The Coronavirus invasion has had a Shock and Awe impact around the world. It has induced panic selling in the stock market and is likely to lead to a recession as economic activity temporarily grinds to a halt. While we typically use panic selling to buy, it is important to be able to envision an end to the downturn and the risks involved. We do not see those yet.

The Shock aspect of the virus has brought confusion and uncertainty. Markets do not function well under these circumstances, hence the anxiousness to sell and reluctance to buy. This generates extreme volatility as investors only want to trade at the margins—sell at highs and buy at lows. Up to this point there has been almost no place to hide in equities as almost everything has slumped.

We believe we are moving into the Awe phase of the impact which means investors focusing on what will do well in a recession and in the ensuing recovery. Investors will also try to determine what will be hurt and underperform. It is important to deal with the possibility of a further fallout and we think it is important to be cautious at this time. Historically, bear markets have lasted longer than the current downturn while the depth is greatly influenced by the associated recession. Our research shows on average, bear markets with a recession take about 6 years’ worth of gains out of the market. This would mean going back to 2014 levels with the S&P 500 around 2000, which is more than 15% below where we are now. In addition, a number of recession related downturns have seen Price/Earnings ratios drop to around 10, significantly lower than the current level of around 16. These risks lead us to believe it is wise to cut equity levels and move to the lower range for our clients.

We never know for sure which stocks will recover first but we do know we should be diversified and have a stake in stocks which could begin their moves before the general market. What are these stocks? First, larger cap stocks should be favored since they can better withstand the business shutdown. Second, we believe companies with lower debt levels and stronger balance sheets should be favored. Third, recession resistant companies are likely to do better, this would include consumer staples and healthcare. In addition, technology stocks should fair relatively well since they provide many solutions to the current isolation situation. Lastly, bonds have been a refuge and the shock absorber we have often spoken about. However, at these extreme levels, they can cause volatility since any change in rates moves bond prices much more than we have been accustomed. We see the middle of the yield curve providing some income without the volatility of the longer end. However, rates are likely to further ease as the recession unfolds so holding some longer term bonds makes sense.
TO SUMMARIZE:

We do not think this downturn has run its course but it may be close to ending for certain sectors and industries. We would lower equity levels on strength and where appropriate be sure to have a significant portion of the portfolio in bonds and cash. We are closer to the end than the beginning and active management often proves its value under these circumstances.

We are staying alert and focused on our clients’ behalf and look for better days once the current situation begins to be resolved. As for now, it is too early to start aggressively buying, but with rapidly moving markets, it could be very soon.

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