STATERA
ASSET MANAGEMENT

Commentary: March 2020

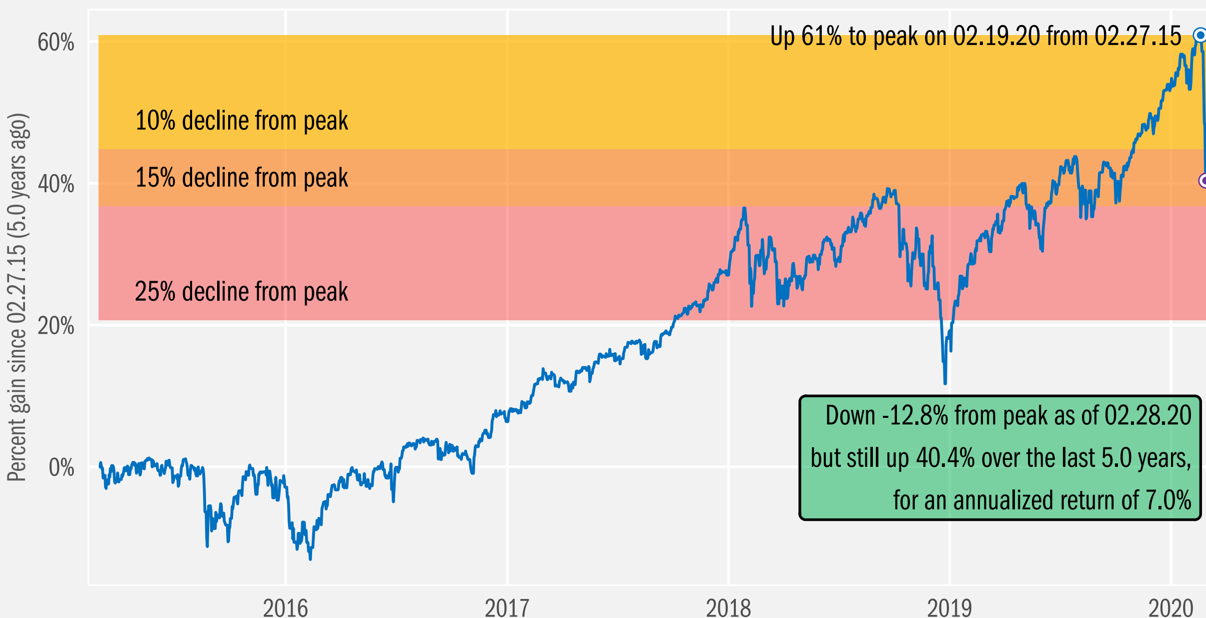
NOVEL, BUT NOT NEW

It would seem that investors finally began to focus on the near-to-medium-term potential impact of the COVID-19 virus. Or, was it that the Democratic Party debates were stirring fears of an increasingly tumultuous progression to the 2020 Presidential Election? We might best assume both, even as we respond to the recent dramatic decline in the equity markets by staying the course. That is, to the extent that we always should expect the unexpected as part of the investment process, the longer-term plans we have set before such events likely need not be altered.

That Was Quick

From its record high close of 3386.15 on February 19, the S&P 500 Index has declined 12.8% as of the close today, marking the quickest correction from a record high. A correction being a drop of 10% or more, they are not generally considered rare. They certainly prove great news fodder, though, the attention they gather focusing investor concerns on just how bad it might get. The near-term plunge places the S&P at a year-to-date 8.6% loss, and leaves the index at a level first seen in June of last year.

Figure 1: S&P 500 Index Total Return



From 02.27.15 to 02.28.20. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

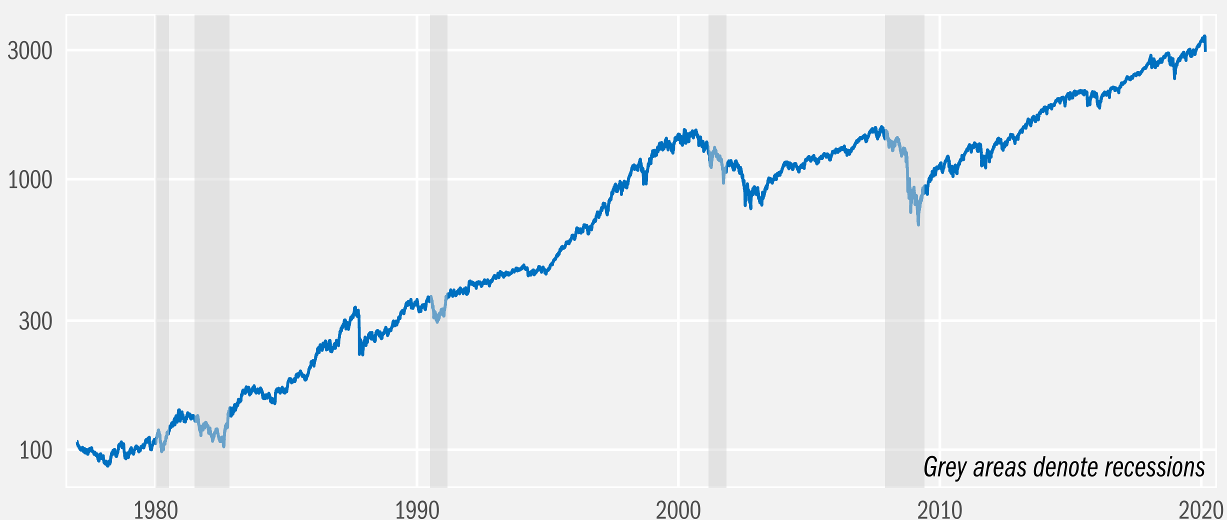
A Material Recession

Due to work stoppages, transportation shutdowns and consumer immobilization, China has experienced a dramatic reduction in growth since the start of the year. Meantime, COVID-19 is only now beginning to show up in Europe, where manufacturers—already stinging from the effects of America's various trade "wars"—likely will experience further drops in demand and productivity. With Japan there already and Germany potentially entering a near-term recession, macroeconomic duress is likely to continue to spread. And that's before we consider that the virus here, too, is only just beginning to show up. Our far freer society being entirely without the ability to force folks to stay inside and round up those who are sick to be placed in medical internment, we should not be surprised if major local and regional outbreaks occur. We mean not to be alarmist, but we suggest as much in part to develop a foundation for setting proper expectations. Put succinctly by former trader Cameron Crise in a Bloomberg note this morning, "It seems to me that we are now at the juncture where the measures that will minimize the human cost of the outbreak are likely to maximize the economic cost."

We thus may surmise that global macroeconomic activity has slowed tremendously in the near term. While the U.S. economy had been (and still is by most measures) running strong, we are likely to see modest and perhaps may even see a material downside to near-term growth. U.S. companies from tech to travel, those more obviously on the front lines of the globalization trend, already are suppressing expectations for upcoming earnings announcements. Going forward, we are likely to see weakness among the more domestically focused sectors of the economy (read: in-person retail and entertainment) if viral outbreaks become more common and Americans choose to avoid leaving their homes.

Figure 2: S&P 500 Index

Neither the beginning, not the ending of recessions clearly align with market moves each might be seen as warranting. The accuracy of market timing decisions related to recessions is further challenged by the general delay in the identification of recessionary periods.



From 12.31.76 to 02.28.20. Price data that do not take into account the receipt or reinvestment of dividends. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

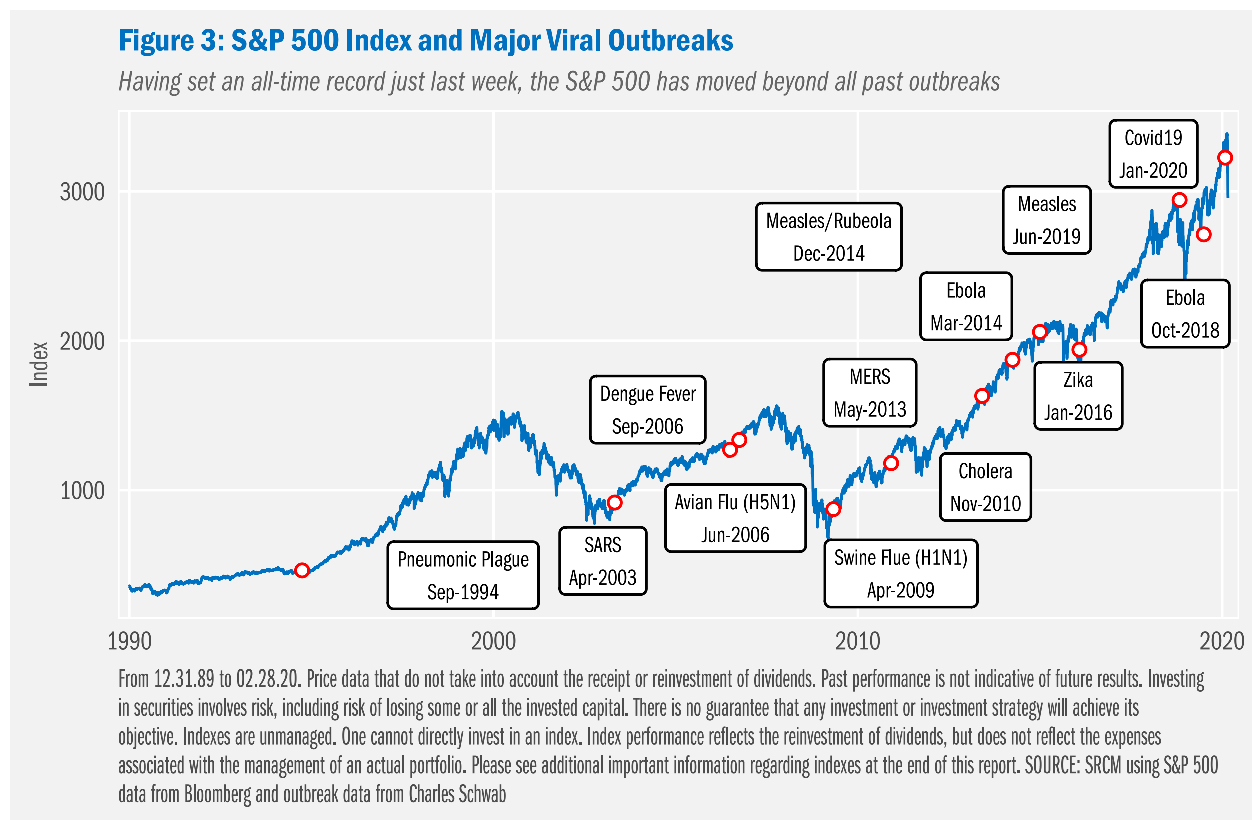
Might that mean a recession is imminent? Perhaps not, the definition widely considered to be two quarters of negative growth. But, we sit at a time among the more uncertain of the past three decades with regard to the near- and medium-term direction of the economy, and more specifically the potential ramifications of the continued spread of a highly contagious virus. The market obviously already is expressing that uncertainty, "discounting" the potential fundamental effects through a reduction in current stock prices. That is, we think recent market movement already reflects an eventual slowdown that sits somewhere between the (purposefully qualitative) modest to moderate range. The question remains as to how much more material that macroeconomic downside might get. Unfortunately, no one has a good answer to that question.

Been Here Before

Looking longer term, however, there remain reasons for calm and confidence. Reprising code that we think demonstrates U.S. Presidential irrelevance with regard to U.S. stock market performance (you'll see that chart soon enough…), we draw in Figure 3 a range of historical outbreaks against U.S. stock performance. Note that just before this latest decline, the S&P 500 reached a record high. So, the U.S. stock market has more than persevered through every outbreak that has ever occurred, outside of the latest.

Figure 3: S&P 500 Index and Major Viral Outbreaks

Having set an all-time record just last week, the S&P 500 has moved beyond all past outbreaks



From 12.31.89 to 02.28.20. Price data that do not take into account the receipt or reinvestment of dividends. Past performance is not indicative of future results. Investing in securities involves risk, including risk of losing some or all the invested capital. There is no guarantee that any investment or investment strategy will achieve its objective. Indexes are unmanaged. One cannot directly invest in an index. Index performance reflects the reinvestment of dividends, but does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using S&P 500 data from Bloomberg and outbreak data from Charles Schwab

Brighter Sides to Ponder

Terrible as the COVID-19 outbreak has been and will continue to be for many, it demonstrates that the world very obviously remains well unprepared for a more lethal pandemic. The test that COVID-19 is providing may help national and regional governments to establish firmer emergency-level preparedness for the next, potentially far worse outbreak.

Meantime, it's is a good thing that we are having such raucous debates about balance with regard to individual freedom and well-being, future macroeconomic growth, environmental impact and social propriety, no? *Not* talking about them surely doesn't help, and the debate should foster gravitation towards a more central path.

Finding a Foundation

Market activity today seemed well representative of the struggles investors are having determining whether the recent declines are sufficiently negative to reflect the likely continued macroeconomic pressures the virus will create. Down more than 4% off the bat, only to quickly gain most of that ground back, it fell anew, rebounded and dropped again to be off more than 3.5% right before the close, at which point the S&P bounced back to just under its highs for the day. With the index ending the day down 0.82%, that's a lot of sloshing about for one day. But it also shows investors continue to adjust to new information, setting fresh details against past expectations and balancing nearer-term caution with longer-term potential.

And so should work our discussions regarding our abilities to tolerate market tumult and our desires for the potential longer-term wealth to be obtained through investing. Does the threats that COVID-19 presents mean we should alter the approach we have chosen to incorporate into our longer-term financial plans? Perhaps, but we think solely to the extent that your comfort with market volatility has changed. As we so often have noted on these pages, such risks are ever present. That they *might* happen should be seen as no different than the fact that they *may be* happening.

Even so, if the evolving risks of the virus present sufficient cause for an adjustment to market exposure among your portfolios, we welcome those discussions. Please reach out to your advisor as desired, whether your comfort with market risk has weakened in some permanent way, or conversely if you wish to take advantage of the market drawdown to increase market exposure. Call, too, if you simply want an update on how your portfolio has evolved through the recent market tumult.

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