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MARKET MATTERS

SPECIAL UPDATE March 16, 2020

Economic Indicators				
	12/31/2019	**1/31/2020**	**2/28/2020**	**3/13/2020**
3-Month Treasury Rate	1.55%	1.55%	1.27%	0.28%
10-Year Treasury Rate	1.92%	1.51%	1.13%	0.94%
ICE BAML High Yield OA Spread	3.60%	4.03%	5.06%	7.4%*
Fed Funds Rate Upper Target	1.75%	1.75%	1.75%	1.25%
Unemployment Rate	3.50%	3.60%	3.50%	n/a
WTI Crude Oil Spot ($/bbl)	$61.06	$51.56	$44.76	$31.98
VIX Index Level	13.78	18.84	40.11	57.8
U.S. Mfg PMI (IHS Markit)	52.4	51.9	50.7	n/a
U.S. Service PMI (IHS Markit)	52.8	53.4	49.4	n/a
Consumer Sentiment (Michigan)	99.3	99.8	101.0	95.9
U.S. Hotel Occupancy (STR)†	48.5%	57.6%	64.1%	61.8%

*As of 3/12/2020. †As of 12/28/2019, 2/1/2020, 2/29/2020, and 3/9/2020, respectively.

The Fed Takes Emergency Measures

On Sunday, March 15, the Federal Reserve (the "Fed") announced a 100 basis point cut to the federal funds rate to a range of 0% to 0.25%, after having reduced it by 50 basis points on March 3 to a range of 1% to 1.25%. The Fed last reduced the federal funds rate to a range of 0% to 0.25% in 2008 and did not raise it again until the end of 2015. Fed Chairman Jerome Powell indicated that the Fed does not favor moving interest lower to negative nominal rates, but the Fed will maintain rates at the current range "until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals."[1,2]

On Sunday, the Fed also announced $700 billion in asset purchases in U.S. Treasuries and mortgage-backed securities ("MBS"), as well as more favorable terms on its discount window

[1] "Fed Cuts Main Interest Rate to Near Zero, Vows Massive Bond-Buying Program," *Bloomberg*. https://www.bloomberg.com/news/articles/2020-03-15/fed-cuts-main-rate-to-near-zero-to-boost-assets-by-700-billion. March 15, 2020.

[2] "Fed Takes Emergency Steps as Virus Pushes Economy Toward Recession," *Wall Street Journal*. https://www.wsj.com/articles/fed-takes-emergency-steps-as-virus-pushes-economy-toward-recession-11584310776. March 15, 2020.

(short-term lending to banks). This came on the heels of liquidity measures announced on March 12 in which it would offer an additional $1.5 billion in overnight repurchase agreements, also known as "repos."[3,4] Declining economic activity and fears of a recession have reduced the availability of short-term lending and increased interest rate spreads, which has prompted the Fed and other central banks to implement liquidity measures. However, the asset purchases announced by the Fed do not directly address the corporate lending market, which is under pressure.[5]

Due to the Fed's Sunday emergency meeting, the Federal Open Market Committee ("FOMC") will not be holding its scheduled meeting for this week.

Below are other monetary measures announced in the last week:

- The Fed, Bank of Canada, Bank of England , Bank of Japan, European Central Bank, and Swiss National Bank, all announced coordinated efforts to support the supply of U.S. dollars,[6] which are in high demand due to an international flight to safety that has increased demand for reserve currencies.
- The European Central Bank announced additional liquidity facilities and lower rates, and €120 billion in additional asset purchases.
- The Bank of England cut its benchmark interest rate by 50 basis points to 0.25%.
- The People's Bank of China reduced its required reserve ratio.
- The Bank of Japan has been purchasing about ¥100 billion in ETFs per day.

Not Enough

Markets did not react well to the Fed's actions, largely considering it insufficient given the scale of the economic slowdown. During the morning of Monday, March 16, S&P 500 tracking ETFs dropped more than 10% which, if it holds would trigger circuit breakers to stop trading for fifteen minutes at the open of trading on Monday. This follows a 9.5% drop in the index on Thursday, March 12 and a 9.3% increase on Friday, March 13. Friday's rise may have been pricing in more significant action by the Fed. On Sunday night, the yield on the 10-year Treasury futures dropped below 0.7% in a flight to safety.

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[3] "Federal Reserve cuts rates to zero and launches massive $700 billion quantitative easing program," *CNBC*. https://www.cnbc.com/2020/03/15/federal-reserve-cuts-rates-to-zero-and-launches-massive-700-billion-quantitative-easing-program.html. March 15, 2020.

[4] "The Fed's $1.5 trillion loan injection, explained," *Vox*. https://www.vox.com/policy-and-politics/2020/3/13/21178457/1-5-trillion-stimulus-loan-fed-federal-reserve. March 13, 2020.

[5] "Key Source of Corporate Cash Seizing Up Amid Credit Market Rout," *Bloomberg*. https://www.bloomberg.com/news/articles/2020-03-15/key-source-of-corporate-cash-seizing-up-amid-credit-market-rout. March 15, 2020.

[6] "Coordinated Central Bank Action to Enhance the Provision of U.S. Dollar Liquidity," The Federal Reserve. https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315c.htm. March 15, 2020.

We believe the markets are now pricing in a higher risk of a recession and insufficient fiscal stimulus, which is increasingly critical as monetary policy becomes less effective. Monetary policies can help address the supply shock induced by the onset of the coronavirus ("COVID-19") outbreak, but are less effective in addressing the subsequent negative demand shock. Global demand is expected to decrease further as movement restrictions increase, and business revenue and personal incomes decline, potentially leading to mass layoffs.

JPMorgan now expects U.S. and Eurozone GDP to decline by 2% and 3% in the first and second quarter, respectively.[7] The hardest hit industries are travel (airlines have cut the majority of flights), hospitality (hotel occupancy and RevPar are down materially), and retail (restaurants, bars, and many other retail locations have been shut down). Energy has been hurt by both the virus outbreak and the oil price war, which will hurt countries and business in oil production, including shale drillers in the U.S.

Governments React

Last week governments outside of East Asia reacted more aggressively to the COVID-19 outbreak after markets saw massive selloffs on Monday, March 9 on heightened fears of a recession after an oil price war broke out between Russia and Saudi Arabia. Thursday, March 12 saw additional negative market reaction after the U.S. federal government failed to show a coordinated response to a slowing economy and the accelerating spread of COVID-19 outside of China—on Wednesday, March 11 the World Health Organization ("WHO") declared COVID-19 to be a global pandemic. The S&P 500 Index dropped 7.6% and 9.5% on Monday, March 9 and Thursday, March 12, respectively. The sentiment changed completely on Friday, March 13 when the S&P 500 Index increased 9.3%.

Stock futures started declining on Wednesday night during President Donald Trump's national address as it became evident that the federal government had not come to an agreement on a fiscal stimulus plan, and as Mr. Trump announced a surprise travel ban on Europe (except the U.K. and Ireland).[8] The sentiment changed on Friday on news that House of Representatives Speaker Nancy Pelosi and Treasury Secretary Steven Mnuchin had reached a compromise on a more limited bill, and after Mr. Trump declared a national emergency, which would provide additional funding, coordination, and flexibility in responding to the outbreak. The House passed an economic relief plan on Friday night, with a Senate vote expected this week. The legislation includes free COVID-19 testing, two weeks of paid sick leave, and additional funding

[7] "JPMorgan officially forecasts a coronavirus-driven recession will rock the US and Europe by July," *Markets Insider*. https://markets.businessinsider.com/news/stocks/coronavirus-fuel-recession-forecast-us-europe-economic-july-market-jpmorgan-2020-3-1028994637. March 13, 2020.
[8] "Global Markets Weekly Update," T. Rowe Price. March 13, 2020.

for jobless benefits, food aid, food banks, and Medicaid benefits.[9]

Below are other major governmental responses to COVID-19 announced in the past week as of Sunday, March 15:

- On March 14, the U.S. extended the travel ban to U.K. and Ireland, which were not included in the earlier travel ban announced on March 11.
- Russia, Norway, Spain, Switzerland, and other European countries have restricted border entry. Norway appears to have completely shut down all border crossings.
- China and India implemented quarantine measures on incoming travelers.
- France ordered the closure of all schools on March 12, and all restaurants, cafes, and cinemas on March 14. Other European countries have implemented similar measures. On March 15, France announced it would begin restricting domestic travel.
- On March 11, Italy implemented a national quarantine and closed all businesses, except for grocery stores and pharmacies. Spain followed suit on March 14.
- Several Latin American countries, with the notable exception of Mexico, have implemented restrictions on gatherings, movement, businesses, and border entry.
- Several U.S. states have implemented restrictions to varying degrees.
- In a positive sign, China has closed down all temporary isolation hospitals in Wuhan.

Below are other fiscal measures announced in the past week:

- The U.K. announced a £30 billion spending package and other relief measures on business property taxes, extended sick pay, and additional funding for the National Health Service (“NHS”).
- Germany announced €12.4 billion in state investment in infrastructure over the next three years.
- Italy announced that it would suspend mortgage payment and inject €10 billion into the economy.
- The European Union agreed to ease spending rules and provide €25 billion in funding.

[9] “House Passes Legislation to Combat Coronavirus,” *Wall Street Journal*. https://www.wsj.com/articles/mnuchin-says-talks-on-coronavirus-stimulus-deal-going-well-11584106226 . March 14, 2020.

Data Sought

Due to the rapid spread of COVID-19 across the globe, it has been quite difficult for economists to obtain a real-time analysis of economic impacts and instead we are having to rely on shorter-term economic indicators for direction.

According to data from Comscore, U.S. movie theater gross receipts over the weekend ended March 15 fell to $55.3 million, the lowest levels seen since 1998 and off 60% from levels of a year earlier. OpenTable publishes a daily report showing restaurant sales across the United States and globally. Interestingly, sales declines across the globe were relatively modest until March 9, which pointed to a fall of 10% across the globe. According to its data, global restaurant sales were down 40% year-over-year on Saturday, March 14 with U.S. sales lower by 42%. Meanwhile, panic shopping at grocery stores has resulted in significant increases in sales and shortages of certain items such as meat, toilet paper and bread.

Change in Market Indices				
as of 3/13/2020, not annualized	**MTD**	**YTD**	**1 Year**	**3 Year**
S&P 500 PR	-8.23%	-16.09%	-2.88%	14.26%
Russell 2000 PR	-18.04%	-27.47%	-21.92%	-11.36%
MSCI EAFE PR USD	-18.20%	-27.33%	-20.49%	-16.08%
MSCI Emerging Markets PR USD	-11.37%	-20.05%	-15.25%	-3.77%
Barclays U.S. Aggregate Bond TR	-1.35%	2.36%	9.43%	15.65%
Barclays High Yield Corp TR	-7.56%	-8.84%	-1.87%	7.76%
Barclays Global Agg Bond TR USD	-1.43%	-0.89%	3.48%	12.60%

Equity Markets Enter a Bear Market

Equity markets fell sharply for the week ending March 13, although a Friday rally helped to soften the decline. The S&P 500 Index ended the week down 8.8%, bringing its decline to 19% since reaching its peak on February 19. On Thursday, the S&P 500 Index recorded its fifth worst percentage drop in history, falling by 9.51%. The drop in the S&P 500 Index on Thursday brought the S&P 500 Index into bear market territory with a decline of 26.7% from the high reached just three weeks earlier. S&P 500 movement from a record high to a 20% drop occurred over just 16 trading days – the shortest time period for the start of a bear market from a record high since the Great Depression. Below is a look at the historical performance of equities following a 20% drop since the end of the Great Depression.

Start of Bear Market	Forward 1 Month	Forward 3 Months	Forward 6 Months	Forward 1 Year
12/1/1941	-4.2%	-7.6%	-7.9%	3.2%
9/9/46	-3.2%	2.3%	-1.5%	0.4%
6/13/49	9.1%	16.2%	22.9%	41.4%
10/21/57	2.0%	5.6%	10.2%	29.8%
5/28/62	-5.2%	5.9%	12.5%	27.4%
8/29/66	3.5%	7.9%	18.5%	26.4%
1/29/70	4.7%	-4.7%	-8.9%	12.5%
11/27/73	2.1%	0.5%	-8.8%	-28.8%
2/22/82	1.8%	2.9%	3.4%	34.1%
10/19/87	8.1%	7.9%	14.1%	26.2%
3/12/01	-1.0%	6.4%	-12.5%	-2.7%
7/9/08	1.7%	-20.9%	-28.5%	-25.1%
AVERAGE:	**1.6%**	**1.9%**	**1.1%**	**12.1%**

Source: S&P

According to data from FactSet, the forward 12-month P/E ratio for the S&P 500 Index fell to 14.0 as of March 12, compared to a five-year average of 16.7 and a 10-year average of 15.0.[10] We would caution, though, that the average earnings estimate still calls for record high earnings as analysts have been slow to bring down earnings estimates with the quick onset of the COVID-19 outbreak. Overall, we believe that the S&P 500 Index remains slightly overvalued. Recall that the index is still up more than 11% from its recent correction lows on December 24, 2018.

Fixed-Income Prices Decline, Spreads Widen

Fixed-income markets were mostly lower in trading during last week. The benchmark

[10] "S&P 500 Forward P/E Ratio Falls Below 10-Year Average Of 15.0," FactSet. https://insight.factset.com/sp-500-forward-p/e-ratio-falls-below-10-year-average-of-15.0. March 13, 2020.

Bloomberg Barclays Aggregate Total Return Bond Index fell by 3.2% as yields increased across nearly all fixed-income sectors. For the year-to-date period, the Bloomberg Barclays Aggregate Total Return Bond Index is higher by 2.4% and remains 9% above levels of a year ago. Treasury yields rose during the week with the 10-year Treasury note finishing the week with a yield of 0.94%, 20 basis points above the closing level from the prior week.

There was much more going on in fixed-income markets behind the scenes as liquidity in the fixed-income market largely dried up and spreads on many credits blew out to their highest levels in many years. In Europe, the iTraxx Europe CDS Index Spread climbed by 30 basis points in a single day on Thursday, breaching levels last seen in the 2015-2016 oil collapse. In a single month, the CDS Index Spread has climbed from just 40 basis points to over 110 basis points. In the U.S., significant underlying issues existed due to reduced liquidity in the repo market, highly leveraged relative value trades blowing up, and large spreads occurring in certain fixed-income ETFs due to the difficulty of pricing certain securities. On Thursday, the Fed announced the injection of $1.5 trillion in additional liquidity to try to calm markets. The TIPS market also witnessed significant anomalies as the 10-year breakeven inflation rate fell to just 0.8% during the week. Another area of noticeable movement was in closed-end funds, where many municipal bond strategies traded at 10% or greater discounts to NAV. Commercial paper spreads also widened to their highest levels since the Great Recession from near zero basis points at the start of last week to 80 basis points by the end of the week. Finally, investment-grade bonds saw their worst four-day performance in history, falling by more than 6% in response to credit and economic concerns.

On an individual sector basis, the most noteworthy moves were found in the airline sector where spreads have moved from around 2% to over 10% in multiple cases. Bank loans have also seen noticeable weakness where the average loan price is now nearing its worst levels since 2008. In just the last week, the spread on the S&P Leveraged Loan Index has risen from around 500 basis points to over 800 basis points. The week ahead will be interesting to see if global central banks and governments start providing more stimulus and liquidity into the marketplace.

The current volatility serves as a reminder of the importance of maintaining diversified portfolios across multiple asset classes. Timing the market is a very difficult task as market conditions can change abruptly. It is prudent for you to maintain a long-term investing approach. If you have any questions about financial markets or your investments, contact your financial professional.

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