March 10, 2020

Over the past few weeks, the spread of COVID-19 and the global response has significantly dampened the outlook for economic growth and resulted in heightened volatility in the markets. Additionally, over the weekend, a meeting of OPEC oil producers and Russia failed to yield an agreement to limit supply after global demand had dropped. The result was an announcement by Saudi Arabia indicating they were cutting offering prices and increasing output to protect their market share. This caused oil prices to fall materially and negatively impacted stock prices – in particular, stocks across all facets of the energy business.

U.S. Treasury securities have been one of the few safe havens for investors during this fear-induced market. The 30-year Treasury bond has soared higher in price, while the yield has fallen below 1%. The message the U.S. Treasury market is sending with these unprecedented low yields is concerning. Credit spreads (the difference in interest rates between "safe" and "risky" bonds) have also begun to widen, indicating an increase in the chances for a recession, and leading bond investors to demand higher yields even as Treasury rates fall. Last week, the U.S. Federal Reserve (Fed) made an emergency rate cut of 50 basis points to their target rate. This week, the Fed boosted the size of their short-term lending operations to provide ample liquidity to offset market stresses. It is clear the Fed needs to act further, and we expect them to do so quickly and aggressively.

There are still many more questions than answers around the spread and economic impact of COVID-19. The virus has spread to 112 countries or regions across the globe with varying impacts on each. Investors are not able to assess the final effect of the virus on the global economy. This lack of clarity and escalated degree of uncertainty has resulted in a significant increase in volatility within domestic and global markets. We cannot ignore the possibility that volatility could remain elevated for some time. The number of COVID-19 cases within the U.S. and around the globe is expected to increase from here. Fortunately, the U.S. economy came into this year on strong footing – with low unemployment rates and sound economic growth. Congress already passed an $8.3 billion package last week to focus on treating and preventing the outbreak. The more we do to address the virus in the short-term, by limiting interaction as other countries have done, the more quickly it will run its course and allow the economy to recover.

It is clear that global monetary and fiscal policy need to be coordinated and enacted in the weeks ahead. We anticipate the following actions over the next several weeks.

- The Fed will likely cut the Fed funds target rate at their meeting in March, if not sooner.
- We expect the Fed to provide verbal guidance that they will keep rates low for an extended period, as well as the possibility of implementing Quantitative Easing (QE).
- The President could propose one or multiple tax cuts to help stabilize the economy. In addition, he may implement a plan for fiscal measures to provide targeted assistance to the segments of the economy most impacted by the COVID-19 virus.

Our base case does not include an outlook for an imminent recession but we acknowledge that the chances of a recession have increased, particularly if the spread of COVID-19 is more significant or lasts longer than we currently anticipate.

The heightened level of volatility requires a light touch when it comes to investment decision-making. Investors should not oversteer in one direction or another. Prudent investors realize there are many unknowns and that we should be cautious in actions at this time.

During such periods of market stress, a long-term investment approach characterized by diversification and risk management is important. An investment portfolio properly allocated to your time horizon and investment objective, and based on the principles above, likely has not experienced the full impact of the recent market moves since bond investments have, overall, increased in value to help offset the value decline in stock investments.

Periods like this are always un-nerving. Long-term investors should remain focused on their objectives and understand we have experienced, and recovered from, periods of market volatility in the past. Our longer-term confidence in the U.S. economy remains intact.

As always, we are available for questions and further discussion.

Disclosures