Regal
Wealth Management, LLC

WEEKLY COMMENTARY

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Why Markets Are Having a Bad Reaction to an Inoculation

We hope this note finds you and your family healthy. There is a lot of confusion, and opinion, about what is happening with global markets. Until this volatility recedes, we plan on sending continued updates when appropriate. As always, if you prefer a phone call or virtual meeting we will make ourselves available at your convenience – nights, weekends, it doesn't matter.

For many investors, it may feel as if we have entered uncharted territory. While the specific circumstances may differ, it is important to remember that we have been here before. For long-term investors, especially those who receive guidance from financial advisors, times like these are the reason so much care goes into portfolio construction and financial planning. It's easy to stay invested when markets are going up, as they have been for the better part of the past 11 years. However, it is when the world seems the most uncertain that investors need to stay disciplined and trust in their preparation.

To recap today, the 7.6% drop in the S&P 500 was largely due to two key factors: **1) the stock market's continued inability to accurately quantify the economic impact of the coronavirus on corporate earnings, and 2) a somewhat unexpected, virus-induced oil price war, which has broken out between Saudi Arabia and Russia.**

These issues saw oil prices trade down by the most since the Gulf War in January 1991 and interest rates reach record lows across the board. Crude prices, along with U.S. government bond yields, are typically viewed as key barometers of economic health and confidence. Year-to-date, U.S. stocks have already fallen 15% as today's close while, globally, the MSCI All Country World Index has shed 16%. The 10-year U.S. Treasury, above 2.5% just a year ago, collapsed to a record low below 0.50%, and the 30-year Treasury yield traded below 1%. Markets expect the Fed to cut rates again next week, possibly reaching 0% on the federal funds rate within two meetings. Oil has fallen to around $31 per barrel as Saudi Arabia and Russia respond to a sudden lack of demand.

Surges in uncertainty should not be foreign to long-term investors. On October 19, 1987, the stock market fell over 20% in a single day, later dubbed "Black Monday." One can only imagine how this must have felt on Wall Street, let alone for those on Main Street watching the evening news. On May 6, 2010, a "flash crash" caused the Dow to drop 9% before quickly recovering. Some large cap stocks briefly fell below $1. In August 2011, the U.S. debt was downgraded causing a 7% market drop the next day, pushing the S&P 500 to 17% below its peak just months prior. In the moment, there was significant uncertainty not only for markets but for the functioning of the U.S. government.

These are but a few examples of swift spikes in uncertainty, each with different catalysts. However, they did all have one thing in common: markets eventually recovered each time because the underlying economy was still healthy. In the short run, markets can swing wildly in any direction and can often do so for longer than investors expect. However, having a solid economy and sound fundamentals can form a foundation on which the stock market can stabilize. This is often the key difference between a market correction and a true bear market.

How does this apply to today's environment? In many ways, the market is having a bad reaction to governments and the public health sector inoculating society against the coronavirus (COVID-19). Quarantining cities, instituting work-from-home policies, canceling conferences, social distancing and other responses to the coronavirus are an attempt to keep contagion at bay. *Whether this will work is still unclear.*

This is not 2008 when the financial system came to a grinding halt due to its own excess. This is not 2001 when tech valuations were sky high. This is not due to the misallocation of resources, runaway inflation or significant trade, fiscal or monetary imbalances. In fact, it's highly unusual that we can pinpoint the exact cause of economic weakness. Typically, we rarely know the direct reason for poor economic readings and are forced to make educated guesses or wait for more data. In this case, we know with a high degree of certainty why manufacturing activity in China came to a halt and why service sector activity will likely slow in Europe and possibly the U.S.

Still, with recent market swings, this knowledge may provide little comfort to some investors. This is when it's more important than ever to focus on holding appropriately diversified portfolios rather than attempting to trade in and out of markets. Investors should take comfort in the fact that balanced portfolios have done what they were designed to do this year: create a steadier ride amid market uncertainty.

The bottom line? As the U.S. stock market approaches bear market territory, it's important for investors to stay calm, remind themselves of past pullbacks, and continue to hold on to balanced portfolios.