Market Commentary

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Staying Calm during Market Volatility and Taking the "Right" Action

Some are saying this is the fastest -20% slide in U.S. stocks in over 100 years. Credit spreads have been widening as Treasury yields have declined. Investors are wondering what else is coming and when this will end.

In times like this, it's important that you remain calm and remember that the financial markets are not the same thing as the real economy. Consider the following:

- The average consumer is in good shape financially with lower levels of debt and unemployment.
- Most U.S. banks have strong balance sheets.
- Policymakers are reviewing fiscal aid to businesses and individuals.
- Central banks are fully engaged, ready to cut rates further and provide additional liquidity into credit markets.
- World health officials are working hard to find solutions.
- Individuals, organizations, and municipalities are each acting to stem any contagion.

BACKDROP

This year, investors have seen markets fluctuating significantly on a daily basis, grappling for some news to hold on to. Stocks rallied recently on hopes of potential fiscal stimulus being proposed by President Trump but gave back those gains when Congress pushed back against those measures and the World Health Organization officially declared coronavirus disease 2019 (COVID-19) a pandemic.

The impacts of the virus seem to be spreading beyond the financial markets just as rapidly as the virus itself. Recently, the Organization of the Petroleum Exporting Countries (OPEC) met in Vienna to discuss how to support oil prices in the face of weakening global demand related to the virus. Talks were unproductive; instead of announcing a plan to support prices, OPEC announced they were cutting prices, sending oil prices down over -30% and dragging risk assets (like stocks) down with them.

Now a 30-day travel ban from Europe to the U.S. is also contributing to stocks declining.

The news keeps flowing and investors are looking for moorings. When the news settles down, market volatility will likely calm as well.

No one knows the future, but if there's one thing that is predictable, it's when uncertainty increases, markets experience turbulence in order to price in unknown outcomes. The current situation is uncertain, but this isn't all entirely unfamiliar territory.

We've seen general market price sell-offs before. The S&P 500 has now experienced its 15th price drop of greater than -19% from bull market highs since its inception in 1957. In eight of those previous occurrences, that price decline essentially signaled the bottom of the sell-off. In two cases, prices fell another -5% to -10%. In four instances, the S&P went on to experience further double-digit losses; a recession occurred in all four of these instances.

We've seen event-driven bear markets before from exogenous events such as war or oil supply shocks, although not so much from viral outbreaks. Goldman Sachs reports that the average event-driven bear market results in a -29% decline in stock prices and lasts 15 months.

Historically, we've seen new viruses cause various levels of human tragedy. Fortunately, viruses run their course and then eventually blend into the background.

We understand COVID-19 may feel unique. It feels unique because we are experiencing it firsthand, in real time. There's a psychological journey that investors are taking day-by-day.

Although we would all like to know when it will end, no one knows. The Fed acted aggressively to cut rates and increase asset purchases. It doesn't appear to be providing any floor to asset prices.

We all want answers, but the range of outcomes is simply too great to put any definitive handles around it. We believe that investors should know that bigger economic risks may potentially play out. For instance, the weakness in oil prices and a falloff in demand is spilling over into credit markets and could lead to a recession.

WHAT DOES THIS MEAN FOR YOU?

Until there are answers, market prices will swing on news headlines. Without answers, investors tend to take their cues from other investors, who also don't have answers. This leads markets to overshoot to the downside.

So what's an investor to do? It's natural to dwell on fear and to focus on what might happen. Fortunately, hypotheticals don't mean that the underlying resilience of our global economy has changed. Here's what we believe will help investors keep calm during the volatility we've seen:

- Review your financial plan. The importance of keeping an up-to-date financial plan and sticking to your investment process are key during times like this. This includes following the financial principle of spending less than you earn, allowing for financial margin. Investors should maintain some lower-volatility assets to provide for cash flow needs during times of dislocation like this in stocks. Stocks are volatile in the short term, but we believe they are still the best means of preserving capital over the long term.
- Regularly rebalance your assets. In the current environment, that likely entails rebalancing from intermediate-term assets that have benefited from a decline in interest rates into longer-term investments with greater growth potential.
- Resist the urge to time the market. Some investors who normally understand that timing the market is folly, may feel a strong urge to try and side-step this drawdown as they recognize trading patterns. We would strongly discourage panic selling or speculative buying. This is the time to exhibit patience.
- Expect the unexpected. The more comfort that investors have with uncertainty, the more easily they can endure market shocks.

The objective of the long-term investor is not to try and avoid volatility nor drawdowns. The principle of instability tells us we should know that this event will not last forever. Historically, equity markets are up three times as often as they are down. As much as we would all like to avoid volatility and drawdowns, we must appreciate that these events are what allow investors to earn a greater return on stocks (known as the equity risk premium). If this premium did not exist, it would be impossible to earn the long-term returns we have grown used to in the stock market.

In the meantime, we are here to help and are happy to meet and review your plan with you.

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