Mesirow Financial

A Look Toward the Horizon

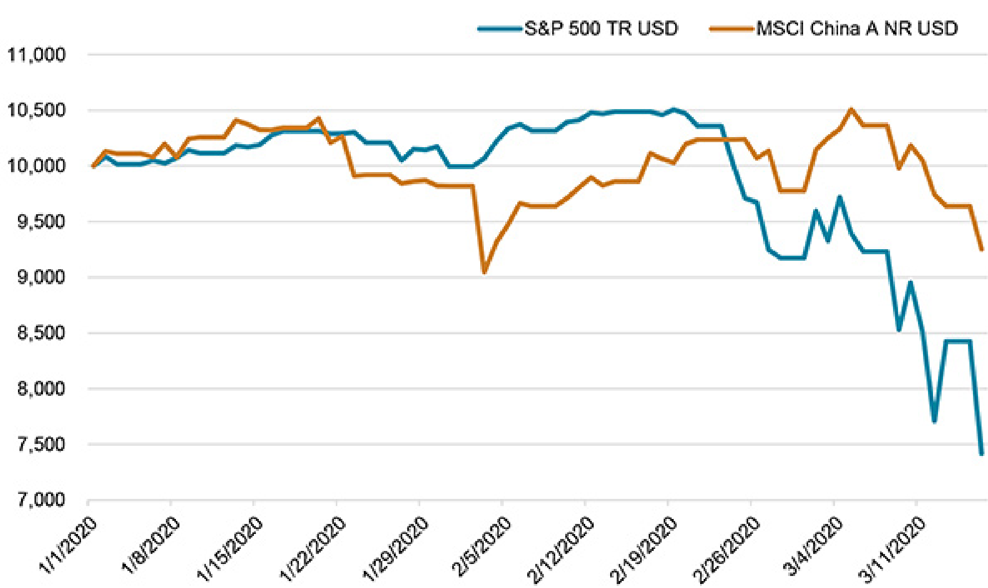
The U.S. stock market has been in a volatile free fall since the S&P 500 Index (total return) closed at an all-time high on February 19, 2020. Since then, investors have seen the worst single day return (-11.9% on March 16) since the historical stock market crash of 1987. Fear and greed around the impact of the COVID-19 virus has led to manic buying and selling each day, and even intraday, over the past few weeks with daily returns of +/- 1% or 2% a common occurrence. Since the high, the market fell 13% to the end of February, and through yesterday was down 29%. The index also crossed below key trend-investing markers such as its 200-day moving average in late February. That decline contributed to heightened trading volume and activity as trend following is a common gauge of market sentiment and hasn't been negative since May 2019 (only briefly) and previously in late 2018.

Despite the uncertainty and anxiety in the market, we want to reiterate that this is likely a short-term market phenomenon. Sudden shocks such as 9/11 have led to manic market performance in the short-term, but a rebound to some normalcy. In the weeks following Sept. 11, 2001, the stock market fell as much as 12% from its Septemper 10 close before rebounding and gaining 5% from that date through the end of the year. This year seems somewhat more dramatic; however, as the stock market was up 5% through February 19 of this year, whereas the market was already down 17% on a year-to-date basis through September 10, 2001.

Echoing our previous comments, it is reasonable to anticipate a short-term dip in economic growth as the economy absorbs the global impact of disruptions to Chinese manufacturing output and recently announced curtailments on restaurant and other larger group public gatherings. However, there were many strong points coming into this recent volatility. Both inflation and unemployment remain low and the Fed has signaled an accommodating investment policy by lowering rates twice in the past few weeks and beginning a bond buying program to give the market further support. Perhaps more importantly, the U.S. consumer has a significantly lower debt to income ratio compared with the start of the Financial Crisis. At the end of 2007, debt obligations were 13% of income, while the current data shows that ratio down to 9.7%[1].

In addition, the local stock market in China has begun to show some signs of life as the outbreak caseload has stabilized in recent weeks[2]. The chart below shows the year-to-date return of the China A-share market (stock market for direct local market investors) and the S&P 500 Index. China's stock market experienced a downturn then recovery about 6 weeks prior to our current decline, which appears to follow the timeline of reported cases in each country.

YTD Growth of $10,000



Through 03/16/20. Past performance is not indicative of future results.

The domestic stock market has also shown previous resilience after viral outbreaks. The chart below shows the performance of the S&P 500 Index and a balanced portfolio such as Vanguard Balanced Index (VBIAX) during the outbreak and over the subsequent 12 months[3].

		During Outbreak	1Yr After
SARS	S&P 500 Index	-3.2%	35.1%
	Vanguard Balanced	-1.3%	24.7%
Avian Flu	S&P 500 Index	0.4%	12.6%
	Vanguard Balanced	1.5%	11.1%
MERS	S&P 500 Index	1.3%	30.3%
	Vanguard Balanced	1.1%	17.3%
Ebola	S&P 500 Index	3.5%	15.5%
	Vanguard Balanced	3.1%	10.4%
Zika	S&P 500 Index	-6.3%	25.0%
	Vanguard Balanced	-3.7%	15.8%
COVID-19	S&P 500 Index	-25.8%	TBD
	Vanguard Balanced	-16.0%	TBD

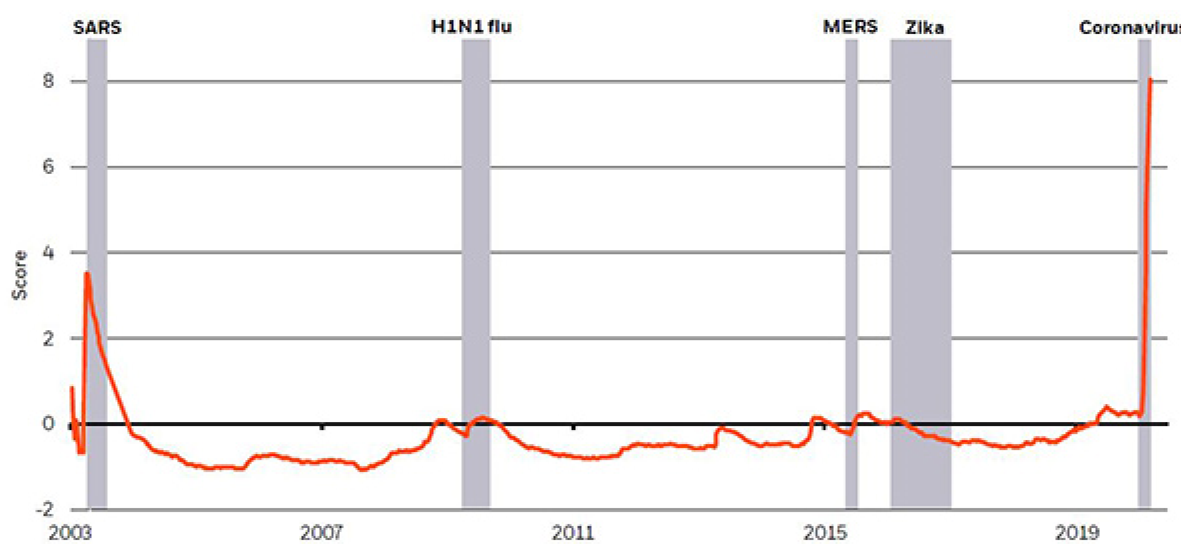
Through 03/16/20. Past performance is not indicative of future results.

Data from the World Health Organization currently shows there has been 85 fatalities from the Coronavirus in the US with 48 occurring in the state of Washington through March 16[4]. The loss of human life is not to be trivialized or minimized in any way, but should be kept in broad context if portfolio decisions are going to made. The manic and volatile performance of the equity markets this time has certainly been impacted by the increased use of social media and virtually instantaneous access to any worldwide commentary. The below chart from Blackrock highlights the increased volume of mentions of the Coronavirus within the brokerage community compared with previous viral outbreaks.

Record market attention to outbreak

Market attention to the coronavirus, measured by mentions in broker reports and financial media, is far higher than it was for other diseases – and even SARS.

Market attention to global disease outbreaks, 2003-2020



Sources: BlackRock Investment Institute, with data from Refinitiv, March 2020. Notes: We identify specific words related to major disease outbreaks since 2003, then use text analysis to calculate the frequency of their appearance in the Refinitiv Broker Report, as well as the Dow Jones Global Newswire and Reuters News databases. We then adjust for whether the language reflects positive or negative sentiment, and assign a score. A zero score represents the average level over its history from 2003 up to that point in time. A score of one means the attention level is one standard deviation above the average. We weigh recent readings more heavily in calculating the average.

Past performance is not indicative of future results.

Current market swings are not based on long-term company-specific changes. Has the long-term value of a company such as Microsoft or Apple changed by 10-30% in the past few days? To look at the market more broadly, the current valuation of the S&P 500 Index is about 16x, meaning that the total value is about 16 times this year's earnings. But that also means that 94% of the market's value (15/16) is based on *future* earnings. As we previously commented, earnings over the next quarter, perhaps into the summer, may decline somewhat as companies digest recent supply and demand disruptions. But we remain confident in a market recovery in the later part of this year. The uncertainty of the upcoming Presidential election may add to volatility, but one thing the market does appreciate is clarity, and election results combined with a plateau and decline of the Coronavirus domestically as we are starting to see in China should provide a path to recovery.

Index return data from Morningstar Direct.

1 The Federal Reserve Board https://www.federalreserve.gov/releases/housedebt/default.htm

2 https://www.cnn.com/2020/03/16/world/coronavirus-covid-19-update-intl-hnk/index.html

3 Timeframes for the viral outbreaks are as follows: SARS Jan 2003 – March 2003, Avian Flu Jan 2004 – August 2004, MERS Sept 2012 to November 2012, Ebola Dec 2013 – Feb 2014, Zika Nov 2015 – Feb 2016. Coronavirus start is Jan 2020 through March 16, 2020. Source: Morningstar Direct.

4 https://coronavirus.jhu.edu/map.html