**SPECIAL REPORT | Volatility**

March 10, 2020

HORIZON INVESTMENTS®

# Equity market losses trigger marketwide trading halt

Equity markets opened sharply lower this week, triggering the first marketwide trading halt during market hours since 1997. After trading resumed in the morning, equities remained depressed throughout the day as the market reacted to the dramatic fall in oil prices and continued uncertainty about the ultimate impact from the coronavirus. Equity market volatility on Monday reached a level not seen since the 2008 financial crisis [Graph 01]. In the 11 trading sessions from February 24th to March 9th, the S&P 500 (SPX) closed above or below 2% from the previous close eight times, and above or below 3%, six times.

## What's causing the volatility?

- **Coronavirus (COVID-19) spreading.** Confirmed coronavirus cases have reached 110,000 in total, and more than 3,800 people have died. In an effort to mitigate the spread, many businesses have started implementing work-from-home plans for their employees while limiting domestic and international business travel until further notice.

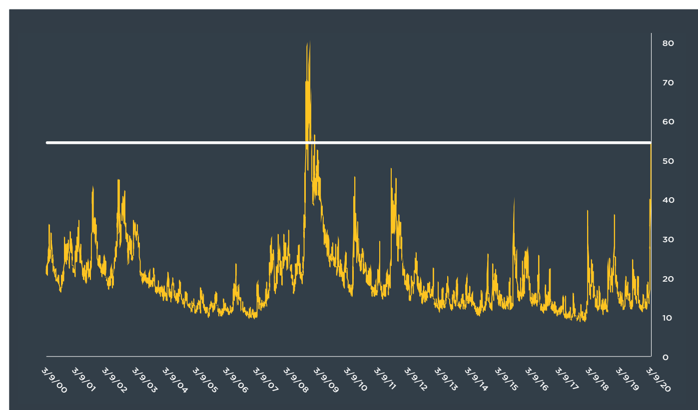
- **Oil Market dislocation.** Oil prices saw the biggest one-day decline since 1991. Saudi Aramco announced it was cutting oil prices by $6-$8 per barrel across all regions to entice refiners in Asia, Europe and the U.S. to use Saudi crude. In addition, Saudi Arabia has implied it could raise oil production to a record 12 million barrels a day, which could have drastic implications on global oil supply and demand dynamics.

  - Typically, severe oil price declines are seen as recessionary because they imply demand destruction caused by a slowing economy – that is far from the case with Monday's drop, however. Monday's drop was due to a very sharp increase in the global supply of oil, which implies something very different.

- **The field for the Democratic Presidential nomination changed significantly following Super Tuesday.** Bernie Sanders entered Super Tuesday with a large lead according to PredictIt; however, as other moderate candidates ended their campaigns, support for Joe Bidden surged in early March [Graph 02]. Markets have generally reacted more favorably to the moderate policies of Biden compared with the democratic-socialist policies of Sanders.

Graph 01

**Volatility highest since 2008 Global Financial Crisis**



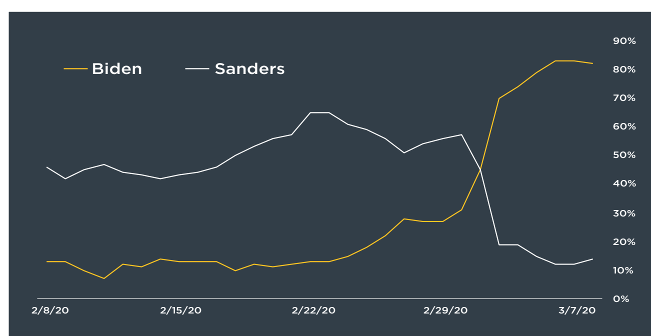

Source: Factset

## What effects have this had?

- **Equity markets have continued to sell-off globally [Table 1].**
- **Oil prices have fallen significantly.**
- **U.S. Treasury curve has continued to fall.**
- **The US 10-year fell 125 basis points from February 19th to March 9th [Table 1].** The general consensus is that falling long-term rates signify a drop in expected future growth. However, we feel that it's important to look at what's driving the change.

Graph 02

**PredictIt odds now in favor a Biden Nomination**




Source: PredictIt

Table 01

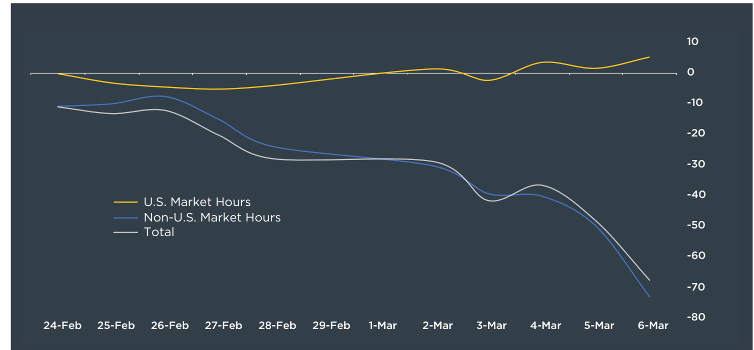
## Returns of headline broad market segments

| Market | Return Since Outbreak | YTD Return |
|---|---|---|
| S&P 500 | -17.5% | -15.0% |
| Nasdaq | -15.3% | -11.4% |
| International Developed | -11.9% | -11.0% |
| Emerging Markets | -11.7% | -9.2% |
| U.S. 10 Year Yield (bp) | -125 | -135 |

Source: Index data from Bloomberg L. P. & Horizon Investments, as of 3/9/20 close
"Return Since Outbreak" start date is 2/19/2020

Graph 03

## Change in 10-Year by Trading Session (Since close on 2/21/2020)




Source: Blooomberg L.P. & Horizon Investments

When you look at the change in the 10-Year U.S. Treasury rate when U.S. equity markets are open (U.S. Market Hours) versus the change when U.S. equity markets are closed (non-U.S. Market Hours), you'll see that almost all of the recent moves in rates occurred during overnight trading sessions [Chart 3].

This suggests foreign investors are the driving force behind demand for U.S. Treasuries as a means of safety and/or to capture a higher yield than what's currently possible in their home markets. For this reason, we'd caution against the common belief that the fall in rates is a signal of deterioration in future growth.

- **The result of the breakdown in OPEC negotiations with Russia was a 1 day drop in oil prices of over 25%.** This massive move downwards also put pressure on credit markets, specifically high yield. U.S. high yield bonds fell 3.1% on March 9th alone and are now down 4.9% for the year, even in the face of significantly falling rates.

- **Many companies are reviewing their earnings guidance to incorporate how the coronavirus has affected growth.** As risk mitigation measures like social distancing spread, business growth is likely to be affected by the disruption, which could be reflected in Q1 and Q2 earnings.

## What are we watching going forward?

The rate of growth of infected cases, and global mitigation efforts. Now that the virus has reached more areas of the world, governments are primarily focused on mitigating the effects of continued spread rather than containment of the disease. It's important that governments proactively approach this and are willing to provide fiscal stimulus when necessary.

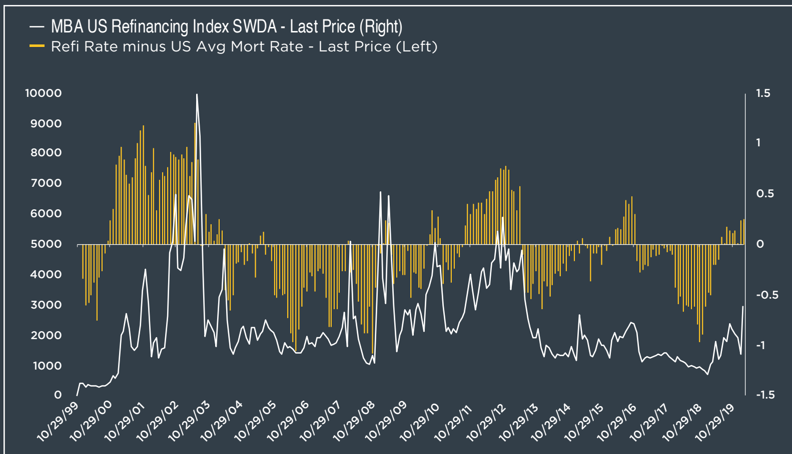
The effects in credit markets from the fall in the price of oil. The largest sector issuer of High Yield debt is the energy sector. As these debt-laden companies are forced to operate in a low price environment, it will be important to monitor price action and liquidity in credit markets when these companies are in need of short-term financing.

## What about the macro backdrop in the U.S.?

With outside events affecting U.S. equity markets, it's important to note the continued strength of the U.S. consumer and their importance to U.S. economic growth. The consumer continues to hold low debt levels relative to history, and the labor market continues to be strong, as seen with the non-farms payroll report on March 6th exceeding expectations (payrolls rose 273,000 in February vs. estimates of 175,000).

Graph 04

**U.S. Refinance Activity**




Source: Blooomberg L.P. & Horizon Investments

The net effects of the fall in interest rates and the price of oil should only improve the position of the U.S. consumer going forward. These effects may not be seen instantly, but lower oil prices means more discretionary income for consumers to spend elsewhere. The largest effect may be the fall in long-term interest rates and the potential for consumers to refinance mortgage debt. A boom in refinancings essentially acts as a form of fiscal stimulus, affording the U.S. consumer greater monthly spending power. Based on past experiences, refinance activity begins to pick up when a refi will result in savings of about 50 basis points [Chart 4]. As we have reached that rate over the past two weeks, it is increasingly likely that consumers will begin to refinance their long-term debt.

## Importance of relying on your investment process

The volatility we are seeing in markets is certainly elevated due to the exogenous risks that have affected global markets. As prices move at such a fast pace it's important to rely on your investment process and not deviate from your long-term strategy. Should you have any additional questions or comments, please reach out to your primary Horizon Investments contact.

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