Bangor Wealth Management
A Division of Bangor Savings Bank

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Key Points

- The longest bull market and economic expansion in history ended abruptly as a result of the COVID -19 pandemic.
- Analysts expect U.S. GDP to suffer two quarters of contraction, technically a recession, with the worst impact occurring in the second quarter.
- The Fed took unprecedented action, slashing the Fed funds rate by 1.50% and adding market liquidity through unlimited purchases of Treasuries and mortgage-backed securities. The central bank also unveiled several new lending facilities aimed at smoothing strains in funding and credit markets.
- Both global and domestic stock market indices fell more than 20%, the definition of a bear market. U.S. Treasuries and gold were the only major asset classes that provided positive returns as investors sought safe haven assets.
- Market volatility will likely persist in the near term, but over a longer time horizon should dissipate. The tremendous monetary and fiscal policy support will provide a solid foundation once the pandemic crisis subsides.

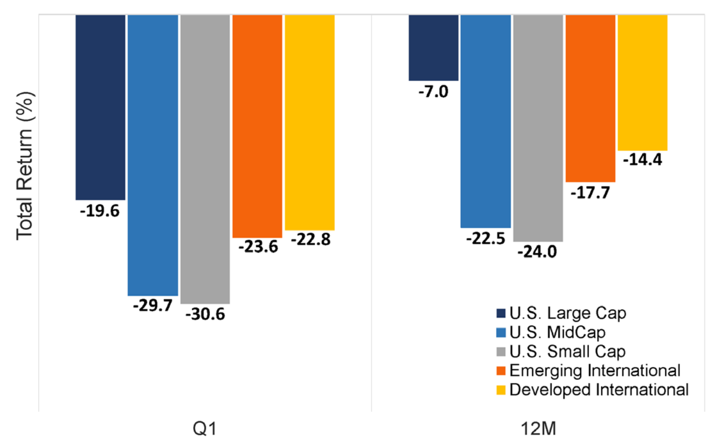
"History is merely a list of surprises. It can only prepare us to be surprised yet again."
- Kurt Vonnegut

The first quarter of 2020 will surely be one for the history books. For most in the U.S., the arrival of COVID-19 marked a surreal transition from business as usual to a new norm: work and school from home while group gatherings of all kinds were suddenly shifted or canceled. For many, it marked an abrupt end to employment. And for the markets, it was one of the most rapid transitions from a bull market to bear market on record.

Equity Markets Decline

While it is still early in terms of understanding the full economic impact of COVID-19, global markets have telegraphed expectations of recession. With countries around the world suddenly grinding to a halt as citizens practice social distancing, it stands to reason that economic activity will see dramatic declines in the current quarter and into next. Equity markets showed the largest dislocations in the first quarter, with the S&P 500 declining 19.6%, after hitting record highs in February. Smaller-sized companies fared worse, with U.S. Mid-Cap and Small-Cap indices falling 29.7% and 30.6% respectively. Developed international and emerging markets declined in line with U.S. large-cap as measured by the S&P 500 (Fig 1.) It was a synchronized global sell-off where well-capitalized large company stocks offered some measure of safety, but absolute returns suffered across the board.

Fig 1. Stock markets around the world sold off in reaction to the pandemic. U.S. large-cap stocks suffered the least.

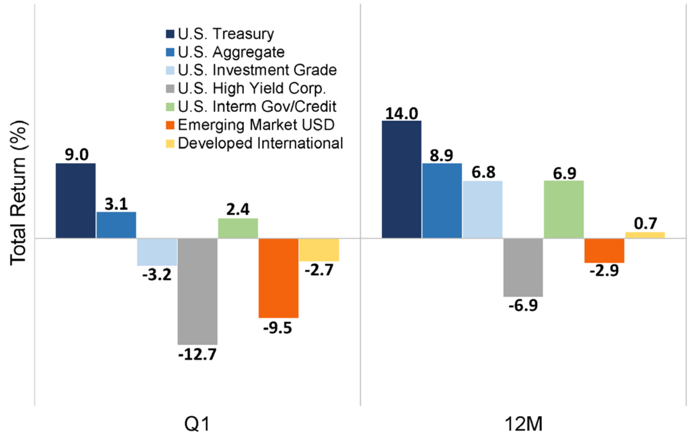


Data Sources: Bloomberg Financial LP, BWM

A Shelter in the Storm

Asset protection was a dominant theme in the world of fixed income. As is often the case during times of panic-induced selling, capital flows to the safest haven, the U.S. Treasury market. This past quarter was no different. Investment-grade municipal and corporate bonds were also sold, as investors sought the highest levels of credit quality. As the imbalance between sellers and buyers mounted, liquidity dried up. Prices of corporate and municipal bonds, especially lower-rated issues, fell relative to Treasuries. This activity can be seen illustrated in the relative performance of Treasury bonds (Fig 2.) U.S. Treasury bonds returned 9%. In comparison, investment-grade corporate bonds declined -3.2%, a difference of more than 12%!

Fig. 2 U.S. Treasury bonds benefited from a flight to quality. Relative strength was in direct proportion to credit quality in Q1.



Data Sources: Bloomberg Financial LP, BWM

Lender of Last Resort

In the midst of all this upheaval Jerome Powell and the Federal Reserve brought the full force of monetary policy tools to bear. At no time in history has the Fed moved so quickly to inject massive liquidity into the market. In less than two weeks, the Fed took two emergency actions to cut the Fed funds rate by 1.50% to near zero. They also established several emergency facilities supporting money and credit markets, and expanded their balance sheet by open-ended buying of Treasuries and mortgage-backed securities. The Fed's all-in response has helped to restore some calm and will likely remain in place until markets resume normal behavior. As a result of these unprecedented rate cuts and expectations of economic weakness ahead, Treasury yields dropped dramatically. Rates now hover near zero on Treasury bills and less than 0.7% for the 10-yr note.

The Weeks Ahead

Since most economic data is reported with a lag, we are only just beginning to see the impact of social distancing on business activity. The unemployment numbers reported for the last two weeks of the quarter showed over 9.99 million unemployment claims, a figure that eclipses any previous report. It will be some time before we see official U.S. GDP reports, but current estimates for Q1 are -5% and -8% or more for Q2, meaning we are likely already in recession. Second quarter GDP estimates are particularly challenging given lack of visibility on how long the pandemic persists and how long social distancing remains in place.

As far as the stock market is concerned, we have seen some dramatic moves down in prices. Compared to previous bear markets, the movements have been similar in magnitude, but occurred much more quickly. Bear markets, defined as a decline of 20% or more, have averaged approximately 35% in recessionary periods and lasted just over a year. Measured by the broad market index, the S&P 500, this years' decline (peak to trough) has totaled 34% in a month. So while we expect continued volatility, we do believe much of the damage has already occurred. There will be a stream of negative news in the weeks and months ahead, but the capital markets have anticipated a large portion of this news, reflected in current prices. And similarly, when things begin to improve, the markets will lead in advance of the actual recovery.

The investment team at Bangor Wealth Management continues to monitor this evolving situation. While the coronavirus is certainly unique, bear markets are nothing new – our team has navigated them going back 30 years. Like many, we are minimizing our interactions with the public and working remotely. But we are available by phone, email, or video conference to help you weather the storm. Should you have questions, please do not hesitate to reach out to your Portfolio Manager or Relationship Manager.

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