

Quarterly Market Outlook

April 2020

COVID-19 Becomes a Global Pandemic

The COVID-19 pandemic has spread quickly around the world, impacting over 200 countries with approximately 2.5 million confirmed cases and nearly 200,000 deaths. The US has now become the epicenter of the pandemic with over 800,000 confirmed cases.¹

Aggressive Social Distancing is Flattening the Curve

Stay at home policies around the world have shown success in slowing the spread of COVID-19 which has helped hospital systems respond more effectively to the influx of patients. Some cities/countries are now looking to relax restrictions but a full return to normalcy is unlikely without a vaccine. For example, Singapore, which had been successful in initially containing the virus, is now being forced to implement tighter restrictions as they see new highs in the number of cases.

Virus Reaction Producing a Devastating Economic Collapse

While we are starting to see positive progress in the fight to contain the virus, we are just coming to terms with the economic fallout, which is the worst since the 1930s. Over 26 million Americans have filed unemployment claims in just the past five weeks, representing more than 15% of the US labor force.² Companies are confronting a harsh reality of limited to no economic activity for several months, and many are struggling to even provide forward earnings guidance. We expect many companies will not survive.

Unprecedented Market Moves

The market reaction to the crisis was breathtaking in terms of magnitude and speed, with the global stock market declining 34% from February 19th through March 23rd. The VIX, a measure of the implied volatility in the US equity market, reached its highest ever recorded level of 83 in mid-March (more than 4x the normal level). Margin calls created forced selling for many leveraged players in credit markets, producing a dramatic rise in credit spreads across corporate, mortgage and municipal markets. During two weeks of particularly frenzied selling in March, high yield markets experienced five of their 10 worst days in the past 20 years. The oil price ended the quarter down over 60% as the market faced massive demand destruction combined with a price war initiated by Saudi Arabia.³

Modern Monetary Theory is on Full Display

Governments around the world have responded forcefully to the crisis. In the US, the Federal Reserve cut interest rates to zero, announced “unlimited” quantitative easing and provided backstops for several credit markets. Congress also passed three stimulus packages which provided over \$2.5 trillion in support to households and businesses. These actions are driving a massive expansion in the Fed balance sheet which is being used to finance

¹ Source: WorldOMeter, COVID-19 Coronavirus Pandemic Data, 4/21/20. <https://www.worldometers.info/coronavirus>.

² Source: U.S. Employment and Training Administration, Initial Claims [ICSA], retrieved from FRED, Federal Reserve Bank of St. Louis, April 20, 2020; <https://fred.stlouisfed.org/series/ICSA>.

³ Source: Bloomberg. Global equity data corresponds to the daily performance of the MSCI ACWI Index. VIX data corresponds to the CBOE Volatility Index, a measure of the 30-day implied volatility of the S&P 500 Index. US high yield data corresponds to the daily performance of the Bloomberg Barclays High Yield Index. Please see index disclosures for more detail on final page.

a 2020 fiscal deficit that is projected to be nearly 20% of GDP.⁴ This coordination of fiscal and monetary policy is known as “Modern Monetary Theory” and is likely to be the template for policy going forward.

Massive Forces at Play

Tremendous market volatility is being driven by two competing and massive forces – (1) the economic collapse resulting from the virus and (2) the explosion in money printing. In late February and early March, the economic collapse drove the market crash, while the government response has since helped to stabilize asset prices. We are uncertain as to how these forces will net out going forward but do expect market volatility to remain elevated.

Timeline for Recovery is Uncertain

With efforts to contain the virus ongoing and little potential for a vaccine in the next 12 months, economic activity is likely to be impacted for an extended period of time. As we’ve discussed in the past, we are concerned about the ability of governments to effectively stimulate with interest rates at zero and large fiscal deficits. As a result, we do not expect a V-shaped recovery and are worried about prolonged economic weakness.

Benefits of a Balanced Portfolio

While growth-dependent assets – equities and industrial commodities – have experienced large losses, safe haven assets – gold, TIPS and Treasury bonds – benefitted from the expectation of slower growth. A balanced portfolio of these assets has held up relatively well.

Asset Class	Index	2020 YTD Bear Market	2019 Bull Market
Global Equities	MSCI ACWI Index	-21%	+27%
Commodities	Bloomberg Commodities Index	-23%	+8%
Treasuries	Barclays US Aggregate Long-Term Treasury Index	+21%	+15%
TIPS	Merrill Lynch 15+ Yr. US Inflation-Lkd. Bonds Idx.	+9%	+18%
Gold	Spot Price of Gold (% change)	+4%	+18%
Average	Equal-Weighted Average	-2%	+17%

Source: Bloomberg. 2020 YTD: 12/31/19 – 3/31/20. 2019: 12/31/18 – 12/31/19. Please see index disclosures for more detail on final page.

1930s Parallels

There are many analogues between the current period and the 1930s. During that environment, we had high debt levels, short-term interest rates near zero, a large increase in the money supply and government purchases of bonds in order to limit increases in long-term interest rates. Extreme wealth gaps produced a rise in populism, which led to increasing tensions among different countries and ethnic groups. We believe it is critical for investors to be well diversified to the wide range of potential outcomes, many of which have the potential to destroy wealth (deflation, inflation, currency crises, higher taxes, etc.).

⁴ Source: Reuters.com, Business News, ‘U.S. deficit to soar to record \$3.8 trillion...’, April 13, 2020

Disclosures

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Index Disclosures:

Global Equities: The MSCI ACWI reflects the performance of large and mid-cap stocks across 23 developed and 26 emerging markets. As of December 2019, it covers more than 3,000 constituents across 11 sectors and approximately 85% of the free float-adjusted market capitalization in each market and takes into account variations reflecting conditions across regions, market cap sizes, sectors, style segments and combinations.

Commodities: The Bloomberg Commodity Index is calculated on an excess return basis and reflects commodity futures price movements. The index rebalances annually weighted 2/3 by trading volume and 1/3 by world production and weight-caps are applied at the commodity, sector and group level for diversification. Roll period typically occurs from 6th-10th business day based on the roll schedule.

Treasuries: The Bloomberg Barclays US Aggregate Long-Term Treasury Index is a long Index that measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury with 10 years or more to maturity.

TIPS: The Bank of America Merrill Lynch 15+ Year US Inflation-Linked Treasury Index (BB: G8QI) is an unmanaged index comprised of U.S. Treasury Inflation Protected Securities with at least \$1 billion in outstanding face value and a remaining term to final maturity greater than or equal to 15 years.

Gold: Reflects the percent change in the spot price of gold (BB: XAU).

The CBOE Volatility Index is a calculation designed to produce a measure of constant, 30-day expected volatility U.S. stock market, derived in real-time, mid-quote prices of S&P 500 Index call and put options. On a global basis, it is one of the most recognized measures of volatility.

The Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded.