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Triage: Throwing everything at the virus

Key points

- The questions continue to outnumber the answers, while the virus continues to infect people, markets and the economy.
- Monetary and fiscal stimulus can serve as triage; but they're not the cure.
- Investor sentiment and market technicals are at extremes; but valuation analysis is pointless.

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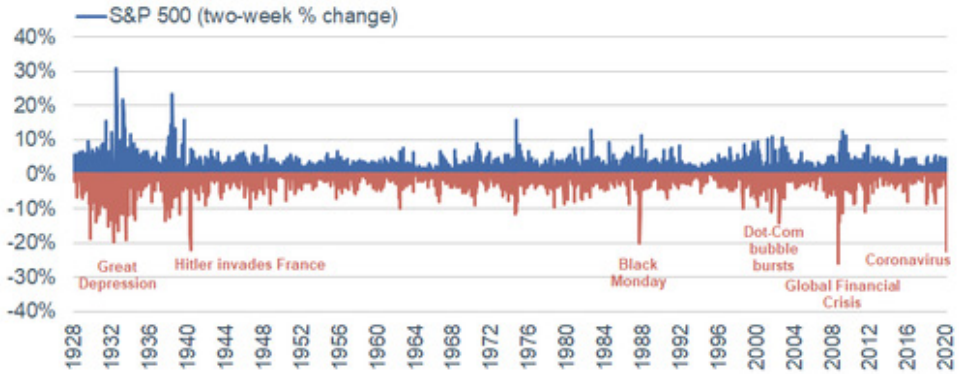
We know a lot more about COVID-19 than we did a few weeks ago; but there remain questions that are unanswerable at this stage. We don't know how much worse this gets before it starts to get better (i.e., when the incidents of confirmed cases begins to level off, like they have in China and South Korea). We don't know how severe the economic impact will be as a result of containment effort; or how long we will stay in this level of containment. Finally, we don't know when markets will find their footing—especially given that traditional technical, sentiment and valuation metrics are less relevant in a pandemic-driven bear market.

If the virus wasn't enough, we are also in the midst of a "fire sale in the bond market," as my colleague Kathy Jones put it in a conversation. There was a global rush to cash. Outside of short-term treasuries, everything was for sale last week at discounted prices. Leveraged investors such as hedge funds, and those using margin, were forced to liquidate as prices fell. Portfolio managers had to sell to meet redemptions from institutional and individual investors. They sold what they could—those investments that were liquid enough to get a bid—including long-term treasuries. Much of the selling was indiscriminate, driven by the demand for cash.

Roll in the crash cart

Meanwhile, over in stock market land, we are in the midst of the swiftest move from all-time highs (February 19 in the case of the S&P 500) to the fastest bear market in history—besting the move in 1929. As you can see in the chart to the right, the past two weeks' decline has been one of the worst in stock market history. The rout has been exacerbated by the blow-out in credit spreads in both the investment grade and high yield corporate bond market—with the crash in oil prices and attendant impact on the beleaguered energy sector—yet another brush fire.

Epic 2-week plunge



Source: Charles Schwab, Bloomberg, as of 3/20/2020.

The high in the stock market is likely to be fairly close to the start of the recession we are undoubtedly in. The National Bureau of Economic Research (NBER)—the official arbiters of recessions—historically dated recessions' starts well after the fact. But let's take a stab at it and assume it started this month. Below is a history of all post-WWII -20% bear markets (allowing for rounding) which occurred in conjunction with economic recessions—with the bear markets typically starting in advance of recessions.

Bear market		S&P 500 %	Recession	
Start date	End date	change	Start date	End date
6/15/48	6/13/49	-20.6%	Nov. 1948	Oct. 1949
8/2/56	10/22/57	-21.6%	Aug. 1957	Apr. 1958
11/29/68	5/26/70	-36.1%	Dec. 1969	Nov. 1970
1/11/73	10/3/74	-48.2%	Nov. 1973	Mar. 1975
11/28/80	8/12/82	-27.1%	Jul. 1981	Nov. 1982
7/16/90	10/11/90	-19.9%	Jul. 1990	Mar. 1991
3/24/2000*	9/21/01	-36.8%	Mar. 2001	Nov. 2001
10/9/2007*	11/20/08	-51.9%	Dec. 2007	Jun. 2009
1/6/2009*	3/9/09	-27.6%	Dec. 2007	Jun. 2009
	Average	**-32.2%**		
	Median	**-27.6%**		
2/19/20	3/20/2020**	-31.9%	Mar. 2020?	N/A

Source: Charles Schwab, Bloomberg, National Bureau of Economic Research. Bear market defined as 20% or greater drop in S&P 500. "Near" bear market defined declines of more than 19% but less than 20%. *3/24/2000–10/9/2002 is generally considered one long bear market (-49.1%), but there were two 20% rallies within that span. 10/9/2007–3/9/2009 is generally considered one long bear market (-56.8%), but there was one 20% rally within that span. **Does not denote end date. Current bear market is thru 3/20/2020.

As you can see, the market's decline is right at the average; but that doesn't prevent it from descending more, which is likely given the magnitude of the virus crisis. I've been in the business for 34 years and have been asked what the current environment is most reminiscent of historically. My response has been that it feels like a monster mashup of the Crash of '87 (magnitude and speed), 9/11 (fear of the unknown), and the global financial crisis (GFC) of 2008 (serious economic hit to economy and financial system).

The Price is Right

One of the goals in the long-running game show *The Price is Right*, is to guess the price of merchandise, without "going over." The past few days has brought a competition of sorts by major firms' economics departments to publish—and revise multiple times—extreme estimates for gross domestic product (GDP) for the second quarter.

Question for Morgan Stanley (see table): -30.1%? I guess that's much worse than -30.0%?

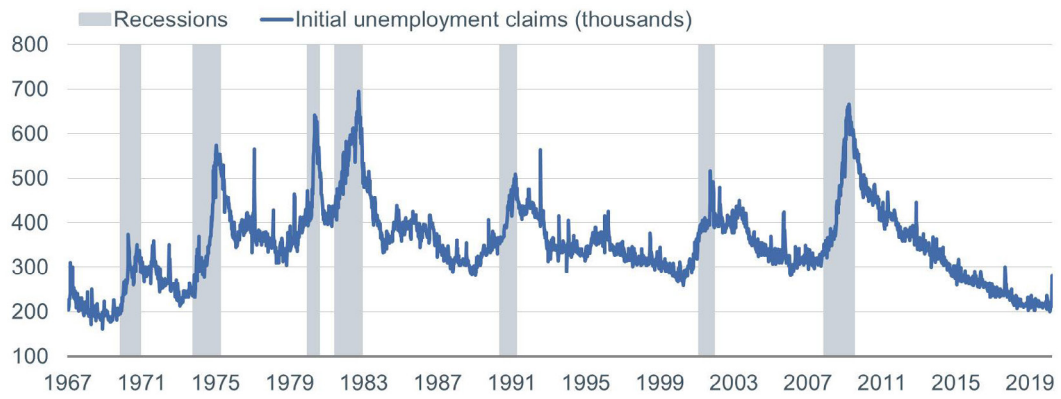
We will get the initial read on first quarter GDP next month; with estimates nowhere near as dire given economic strength in the first two months of the quarter. It's second quarter growth that's set to decline at depression-era levels. Key to watch in the near term, to gauge who on the list will prove to be most accurate, are key leading indicators—especially regarding the inevitable devastation in the labor market.

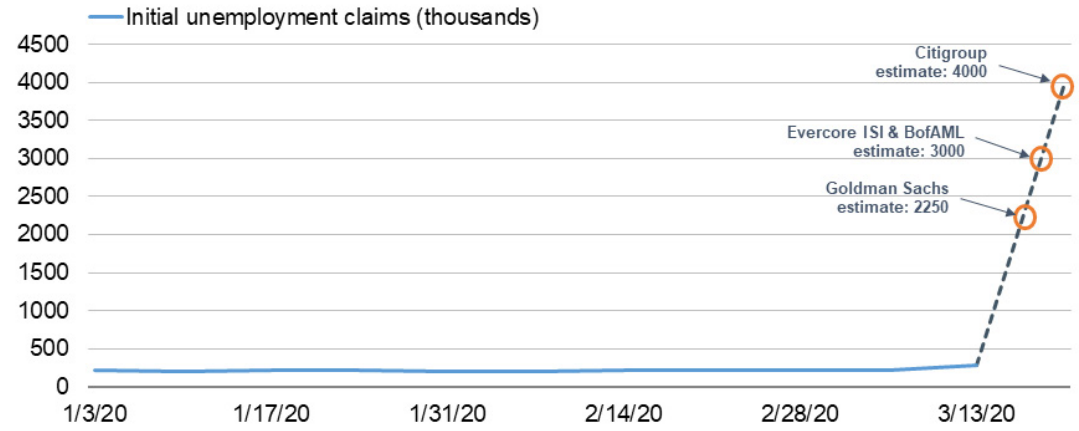
Last week we already saw a significant jump in initial unemployment claims. But what's shocking are the estimates being trotted out for the ascent still ahead of us. As you can see in the chart below, from recent record-breaking lows down near 200k, some estimates are as high as four million in the nearterm.

Firm	2Q2020 GDP estimate
Wells Fargo	-3.3%
IHS Markit	-5.4%
Pantheon	-10.0%
Strategas	-10.0%
Capital Economics	-10.0%
Cornerstone Macro	-11.0%
Oxford Economics	-12.0%
Bank of America Merrill Lynch	-12.0%
Deutsche Bank	-13.0%
JPMorgan	-14.0%
TSLombard	-17.7%
Evercore ISI	-20.0%
Goldman Sachs	-24.0%
Morgan Stanley	-30.1%

Source: Charles Schwab, as of 3/23/2020. For illustrative purposes only.

Unemployment claims set to spike

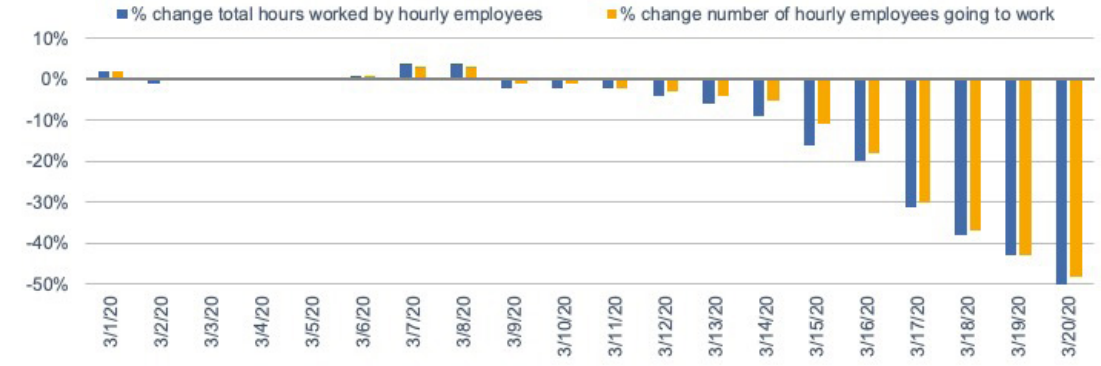




Source: Charles Schwab, as of 3/23/2020. For illustrative purposes only.

A sense of the coming hit to claims can be gleaned by analyzing the recent change in both hours worked and the number of hourly employees actually going to work. From increases for both measures as recently as the first week in March, both have now plunged nearly 50% as you can see below—and are likely to get worse.

Hours worked plunging



Source: Charles Schwab, Homebase, as of 3/20/2020. Percentages compare that day vs. median for that day of the week for the period 1/4/2020-1/31/2020. Homebase data covers 60,000 businesses and 1 million hourly employees.

Fed to the rescue?

The Federal Reserve, along with other global central banks, was quickly out of the blocks to stem the contagion within the financial system. The flurry of actions was summarized as follows:

- Cut the fed funds rate by a total of 100 basis points to a range of 0% to 0.25%
- Increased the amount of liquidity in the repo market to highest ever
- Restarted quantitative easing (QE) by expanding maturity range for its $60 billion/month purchases
- Started new QE program, buying $500 billion in treasuries and $200 billion mortgage-backed securities (MBS)
- Issued forward guidance that rates will stay lower for longer
- Pressured banks to help borrowers in need by using forbearance
- Increased/broadened foreign currency (FX) swap lines with foreign central banks; lowering cost and increasing frequency
- Lowered discount rate to 0.25% for primary banks and 0.75% for small banks to encourage direct borrowing from Fed
- Eliminated reserve requirements
- Activated commercial paper (CP) funding facility
- Activated primary dealer facility
- Allowing banks to use capital and liquidity buffers
- Activated money market lending facility
- Declaring QE to be unlimited (new this morning)
- Supporting flow of credit to employers, consumers and businesses with new programs that will provide up to $300 billion in new financing (new this morning)
- Expected to announce establishment of a Main Street Business Lending Program to support eligible small- and medium-sized businesses to complement SBA's efforts (new this morning)

More from the Fed is likely coming; including the possibility that Congress amends the Federal Reserve Act to allow it to buy municipal and/or corporate bonds for its balance sheet. All of this harkens back to the extraordinary measures unleashed by central banks in the midst of the GFC in 2008. But there are important differences between then and now. First, the GFC was a financial contagion that infected Wall Street first and then spread to Main Street. The Global Virus Crisis (GVC)—hat tip to Ed Yardeni—is a health-related contagion that infected Main Street and then spread to Wall Street.

Fiscal policy to the rescue?

There was a cloture vote on a nearly $2 trillion fiscal stimulus package on the Senate floor last night, but the vote failed and another vote is scheduled for mid-day today. This has many harkening back to the dark days of the GFC when the first TARP bill didn't pass—causing a rout in the stock market, which was the trigger for eventual passage. There is an important difference between these two bills however. The vote about TARP was simply whether to do it or not; while the disagreement within Congress today is about the bill's details. And as many are speculating today, the failed vote was "deliberately made" to set up the compromise (by showing where each member stands).

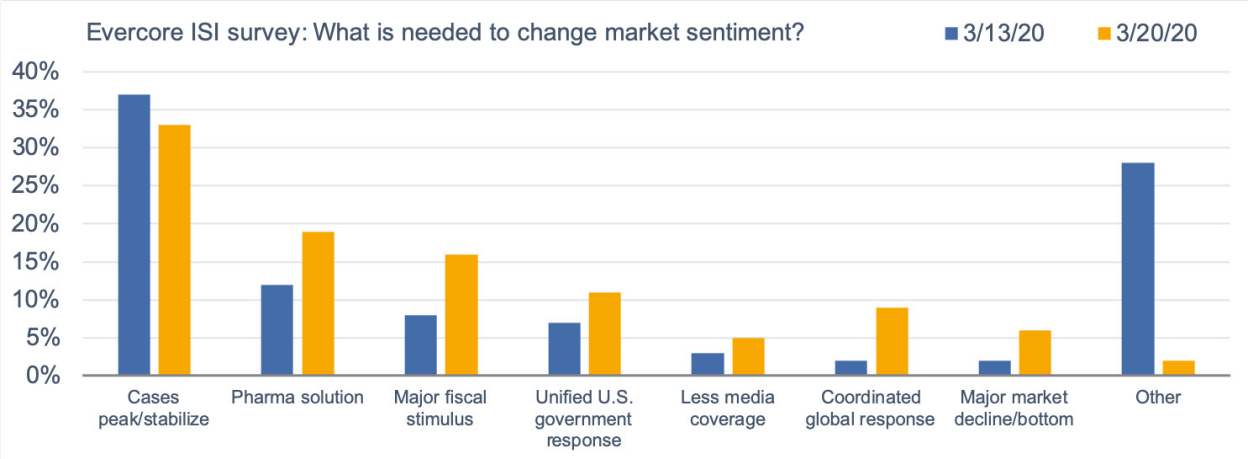
Although it's a moving target, the items likely in the ultimate package will include tax rebates/checks for individuals, corporate tax relief, small business loan forgiveness, bailouts/aid for distressed industries, extended/enhanced unemployment benefits and public health spending. Regardless of the details of the final package, it may cushion the blow to the economy, but in reality it's more about triage than it is about stimulus. Think about natural disasters ... in the immediate aftermath of their wrath, government efforts are more about "rescue" than "recovery." Once the final package is agreed to, I would urge you to follow my colleague and DC maven Mike Townsend on Twitter (@MikeTownsendCS) as well as read his reports on schwab.com.

As BCA Research noted in an early morning report today, "Officials could lift much of Treasury Secretary Geithner's 2009 remarks announcing the [bank] stress tests to explain the rationale for the measures they're proposing now. The difference is that policymakers in 2008 and 2009 could directly wield their monetary and fiscal tools to backstop a wobbling banking system, whereas now, the potent resources they've marshaled to spur the economy won't be able to take full effect until the pandemic recedes."

What's needed to change sentiment

EvercoreISI does some of the most-widely watched surveys in the business. They recently surveyed a large swath of investors about what is likely needed to shift market sentiment. You can see the results below; and it should come as no surprise that the top answer was that the virus case count needs to stabilize and/or peak.

Investors looking for case stabilization



Source: Charles Schwab, Evercore ISI, as of 3/20/2020.

In the meantime, investor sentiment has already shifted to an epic degree, with nearly every behavioral and attitudinal measure of sentiment moving into extreme pessimism territory (from the opposite extreme in early February). However, as I discussed in my late-January report on sentiment—when it was registering as euphoric—sentiment at extremes is a contrarian indicator; but typically a catalyst has been needed to trigger the market's contrarian shift. An improvement in the trajectory of the virus could be one such catalyst.

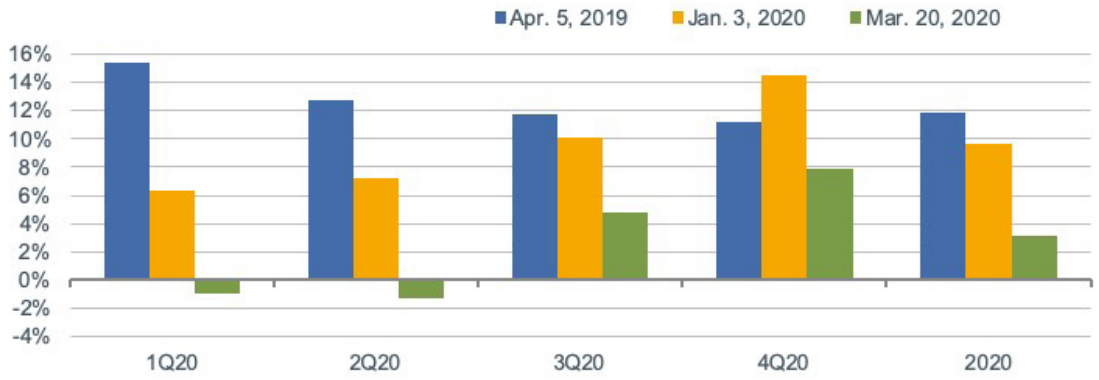
Valuation analysis is pointless

Valuations are not likely to be a catalyst—at least not until the "E" in the forward P/E finds its bottom. As you can see in the chart below, the forward price/earnings ratio for the S&P 500 has plunged. In a "normal" environment, that level might attract value-oriented buyers. The rub today is that most companies which have been directly impacted by the virus and related containment efforts have simply withdrawn guidance to Wall Street's analysts—making estimating earnings nearly impossible. The second chart shows that estimates have been coming down; but in my opinion, they have much further to go—at least for the second quarter.

Plunging forward P/E (doesn't matter)

Source: Charles Schwab, FactSet, as of 3/20/2020.

More downward estimates coming

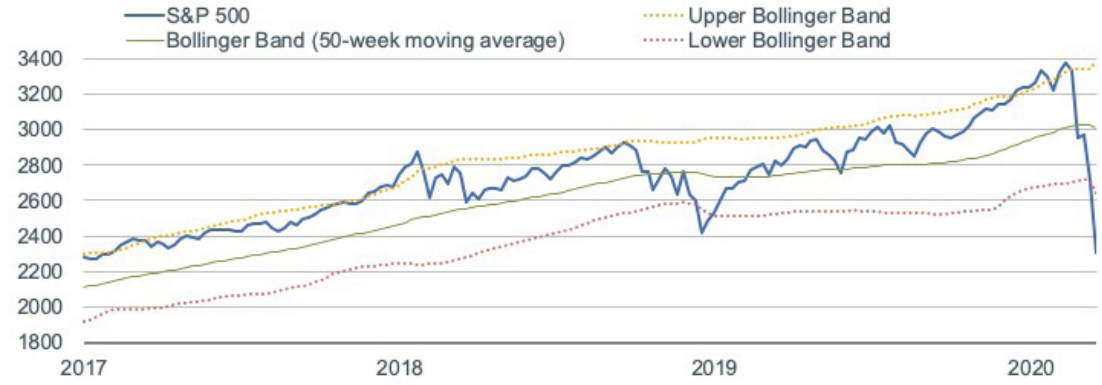


Source: Charles Schwab, I/B/E/S data from Refinitiv, as of 3/20/2020.

Stocks oversold, but ...

Technicians can point to dramatically oversold conditions; but again, that may not be enough. In my late-January report, I wrote about some technical conditions in addition to sentiment. I showed a chart of the S&P 500 relative to its Bollinger Bands—seen updated below—which compares the trend in the S&P 500 to a set of lines plotted a certain number of standard deviations away from a simple moving average (further details in the link within the chart's footnote). Clearly, we are at an oversold extreme. However, investors should heed the thinking from John Maynard Keynes, who said in the 1930s: "Markets can stay irrational longer than you can stay solvent."

Stocks extremely oversold



Source: Charles Schwab, Bloomberg, as of 3/20/2020. For more information on Bollinger Bands®, see Bollinger Bands®: What They Are, and How to Use Them.

What to look for

In addition to looking for a stabilization in the number of COVID-19 cases, there are broader signs we can look for economically, once the cases start to taper—some of which I've highlighted in this report; others I've been highlighting on Twitter (@LizAnnSonders):

- Unemployment claims
- Hours worked
- Anecdotes from small businesses
- Consumer confidence
- Financial conditions
- Traffic conditions
- Restaurant reservations
- Hotel occupancy
- Retail sales
- Mortgage applications
- Cinema/Broadway box office receipts

Panic is not a strategy

In terms of the stock market and advice for investors, don't attempt to time a bottom—especially if you are making all-or-nothing investing decisions. Historically, "waterfall declines" (like in 1929 and 1987) have had selling climaxes, followed by sharp rallies; but ultimately tests (if not breaches) of the lows.

Maintain discipline around diversification and periodic rebalancing and don't try to be a hero. Market bottoms tend to be processes over time, not moments in time; just like investing should be a process over time; never about a moment in time. And remember, panic is not an investment strategy.

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