February 24, 2020

What Happened in the Markets?

- US stocks fell sharply on Monday, extending last week's losses as the S&P 500 declined 3.4% to close at 3,226. The Dow Jones Industrial average declined by more than 1,000 points for just the third time in history, though in percentage terms the loss holds less historical significance. With Monday's sell-off, the S&P 500 has now erased its gains for the year, sitting -0.2% year to date.
- US stocks finished lower for the third consecutive trading day, as renewed concerns over the spread of the COVID-19 virus (coronavirus) appear to have sparked a risk-off move across financial markets. With a growing number of cases now being confirmed outside of China, and with reports over the weekend of multiple deaths in Italy, South Korea and Iran, markets appear to be pricing in a higher likelihood of economic disruption. While just last week many US and European equity markets traded to new all-time highs, in the past three days equity markets have corrected nearly 5%, while "safe-haven" assets like gold and long-term US Treasuries have rallied to multi-year highs.
- All 11 S&P 500 sectors finished lower Monday, with Energy (-4.7%) and Tech (-4.2%) the laggards on the day. While still finishing the session lower, Utilities (-1.2%) and Real Estate (-1.3%) were relative leaders.
- Rates fell across the curve as Treasuries rallied, with 30-year yields moving to new all-time lows at 1.83% while 10-year rates, at 1.36%, are within range of the all-time low set in 2016 at 1.32%. Gold continued its recent rally, up 0.9% on the day and sitting at a seven-year high of $1,658 per ounce. Oil prices were sharply lower, down 4.0%, though the WTI crude oil contract did stay above $50/barrel in Monday's trading.

Catalysts for Market Move

US equities saw their worst day in more than two years as the S&P 500 fell 3.4% to close at 3,226. In the past three trading sessions, the S&P 500 has fallen 4.8%, marking the sharpest peak-to-trough decline for the index since August of last year. As more cases of the COVID-19 (coronavirus) have been reported outside of China in recent days, markets appear to be pricing in a more negative outcome as it relates to the virus' potential impact on the global economy. While concerns over the virus spreading have clearly played a part in the recent market move, some consolidation of equity market gains may have already been due, given the extent of strength across US stocks alongside near record-low volatility in recent months. To that end, many technology stocks that had led the market in recent months have been among the biggest laggards over the past few sessions.

Importantly, this is not the first COVID-19 related sell-off markets have witnessed in 2020. Late last month, the S&P 500 saw a ~3% pullback as reports of the virus' spread first hit. However, the index surged to new all-time highs, recovering those losses in the weeks that followed. While at this point the market and economic impacts of the virus outbreak are clearly a "known unknown," historically similar events have tended to have little long-term market impact. Two recent examples that come to mind include the Ebola concerns in 2014 and the SARS outbreak in the early 2000s. While near-term demand is likely to be displaced and company supply chains may be disrupted as a result of the virus, over the intermediate and long term, the economic impact from these types of events generally sees a delay in growth, not a derailment. As a result, we would caution against overreacting to headlines from a portfolio standpoint, and near-term volatility may even create opportunity for long-term investors.

Outside of the equity market, action in rates has been notable in recent sessions. Ten-year yields at 1.36% are within basis points of the all-time lows set in 2016 (1.318%), while 30-year yields have already moved to new all-time lows at 1.83%. For context, 10-year yields began the year at 1.92%, meaning Treasuries have seen a sharp rally year to date. Bond markets are clearly pricing in more concern as it relates to the economic growth outlook given the move lower in yields, and this has also been expressed through the yield curve, with the 10-year – 3-month curve again in inversion.

Looking ahead, this week is relatively light on the economic data front as markets close out the month of February. Fourth quarter earnings season will also be winding down this week, with ~10% of the S&P 500 scheduled to report. The political calendar will heat up as we move into March, however, with the "Super Tuesday" primaries scheduled for March 3.

The Global Investment Committee's Outlook

The market environment in 2018 was one of the most challenging for equity investors since the Financial Crisis, with every region and most stocks delivering negative returns. Unusually, bonds and stocks simultaneously fared poorly, reducing the effectiveness of asset allocation in balancing out the losses with some gains. In sharp contrast with how 2018 ended, 2019 saw a broad rally across asset classes. Beginning in January 2019, the dramatic pivot by the Federal Reserve helped ease financial conditions and improve market sentiment. While 2019 portfolio returns were strong as a result, the GIC continues to advocate investors exercise patience, as opposed to chasing performance to begin 2020. While the GIC believes a modest recovery in the global economy, led by international and emerging markets, will take hold this year, US growth is forecasted to only stabilize, or even decelerate, in 2020. With significantly more good news currently priced into markets, the GIC advises caution as US stocks appear fully valued and earnings forecasts may have further to fall. While the GIC remains overweight equities relative to fixed income, they believe international stocks may offer the most upside potential going forward. Within fixed income, the GIC remains underweight corporate credit, and prefers high-quality, short-duration bonds as a proxy for cash, which it will look to deploy as opportunities arise. The GIC also recommends a moderate allocation to long-duration Treasuries as a defensive portfolio hedge against the risk of a future equity or credit market correction.

Market data provided by Bloomberg.
Dow Jones Industrial Average (DJIA): A price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry.
NASDAQ Composite Index: A broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market.
S&P 500 Index: The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization US stocks.

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The value of **fixed income securities** will fluctuate and, upon a sale, may be worth more or less than their original cost or maturity value. Bonds are subject to interest rate risk, call risk, reinvestment risk, liquidity risk, and credit risk of the issuer. **High yield bonds** are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues. **Duration**, the most commonly used measure of bond risk, quantifies the effect of changes in interest rates on the price of a bond or bond portfolio. The longer the duration, the more sensitive the bond or portfolio would be to changes in interest rates. Generally, if interest rates rise, bond prices fall and vice versa. Longer-term bonds carry a longer or higher duration than shorter-term bonds; as such, they would be affected by changing interest rates for a greater period of time if interest rates were to increase. Consequently, the price of a long-term bond would drop significantly as compared to the price of a short-term bond.

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Equity securities may fluctuate in response to news on companies, industries, market conditions and general economic environment.

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Because of their narrow focus, **sector investments** tend to be more volatile than investments that diversify across many sectors and companies. **Technology stocks** may be especially volatile.

Asset allocation and diversification do not assure a profit or protect against loss in declining financial markets.

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