Introduction:

Many find themselves reflecting daily on the impact of the COVID-19 pandemic and we are no different (https://www.visualcapitalist.com/history-of-pandemics-deadliest/). We often reference the quote by Tony Hsieh, CEO of Zappos, and Technology Entrepreneur, "Things are rarely as bad or good as they seem." – especially as it relates to financial markets (https://www.linkedin.com/posts/activity-6649089387554582529-yzUb).

"The key to successful investing is not predicting the future but looking at the present with clarity."

- Dr. David Kelly, CFA, Chief Global Strategist of JP Morgan Asset Management

Solely from a financial market(s) perspective, the performance data is not atypical from that of a "normal" recession. There are three primary differences this time: the velocity, the volatility, and the source (COVID-19). Normally recessions take months to mature from initiation through the bottom and ultimately into recovery. The source, COVID-19, and the uncertainty around the full impact resulted in a high velocity, high volatility downturn as markets responded to the lack of clarity. Collectively, these factors led the Federal Reserve Board and our elected officials to lead – providing record levels of both monetary and fiscal stimulus to accelerate the stabilization and (hopefully) hasten the recovery. These factors give me great confidence for the recovery of our financial markets.

Recessions:

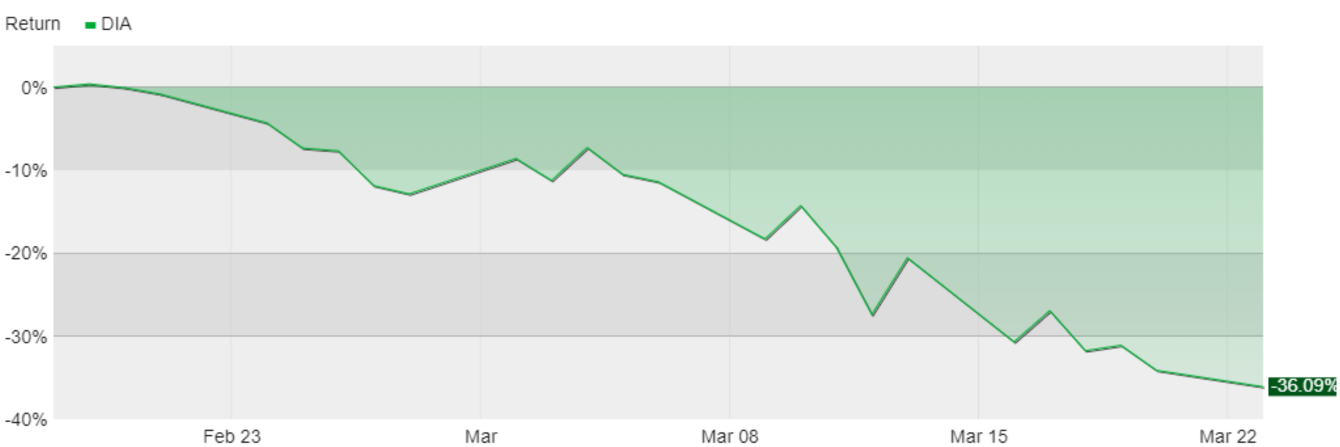
What is a recession? A recession is generally defined by economists as two consecutive quarters of negative gross domestic product (GDP). GDP is the sum total of all goods and services produced by a specific nation.
Why is a recession important? During a recession, the output for the country declines causing a cascade effect through the economy. The result is lower industrial output, increased unemployment, stagnating wages and declining retail sales as a consequence.
How long do recessions last? Thankfully, they generally do not last long – since 1950 the average recession has lasted only 11 months from beginning to end.
How do we avoid a recession? Unfortunately, we can't. Recessions are part of the business cycle and are healthy for the economy, removing excess from the system and preventing bubbles.

Is the stock market always negative during recessions? Not necessarily. During the past 10 recessions, the average return on the S&P 500 Index was approximately 3% – not as good as returns during times of expansion but positive, nonetheless.

What if this time it is different? While we cannot predict the future, historically, it never has been. Remember, things are rarely as good or bad as they seem in the moment – this is largely because of our limbic system. Our basic "fight or flight" instinct that serves us so well for basic human survival is our enemy when it comes to investing. This is a primary reason we, as a firm, focus on the importance of aligning your investment risk budget and focusing on significant life goals through our financial planning process. Our "flight" instinct is awakened during times of market stress and makes us all want to sell. This instinct is nature and should not be denied, but rather acknowledged and managed. If left unmanaged, it cannot be disarmed. In order to make clear, rational investment decisions the "flight" instinct must be disarmed as our physiology prevents us from using our logic centers while our "flight" instinct is engaged. This may be especially difficult during the current environment and the elevated anxieties around COVID-19.

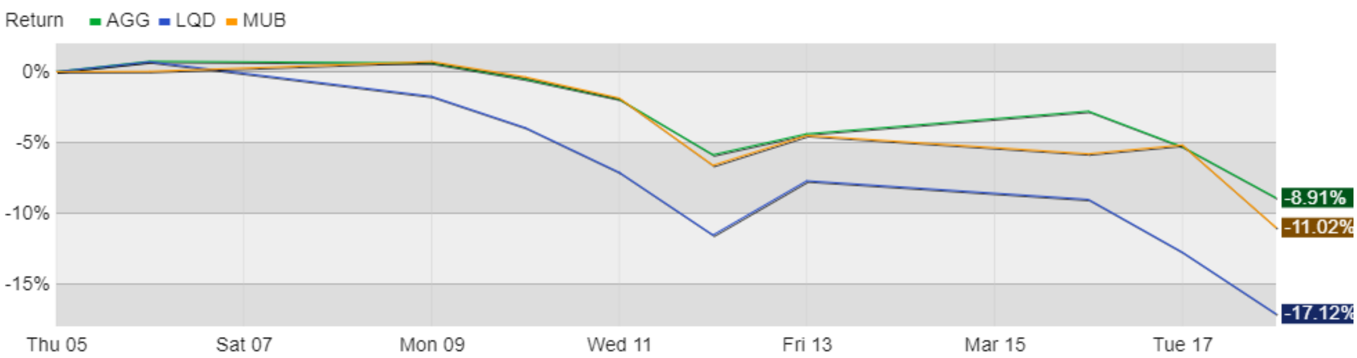
Financial Markets:

In response to the significant unknowns around the COVID-19 virus financial markets responded with extraordinary speed and volatility. The result was the Dow Jones Industrial Average (DIA) casting -36.09% of its value in just over 30 days.



Source: Kwanti Analytics

Although not covered as broadly, another significant abnormality stirred in the bond markets with bond yields spiking from heavy selling pressure in government, municipal and investment grade corporate debt as banks scrambled to generate cash to fund lines of credit for corporate borrowers. This volume in addition to new market supply virtually extinguished market demand, pushing bond prices significantly lower. During the timeframe from March 5th to March 18th, the benchmark Aggregate Bond Index (AGG) shed -8.91%, the Investment Grade Corporate Index (LQD) declined -17.12%, and the National Municipal Bond Index (MUB) fell -11.02% respectively as liquidity nearly disappeared from fixed income markets.



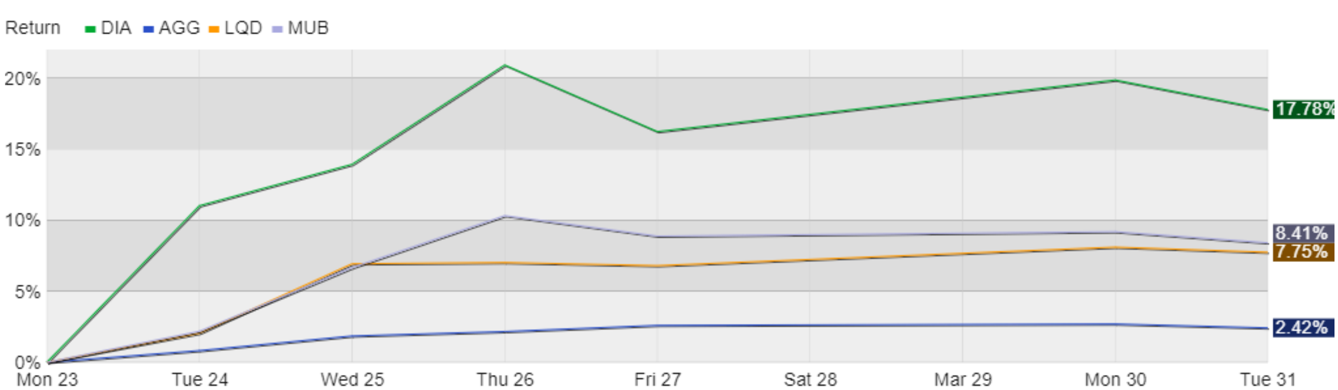
Source: Kwanti Analytics

"Bull markets are born on pessimism, grown on skepticism, mature on optimism and die on euphoria. The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell."

– Sir John Templeton, legendary investor, mutual fund manager and philanthropist

Stimulus Package:

In response to the forecasted economic impacts of the COVID-19 virus and the violent downturn in financial markets the Federal Reserve Bank responded first with a sharp reduction in interest rates then added monetary stimulus with a bond buying program all aimed to lubricate credit markets. Fiscal stimulus from Washington came next with a series of legislative actions targeted at stemming the recessionary impacts of the COVID-19 virus. The combined fiscal and monetary stimulus provided markets with a much-needed updraft into month end.

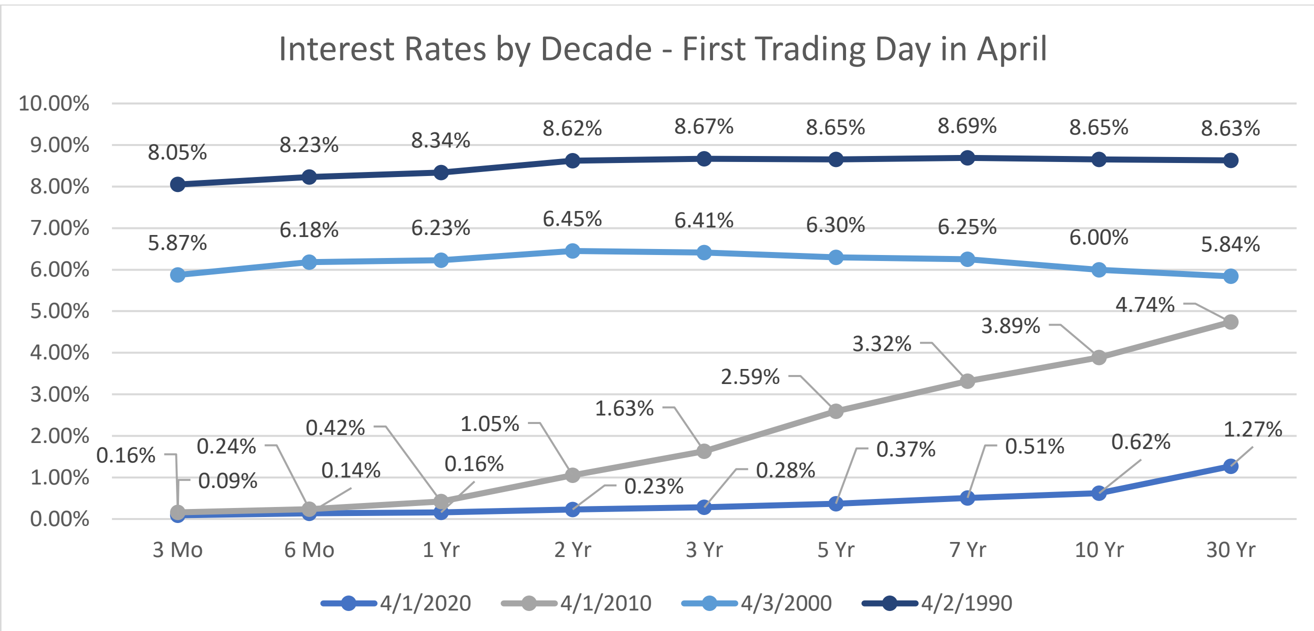


Source: Kwanti Analytics

Risk and Realities

We are likely to experience a period of elevated volatility that will reside between the extremely elevated volatility experienced during March of 2020 and historically low volatility enjoyed during the prior decade ending December 31, 2019. This moderately elevated volatility is likely the norm until there is a measurable break in the COVID-19 data domestically. Experts believe we may see an apex in the United States in the coming weeks as the effects of social distancing take hold and the spread prevention actions materialize in the data. As the spread of COVID-19 slows, that change should provide markets with considerable relief and a pathway to stability. Markets will then likely begin to shift focus toward the realities of the underlying economic data which has the potential to create yet another pocket of volatility. This pattern of sorting out the data is not abnormal and should present considerable buying opportunities for disciplined investors.

As we focus on the future a new reality begins to emerge – a future that is much riskier than the past. But not because of COVID-19 or economic recession, but rather the collective impact on financial markets from the Great Recession of 2008-2009 and the COVID-19 pandemic – explicitly the impact on the fixed income market. Simply stated, risk in the fixed income complex has increased as yields have diminished. Since 1990, the yields across all maturities of US Treasury debt decreased from over 8% per annum to under 1% in 2020, with the sole exception being the 30-year bond standing at a paltry 1.27%.

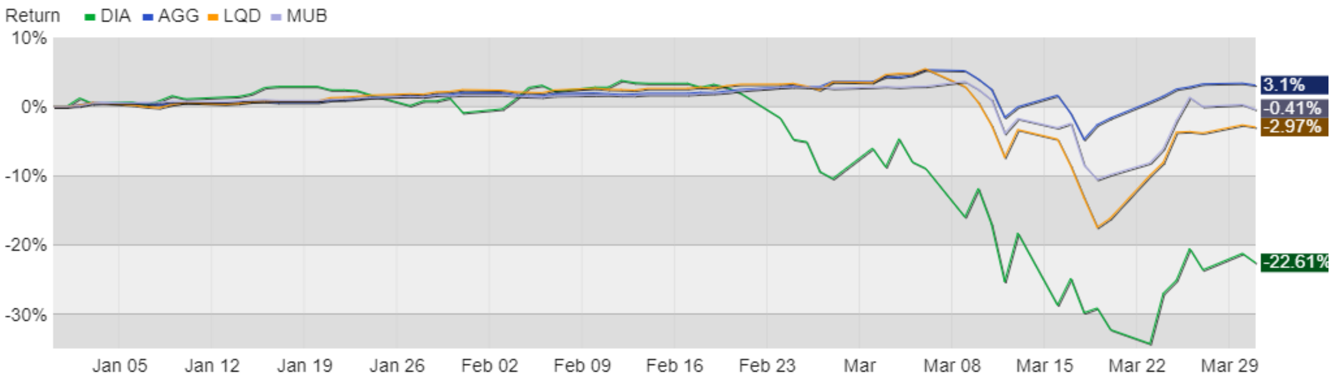


Source: US Treasury Department

In basic terms, the interest rate on a treasury bond can be seen as an indicator for the amount of defense it may present during times of market stress. For example, assuming one bond paying 8.63% per annum is purchased at par ($1,000) and investor will receive interest payments equal to the purchase price in approximately 8.34 years whereas a bond paying 1.27% that is purchased at par ($1,000) will take nearly 57 years to do the same. Bonds serve different functions in a portfolio; in some cases, they provide defense and for many retirees they provide cash flow. In either case, the fundamentals have shifted, and the data suggests investors will be forced to absorb additional risk and volatility in the future – certainly at least in the near-term.

As we reflect on a difficult quarter in both the equity and fixed income complex it is important to remember that this too shall pass and in the immortal words of legendary investor Benjamin Graham, “To be an investor you must believe in a better tomorrow.”

1st Quarter 2020:

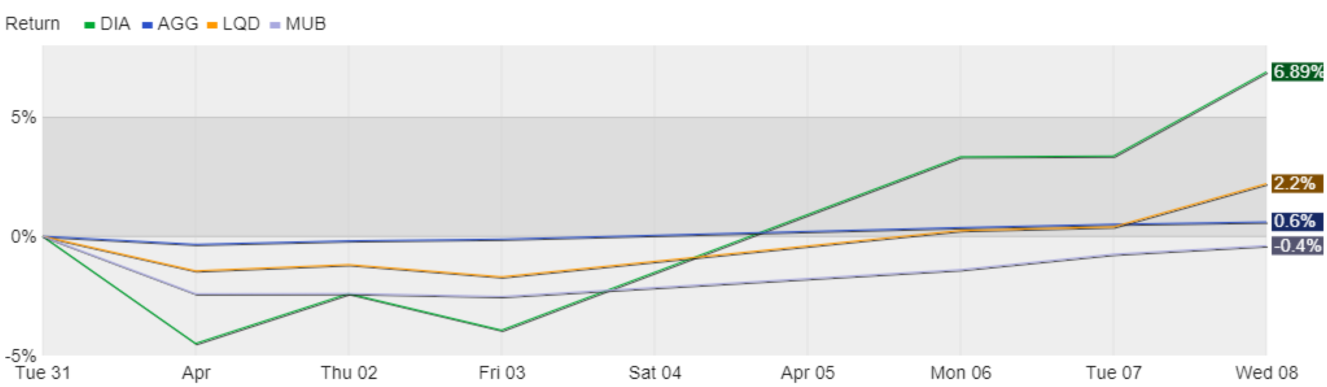


Source: Kwanti Analytics

We do believe in a better tomorrow. The COVID-19 virus will be tamed, and the colossal fiscal and monetary stimulus should help ballast our economy and forge a pathway for us to climb out of recession. As Jack Bogle, founder of the Vanguard Group famously said, "Your success in investing will depend in part on your character and guts, and in part on your ability to realize at the height of ebullience and the depth of despair alike that this too shall pass."

As we begin the second quarter, there are signs that the worst may be behind us and we are moving toward this being in the past. Only time will reveal that answer and there are reasons to look to our future with renewed optimism.

2nd Quarter 2020:



Source: Kwanti Analytics

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