FROM THE DESK OF BOB CENTRELLA, CFA *April 7, 2020*

FIRST QUARTER REVIEW & 2020 OUTLOOK

First, I want to offer my wishes for good health and safety to you and your families. It's been an unreal 30+ days since the virus took hold here in the States and something that none of us have ever experienced. Life will be permanently altered even when this virus passes. Although it has been hard to stay cheery in these times, I will say I've never seen so many emails, texts, videos, memes from people with jokes, pictures, etc. to provide some humor.

Needless to say, we've also never seen anything like what's been happening in the financial markets. During March, the S&P 500 averaged a daily move of 5.2%! Generally, it is less than 1%. That is incredible volatility for the world's largest market. Let me quickly give some of the firsts:

- The market was down the first 3 months in a row of the year – this has happened only 5 times in history, with the last time being 2008 (the S&P has ended those years down 12% on average)
- This was the worst Q1 ever (-20%) and worst month (-12.51%) since the 2008 financial crisis for the S&P 500
- For the Dow, it was the worst first quarter ever in its history and worst quarter since Q4-87
- From the high of 3,386 reached on 2/19, In 18 days during February/March the S&P gave up the 42% gains of the last 3 years when it bottomed at 2,237. (We've since rallied 17% from there as of today.)
- The yield on the 10-yr UST closed at .67% down from 1.92% at the beginning of the year

And I could go on and on, but I think we all have lived it and understand the severity of the past 45 days since this all started. One market commentator made a great analogy towards baseball – to paraphrase " if the economy were a baseball team, basically all our bats were taken away and now we are batting zero"!

ECONOMY

It is a good thing that the economy was humming along, and unemployment was at 3.5% because we went into this in a much stronger position than in previous crisis'. This is not a financial crisis it is a health crisis that has led to forced economic stoppage. A record 6.6 million Americans applied for unemployment benefits last week, up from 3.3 million the week before – claims had been averaging about 200K for the last several years. That is 6% of the workforce in the past 2 weeks, and it is going to get worse. The jobless rate is expected to go to 10%+ in April. On the plus side, the Federal Reserve acted very quickly in basically lowering rates to zero and has indicated it will do whatever is necessary to save the economy from a depression. The Fed will add trillions of dollars in liquidity & credit to keep markets from collapsing. On the government side, a $2 Trillion rescue package is in the process of being implemented. All total the fiscal and monetary stimulus could reach $6 Trillion. All these things will do well to help but the only thing that will stop a collapse is stopping the virus itself. We will be in a forced recession, likely for 2 quarters. But this is not a recession in the normal sense. The debate is, will the recovery be quick or prolonged? The economic numbers we will see for the next several months are going to be awful. GDP could decline 20%+ as everything has come to a halt. This we know. But as the virus recedes, will the economy bounce back sharply, a V-shaped recover, or will it be prolonged – a U-shaped recovery. The bearish view would be an L-shaped recovery where it takes much longer. This seems less likely, but anything can happen. Life will not return to normal – there will be a new normal. It will also take time for people to be comfortable going out into crowds again. The game changer will be when a vaccine or antibody is produced that will halt the virus. And there are many companies pursuing one. This will bring back normalcy.

STOCKS, BONDS and OTHER ASSETS

There were not many places to hide in Q1. As you might expect in a crisis, Treasury Bonds were a place of sanctuary with long term bonds advancing double digits as rates declined. The bond aggregate index was up 3.10%. But many other fixed income-like assets like convertible bonds, preferred shares and high yield funds declined 12% to 15% as investors steered clear of credit risk. Gold, generally a safe haven in turbulent times, gave a positive return rising 3.6%. Somewhat surprisingly and ironic, China, where the virus originated, saw its market only decline 12.65% and other Asian markets outperformed with low teens declines. In the US, the S&P 500 declined -19.43% while the Dow dropped 22.61%. The Nasdaq held up decently on a relative basis dropping 10.26% as large tech stocks with big cash hordes outperformed. Here's a list of returns (or lack thereof for the past quarter).

Asset Class Performance March, Since 2/19, and YTD - Total Return (%)

US Related			Since		Global			Since	
ETF	Description	March	2/19	YTD	ETF	Description	March	2/19	YTD
SPY	S&P 500	-12.46	-23.35	-19.43	EWA	Australia	-22.76	-32.73	-31.36
DIA	Dow 30	-13.61	-25.02	-22.61	EWZ	Brazil	-38.58	-46.34	-50.35
QQQ	Nasdaq 100	-7.29	-19.48	-10.26	EWC	Canada	-20.80	-29.01	-26.90
IJH	S&P Midcap 400	-20.26	-31.01	-29.70	ASHR	China	-9.38	-10.38	-12.65
IJR	S&P Smallcap 600	-22.55	-32.53	-32.77	EWQ	France	-18.98	-27.61	-28.34
IWB	Russell 1000	-13.35	-24.33	-20.24	EWG	Germany	-18.08	-27.19	-26.94
IWM	Russell 2000	-21.48	-31.77	-30.65	EWH	Hong Kong	-13.19	-17.19	-18.04
IWV	Russell 3000	-13.67	-24.75	-20.91	PIN	India	-23.36	-29.30	-29.27
					EWI	Italy	-23.75	-31.74	-29.59
IVW	S&P 500 Growth	-10.29	-21.37	-14.49	EWJ	Japan	-6.74	-14.07	-16.63
IJK	Midcap 400 Growth	-16.99	-27.66	-24.83	EWW	Mexico	-31.88	-40.39	-37.04
IJT	Smallcap 600 Growth	-20.13	-30.27	-28.48	EWP	Spain	-22.71	-30.98	-29.74
IVE	S&P 500 Value	-15.29	-26.06	-25.35	RSX	Russia	-21.95	-33.33	-33.20
IJJ	Midcap 400 Value	-24.40	-34.91	-35.12	EWU	UK	-18.50	-27.35	-29.97
IJS	Smallcap 600 Value	-25.76	-35.33	-37.50					
DVY	DJ Dividend	-19.13	-29.63	-29.46	EFA	EAFE	-14.11	-22.51	-23.01
RSP	S&P 500 Equalweight	-17.97	-28.48	-26.65	EEM	Emerging Mkts	-15.77	-22.84	-23.94
					IOO	Global 100	-9.81	-20.70	-17.20
FXB	British Pound	-3.10	-3.84	-6.21	BKF	BRIC	-15.53	-22.07	-21.36
FXE	Euro	-0.19	1.93	-1.88					
FXY	Yen	0.30	3.34	0.87	DBC	Commodities	-17.34	-24.50	-29.47
					USO	Oil	-55.45	-62.34	-67.14
XLY	Cons Disc	-14.91	-25.49	-21.42	UNG	Nat. Gas	-4.20	-17.87	-25.56
XLP	Cons Stap	-5.51	-15.04	-13.00	GLD	Gold	-0.22	-2.46	3.60
XLE	Energy	-34.27	-45.75	-50.44	SLV	Silver	-15.97	-24.26	-21.76
XLF	Financials	-20.99	-32.52	-31.75					
XLV	Health Care	-3.86	-14.42	-12.59	SHY	1-3 Yr Treasuries	1.24	2.19	2.72
XLI	Industrials	-18.60	-29.29	-26.98	IEF	7-10 Yr Treasuries	3.72	7.20	10.50
XLB	Materials	-13.97	-25.05	-26.15	TLT	20+ Yr Treasuries	6.38	13.53	22.15
XLK	Technology	-8.57	-21.40	-11.86	AGG	Aggregate Bond	-0.53	1.05	3.10
XLC	Comm Services	-12.60	-22.95	-17.28	BND	Total Bond Market	-1.43	0.16	2.20
XLU	Utilities	-9.95	-20.25	-13.35	TIP	T.I.P.S.	-1.76	-0.70	1.27

All 10 sectors in the S&P 500 declined in the quarter with 5 of 10 falling over 20%. The Energy sector was the worst down 50% followed by the Financials down 31.75%. The best performing sectors were Technology, HealthCare, Staples and Utilities. Growth stocks widely outperformed Value stocks and large caps did better than Mid and Small Caps. The US stock market outperformed most international markets. Oil was the worst asset class and declined sharply by 67%, including 25% in 1 day, as Russia and Saudi Arabia decided this would be a good time for a spat over pricing and production. Demand also fell off a cliff as world economies came to a halt.

So why are stocks getting slammed so much? Let's revisit our Finance 101 lesson – remember that the tendency over time is for stocks to beat bonds in return. The average long-term return on stocks being about 9.5% while about 5.5% for bonds. This tendency is called the "equity risk premium" or the premium over the risk-free rate of return. **This premium comes with increased risk and sometimes that risk comes due**. In this case and in other times of crisis, that means stocks decline sharply while bonds hold their value. Stocks don't always go straight up and at times enter bear markets to remind us of the risk. Technically we are now in a bear market (down 20%). The fastest bear market ever occurring in 23 days.

Where we go from here is hard to determine. There are several possible paths the market can follow. All of it depends on when the economy resumes and returns to growth. The sooner that happens and the sooner companies and employees get back to work, the more likely we start the recovery. For now, I believe we will continue to see volatility in stock prices up and down. We will see good days and we will experience lousy days. There are still a lot of unknowns. It's impossible to call a bottom but if you believe in the Finance 101 lesson that stocks outperform bonds over the long term, then now is still a good time to be owners of equities – assuming the virus is halted and life eventually goes on.

What happens soon is that companies will start reporting Q1 earnings and attempt to provide an outlook. The results are likely to be bleak for most companies. Economic numbers will also be pretty bad as the depth of the economic stoppage takes effect. The market has been discounting a lot of this with its decline. Again, I don't know if we hit a bottom, but I believe that we are in the ballpark. Could we retest the lows? Sure, but at this point I think any retest would be shallow and a rally would follow – again, assuming the virus slows and is halted.

CONCLUSION

Usually this is where I give my outlook and recommendations on what I like. In the pre-corona days, I preferred equities to bonds but recommended both in a balanced account. I also preferred investing in the US to international. I thought we would get a 5-10% correction during 2020 but that was quickly surpassed and now we are technically in a bear market. Since it is tough to call the bottom (but again I think we are in the ballpark), one must take a view of where do we think markets will be 1,3,5 years from now regardless of where the actual bottom is. I'm going under the assumption that the virus will be arrested in coming months and in 2021 we will have a vaccine. Under that scenario, I believe that equities will outperform 1,3 and 5 years from now under normal circumstances. But we do have an election coming in November I'm sure I don't have to remind you. And depending on that outcome, a lot can happen again. So, for 2020, I have to remain cautious (but still long-term optimistic) on stocks but want to continue to own quality companies. It's a great time to prune the portfolio and upgrade the quality of what you own. If you can own a higher quality company at a similar price as less quality, consider making the swap. Be careful of ultra-high dividend yields as many companies will have to halt payments for a while. I believe that stock picking is important and can provide an edge over just owning the market. Equities are still off by 20%+ from their highs. You don't want to miss the rebound by being in cash. If you panic sold or have cash, start getting back in especially on the days where the market is down. As for bonds, I don't see the Fed able to raise rates for the foreseeable future. The 10-Yr UST only yields .69% and short-term bills yield under .20%. Bonds can provide capital preservation, so owning bonds will not offer much in income but some stability. Stick with short to intermediate investment grade bonds and treasuries. If buying convertible bonds or High Yield, you must be careful of what you own. Gold is a great store of value and a hedge against a crisis so it should be a part of any portfolio. Finally, regarding international stocks, I continue to prefer to own US. You can own a small percentage for diversification, but I'd keep it under 5%.

Praying you and your family stay safe and healthy. Feel free to give me a call or drop me an email at any time to discuss.

Bob