THE COVID-19 RECESSION AND BEAR MARKET

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Investors should be less concerned about timing a market bottom, with a greater focus on strategic asset allocation, diversification, and sector selection. Stock market bottoms can only be identified retrospectively. The stampede into perceived safe-haven stocks — and aversion to economically sensitive stocks — will likely continue until economic confidence improves. Beyond the short term, market leadership should shift from growth to value managers and to badly punished value stocks. The top-performing market segments in 2021 and 2022 should be small- and mid-cap value stocks.

Summary and Major Conclusions:

- Conditions pertaining to both public health and the economy continue to deteriorate on a daily basis. The number of new cases of COVID-19 nationwide is unlikely to peak until May, while the economy will be in freefall until the third quarter. Investors remain rattled by the fastest bear market in history, along with growing uncertainty regarding the future path of medical and economic trends.

- There remain several critical knowns and "known unknowns." The key knowns are: (1) The US and world economies have entered a deep recession; (2) Policymakers have responded to the crisis with unprecedented size and speed; and (3) The COVID-19 epidemic in the US will be entering its most intense phase over the next several weeks.

- We also know that there are tentative signs of a peak in both new and confirmed cases in Italy, Spain, France, and Germany. The Asian countries have already witnessed a plateau and decline in both new and confirmed cases, and are slowly restarting their economies. The US and the UK are the global laggards, with the major epicenters of COVID-19 being London and New York (NYC).

- The nationwide epidemic appears to be unfolding in a rolling pattern, with waves of outbreaks striking different cities and regions in a sequential manner. Seattle, San Francisco, and the NYC metropolitan area have been in the forefront.

- Sun Belt states such as Florida, Louisiana, Georgia, and Texas are rapidly becoming the new epicenters of the pandemic. The infection rate in rural communities has been low thus far and appears likely to lag major urban centers.

- According to Governor Andrew Cuomo, NYC is on track to reach its "apex" of new cases within the next week to ten days. New cases of COVID-19 in NYC continue to double every three days, but this doubling rate could begin to gradually lengthen by mid-April.

- There are also several key known unknowns. These include: (1) The regional path of future new COVID-19 infections in the US; (2) The duration of the self-induced recession; (3) The speed at which the economy can restart and return to relative normalcy thereafter; and (4) The potential for a phase two of the pandemic in the autumn, following a lull in the summer months.

- Another unknown is the capacity of the healthcare system (hospital beds, vital supplies, and medical professionals) to cope with the escalating crisis. Although still in critical shortage in some cities, the availability of medical equipment and supplies is set to improve in coming weeks and months.

- The private sector has responded swiftly and aggressively to the challenge presented by the pandemic, expanding manufacturing facilities to produce medical devices in short supply, including ventilators and respirators. US companies leading the way include Honeywell, General Electric, Ford, General Motors, and 3M.

- There is a growing consensus among medical experts that a phase two of the epidemic could develop following an improving trend in the summer months. The hope is that the nation will be in a better position to weather a phase-two coronavirus outbreak because of heightened public health preparedness.

- There should be an increased stockpile of supplies by the Fall, along with improved testing. The likelihood of newly discovered therapeutic (anti-viral) medications should mitigate both symptoms as well as the number of fatalities. Electronic surveillance measures could also be available by the Fall. Finally, a possible build-up of herd immunity over time should suppress transmission of the virus.

- The response of economic policymakers has been encouraging. However, the practical real-world issues of logistics and execution are yet to be adequately resolved. The critical challenge is ensuring that federal funds are channeled quickly and efficiently to the floundering small-business sector and its workers.

- More than $350 billion of the total fiscal stimulus package of $2.2 trillion is allocated to the Paycheck Protection Program (PPP), designed to provide forgivable loans for small businesses to assist them with monthly payroll, rent, and utility payments.

- These fiscal lending and transfer programs are designed to serve as a bridge between the current cash flow crisis and the economic recovery, once public health trends stabilize. It is likely that additional funds will be made available for small businesses when the current eight-week program expires.

- Another vital economic issue can be described as worker attachment: The ability of the private sector to preserve the connection between businesses and their employees. This is of utmost importance in order to avoid the scenario of widespread job losses, followed by three years of rehiring, retraining, and lost productivity.

- News of the collapse in quarterly GDP and company profits is almost certain to proliferate in the media. It is important for investors to understand that the depth of declines in quarterly GDP and company earnings is of little enduring relevance. Rather, the outlook for common stocks is predicated upon the duration of recession.

- Alarming incoming economic data for April, May, and June should be viewed as temporary, artificial, and not sustainable. What is important for investors is the normalized level of GDP and corporate profits in the fourth quarter of this year and throughout 2021 and 2022.

- Another prerequisite for economic stabilization is further improvement in credit markets. It is encouraging that risk spreads have narrowed somewhat, although they still reflect ongoing stress in credit. The Federal Reserve has signaled its intention to intervene on an unprecedented scale to prevent a credit/financial crisis.

- Investors should expect a U-shaped — rather than V-shaped — recovery during the second half of this year and in 2021. Another L-shaped recovery similar to that following the Great Recession is unlikely because of the absence of severe economic and financial imbalances. There is no need for another debilitating deleveraging cycle as has occurred over the past ten years.

- Following a collapse in the second quarter, US GDP should stabilize during the third quarter and return to growth in Q4. Full-year GDP could decline by 5% this year, followed by ballpark estimates of 5% growth in aggregate output in both 2021 and 2022. US real GDP could return to its yearend 2019 peak of $19.22 trillion by the second half of next year.

- Investors also need reassurance and confidence that government officials are in control and acting with unswerving leadership. Fed Chairman Powell has demonstrated enormous courage, expertise, creativity, and leadership in providing an unlimited policy response to the crisis. Some mayors and governors — most notably Andrew Cuomo of New York — have also demonstrated effective leadership.

- The president must also exhibit inspirational leadership in unifying and mobilizing the nation by providing a clear vision of the future. In the end, the president is the primary source of national leadership and direction, reflected in skilled communication and a cogent education policy.

- The Trump Administration has begun to show greater leadership following a very slow start in January and February. Use of the "bully pulpit" — as popularized by Theodore Roosevelt — can be effective in bolstering public confidence and sentiment. Ultimately, a healthy recovery in financial markets is dependent upon consistently strong government leadership at the federal level.

- As an approximate roadmap, the equity bear market should follow the path of previous severe market declines of the past five decades. This includes a primary bottom within the first four to six weeks, followed by a volatile bottoming process lasting for another one to two months.

- It appears that the bottoming process has begun, and could end during April or May. Based upon market history, stock prices could be at least 25% higher in three months and greater than 50% higher in one year. Compound annual total returns for the S&P 500 could be well in excess of 10% over the next three to five years.

- The October 1987 crash bears the closest resemblance to the current stock market decline: The market tumbled by 30% during a period of only several weeks, entered a highly volatile sideways bottoming process for another several weeks, and eventually bottomed on December 4th with a cumulative decline of 36%.

- Investors should be less concerned about timing a market bottom and should focus instead on strategic asset allocation, diversification, and sector selection. Stock market bottoms can only be identified retrospectively. That said, the domestic equity market appears to have begun a lengthy bottoming process, and appears very cheap in a long-term valuation context.

- The stampede into perceived safe-haven stocks — and aversion to economically sensitive stocks — will likely continue until economic confidence improves. Beyond the short term, stock market history strongly suggests that leadership will shift from growth to value managers and to badly punished value stocks. The top-performing market segments in 2021 and 2022 should be small- and mid-cap value stocks.

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Bloomberg Barclays U.S. Treasury Inflation-Protected Securities (TIPS) Index: Measures the performance of rules based, market value-weighted inflation protected securities issued by the U.S. Treasury. It is a subset of the Global Inflation-Linked Index (Series-L).

CBOE Volatility Index: An index of implied equity market volatility, reflecting the market estimate of future volatility for the S&P 500 Stock Index over the next 30 days, using options.

MSCI Emerging Market Index: An index of equity market performance for developing markets, primarily in Asia, Latin America, and Eastern Europe. The index tracks both large-cap and small-cap stocks and is weighted by market capitalization.

MSCI World Ex US Index: Measures the performance of the large and mid-cap segments of world, excluding US equity securities. It is free float-adjusted market-capitalization weighted.

Russell 2000 Small-Cap Index: Is an index measuring the performance of approximately 2,000 small-cap companies within the United States.

S&P 500® Index: Measures the performance of 500 widely held stocks in US equity market. Standard and Poor's chooses member companies for the index based on market size, liquidity and industry group representation. Included are the stocks of industrial, financial, utility, and transportation companies. Since mid-1989, this composition has been more flexible and the number of issues in each sector has varied. It is market capitalization-weighted.

State Street Investor Confidence Index: measures investor confidence or risk appetite quantitively by compiling actual buying and selling patterns of institutional investors.

US Trade-Weighted Dollar Index: An index that measures the value of the US dollar in relationship with other currencies, statistically weighted on the basis of importance to the US as trading partners.