MARCH 27, 2020

We thought it would be helpful for us to concisely re-cap the biggest economic and capital market stories affecting investment portfolios this past week. Additionally, we wanted to share a list of some stories that are likely to consume capital markets' attention next week.

News of Note: Weekly Economic and Market Developments

- Most of the COVID-19 related news remained, on balance, more dire than reassuring. US cases continued to explode, particularly in NYC and in New Jersey, with stresses rising on healthcare systems throughout the country. Outside the US, Europe (particularly Italy and Spain) faced a growing crisis. But net new cases were still leveling-off (China) or not rising as rapidly (notably, Japan and South Korea) in other Asian countries.
- The US Federal Reserve further stepped-up its interventions to ensure the daily functioning of US capital markets and initiated programs to support the availability of credit to businesses and consumers. It established programs to provide liquidity in the corporate bond market and to support new lending and bond borrowing; it created programs to provide liquidity in markets for existing short-term municipal financing securities and to support future short-term borrowing by municipalities. Chairman Jerome Powell said that the Fed would use all the tools at its disposal and promised that it would not "run out of ammunition" in the fight to mitigate the financial market damage of the crisis.
- The US government spent most of the week negotiating and hammering out a third – and record smashing – crisis-related spending bill. The estimated $2 trillion spending package will provide near-immediate cash payments to a large segment of the populace, increases unemployment benefits and extends them through year-end, gives financial assistance to businesses (e.g., a refundable payroll tax credit for keeping employees on payrolls); provides loans and grants to businesses; and allocates additional funding to the healthcare system. Beyond its sheer size, the plan's "sunsetting" provisions (most of the spending is slated to occur between now and year-end) are also unique relative to past economic stimulus packages.
- The US Department of Labor's weekly report on Initial Jobless Claims (the number of first-time filing for unemployment benefits) surged to nearly 3.3 million people, four times as great as the previous (October 1982) record for a single weekly increase. Claims were greatest in Pennsylvania (which, as many of us well know, started to shutter non-essential businesses two weeks ago), Ohio, and New Jersey.

With the Federal Reserve and US government both aggressively stepping into the fray this week, a good portion of the extreme angst that plagued capital markets across the prior two weeks subsided during the week ended March 27, 2020. After setting an inglorious record the previous week ("worst week for markets since 1928"), US stock prices rallied over 17% ("best 3 days since 1933") from Tuesday through Thursday. The stock market closed lower on Friday.

More importantly, particularly from a balanced investment portfolio perspective, the taxable and tax-exempt bond markets largely recovered from the sharp pricing dislocations of the past three weeks (see the analysis we published on Tuesday March 24 , *Shelter from the Storm?*). Credit spreads on corporate bonds tightened slightly during the week, pushing some taxable bond prices about 5% higher. Anomalous excess yields on municipal bonds (e.g., yield premiums of +250 to +300 basis points versus comparable maturity Treasuries through Monday of this week) largely evaporated this week amid Federal Reserve activities to ease market illiquidity. This development also pushed prices about 5% higher in this segment of the US bond market.

Next Week: What to Look For

The year's first calendar quarter ends Tuesday, closing-out a period for capital markets that started confidently but finished with the highest levels of uncertainty in more than a decade. Through Friday (March 27, 2020), US and global equity indices are on track to log their worst quarterly return since Q4 2008 (-23% and -22%, respectively). Updated COVID-19 data aside, some of the salient news and statistics to watch for next week include:

- Consumer Confidence: Two widely watched indices that track consumers' short- and longer-term confidence will be released (University of Michigan on 3/27; Conference Board on 3/31), likely showing very substantial declines in consumers' sentiment.

- Manufacturing and Services Activity: Surveys of senior executives of private sector companies to gauge directional levels of business activity (expanding or contracting) to be released on April 1 will likely show that US economic activity shrank in March. Data on factory orders (4/2) will similarly validate a slowing pace of activity.

- Joblessness: Reports on total employment (from ADP on 4/1) and on announced job cutbacks (from Challenger on 4/2) will likely show further weakness as will the next weekly Initial Jobless Claims report (4/2). The capstone report of the week: the US Bureau of Labor Statistics will report March changes in private payrolls and the month-end nationwide unemployment rate. The latter is virtually certain to move well-higher from its recent 50-year low rate of 3.5%.

- Corporate Earnings: The so-called earnings season – the roughly six week period across which most publicly traded companies report quarterly outcomes and provide forward guidance on revenues and profits – will get off to a slow start next week. Only five companies, none of which are considered bellwethers of their industries or the economy, are scheduled to report.

For markets and for investors, we think that the "good news" arising out of a week with so much news is that large scale Federal Reserve activities and unprecedented US government spending programs are either up and running or will soon be rolling out. On balance, this should temper the heretofore high levels of day-to-day market volatility. But there are not inconsiderable health and economic risks still to be confronted. We think it will take more time – and more data – before investors generally and Mill Creek in particular can declare that prospective Risk/Return tradeoffs come down unequivocally on the side of substantially re-risking investment portfolios to take advantage of opportunities that are ultimately likely to produce once-in-a-decade excess returns.

Investment Strategy Group
Mill Creek Capital Advisors
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