Market Review and Outlook—April 6, 2020

Stocks Test Positive for COVID-19—News of the global spread of the Coronavirus (COVID-19) combined with news of a free-fall in oil prices bring stock prices down sharply starting in late February and lasting five weeks. Investors sold not only stocks, but also bonds, and seemed to only trust government bonds and cash. Even the traditional safe-haven during global fear, precious metals, failed to provide support, as these funds fell 26% during the quarter. While the last week of March brought a rebound of about 10% in many markets, it was a very painful quarter, as shown below by the red ink in the table.

Economy is in Free Fall—The primary tactic to address COVID-19, social distancing, has been devastating for much of the US service industry—restaurants, bars, hotels, tourism, and non-food/beverage retail. This makes up about 20% of our economy, and 20% of the jobs in the US. Fortunately for investors, this segment makes up less than 10% of the S&P 500's earnings. However, as noted earlier, this pandemic coincides with a 66% drop in oil prices, which will further pull down stock earnings. In the coming weeks we expect to see double-digit unemployment figures, a sharp drop in the GDP in the 1st and 2nd calendar quarters, with coincident declines in S&P 500 earning figures. State governments are being hit with a sharp decline in expected revenues, and a sharp increase in demand for state services. What occurs economically beyond June is less in focus.

Congress and the Fed to the Rescue?—In 2008-2009 the Fed rushed into the crisis with massive liquidity, to ensure that the financial system would not seize up. Similarly, the Fed has reacted aggressively with liquidity and with quickly cutting the Fed rate to near-zero. Congress has also passed several large laws to support the country, targeting those harmed the most from the crisis—laid off service-sector workers, restaurants and other small businesses, large companies in hard-hit industries, state and local governments, and healthcare systems. The most recent law, the CARES Act, is massive; combined with the Fed's actions, these steps come to $3 trillion of aid. The goal is to 'buy us time,' perhaps three months of covering the economic cost of social distancing. Again, what occurs past June is hazy, as it depends on the path of a microscopic virus called COVID-19.

Investing on the Edge—Uncertainty and volatility are very high at this time. That means that it is tempting to discard age-old wisdom. Yet this also means that following age-old wisdom can be the most important. Diversifying means buying areas that have fallen, and buying more when losses are greater. The table below shows that we have a target-rich environment. We have no illusion that we know whether stocks will fall further or, if so, how far down. We do believe that rebalancing is the best strategy during uncertainty and volatility.

Category	3 Months	12 Months	3-Yr Avg	5-Yr Avg	10-Yr Avg
Fidelity Cash Reserves	+0.26%	+1.63%	+1.39%	+0.87%	+0.44%
Intermediate Term Bond	+1.57%	+6.78%	+3.90%	+2.74%	+3.51%
Intermediate Muni Bond	-1.53%	+2.44%	+3.03%	+2.38%	+3.42%
Large-Cap Stock	-20.92%	-9.97%	+2.80%	+4.46%	+8.84%
Mid-Cap Stock	-28.28%	-20.69%	-3.71%	-0.58%	+6.60%
Small-Cap Stock	-32.37%	-26.41%	-6.82%	-1.76%	+5.96%
Foreign Large-Cap Stock	-23.39%	-15.67%	-2.74%	-1.14%	+2.15%
Financial	-34.67%	-23.87%	-6.50%	-0.07%	+4.87%
Health	-13.94%	-3.97%	+6.41%	+3.27%	+12.40%
Technology	-14.39%	-26.41%	-6.82%	-1.76%	+5.96%
Moderate Allocation (60% stocks)	-14.74%	-7.01%	+1.48%	+2.40%	+5.75%

The data in this table comes from Morningstar and is as of March 31, 2020.

Before and After—The stock market during the Great Recession of 2008-2009 bottomed out on March 9, 2009. I have included a few rows and columns from the asset performance table we published in March 2009 and the one we published a decade later (each using February 28th data).

February 28, 2009 Data Category	3 Months	Past Year
Money Market, Taxable	*+0.22%*	*+1.73%*
Intermediate Term Bond	*+2.09%*	*-6.92%*
Intermediate Muni Bond	*+4.42%*	*+3.20%*
Large-Cap Blend Stock	-14.89%	-43.36%
Mid-Cap Blend	-11.68%	-44.44%
Small-Cap Blend	-15.53%	-44.20%
International Stock	-13.44%	-50.48%
Conservative Allocation	-3.60%	-22.10%

February 28, 2019 Data Category	10-Yr Avg
Fidelity Cash Reserves	*+0.30%*
Intermediate Term Bond	*+4.54%*
Intermediate Muni Bond	*+3.96%*
Large-Cap Stock	+15.31%
Mid-Cap Stock	+15.45%
Small-Cap Stock	+15.85%
Foreign Large-Cap Stock	+9.13%
Moderate Allocation (60% stocks)	+10.44%

The table on the left shows the terrible losses suffered during the financial crisis. At the time, there was no reason to believe that there would not be further losses to come; there was no positive economic news expected—no light on the horizon, just a storm front. Further, the table on the left illustrates how much better the cash and bonds did, and how badly you would have felt holding stocks at that point.

Now look at the table on the right, with the investment results for the following ten years. US stocks outperformed cash and bonds by more than three times. You would have earned 56% (not annualized) over that decade from the best conservative option—Intermediate Term Bonds, but you would have earned 315% over that decade with US Large-Cap Stocks. If you began March 1, 2009 with $100,000 in bonds you would have earned about $56,000, while if you had held large US stocks you would have earned $315,000.

We have been here before. In March 2009 we had no idea how we would emerge from the global financial crisis, if it would take months or years. Similarly, we do not know the future path of the COVID-19 crisis. We don't know if a vaccine will be discovered in a month or a year, and when it will be produced in sufficient quantities to enable our global society to truly get back to normal. If the current steps in the US fail to 'flatten the curve' this Spring, we don't know if Congress will take further steps to maintain the economy as we adopt stricter steps and incur much greater costs.

Great Investing is Like Great Hockey—I love the quote from hockey great Wayne Gretzky: "I skate to where the puck is going to be, not where it has been." While investors can be overwhelmed by the strong emotions of fear and greed, in time investors make decisions based on what is on the horizon—what a company is expected to do in one or two years, what the economy is likely to be doing next year and the following. The stock market rose on March 26 when over 3 million new jobless claims were announced, and again on April 2nd when 6 million new claims were announced. This is awful news, but it was already expected, and priced into the stock market—it reflected where the puck had been.

COVID-19 introduces a great amount of uncertainty on where the puck is going. Will the curve have flattened by June? Will a vaccine be created by summer? Will other large hot-spots arise in the US—Los Angeles, Dallas-Ft Worth? Will the curve flatten in June, restrictions be relaxed, and then the curve rise again by fall? Without the vaccine available this winter, will COVID-19 grip the world next winter?

While this list of uncertainties is extensive, the greater uncertainty is whether the challenges presented by COVID-19 are already priced into the stock markets (world stock markets are down about 25% from their February highs despite the recent rebound). Investors must decide where they think the puck is going. They must also decide when they think that other investors will push away the fear and act based on the economics. Finally, they must decide what they will do if their expectations are wrong, if fear continues to drive global markets.

Alternatively, investors can choose to rebalance and ignore the headlines, and wait out the uncertainty and the fear, even if it takes several years. Investing requires decision-making during times of uncertainty—great uncertainty at times. Rewards are typically greatest when the uncertainty is greatest. Likely, in March 2030, we will see very strong 10-year returns from stocks. I hope.