NEW MARKET WEALTH MANAGEMENT

Toilet Paper and Hand Sanitizer

Capital Markets Review
First Quarter 2020

Be Prepared! The Boy Scout motto since 1910. Unfortunately, the global Coronavirus pandemic of 2020 has caught everyone off guard and ill-equipped to confront the crisis. No business or government was prepared for the rapid pace and depth of the effects from this health and economic calamity. Who among us could have envisioned our society in a viral lockdown, contemplating ways to find additional toilet tissue or researching methods of making homemade hand sanitizer because of its scarcity on store shelves? Did we need a reminder that we are more connected globally, physically, electronically, or pathologically than in any time in human history? Indeed, we are experiencing a remarkably different sort of “global war.” The question we must ask ourselves is, how does this effect investors and what actions should be taken?

The profundity of the physical and economic misery from COVID-19 has astounded us all. Information and data are changing at a blistering pace. As of the first week in the second quarter, Johns Hopkins University is reporting 1,339,970 cases and 74,410 deaths worldwide. The US has 2.5x more cases than any other country with 362,995 along with more than 10,000 deaths. Sadly, by the time you read this, all of those figures will surely have increased. In the US, at least one-quarter of the economy has suddenly gone idle amid the pandemic. Moody’s reports that 8 in 10 US counties are under lockdown orders representing nearly 96% of national output. Many large and small businesses have been forced to stop, or significantly slow, business operations resulting in unprecedented layoffs. As a result, nearly 10 million people have filed for unemployment insurance in just the last two weeks. Government operations have also been impacted. Barron’s reports that Federal income tax withholdings were down 10% in the last two weeks of March from the total a year earlier and state tax-collection forecasts were down 73% from February.

Naturally, all of this woe and uncertainty effected the capital markets as investors experienced alarming declines in asset prices during the quarter. From their peak, US, international developed and emerging market indices were down -33.8%, -34.4% and -33.7%, respectively. The asset selloff was not limited to stocks during this period of investor risk avoidance—irrespective of financial wisdom or perspective. Crude oil prices were down -54% in March and -66% during the quarter, reaching an 18 year low. REITs, BDCs, MLP, high yield bonds, along with other diversifying asset classes, all suffered during the quarter. This period has been defined as pure panic selling. Uniquely, we even witnessed an almost complete shutdown in trading in the municipal bond market, a traditional safe harbor, for even the highest quality credit as investors sought even more safety in a flight to cash. Yet, the losses for most balanced portfolios were indeed tempered during the quarter as diversification proved to be a reliable answer during the heightened volatility.

It’s likely that the abrupt cessation of global business operations and interruption of supply chains is going to cause a significant impact to corporate earnings. Certainly, this impact will effect Q2 earnings and probably, Q3 as well. We think it is likely the US economy will see some form of recession during the year. The length of a recession is somewhat tied to the length of the lockdown in the US. Regardless, we do not see the economy teetering into anywhere near the level of a Depression, defined as two or more years of severe economic contraction.

There are many factors contributing to an eventual economic recovery. The Federal government's response, while choppy at the start, has been aggressive. The Federal Reserve has said they are prepared to do "whatever it takes" to provide support to the economy. US interest rates are the lowest in history. Congress passed a $2.2 trillion economic rescue package, including $350 billion in forgivable loans to small businesses, in an effort to provide immediate relief. And talk of an additional stimulus bill is already underway on Capitol Hill. There is also a global effort, with the support of almost every bio-tech related company in the world, to develop a vaccine for COVID-19 and to improve treatment. These are powerful forces at work. Entering into this period, we are also much better financially prepared to weather this economic shock. Household debt was at a historically low 96% of GDP, with the lowest household debt-service ratio since 1981. Households were saving about 8% of their income, more than twice the level of 2007. Our financial institutions are also far better capitalized than they were in the past. Banks' common equity tier one ratio, a measure of a bank's financial strength, is 2-5x higher than in 2007. US banks have $1.3 trillion in common equity and are holding almost $3 trillion in cash, a far cry from the levels seen during the global financial crisis of 2007 when the US banking system effectively became insolvent. Unemployment is also likely to evolve. While many industries are suffering, perhaps some permanently, many others will advance, take root and prosper. There are currently about 13 million Americans working in industries likely to benefit from the current disruption. Many industries are looking for additional workers. Imagine the eventual job growth in textiles, bio-tech, sanitary services, virtual meeting technology, etc. Finally, the science cavalry is on the way. Forecasts are that by the end of May, 95% of all workers will be able to receive a quick, point-of-care test for COVID-19 antibodies. It has been a historically bad idea to bet against the skill of medical research professionals in our country and will likely be again in the development of a vaccine during this healthcare crisis.

A review of difficult periods in history is also a good place to find respite and perspective. This is not the first time our country, indeed the world, has seen great loss, leaders who struggle, economic uncertainty, or lack of preparation. World War II caused an estimated 70-85 million deaths globally. The US was ill-prepared for a global war, fighting adversaries on two fronts; Europe and the Far East. In 1939, the year Germany invaded Poland, the standing US Army was a total of 190,000 troops. In 1940, the annual production of US military combat aircraft was 1,771 of which, only 46 were heavy bombers. Early in the war, US losses in Europe and the Pacific, were staggering. Our leaders lacked confidence. The country was not united as to the very notion of war as many citizens wished to remain neutral. We know the outcome. The US engine of production and manpower overwhelmed the enemy. By 1945, the US Army grew to 8.3 million men and a total of 16 million in combined services. By 1945, US production of military aircraft rose to 9 planes an hour reaching a total of nearly 75,000 for the year. Our leaders and our country united in such a way that they are now known as The Greatest Generation. In another part of our history, the Civil War, the South lost 22% of all men between 20-24 years of age. The entire agrarian economy was destroyed. By 1870, economic production in the South was 105% of peak 1859 levels. History tells us that governments, people, Americans are remarkably resilient, particularly during a unifying crisis.

We think the resiliency of US workers, healthcare professionals, and our leaders, is a positive sign for investors. There remains a lot of uncertainty, economically and regarding the virus, at this time. In times of uncertainty, the only thing we can directly control is our own behavior. While the cause of this bear market is unique, the fact that the market has declined is not. Market corrections and bear markets are natural parts of the stock market and of the investor experience. At New Market Wealth, we endeavor to understand time horizons and risk tolerances for all of our clients, anticipating that difficult markets are a part of the process. Investors should continue to expect poor economic data and market uncertainty. They should focus on remaining disciplined and ensuring their balanced portfolios match their long-term financial goals. We are here to provide assistance, perhaps just a sounding board, at any time. We understand the difficulty facing our clients. During this period, we send our sincere wishes that you and your family continue in good health.

**Performance returns and data cited above are represented by:*
US Stocks (S&P 500 Index), Developed International Markets (MSCI ACWI-Ex US Index), Emerging Markets (MSCI Emerging Market Net Index), Crude Oil (West Texas Intermediate). In addition, World War II production data comes from the Army Air Forces Statistical Digest World War II Report, and Civil War production data comes from JP Morgan.