

# NABE Webinar: Financial Turbulence in Covid Times

April 14, 2020

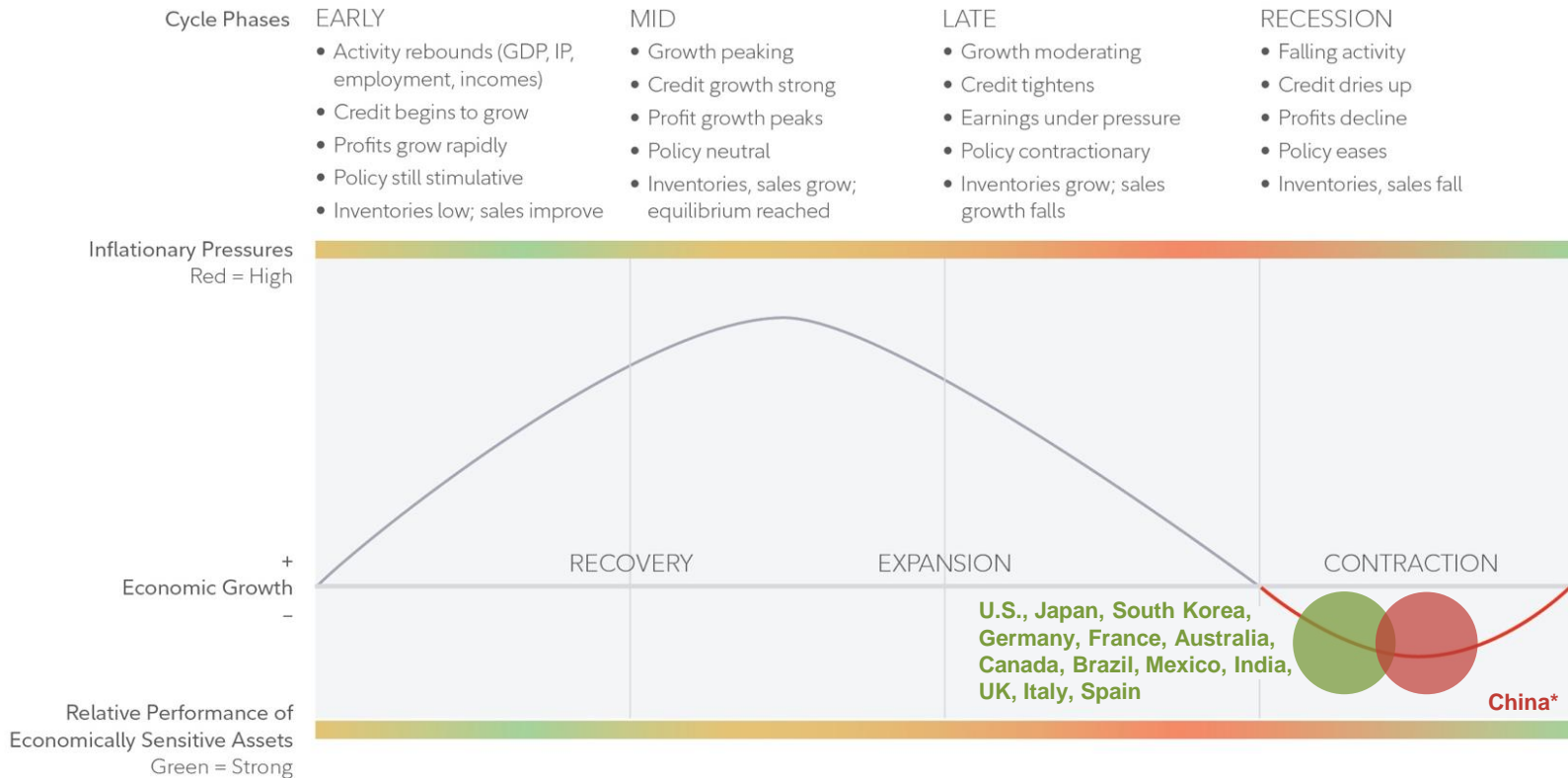
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# Unprecedented Global Recession

## Business Cycle Framework



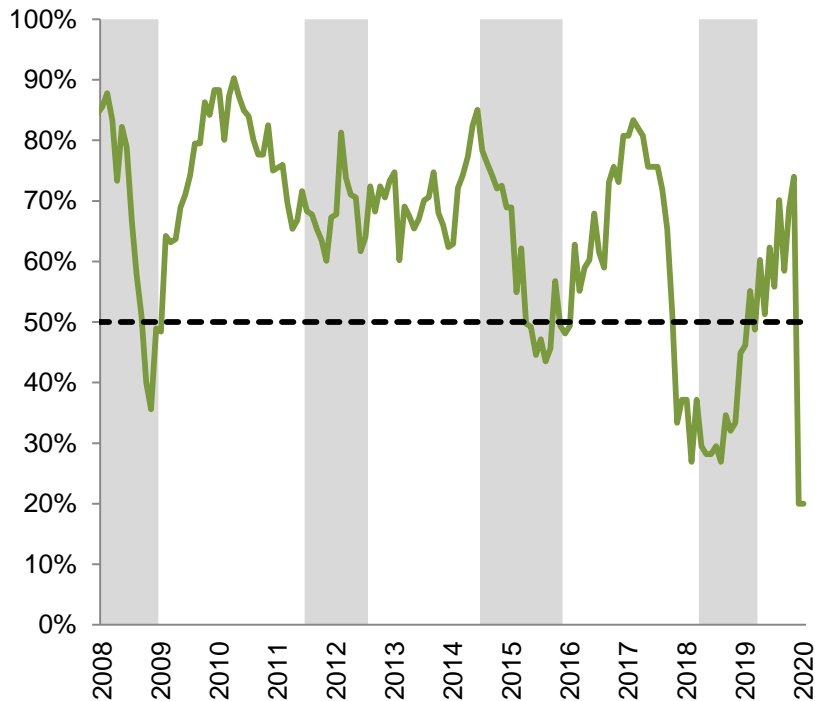
Note: The diagram above is a hypothetical illustration of the business cycle. There is not always a chronological, linear progression among the phases of the business cycle, and there have been cycles when the economy has skipped a phase or retraced an earlier one. \* A growth recession is a significant decline in activity relative to a country's long-term economic potential. We use the "growth cycle" definition for most developing economies, such as China, because they tend to exhibit strong trend performance driven by rapid factor accumulation and increases in productivity, and the deviation from the trend tends to matter most for asset returns. We use the classic definition of recession, involving an outright contraction in economic activity, for developed economies. Source: Fidelity Investments (AART), as of 3/31/20.

# China Perhaps a Leading Indicator to Developed World Path

## China Industrial Activity

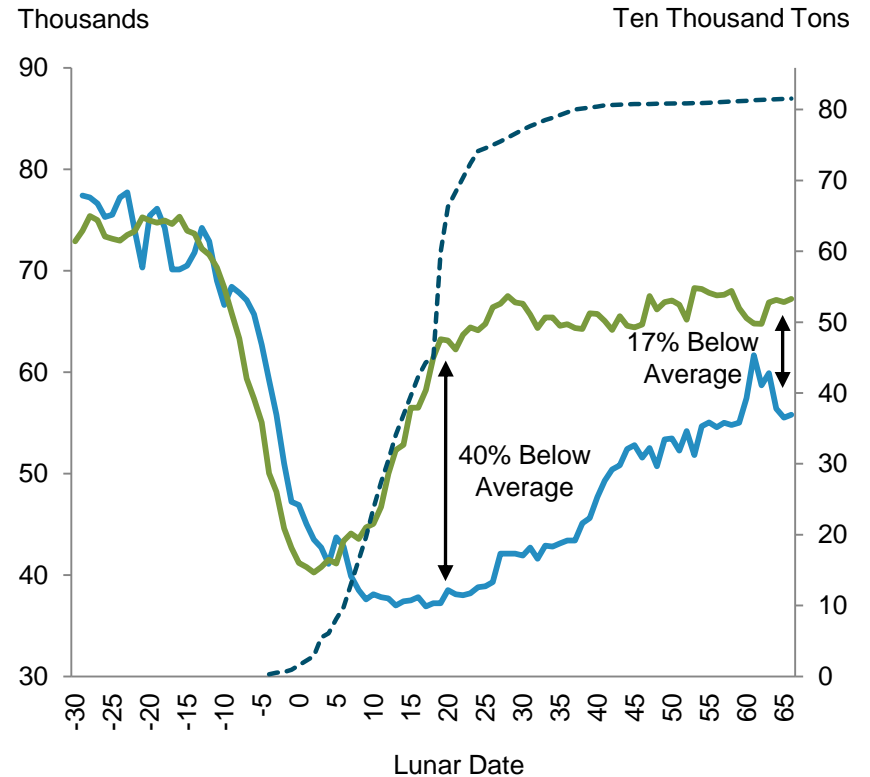
— AART Industrial Production Diffusion Index

Percent of Industries in Expansion



## China Coal Consumption and COVID-19 Cases

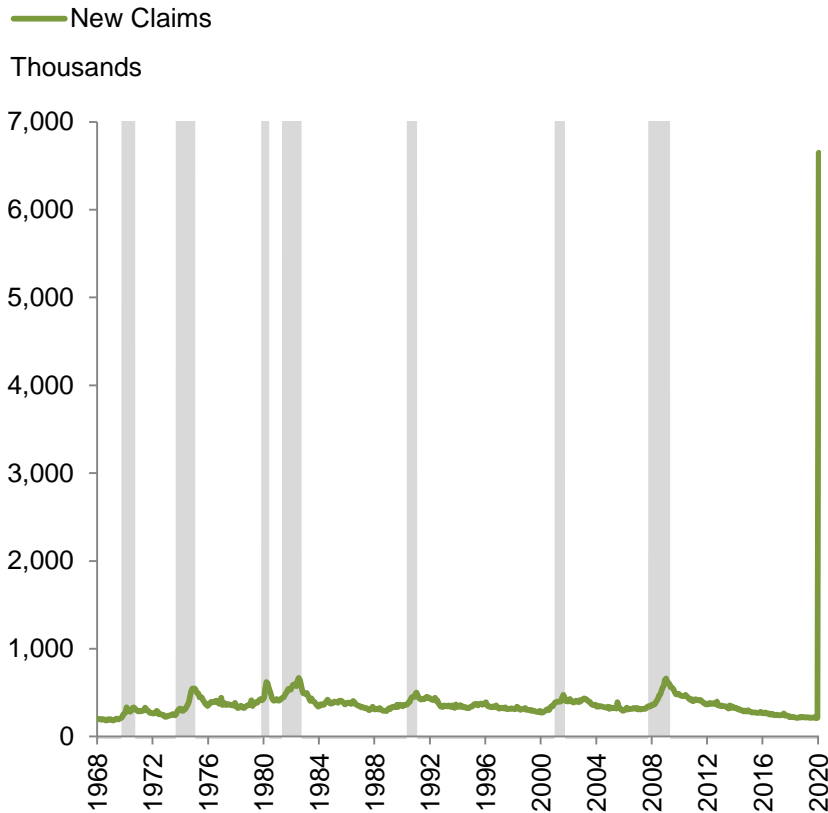
— Consumption in 2020      — Average Consumption  
 - - - Confirmed Cases



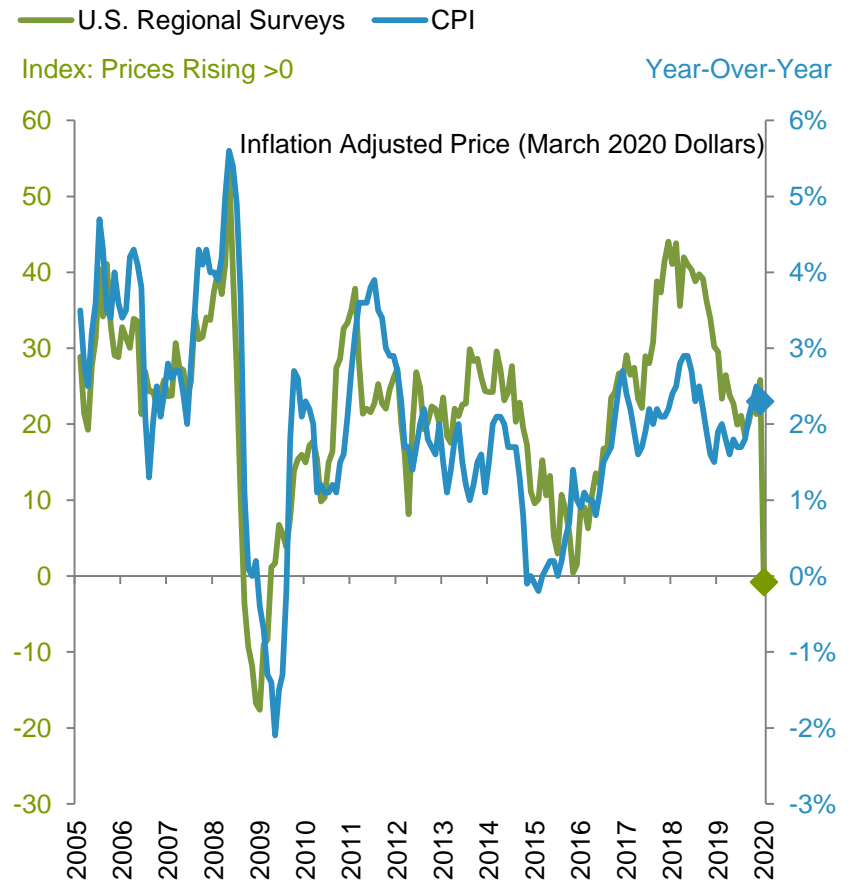
**LEFT:** Gray bars represent China growth recessions as defined by AART. Source: China National Bureau of Statistics, Haver Analytics, Fidelity Investments (AART), as of 3/31/20. **RIGHT:** The Lunar Date on the x-axis is indexed to days surrounding the Chinese New Year Holiday each year. Day “T=0” corresponds to the day of the holiday. Source: Wind, UBS Securities, Haver Analytics, Johns Hopkins University, Fidelity Investments (AART), as of 3/31/20.

# Sudden Stop on Real Activity and Inflation

## U.S. Unemployment Claims



## U.S. Inflation and Prices Received



**LEFT:** Source: Census, Haver Analytics, Fidelity Investments (AART), as of 4/2/20. **RIGHT:** CPI: Consumer Price Index. Regional Surveys are the average of the Dallas, Kansas City and Philadelphia Regional Surveys for Prices Received. Source: Federal Reserve Board, Bureau of Labor Statistics, Haver Analytics, Fidelity Investments (AART), as of 3/31/20.

# Fiscal and Monetary Bazooka

## CARES Act: Categories and Fiscal Multipliers

Category	USD (Billions)	Multiplier	GDP Impact
Cash to Individuals	290	1.9	3%
Unemployment Insurance	250	1.9	2%
Aid to State and Local Governments	150	1.8	1%
Public Health Spending	340	2.3	4%
Loans to Small Businesses	376	1.9	3%
Tax Relief for Businesses	232	0.3	0%
Targeted Industry Support	78	1.1	0%
Risk Capital for Fed Facilities	454	N/A	N/A
<b>Total*</b>	<b>2,170</b>	<b>1.7</b>	<b>14%</b>

## Federal Reserve Actions in Q1 2020

### Liquidity Injections/Bank Support

- Unlimited QE
  - Treasuries, agencies, mortgages, CMBS
- Repo with U.S. and global banks
- Swap lines and repo with global central banks
- No required bank reserves

### Expanded/Re-Launched Programs

- Term Asset Backed Securities Loan Facility
- Primary Dealer Credit Facility
- Money Market Mutual Fund Liquidity Facility
- Commercial Paper Funding Facility
  - Expanded to include short-term muni bonds

### New Programs

- Primary Market Corporate Credit Facility
- Secondary Market Corporate Credit Facility
  - Fed can purchase corporate bond ETFs
- Main Street Business Lending facility
- ESF backstop increased to \$475B

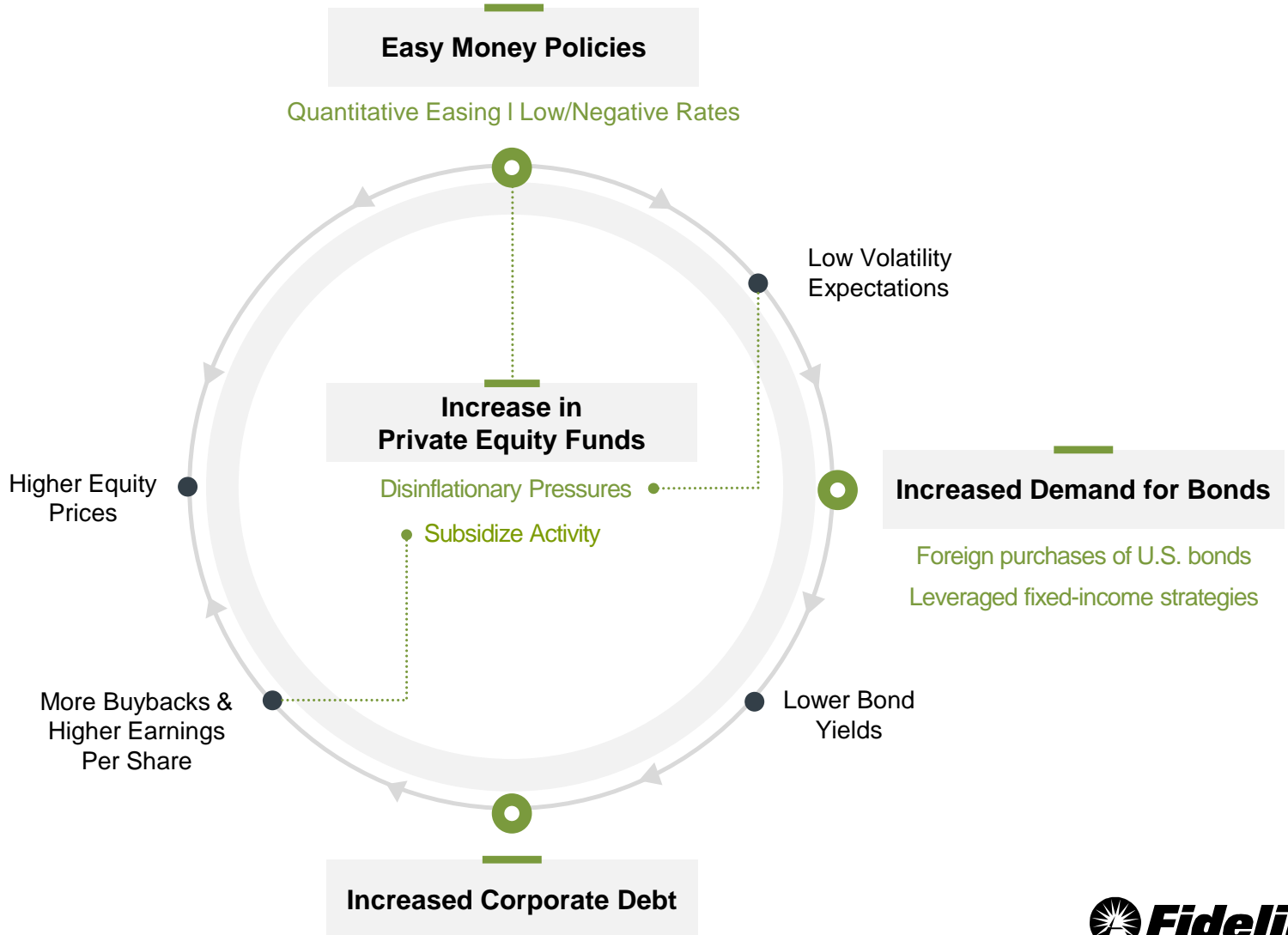
\*Total multiplier and GDP impact columns exclude \$454 appropriated to provide risk capital to support the Fed's lending facilities listed in the previous slide. While these facilities are helpful for financial conditions, their impact on GDP remains unclear. **LEFT:** CARES is defined as "Coronavirus Aid, Relief, and Economic Security." Targeted industry support assumes the average multiplier for cash transfers and tax relief. The multiplier is defined as the ratio of a change in GDP over a change in fiscal deficit. Source: Congressional Budget Office, Brookings Institution, Fidelity Investments (AART), as of 3/31/20.

**RIGHT:** QE: Quantitative Easing.

CMBS: Commercial Mortgage-Backed Securities. ESF: Exchange Stabilization Fund. Source: Fidelity Investments (AART) as of 3/31/20.

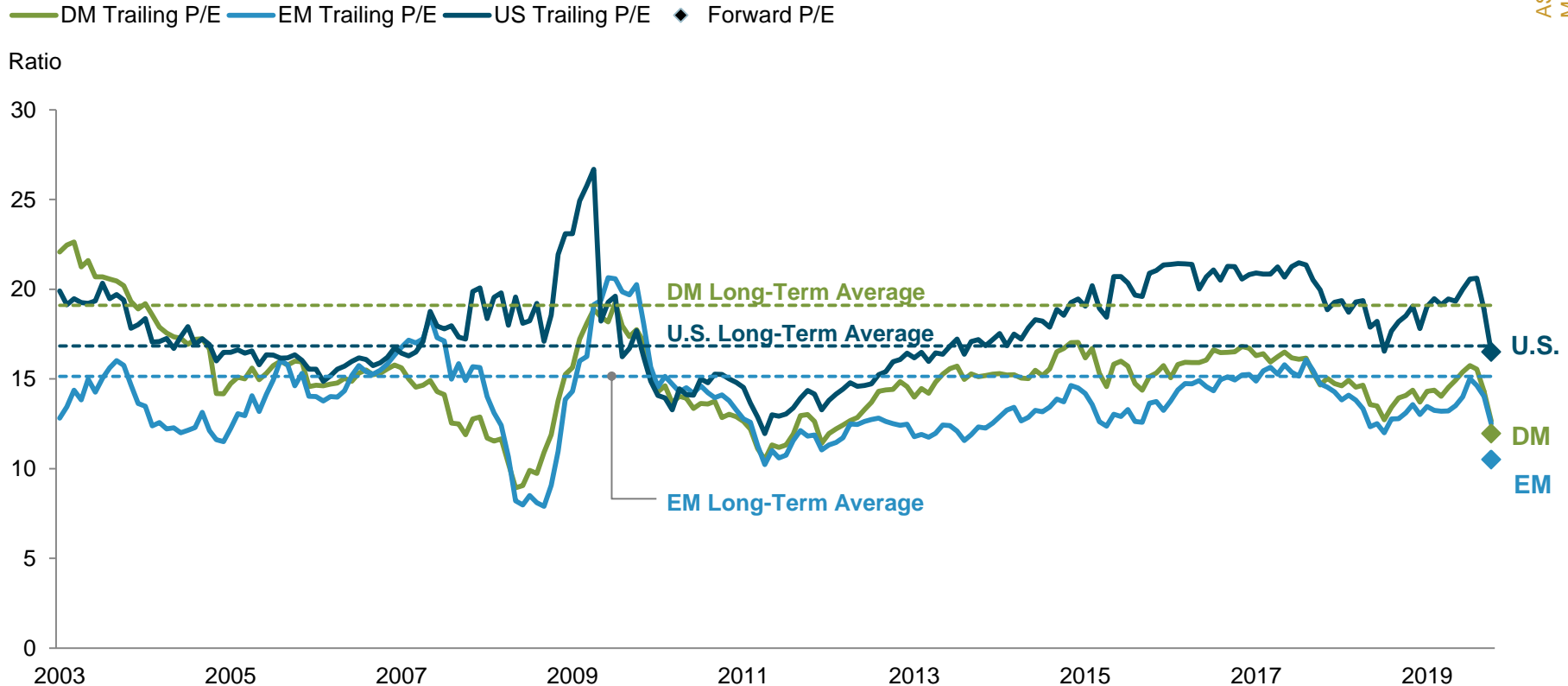


# Pre-Existing Vulnerabilities: Virtuous Cycle Upended



# Equity Valuations

## Global Market P/E Ratios



DM: Non-U.S. Developed Markets. EM: Emerging Markets. Past performance is no guarantee of future results. It is not possible to invest directly in an index. All indexes are unmanaged. See Appendix for important index information. Price-to-earnings ratio (P/E): stock price divided by earnings per share. Also known as the multiple, P/E gives investors an idea of how much they are paying for a company's earnings power. Long-term average P/E for Emerging Markets includes data for 1988–2017; for Non-U.S. Developed Markets, 1973–2016; for the United States, 1926–2017. Indexes: DM—MSCI EAFE Index; EM—MSCI EM Index; United States—S&P 500. Source: Bloomberg Finance L.P., Fidelity Investments (AART), as of 3/31/20.

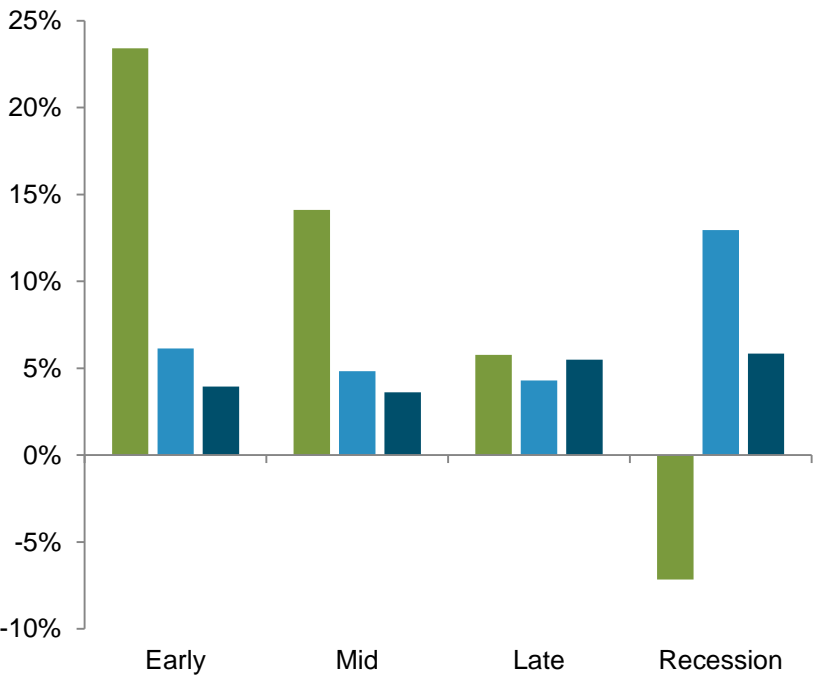


# Business Cycle Important but Medium Term Return Starts to Skew Positive in Recession

## Asset Class Performance by Cycle Phase (1950–2018)

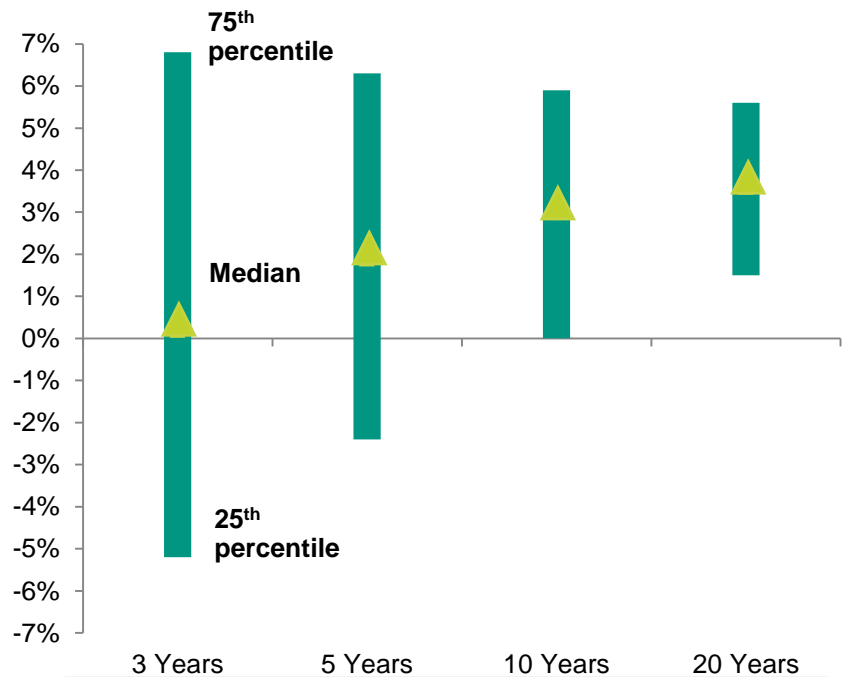
■ U.S. Stocks ■ IG Bonds ■ Cash

Annualized Nominal Return



## Portfolio Return Distribution Starting in Recession

Annualized Real Return



**Sample Portfolio: 36% Domestic Equity • 24% Foreign Equity • 30% IG Bonds • 10% HY Bonds**

For illustrative purposes only. Past performance is no guarantee of future results. Diversification does not ensure a profit or guarantee against a loss. It is not possible to invest directly in an index. All indexes are unmanaged. See Appendix for important index information. Fidelity proprietary analysis based on Monte Carlo simulations using historical index returns. Domestic Equity: Dow Jones U.S. Total Stock Market Index; Foreign Equity: MSCI ACWI ex USA Index; Investment Grade (IG) Bonds: Bloomberg Barclays U.S. Aggregate Bond Index; High Yield (HY) Bonds: ICE BofA U.S. High Yield Index. Source: Fidelity Investments, Morningstar, Bloomberg Barclays; data as of 3/31/20.





# Secular: Rising Policy and Political Risk

## Regime Shift Driven by Powerful Underlying Dynamics



Rising Populist Demands



Geopolitical Instability



Anti-Globalization Pressure



Widespread Aging Demographics

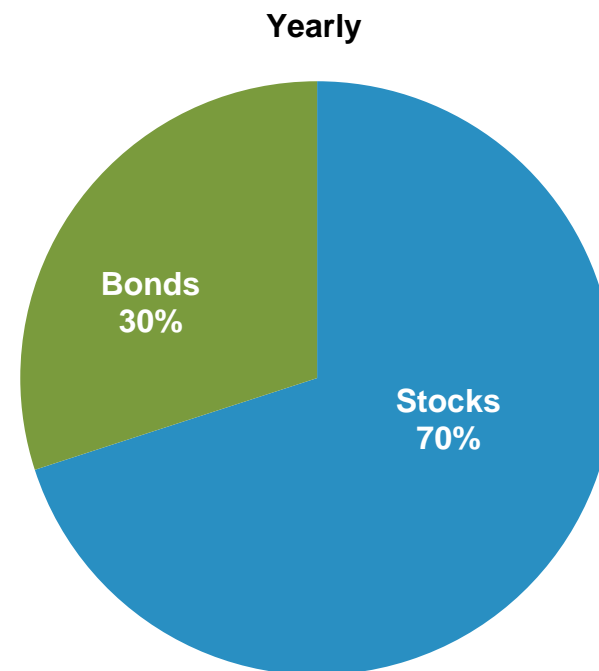
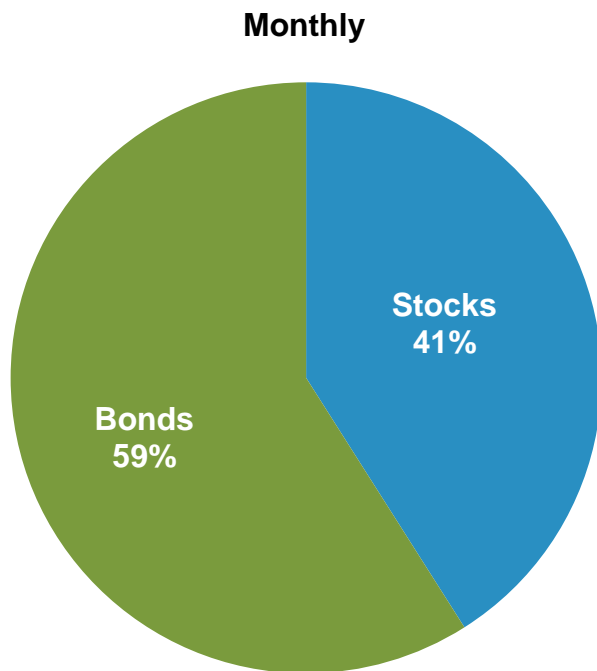


Unprecedented Accumulation of Debt

Policy Dynamic	Expected Shift
<b>Monetary</b>	<ul style="list-style-type: none"> <li>• Increased political influence on decisions</li> <li>• Sustained financial repression</li> <li>• More active role in financial markets</li> <li>• More permissive of inflation</li> </ul>
<b>Globalization</b>	<ul style="list-style-type: none"> <li>• Trade, capital, and labor flows more restricted</li> <li>• Weaponized economic measures for geopolitical ends</li> </ul>
<b>Fiscal</b>	<ul style="list-style-type: none"> <li>• More permissive of large deficits and rising debt levels</li> </ul>
<b>Regulatory</b>	<ul style="list-style-type: none"> <li>• Trend toward greater interventionism</li> </ul>
<b>Political risk</b>	<ul style="list-style-type: none"> <li>• More commonplace in economic and commercial affairs</li> </ul>

# Myopic Loss Aversion Highlights Importance of Discipline During Market Turmoil

## Impact of Feedback Frequency on Investment Decisions



In a study, subjects were assigned simulated conditions that were similar to making portfolio decisions on a monthly or yearly basis. Source: Thaler, R.H., A. Tversky, D. Kahneman, and A. Schwartz. "The Effect of Myopia and Loss Aversion on Risk Taking: An Experimental Test." *The Quarterly Journal of Economics* 112.2 (1997), used by permission of Oxford University Press; Fidelity Investments (AART), as of 12/31/19.