No Fiscal Gain. More Market Pain.

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The Standard & Poor's 500 equity index officially moved into bear market territory for the first time in 11 years with a 5% decline y esterday, followed by a nearly 10% drop today. As we've discussed before, the fear caused by the spreading coronavirus appears to be slowing the global economy to a standstill. Following China's lead, Italy has shut down everything except pharmacies and grocery stores to help stem the virus. Here in the U.S., assessments and predictions from credentialed experts have varied greatly, adding to fear around the potential magnitude and duration of the outbreak. Anecdotal evidence over the past 48 hours, including the suspension of several professional sports leagues and the announcement that Hollywood actor Tom Hanks had tested positive, hit home for the average American. The virus is no longer viewed as primarily a "foreign" issue.

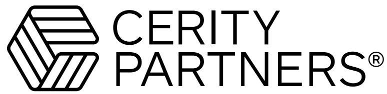
Investors are anxious for an aggressive policy response from global monetary and fiscal authorities. The Chinese authorities largely complied with rate cuts and fiscal policy ease that targeted those directly affected while attempting to offset the broader economic downturn caused by the February shutdown. Unfortunately, monetary policymakers in Japan and Europe do not have the same abundance of tools at their disposal. Their benchmark rates are already negative, and both the markets and committee members are questioning the effectiveness of their easing policies. Like China, initial fiscal policy responses appear to be targeting those directly impacted by the outbreak. However, unlike China, they're not large enough to support a general economic downturn.

In the U.S., President Trump announced a 30-day restriction on travel from Europe. He also again called for a payroll tax holiday as well as paid sick leave for affected workers, a $50 billion increase in small business lending, and deferred income tax payments for individuals and businesses impacted by the virus. The response seemingly underwhelmed the markets as it failed to adequately address the spread of the virus and its potential economic impact. Perhaps market participants are merely expressing skepticism that governments can effectively provide any type of stimulus.

The collapse in oil prices has added to the near-term economic impact from lost business in the travel, hospitality and entertainment sectors. If these lower prices persist, they could negatively impact overall capital spending in the U.S. While we've been encouraged by the strong increase in corporate software and technology purchases over the last year, businesses may limit spending for a quarter or two until they see how the virus impacts consumer spending.

Today, we experienced unexpected deterioration in the credit markets. Spread widening in the high yield and investment-grade corporate bond markets is to be expected. However, high-grade municipal bonds also sold off and moved inversely to the safe-haven Treasurys. The spread between AAA-rated mortgage-backed securities and Treasurys also widened. This widening means mortgage rates aren't declining at the same rate as Treasurys, and therefore, aren't providing the same incentive to consumers as they were just last week.

Looking at China, strict measures to limit population mobility appears to have stopped the spread of the virus. New cases have slowed to near zero. The economy is likely to experience a sharp downturn in economic growth in the first quarter with spillover into the second quarter. The country should experience a notable recovery in the second half of 2020 unless it's hit with a second round of the contagion. The U.S. was set to have reasonably strong first-quarter economic growth based on the statistics published through February. March reports will likely reflect some virus-related weakness. Still, the greater impact may come in the second quarter, with the downturn being more significant than originally estimated. Like China, if the virus dissipates at the same rate, the third and especially fourth quarters should see a return to a degree of economic normalcy.



Europe and Japan were already on the brink of a recession before the outbreak, so aggressive containment measures in countries such as Italy and Spain will likely throw the continent into recession. Japan, which had negative growth in the fourth quarter of 2019 due to the consumption tax increase, is poised to have another negative quarter due to lost productivity from the coronavirus. We are concerned about the virus' longer-lasting impact on these economies, and the very weak policy response we have seen from their central banks and governments.

A much healthier U.S. banking system combined with a Federal Reserve that just provided another liquidity injection and balance sheet expansion makes this bear market environment different from the last one more than ten years ago. As such, the U.S. economy and equity markets should find a bottom soon. While the situation is rapidly evolving, the inherent health of the U.S. economy going into this crisis keeps us cautiously optimistic. We continue to look for opportunities to increase our weighting in U.S. equities.

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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