MARKET VOLATILITY, MARKET OPPORTUNITY

Market Review **FEBRUARY 2020**

Financial markets remain in a state of unrest while businesses, policymakers, and investors continue to assess the real economic impact of COVID-19. The economic disruption caused by the virus could become even more significant if more events get canceled, businesses and institutions close, and the mobility of people slows. The consequences of such actions could dip into consumption and delay the plans of businesses. Hopefully, the worst of those scenarios won't materialize and the virus will soon be contained.

It is reasonable to expect that any short-term losses in economic activity could be recovered in future quarters. While some factories are closed in China, the demand on those supply chains has not gone away yet. Current demand will likely increase supplier backlogs and once things come back online, plants will go to full capacity and play catch-up with their orders. However, there definitely will be some permanent losses in sales, especially in industries of travel or leisure.

Political parties in international governments are at a critical junction to pass meaningful spending bills that can help counteract any unintended economic pitfalls. The Chinese government is likely one step ahead, with support being lent to small businesses. Germany was reported to unfreeze caps on fiscal budgets as a countermeasure policy tool. The US could do more, such as passing bills that would support small businesses or give financial assurances to employees who could lose wages from a temporary and unpaid layoff.

Swift action is being taken by world central banks. Multiple central banks have already cut their key term interest rates, which can raise the monetary base in the financial system. The US Fed, in particular, just made an emergency interest rate reduction. More interest rate cuts by central banks are expected in March. The goal is to get ahead of a possible credit crunch that could produce an intertemporal decline in output. Recessions can be born out of a contraction in the credit cycle. Pundits, however, fear that the global race to the bottom in interest rates signals more about future weakness and they don't understand how lower rates will help if people become more afraid of a disease.

While global institutions attempt to find solutions that might mitigate the economic impact of COVID-19, investors are fleeing into safer asset allocations. Government bonds and gold prices have climbed to multi-year highs. In particular, longer-term US treasury yields have reached all-time lows and yields on the whole German government bond curve are negative. How much of the move in bonds and gold is due to monetary stimulus and how much is associated with recessionary fears isn't clear.

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Equity indexes in developed countries began to react poorly after COVID-19 began to spread outside of China. The drop in US equity prices was quick. It took one popular market-cap weighted index of large stocks only 6 days to reach a correction from its prior peak. Some of the sell-off was likely necessary to release some air out of equity prices relative to their fundamentals. However, a technical viewpoint could now find US equities oversold at current levels. For example, the same US large-cap index breached its 200-day moving average and market breadth indicators have fallen to or near multi-year lows. Further, there is risk that COVID-19 may eat into the future earnings estimates of equities. In that case, a new level of support for equity prices may depend more on future fundamentals and be agnostic towards the technical argument.

The unknowns about the spread of COVID-19 has sent volatility into riskier asset markets. How much longer this goes on are only guesstimates. Diversified investors are inherently prepared for a range of outcomes. Some balance between stocks and bonds has likely done better as fear has risen in riskier markets. Stocks and bonds have worked well together, providing the counterbalance that investors desire by using these assets together. Investors should focus on their long-term goals and not look to drastically change portfolio risk in light of short-term market events. Investors that are positioned according to their financial goals should remain confident in their portfolio allocations and that these recent market events will be resolved with little disruption to their long-term financial plan.

Asset Categories	US STOCKS	FOREIGN STOCKS	US BONDS	FOREIGN BONDS	HARD ASSETS	HYBRIDS
Monthly	-8.84%	-7.03%	0.02%	-0.75%	-6.57%	-3.10%
Year to Date	-10.67%	-10.29%	1.13%	0.14%	-8.34%	-1.57%

*DATA USED IS SOURCED FROM MORNINGSTAR®, DATE ENDING FEBRUARY 29, 2020.

US STOCKS

US Stocks hastened a quick slide into a correction last month. The overall category average fell -8.8% bringing the full year total return down to -10.7%. The small-cap category average saw deeper losses by month end. Their full-year total return performance is now -12.6%. The large-cap category average has seen lesser declines. In the last two months, large-cap equities are down -8.7% with most of that loss attributed to February.

FOREIGN STOCKS

Foreign Stocks tracked with the declines in riskier assets last month. The whole category average finished February with a -7.0% total return. The foreign stock category has actually done marginally better against US stocks this year. Foreign stocks were surprisingly helped out by slimmer monthly losses in the emerging equity category average. The monthly total return in emerging equities closed at -4.9%, but their full year losses track with the rest.

US BONDS

US Bonds produced another month of gains, which raises their full year total returns to 1.13%. Outperformance in the group came from the government bond category average on 1.52% gains in February. Category averages that represent higher quality bond allocations, including corporates, offer near 3.0% in total return performance this year. Categories in possession of mild losses this year are higher risk bonds such as high-yield corporates and leveraged loans.

FOREIGN BONDS

Foreign Bonds drew total return losses in February and their performance is mixed for the year. Emerging market bonds were more badly hit with monthly total returns of -1.2% in the category average. The world bond category average finished last month with a mild loss of -0.3%. Full year, total return performance shows world bonds with a 0.4% gain and emerging bonds at a -0.1% loss.

HARD ASSETS

Hard Assets continued to wane in February. The energy category average sustained weakness last month with further declines of -11.4%. By end of February, a bear market might be able to be called in the energy category given the full year total returns were below -20.0%. Some pain is also being felt in the real estate category averages. Both global and US real estate category performance has dipped below -6.0% in the last two months.

HYBRIDS

Hybrids were sold along with equities in February. The extent of the losses, however, were not as great as pure equity exposures. Losses in the category averages of convertibles and preferred stock were almost in tandem to produce the monthly total return loss of -3.0% for the entire category. Although, total return losses in the last two months are not as great. The whole category of hybrids is down -1.6% on greater preferred stock losses.

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