Market **Insights**

Economy | **Capital Markets**

Q1 2020

Economy

John F. Kennedy once said, "the symbol for crisis is composed of two characters. One represents danger and the other represents opportunity." Today, we are dealing with the danger; in the future, there will be plenty of opportunities. The crisis from the Coronavirus outbreak on our economy and capital markets are both historic and unprecedented. Never has one event virtually shut down economic activity and altered our daily lives. Not only domestically, but in major developed economies around the world. While the safety of all citizens is the top priority, major sectors of the economy could be severely impacted for months as this global pandemic plays out. It is unclear whether most companies have the financial flexibility to survive. The Federal Reserve (Fed) along with the federal government have taken some action to try and quell the potential financial disaster ahead for both companies and employees, but more action is expected. It is still too early to know whether these actions will be enough to halt the economic and financial market slide. Collectively, our society will find a way through this situation, but our reality has changed. Many personal and economic obstacles lie ahead. As this unfolds, we are analyzing the constantly changing information and taking appropriate action in client accounts. Our primary goal is to protect client capital as best we can in these extremely turbulent times.

Prior to the Coronavirus outbreak and ensuing economic tsunami, the economy was in pretty good shape. The nation's unemployment rate had fallen to a 50-year low of 3.5%, jobless claims were minimal and wage growth had finally started to accelerate. The manufacturing sector was rebounding a bit from its recent slump, and new housing starts were accelerating. This has now all changed. Economic activity has come to a crawl as most states impose measures to slow the spread of the virus. Schools, bars, restaurants and other non-essential businesses have been severely curtailed for the next several weeks, if not months. While still unclear, the economic fallout is expected to be massive and most certainly lead to a recession. Early estimates indicate a fall in Gross Domestic Product (GDP) of close to 10 percent or more for the second quarter. Assuming the effects of the virus subside by summer, the final two quarters could see a huge rebound in the economy and, hopefully, a return to business as usual. But, like everything, we need to take a wait-and-see approach.

Amidst this social and economic upheaval, the Fed has taken dramatic steps to aid both the economy and capital markets. They cut interest rates to zero and increased their balance sheet by about $700 billion in order to purchase U.S. Treasury bonds and mortgage-backed securities. They have become the lender of last resort with virtually no limits on the amount they are willing to commit to stabilize the financial system. The federal government also stepped in to help individuals and businesses impacted from the effects of the virus. The U.S. Treasury is poised to send out a one-time payment of around $1,200 within weeks to all citizens. Further, congress recently approved a massive stimulus package of around $2 trillion to keep businesses afloat and pay workers during this nationwide lockdown. Governments and central bankers around the world have joined in to support their economies and capital markets. The European Central Bank (ECB) announced a new $700 billion Pandemic Emergency Purchase Program to purchase securities to help support the European economy. The Bank of England (BOE) cut interest rates to 0.1 percent and increased their bond buying program to $750 billion. Other central bankers around the world have taken similar action to try to halt the economic and capital market slide. The depths and uncertainty of this crisis can't be underestimated or minimized.

As these events unfolded, the volatility in the capital markets became historic. The S&P 500 Index fell 23.5% from its mid-February high. By certain measures, this was the quickest decline into a bear market in the market's history. Small- and mid-cap indices have declined close to 31% from their highs and are back to levels not seen in about five years. International stock markets were also hit extremely hard, as their economies wrestled with the virus. In bonds, the highest quality ones held up the best, while investment-grade and high-yield corporate bond prices fell very hard. Investors rushed to sell financial assets for the safety of cash amidst extreme social and economic uncertainty.

What action have we taken? First and foremost, we are long-term investors. That has not changed. We believe that while markets can be volatile over short periods of time, over the long term, markets tend to rise. However, during extreme market conditions, we believe immediate action may be appropriate for client accounts. In early March, we thought both the economy and capital markets would continue to fall as a direct consequence of the virus outbreak. At that time, we reduced equities across client accounts, along with a slight reduction in a bond fund and held an extraordinary amount in cash. In general, we raised about 25-30 percent in cash for clients. This was not an emotional reaction, but one based on our assessment of the unprecedented situation and our view that risk assets, such as stocks, would continue to suffer until the federal government and the Fed flooded the system with money to save the financial system. By the end of March, the government and the Federal Reserve did just that. They agreed on massive stimulus packages to help individuals, corporations and the financial system during this dire period. Investors are now assessing whether this will be enough. Given this new information, we are assessing when it might be appropriate to reallocate client cash into the capital markets.

In this extremely uncertain and historically unprecedented period, we are singularly focused on your long-term financial health and protecting your assets. We are also keeping an eye on when opportunities might present themselves. As a nation, we will rise to the occasion and work through this crisis. It will take time, with many sacrifices along the way. We are eternally grateful for your continued confidence and trust in our firm.

Capital Markets

Stocks declined dramatically during the quarter from the direct economic impact of the Coronavirus. Most fixed income markets also declined, while the yield on the 10 year U.S. treasury yield fell. The Federal Reserve lowered interest rates which helped to stabilize the markets toward the end of the quarter.

Disclosure: It is not possible to invest directly into an index. The indices listed above are unmanaged and are not affiliated with the Advance Capital Companies.

Market Index Performance (%)
As of March 31, 2020

	1st QTR	YTD	1 Year	Annualized 3 Year
S&P 500	-19.60	-19.60	-6.99	5.09
Dow Jones Industrial	-22.73	-22.73	-13.38	4.41
Nasdaq Composite	-13.91	-13.91	0.78	10.45
Barclays Aggregate Bond	3.15	3.15	8.93	4.82
FTSE USBIG Corporate	-3.35	-3.35	5.05	4.23
MSCI World	-20.93	-20.93	-9.87	2.51

Economy from a Historical Perspective

	Latest	Average*	Definition	Comments
U.S. Unemployment Rate	3.50%	6.00%	**Represents the number of unemployed persons as a percent of the labor force**	Expected to spike higher
Consumer Price Index	2.30%	4.00%	**Represents changes in prices of all goods and services purchased for consumption**	Trending modestly lower
U.S. Capacity Utilization	77.00%	80.20%	**The greatest level of output that a plant can maintain within the framework of a realistic work schedule, accounting for normal downtime**	Trending lower
Gross Domestic Product+	2.10%	2.80%	**Total value of all goods and services produced indicates strength or weakness of the economy**	Low and expected to fall
10 Year Treasury Yield	0.70%	6.25%	**Yield on the current 10 year treasury bond**	Historically low
Annual Housing Starts	1,599,000	1,432,000	**New privately owned housing unit starts annualized rate**	Modestly higher, but expected to fall

*Average from 1966 to Present + Annualized *Source: Bloomberg*

Disclosures: Investments are not insured, and may lose money. Client should be prepared to bear the risks associated with investing.

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