Great-West Investments Capital Markets Perspective

Week in Review: March 30th – April 5th

INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD
Dow Industrials	Lg. Cap Eq.	21,052.53	-2.7%	-26.2%
S&P 500®	Lg. Cap Eq.	2,488.65	-2.1%	-23.0%
NASDAQ Comp.	US Equity	7,373.08	-1.7%	-17.8%
Russell 2000®	Sm. Cap Eq.	1,052.05	-7.1%	-36.9%
Stoxx 50	Europe Eq.	2,662.99	-2.4%	-28.9%

INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD
FTSE 100	UK Equity	5,415.50	-1.7%	-28.2%
Nikkei 225	Japan Equity	17,820.19	-8.1%	-24.7%
EEM:US	Emkt. Equity	$33.13	-0.7%	-26.2%
EFA:US	Non-US Equity	$50.90	-3.7%	-26.7%
UST 10y (yield)	US Treasury	0.59%	-0.08%	-1.33%
B/Barc AGG	Fixed Inc.	2,298.95	+0.64%	3.32%

Two numbers.

To understand what moved markets last week, you only need to understand two numbers: 100,000 and 6.6 million. These two figures represent the lower bound of estimates for US COVID-19 fatalities and number of first-time unemployment filers last week, respectively.

Both are sobering, and its **frankly a little surprising this week's losses weren't steeper**. I suppose that's a testament to how fast and how far stocks have already fallen, as well as the degree to which investors have resigned themselves to receiving bad news. Policymakers might also assign some of the relative calm to their efforts, which have so far been as robust and timely as anyone could have hoped, at least from a capital markets perspective.

Let's take both of these figures in turn. **As horrific as it is, the 100,000 fatalities figure was actually the *low* estimate** issued by a White House task force led by Dr. Anthony Fauci, director of the National Institute of Allergy and Infectious Diseases (NIAID); as many as 240,000 Americans may ultimately perish from COVID-19, and that's assuming that the current stay-at-home and social distancing orders remain in place[1]. **Markets reacted to the announcement in exactly the way you'd expect them to: by falling sharply** on Wednesday.

But **markets took last week's other important number – Thursday's announcement that there were 6.6m new unemployed[2] – more or less in stride**. That still does little to diminish the eye-watering nature of the figure, which combined with the previous week's tally of 3.3m, brought the total number of newly out-of-work Americans to just under 10m. That **matches the *total* number of people receiving benefits during at the height of the Great Recession** in 2008-09. The final joblessness report of the quarter eclipsed the former record number of claims by nearly a factor of 10, and these numbers will probably get worse before they get better.

[1] https://www.washingtonpost.com/world/2020/03/31/coronavirus-latest-news/
[2] https://www.dol.gov/ui/data.pdf

But markets were **somewhat less forgiving when March payrolls** were released the next day. It certainly came as no surprise that payrolls would disappoint, **but the magnitude of the miss** – nearly six- or seven *times* the decline of 100,000 – 150,000 or so that was expected[3], **may have caught investors off guard. Particularly since the end of the survey period was the week of March 12,** or roughly a week before California, Illinois, New York and Pennsylvania simultaneously locked down their residents to great fanfare.

Other economic data from last week were more mixed, but probably also less consequential. Examples included ISM and PMI figures ("Institute of Supply Management," and "Purchasing Manager Indexes", respectively,) for both manufacturing and services, which were on the whole less horrible than assumed[4]. Still, all four of these reports showed evidence of **declines rivaling (or surpassing) declines wrought by the Great Recession 11 years ago, and it's logical to assume that the numbers may have been artificially elevated** by stockpiling behavior earlier in the month as the likely extent of the US lockdown became known (similar to what high-frequency retail data like Redbook had shown in earlier weeks.) That doesn't bode well for future ISM- and PMI readings.

Meanwhile, **ongoing volatility in the energy markets may have escaped your notice** amid all the COVID-related headlines. After bottoming near $20 early in the week, **US crude surged more than 30% on Thursday and Friday** following reports that Saudi Arabia and Russia may have resolved their differences[5]. Among the news that broke last week was a tweet from the Commander-in-Tweet (remember those?) saying the two sides had agreed to cut production by 10m barrels per day. Some **analysts remain skeptical** that such a deal will be reached and that even if it is that it will do much to alter the energy markets' dynamics – particularly given the huge fall in demand that has resulted from the near shutdown of the global economy to combat COVID.

Meanwhile, the **OPEC-sponsored production quotas that spurred the disagreement have since gone out-of-force** and a formal deal regarding new quotas has yet to be reached[6]. But maybe the most interesting aspect of the ongoing displacement in oil markets is one of perspective: this would certainly be a market crisis, breathlessly covered by the financial media in its own right if it weren't for COVID. But **as it stands, it's almost hard to remember that energy markets are melting down** as the virus continues its rampage. **One crisis at a time, I suppose**.

Finally, there was **at least one ray of hope last week in the form of PMI figures from China**. Specifically, the Caixin China General Manufacturing PMI climbed from its record low of 40.3 in February to 50.1 in March[7]. As a reminder, any reading above 50.0 suggests expansion in the sector, making this a strong reading which **may provide hope that other countries will see economic activity similarly rebound as their own economies begin to re-boot**. But at the risk of throwing cold water on that particular bit of optimism, reports leaked last week also suggested that the **US intelligence community had concluded that Chinese officials deliberately misled the world** about the scope and severity of the outbreak[8]. That does little to bolster confidence that the above-reported Chinese PMIs are accurate.

Regardless, **China was the first country to dive into the COVID-19 abyss, and barring a sudden return of the virus it will be the first out.** That makes any sign of accelerating economic activity there relevant to investors trying to understand how quickly and powerfully the worldwide economy will return to growth when the outbreak subsides. And as **a potential antidote for skepticism regarding any data released by Chinese authorities, the world will be watching infection and mortality rates from other COVID hot-spots** such as Italy and Spain for clues about how soon the pandemic may end.

One other miscellaneous comment before we close the week-that-was section of this update. While we have recently limited most of our comments to how large-cap US equity indices such as the S&P 500 Index have responded to the news, sharp-eyed readers will have noticed that other areas of the equity market have charted their own courses in recent days. Specifically, **small caps (as represented by the Russell 2000 Index) have**

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[3] https://www.bls.gov/news.release/empsit.nr0.htm, and econoday.com
[4] https://www.markiteconomics.com; https://www.instituteforsupplymanagement.org/
[5] Data: generic front-month US WTI futures, Bloomberg.
[6] Bloomberg
[7] https://www.markiteconomics.com/Public/Home/PressRelease/26d2e64100134c259a5553462889c8c1
[8] Bloomberg

been absolutely crushed, underperforming large-caps by more than 10% year-to-date. **On the other hand, emerging market stocks have held up relatively well** – generally pacing US large caps in spite of their riskier profile (this week, for example, the MSCI iShares Emerging Markets ETF *outperformed* the S&P 500 by nearly 150 basis points.)

Of course, **the relative underperformance of small-caps is understandable**. As a rule, small caps tend to be more sensitive to economic cycles, may have higher financial and operating leverage, and may also have less financial firepower to withstand severe economic disruptions than their large cap peers.

On the other hand, **the relative** (risk-adjusted) **outperformance of emerging markets last is perhaps less obvious**. **Encouragingly, it may also provide an example of ways that the ongoing policy response is shoring up markets in ways that go beyond headline-grabbing announcements** of multi-trillion dollar rescue packages. Namely, the decision by the Federal Reserve to allow foreign central banks to place an amount of foreign currency on deposit with the Fed in exchange for dollars at current rates, using their US Treasury holdings as collateral. That in turn takes some of the pressure of foreign holders of US Treasuries to sell those assets to obtain greenbacks in a bid to defend their own currencies[9].

This somewhat esoteric program (the details of which are probably not all that important to the average market participant,) is **one example of how regulators are confronting the massive and complex challenges** presented by the COVID crisis. **To see it show up in returns at the asset class level is, in my view, one of the most encouraging developments from last week**.

What to Watch This Week: April 6th – 12th

What to Watch (April 6th – 12th)

Monday: *no major releases expected*

Tuesday: JOLTS (February), Consumer Credit (February)

Wednesday: FOMC minutes

Thursday: Weekly jobless claims, UofM Consumer Sentiment, Fed Balance sheet

Friday: *Good Friday – markets closed*

I suppose it's just a matter of perspective, but **last week felt a little more "normal" than recent weeks**. After all, the biggest absolute move by the S&P 500 Index last week was less than 4.5%, and **the last time we've had a week that "calm" was at the end of February**.

That might mean that economic data will begin to matter again, but **as with prior weeks, I'm afraid daily market performance will continue to be driven by the smallest bit of news related to the pandemic** and government efforts to combat it. That's because of a continued (and still near-complete) lack of clarity regarding the economic and financial impacts of the virus and the global shut-down. Until that begins to change in earnest, **this will remain a sentiment-driven market. And sentiment, in its turn, is driven by headlines**.

That said, there **are a few scheduled events that might merit attention**. Chief among these is Thursday's weekly jobless claims figure, as well as the **University of Michigan's preliminary view of April consumer sentiment**. The speed and velocity with which the US economy recovers will depend to a very large extent on how consumers feel about spending their stimulus checks when this is all over, meaning that measures like the UofM survey and it's compatriot, the Conference Board's consumer confidence index, are paramount. And those are linked in no small way to how many people ultimately lose their jobs.

[9] Cornerstone Macro, Seekingalpha.com, and https://www.federalreserve.gov/newsevents/pressreleases/fima-repo-facility-faqs.htm

Also on Thursday, markets will get their **weekly view into the size of the Federal Reserve's balance sheet**. These data have been produced by the Fed for years but rarely get a second glance. This time, however, investors are watching the figure with awe as the various Fed programs introduced in response to COVID have pushed the Fed's balance sheet toward $6t and into record (read: nosebleed) territory. As readers likely recall, Fed Chairman **Jerome Powell told the American public that the Fed's firepower in this regard was essentially limitless**. Whether or not that proves to be the case, investors will continue to watch the balance sheet balloon, merely in curiosity if not concern.

Finally, **markets are scheduled to shut down for Good Friday at the end of this week**. So far, exchange authorities have resisted efforts to close the markets in response to COVID, and for good reason. And because Friday represents a pre-planned closure scheduled months ago, it **will probably lack the psychological impact that a forced closure would have generated**. That said, it may still be interesting to see how markets react on Thursday as they prepare for a long weekend: will investors try to inoculate their portfolios against unforeseen (negative) developments regarding the virus, or will they take things in stride?

Like everything the markets are dealing with right now, **only time will tell. Thanks, and stay safe.**

Source for index data: Bloomberg.com; GWI calculations.