# clearstead
# MARKET MINUTE

2020 VOLUME 3: FEBRUARY REVIEW

*This month's Market Minute reflects the views of Clearstead's Research Team and was composed by Anna Rathbun, Managing Director.*

## OVERVIEW

Investors saw the U.S. equity markets hit multiple highs during the first three weeks of February, as the world digested positive corporate earnings reports. On the sidelines, they watched the number of coronavirus cases grow within China, still largely contained. However, the last week of the month experienced a complete reversal as the markets entered a sudden correction, in fact, the fastest on record, as the illness count began to advance outside of China and community transmissions began to appear across the world. We understand that such an abrupt about-face in the markets can be unnerving for our clients, and many things remain uncertain since the world is still in the middle of this viral episode. We spend some time at the end of our normal "Market Minute" piece to share with you our thoughts and expectations from the current vantage point.

## DOMESTIC EQUITY

*As of February 29, 2020*

| U.S. EQUITY MARKETS | | | | |
|---|---|---|---|---|
| Index | 1 Month | Quarter-To-Date | Year-To-Date | 1 Year |
| DJIA | -9.8% | -10.6% | -10.6% | 0.4% |
| S&P 500 | -8.2% | -8.3% | -8.3% | 8.2% |
| Russell 2000 | -8.4% | -11.4% | -11.4% | -5.0% |
| Russell 1000 Growth | -6.8% | -4.7% | -4.7% | 15.1% |
| Russell 1000 Value | -9.7% | -11.6% | -11.6% | 0.5% |

The U.S. equity markets started February positively as earnings releases came in largely better than expected. As we neared the end of the month, concerns about a potential worldwide pandemic dragged markets lower. The selloff was indiscriminating across the board within the domestic markets, with large caps performing roughly in line with small caps. Still, growth stocks managed to continue the trend of outperforming their value counterparts.

While the latest virus scare has brought down the equity valuations from their lofty levels, we still find it prudent to be defensive in our positioning. The rest of the year 2020 has uncertainties ahead surrounding continuing trade negotiations and the U.S. Presidential Election. Additionally, we feel that it is still too early to have clarity on the full impact of this virus on future corporate earnings as well as on economic growth.


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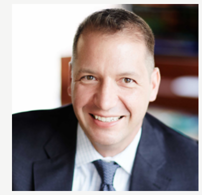
Sr. Managing Director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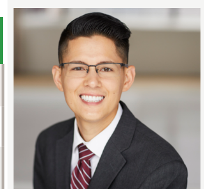
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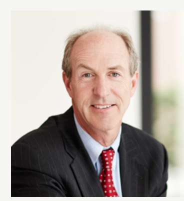
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## INTERNATIONAL EQUITY

*As of February 29, 2020*

| INTERNATIONAL EQUITY MARKETS | | | | |
|---|---|---|---|---|
| Index | 1 Month | Quater-To-Date | Year-To-Date | 1 Year |
| MSCI ACWI ex USA | -7.9% | -10.4% | -10.4% | -0.7% |
| MSCI EAFE | -9.0% | -10.9% | -10.9% | -0.6% |
| MSCI Emerging Markets | -5.3% | -9.7% | -9.7% | -1.9% |
| MSCI EAFE Small Cap | -9.8% | -12.4% | -12.4% | -0.9% |

Much of the virus' rampage in China, which also brought economic activity to a halt in the Hubei Province, was reflected in the latest PMI number, clocking in a record low in both manufacturing (35.7) and non-manufacturing (29.6) sectors[1]. January's -4.8% return on the MSCI China Index also anticipated this economic freeze, which dragged down the MSCI Emerging Markets Index with it. For February, non-U.S. markets held up generally better than the U.S. markets, despite the U.S. dollar strengthening against both developed market and emerging market currencies. February was a month of recovery for China, as infection growth rates started to slow, and people began to trickle back to work. The recovery of the Chinese equity market led the Emerging markets, represented by the MSCI Emerging Markets Index, to be the best performer on the global stage.

The month of February also saw the coronavirus make its way into the South Korean and Italian peninsulas. We are continuing to see the illness count coming from nearly all continents, and now from more than 60 countries. In a globalized world, efforts to curtail the spread of disease include limitations on travel and trade. These effects will translate to losses at the fundamental level, and we anticipate a more accurate picture in the corporate earnings calls and GDP calculations in the coming quarters.

## FIXED INCOME

*As of February 29, 2020*

| FIXED INCOME MARKETS | | | | |
|---|---|---|---|---|
| Index | 1 Month | Quarter-To-Date | Year-To-Date | 1 Year |
| BarCap US Aggregate | 1.8% | 3.8% | 3.8% | 11.7% |
| BarCap Global Aggregate | 0.7% | 2.0% | 2.0% | 7.9% |
| BarCap US High Yield | -1.4% | -1.4% | -1.4% | 6.1% |
| JPM Emerging Market Bond | -0.8% | 0.9% | 0.9% | 9.9% |
| BarCap Muni | 1.3% | 3.1% | 3.1% | 9.5% |

With equity markets in distress, the U.S. 10-year Treasury yield experienced a flight-to-quality effect and reached a historic low of 1.15%. Fixed income risk assets saw spreads widen over the Treasury yields, but not as wide as one might expect given the losses in the equity markets, with the Bloomberg Barclays High Yield Index returning -1.4%. The Emerging Market Bond Index also declined, posting -0.8% for the month.

The U.S. yield curve steepened during the month on the longer end, which came as a bit of a surprise given the bearish sentiment from the equity markets. While the 10-year Treasury yield declined by 36 bps, the 30-year Treasury yield also fell to its own record low but by a less amount. The front end of the curve inverted, as the 2-year Treasury yield fell below 1%. With the benchmark yield at historic lows, there may be pressure on the Federal Reserve in the coming months to lower the policy rate, and the market is currently pricing in 100% probability of a 25-basis-point rate cut during the month of March.

## CLOSING

First and foremost, the most direct and significant impact of the coronavirus outbreak is the toll on human lives and on our global community. We are watching these events unfold along with the rest of the world with great sadness and hope for containment. While we are not equipped to speculate on the trajectory of this epidemic, it is our job to take stock in recent developments and to understand the investment implications. Here, we share with you our thoughts.

At this point in time, we must remember that it is still too early to tell the magnitude of the impact this virus will have on the global economy because it is only early March and we do not have enough information about this new virus. Depending on the duration and the severity of the epidemic, the range of outcomes at the end of this episode is very wide. We do know at this time that there are isolated economic casualties, where the losses may be temporary but very real. Investors worry about the global impact because the epidemic originated in China, and the sheer size of its economy can have growth implications beyond its borders. The degree of the epidemic was the most severe in China by a high margin, and there will undoubtedly be an economic cost due to the shutdown of factories, stores, and the quarantine of at least 50 million people in the Hubei province. Global businesses that rely on Chinese customers for sale of goods will see near-term loss of revenue, and those for whom China is a part of their supply chain will see a bottlenecking in their production of goods. For U.S. companies, the supply chain disruption in China is a déjà vu: many corporations have already had to diversify their supply chains in the last few years due to the Trump trade dispute with China. Other international companies may still have concentrated relationships with China, and the impact on these companies remains to be seen in the coming quarters.

A bit of good news is that the pace of growth in the number of new cases in China seems to be slowing down. We hear of new cases of the coronavirus around the world, but not to the magnitude of growth that we saw in China last month. As of Monday, March 2nd, South Korea and Italy, the two countries with the largest numbers of cases outside of China, reported 4,335 and 1,694 cases, respectively. Iran is catching up with 1,501 reported cases. Over 60 countries have reported cases of coronavirus infections, although in much smaller numbers than in China. Going forward, the worry is that continuous measures of limiting travel and trade to prevent a global pandemic will disrupt the economic interconnectedness and interdependencies of countries in a globalized world. At this point in time, the travel restrictions seem to be increasing – how everything turns out will depend on the duration of this global hardship. As we round out the winter months and head into spring, we hope to see the coronavirus contained and not manifest into a global pandemic.

We also know that governments and central banks can act in an attempt to mitigate the blow from the epidemic. China is taking steps to avoid a spike in non-performing loans, Hong Kong & Singapore are providing direct payments to their citizens, and South Korea is targeting loans to key sectors and firms. We also anticipate significant pressure on the Federal Reserve to lower rates and/or implement other expansionary monetary measures. What is important for us to remember is that the U.S. economy is uniquely strong enough in the world to withstand a brief challenge to its massive economic engine. We hope that the current restrictive global travel policies will only cause temporary disruptions in supply and inventory aspect of businesses, and not stretch into longer-term worries about profitability and workforce utilization.

We have communicated over the course of 2019 to maintain a prudent rebalancing protocol and to remain defensive. We did not foresee that the impact of the virus on the markets would be so severe... In fact, we did not know that the coronavirus would be the exogenous shock that would eventually test the markets' resilience. What we knew was that risks were building into the system, with equity markets stretching toward higher valuations and credit spreads remaining tight by historical standards. Our message to clients is to build portfolios based on their goals, with robust allocations and healthy investment policy that are designed to be agnostic to market cycles and short-term gyrations. History has taught us that moments like the past week, while intense, recede into the background when we zoom out for the long term. Consider rebalancing your portfolios and stay invested.

**Sources:**
1 China Federation of Logistics and Purchasing, 2/28/2020