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MARKET COMMENTARY

March 13, 2020

The current market volatility began two weeks ago as the coronavirus outbreak continued around the world. A simplified economic overview is that if millions of people are quarantined, they will not leave their homes to go to work, travel or take vacations. This will decrease corporate profits in the future, so stocks will decrease today. The market discounts future earnings and assigns a value or price on the stock today that reflects the anticipated profits or losses of a company. In the bond market, agencies such as Moody's or Standard and Poor's, assign a rating to corporations based on their credit risk. The ability of corporations to repay their lenders is based on their profit and loss or income statement. So, both the price of a stock and the rating of a bond is tied to future earnings. If a company's earnings outlook is poor, then the stock price and bond rating will decrease.

The recent stock market downturn to the virus was interrupted by two up days last week, Monday and Wednesday. Monday was a rebound after a week-long sell off. Wednesday, March 4th, was a "Biden Bounce," a relief rally that a Sanders Administration would not take over the health care system in the United States, raise corporate and personal taxes and issue regulations. The selling continued on Thursday and Friday. Friday's market did not close at the very bottom of trading. There was buying into the close, which may have signaled a muted open this past Monday.

This week's activity has two additional factors: policy uncertainty and an oil shock. Saudi Arabia stated that they would increase the production of oil in response to an unwillingness of Russia to cut production to boost prices. Oil dropped roughly 20% and market opened much lower. Investors correctly believe that lower oil prices are good for the economy. If it costs less to drive, fly and transport everything, this should lead to less money spent, so more money can be spent or saved elsewhere. Corporate profits would rise as transportation cost is less. This is true in the long run. However, because energy companies are highly leveraged, they rely on profits to repay their bond holders. At $32.00 per barrel, domestic drillers and oil companies cannot make the profit they need to conduct operations. This is the reason, in addition to the spread of the virus, the market is down.

Further, over 70% of the trading on the exchanges is due to programmed trading and algorithms. Most professionals, traders and fund managers are looking for entry points to buy stocks that are now bargains compared to price levels three weeks ago.

Wednesday's downturn was a result of no policy news on Tuesday regarding some type of stimulus or a backstop for the airlines and other industries. Yesterday, the market reacted negatively to the President's oval office address. The market was looking for specifics on policy. Today, there is some news regarding discussions between the Secretary of the Treasury and Congressional leadership.

In light of all of the bad news there are some elements of good news. China's draconian measures of mass quarantine have resulted in new cases of the virus decreasing at a rapid rate. Interest rates are at record lows. This lowers the cost of borrowing for everyone. It has already resulted in refinancing and purchasing of homes for individuals. Inexpensive oil will eventually be good for economic growth.

This volatility may continue through April, when companies will miss earnings. Dr. Anthony Fauci, a well-respected immunologist, stated today that this outbreak will not slow for 2-8 weeks. Once we get back to work and economic activity regains its footing globally, earnings will recover.

Look for a modest summer and maybe an upturn in October as companies beat earnings estimates, that they intentionally lowered.

Thanks for your patience!

David R. Breuhan

Vice President