The Stonebridge Market Commentary

March 1, 2020

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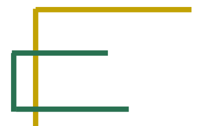
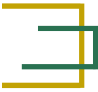




Equity Market Commentary

I'm not often speechless but watching the market last week left my mouth hanging open. Markets often behave in ways that are hard to explain but the last few days were a doozy. We have been watching and reading scads of articles trying to get a handle on how much disruption the coronavirus will potentially have on the world economy and our economy domestically. This effort has been going on since at least mid-January. Since the virus has been front of mind, the market has had a couple of bad days, most notably the last day of January. Then as the story grew, the market sprinted to new highs before last Thursday when the current downtrend began. Much of what has transpired regarding the virus was predictable, and yet last Monday the wheels came off.

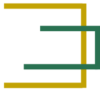
The fact that we lost over 11% on the S&P so quickly made me look for something comparable. I found the aftermath of 9/11 was similar. In both cases we faced several "known unknowns". Like today, one of the most important fears then was how badly will this event hit the economy? Will there be a recession? Of course, in 2001 we had the added concern of going to war and the real possibility of further attacks. The chart of the period before and after 9/11 is below. Remember that the stock market was closed for a week, reopened on 9/17 and promptly dropped 10.2%. For the rest of the year the market gained back most of the drop.

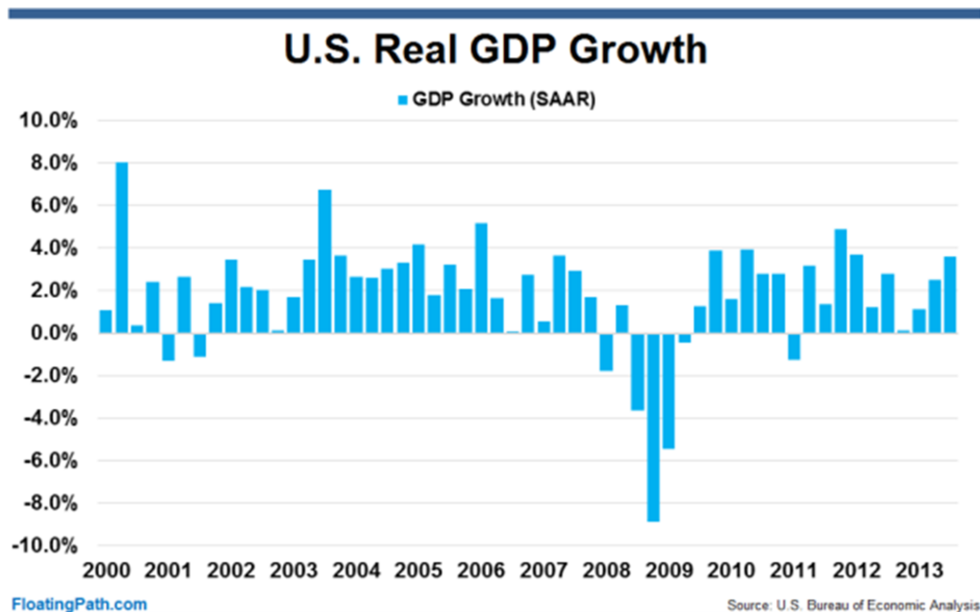
How about the economy? Remember, we were already trying to recover from the dotcom bust in 2000-2001 when 9/11 happened. In fact, revised data show the economy contracted in the first three quarters of 2001 and then bounced 2.7% in the fourth quarter. So, no recession then. How about now? Time will tell but it is clear that the economy will slow to a degree worldwide this spring. Travel is suffering and supply chains are disrupted. Lack of components will cause production slowdowns or even shutdowns.

Like all news coverage these days any big story is susceptible to overhyping and this one is no different. Some perspective may be in order. As of this writing we have had 80-90 cases of coronavirus and five deaths in the U.S. According to the CDC we have had 32 million flu cases this season. This resulted in 14 million doctor visits, 310,000 hospitalizations and 18,000 deaths. I'm not saying that this new virus is not

Table 1

Source: @StockChars.com





bad, it is, but I am surprised by the 3225 point (11.5%) drop in a week. I think a measured approach will pay off here. Be mindful of your risk tolerance and above all, don't panic. Last week's drop is a pretty good-sized down payment toward any bear market we may encounter. We may have a recession from this, and we may not.

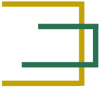
Certainly a recession is in our future, it always is after all, but is it now? We'll know more in a month.

As far as February goes, it was fine until the final week, just like January. For the month the S&P fell 8.41% and for the year we're down an almost identical 8.56%. What to do now? Above all be measured in your response to the day to day turmoil of the news cycle. There will be more cases of the virus in the U.S. and with them will be more uncertainty. Know that just like SARS and Zika, this will pass. Don't turn your investments upside down.

Fixed Income Commentary

As you are aware, we have been advocating and implementing defensive strategies for client portfolios for some time now. The moves to de-risk portfolios by moving equity allocations lower and fixed income higher do not eliminate volatility in turbulent markets like we saw in the last seven trading days of the month, but they certainly have a cushioning effect on values and performance.

As volatility roiled the equity markets the latter half of the month, the flight to safer assets propelled bond values to new all-time highs. The 10-year US Treasury bond continued to set new historic low yields throughout the last week of the month, ending trading at 1.13%. The 30-year Treasury bond yield fell to just 1.65%. That's 1.65% for 30 years! The shift in rates did drive fixed income benchmark indices' performance to big monthly gains. The ICE BofA 1-10 Year US Treasury Index rose 1.61%. Tax-exempt bonds had the strongest weekly rally in seven years during the last week. 10-year AAA rated benchmark municipal bonds now yield less than 1% (closing the month at 0.93%). The ICE BofA 1-22 Year US Municipal Index returned 1.05% in just one month. Given the rally in bonds, we continue to move cash into fixed income markets with a measured approach only when we find opportunities for added yield pick up



within our strategy of positioning along the curve for maximizing returns while minimizing duration. If low interest rates here leave you uninspired, just consider that German and Dutch 30-year yields turned negative at month-end. Compared to paying someone to borrow your money, the rate environment here may not be so unattractive after all.

Sources:
Data sourced through Bloomberg, Morningstar, @StockCharts.com, and U.S Bureau of Economic Analysis

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