



MARKET UPDATE

Coronavirus Market Impact

CONCERNS OVER COVID-19 AND ECONOMIC DOWNTURN

The coronavirus outbreak, recently declared a global pandemic, continues to dominate headlines. As of Sunday evening in the US (March 15th), confirmed global cases of the virus (officially COVID-19) had topped 167,000 and claimed more than 6,400 lives.

In the US, the focus has intensified on “flattening” the peak of the virus, with actions including event cancellations, limits on the size of public gatherings, school closures, implementation of remote work models and a push to improve inadequate testing. Developments in China and South Korea, meanwhile, are improving. Wuhan, the epicenter of COVID-19, reported just a handful of new cases for a second straight day—and there were no new infections elsewhere in China. South Korea reported more COVID-19 recoveries than new cases for the first time. However, other parts of the world are worsening, including the US and Europe.

As concerns have grown about the virus and the potential economic damage it could cause, global stocks have declined by around 20% year-to-date. However, viewed over a longer historical time frame, equity markets are still up ~20% (cumulatively) since early 2015 (a 3.8% annualized gain).

Over time, stocks are valued based on earnings and cash flow, and history makes it clear that this relationship will eventually return, no matter how long and deep the dislocation may be.

Bond markets have also been showing signs of stress from factors including a lack of liquidity and the increased prevalence of technical trading strategies. In the current environment, volatility is extremely high, and liquidity has fallen across many segments, including government bonds. Central banks’ actions last week will undoubtedly be followed by more moves. We’re encouraged by their efforts to bolster markets.

We hope the next few weeks provide more clarity about the scope of COVID-19, and that new cases outside China will begin

to slow. That development, combined with strong support from central banks, government action and a generally solid economic foundation, would make us more optimistic that we’ll see improving sentiment—and eventually markets.

CENTRAL BANKS AND GOVERNMENTS RESPOND

The Federal Reserve on Sunday cut its benchmark rate by a full percentage point to near zero and will resume QE with at least \$700 billion in new securities purchases in an effort to cushion the U.S. economy from the coronavirus outbreak. The central bank also announced several other actions designed to keep liquidity ample both in the US and globally, in coordination with other central banks. While we don’t think the Fed is likely to resort to negative rates, we do believe that the central bank will be willing to take other measures to support the economy if it proves necessary. Here’s a quick summary of other recent monetary policy responses:

- PBOC (China) announced targeted required reserve ratio cuts that it said will release 550 billion yuan (\$79B) of liquidity (*Source: Bloomberg*).
- BOJ (Japan) announced it would buy ¥200B (\$1.9B) of JGBs with maturities of five to ten years in an unscheduled move. It also said it would inject an additional ¥1.5T in two-week lending (*Reuters*).
- ECB (Europe) chief economist Philip Lane said, in a blog post, that the bank won’t tolerate any risks to smooth transmission of its policy and stands ready to do more (*FT*).
- RBA (Australia) injected \$8.8B into the country’s financial system (*Financial Review*).
- Riksbank (Sweden) plans to lend \$51B to banks to maintain the supply of credit to Swedish companies (*Bloomberg*).
- Norges Bank (Norway) cut its key rate by 50 bp to 1%, lowered the countercyclical bank capital buffer by 150 bp to 1% and said it’s prepared to cut rates further (*Bloomberg*).

Rate cuts are normally good news for investors, but we need to be realistic about what central banks can and can't achieve on their own. Governments have agreed to turn to fiscal policy (which addresses demand shocks), since monetary policy (which addresses supply shocks) clearly isn't enough.

The fiscal response in the US will likely include immediate measures to deal with the challenges individuals and small businesses face as the country tries to contain the spread of the virus—and to address the much broader fallout of the economy over the longer term. President Donald Trump waived interest on all student loans held by government agencies, and said the administration would disclose other measures soon.

Ultimately, we think the global economy will be very challenged in the near term but will likely resume its previous growth trajectory, though not until late 2020, or 2021 at the earliest. The odds of a recession have meaningfully increased. We'll continue to reassess expectations as more data emerges.

WHAT ARE WE DOING IN OUR PORTFOLIOS?

The pandemic has driven volatility up sharply, sapped liquidity and caused a pronounced flight to quality across markets. In our equity portfolios, we're being cautious and deliberate. In some cases, we've sold stocks most exposed to potential demand destruction. In other cases, we've identified new opportunities that have become more attractive.

For example, the market is clearly discounting a higher likelihood of recession. Forward price/earnings multiples on the S&P 500 have compressed from ~19.5x at year end to ~15.0x today. Lower asset prices will create opportunities to reposition portfolios for future success at more conservative valuations.

From a fixed-income perspective, yields could still decline in the near term (the next few months or the rest of the year), but we could see some mean reversion, with yields rising modestly. This would be hard to time, so we're keeping structural duration in portfolios. With risk assets selling off recently, we've tapped opportunities to add to our high-yield corporate exposure. We still find securitized assets attractive, given their greater insulation from global risks.

Within our multi-asset solutions, we've responded to greater uncertainty by shifting to more defensive positioning during March. Valuations have become more attractive, but we're waiting to gain more clarity on the fundamental impacts before becoming more aggressive.

Of course, our portfolio teams will continue to closely monitor this rapidly evolving situation and the implications for clients' portfolios.

SUMMARY OF INDEX RETURNS (AS OF MARCH 13, 2020)

Index	Last Week (%)	Last Month (%)	YTD (%)
S&P 500 TR	-8.73	-19.48	-15.73
MSCI World	-12.41	-22.41	-19.96
MSCI EM	-11.92	-19.32	-19.91
Russell 2000	-16.44	-28.43	-27.27
Global Agg*	-2.51	-0.01	1.68
US Agg*	-3.17	0.62	2.36
Global HY*	-8.39	-10.91	-9.80
US HY*	-7.15	-9.84	-8.84
EMD Index**	-10.37	-10.58	-8.86

Past Performance does not guarantee future results

** Bloomberg Barclays Indices (USD Hedged)*

***JPM EMBI Global Diversified TR US*

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A WORD ABOUT RISK

Market Risk: The market values of the portfolio's holdings rise and fall from day to day, so investments may lose value. **Interest-Rate Risk:** As interest rates rise, bond prices fall and vice versa—long-term securities tend to rise and fall more than short-term securities. The values of mortgage-related and asset-backed securities are particularly sensitive to changes in interest rates due to prepayment risk. **Credit Risk:** A bond's credit rating reflects the issuer's ability to make timely payments of interest or principal—the lower the rating, the higher the risk of default. If the issuer's financial strength deteriorates, the issuer's rating may be lowered and the bond's value may decline. **Allocation Risk:** Allocating to different types of assets may have a large impact on returns if one of these asset classes significantly underperforms the others. **Foreign (Non-US) Risk:** Non-US securities may be more volatile because of political, regulatory, market and economic uncertainties associated with such securities. Fluctuations in currency exchange rates may negatively affect the value of the investment or reduce returns. These risks are magnified in emerging or developing markets. **Derivatives Risk:** Investments in derivative instruments such as options, futures, forwards or swaps can be riskier than traditional investments, and may be more volatile, especially in a down market. **Leverage Risk:** Trying to enhance investment returns by borrowing money or using other leverage tools may magnify both gains and losses, resulting in greater volatility. **Below-Investment-Grade Securities Risk:** Investments in fixed-income securities with lower ratings (commonly known as "junk bonds") tend to have a higher probability that an issuer will default or fail to meet its payment obligations.

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