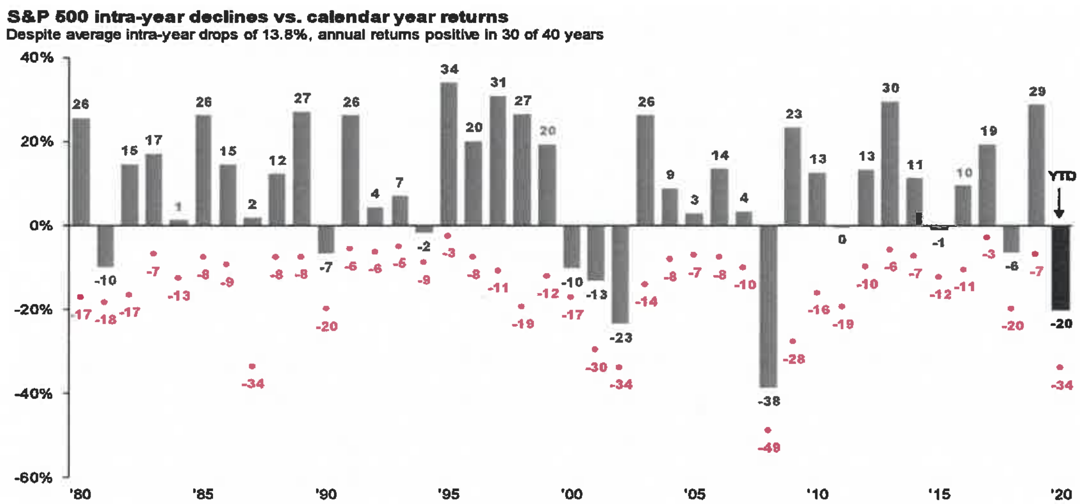
The Longer View

Comments & Outlooks from Longer Financial

April 7, 2020

Historic Volatility Hits Markets amid COVID-19 Pandemic

When we noted our cautious outlook for equities back in early January, we never would have dreamed that just a few short months later, we would land in the midst of a generational crisis as we are experiencing with the COVID-19 or Coronavirus pandemic. The market had benefited from a powerful rally at the end of 2019, driven by a "phase one" trade agreement with China, low interest rates, and a robust labor market. Analysts were forecasting a return to higher growth rates for corporate earnings, recessionary fears were fading, and stocks were reaching for all-time highs. That all quickly changed, as the Coronavirus went from a tragic problem isolated to China to a global pandemic of frightening proportions. Markets soon began to process just how serious the economic slowdown might be, with nations around the globe quickly implementing social distancing measures, causing several industries to grind to nearly a complete halt. As indicated in red in the chart below, the S&P 500 fell by as much as -34% for the year before rallying to close the quarter off -19.60%.



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

The DOW was off -22.73%, in what was officially the worst first quarter ever for the index, while the CRSP Large Cap Value Index dipped -25.01%. Small Caps were hit even harder, with the Russell 2000 falling -30.61% in the quarter. Other risk assets such as real estate, oil, and even corporate bonds have also struggled, as the flight to safety has impacted nearly every asset class outside of U.S. Treasuries. The energy sector has been hit particularly hard, as a combination of reduced demand and the lack of cooperation between Saudi Arabia and Russia to limit output has caused oil prices to plummet to levels that are largely unsustainable for U.S. producers. This slew of negative numbers has left us thankful to have been more defensively positioned to start the year, and thus able to shield our portfolios from the full brunt of the market sell-off.

Unprecedented Job Loss Brings Forth Unprecedented Government Stimulus

As mentioned above, we came into this crisis with a very robust labor market, as the unemployment rate sat at a 50-year low near 3.5%. However, sweeping shutdowns have caused record job loss, with unemployment claims reaching an all-time high of more than 6.6 million, for *just one week* in late March. To put that in perspective, the highest weekly total in the 2008-2009 financial crisis was approximately 665,000. Many economists now expect the unemployment rate to reach 10%+ in April, with the St. Louis Federal Reserve President suggesting that the rate could peak, at least briefly, above 30% in the coming months. To help combat this, the federal government passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The total price tag on this package is over two trillion dollars, which represents over 9% of U.S. annual GDP. Key provisions are highlighted in the chart below.

CARES Act Relief

$500 billion in large business lending/credit	**$250 billion** to expand unemployment insurance	**$350 billion** in loans to small businesses	**$300 billion** in direct payments to households

This package is intended to help consumers and displaced workers through enhanced unemployment benefits and direct payments, but also to provide a lifeline to both small and large businesses that have been impacted through largely no fault of their own. The Federal Reserve has also made waves by quickly cutting rates to zero, and undertaking massive bond buying or quantitative easing measures to stabilize fixed income markets. In the past, the Fed had only purchased Treasury securities, but it has now also stepped in to support municipal bonds, agency securities, and even corporate bonds through the purchase of Exchange Traded Funds. Perhaps drawing on lessons learned, the combination of the CARES Act and Federal Reserve action now dwarfs the governmental stimulus response throughout the entire Financial Crisis in 2008-2009.

Moving Forward

It's important to remember that the stock market tends to move ahead of the economy—making predictions about what will happen in the coming months. While an immense amount of uncertainty remains in play, the stimulus package, coupled with emerging hopes of cases peaking in the hardest hit cities in the U.S., have given stocks life in recent weeks. We have started to deploy cash in our portfolios, but most often with protective stops in place to limit the downside on any particular new position, in the event that we face another leg down in this crisis. Please rest assured that our team is fully operational and remains ready to serve, should you have any questions or needs in the coming weeks. We also recognize that the economic issues and stock market concerns are only a small part of the story here, and sincerely hope that you and your loved ones are able to remain safe and healthy through these uncertain times. Thank you for your continued trust.

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