Global Markets: Bottoming Is A Process

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Today, as the markets give back all of Friday's rebound, we're reminded that finding a bottom is a process that will take some time in this ever-evolving medical and economic environment. The need to limit social contact is grinding the world and U.S. economies to a halt. We're now trying to assess how long many of these mobility restrictions, both mandated and self-imposed, will last. A national lockdown over the coming days is possible.

The U.S. Federal Reserve announced another dose of monetary policy stimulus Sunday night. In addition to cutting the federal funds rate 1.0% (100 basis points) to a range of 0.0%-0.25%, the Fed boosted asset purchases (otherwise known as quantitative easing) by $700 billion, with $500 billion earmarked for intermediate-term Treasury securities and $200 billion for mortgage-backed securities. It is also trying to coordinate action with central banks around the world. The central banks of New Zealand, Korea, and Japan have enhanced monetary ease in their respective economies. In his press conference, Fed Chairman Powell called for more fiscal stimulus to complement monetary policy and to better support demand in the U.S. economy.

Following the leads of China, and to an extent, the U.K., governments will have to implement fiscal programs beyond those targeting individuals at most economic risk. In the U.S., we need to move past the rhetoric that a broader fiscal response is simply a boon to corporations. The airline, travel/leisure and hotel industries are suffering through no fault of their own.

The United States and China both entered the coronavirus crisis with reasonably strong economic growth outlooks. The same cannot be said for the Eurozone and Japan, which were teetering on the brink of recession. Each of these economies will likely enter a recession by next quarter. Japan may already be in one due to its fourth-quarter 2019 consumption tax increase. These countries also have limited policy tools at their disposal. The benchmark rates for the European Central Bank and Bank of Japan are already below zero. Regarding fiscal policy, the Japanese appear committed to programs that will reduce their large budget deficit. Germany, the largest and most economically powerful country in Europe, continues to cling to its balanced budget philosophy and seems hesitant to adopt needed deficit-financed spending programs.

Here in the U.S., as we move closer to a partial or full national shutdown, we look to China and South Korea for clues to the potential impact. As the first affected country, China instituted a strict quarantine, which at the time appeared to be a draconian response. South Korea effectively marshalled resources to conduct a large testing program to give the population a better sense of the magnitude of the spread and the mortality rate. The quarantine in China likely caused a sharp slowdown in first-quarter growth, but aggressive monetary and fiscal policy initiatives should help the recovery. Businesses are beginning to reopen, and manufacturing employees are returning to work.

Extrapolating that experience to the U.S., first-quarter GDP growth should be +0.5% to 1.0% due to a healthy consumer in January and February. The first signs of economic deterioration began in March. Second quarter should show the worst of the contraction with an expected GDP growth rate of –4.0%. Assuming the limited social contact and social distancing programs effectively contain the virus, third-quarter GDP growth should be flat and set the economy up for a nice 4% to 5% GDP growth rebound in the fourth quarter.

Based on this analysis and forecast, we prefer to concentrate any equity purchases first in the U.S. and then the relatively cheap emerging markets. It is best to underweight the developed international (EAFE) asset class right now. Finding a bottom in bear markets is a process that typically takes some time. As such, we prefer to absorb the news around the virus and look for signs that social distancing policies are working before investing additional funds or the proceeds of any sales to equities.

In response to questions we have received, here is what we are watching closely to evaluate our current forecasts and equity weightings:

1. **Spread of the coronavirus both globally and in the United States.** More testing in the U.S. will provide better information about the spread of the virus and the mortality rate. With winter ending soon, we'll watch to see if this virus strain experiences the typical seasonal dissipation.
2. **Economic statistics.** Consumer and business confidence figures will be lower over the next few months and will provide a preview of the magnitude of the second-quarter contraction. Employment numbers will likely turn negative soon as well. In addition to the impact of the virus, the oil price war between Russia and Saudi Arabia has negatively impacted business spending on capital projects.
3. **Industries.** Like economic statistics, company earnings reports and preannouncements will be negative and serve to effectively confirm the recent downdraft in stock prices. Over the coming months, company managements will provide clues about the reopening of certain businesses and the return to production.
4. **Policy Responses.** The monetary policy responses in the U.S. have been pronounced. Still, we await more clarity on whether policymakers can penetrate the sharp partisan divide to produce economy-wide fiscal policy prescriptions.
5. **Liquidity Issues.** Monetary policy has the most impact here. Based on lessons learned from the 2008-2009 financial crisis, the Fed has been very proactive in ensuring ample liquidity to the financial markets. Regardless, we are monitoring for any trading anomalies, which may develop around ETFs as well as any signs of a credit contraction turning into a credit freeze.

We will continue to track the development of the virus and the impact on markets and will update you with any important changes to our outlook. Please reach out to your advisor with any questions.

Ben Pace is the Chief Investment Officer and a member of the Investment Committee. Prior to joining Cerity Partners, he was Chief Investment Officer, and Head of Global Investment Solutions for Deutsche Bank Private Wealth Management in the U.S. Ben has more than 25 years of experience in investment management. Prior to joining Deutsche Bank in 1994, he managed equity income funds for two investment organizations.

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