

# INVESTMENT STRATEGY UPDATE



MARKET REPORT

QUARTER 2 • 2020

## MARKETS FALL OVER VIRUS IMPLICATIONS

The bull market for US equities continued into the beginning of 2020, with stocks reaching new all-time highs in February before falling dramatically into bear market territory as the new coronavirus spread around the globe. In addition, a price war between Saudi Arabia and Russia rocked oil markets, adding to equity market concerns. Volatility spiked in March, with the S&P 500 and the Dow moving 1% or more on 21 of the 22 trading days for the month. Stocks rallied at the end of the quarter to recover some losses, however all equity indices finished lower, posting the worst first quarter on record.

As the world transitioned to working and learning from home with the help of technology, it is not terribly surprising that the tech heavy NASDAQ fared better than other indices with a -14.2% return. Energy stocks suffered the most, hit by both the Saudi-Russia price war and a drop in global demand due to economies shutting down. Within the US, small and mid-sized companies also struggled over concerns

about their resiliency in this economic environment, with the small cap Russell 2000 index declining -30.6% and the Russell Mid Cap index down -27.1%. Emerging markets were generally in line with the US and other developed markets, the MSCI Emerging Markets Index falling -22.8% for the quarter.

Markets have valid reasons for concern. Measures to contain the spread of the new coronavirus involve severely restricting economic activity. Millions of workers are unemployed as a result of business closures and social distancing mandates. Central banks and governments around the world have implemented massive stimulus programs to cushion the blow, but there is no clear answer to how long and severe the economic suppression will be.

Normally a safe haven in times of uncertainty, bonds were not immune to concerns. Overall, the bond index posted a positive return, but performance was mixed with credit concerns causing corporate bonds to lose value while US treasury and

Index	2020 (through 3/31)
S&P 500	-20.0
DJIA	-22.8
EAFE (Int'l)	-23.6
BC Ttl Bond	+3.2

### Dow Jones Relative Risk Benchmarks

Conservative	-3.4
Moderate	-15.1
Aggressive	-24.3

agency bonds gained. The Federal Reserve made two emergency rate cuts in March in response to the deteriorating economic outlook, bringing the benchmark rate to 0%. The yield on the 10-year US treasury started the quarter at 1.92%, then touched an all-time low of 0.54% on March 9, rallying slightly to close the quarter at 0.70%.

## 2020 OUTLOOK

**FIXED INCOME** — Investors have been wary about the recession's impacts on bond issuers, and at times seemed to prefer cash, causing bond prices to fall along with stocks. When these fears threatened to gridlock the bond market, the Federal Reserve stepped in to buy bonds on a large scale, providing the liquidity for markets to function and necessary capital to borrowers. The Fed has basically stated it will do whatever it takes to keep markets operating. Bonds did perform better than stocks for the period, and as a result most portfolios are now overweight fixed income. With uncertainty high, we are not yet recommending reducing bonds to rebalance, but are relying on bonds to support portfolio distributions. We remain committed to employing active managers to determine the best positioning and adjust portfolios as needed. Particularly in times like this, fixed income maintains an important role in managing risk.

**Our View —**  
*Maintain allocation, use active management to navigate volatility*

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## 2020 OUTLOOK (CONTINUED)

**US EQUITIES** — The US economy has come to an abrupt slowdown and stock prices are reflecting the contraction. The S&P 500 closed the quarter 24% below its peak achieved in February, but was up 15.5% from its March low. It is likely that volatility will persist and markets may fall further with lingering uncertainty surrounding how long economic suppression will last and how much the CARES Act stimulus will cushion the blow. The hardest hit industries- hotels, tourism, transportation, entertainment, restaurants & bars, and retail represent 20% of US employment and 19% of US GDP (JP Morgan, Guide to the Markets, March 2020). Some economists are projecting a surge in these industries from pent up demand once social distancing is lifted, creating a quicker recovery. The timing and speed of a recovery is unknown, so we recommend staying invested in equities to capture the rebound. Markets are forward-looking and typically recover ahead of the economy. We suggest being patient with rebalancing into more equities until there is more clarity on the situation..

**Our View —**  
**Maintain allocation,**  
**wait to rebalance**

**INTERNATIONAL EQUITIES** — As the origination point for the virus, China was first to feel its effects, closing down businesses at the end of January. At the end of the first quarter China was still in the process of reopening its economy. China is expected to see a 10% contraction in GDP for the first quarter of 2020 (Wall Street Journal, Apr 2), and will likely continue to suffer from lower global demand. Europe has also been hit hard, and governments there are also enacting stimulus measures to prop up economies, but the effectiveness of these actions remains to be seen. We recommended a reduced weighting to developed foreign stocks at year end and are suggesting no change at this time. In many emerging markets, the effects of the virus have been less significant to date, and we will continue to rely on active managers to identify opportunities.

**Our View —**  
**Maintain allocation,**  
**use active management**  
**in emerging markets**

## WHAT ABOUT THE BEAR?

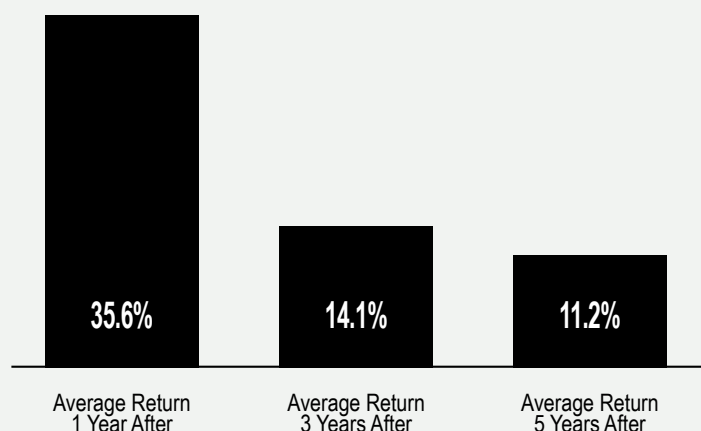
With equities in bear market territory, you may be wondering what that means and what to expect. Here is some historical data regarding bear markets and recessions to consider.

- Stocks have historically bottomed four months prior to recession end and four to six months before corporate earnings bottom.
- As of March 31, the S&P 500 was trading at a price/earnings multiple of 15.4. This is 28% below its peak P/E of 20.7, and the average P/E multiple contraction during a bear market is 28%.

### RECESSIONARY BEAR MARKETS

Market Top	Market Bottom	Total Months	Bear Market Decline	Months To Return To High From Bottom
Jul-57	Oct-57	3	-20%	12
Jan-60	Oct-60	10	-18%	6
Dec-68	May-70	17	-36%	31
Jan-73	Oct-74	22	-48%	75
Feb-80	Apr-80	2	-21%	4
Feb-81	Aug-82	6	-24%	3
Jul-90	Oct-90	3	-21%	4
Mar-00	Oct-02	27	-49%	60
Oct-07	Mar-09	17	-59%	50
<b>Average</b>		<b>11.9</b>	<b>-33%</b>	<b>27</b>
<b>Median</b>		<b>10.0</b>	<b>-24%</b>	<b>12</b>

### AVERAGE PERFORMANCE FOLLOWING A BEAR MARKET SINCE 1950, 13 BEAR MARKETS



# TIMELINE OF EVENTS - Q1 2020

**January 4** - World Health Organization reports a "cluster of pneumonia cases of unknown cause" in Wuhan China.

**January 9** - China's state media acknowledges new virus spreading in Wuhan.

**January 11** - First death caused by the new coronavirus reported in Wuhan, China.

**January 22** - China initiates lockdown of Wuhan in effort to contain the virus.

**January 26** - First cases of coronavirus reported in US in Washington state.

**January 30** - World Health Organization declared outbreak a global emergency.

**January 31** - President Trump bans foreign nationals who have traveled to China from entering the US. American, Delta, & United airlines suspend flights to & from China.

**February 11** - World Health Organization names the disease caused by the virus "COVID-19."

**February 12** - Dow Jones Industrial Average hits new all-time high.

**February 19** - S&P 500 hits new all-time high.

**February 29** - First COVID-19 related death in US. China extends lockdown, restrictions on travel.

**March 3** - First Fed rate cut- lowered target rate by .5% to 1.0%-1.25%.

**March 5** - Senate passes \$8.3 billion funding package for public health, state & local governments to address virus related costs.

**March 8** - Saudi Arabia initiates a price war with Russia causing oil prices to plummet. Italy enters lockdown to control spread of the virus.

**March 11** - World Health Organization declares COVID-19 a pandemic with cases in 110 countries & territories. Dow enters bear market. President Trump bans travel from Europe for 30 days.

**March 12** - NBA suspends season after a player tests positive for the virus. Political rallies are suspended.

**March 14** - Spain locks down to prevent spread of the virus.

**March 15** - Second Fed rate cut- target rate 0%-0.25%. Minnesota governor orders closure of schools.

**March 16** - President Trump issues CDC 15-day guidelines for social distancing- recommending closure of schools and discouraging gatherings larger than 10 people, eating out, and discretionary travel.

**March 17** - All 50 states have reported a confirmed case of the virus. Federal Reserve starts buying commercial paper to support market liquidity. Nevada governor orders closure of casinos & other non-essential businesses.

**March 19** - Italy overtakes China for number of virus-related deaths. California's governor is the first to issue a stay-at-home order.

**March 20** - Illinois & New York issue stay-at-home orders.

**March 23** - US equity indices hit low point for the quarter. Federal Reserve expands liquidity measures to include corporate bonds and paper for municipalities. Massachusetts, Michigan, & Oregon issue stay-at-home orders. British Prime Minister Boris Johnson orders 3-week closure of stores & bans gatherings for 3 weeks.

**March 24** - Tokyo Olympics are postponed to 2021. Wisconsin governor issues safer at home order.

**March 25** - Minnesota governor issues stay-at-home order.

**March 26** - Unemployment claims in the US hit a record of 3.3 million for the week ending March 21, 2020, primarily due to virus related business closures.

**March 27** - \$2.3 trillion economic stimulus package is signed into law as the "Coronavirus Aid, Relief, and Economic Security" (CARES) Act. President Trump invokes the Defense Production Act to compel General Motors to produce more ventilators.

**March 29** - President Trump extends CDC recommendations for social distancing for 30 days, through the end of April. 30 states have stay-at-home orders in place, with non-essential businesses closed.

**March 31** - White House Coronavirus Task Force announces projection of 100,000 – 240,000 deaths nationwide due to the virus with current mitigation efforts.

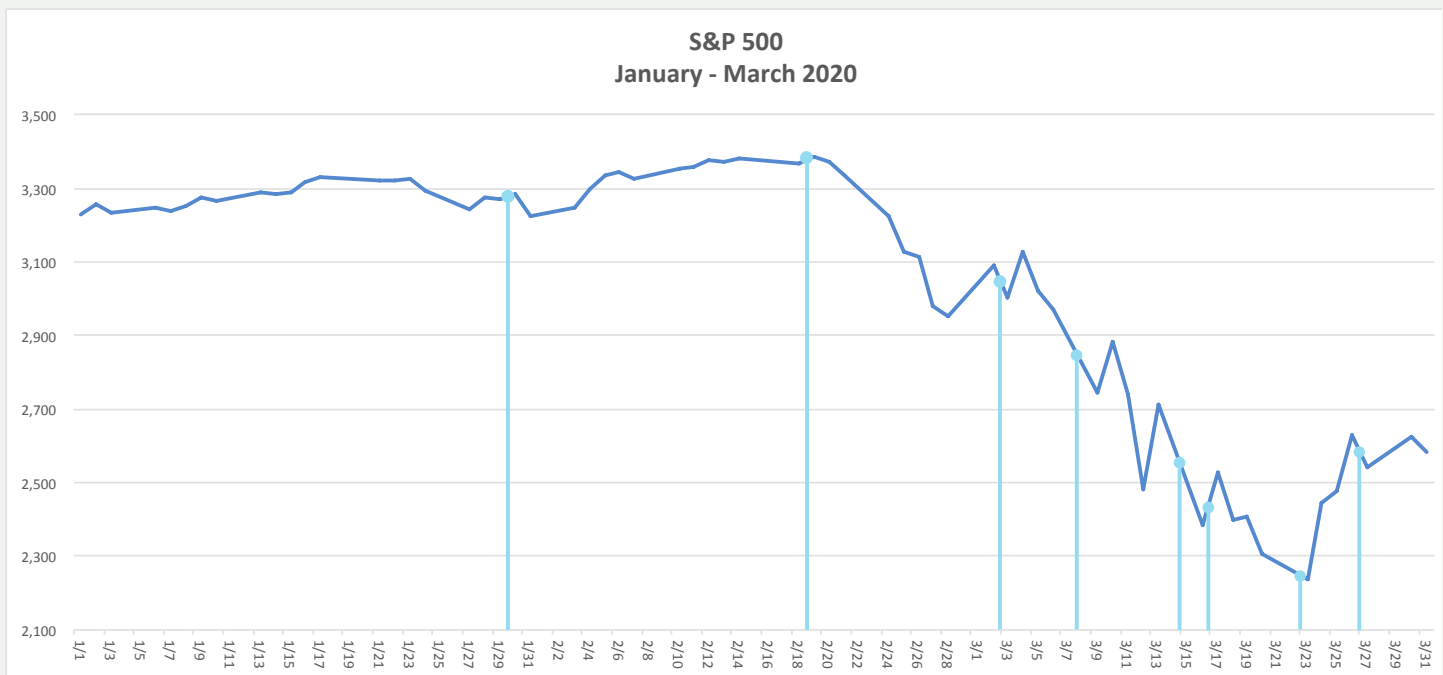


Chart source: Thompson One

# CARES ACT - WHAT IT MEANS

In response to the COVID-19 pandemic Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act, a \$2.3 Trillion stimulus package to provide aid to the American people, businesses, health care systems, education, and state & local governments. Notable highlights include:

- **Direct Payments to Taxpayers:** Based on income and family makeup, most Americans can expect to receive \$1,200 each (\$2,400 for joint filers) and \$500 per dependent under age 17. Amounts phase out for those who reported gross income over \$75,000 for individuals and \$150,000 for joint filers based on 2019 income (2018 if current year has not been filed). The Treasury Department has targeted April to deliver the funds.
- **Required Minimum Distributions (RMD) Waived:** The CARES Act waives required minimum distributions from retirement accounts for 2020. Those who would normally be required to take an RMD, including inherited IRA beneficiaries, will not need to take a distribution until 2021. For those who have already taken a 2020 RMD, it may be possible to undo it. Contact us if you are interested.
- **Early Withdrawal Penalty Waived:** The CARES Act eliminates the 10% early withdrawal penalty on distributions from IRAs and/or employer retirement plans for those impacted by the coronavirus. Up to \$100,000 can be withdrawn and the income tax liability can be taken in 2020 or spread over three years. In addition, there is an option to repay the distributed funds back to the retirement account over the next three years.
- **Expanded Unemployment Benefits:** Unemployment benefits were increased by \$600 per week in addition to state benefits, for up to four months. Coverage was expanded to include self-employed individuals, independent contractors, and furloughed employees.
- **Support for Small Businesses:** Small businesses can apply for loans through the "Payment Protection Act" to cover payroll and other qualifying expenses. Based on certain incentives for employee retention, these loans may be forgiven. Loans can be acquired through SBA lenders with no fees. Visit [www.sba.gov](http://www.sba.gov) for details. In addition to loan support, the employer portion of payroll taxes can be deferred until 2021 & 2022.
- **Deferral of Federal Student Loans:** Required payments on Federal student loans are suspended through September 30, 2020 and no interest will accrue on the debt through this period. Payments may continue to be made if desired and will reduce the principal balance.

## Coronavirus Aid, Relief, and Economic Security Act

Amount (\$ bn)	Measure
\$290	One-time stimulus checks amounting to \$1,200 per adult and \$500 per child up to certain income limits
\$260	Enhanced, expanded and extended unemployment benefits, adding \$600 per week to every unemployment check for 4 months, expanding program to cover contractors and self-employed and extending program to 39 weeks from 26 weeks
\$510	Loans to distressed businesses, cities and states. Includes \$29 billion for airlines, \$17 billion for firms deemed important for national security and \$454 billion as backstop for loans to other businesses, cities and states
\$377	Small business relief, largely in the form of "forgivable loans" for spending on payroll, rent and utilities
\$150	Direct aid to state and municipal governments
\$180	Health-related spending
\$516	Other spending and tax breaks
<b>\$2.283 trillion</b>	<b>~10.8% of GDP</b>

Source: JP Morgan, Guide to the Markets, March 31, 2020



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