"From Euphoria To Hysteria…In 7 Days"

Market Commentary – March 2020

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The second estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 2.1% in the fourth quarter of 2019. This is the same as the 2019 Q4 advance estimate and the reading in 2019 Q3. Coronavirus effects are likely going to distort economic readings in 2020 Q1 and perhaps subsequent quarters. The Chinese economy suffered cardiac arrest as millions of people were quarantined to help stop the spread of the virus. It is unclear to what extent the economy in China is restarting. We expect this air pocket to ripple throughout the global economy. Moreover, we may see additional large quarantines of people worldwide, further disrupting supply chains. Also, consumers may adjust their behavior (such as avoiding public places), which will cause its own effects. Perception can become reality in economics.

Fear of the unknown regarding the coronavirus has caused financial markets to go from euphoria to hysteria *in only seven days*. Stock markets worldwide have plunged, and interest rates have tanked, at speeds challenging the most rapid declines in modern history. On Friday, February 28 at 2:30 p.m. ET, as financial markets spiraled downward, Federal Reserve Chair Jerome Powell issued an unscheduled statement. The Fed is monitoring developments in the economy due to the coronavirus and is prepared to "use our tools and act as appropriate to support the economy". Fed funds futures have priced in four 0.25% reductions in the federal funds rate (by March, May, July, and February 2021). The March cut may even occur prior to the U.S. stock market opening on Monday, especially if equity futures are down drastically. The next Federal Open Market Committee meeting is scheduled for March 17-18.

While rate cuts will help, the problems here are biological and psychological. Lower interest rates will not persuade people to go to work or socialize in public settings if they are afraid of getting sick, so it is important to step back and look at the big picture. The coronavirus has infected about 85,000 people worldwide (out of 7.8 billion people) and has caused about 2,900 deaths. The mortality rate of coronavirus seems to be about 2%, which is hardly an instant death sentence for those who get ill. (Compare this to the Ebola virus, which has a 90% death rate.) The smartest minds in the world are working on vaccines, although it may take months for these to be proven. So far, the worst effects of the coronavirus have been *psychological* as people worldwide are panicking. Traditional and social media are magnifying this event into a panic when there are other things to be more worried about. For example, the U.S. Centers for Disease Control and Prevention projects 32 to 45 million cases of flu *in the United States alone* this year, causing 18,000 to 46,000 deaths. Why are people more worried about the coronavirus than the flu?

Technical factors of the market are bearish (more supply than demand), while fundamentals are attractively priced – therefore, we are bearish on the market. The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) over the next 12 months is $173.45, which implies a price-to-earnings (P/E) ratio of 17.0 with the S&P 500 at 2,954. The earnings yield (E/P) of 5.87% represents attractive value relative to the 10-year U.S. Treasury note yield of 1.13%. The spread of 4.74% is the largest since June 2013. We must keep in mind, however, that earnings estimates will likely come down as the economic effects of the coronavirus become clearer.

The stock market is in a doozy of a correction, with the S&P 500 plummeting nearly l3% in the last seven days. Technical analysis is not as meaningful in an emotional panic, but it will become more important once stocks have stabilized. We anticipate that our 2008 playbook will likely serve our clients well. Depending on the client, as the stock market drops, we are *incrementally* buying stocks that are being irrationally discarded by sellers. Investors are no longer wondering why we keep so much cash. While we certainly did not predict coronavirus, we did plan for it. We have been effectively *short* the stock market with our cash. Given that it is impossible to know where the bottom is on stock prices, the next best thing is to acknowledge that Wall Street is currently on sale. Did investors really think that "buying low" is easy?