2/28/2020		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	25,409.36	-3583.05	-12.36	2.54	-10.96	-2.22
S&P 500	2,954.22	-383.53	-11.49	2.04	-8.56	5.80
NASDAQ	8,567.37	-1009.22	-10.54	1.02	-4.52	13.41
S&P MidCap 400	1,814.00	-270.33	-12.97	1.97	-12.07	-5.44

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	0.88	Euro/Dollar	1.10	1.22
5-Year	0.92	Dollar/Yen	107.87	-3.44
10-Year	1.14	GBP/Dollar	1.28	-1.44
30-Year	1.67	Dollar/Cad	1.34	1.51

Source: Bloomberg/FactSet

Economy

The most anticipated report this week was the durable goods report, which was released on Thursday. Overall, new orders for durable goods decreased by 0.2% in January and are now down 3.9% year-over-year. Core capital goods orders and core capital goods shipments advanced by 1.1%. Core capital goods orders are one of the best leading indicators for the U.S. economy, and core capital goods shipments are used by the government to calculate business investments for GDP purposes. In other news this week, real GDP growth in Q4 was unrevised coming in at a 2.1% annual rate, matching consensus expectations. This was the second analysis of Q4 GDP, with the final report due on March 26th. On Tuesday, the Conference Board consumer confidence index inched up from 130.4 to 130.7 between January and February. More importantly, the labor market differential (jobs plentiful less jobs hard-to-get) declined from 35.3 in January to 29.8 in February. This was the largest monthly decline of the entire expansion. Finally, on Friday, personal income increased by 0.6% month-over-month in January and personal spending advanced by 0.1%.

Equities

Domestic equities continued their decline from all-time highs throughout the week as investors digested more news about the ongoing spread of the coronavirus. Over the weekend, the focus shifted from developments within China to the spread of the virus outside of China. The S&P 500 dropped 6.3% over the Monday and Tuesday trading sessions suffering its first back-to-back declines of over 3% since August 2015. The selloff persisted in the following days ultimately pushing all three major domestic equity indexes into correction territory, a pullback of more than 10% from a week ago Wednesday. Uncertainty surrounding the economic implications of the virus has resulted in a number of companies reducing or withdrawing their Q1 and full year 2020 financial guidance. Microsoft is the latest high-profile name that announced it does not expect to meet its Q1 revenue guidance in one of its business segments. All sectors finished the week substantially in the red with utilities continuing to be a relative outperformer on a year-to-date basis.

Fixed Income/Credit Market

Amid this week's flight-to-quality trade in U.S. Treasury bonds, yields are lower across the curve anywhere from 12.9 basis points (bps) to 43.5 bps. The potential impact of the coronavirus on corporations is now evident in both investment-grade (IG) and high-yield (HY) credit spreads. Week-over-week, IG option adjusted spreads (OAS) have increased 19 bps to 116 bps. On Thursday, IG spreads widened 8 bps or roughly 7.5% - the biggest move in percentage terms since the financial crisis, according to Bloomberg. Over the same one-week horizon, the move higher in HY OAS spreads was even more dramatic at +112 bps to 461 bps. Additionally, on the week IG 5-year AA, A, BBB-rated composite spreads have increased 25.6, 25.5, and 26.4 bps, respectively. HY 5-year BB and B-rated composite spreads increased 76.6 and 91.4 bps, respectively. On the week the yield on the benchmark 10-year Treasury Note decreased 30.5 bps to close Friday at approximately 1.17%.

Covid-19 Impacts The Financial Markets

The financial markets this week focused on the potential economic impact of the coronavirus (Covid-19). With 83,694 confirmed cases (62 in the United States) and 2,809 deaths globally, the virus has now spread to 50 countries. Its estimated fatality rate is 2.3% and is highest among older adults with pre-existing medical conditions (fatality rate is well under 0.5% for patients under 50 years old). For comparison's sake, in 2003, the SARS pathogen had 8,096 total cases and 774 deaths with a similar transmission rate profile (just as contagious).

The economic impact from Covid-19 will take several quarters to work through the global economy. Absent another exogenous shock it could take over a full year from the initial recognition of the virus in early December 2019 for its economic effects to be fully realized. The virus will affect the economy as people are unable to pursue economic interests due to illness or from containment efforts to control the virus' spread. Consumer spending is also likely to be reduced as consumer behavior adjusts, while individuals avoid situations that potentially expose them to the virus (for example, people stop dining out and taking cruises). Finally, supply chain issues can reduce activity as manufacturers cannot produce products without input sources.

The magnitude of the Covid-19 triggered downdraft is uncertain given the unpredictability of the virus' progression and economic impact. After a 30% plus year in 2019, we had expected the equity market to provide modest returns in 2020. The weakening domestic economy and the supply chain disruptions could meaningfully impact earnings growth. New earnings estimates for 2020 will likely be flat or up only modestly. Equity price levels and valuations are in the process of incorporating revised earnings expectations. The S&P 500 is down over 10% and has entered correction territory since reaching a new all-time closing high of 3386 only last Wednesday (02/19/2020). The blended 12-month forward price to earnings ratio was 19.0x last week and is now approximately 16.8x – its median going back to 1990 is 15.1x. Historically, 5% to 10% corrections occur a few times per year. In previous equity corrections, dating back to 1945, the average peak to trough has taken 4.1 months and the average peak-to-peak lasted just under 8 months. With today's advances in technology coupled with algorithmic trading, however, markets move much faster than in the past.

Since the end of 2019, interest rates across the U.S. Treasury yield curve have dropped as much as 75 basis points with the 10-year tenor reaching an all-time low of 1.17%. Despite historically low rates, investors have reallocated capital to bonds to mitigate risk. According to Bloomberg's forward curve matrix, the 10-year Treasury is forecast to increase only 6 bps to 1.23% within one year. The 2-year Note, thought to be a proxy of where the Fed funds rate will be one year forward, is at roughly 0.93% which implies 75 bps of reductions in the Fed funds rate. Fed funds futures predict a drop of 37 bps in the Fed funds rate by March 18th, or a 100% probability of one rate cut with a 45.6% chance of an additional cut. Fed funds futures are now pricing in roughly 2.05 cuts by the time the Fed meets in April. The Bloomberg Barclays high yield option adjusted spread (HY OAS) is up 139 bps since mid-January and 27 bps above its 5-year mean. However, the HY OAS is nowhere near its 5-year high of 839 bps on 02/11/2016.

Based on analysis from prior pandemics, Treasuries outperform at the start of an outbreak, but after 3 to 6 months equities tend to gain once uncertainties begin to subside. During times of extreme market volatility, it is difficult for investors to think rationally and control their emotions, but it is important to remain long-term oriented. Portfolios are structured based on risk metrics geared toward full market cycles. Long term investors can and will find opportunities in times of market stress.

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