COVID-19 and the Continued Impact

Since we last wrote on this topic, the equity markets have experienced their fastest decline in history. We experienced a 30 percent decline in just 22 days. As a comparison, the same deterioration during the stock crash of 1929 took 31 days, and that decline took 250 days in the early days of the financial crisis in 2007.

Similarly, fixed income markets have experienced tremendous volatility. In a flight to quality (purchases of U.S. Treasuries) and the so-called “dash to cash”, short-term Treasury yields are now negative and overnight lending rates are at 0 percent.

Credit spreads have widened significantly with corporate and municipal spreads up from 120 basis points to over 300 basis points over Treasuries. While spreads hit significantly higher levels during the 2008 financial crisis, the fact that there has been a 2 percent increase in spreads and yields in the last 2 weeks is one of the fastest increases we’ve seen.

While the effects of COVID-19 will impact industries differently, so far markets have not hugely distinguished between deterioration in sectors. Those that are likely to be most impacted are hospitality (hotels, leisure, tourism, gaming), automobiles, apparel and non-food retail, airlines, and shipping. Additional fixed income impacts are expected to be felt in credit ratings downgrades.

Government Actions

The Federal Reserve (Fed) has led the charge in helping to ensure liquidity remains in the market. At this point, they have shown they are willing to do whatever it takes to facilitate the flow of money through the financial system. The actions to date include:

- Unlimited Quantitative Easing (QE) through purchases of Treasuries and Agency-backed mortgages
- Support for commercial real estate by including CMBS in QE efforts
- Support for consumers and businesses through a $300 billion credit facility
- Support for corporate bonds through purchases in the secondary market
- Support for consumer credit through issuance of debt
- Support for municipal finance through expansion of the Money Market Mutual Fund Liquidity Facility and expansion of permitted securities in the commercial paper facility
- Support for small and medium-sized businesses through a Main Street Business Lending program

These last three are helpful for the impact on smaller business and also cross over into fiscal policy support measures.

From a fiscal policy standpoint, very little has yet been completed. While both the White House and Congress have expressed their desire to provide support for businesses and citizens, and that support will indeed be needed to jump start economic momentum, the type of support has not yet been agreed upon.

News reports suggest an agreement is now closer given new willingness to include additional protections for workers laid off due to the health crisis and additional support for hospitals and medical facilities.

Economic Impact

At this point, it is unlikely the U.S. will avoid at least a temporary recession. The timing and depth of the recessionary indicators depend heavily on our success in mitigating infections quickly.

As a country, we have not experienced a situation quite like this, but we do have other countries to use as examples. Current projections are that social distancing and more stringent measures will succeed in slowing new infections within months, as they seem to have done in China. If so, economic activity should gradually resume sometime in the middle of the second quarter, allowing GDP to start rising again by the third quarter. However, there are many risks to this forecast. Activity could take longer to resume if it takes longer to slow new infections.

However, even if GDP remains low at the end of 2020, many forecasts show that the resumption of normal activity – whenever that does in fact happen – leads to a strong recovery. The constraint on economic activity is physical, suggesting a faster downturn, as we have seen, but potentially also a faster recovery.

Caveats

It is important to note that the forecasts mentioned above, and our current belief that the U.S. will recover by early 2021, is heavily based on slowing and mitigating new infections. Recent remarks by the Trump administration regarding their desire to end social distancing and get people back to work are concerning. The White House could decide that stimulus programs are not needed if people return to work. The challenge is that will not slow new infections.

For the 40 percent of Americans living paycheck to paycheck, a move toward ending distancing or a veto of stimulus could force employees to decide between containing illness and maintaining their financial solvency. With many returning to work to pay their bills, the disease would likely spread further, and Americans would remain fearful of resuming regular activities.

It is possible that activity would remain lower for longer and the eventual unemployment numbers would be higher if we do not contain infections more quickly.

Conclusion

As mentioned above, there are certain industries that will be most impacted by the downturn, but all industries have so far faced significant deterioration due to COVID-19. That suggests there are and will be opportunities for stock selection and portfolio management adjustments. While it is unknown when the rate of infection will decrease or when the recovery will begin, we remain positive on U.S. business capabilities and creativity, as well as the resilience of our economy and the U.S. consumer.

All of us at Miles Capital are monitoring events closely and remain focused on the best interests of our clients in the short- and long-term.