Clear Point
ADVISORS INC

Quarterly Commentary

First Quarter 2020

Investment Commentary

Elated investors with 20% to 30% rises in the 2019 stock portions of their portfolios were dealt a most serious setback this quarter when the economic activity froze in response to the COVID-19 pandemic. The bull market that began in March 2009 abruptly hit the emergency brakes during early March that precipitated a decline of 34% from its peak. After an 11-year run, the Dow Jones Industrial Index went from its high on Feb 12th to bear market territory in only 19 trading sessions.

Equity markets experienced volatility in March not seen since the 1930s, with daily declines so sharp that rarely-used "circuit breakers" were activated by the exchanges to halt trading on multiple occasions. The S&P 500 Index saw an average daily change of 5.2% in March, the most extreme volatility since November 1929. The Dow had its worst quarter *ever*, marked by daily declines exceeding 10% on a few trading days. Short-term expectations of stock market volatility, as measured by the VIX "fear" index closed at an all-time high in its 30-year history on March 16. The market's actual realized volatility has only been higher back in October 1987 (Black Monday) and during the late 1920s.

When the dust settled, the S&P 500 Index dropped 20% for this first quarter, while the Dow surrendered 23%. International stocks as measured by the EAFE index also declined 23%. Small- and mid-cap stocks fell even more.

The CARES Act

With the coronavirus continuing to wreak havoc on individuals, small businesses and economies worldwide, governments are confronted with an unprecedented and uncharted environment. In response, massive fiscal and monetary stimulus efforts set in motion by the Administration and the Federal Reserve have been put in place to provide unparalleled economic relief and stimulus.

The passage of the bipartisan $2.2 trillion stimulus plan, known as the Coronavirus Aid, Relief and Economic Security Act (CARES Act), is providing critical funds to various sectors of the economy in the form of payments, tax breaks, loans, and subsidies to individuals and small businesses.

As the largest economic relief package in U.S. history, the $2.2 trillion stimulus plan equates to 9% of GDP, which is roughly $21 trillion. The primary goal of the stimulus program is to alleviate personal and business bankruptcies brought about by government-mandated shutdowns and restrictions.

Fixed Income Markets

On March 3, the Fed made an emergency rate cut of 0.5%, its biggest single cut in more than a decade. This decisive action was taken as a pre-emptive move to protect the economy from the financial impact of the coronavirus. The Fed saw it necessary to act again on March 15 when it dropped rates effectively to zero and announced a program of quantitative easing. This round of QE entails the purchase of Treasuries and mortgage-backed securities to the tune of $700 billion.

In the midst of the equity mayhem during mid-March, a surge in demand for short-term government bonds outstripped the supply of Treasury bills. The Fed action helped to stem what was becoming a stampede to exit bonds, including the bonds of high quality issuers, earlier in March. (After the end of the quarter, The Fed doubled down and announced an additional $2.3 trillion facility to help support high yield bonds of solvent companies and other debt including municipal bonds.)

Worst Month in Years for Oil

To add to the economic woes, oil prices collapsed when Russia and Saudi Arabia failed to reach an agreement on supply. When negotiations broke down we saw a potential increase in oil production at a time when demand fell worldwide due to the virus outbreak. Oil markets experienced extreme volatility as prices fell to their lowest levels since 2002, tumbling to $20.37 (WTI) on March 16th, then rebounding 25% on March 19th, the largest one day rise in oil's history.

In an aggressive attempt to capture market share from Russia, Saudi Arabia dropped their oil prices and ramped up supply to over 12 million barrels a day, 2 million more than previous supply levels. The newly launched oil price war couldn't have come at a worse time and cratered global stock markets with the largest one day decline since 2008. (A deal was just reached to cut production by 9.7 million bbl daily.)

Many oil industry analysts believe that both Russia and Saudi Arabia are trying to dislodge and eliminate U.S. producers by inhibiting their margins and drive them out of business.

U.S. oil drillers and producers have proven to be flexible regarding their production. This has enabled them to be resilient and weather price manipulation efforts in past years. The current situation will be more difficult for many energy companies to navigate, due to the added problems created in the economy by the pandemic.

"V, W or L" Shaped Recovery?

It is too soon to determine what the full impact of this crisis will be. Personal and business bankruptcies are expected to rise dramatically as a result of government mandated shutdowns that have arrested income for employers and employees across the country. A historical spike in unemployment claims of nearly 10 million was brought about by mass layoffs as governmental entities mandated business closures and restrictions across the country. The immense jump in unemployment claims over just two weeks worsened with another $6.6 million Americans losing their jobs as of this writing, bringing the number of total unemployed to more than 16 million Americans.

With the massive stimulus plans now in place, the market's recovery has become contingent on the virus timeline for containment and widespread effective testing. Analysts expect that once the virus outbreak has abated, the leveling of the curve may provide an opportunity to look forward to the gradual reopening of the economy.

In spite of the expected economic damage and the sharp declines seen during March, the market staged a strong rally following the enactment of the $2 trillion CARES Act passed on March 23. At the time of the Easter holiday weekend, the market had recovered more than half of the losses from its low point before CARES. The positive momentum has continued based on the belief by some investors that the valuations of stocks may have fallen to levels that warrant the accumulation of stocks. Does this represent a bounce from a true market bottom? The premise will soon be tested as the announcement of corporate earnings and forward guidance are presented over the next few weeks.

Economists and market analysts note that this is a health crisis at its core, not a financial crisis as was the case in 2008. Atlanta Fed President Raphael Bostic said that "this is a public health crisis and different from a typical recession". Given the level of relief and stimulus that is being provided and that yet may become available, Dallas Fed President Robert Kaplan commented "we've got a great chance to come out of this very strong."

Portfolio Diversification

We diversify across asset classes including equities and fixed income knowing that there will always be leaders and laggards in your portfolio. A portfolio mix is intended to help build resiliency and protect a portfolio through diversification, rather than betting on a single outcome that can produce a harmful financial result if it doesn't work out.

Historically, our fixed income holdings have bolstered our accounts to blunt the zigs and zags of the equity markets during periods of volatility. The extreme uncertainty and fear of a deep recession hit most fixed income strategies hard this quarter, reminiscent of the 2008 financial collapse. Bonds that assumed higher level of credit risk suffered the most, but most all bonds participated except for short-term government bonds and money market funds. In 2008 we saw many fixed income securities suffer double-digit declines. Given that 2008 experience, we moved to reduce risk in our managed accounts this quarter by liquidating certain of our fixed income holdings in favor of the safety of more stable short-term securities. In the present case, many bonds did decline significantly before showing a level of recovery following the Fed intervention in bond markets.

We are all living through a period in history that none of us will forget. The impact on our families, communities, and country is profound. There remains great uncertainty and worry about the coronavirus and its impact: How long will it last? When will markets and the economy stabilize? While we cannot predict a timeline, our belief continues to be that this crisis will resolve and the economy will heal over time. Though there may well be more challenges along the way, we will be here to talk with you about your situation and help chart an appropriate course. Be careful, keep distance and we'll get through this together!

Best Regards,

Clear Point Advisors