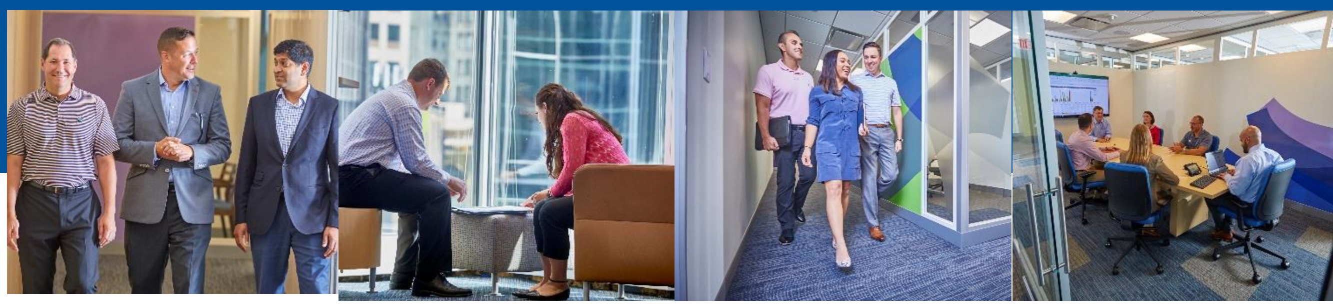
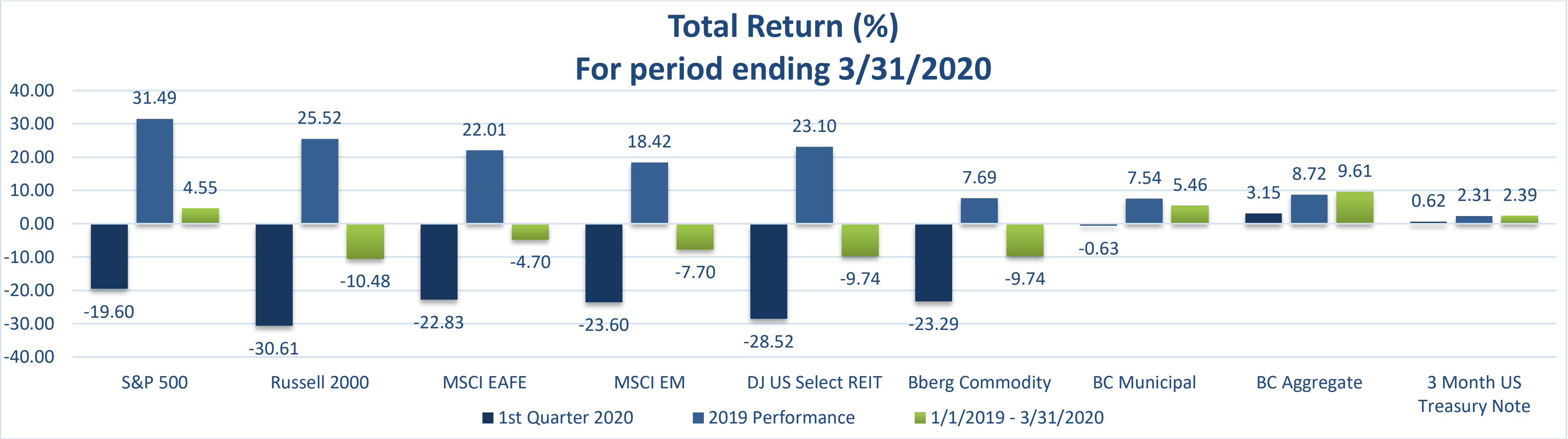
SCHNEIDER DOWNS
Wealth Management

Markets Meet An Invisible Enemy: Coronavirus Infiltrates Capital Markets



Schneider Downs Wealth Management Advisors, LP
Q1 2020 Market Commentary

Big Thinking. Personal Focus.

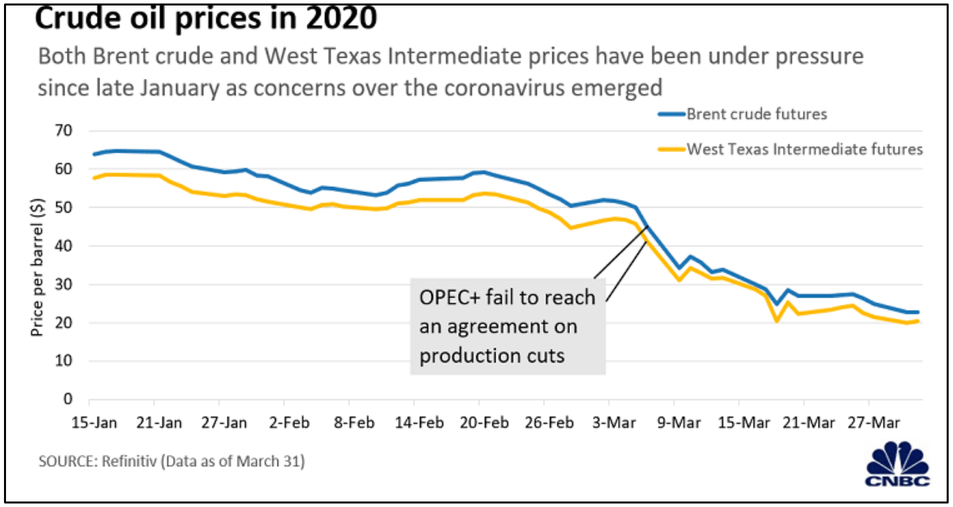


The team at Schneider Downs Wealth Management Advisors hopes this note finds you and your loved ones safe and healthy. Throughout this letter we will discuss the economic and capital markets ramifications of COVID-19/Coronavirus and its impact on portfolios. However, before getting into a more technical breakdown of the quarter, we want to first emphasize the human element of this pandemic. The country (and world) is undergoing a devastating health crisis, with over 1.5 million diagnosed COVID-19 cases, and 87,000 fatalities globally at the time of this letter.[1] Those numbers are only going to move higher in the coming days as the virus continues to make its way across the globe. Over 10,000,000 people in the United States lost their jobs in the last two weeks of March, with many more millions likely to lose their jobs in the coming weeks.[2] Thousands of families' lives will forever be altered by the loss of their loved ones, and millions of families are confronting the gut-wrenching reality of losing their job during a global health crisis. It is with a profound sense of melancholy that we write the past few sentences. However, we also want to put a spotlight on the sacrifice that is being made as a collective to "shelter in place." To endure economic hardship for the betterment and safety of a society, and to take better care of our neighbors and community by staying home, is a sacrifice that shouldn't be minimized, but rather emphasized. Finally, the bravery and steadfastness of those on the front lines, from first responders (police, firefighters, and EMTs), doctors, nurses, and support staff at hospitals, municipal workers, grocery store workers (and supply chain), that are keeping us safe and allowing society to temporarily shut down so that we can emerge stronger: from the bottom of our hearts, thank you.

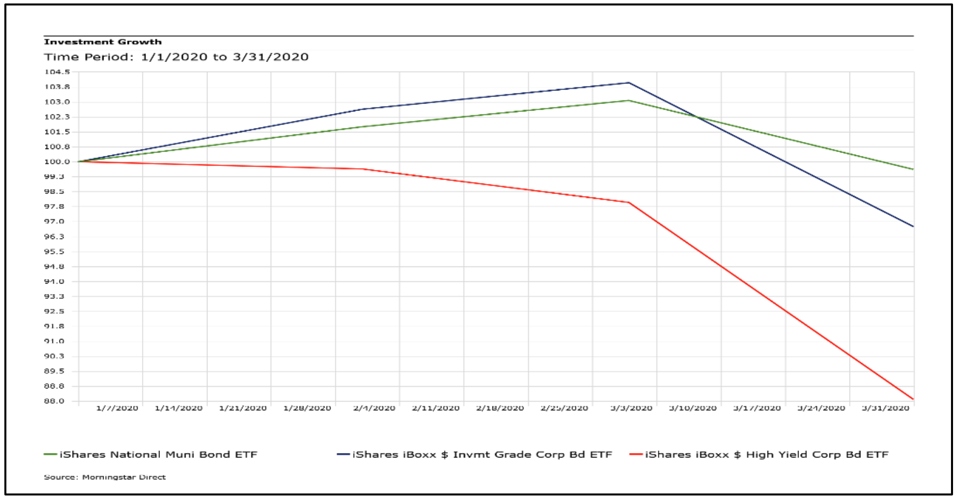
Coming into 2020, Goldman Sachs pronounced the U.S. "recession proof" when describing the health and strength of the domestic economy[3]. For the first 50 days of the quarter, U.S. equity markets rewarded a rather bold call, seemingly setting a new "all-time high" every few days. Monetary policy was exceedingly accommodative, with interest rates low and consumer confidence and risk sentiment high. Despite scattered news about a virus affecting the city of Wuhan in the Hubei province of China, U.S. markets (and most capital markets in general) continued to plow ahead, with the S&P 500 reaching an all-time high on February 19th of 3,386. However, from its all-time high, the S&P 500 would drop almost 35% before staging a relief rally to close the quarter down ~20% (down 23% from its all-time high). The sharp decline in asset prices, and the corresponding stress in financial markets, were caused by the reality that in order to combat the spread of COVID-19, the global economy would need to implement shutdown measures similar to what the Chinese government imposed on Wuhan and select other

1 https://coronavirus.jhu.edu/map.html
2 https://www.bloomberg.com/news/articles/2020-04-02/u-s-jobless-claims-doubled-to-record-6-65-million-last-week
3 https://www.cnbc.com/2019/12/31/goldman-sachs-is-saying-the-economy-is-nearly-recession-proof.html

provinces and cities. At the moment when all of the economic uncertainty was pushed to the forefront, it was met with record high markets and equity valuations domestically.[4] The market then corrected in record fashion, ending the eleven-year bull market, and entering a bear market in a record time period of only 19 days.[5]



Market participants and investors scrambled to "re-rate" everything from stocks and real estate to high-quality municipal bonds and U.S. treasuries. Further exacerbating the drawdown in asset prices was the oil price war that Saudi Arabia and Russia entered into; which drove the price of oil from $60 to start the year to as low as $19 in late March.[6] The chart to the right shows the price of oil from the start of the year, and around March 3rd, well into the equity market decline, Saudi Arabia and Russia failed to come to an agreement on production. This failure to come to an agreement (both increasing supply instead of decreasing it), created additional downward pressure on the price of oil, and in turn, wratcheted up pressure on companies up and down the global oil supply chain. COVID-19 and the oil price war wreaked so much havoc on stock and bond markets that the U.S. Federal Reserve and U.S. Congress would intervene with more accommodative monetary measures than it deployed during the Great Financial Crisis of 2008 and 2009.



One of the main reasons for the U.S. Federal Reserve's quick, massive, and unprecented intervention into capital markets in March was the dysfunction and illiquidity in fixed income markets.[7] As "risk assets" such as stocks, publicly-traded real estate, and oil began their sharp decline in March, perceived "safe haven" assets like municipal bonds, investment-grade corporate bonds, and U.S. treasuries also began to move lower. Historically, the relationship between high-quality bonds and risk assets like stocks has been relatively low, and in some cases, negative. However, during a 10-day period from March 10th to March 20th, fixed income behaved like an equity, with the proxy for investment-grade municipal bonds down ~11% and investment-grade corporate bonds down ~17%[8]. There was a lack of liquidity in the markets where panicked sellers could not find buyers, and when they did, the prices were significantly less than the price of the bond a mere seven days prior. For those of you that were checking on your accounts, it had to be concerning to see the "ballast" of your portfolio reacting in such a manner. The team held near-daily calls with several fixed income strategists and diagnosed the problem to be transient, rather than structural in nature. We held onto our core fixed income, and the broad market index rallied over 5% during the last eleven days of March. A favorite quote of a team member is "chance favors the prepared

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[4] https://fortune.com/2020/03/11/coronavirus-stock-market-stocks-high-valuations/
[5] https://www.forbes.com/sites/naeemaslam/2020/03/12/the-bear-market-is-here-fastest-plunge-of-20-on-record/#10a78bbd627f
[6] https://www.cnbc.com/2020/04/01/5-charts-that-explain-the-saudi-arabia-russia-oil-price-war-so-far.html
[7] https://www.marketwatch.com/story/fierce-bond-market-swings-dry-up-liquidity-in-wide-swathe-of-15-trillion-us-bond-market-2020-03-12
[8] iShares National Muni Bond ETF (MUB) proxy for investment grade municipal bonds, iShares Investment Grade Corp Bond ETF (LQD) proxy for investment grade corporate bonds and, iShares High Yield Corp Bond ETF (HYG) proxy for high yield/junk bonds. Returns from Morningstar Direct.

mind,[9]" and that was never more relevant than in assessing and analyzing the dislocation in the municipal bond market. Our team has placed an emphasis on investing in high-quality credits in our core fixed income sleeve to ensure the investment thesis remains intact. By not reaching for more risky assets in our core fixed income allocation, we were were able to withstand the volatile 10-day period, and stay invested to enjoy the recovery during the last two weeks of the quarter. We continue to believe fixed income plays a vital role in client portfolios, providing diversification and cash flow, to help weather difficult months like March.

The question we have received most from clients is also the question we keep asking ourselves: so, what's next? The short- and intermediate-term answer is an amagalmation of uncertainties. On the one hand, the United States of America has never systematically shut down its entire economy for any period of time, let alone an indefinte one (not even during the Civil War or either World War). As we discussed in our opening of this letter, 10,000,000 people have already lost their jobs domestically, with many more millions likey to lose their jobs before its over. The economic toll on our small businesses, which account for approximately 44% of domestic GDP,[10] is crushing and unquantifiable. In a nutshell, that is the bear case. The flip side to the coin is that the the U.S. Federal Reserve, along with the U.S. Congress/Trump Administration, has enacted an unprecenteded amount of monetary and fiscal policy to try and stave off as much long-term economic pain as possible. During the depths of the great financial crisis, monetary policy led the policy response with fiscal policy lagging in both time and size of the response. Jerome Powell and the U.S. Federal Reserve enacted more programs and monetary policy response in the past four weeks than in the entirety of the Great Financial Crisis. The U.S. Congress/Trump administration have passed a fiscal policy response that could end up being 4 times the size of the 2009 stimulus legislation. For our part, we came into 2020 conservatively positioned with meaningful allocations to core fixed income and low correlation/alternative equity strategies that have helped dampen the capital markets volatility. In our non-core fixed income (Strategic Income) sleeve, we reduced risk in early March, avoiding a large part of the sell-off in the structured and high yield credit markets. The team is looking to opportunistically redeploy back into those markets now that yields are reaching levels last seen during 2008-2009 time period. Despite making some changes in the portfolio, we have mostly eschewed making large-scale rebalances of portfolios (e.g. adding to stocks and selling bonds) due to the uncertainty facing capital markets. Given the current uncertainty, we would rather be a little late in missing the initial recovery in order to have greater conviction in the path moving forward. Having said that, we have worked hard over the past month through emails and phone calls to keep our clients invested and not sell their equity positions so that they have received the benefit of the most recent upturn in the markets.

The team hopes you have been able to read the content that we have been producing and publishing during the past several weeks; we have covered capital markets, portfolio rebalancing and tax loss harvesting, asset location, and how the recently passed CARES act legislation will potentially effect you. If you have not received these via email alerts, please let your advisor know and we will follow up and provide the links to each. As we reflect on this new normal, our team is incredibly grateful for the partnership we have with you and for the trust you have placed in us to guide you and your families through these turbulent and arduous times. Please stay safe and do not hesitate to reach out with any questions related to the market or the recently passed CARES act legislation.

[9] Under Siege II: Dark Territory
[10] https://advocacy.sba.gov/2019/01/30/small-businesses-generate-44-percent-of-u-s-economic-activity/