ICR® 1st Quarter Newsletter – April 2020

The effects of COVID-19 and government-ordered shutdowns wreaked havoc in global markets during the first quarter of 2020. The S&P 500 saw its fastest-ever 30% decline, taking just 22 trading days from February 19th to accomplish the feat. Energy stocks lost over 50% of their value during the quarter amid plummeting global demand and an oil price standoff between Saudi Arabia and Russia.

Markets around the world suffered along with the U.S. The MSCI All-Country Ex-U.S. index was down over 23% during the quarter. Interestingly, the Chinese stock market posted one of the smaller losses ("only" 10%), as it was viewed as being closer to a return to normalcy than most other countries.

Amid the fear and panic in February and March, investors flocked to safe haven assets like U.S. treasury bonds and gold. The yield on the ten-year treasury fell from 1.92% all the way to 0.67% as investors scrambled to find a place to hide. Gold also demonstrated its safe haven characteristics, posting a 5% gain amid the carnage.

Exogenous Shock and Policy Response

The coronavirus pandemic is a crisis like no other – a global natural disaster requiring extraordinary action from everyone. First and foremost, it is a public health and human tragedy. Therefore, we are all doing everything we can to support our health system and healthcare workers as they courageously protect life and fight the virus.

In order to slow the spread of disease and avoid overwhelming our healthcare system, governments have implemented containment and social distancing policies. These measures are necessary, but they are having brutal social and economic consequences. It is as if the power switch for much of the global economy has been turned off to fight the virus. Economic activity has been paused and the slowdown is reflected in jobs numbers, oil prices, and other measures of domestic and global commerce. In the U.S., over 26 million people have applied for unemployment benefits in the last five weeks. That's more than all the net jobs created in the economic expansion since the Global Financial Crisis of 2008.

In discussing policy response, it is important to understand that economies don't contract and enter recession because of dropping stock prices or market volatility. Economic expansion is threatened when the circular flow of payments is interrupted or greatly diminished. During a crisis, be it war or pandemic, the primary risk to the economy is missed payments, unmet obligations, and balance sheet impairment.

Therefore, governments need to facilitate the continued flow of payments through the economy. Using the tools of wartime finance – debt expansion, money printing, etc. – it is possible to dissociate payment flow from the lack of economic activity for a period of time. Governments and central banks are stepping in to ease cash flow pressures and avoid lay-offs. By providing liquidity and cash to viable businesses and households, we can reduce the long-term economic damage caused by widespread financial failures.

The actions being taken by the Federal Reserve and Congress ensure that payment and debt obligations are met in the short term. These actions include managing interest rates, taking securities in exchange for money, and expanding the menu of assets the Fed is willing to buy. That menu of collateral has been expanded under section 13(3) of the Federal Reserve Act, which provides that in emergencies the Fed has greater lending latitude than normal. These assets now include investment grade corporate bonds, municipal bonds, asset backed securities, and even small business loans created through the CARES Act.

If policy makers get things right, most of the economic framework will remain intact so it can be reenergized when it is safe to do so. Hopefully, we will be able to look back to 2020 and see a period where the data reflect an economy that was turned off to fight the virus and then started up again – once the virus was controlled, which it will be.

In the interim, we believe the ripple effects of social distancing measures will continue to weaken household and corporate balance sheets and wreak havoc on consumer confidence and labor statistics. So, while aggressive monetary and fiscal policies appear to have largely addressed the liquidity-based stresses, the solvency concerns in the real economy are moving to the forefront. Therefore, we are reviewing the financial durability of our holdings, both with respect to balance sheet strength and relevance to what might be a very different post-virus economy. And we are looking for opportunities to upgrade portfolios where possible. For companies that remain relevant, surviving is thriving, as they should be able to capture greater market share when the dust settles.

Finally, we wish to acknowledge the incredible goodness of everyone who is providing for and preserving life. Healthcare professionals and support staff who, in the face of plague, stay bedside. Municipal, postal, delivery and supply chain personnel, and grocery and pharmacy employees who make sure the rest of us have what we need. And everyone who is doing what they can to support these heroes by keeping themselves and their neighbors safe.

"*Great perils have this beauty, that they bring to light the fraternity of strangers.*"
– Victor Hugo

As always, please call if you have questions or concerns, and do let us know if we can help in any way.

Sincerely,

James A. Heine

James L. Cobb

Market Report (as of 3/31/20)

Index	2020 (%)	3-Year Annualized (%)	5-Year Annualized (%)
S&P 500	-20.0	3.0	4.6
Dow Jones Industrial Average	-23.2	2.0	4.3
U.S. Aggregate Bond Index	3.2	4.8	3.4
MSCI EAFE (Foreign Index)	-20.3	-4.0	-3.6