Market Volatility: COVID-19 – Informational Call Notes – Tuesday March 17th

Thanks Michael, and good morning everyone. Thank you again for taking time to listen in to our call. We are truly in historic times. Businesses and schools are closing, and events of all types are being cancelled. We have seen normal everyday activities grind to a complete stop. As a result of this virus, our everyday lives have been completely and totally upended. We are collectively being bombarded by information at a rate faster than most of us can keep up with, and we have to quickly discern what is fact, what is partly fact, and what is fiction.

I believe that it is in times like these, our unity as a community and as a country are really important. We have a government that is acting. They have provided fiscal support and stand ready to provide more as necessary to get us through this. Additionally, they are not acting alone – they are working in concert with governments all over the world to find a solution, not just for us, but for all those affected. We have a monetary authority in the Federal Reserve that has pulled out all the stops to provide liquidity so markets can function. While the effects of this pandemic are undoubtedly painful on our lives and the economy, it is, in fact, temporary, and life as we know it will resume.

I think in times like these, we absolutely need to remind ourselves of that – we need to stay calm and help each other out, as we Americans do. Yesterday morning when I logged onto my Bloomberg terminal, there was a famous quote and I thought it was quite appropriate for today and very relevant to what I just said. The quote was from Helen Keller, and it said, “Optimism is the faith that leads to achievement. Nothing can be done without hope and confidence.”

Given the incredible movements in both equity and fixed income markets, and the unprecedented monetary and fiscal policy responses from both the Fed, the White House, and Congress, I wanted to give you my perspectives on four areas:

1) A quick overview of the US fiscal stimulus package unveiled Friday,
2) The highlights of the Fed’s unprecedented actions Sunday night,
3) An update on market actions and when we might see a bottom start to form, and
4) What we are doing in your portfolios

Before we jump in, yesterday afternoon I put out a new write-up - if you haven’t received a copy already, please reach out to your First Citizens Bank relationship partner and get a copy. It’s called, “Market Volatility: COVID-19 – 3 Weeks in Pictures.” It covers equity, fixed income, rates, and all the unprecedented market actions we’ve witnessed these last 3 weeks. AND very few words (at least relative to my normal short write-ups!)

1) **US Fiscal Policy Actions: Just What Markets Needed**

On Friday the 13th at 3pm, President Donald Trump, members of his administration, industry leaders, and health officials delivered a clear, detailed, and powerful message not only to America and the world, but to markets. The White House and the US government would take swift, strong, and robust fiscal actions to counteract the devastating economic effects of COVID-19. Markets swiftly reacted to the proposed measures, and from the beginning of President Trump’s speech to market close at 4pm, the S&P 500 rose more than 4%, closing up over 9% for the day, unwinding a significant amount of Thursday the 12th’s record sell-off.¹
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Brent Ciliano, CFA | SVP, Chief Investment Officer

- Friday the 13th – President Trump declared a national emergency (enacting the powers under FEMA) that he said would free up as much as $50 billion to help states and cities respond to the health crisis, waive student-loan interest, purchase large quantities of US oil and confer new authority on his health secretary to bypass hospital regulations.²

- The 110-page House Bill, H.R. 6201: Families First CoronaVirus Response Act, includes free testing for everyone who needs it, and two weeks of paid sick leave to allow people with the virus to stay home from work and avoid infecting co-workers. It also includes enhanced jobless benefits, increased food aid for children, senior citizens and food banks, and higher funding for Medicaid benefits.²

- Early Saturday morning the 14th, the House of Representatives pushed through the economic stimulus measure by a vote of 363-40. With Trump’s endorsement, the bill is expected to win support from GOP lawmakers as it will be taken up by the Republican-led Senate early this week of the 16th.²

- Given the continued escalation of business closures, virtual shutdown of everyday life activities, and the significant economic impact that this will have broadly on the US economy, I believe that there will be more fiscal stimulus from Congress, and more is necessary in the coming days and weeks. The Senate has said they will remain in Washington DC this week. And while the House went out on break after voting on the stimulus bill Saturday, they will more likely than not be called back to DC to help legislate.

2) Fed’s Actions Sunday night.³

- In direct response to the temporary, but devastating economic impact caused by COVID-19 on the US economy, the US Federal Open Market Committee (FOMC) pulled forward their regularly scheduled March 17-18 meeting and addressed markets on Sunday evening the 15th. In an unprecedented move, the Committee decided to lower the target range for the federal funds rate down a full 1%, to 0 to 0.25%. We are truly in uncharted territory, as this is the first time in US history that the FOMC had lowered the Fed Funds rate twice in a two week period for a total of 150 bps or 1.5% - historical policy norms has been 1 cut/hike at a time for 0.25%.

-QE is back and we are now on round #4 – the FOMC started a new $700 billion Quantitative Easing program consisting of $500 billion in Treasury purchases and $200 billion in mortgage purchases. They also stated they will be reinvesting all proceeds from bonds currently on the Fed’s balance sheet that are/have matured. The Fed will also provide liquidity to overnight borrowing markets (i.e. repo facilities - $1.5 trillion - $500b 1-month, $500b 3-month, and $500b term). The total amount of stimulus will take the Fed’s balance sheet to roughly $5.4 trillion – about $1 trillion more than at the peak of the Great Financial Crisis (GFC).

- A little Fed QE history – Pre-GFC, Fed’s balance sheet was $1 trillion back in 2007 – after 3 rounds of QE post the GFC, it grew to $4.5 trillion. After things settled down, the Fed unwound a little more than $1 trillion, getting it down to $3.3 trillion.

- The FOMC noted that “the effects of the coronavirus will weigh on economic activity in the near term and pose risks to the economic outlook. The Committee expects to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals.”
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➢ The Fed also took action related to the discount window where banks like us and others borrow, intraday credit, bank capital & liquidity buffers, and reserve requirements. The Fed is making sure liquidity will be available.

➢ Additionally, the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, the Federal Reserve, and the Swiss National Bank announced a coordinated action to enhance liquidity via the standing U.S. dollar liquidity swap line arrangements. In essence, they are making sure that US $ are available for foreign countries that need USD for global transactions, - i.e. think commodity purchases like oil, etc. that trade in USD.

➢ This unprecedented scale of coordinated monetary policy stimulus coupled with fiscal stimulus out of the White House, Congress, and foreign governments, I believe, will be enough to get us through – I also believe more governmental support and stimulus is forthcoming as businesses and consumers start to see the cash flow strains this pandemic is likely to inflict over the coming weeks and months.

3) Markets:

➢ Yesterday was yet again, a historic day with the S&P 500 down 12%, the Dow down almost 13% - similar to Thursday March the 12th’s selloff, but worse. Worst day for markets since Black Monday 10/19/87.1

➢ From February 19th through last night the 16th, the S&P 500 is down 29.4%, year-to-date down 25.8%.1

A question you’re likely asking is, “So if we’ve had all of this unprecedented fiscal and monetary stimulus and support, why are the markets still falling?”

I believe there are a number of reasons why:

1) One reason is that we’ve never had this level of actual and potential economic impact and shock to the US economy, and market participants are having a hard time assessing the true economic damage, and then trying to determine how long it’s going to take to recover.

2) As an owner of stocks, you are a claimant on the residual earnings of those companies you own. Well, it’s hard to assess the impact to corporate earnings and revenues at this early stage, and as such, truly determining the “E” in the forward P/E (Profits/Earnings) ratio and thus where shares of a given company should trade are very difficult at this stage. In time we will undoubtedly know – but hard to tell right now.

3) Lastly, market participants are scrambling to generate liquidity - As you get closer to a capitulation point in markets, even the best stuff gets sold – it’s a “sell what you can, NOT what you should” mentality right now.

So when might we start seeing a bottom and how long until we recover? – First, please review my write-up which gets into a good bit of detail on this based on many other historical experiences.

In my opinion, we may likely start to see a bottom when either 1) the number of reported cases in the US starts to peak and/or fall, and 2) the US, in concert with other nations or unilaterally, brings out the fiscal bazooka to support consumers and businesses likely cash flow shortages as this virus continues to spread.
Looking at the long-term history and every bear market since the mid 1800’s, we find that there are three different types of bear markets; each type is a function of different triggers and has distinct characteristics. The three categories are:

- **Structural bear market** - triggered by structural imbalances and financial bubbles. Very often there is a ‘price’ shock such as deflation that follows. **Examples are 2000-2002, 2007-2009.**

- **Cyclical bear markets** - typically a function of rising interest rates, impending recessions and falls in profits. They are a function of the economic cycle. **Most economic cycles end and bear markets begin this way.**

- **Event-driven bear markets** - triggered by a one-off ‘shock’ that does not lead to a domestic recession (such as a war, oil price shock, EM crisis or technical market dislocation). **A la today.**

We are obviously in an Event-Driven bear market today. The key takeaway is that “Event driven” bear markets last on average 9 months, fall on average 29% from peak to trough, and maybe more importantly, fully recover on average in 15 months. These tend to be the shortest, least damaging and fastest time to recovery out of the 3 types of bear markets!!

4) **What are we doing in your portfolios?**

- **Tax-loss harvesting** - In extreme market environments like we’re experiencing now, we focus even more deeply on tax-loss harvesting as means to provide clients potential added after-tax benefit (where appropriate). Remember that we look to dynamically harvest losses where and when appropriate, **ALL year long** – not just towards the end of a given year.

- **Dynamic asset allocation** - Our portfolios are perpetually dynamic, never static or “set it and forget it.” We continue to dynamically adjust portfolios each quarter based on our forward-looking market expectations, thus allowing your portfolio to be nimble and reflective of what’s “coming down the pike” from a market perspective.

  - A static or long-term strategic allocation completely disregards the frequent dislocation in asset prices over intermediate time periods within that long-term horizon – and, by default, foregoes the potential enhancements associated with a more dynamic allocation process. Our portfolios are re-optimized on a quarterly basis using our updated forward-looking capital market assumptions.

- **Active risk budgeting** - Within all areas of our portfolios, we continue to focus on and enhance our risk-optimization process through our “Manager Fit” approach, which looks to diversify the nature, extent, and most importantly, timing of our manager’s returns, while potentially helping to reduce the active risk managers impart on portfolios.

Please always remember and consider two things:

1) Know, and have comfort in, the fact that we are constantly seeking to manage the risks associated with thoughtfully and judiciously growing your wealth over time.

2) It is time **IN** the market - **not timing** the market – that helps create long term wealth.
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Available Online at FirstCitizens.com

5

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1 – Bloomberg / Bloomberg Data
2 – Associated Press (AP), Bloomberg News
3 – New York Federal Reserve Bank
4 – Goldman Sachs Investment Research