Market Review with Ted Halpern

We’ll Make It Through This Historic Time in the Markets

You know the first quarter of 2020 was severe when the word most used to describe it is ‘historic’. Q1 2020 was truly one for the record books.

In the U.S., markets experienced the worst quarter since the 1987 market crash and the worst first quarter of the year ever. The public health crisis we are experiencing now is a global challenge that caused markets across the world to experience historic declines during the quarter.

The combination of an oil crisis and the Covid-19 crisis was simply too much for markets to handle rationally. Either one of these events would cause a correction; paired together, a bear market was born.

The bear market period we experienced was notable for its volatility and speed—to the downside, but also to the upside! Just look at the extraordinary moves during the final month of the quarter:

- Six of the top 10 largest single day point losses occurred in March 2020
- The second worst percentage declining day ever occurred on March 16, 2020.
- In a mirror image, 7 of the top 10 best single day market gains occurred in March!
- On a percentage basis, March 24, 2020 was the 4th highest gain in market history.
- The Dow Jones Industrial Average had a cumulative absolute percentage change of 117% in March 2020. With only 22 trading days in the month, that is an average absolute daily change of a whopping 5.3%. The next highest month (Oct 2008) only had an average absolute daily change of 3.8%.

Good riddance to you, March!

Time in the Market is Better than Timing the Market!

The most money in equity markets is made when the situation goes from bad to ‘less bad.’ Staying invested allows you to participate in the quick upward swings of markets. For investors who reacted by selling to cash (fortunately none of our clients), and missed those key days—the recovery will be far slower. Markets improve during the bad news; they do not wait for an ‘all clear’. In fact, once we do get official word of an improved situation, markets have likely already priced in much of the recovery.

Extreme cycles like this require extreme help. Monetary and fiscal policies are in place in
countries all over the world. The U.S. enacted the largest-ever relief package in a completely bipartisan manner.

First, the Federal Reserve’s monetary policy changes “cleared the pipes” for credit markets, allowing liquidity to flow and trades to occur. The $700 billion+ program provides a backstop to certain credit markets, and now the Fed will act as a direct purchaser of other debt. The Fed’s actions helped to ensure credit markets function normally and provided the required liquidity for the massive market volatility. For every seller, there must be a buyer, and the Fed is playing that role.

The CARES Act provides a record $2.2 trillion+ of support and was accomplished in record time with bipartisan support. The purpose of this fiscal package is to fill some of the gap for businesses and individuals during this period of economic hiatus. These actions taken match past wartime efforts.

The Real Question Is: How Long Will the Bear Market Last?

This largely has to do with two key things: 1) when we reach a turning point with the virus (perhaps when the cases hit a peak or when we have effective treatments) and 2) when the economy is able to restart.

Data from the IHME model states the peak of coronavirus in the U.S. will be April 15! Good news, this date is very close. Bad news, data on the virus will grow to hit this peak over the near term and these headlines create anxiety. Certainly, any news about treatments or when we might be able to begin a slow return to normal economic activity will inspire markets.

Without knowing these two important variables, we can look at the factors we do know. There are 3 types of bear markets:

1. **Structural bear market**: The 2008-2009 bear market was an example of a structural downturn. It was caused by a financial bubble, too much leverage, credit market dislocations, and other imbalances.

2. **Cyclical bear market**: Cyclical bear markets happen as a function of the business cycle. When growth leads to inflation, interest rises too quickly, loan activity declines, and demand wanes...these trends are cyclical in nature.

3. **Event-driven bear market**: Event-driven bear markets are triggered by an external event, like an energy crisis, war, or a global pandemic.

Data from Goldman Sachs going back through all of market history, examines the relative magnitude and duration of each of these categories. It is logical for structural bear markets to be the most severe, as they result from systemic issues in the financial system and capital markets. These situations take a significant amount of time and pain (in the form of bankruptcies, restructurings) to clear up.

Cyclical bear markets are second in terms of severity. They typically require the business cycle to run its course, accompanied by monetary and fiscal stimulus to stoke demand. Cyclical bear markets can be significant, but have tended to resolve themselves with time and adequate policy responses.
Last are ‘event-driven’ bear markets. These have shown, throughout history, to be shorter, less severe on the downside and take less time to recover than other types of bear markets. This makes sense. In many cases, the global/US economy is in decent or good shape before the event takes place, meaning that it does not take quite as long for the economy to recover once the impact of the event fades. Fortunately, we had an outstanding economy prior to this crisis.

Millions of jobs were lost very early in the crisis as businesses made swift and severe adjustments to cope with shutdowns and restrictions. But once these restrictions are removed, the lost jobs could return at a strong pace—certainly more quickly than if this were a structural or cyclical recession.

It is important to keep in mind this is a unique situation caused by a pandemic event. There is a risk that an event-driven bear could morph into a structural bear if the crisis is not contained within a reasonable amount of time.

The massive size and speed of the fiscal ($2.2 trillion) and monetary (virtually infinite liquidity) stimulus should help keep this bear market in the event-driven category for a few months. If we can manage to contain the crisis and the ‘flatten the curve’ in the near-term, then we can slowly get back to normal economic activity.

**Time Will Tell.**

The shorter the time it takes to contain this virus, the steeper the recovery. The longer the time, the slower the rate of recovery.

At this point in the market cycle, everyone wonders if we have seen the market bottom or if it is still to come. As you might imagine, this is like trying to guess the lottery numbers for a future drawing. There is simply no way of knowing. However, history tells us bear markets can come to an end even as the news remains bad or gets worse. In other words, I think on day 1 of the new bull market, we will still be reading about job losses, lost profits, and bleak statistics about the pandemic.

Since we are in the midst of the bear market, the most important outcome for investors is to make sure you are properly positioned from Day 1 to participate in the rebound when it begins (if it already has not done so).

Remember, in an event-driven bear market, the recovery can arrive far sooner than many anticipate. Even during the financial crisis, the bottom of the bear market was in early March of Q1 2009, but the worst of the GDP data did not come until June of Q2 2009.

This is a reminder that the stock market is not the economy. One can surge while the other remains in tatters and vice versa.

“In bear markets, stocks return to their rightful owners.”

**The good news is certain to come!** Even the worst of the doomsayers believe we will experience steep, record-setting growth quarters once this has passed. Opinions only differ on timing—whether the recovery will commence during Q3, Q4, 2020 or Q1 2021.
In our view, we are nearing peak numbers for the virus and the massive stimulus (Fed and Monetary) will propel a substantial recovery. Between right now and the other side of 'now', we expect a “W” type of move for markets as uncertainties persist. Once any of these time variables comes more clearly into focus, the recovery can gain sound footing and forge ahead to a better tomorrow!

When progress is measured generationally, results and performance should not be measured quarterly.

Be safe! And, here is to some health, wealth and happiness ahead!
Investment Commentary with Kirsty Peev, CFP®

Summary:

The dual factors of a global pandemic and a potential oil price war combined to produce the fastest bear market ever in history! Equity markets started the year entirely flat in January, and then in early February, all 3 indexes closed at all-time highs! Then February and March combined to propel equity markets into a bear market.

Bond funds soared in price through the first two months of the year, then fell subject to investor fear. Losses in March wiped out the gains for the year and put all bond fund asset classes in negative territory for the year-to-date. This short-term dislocation in pricing was entirely due to panic sellers. Since the Fed stepped in to clear the credit pipes in the bond market, the resulting snap back in prices has been strong.

Our Response to the Bear Market

Now is when our proactive approach pays off. Ever since the financial crisis of 2008, we copied a process the Federal Reserve imposes on banks. We ‘stress test’ client portfolios regularly during a variety of market climates to determine portfolio capabilities. This includes extreme market conditions, and even tests of ‘black swan’ events. We use this data to build your portfolio and provide financial advice to navigate the unknown, both good and bad.

While we continue to advocate a long-term focus, “hope and hold” is not enough. Time after time, regardless of how fast or volatile or steep market reactions are, a disciplined investment approach built on asset allocation WORKS. Crisis moments like this present opportunities to actively make adjustments to benefit you for the long term.

We are making targeted purchases and sales. This includes realizing targeted profits in certain bond classes that have performed well, and adding to specific sectors we believe will thrive during a recovery. We have a strong focus on technology, healthcare, and large cap, value-based domestic equities with low volatility metrics. This helps us gain exposure to cash-healthy companies with low volatility that can sustain through poor economic cycles.
We are seizing opportunities for tax loss trading. Tax loss trading is when we sell positions that are in negative territory, and repurpose them with ETFs or mutual funds in line with your intended portfolio allocation. As usual, we avoid all transaction fees, commissions, and market timing strategies. The key here is no time out of the market while harvesting losses! These losses can be used to decrease your taxable gains in the future. We fully expect you to have gains in the future, and now is the time to put this tax-efficient strategy in place.

Your portfolio is not the same as “the market.” We take a diversified approach—which means you are less likely to experience the same level of pain as equity markets.

Equities:

Strong January jobs numbers boosted markets in February, but were overshadowed by coronavirus and the potential oil price war.

The U.S. economy had added a better-than-expected 225,000 jobs in January. There is no doubt the U.S. entered this situation from a position of record-setting economic strength in terms of record low unemployment figures.

Technically the bear market ended in March! By March 17th, prices recovered intraday to 20% higher than their low. While the losses were still painful, we welcomed this strong intra-month recovery, though we are not out of the woods yet.

Bonds:

A turnaround for bonds. The start of the year through mid-March provided bond investors with very strong gains. While equity markets dipped in February, your bond funds continued to soar in a ‘flight to safety’. Bond markets faced a real challenge during the third week in March when a ‘cash is king’ mentality took over and bond markets faced massive redemptions. These sales caused a temporary dislocation in normally efficient bond markets and negative movements ensued. Higher yielding (lower quality) bonds in particularly faced price pressure since a) these are often more highly correlated with equity markets and b) those markets tend to be the least efficient and have lower trading volumes than high quality bond markets.

The Federal Reserve stepped in to help in a big way! The Fed cut its target interest rate to near-zero. They also implemented a significant and unprecedented amount of accommodative measures including purchase of Treasury bonds and mortgage backed securities, deals with other central banks to keep financial markets flowing.

Significantly, the Fed stepped up to be a buyer of corporate bonds AND muni bonds to provide support for bond markets. Muni bonds had been a bastion of strength and stability for an incredibly long time. However, they were not immune to the negative effects of the extreme selling through and heavy selling took its toll. The Fed action has helped significantly and muni bond markets are regaining their position of strength.
Expectations and Perceptions for the Future:

**EQUITIES**

**Innovation and optimism win.** Our health and wealth both faced an onslaught of attacks, and there is no doubt this has been an incredibly painful time. However, we have also seen incredible support from public and private interventions.

- **A few examples of companies stepping up:** paying cash bonuses and pay raises to their employees, changing their production line to produce masks and ventilators, waiving delivery charges on food delivery, free storage for college students who had to suddenly move out, partial refunds on auto insurance for less driving time, direct donations, and incredible cooperation and innovation from the medical community working together on treatments and vaccines.

- **Massive and unprecedented economic stimulus packages around the globe:** In the U.S. alone the value of our stimulus package (CARES Act) totals $2 trillion—and growing.

**Stock markets will improve, even while we are still in the thick of the virus impact.** Remember stock markets are forward looking and base their prices on anticipated future earnings. This means equity markets historically show signs of recovery well before the full threat has been extinguished. The price of oil has come back significantly from the lows and there are signs of progress in OPEC talks.

**Economic stimulus, pent-up consumer demand, and the fact that the bear market started when the economy was quite strong all should serve markets and the economy very well.** The CARES Act, Federal Reserve monetary stimulus, and stimulus from states and private enterprise are designed to provide massive amounts of liquidity into the system—cash to kick-start the economy. Also, consumer demand for goods and services has not disappeared; it has been deferred until a point when restrictions are lifted in the future. We don’t anticipate a smooth road ahead—but we do firmly believe the road is pointing in the right direction for long-term market progress.

**BONDS**

**Bond analysts from JP Morgan, Goldman Sachs and Blackrock expect a faster recovery from bonds than during the Great Financial Crisis.** The Fed learned a lot from bond markets during that time, and is using the tools that proved most effective. We believe bond prices will recover faster this time around. We may still see some temporary negativity as investors sell holdings for opportunistic equity purchases, tax payments, or to shore up their reserves. Fundamentally we believe bond markets are in a place of strength and are already showing their ability to snap back quickly.

**Large scale defaults are NOT expected. We may see credit downgrades, but not defaults.** The decline started from a period of fundamental strength in the economy, and in a very low interest rate environment. We believe this selling was almost entirely about accessing liquidity, and not about a shift in the fundamental outlook for bond markets.

**High yield bond markets are pricing in a ridiculously overblown default rate of 50%**. It’s true that coronavirus will have an economic impact. But common sense tells us that 50% of high yield companies are not going out of business because of it. To provide a point of comparison, in 2008, when highly leveraged banks were literally going out of business, the default rate was 20%—and this is not the situation we have today. Remember high yield bonds are more highly correlated to equity markets and as such, historically tend to recover faster than other bond categories.
It is possible that this the record amount of global stimulus will lead to inflation. Your bond positions all have the ability to float as rates adjust! Plus, we will add in some asset classes to help push us along the rising rate curve, once we see the economy reignite.

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