STRATEGAS

insight

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The Virus, Then the Cure…

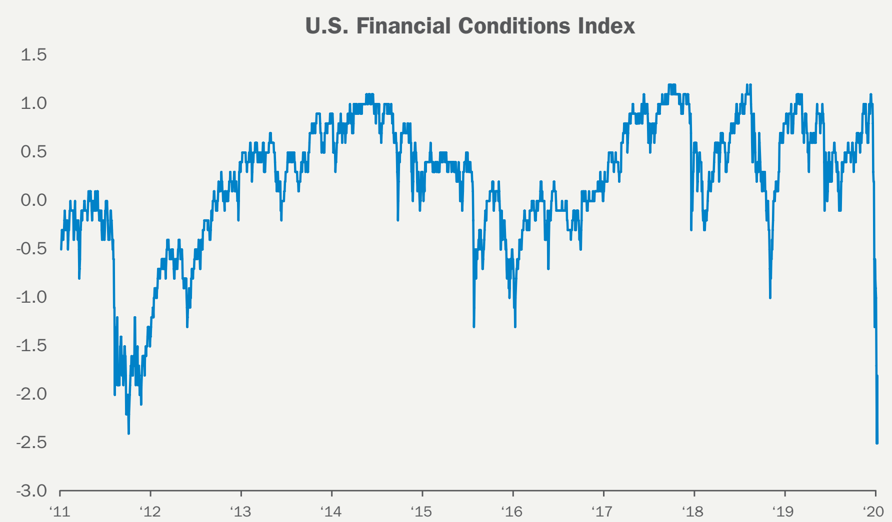
The rapid spread of the novel coronavirus (COVID-19) has created an international health crisis. It is serious and it is tragic. Last month in this space, we postulated on what we hoped would be the transient nature of its human health effects. Clearly, we undershot, but we would redouble our emphasis on the second point of discussion: the knock-on effects presented by the reaction to the virus. The volume and speed of information—*and misinformation*—disseminated related to the virus, and concomitant efforts to avoid it, have created an acute economic shock with the potential to manifest into a crisis in its own right. Never in history have we evidenced the simultaneous quarantine of so many millions of people outside the envelope of war. Whether mandated by the government, compelled by health professionals, or undertaken voluntarily, the global stoppage of daily human activity has reduced economic activity to a subsistence crawl. It is only likely to get worse. Strategas has raised the probability of an economic recession in calendar year 2020 from 20% to now 75%.

The title of our note last month was 'This Too Shall Pass,' and without being cavalier, or dismissive of individual tragedy, the human health crisis certainly will. Perhaps longer than expected and certainly longer than hoped, but it will. What the health crisis also has revealed, however, are the threads of weakness and extreme woven into the global economy and bid into risk asset prices. Left alone, they likely would have been worked out in turn. In the vacuum of an exogenous shock, all (or nearly all) of these threads have come to a head at once. The effects of this will be evidenced well after the health-related impact of novel coronavirus begins *mercifully* to ebb. The sharp rally in safe-haven assets, particularly U.S. Treasurys, and the associated sell-off in global equities confirm this. Whether this financial panic metastasizes to the order of magnitude of the global financial crisis—as has been suggested by the media—is irresponsible speculation, but waiting to see is a fool's errand. In periods of heightened uncertainty, we are compelled to return to *first principles*. With that in mind, we are inclined to navigate developments related to the novel coronavirus and economic shock with three qualifications in mind:

- We know what we do not know; the virological elements of coronavirus are well beyond our capacity to predict.
- While not always unconditionally supported among the political class, governments generally offer proportional responses to exogenous events.
- Individuals generally, though not universally, will exercise an abundance of caution during periods of uncertainty

Through this prism we offer five observations:

1. We likely have not seen the worst of the human impact from the spread of coronavirus. We anticipate the number of confirmed cases (and, sadly, the number of deaths) to grow in both volume and in geographic dispersion
2. In the aggregate, 1H20 economic and corporate data are likely to be disappointing. **The equity market sell-off reflects this shift in consensus.**



Source: Bloomberg

3. Additional monetary policy accommodation—*generally a demand-side salve*—is unlikely to provide much assistance (i.e., within their mandate the Federal Reserve's response is proportional). **The currency market suggests this remains balanced.**

4. The increased size and urgency surrounding fiscal policy proposals are proportional but may lack in both their ultimate timeliness and accuracy in hitting their target. Our clients remain skeptical as to whether something gets done at all. **The bond and options markets are discounting this now.**

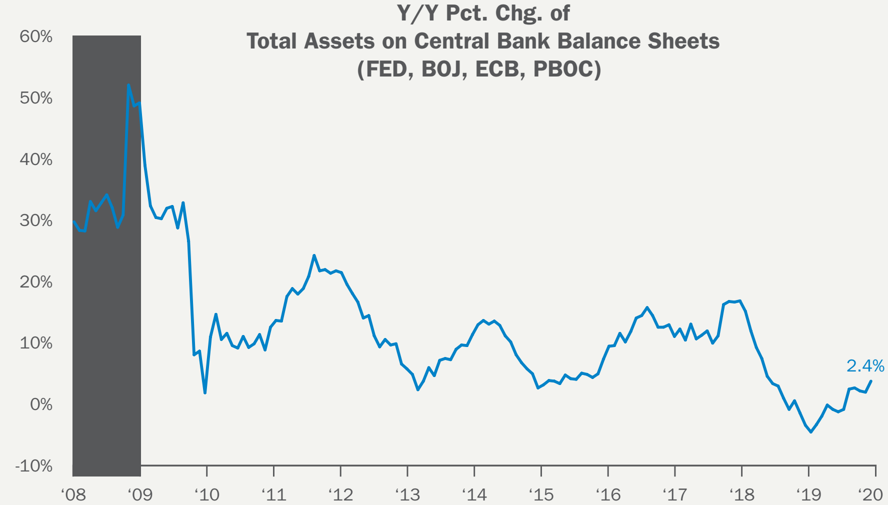
5. Ironically, nationalist economic policies may help both to mitigate the longer-term fundamental drag on acute economic shock (softer growth, weaker profits) and to support a sharp recovery when—*and only when*—the global consensus agrees that the health risk presented by the virus has abated.

From this vantage point, we believe investors should consider:

- The building blocks remain in place for a late-cycle reacceleration in activity.
- The prospect of recession has risen considerably, and without well-targeted fiscal stimulus and material increase of organic activity thereafter, we fear the natural propensities of economic gravity will manifest sooner rather than later.
- Given the sharpness of the decline in equity prices, investors should reconsider the proposed merits of passive investing and consider the opportunities that high-correlation drawdowns present.

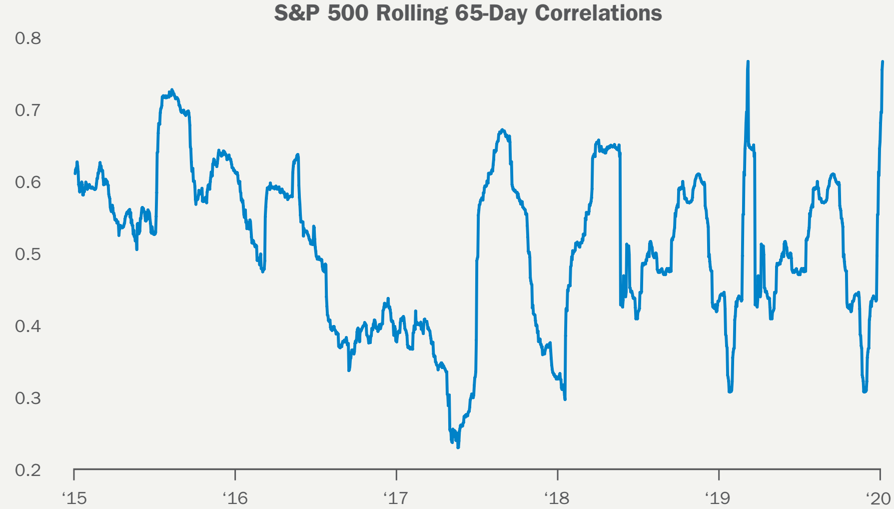
This too shall pass.

Y/Y Pct. Chg. of Total Assets on Central Bank Balance Sheets (FED, BOJ, ECB, PBOC)



Source: Strategas

S&P 500 Rolling 65-Day Correlations



Source: Strategas

Strategas Recommended Asset Allocation (March '20)

	Equities	Bonds
Overweight	Dev AC Core EM AC Core	IG Corporates TIPS
Neutral	US LC Value US LC Core US LC Growth US MC Value US MC Core US MC Growth US SC Core	Agencies ABS/CMBS US Dollar EMD Local EMD High Yield Convertibles Bank Loan
Underweight		US MBS U.S. Treasuries

About Strategas

Strategas is a global institutional brokerage and advisory firm. The Firm provides macro research, capital market and corporate advisory services, and investment management solutions to institutional investors and corporate executives in more than twenty countries around the world.

Founded in 2006 by Jason DeSena Trennert, Nicholas Bohnsack, and Don Rissmiller, the Firm was acquired by Baird Financial Group in 2018. Strategas operates independently as a wholly-owned subsidiary of Baird and offers institutional securities services through Strategas Securities, LLC, a broker-dealer, and investment management solutions, including this commentary, through Strategas Asset Management, LLC, a registered investment advisor.

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Index Overview & Key Definitions

Fed, The Fed or FED refers to the Federal Reserve System, the central bank of the United States. **Fed Funds Rate**, the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. The **Gross Domestic Product (GDP)** rate is a measurement of the output of goods and services produced by labor and property located in the United States. **Real Gross Domestic Product (GDP)** is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy in a given year. **Nominal Gross Domestic Product** is gross domestic product (GDP) evaluated at current market prices. The **S&P 500 Index** is an unmanaged index comprised of 500 widely held securities considered to be representative of the stock market in general. The **Russell 1000 Index** is a market capitalization weighted benchmark index made up of the 1000 largest U.S. companies in the Russell 3000 Index. The **Russell 2000 Index** is an unmanaged index considered representative of small-cap stocks. The **PCE (Personal Consumption Expenditure) Index** of Prices is a US-wide indicator of the average increase in prices for all domestic personal consumption. Using a variety of data including U.S. Consumer Price Index and Producer Price Index prices, it is derived from personal consumption expenditures; essentially a measure of goods and services targeted towards individuals and consumed by individuals. The **Producer Price Index (PPI)** program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services. **FAANG** is an acronym for the five of the market's most popular tech stocks, namely Facebook, Apple, Amazon, Netflix and Alphabet's Google. The **North American Free Trade Agreement (NAFTA)** is an agreement signed by Canada, Mexico, and the United States, creating a trilateral trade bloc in North America. The **Seasonally Adjusted Annual Rate (SAAR)** is a rate that is adjusted to take into account typical seasonal fluctuations in data and is expressed as an annual total. SAARs are used for data affected by seasonality, when it could be misleading to directly compare different times of the year. The **Atlanta Fed GDPNow** forecasting model provides a "nowcast" of the official estimate prior to its release by estimating GDP growth using a methodology similar to the one used by the U.S. Bureau of Economic Analysis. GDPNow is not an official forecast of the Atlanta Fed. Rather, it is best viewed as a running estimate of real GDP growth based on available data for the current measured quarter.

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Alternative Investments may have complex terms and features that are not easily understood and are not suitable for all investors. You should conduct your own due diligence to ensure you understand the features of the product before investing. Alternative investment strategies may employ a variety of hedging techniques and non-traditional instruments such as inverse and leveraged products. Certain hedging techniques include matched combinations that neutralize or offset individual risks such as merger arbitrage, long/short equity, convertible bond arbitrage and fixed-income arbitrage. Leveraged products are those that employ financial derivatives and debt to try to achieve a multiple (for example two or three times) of the return or inverse return of a stated index or benchmark over the course of a single day. Inverse products utilize short selling, derivatives trading, and other leveraged investment techniques, such as futures trading to achieve their objectives, mainly to track the inverse of their benchmarks. As with all investments, there is no assurance that any investment strategies will achieve their objectives or protect against losses.

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