered. Exports were down 64%. The positives? Very few. Consumer Spending on Durable Goods declined "only" 1.4% and Investment into Intellectual Property Products fell "only" 7.2%. Federal Government Spending surged 17%, including a 40% increase in Nondefense Spending, reflecting Congress' $2.3 trillion spending program. A 53% decline in Imports also supported GDP. This is likely (hopefully) the worst quarter, as most of the country was shut down for at least several weeks. That said, some states that had reopened parts of their economies are closing down again as coronavirus cases surge. There will be an economic comeback, and it might start as early as this quarter—but we expect GDP to be impacted by the pandemic well into 2021.

A RARE GLOBAL RECESSION

For the first time since the Great Depression, worldwide annual GDP is expected to turn negative in 2020. As 2020 began, the International Monetary Fund was looking for global growth of 3.2%. In its latest update, the IMF expects a 4.9% decline, with industrialized economies contracting by 8% and emerging economies slipping 3%. The IMF expects U.S. GDP to decline 8%, while European GDP drops 10% and Japan falls 6%. Meanwhile, central banks around the world have cut rates and governments have launched stimulus programs, expanding budget deficits as a percentage of GDP in the U.S., Europe, China and Japan. But that's a problem for a later date. The early forecasts point to recovery in 2021, though, and the IMF sees rebound growth of 5.4%.

ONLY CHINA IS EXPECTED TO GROW IN 2020

China is a $14 trillion economy and represents about 16% of the $86 trillion global economy. Thus, it is a critical contributor to overall global economic growth, even if it grows "only" 5%-6%. In fact, 6% growth in the Chinese economy today adds more to global output (by our reckoning, 20% of incremental GDP growth in a normal year) than the 10% growth achieved five years ago, when China was growing faster but was smaller. Of course, this is not a normal year. Even so, while the global economy is expected to contract this year, China is still forecast to eke out a 1% gain. Over the long run, China is an important growth market, to which U.S. companies want access on fair terms.

RATES VERY LOW FOR VERY LONG

The Fed has announced that it expects to keep interest rates at the current level of 0-0.25% until it is "confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals." So, the policy is now open-ended. But that doesn't mean the central bank won't be busy. The Fed will leave intact all of its funding programs through the end of the year, and extend repo operations and dollar liquidity swaps through March 2021. The central bank will also continue to purchase large amounts of U.S. Treasuries and agency mortgage-backed securities, effectively "controlling" longer-term rates as well. These moves will keep mortgage rates at or near the current 3% level. The Fed has no plans to purchase equities, as it feels that buying corporate bonds is its way of supporting the equity markets. One thing we don't expect the Fed to do is to lower interest rates below zero. Although that strategy has been implemented in some countries, it is not clear to Chairman Powell that the tool works. Further, he does not think it is appropriate in the U.S. given the country's dependence on money-market mutual funds.

VOLATILITY REMAINS, DESPITE STRONG JULY

The VIX Volatility Index lifted off in February, soared in March, and remains elevated. Investors should expect volatile market conditions through at least the balance of 2020. This forecast fits in with our "Three Levels of Recovery" theory. We look for public health to recover first with widespread COVID-19 testing, treatment options and then a vaccine in late 2020/early 2021. The second level of recovery will be the economy, helped by the government, which we think is almost certain to approve another rescue package. We look for historically weak economic numbers in 2Q20 before the economy grows again in the second half of 2020 and full-year 2021. The third level of recovery will be earnings and the stock market. At this point, investors are less focused on the latest numbers and more on the outlook. Stock investors have anticipated a turnaround in earnings and have bid shares higher even before the economy grows again. But the path has not been straight higher, and investors should brace for volatility in the months ahead.

Introduction: Andrea Ruiz, Trust Officer

Dear Clients, Friends,

It is my pleasure to introduce Trust Officer Andrea Ruiz.

Andrea joined our team in June of 2018 and has since supported a vast majority of Exchange Bank's personal trust relationships, cementing a strong understanding of our fiduciary practices and principles. Andrea has completed Cannon Financial Institute's Trust I and Trust II courses with plans to complete the series later this year. In her position, Andrea will administer complex trust accounts including revocable, irrevocable, charitable and terminating trusts. Prior to joining Exchange Bank, Andrea obtained a Specialized Associates Degree from Empire College and worked as a paralegal.

Please join me in congratulating Andrea on her promotion.

Sincerely,

Emily Menjou
Vice President and Personal Trust Fiduciary Manager

Email Delivery of Wealth Management Update

If you are a client or an estate planning professional and you have changed your email recently, please give us a call so that we can update our records. Print copies will continue to be mailed by request.

We hope you enjoy our quarterly update and musings, and we look forward to continuing our coverage of an array of wealth management topics that can assist you in meeting your investment, retirement, and estate planning goals.

If you would like to be removed from our mailing list, please contact: **ebmarketing@exchangebank.com**.