Outlook for March 2020

Key Market Driver

Uncertainty Around Coronavirus Intensifies

As the coronavirus continues to spread, concerns about the impact on global supply chains have increased, calling into question both global and U.S. economic growth estimates. China will likely experience flat first-quarter GDP growth due to lost production caused by quarantines and factory shutdowns. This rate is in stark contrast to the 5%+ estimates at the start of the quarter. Here in the U.S., first-quarter GDP growth should be around +1.0%, compared to 2.1% in Q4 last year. While we still expect lost production to be recouped in the second half of 2020, we have revised our full-year GDP growth estimates slightly downward–2.6% from 3.1% for global growth and 1.8% from 2.1% for the U.S. Of course, these estimates are dependent on the successful containment of the virus and only a temporary closure of global production facilities.

Strong job and wage growth and a historically high savings rate should temper some of the virus' effect on the U.S. economy. However, the tourism sector (airlines, hotels, gaming) may take a hit. Additionally, the virus-driven decline in energy prices could negatively impact capital spending on energy equipment. On a positive note, business spending on technology and software products remains strong.

Our Perspective

Equity Markets

- With 2020 earnings at risk of turning negative, equity prices have corrected any valuation excesses that might have been in the markets. Given the uncertainty around earnings, we have lowered our estimates in line with our GDP growth estimates. We now expect earnings to be flat for the full year with companies being able to largely recover lost first-half revenue and earnings in the back half of 2020.
- Europe's reliance on China as both an export destination and essential cog in the manufacturing supply chain makes the region's earnings more vulnerable. This vulnerability is evident in the cheaper valuation multiple of European equities.
- Japan will likely fall into recession thanks to the combination of negative fourth-quarter growth fueled by the sales tax increase and a virus-related negative first quarter. The Japanese equity market, which trades at a notable discount to the U.S., may need a weaker yen to help spur performance.
- Chinese equity markets are showing some signs of stabilization. As the outbreak in the country slows, we'll be able to better assess the impact of lost production and the magnitude of any recovery. Emerging markets equities outperformed developed markets over the past month, which may be an early sign global equities are nearing their bottom.

Bond Markets

- The short end of the U.S. Treasury yield curve has inverted again with three-month bill rates higher than ten-year notes. The two-year to ten-year spread is still comfortably positive, so this partial inversion is likely a call for Fed easing and not a near-term recessionary signal.
- Spreads in the high-yield market widened. Unless oil prices recover quickly from the $45 level, default pressure in the space may rise.
- Rates in many developed bond markets are more deeply negative amid the coronavirus scare. The entire asset class is notably overvalued.
- Emerging markets debt are at attractive levels, especially if the dollar continues to depreciate modestly from its previous lofty levels.

Outlook for March 2020

Our Perspective (Continued)

Monetary Policies/ Currencies

- Given the market volatility around the coronavirus, it's widely expected the Fed will not wait until its March 18 meeting to cut rates at least 0.25% (25 basis points). If the reduction is only 0.25%, a second 0.25% cut in late spring or summer is a distinct possibility. These moves could cause the dollar to depreciate in the near term.
- Negative interest rates mean the European Central Bank and the Bank of Japan have fewer options at their disposal. Both banks will likely push their respective fiscal authorities to ease but are prepared to move rates deeper into negative territory if necessary.
- The Bank of England also stands at the ready as it assesses the long-term economic damage of the virus. With short-term rates slightly positive, it has room to make cuts.
- The Peoples Bank of China has already aggressively eased interest rates and injected liquidity into the markets. We expect continued easing until economic growth stabilizes.

What This Means for Investors

Any economic growth estimates, price target changes, and policy forecasts are highly dependent upon the path and progression of the coronavirus. We anticipate production and economic growth will resume as winter ends and various policy responses help contain the disease. Until the economic impact becomes more evident, we plan to maintain our equal weighting in the equity and higher-risk fixed-income asset classes despite the attractive price levels.

During times like this, it's best to focus on the things that you can control, like meeting with your advisor to review your portfolio and taking the usual precautions to keep yourself healthy.

For more market insights, contact a Cerity Partners advisor or visit ceritypartners.com.

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Important Information

Benjamin Pace
Chief Investment Officer

Ben Pace is the Chief Investment Officer and a member of the Investment Committee. Prior to joining Cerity Partners, Benjamin Pace 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.