PUTTING THE MARKET CONDITIONS INTO PERSPECTIVE

Old Market Axiom: The stock market can stay unhospitable longer than you can stay solvent.

"It only took the S&P 500 six days to fall from an all-time high into correction levels, marking the broad index's fastest drop of that magnitude outside of a one-day crash. The Dow and S&P 500 and the NASDAQ have fallen over 25% placing them into Bear Market Status if today's close hold up.   The three indexes experienced their biggest one-week loss since the 2008 financial crisis."– CNBC

Three Mondays ago, CNBC was cheering the market's record highs and dismissing the impact of the virus as *"it was just people getting sick in China."* We disagreed, and last week we detailed our own concerns in a special Coronavirus Situation Report.

U.S. equity markets suffered a sharp sell-off at the end of February triggered by fears related to the international spread of coronavirus (Covid-19). This started when all 3 major stock markets suffered a one- week loss near 12%--which has occurred only three times since 1940.

It has now been almost 3 weeks since the markets topped out and began what we termed last week as the Coronavirus Correction. In percentage terms, bear markets are defined by a 20% drop from an all-time high. Today the drop stands at -**25%**.

Certainly, a pullback was expected and even welcomed by most market watchers (including us) who were worried about the sustainability of the recent market drive. What was not welcome was the rapidity by which the decline occurred nor the Coronavirus that has facilitated this market decline. While there have been rally attempts during this correction, markets have free fallen into bear territory and volatility in both directions remains off the charts.

This explains why we have been so busy, adjusting our positioning, rebalancing portfolio risks and accumulating extra cash.

The spread of coronavirus is having a very real economic impact, especially internationally. The Global Manufacturing Purchasing Managers Index (PMI) took a big dive in February as activity in China, the world's second-largest economy, ground to a halt. Given China's central role in global production, there has been a significant disruption to supply chains which will almost certainly have an impact on corporate profits.

In the US, The **NBA** just suspended their season. Flights from Europe curtailed for a month. NCAA March Madness is no more. There are a lot of people not buying hot dogs, sodas, and parking. That's a lot of low wage workers put out of a job. The theme parks could be next. Restaurants, bars and movie theatres could soon follow suit. Markets don't like uncertainty. We can expect nothing but uncertainty for the next several weeks at least.

Central banks throughout the world have responded to the added risk by aggressively easing monetary policies. In the U.S., the Federal Reserve reduced interest rates by -50 basis points in the first *emergency rate cut* since 2008. Investors know the US government has only so much room to maneuver. Even the announced injection of **one half TRILLION dollars** into the system failed to stop the deleveraging.

With the S&P 500 Index is now trading **-25%** off the recent all-time high, it is now sitting at a critical point. What happens over the next few days may have a profound effect on the markets. At this point, market breadth and leadership have deteriorated in line with the indiscriminate selling. The relative strength of these two important indicators will be key in determining the ongoing degree of risk in this market as it attempts to rally off these oversold levels.

Summary:

The Bear Market in the US markets has arrived along with the virus. The risk posed by the spread of coronavirus is not being taken lightly and the collateral toll on the economy by the response measures, has certainly weighed on the global economy.

If the measures being taken now to contain the virus and "flatten the curve" are successful, and the virus soon runs its course, it may not have a prolonged recessionary effect on the U.S. economy. However, if the situation continues to worsen in upcoming weeks some key economies in Asia and in Europe will likely fall into mild or possibly even severe recessions and in that case, the Dominoes may start to fall. Historically the bear market is always well ahead of the recession. Sometimes bear markets occur without an ensuing recession.

The S&P 500 is now back to where it was at the end of 2018. In the big picture, being set back by a year or so in the market occurs periodically. Such corrections have happened dozens of times in history. What makes this time seem different, however, is the *speed and magnitude* of the decline.

It is probable that stock markets will continue to remain volatile until people are confident the outbreak is on its way to being 'contained' or the panic abates.

How are we responding to these changing conditions?

Here, we have saved the best for last. Most of our clients are retirees with the largest portion (if not all) of their retirement assets in TIAA accounts. Our TIAA portfolios are **out of the stock markets** and have been for many months.

For those clients who are in accounts in which TIAA is not an option, at Charles Schwab, you know we have been busy, and your news is favorable as well:

- *Over the past 12 months, we have been taking profits near market highs and systematically reducing market risk levels and stock market exposure.*
- *Over the past year, our additions of bonds to our portfolios have created some impressive gains. We are in the process of banking some of those gains and moving to cash.*
- *We have systematically used the brief market bounce-backs in this correction to take some profits, rebalance and further reduce our equity risks as well. Across our models where we have equities, we continue to re-balance and reduce risk during rallies in the market.*
- *In mid-2019, we initiated a stock market hedge by adding gold to several of our positions. Our gold position was recently increased and has remained positive throughout the correction offsetting some of the market losses.*

Over the past 18 months we have been selling equities in our Schwab accounts each time the S&P reached a new high. In February we sold another 5% (just 7% off the peak) and Monday we sold 10% on the 1100 point one day bounce back so we are holding a record amount of cash. It was only in 2008 that we had more.

On Tuesday, we also sold some of our bond positions. We have enjoyed a good run with our exposure in bonds, we'll look to take some more profits and enhance our cash positions. We take comfort in noting that Warren Buffet's Berkshire Hathaway is holding more cash than at any time since 2007 according to Morningstar. Obviously, he intends to go bargain hunting when the carnage ends. We hope to do that as well. In a bear market, cash is King!

We started lowering our market risk levels (and our exposure to the stock markets) many months ago and today, they are the lowest they have been in years and they continue to go lower.

These are unprecedented times, but then again, it seems like ALL bear markets are unprecedented in their own way. We'll continue to navigate through this with our usual focus on preservation of capital. We are here for any questions or concerns, so please feel free to reach out by phone or email.

Virus Free Meetings

As you know, we have taken the Coronavirus very seriously from the beginning. A large proportion of our clients are retirees who are deemed to be particularly vulnerable to the virus at this point. We want you to avoid taking unnecessary health risks.

We are also taking the current market conditions very seriously and it is times like this that our client meetings become even more important. So, our solution is to offer you alternatives to our face-to-face meetings if you prefer.

On-line meetings. We are as close as your computer and your phone. We can help you go on-line with us and we will conduct your quarterly meeting on-line in the same manner we conduct it when you are here. It's quick, convenient and virus resistant. If you are receiving this message via email and we will help you schedule your next meeting on-line.

Telephonic meetings. We are as close as your telephone. If you don't have a computer (or your computer is not your friend) we will prepare a special packet of information to send out to you. We will review it with you via telephone until the Coronavirus situation subsides.

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