April 1, 2020

First Quarter Investment Commentary

You may not feel like being congratulated, but congratulations are in order. You have managed to live through the worst first quarter on record in the U.S. investment markets. To put it mildly, the decade is not off to a good start.

You also endured the fastest, longest, hardest roller coaster ride in market history, as measured by the VIX volatility index. Basically, that means that one day the markets were down at record or near-record levels, and then as we thought perhaps the bear market would continue, we experienced near-record one-day gains.

The previous record for instability in the stock market was an eight-day stretch in November of 2008, when the markets seemed to be gyrating up and down uncontrollably after traders realized the full implications of the collapse of Lehman Brothers. At the end of this recent first quarter, the CBOE Volatility Index (VIX), presented us with a record 10-day run with the index above 60. (The long-term average for volatility, as measured by the VIX index, is 20.)

Just about every investment saw declines in 2020's disastrous first quarter. The Wilshire 5000 Total Market Index—the broadest measure of U.S. stocks—fell 20.70% since January 1. The comparable Russell 3000 index is down 20.90% so far this year.

Looking at large cap stocks, the Wilshire U.S. Large Cap index lost 19.88% in the first quarter. The Russell 1000 large-cap index finished the quarter with a similar 20.22% loss, while the widely quoted S&P 500 index of large company stocks is down 20.00% so far this year, with 12.52% of that drop coming in the month of March.

Meanwhile, the Russell Midcap Index suffered a 25.66% decline in the first three months of 2020.

As measured by the Wilshire U.S. Small-Cap index, investors in smaller companies were hit with a 31.40% decline in the first quarter. The comparable Russell 2000 Small-Cap Index is down 30.61% in the first three months. The technology-heavy Nasdaq Composite Index is down 13.10% for the year.

International investors are basically in the same boat. The broad-based EAFE index of companies in developed foreign economies has lost 23.43%% in the first quarter. In aggregate, European stocks are down 24.81% so far this year, while EAFE's Far East Index lost 18.15%. Emerging market stocks of less developed countries, as represented by the EAFE EM index, fell 23.87% in dollar terms in the first quarter.

Looking over the other investment categories, real estate, as measured by the Wilshire U.S. REIT index, posted a 25.63% decline during the year's first quarter. The S&P GSCI index, which measures commodities returns, fell 42.34% in the 1st quarter, largely due to a 37.67% drop in petroleum returns and a 17.11% drop in gold investments.

In the bond markets, the inversion in the yield curve has righted itself, though rates are at historic lows. Coupon rates on 10-year Treasury bonds have dropped to 1.50%, while 3 month, 6 month, and 12 month bonds are now sporting coupon rates of 0%. Five-year municipal bonds are yielding, on average, 1.17% a year, while 30-year munis are yielding 2.08% on average.

You don't have to ask why Wall Street traders are abandoning stocks in near panic mode. The coronavirus epidemic, physical distancing, and the closure of offices, malls, theaters, and anywhere else where people once gathered to work, has raised uncertainty about the extent of business disruption in the U.S. and world economies. Economists at the St. Louis District of the Federal Reserve Board are now predicting that the short-term unemployment rate will reach 32%, which is higher than the 24.9% rate at the worst point of the Great Depression of the 1930s. A record-shattering 3.3 million people applied for unemployment benefits in a single week at the end of the quarter. With so much of our economy shut down until further notice, it is hard to imagine that we will avoid a recession in the first half of 2020.

All is not lost, of course. There is every reason to believe that the U.S. will be back at or near the record-low unemployment when people are once again allowed to return to work and leave their homes to shop. To staunch the bleeding, America's central bank is pouring more than $3 trillion worth of loans and asset purchases into the U.S. financial system—an unprecedented commitment. The newly passed CARES Act aid package is worth an aggregate $2.2 trillion more. This aid is broadly distributed with $377 billion being used for loans to businesses that are having trouble meeting their payrolls while they sit on the economic sidelines, $560 billion for individuals and families, $500 billion in outright grants to large corporations, and $340 billion set aside for state and local governments.

There are times when we all face challenges more important than the ups and downs of the markets, and this time certainly qualifies. Staying safe, staying well, staying alive, and keeping our loved ones out of harm's way takes priority in this global pandemic. We are monitoring the markets. We believe that the traders who are making panic-stricken departures from the market are overestimating the long-term harm to Corporate America and their business counterparts around the world.

Just like in 2007-2009, we believe in the resilience of capitalism to weather yet another "once in a century" storm, and in the value of persistence while many investors are making decisions out of panic. Wall Street's quick-twitch traders may be caught like deer in the headlights, but seldom has a strategy based on fear turned out well in the end.

We all have much to be grateful for. We look forward to a time after this pandemic has swept across the world when we have more to be grateful for, including the safety of our loved ones, and a return of value to our portfolios and to our country's economic well-being.

We look forward to continuing to help you navigate these uncertainties and to achieve your financial goals.

Your Partners in Financial Planning Team