March 23, 2020

Weekly Viewpoint

Watching and Waiting

Performance for Week Ending 3.23.2020

The Dow Jones Industrial Average (Dow) fell 17.30%, the Wilshire 5000 Total Market Index℠ (Wilshire 5000℠) lost 14.96%, the Standard & Poor's 500 Index (S&P 500) finished off 14.98% and the Nasdaq Composite Index (NASDAQ) shed 12.64%. Sector breadth was negative with all 11 of the S&P sector groups posting double digit losses. For the week, the Real Estate sector (-22.99%) was the worst performer followed by Energy (-19.63%) and Industrials (-18.385). While still down sharply, Consumer Staples (-11.32%), Communication Services (-12.25%), Consumer Discretionary (-12.53%), Materials (-12.6%), and Healthcare (-13.03%) outperformed the broader S&P 500 on a relative basis.

Index*	Closing Price 3/20/2020	Percentage Change for Week Ending 3/20/2020	Year-to-Date Percentage Change Through 3/20/2020
Dow	19173.98	-17.30%	-32.81%
Wilshire 5000	23082.46	-14.96%	-29.81%
S&P 500	2304.92	-14.98%	-28.66%
Nasdaq	6879.52	-12.64%	-23.33%

Market Observations: 3/16/20–3/20/20

The major market indices finished the week sharply lower, with the S&P 500 posting its worst weekly loss since October 2008 when the index fell by 18.2%. The S&P has now declined in four of the past five weeks and has retreated by nearly 32 percent from the all-time highs reached on February 19. The losses have been broad-based with seven of the eleven S&P 500 sectors posting year-to-date losses in excess of the broader market.

While growing uncertainty around the spread of the COVID-19 virus triggered the weakness, there is now growing fear that the health crisis is on the verge of morphing into both an economic and financial crisis.

Currently over 20% of the US population is on a “stay at home” order and most businesses in every major US city have been shuttered for the unforeseeable future. There is no playbook for this, as such, the situation is very fluid with little in the way of forward visibility.

The speed and breadth of the downturn suggests the markets are now pricing in a high likelihood that the US economy will fall into a recession, if we are not already there. This also means there has been a lot of bad news ALREADY priced into the markets. Said differently – there is virtually no good news priced into stocks. Ultimately the market needs to see a stabilization or decline in the number of new COVID-19 cases and/or solid progress towards a vaccine/cure. In the meantime, market volatility will likely remain elevated as investors react to new headlines and try to gauge what is already priced into the markets against what is likely to come to fruition in the months ahead.

It must be noted, that the US economy was in very good shape through the end of February but as we will start to see in the coming weeks, the March data will show signs of significant stress. There is a developing view by several Wall Street economists that growth in the second quarter could plunge in excess of 10% on an annualized basis. To put that in perspective, during the Great Financial Crisis in 2008 – the worst quarter was down by 8.4%. In fact, you must go all they back to the Great Depression for a worse quarter when the economy contracted by 12.9% during the second quarter of 1932.

There is little doubt that the near-term economic impact is likely to be SHARP, but it could possibly prove short. At some point, stay at home orders will be lifted and “pent-up” demand will be unleashed, which in turn, should help the economy begin to stabilize. In addition, the aggressive efforts by the Federal Reserve and huge fiscal spending and back stop type programs being put in place by the Government should help goose the data once we get over the hump. Remember, markets historically have bottomed several months BEFORE the end of a recession.

Will Cheap get Cheaper? Valuation has plunged with the Price to Earnings (P /E) multiple on the S&P 500 now well below the long-term average. While cheap can certainly get cheaper, ultimately for long-term investors field position does matter. Earnings expectations for 2020 have been ratcheted lower, and more downward revisions are likely as we get better clarity on the degree of economic fallout. Companies may also use this period as an opportunity to “kitchen sink” results as they know they are likely to get a free pass, with 2020 results increasingly expected to be considered a one-off event. The focus will more and more shift to 2021 earnings expectations, which according to the Bloomberg consensus currently stand at $187/share (based on Friday’s closing price, the Price/Earnings multiple on estimated 2021 earnings equals a lowly 12.3 times).

Bottomline – We Will Get Through This: It’s Always Darkest When Your Eyes Are Closed. While no one honestly knows when the ultimate bottom will be made, it is also not the time for panic selling and the best course of action seems like a wait and watch approach. For investors who have a longer time horizon, the return profile is beginning to look asymmetrical, with upside potential over the next couple years seemingly more robust than downside risk during the same time frame. Remember, Spring always follows Winter and

Bear Markets are always eventually followed by Bull Markets. We also need to keep things in perspective. Over the past 90 years, stocks have produced an average annualized total return of nearly 9% (even including the recent sell-off). Throughout this time span we've had numerous recessions, Bear Markets, terrorist events, geopolitical events, pandemics, and both Democratic and Republican leadership. While there were certainly potholes and speedbumps along the way, over time the path of least resistance has been higher.

Technical Support Levels: In effort to gauge potential further downside risk in the market I like to turn to the technicals (the study of price patterns). While Technical Analysis should be viewed more as a "windsock" than a crystal ball and many fundamentally driven portfolio managers shrug off the use of technicals, Traders on the front lines tend to use technicals to help shape and define risk. Remember if enough eyeballs are focused on something then that something becomes important. In this exercise we try to identify past levels that selling pressure has dried up. For the S&P 500, the most immediate level is 2280, which represent the intraday low point made on March 18. From there, the market has a shelf of support at 2150 dating back to the 2015/16-time frame. The last level on the radar is 2030, which represents the 50% retracement level from the 3/9/2009 low - stay tuned.

The Week Ahead: While economic reports have yet to fully capture the effects of the coronavirus epidemic due to their lagging nature, that dynamic will change in the week ahead with a few reports focused on the early part of March. Amongst this group are the Markit Manufacturing PMI, the Kansas City Fed Manufacturing report, and the final reading of the University of Michigan March consumer sentiment survey. The one report that everyone will be watching is Thursday's reading on initial jobless claims for the week ended March 21. After jumping 70K to 281K last week, economists are forecasting an unfathomable spike to 1.5 million, more than double the 665K level reached during March 2009.

Definitions

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Wilshire 5000 Total Market IndexSM represents the broadest index for the U.S. equity market, measuring the performance of all U.S. equity securities with readily available price data. The index is comprised of virtually every stock that: the firm's headquarters are based in the U.S.; the stock is actively traded on a U.S. exchange; the stock has widely available pricing information (this disqualifies bulletin board or over-the-counter stocks). The index is market cap weighted, meaning that the firms with the highest market value account for a larger portion of the index.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

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