Investment Commentary

April 6, 2020

The coronavirus has brought life to a near standstill and the question on everyone's mind is "when will things return to normal". We are in a rolling lockdown established by state and local governments, businesses and other institutions. It is reasonable to be prepared for the lockdown continuing another 6 weeks or so. There is likely another 2 to 3 more weeks of bad news as the number of new cases increases.

At some point we will see a moderation in the spread of the virus and then some light at the end of the tunnel. That will provide much needed clarity on how long the lockdown will last. I expect a gradual relaxation of the lockdown with restaurants and other local businesses opening up and large events such as festivals, concerts and sporting events taking longer.

The Economy

We are now in a recession and the rate of unemployment is moving up rapidly. The severe contraction in the economy will continue during the 2nd quarter and into the 3rd quarter. The rate of unemployment will be extraordinary as layoffs and furloughs continue. Businesses both large and small have experienced a significant decrease in revenue and profits will suffer over the next few months.

Individuals and business are now at the point of having to decide which bills to pay ands which to postpone. It is estimated to be about 3 weeks before individuals begin receiving government stimulus payments. Small businesses could begin to receive loans within a few days although there will be a huge backlog of applications.

It remains to be seen how effective the stimulus will be and if it will keep the economy propped up enough until the lockdown is lifted. But once the lockdown is lifted the economy could experience a significant bounce and hopefully return to normal within months.

Predictions about the effect on the economy are "all over the map". Some predictions are very dire while others sound as if the economy will snap back quickly. No one knows for sure and I suspect the real truth lies somewhere in between.

The Stock Market

Over the past month the stock market was down 35% at the lowest point. The move down was extraordinarily fast in comparison with other bear markets. The stock market is building in a reduction in corporate profits over coming months. It continues to exhibit extreme volatility both up and down. In this environment the best thing to do is refrain from any trading. Eventually the market will reach a bottom and volatility will subside. That provides an opportunity to "rebalance" a portfolio by adding to the stock allocation and increasing it back to the target allocation.

I have reviewed the performance of various asset classes over the past few weeks and large cap growth and dividend appreciation stocks have held up better than small/mid-cap, value and international stocks. And while the conventional wisdom says buy into the hardest hit areas, I am not so sure that will work as well in this environment. In the process of rebalancing I am likely to add to the large cap growth and dividend appreciation asset classes. And I will likely reduce the allocation to other asset classes such as small cap, value and international stocks. Mid-cap growth stocks and the health care sector may also provide good opportunities for investment over the long term.

But it is still a bit early to think about adding to the stock allocation. There is a way to go before we see any clarity on the effects of the virus and the effect on the economy. The stock market is in the process of sorting through the various sectors and industry groups and stock valuations will be adjusted accordingly.

The absolute worse thing to do at this point is to sell a portion or all of the stock allocation. That locks in a loss and it is very difficult to get back into the market at just the right time to catch the upswing. It is best to simply ride through the downturn. Stocks will recover and move back up.

The Bond Market

The Federal Reserve Bank has lowered short term interest rates to nearly zero. The 10 year US Treasury Note has gone from about 1.50% in late February to as low as .57%.

At this juncture, there is not much upside for the overall bond market. Rates could stay low for a long period of time. The purpose of holding bonds in a portfolio is to reduce risk and provide income. But at these low rates the risk is increased and the income very low.

Once interest rates stabilize, changes need to be made to the bond portion of portfolios to reduce interest rate risk and increase the overall yield. At a lower level of interest rates it is a good time to consider reducing the allocation to intermediate term investment grade bond funds and invest in some hard hit sectors such as corporate bonds and even floating rate funds and short term bond funds.
I am also considering adding to preferred stocks to increase the yield.

Overall Perspective
We are in an uncertain environment with tremendously reduced economic activity. The only thing we can do is remain patient, try to stay safe and keep in mind it will come to an end at some point. The economy will eventually recover and things will get back to normal. Investment portfolios will recover over time.