Plotting a Course through *A Challenging Environment* as the Coronavirus Pandemic Brings the World to a Standstill

In 2019, stock and bond returns exceeded expectations. The stock market reached all-time highs as prices caught up with earnings growth and recovered from the sell-off in late 2018. Bond prices rose as interest rates declined due to a shift by central banks toward more accommodative policies. But 2020 brought increased volatility driven primarily by the coronavirus pandemic and its impact on global economic growth.

The 11-year bull market ended in early March, with steep drops in financial markets due to the impact of the coronavirus and an unexpected sharp decline in oil prices. Monetary policymakers and federal legislators responded very quickly to the crisis, providing support to financial markets, businesses, and employees. The Federal Reserve dropped its target interest rate to zero, reactivated many 2008-era liquidity programs, and expanded its open-market purchase activity. These measures were key in restoring the normal functioning of financial markets during the market stress. At the same time, congressional legislators assembled various financial relief packages to respond to the crisis and help bridge the economy through this period of contraction. The largest of these legislations, the CARES Act, provided over $2 trillion in support for the most directly affected parts of the economy.

The economic damage clearly has been severe, but its duration and full breadth are still to be determined. While the stock market appears to be signaling increasing optimism about future economic and corporate profit growth, the bond markets remain more somber. We believe a cautious approach is warranted given the uncertainty. We continue to stay the course with a disciplined, long-term investment approach, knowing that the economic recovery could be choppy for some time. Market volatility may remain elevated until the range of potential outcomes begins to narrow. Even so, we recognize that corrections and bear markets are a normal part of investment cycles and can create attractive buying opportunities for investors who are focused on the long term and willing to take on risk while others are fearful.

Earnings

Corporate earnings estimates for 2020 have declined significantly since the start of the year, and forecasting earnings for the next six to 12 months is challenging given the uncertainty around the coronavirus and the impact of related shutdowns.

Valuations

Despite a drop in U.S. and international stock prices, stocks do not appear cheap compared to trailing earnings results or falling-forward earnings estimates. In general, stock valuations are hovering above their long-term averages for most regions. »

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Consumer Confidence

Confidence levels sharply declined as consumers felt the effects of the coronavirus pandemic and the many restrictions put in place to slow its spread. It is likely that consumer confidence will remain depressed in the near term.

Business Confidence

Business confidence levels are also very low. As some areas of the U.S. slowly reopen, many businesses are unable or hesitant to work at full capacity.

Monetary Policy

In March, between scheduled meetings, the Federal Reserve cut rates twice—down to zero—to combat the effects of the economic slowdown. The Fed has also released a series of sizeable programs to support financial market functioning and the flow of credit.

Fiscal Policy

Near term, fiscal policy is aimed at providing trillions of dollars to support the U.S. economy during this time of economic instability. Legislators and government officials have responded quickly in a bipartisan fashion to support businesses and consumers.

Credit Conditions

Corporations and small businesses will be more challenged to access new debt or refinance current debt in the current environment. The flow of credit to consumers may also be more limited.

Volatility

This year has brought about an increase in market volatility and uncertainty. Volatility is expected to remain at elevated levels in the near term, while the market recovery continues on its bumpy path. ■