TFC FINANCIAL
The Financial Counselors

MARKET UPDATE
March 18, 2020

OUR VIEW

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Pandemic Update

The Covid-19 pandemic has made lockdowns, quarantines and "social distancing" the norm in much of the world. Violent moves in the market have become commonplace, a natural response to uncertainty about the spread of the virus and resultant impact on economic growth. Although Covid-19 is far less lethal than SARs, MERs and Ebola, the novel coronavirus spreads remarkably easily and can be spread by individuals who don't appear to be sick. As of March 18th, there were more than 200,000 confirmed cases of Covid-19, with more than 8,000 deaths. China represents more than 80,000 of the reported cases, but the outbreak has spread rapidly around the world. According to the World Health Organization, Europe is now the epicenter of the outbreak with more reported cases and deaths than the rest of the world combined apart from China. The pandemic creates a supply shock, disrupting the availability of goods; demand for goods and services also is changing in response to the pandemic. Notably, economic activity that requires social interaction and/or travel is disappearing and is unlikely to resume until the outbreak is contained.

The breakdown in the "OPEC +" arrangement between Russia and Saudi Arabia compounds the economic uncertainty created by the pandemic. Tensions between the two major oil producers started when Russia refused to slash oil production during an OPEC meeting on March 6th. Saudi Arabia escalated the conflict, offering discounts to buyers and promising to pump more crude oil than it had ever pumped before. Russia then said it too could raise output. Consequently, on March 9th the price of Brent crude plunged by 24%, to $34 a barrel — the highest one-day drop in nearly 30 years. This isn't the first time that Saudi Arabia has tried to change the balance of power in the oil industry. Saudi Arabia's production expansion in 2014 and 2015 flooded the market with oil but didn't destroy the U.S. shale industry. This time, the pain may be most acute for smaller, unstable countries dependent on oil revenue, such as Nigeria, Iraq and Iran. U.S. shale drillers will again come under pressure, putting stress on the high yield bond market and on employment in the shale industry. Russia and Saudi Arabia may have the financial reserves for a near-term price war but the longer the conflict the more strain on their budgets and domestic economies.

Encouraging news from China is the decline in the total number of new Covid-19 cases. Most large Chinese industrial firms have reopened their factories and appear to be returning to normal levels of productivity. China is planning a significant boost in public investment projects this year, reversing a multi-year falling trend in fixed asset investment. Monetary policy easing is also significant, targeting easier credit for private and state-owned enterprises. China is a major force in supply chains and as a consumer of commodities and consumer products. China's actions in response to the pandemic should have a major impact on the pace of recovery throughout the world.

The Covid-19 pandemic is expected to cause a virtual collapse of economic activity in the second quarter; full-year projections are for global GDP to decline by more than 1%. That full-year global GDP estimate may be overly optimistic given unprecedented measures being put into place to curb the spread of the virus. Consequently, expectations of a rapid "V" shaped return to growth may be overly optimistic -- a slower "U" shaped recovery may be the more likely scenario. Economic activity and equity markets have historically recovered reasonably quickly from past pandemics. If Covid-19 creates a painful but temporary interruption of economic growth, a rapid equity market recovery is likely. The primary risk for investors is that the pandemic causes widespread employment losses and business bankruptcies, creating more permanent harm to the global economy.

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The response of governments and central banks will have a major influence on whether the pandemic causes a temporary interruption of economic growth or spirals into something more severe and longer lasting. We worry that the pandemic could cause a surge in business failures and unemployment – essentially turning a liquidity crunch into a solvency crisis. Central banks are taking meaningful steps to address market liquidity issues, but there are limits to what monetary policy can do. It is critically important that governments follow through with effective fiscal responses. Government leaders are "behind the curve" in many countries, but discussions about fiscal solutions appear to be gaining traction. Investor fears should ease if policymakers take powerful and convincing actions to prevent liquidity issues from creating a solvency crisis.

We remain focused on long-term objectives for each of our clients but are aware of the risks and opportunities created by market volatility. Establishing appropriate liquidity reserves is always an important aspect of the work we do for clients – today that is more important than ever. Market volatility also creates opportunities. Consequently, we are selectively "harvesting" tax losses and repositioning proceeds into investments that we think will offer superior growth prospects and/or lower risk than the investments we've sold. We are also aware that the investment environment has changed, and that some investments that looked attractive before the pandemic may be less attractive even if the pandemic is contained. Some cyclical or indebted companies may struggle to weather the economic slowdown, which reinforces the importance of creating a well-diversified portfolio.

The frightening headlines about Covid-19 may not fade for months. The markets, however, may turn long before the end of the crisis.

It is easy to be torn between the extremes of greed and fear at times like this. Alpine Macro's Chen Zhao has some timely advice: "the speed of the expected stock market rally could mirror how prices have fallen. This is the key reason why investors should neither try to time the market bottom, nor sell into the panic." The frightening headlines about Covid-19 may not fade for months. The markets, however, may turn long before the end of the crisis. There needs to be evidence that containment measures are succeeding to slow the outbreak. Investors will be looking for a slowdown in the number of new Covid-19 cases, progress in the ability to treat victims of the outbreak, and early indications that people can resume normal living. Government policy will also be a major factor, with investors hoping to see a "safety net" in place that prevents large scale bankruptcies and unemployment.

We will continue to monitor developments in the outbreak and implications for economic growth, evaluating whether further changes are called for. In the meantime, please do not hesitate to contact me or your TFC advisor with questions.

Sincerely,

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