



PERSPECTIVE

On March 15th – the Ides of March - the Federal Reserve (“The Fed”), in a surprise move, cut its benchmark interest rate by one full percentage point to a range of 0%-0.25%, as low as it has ever gone. The Fed also announced it was reengaging asset purchases for Treasuries (\$500B) and Mortgage-backed securities (\$200B) to help stabilize those markets, which were showing signs of dysfunction as investors sought safe havens during the equity market gyrations of last week.

Having become an official Federal emergency in the U.S. last week, the COVID-19 pandemic will continue to inflame near-term uncertainty across global markets even though the world’s central banks and governments act or prepare to act aggressively with social, monetary and fiscal responses. Unlike 2008/2009, this crisis is a health emergency that is spilling over to spur a financial crisis. The Fed’s strong, but markedly reactionary, decision is helping set the stage for recovery when the time comes. And, recovery may take a little while...

During the 2008/2009 financial crisis people could still connect, gather and generally get on with the social aspects of their lives – not with the COVID-19 pandemic. The comforts of human connection across the globe have been temporarily disrupted and curtailed with escalating degrees of severity as COVID-19 spreads. As a result, we are amid a “social recession” which, in our opinion, will continue to place negative pressure on consumer sentiment and behavior. With 70% of GDP determined by consumer spending, we are clearly seeing the impact of consumer behavior (either as a result of government policy or personal choice) severely affecting sectors of the economy (e.g. energy, airlines, hotels, restaurants, etc.). We expect the decline in consumer spending and market volatility to continue culminating with a U.S. recession to emerge during 2020.

CONSIDERATIONS

In the meanwhile, the emergency declarations by governments rippling across the world should, at least, help marshal resources to coordinate better policy responses. And, a clearer, straight-talk communications strategy regarding COVID-19 would, in our opinion, go a long way in addressing: 1) overall uncertainty, 2) rampant misinformation and 3) the lack of trust in government and its response (we’re optimists here...).

Regarding markets, the Fed’s actions will provide clear support to the Treasury and Mortgage markets, but the immediate market reaction is one of fear given the magnitude of the Fed’s surprise action and because the Fed has now used up its remaining ammunition to avert recession. Well folks, recession is here - you can see it but not in the numbers just yet.

For our clients, unless there are material changes to your underlying operations and/or risk exposures as a result of COVID-19, the long-term, strategic asset allocations for your organization remain as recommended. Fixed income portfolios will have significant unrealized gains should additional cash needs develop. While mark-to-market portfolios will have a significant portion of negative equity returns offset to varying degrees by positive fixed income portfolio returns, statutory portfolios will feel more short-term, discomfort as only the negative equity returns will show in the financial statements. Lastly and hard to consider now, but we would expect to address strategic portfolio rebalancing later this year. In the interim, we continue to recommend reviewing broad asset allocations versus policy limits quarterly.

In looking for silver linings, any minor improvement in slowing the spread or in treating COVID-19 will have an exponentially positive impact on market sentiment far beyond what any governmental policy or central bank action will provide. For now, we wait while social distancing.