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MARKET COMMENTARY

What started out as a strong quarter, abruptly reversed course and ended up as the worst quarter since the fourth quarter of 2008 and the fifth worst quarter of the past 75 years. The large cap stocks in the S&P 500 reached a new high on February 19th before falling -34% and ending down -19.6% year-to-date. Small cap stocks in the Russell 2000 were down -30.6% for the quarter. International stocks did not fair any better; developed markets in the MSCI EAFE were down -22.8% and emerging market stocks were down -23.6%. Treasury bond yields also plummeted to less than 1% across maturities and the Barclays U.S. Aggregate Bond Index posted a return of 3.15% for the first quarter.

The volatility in the stock market hasn't been this high since 2008 and it set new records. In two consecutive days, we saw the largest one-day point gain and the largest one-day point drop. The S&P 500 was up or down by 4% or more for eight consecutive days—the previous record was 6 days in November of 1929. On March 25th, the DJIA was 25% off its high and 22% off its lows so technically it was in a "bull" and "bear" market at the same time all in a little over a month.

The biggest loser has been energy with a -50.5% loss for the quarter. The oil price war between Russia and OPEC along with at least a 25% reduction in consumption has resulted in WTI crude oil prices plummeting to $20.48 per barrel at quarter end. Oil prices have not been this low since 2002. With production ramping up in OPEC countries and Russia and lower global demand, a supply surge is expected to keep prices low. Even if a production agreement is reached, demand is so low prices are likely to remain below the breakeven price for US shale oil producers. Although low gas prices can be good for consumers, these low oil prices increase financial risks in US shale oil companies as well as the economies and other businesses of the states where they are located.

2020 BENCHMARK RATES OF RETURN

INDEX	FIRST QUARTER	YTD
S&P 500	-19.60%	-19.60%
Russell 2000	-30.61%	-30.61%
International	-22.83%	-22.83%
Fixed Income	3.15%	3.15%
JPMorgan Diversified*	-13.66%	-13.66%

*25% S&P 500 large cap stocks,10% Russell 2000 small cap stocks, 15% MSCI EAFE international stocks, 5% MSCI EME emerging market stocks, 5% REITs, 25% Barclays US aggregate bonds, and 5% each in short term Treasuries, high yield global bonds, and commodities.

All sectors have been negatively affected. Financials were also hit hard with a -31.9% return and industrials with a -27.0% return. The best performing sector has been technology with a -11.9% loss for the quarter followed by healthcare and consumer staples with losses of -12.7% each.

The panic selling was not limited to stocks; it was felt widely across asset classes. Falling stock prices triggered margin calls and investors were forced to sell stocks at prevailing lower prices. Investors then began to sell anything that had retained its value such as gold and bonds. Because there were few buyers, this selling led to freezing credit markets and falling prices in most asset classes. The Federal Reserve responded quickly by cutting the fed funds rate, injecting $1.5 trillion of liquidity to the banking system, reinitiating quantitative easing by purchasing Treasuries, mortgage-backed securities and investment grade corporate bonds. It also created a $1 trillion backstop for short-term business loans. This action stabilized the financial system for the time being. Separately, the House and Senate passed the CARES Act which was a $2.2 trillion package. Between the liquidity injection and stimulus, the dollars spent so far is almost 20% of GDP. For comparison, the Eurozone has spent nearly 12%, the UK 15.5%, Japan 3.6% and China has spent 8.9% according to Cornerstone Macro. We may still see additional stimulus packages in the future.

The federal budget deficit this year could be $2.5 trillion or higher. Prior to COVID-19, the deficit was projected to be $1.1 trillion. This $2.5 trillion deficit is 11.8% of GDP. The largest deficit in the last 75 years was 9.8% of GDP in 2009. At some point, the government will need to tackle the issue of how to pay for this; many analysts expect higher future taxes.

The CARES Act has provisions specifically directed to try to help people who will be unemployed and there will be many who will qualify. Initial jobless claims spiked 3.3 million in one week, the following week saw an additional 6.6 million and more layoffs are expected. The previous high for claims was 695,000 in October 1982. Even during the Great Recession, the highest weekly level was 665,000. The unemployment rate was only 3.5% in February but is expected to surge. Brian Wesbury with

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First Trust projects that it could be 10% when the April figure is released (in May). JPMorgan projects the unemployment rate could rise to 12.5% which would be the highest it has been since the Great Depression.

GDP had been growing near its long term projected rate of 2%. That growth has been disrupted by COVID-19 even in light of the stimulus, the extent to which is unknown at this time. The analysts we follow have widely different estimates for second quarter GDP growth but they all agree that we are in a recession. Growth is expected to range from -10% to -24%. The fastest drop in GDP since 1947 was the first quarter of 1958 due to the Asian Flu and GDP growth was -10%. A recession is expected when the country (and world) is essentially shut down. The question becomes, how long will the economy be shut down and how quickly does demand come back once there is a vaccine and social distancing/quarantining measures are eased. Because the US economy was in good shape before, many are hopeful that the recovery will be buoyed by pent up demand. However, the longer the shut down lasts, the more risk that companies change the way they do business . Structural problems in the economy and financial markets could also emerge. As Warren Buffet as been known to say “only when the tide goes out do you discover who has been swimming naked”. The shutdown may last longer than many people think because a vaccine is needed before people can safely go back to normal behavior otherwise we could see a second wave of contagion. Most analysts think we will see a “U” shaped recovery. David Kelly describes it as “fall, stall and surge”.

Corporate earnings will also be negatively affected but again the extent is unknown at this time. Companies have been given extensions on reporting results and many are declining to give guidance or forecasts. David Kelly of JPMorgan believes we may see a -15% decline in operating earnings per share in 2020. Brian Wesbury projected that 2nd quarter earnings could be down 60%-80%.

Globally, countries are in a similar situation. Their economies are essentially shut down too. The dollar has been strong which has led to underperformance by international stocks. This can also make it difficult for emerging market countries to repay their dollar denominated debt.

The Federal Reserve cut its benchmark interest rate from 1.50%-1.75%. to 0%-0.25% Chairman Powell has said he does not want to see US yields go negative as some international yields have done. The 10-year Treasury bond has seen its yield fall from 1.92% at the end of December to 0.70% at the end of March. It briefly fell as low as 0.398% on March 9th. David Kelly does not believe the Fed will raise rates any time soon, maybe not until 2022. The Fed has indicated that it will be patient. It may be difficult to produce an income stream from the fixed income allocation in portfolios for the foreseeable future.

Although the market is down significantly, analysts are quick to point out that the market may not have bottomed yet—since earnings are unknown, stocks are trading on sentiment. At the very least, the market could go back and retest the lows. It’s next to impossible to call a market bottom when it is happening—it’s much more visible in hindsight. Although it may be tempting to “sit out” until things look better, now is not the time to sell stocks because by the time things look better, stocks may have already moved higher and you could miss out on the rebound. The best one-day gains in stocks are often right around their worst days. According to BlackRock, missing out on the 5 best performing days over the last 20 years reduced your stock return by 30%; missing the 10 best days reduced your stock return by 50%.

It’s difficult to a call a market bottom but David Kelly believes that stocks may recover their lost ground and reach new highs in two to three years. If so, that would mean stocks have good growth opportunities from here even if it is not the low. Retaining or even increasing stock allocations will likely be important to helping clients reach their financial goals as bond returns are likely to be much lower than average. Regardless, investors should invest according to their risk tolerance and not take on more risk than they are comfortable with.

The CARES Act has many provisions to help individuals and businesses including but not limited to tax rebates, forgivable loans, and extensions for tax payments. In addition, the age for Required Minimum Distributions (RMDs) to begin had been changed from 70 1/2 to age 72 in December 2019. Now with the CARES Act, RMDs can be waived in 2020 for anyone who wishes not to take a distribution. For those experiencing cash flow difficulties, the 10% tax penalty is also being waived for people who take money from their 401k or IRA before age 59 1/2. Please talk to your advisor if you have questions about the CARES Act, your situation or your accounts.

CAMBRIDGE ADVISORS NEWS

We sincerely hope that this newsletter finds you and your families healthy and well. In these unsettling times, we want you to know that we are committed to providing our clients the high quality services and personal attention they have come to rely on. We’ve spent the last several years updating our technology so we are fully able to work from remote locations if we would need to due to COVID-19 or any other disruption. We can help you access the client portal if you would like to get set up or have forgotten your password.

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