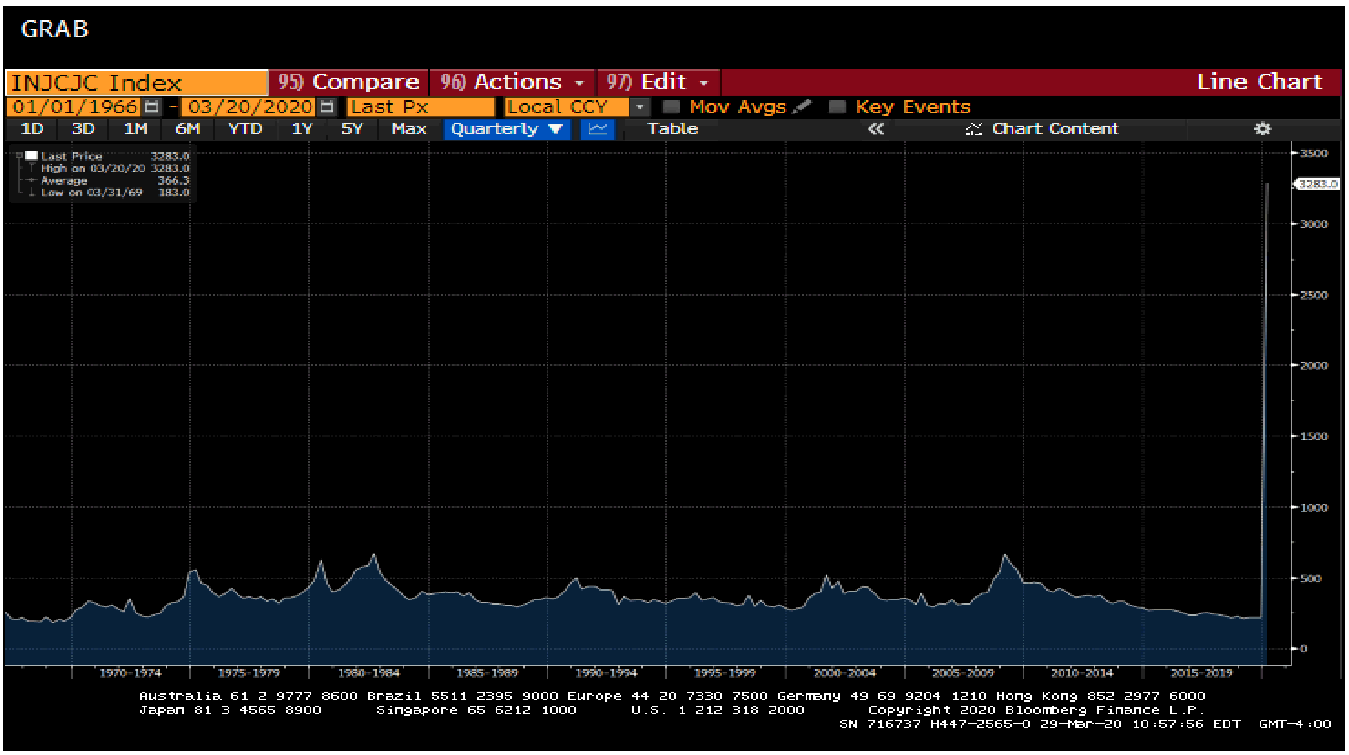
Courier Capital, LLC
Registered Investment Adviser
An affiliate of Five Star Bank

COVID-19 – Making Economic Landfall (03/27/2020)

Latest Developments and Economics

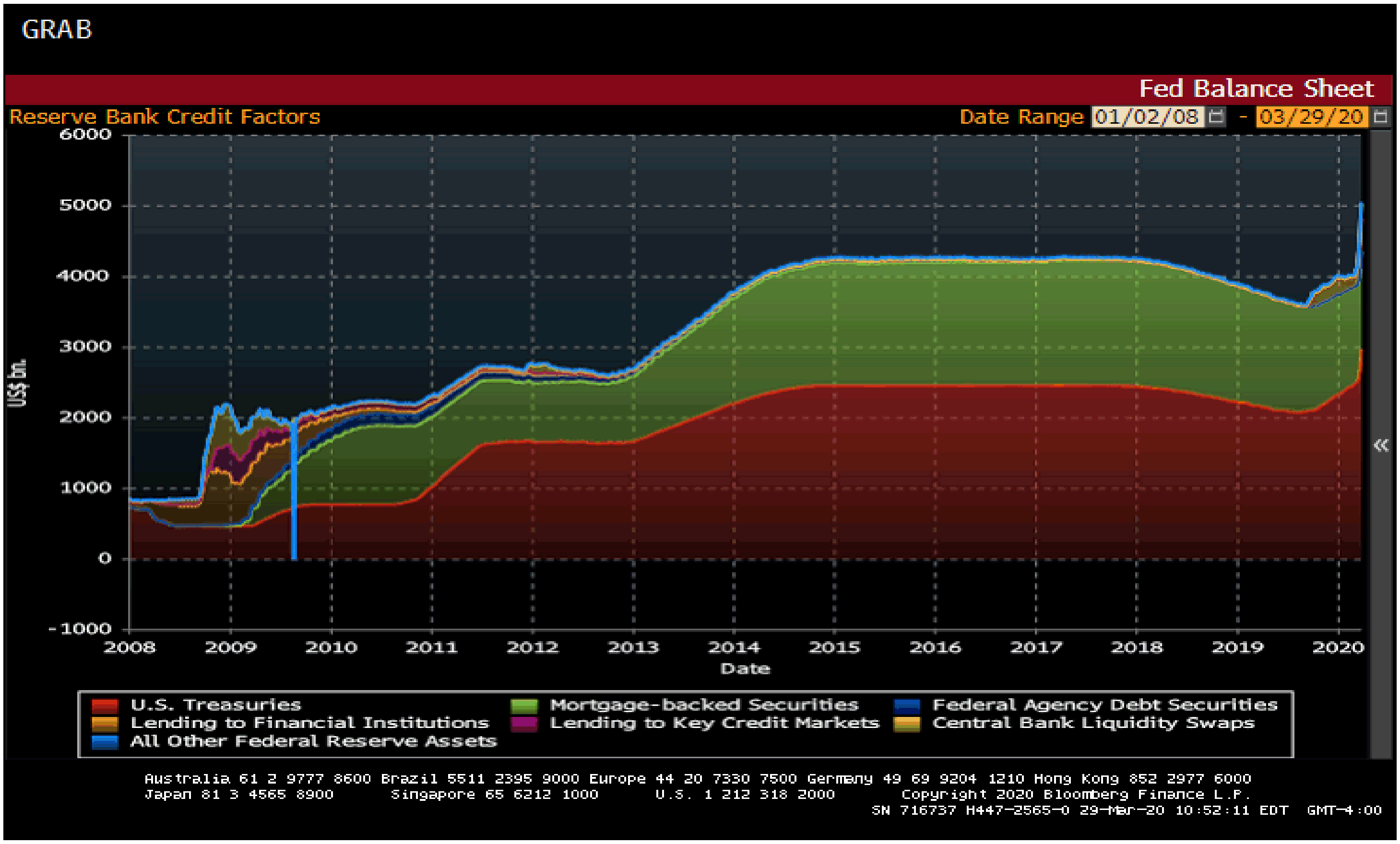
Dr. Ben Bernanke, former Chairman of the Federal Reserve, recently described the current situation as closer to a natural disaster than anything resembling the 2008 financial crisis. If so, we have already felt the social and human effect with social distancing, shelter in place, the number of people infected and, especially those who have passed away. The U.S. increased from about 100 infected cases at the end of February to 100,000, the most of any country, before the end of March. This past week saw the first economic impact as the "hurricane" made landfall with the initial jobless claims recording a weekly total of 3.28 million – crushing the previous weekly record of 695,000 in October 1982. The next print is also expected high as many state systems were too overwhelmed to process all the claims. More impact from the "hurricane" will be forthcoming.



Source: Bloomberg

This upcoming economic data, which will incorporate the impact of the shutdown and oil price disruption, is expected to show a U.S. economy severely handcuffed. General economic consensus plus the Federal Reserve Bank of Atlanta estimate a Q1 GDP of somewhere between 1.5-1.6% but, Q2 will most likely show a historic decline in GDP. Estimates of Q2 range anywhere from -20% to -30% on an annualized basis with Q3 almost certainly negative as well. This is a result of over 2/3 of the American people being asked to stay in their homes and only essential services employed outside the home. Consumer and business spending comprise approximately 85% of the U.S. GDP and neither can grow materially in their currents state.

The federal response has been swift and overwhelming from both a monetary and fiscal perspective.



Source: Bloomberg

In addition to the zero interest rates, the FOMC has pledged to do whatever is necessary to maintain liquid markets – which has resulted in expansion of the Fed balance sheet to $5 trillion – higher than at any time during the financial crisis. Congress and the President also passed a $2.2 trillion emergency funding CARES Act (details are in our forthcoming newsletter) which is intended to stabilize the economy through the crisis to low/middle income earners, small businesses and industries severely affected by the economic shutdown. This seems to be about the right amount to carry a $20 trillion annual economy for roughly 3 months given such a GDP decline. Both fiscal and monetary policy will mute a presumed recession, but they take time to have an impact. As we mentioned in earlier publications the duration of the virus will dictate the cumulative human, social and economic impact. The milestones of widespread testing, slowing progression, effective treatment and virus vaccination will all mark evolution towards a normal social and economic environment. There may also be future federal stimulus packages to follow up the CARE act. If significant progress is made before June a sharp but short recession with recovery in Q4 is very plausible. A coordinated international economic fiscal and monetary response would also aid the global economy in a similar fashion.

Market activity and strategy

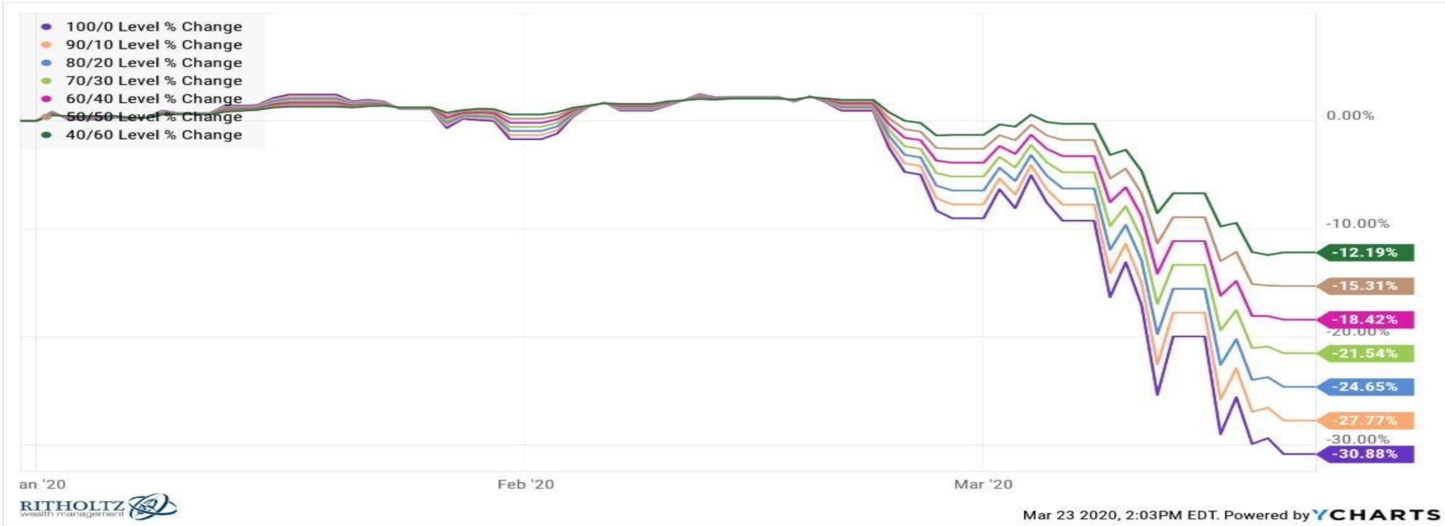
The strong federal response by the U.S. has helped relieve stressed markets. The charts below show a VIX (fear gage) calming from a historic high over 80 – as a point of comparison the financial crisis saw VIX in the 40's. The dollar index, another indicator of flight to quality, has also come down from recent highs. This set the stage for a volatile but, positive week in the S&P 500 and a recently rare 3 day winning streak in the index. The volatility in the S&P 500 is expected to continue until the situation moves towards eventual solution. The news of the day will most likely drive the markets higher and lower. There have been 18 days of moves in the index of 3.0% or greater in either direction out of a total of about 60 trading days in 2020.

Source: Bloomberg

The fixed income markets have been impacted as well as the short end of the yield curve went negative for the first time since 2015.

Source: Bloomberg

So, what does all this mean in the short and long term for investors. As mentioned above the short-term volatility we expect to continue, and it will be difficult for markets to advance until there is more certainty around the economy. The equity markets seem cheaper from a P/E perspective but the 'E' has become problematic in the short term. For long-term investors the current valuations offer an attractive risk/reward opportunity, even if we are not at ultimate market lows. A disciplined program of periodic rebalancing towards your appropriate asset allocation levels most likely means buying equities. A typical 60/40 portfolio looks more like a 55/45 (due to a 25% decline in equities) resulting in incremental equity purchases. You would be in good company as institutional investors (pensions, endowments, etc.) and target date funds in 401(k) plans would be executing the same rebalance.



Finally, even if the market does take a while to recapture its February 2020 price levels, it would result in good average annual total returns on the return trip – much better than what awaits in fixed income currently.

03/27/20 S&P 500 Close	**2,541.47**	
02/20/20 S&P 500 High	**3,386.15**	
Average Annual Return if 25% downdraft is recovered in...		
	Price Return	**Total Return with 2% Dividend Yield**
1 Year	**33.2%**	**35.2%**
3 Years	**10.0%**	**12.0%**
5 Years	**5.9%**	**7.9%**
7 Years	**4.2%**	**6.2%**

Should you have any questions please contact us.

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