Wentz Weekly

March 9, 2020

Markets Finish A Volatile Week Positive

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Market turbulence continued last week with the S&P 500 seeing four consecutive days of 2% plus moves and record low yields on the 10 year U.S. Treasury bond as markets continue to digest how much of an impact the spread of the coronavirus will have on economic growth. Even with the significant volatility through the week, the S&P 500 still finished positive for the week, gaining 0.6% (Yahoo Finance – S&P500 historical data). As we have mentioned the last several months, expect an increased amount of volatility for this year.

President Trump signed a $8.3 billion emergency spending bill to help combat the virus which has funds earmarked for both the CDC and FDA, R&D of vaccines, and funds for state & local health centers. In addition, the administration has been drafting proposals for an economic package to potentially support the economy from any sort of slowdown from the coronavirus and looking at different methods to slow the spread.

Following an unscheduled meeting, the Federal Reserve announced a 50 basis point cut to the federal funds rate leaving the targeted rate in the range of 1.0% to 1.25%. The Fed typically only makes changes to policy at its scheduled policy meetings which run about every six weeks, unless there is a dire need to in between meetings such as the Financial Crisis. Overall we see this as a move to calm the markets, rather than provide any sort of economic boost or prevent an economic slowdown, as rates being 0.50% lower will not stop the spread of the virus or lead to an increase in demand. The Fed has more ammunition if needed, but fiscal stimulus would be more effective and more immediate and we expect that to be announced over the next several days.

Mortgage rates have fallen to the lowest levels on record and continue the move down, based on data from Freddie Mac. The average 30-year fixed rate fell to 3.29% as of last Thursday, which will be an added boost on an already strong housing market. According to Mortgage Bankers Association's weekly survey, mortgage applications were up 15.1% in the week ended February 28, 2020 and this growth is expected to continue. There remains one issue in the housing market though, which is the limited amount of homes for sale. As of January, there was just 3.1 months supply of homes on the market compared to around 6 months supply a year ago. If it makes sense for your individual situation, we think due to lower interest rates, refinancing your mortgage could be something to consider.

The job market as of February remains very strong. The Department of Labor reported the U.S. economy added 273,000 non-farm payrolls in February, which is above the expectation of 177,000 for the month. January's and December's non-farm payroll growth was revised a combined 84,000 higher, and after the revisions job growth has averaged a strong 243,000 over the last 3 months. The most job gains were seen in the health care sector, followed by restaurants, government, and construction, with small job losses in retail. The average hourly earnings rose 0.3% in the month and wages are now 3.0% higher in February than they were a year ago. The labor force participation rate was steady at 63.4% and the U-3 unemployment rate moved lower to 3.5% from 3.6% while the U-6 unemployment rate move higher from 6.9% to 7.0%.

The U.S. trade deficit shrunk again in January, by 6.7% to a deficit of $45.3 billion, according to data by the U.S. Census Bureau. A shrinking deficit is a positive to GDP as that indicates either less imports or more exports. From the details of the report, the decline was mostly due to a drop in imports of oil, autos and cell phones. Total imports fell 1.6%, while exports fell 0.4%. This is data from January and is still too early to tell if any impact from the virus.

Company News

Target reported Q4 results that missed earnings and revenues expectations. Comparable store sales rose 1.5%, short of the 2.1% analysts were expecting. The company guides first quarter comparable store sales growth of 2.6%, and earning in line with consensus.

Skyworks cut second quarter revenue guidance by $30 million to $765 million, which was expected to eventually happen. Management said the virus has not caused disruptions within its manufacturing operations to date, but the demand environment has been negatively impacted from interruptions in global supply chains.

Chinese e-commerce company JD.com reported Q4 results that were better than expected with a 27% growth on revenues. Management guided current quarter sales and earnings above expectations.

The Week Ahead

The collapse in oil prices and the impact of the coronavirus will remain driving forces in the markets. We expect the Fed and government to step up to provide financial support and stimulus in the days and weeks ahead. There are still several retail companies left to report fourth quarter earnings, including Dick's Sporting Goods, Dollar General, Gap, Ulta and tech companies such as Broadcom, Oracle and Slack Technologies this week. Economic data releases include inflation data via the consumer price index and producer price index, in addition to the consumer sentiment report on Friday. The European Central Bank will announce its policy decision after its meeting on Thursday where added stimulus is expected.

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Market Correction – Additional Thoughts

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- The markets opened the week with a 15 minute trading halt due to a circuit breaker after the major indices saw a 7% decline. This reason is threefold:
  - OPEC held the semi-annual meeting last week and was expected to end with an agreement on cutting production to help support oil prices. Instead, Russia voted against production cuts leading Saudi Arabia to offer large discounts on oil and ramping up production, resulting in a price war. Crude oil has fallen 35% since last Monday.
  - Those infected with COVID-19 has spread to over 500 individuals in the U.S. and the spread in Italy intensified. There have been at least eight states declaring a state of emergency, including some of the most populous states. As we had mentioned this is going to spread and while it will be almost impossible to prevent, it will be a matter of how widespread it gets.
  - It is becoming more apparent and there is more media reporting on Joe Biden's cognitive decline. There have been many instances over the last several days on Biden's mental hiccups during rallies and interviews. The concern is this will lead to a Bernie Sanders nomination which is considered a market negative.
- We must keep everything in perspective. We experienced a 25% pullback in the fourth quarter of 2018, which is only 15 months ago, and the markets recovered gaining 38% from that point to record highs on February 19th. As of now, the markets are down just half of what they were down in the fourth quarter of 2018 (Yahoo Finance – S&P500 historical data).
- The media continues to cover this as if we are in the middle of another financial crisis. The fact is company's balance sheets remain in better condition than they were prior to the Financial Crisis. Our fear would be this turning into a self-fulfilling prophecy where we may talk ourselves into a recession.
- The sudden and sharp moves may bring back memories of the Financial Crisis, but there are many reasons to understand this is not 2008.
- Economic data and the consumer remain strong. We do expect weaker economic data over the coming months, but as of now still do not believe this will push us into a significant recession.
- With that being said, we still believe we will see a slowdown over the short-medium term, due to individuals and companies self-quarantining and the media's effect on sentiment. The scope of the slowdown is unknown and it will be impossible to time the markets, but we believe the spread of the virus will eventually slow and economic activity will normalize. Some economic activity will be lost forever, but most should be pushed into future quarters.
- We expect the Administration and the Fed will work together to rollout some sort of stimulus. The Administration is already working on drafting proposals for an economic package to potentially support the economy from any sort of slowdown and looking at different methods to slow the spread.
- Most importantly, remember your long-term goals and objectives and avoid making emotional decisions.

Looking Ahead

Expect market volatility to continue. There is no shortage of news headlines, and the market will take time to digest everything. We expect a spike in confirmed cases in the U.S. as more testing kits are becoming available. We also expect the Administration will release a stimulus package in the near future. Earnings forecast will continue to come down, but we believe most lost activity will be made up in future months.

If you have any questions or concerns, please do not hesitate to reach out.

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