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Investment Strategy Insights

March 23rd, 2020

Coronavirus – Fears, Containment, and Stimulus

- Pandemic Fears
  - Fears and reduced valuations provide a rebalancing opportunity for long-term investors able to weather the storm
- Containment Pain
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- Stimulus Plans
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Pandemic Fears

- **Financial Markets in Bear Territory.** Markets closed off yet another tumultuous week on Friday, with the S&P 500 closing 31.9% below its all-time high. The risk-off environment continues to be attributed to the growing fear and uncertainty around the spread of the coronavirus, with workers in the U.S. and abroad instructed to stay home and companies to remain closed.

- **Investor Panic Intensifies.** Various measures suggest investor panic has fully set in. The percentage of stocks in the Russell 3000 trading above their respective 200-day moving average has plummeted to 5.6%, reflecting the weak aggregate performance of the average stock. The Volatility (VIX) Index ended the week at 66, a reading in the top 1% of history, reflecting the magnitude of uncertainty priced into the options market. Readings like these have historically aligned with double-digit outperformance of stocks over bonds over the following 12 mo period, with positive frequency in over 85% of those periods.

- **Equity Valuations Now Far More Attractive.** Glenmede estimates that U.S. large-cap stocks now sit near the 50th percentile of longer-term fair value, while small-cap and international stocks sit at relatively deep discounts to fair value. Long-term expected returns for stocks now appear unusually high relative to long-term expected returns on cash and fixed income. Such a shift in valuations and expected returns should provide a meaningful rebalancing opportunity for long-term investors able to weather the ongoing storm.

Fears and reduced valuations provide a rebalancing opportunity for long-term investors able to weather the storm

Containment Pains

- **Material Impact on World GDP.** If countries currently exposed to the virus confront outbreaks with similar shut-down measures, the headwind to global growth could be around 3.0%, leading to a global technical recession. This technical recession would be unusual in that it would not be driven by a retrenchment from either excessive debt or investment. Instead, it would mostly reflect the halt in economic activity as workers and consumers stopped their regular activities to wait out the coronavirus storm, pausing to resume and fulfill pent-up demand upon its passing.

- **Coronavirus Pressure on Corporations.** The previous "2020 earnings rebound" theme has been replaced with what is likely to be another soft year for earnings growth. At year end, consensus estimates for earnings-per-share growth for the S&P 500 in 2020 stood at 9.1%. Investors have begun to price in pandemic-related disruptions driving consensus EPS growth down to 4%, but this reduction may still have further to fall.

- **Is it a "V" or a "U".** Typical downturns can be described or illustrated as a "V" or a "U" shape. V-shape downturns typically result from a short-term retrenchment in economic activity due to supply or demand disruptions, which can revert to the original output path quite rapidly. A U-shape downturn is usually caused by a significant retrenchment from over-spending or over-borrowing that results in longer downturns and has the potential to create some measure of permanent impairment to the trend of economic and profit growth. All historic epidemic and pandemic events in the past century have exhibited V-shaped downturn behavior.

The economic headwind will depend on the magnitude and length of efforts required to contain the virus

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Stimulus Plans

- **U.S. Monetary Bazooka.** The Federal Reserve made another move towards monetary easing. After lowering the fed funds target rate from a 1.25-1.5% range to 0-.25% in two separate actions in March, the Fed has now provided a lifeline to money market funds in a step that likely eases the stress brought by outflow. The next move will likely surround efforts to stabilize municipal securities.

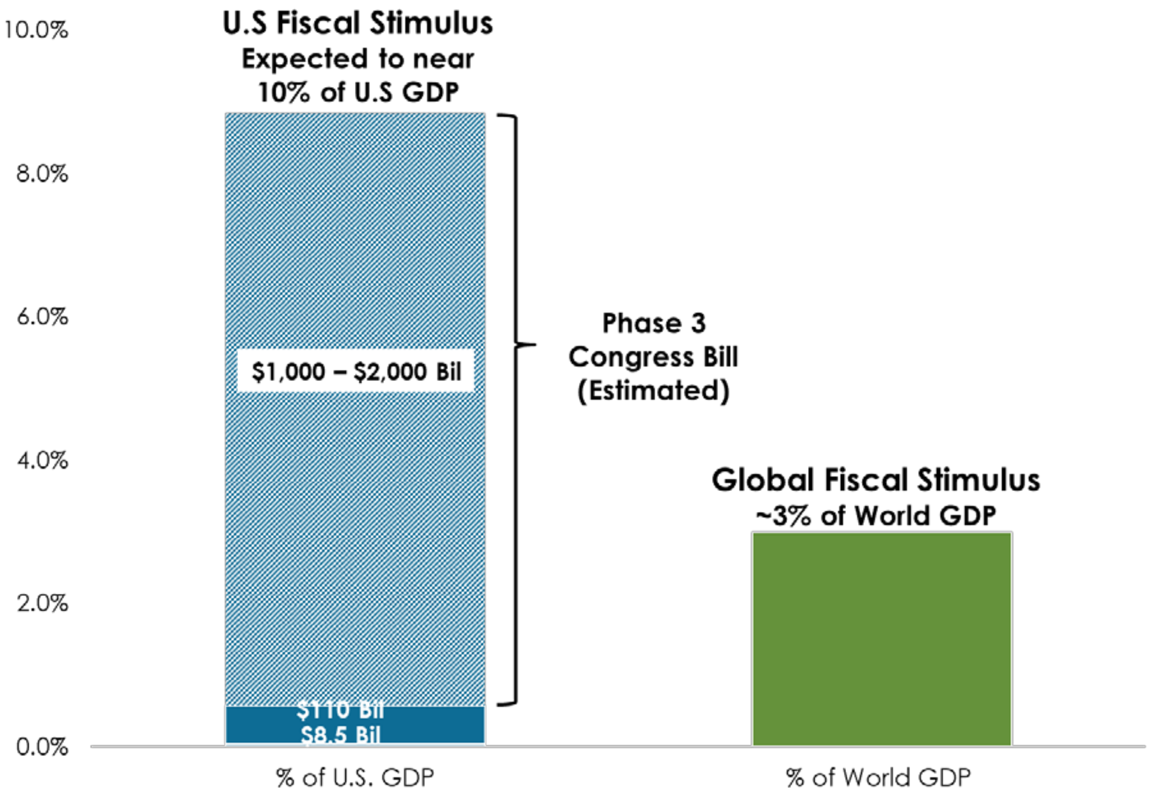
- **Still-Pending U.S. Fiscal Spend.** With overwhelming support, the Senate passed a second fiscal package of $110bn last week. Now, a new, more massive fiscal package, of over $1tn, is going through Congress. This plan includes at least $500 bn in direct household rebates, $50 bn in airline loans, $150 bn in loans to other distressed sectors, and $300 bn in small business loans. With this plan, total fiscal stimulus in the U.S. would accounts for as much as 10% of U.S. GDP. The underlying goal of the plan is to make the initial surge of unemployment temporary, prevent more layoffs, and allow for a quick resumption of hiring in the rebound.

- **Global Stimulus Too.** Worldwide governments continued to increase monetary and fiscal easing in response to the uncertainty surrounding the pandemic. The ECB announced a massive increase to its QE program. The €750 bn of bond purchases, also known as the PEPP*, will total €1.05 tn in securities. The Bank of England (BoE) added £200B to the QE program to a total of £645B, and China is set to unveil new fiscal stimulus measures to revive its economy, including infrastructure spending backed by as much as 2.8T yuan.

[Governments are ramping up their effort to provide material fiscal and monetary support during the coronavirus crisis

Chart of the Week:

Fiscal Stimulus is Ramping Up and More is Expected



Source: Glenmede, Cornerstone Macro, UBS *Data through 03/20/2020*

**PEPP: Pandemic Emergency Purchase Programme*

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