

Hughes Investment Advisory Service LLC

Friday March 13, 2020

Market Update on Coronavirus concerns and related market volatility

It's been 2 weeks since my last update on the markets and related economic dislocation as it relates to the Covid-19 Virus outbreak.

The 10% "correction" that I spoke of on Feb 28th has turned into a "Bear Market" or 20% plus drop from the most recent high on Feb 19th. Yesterday, March 12th the market dropped 10% its worst day since the October 1987 crash. I was on the trading floor then and here at my desk now and I can tell you that these drops both felt similarly bad.

Are there economic similarities to the 1987 and 2009/09 crashes and today? – no, not really other than the price action of stocks and other investments on the downside is similarly bad.

Where are we now is the question? Have stock prices correctly reflected the what has happened and what will happen next? Because of the nature of this crisis, the Covid-19 virus, that answer is opaque, but we should have more clarity soon.

First, the markets. There is a serious liquidity problem in the markets, especially the bond markets however yesterday the Federal Reserve took the steps necessary to restore liquidity to these markets by using "tools" available to them learned from past crises. The Treasury and Federal Reserve are coordinating and will arrange additional "tools" as needed. Company stock buy backs should be forthcoming soon.

Will there be a Recession? The Services industry represents 66% of the US economy and this is the area of the economy that is being hit the hardest due to the virus and related issues. It will be difficult for the US to escape a Recession when 2/3's of the economy is being severely impacted. The economy was strong as of last month, unemployment was at record lows, the banks and financial system are stronger and more resilient than in my lifetime so if this virus can be contained and dealt with quickly I believe the economy can escape a Recession and can bounce back the second half of 2020 perhaps with strong growth. This would be a V shaped bottom and best-case scenario. Can this scenario play out if the US is essentially "Shut Down" for the next 4 weeks? I believe yes and we are about to find out.

So, do stock prices reflect a best- or worst-case scenario? I believe closer to a worst-case scenario is currently being reflected in stock and bond prices which means we should "stay the course" and continue to adjust and react accordingly.

Until yesterday and this morning my impression of Washington's response to the crisis was not high. After yesterday's moves by the Federal Reserve and Treasury Dept and this morning's interview with Treasury Secretary Mnuchin, my confidence level has risen greatly. This

morning's Mnuchin interview and today's news leads me to believe that the Federal Government, at all levels, is reacting accordingly. Quoting Treasury Secretary Mnuchin, "This will be an entire, whole of Government, response to this crisis." There is bi-partisan support for measures soon to be taken to help the average worker who is sent home due to this crisis. Expect a big stimulus package before this weekend is out.

On the virus front we are also seeing progress. China is re-opening for business. All Apple stores are now open in China for example. South Korea's cases have peaked. Italy is an outlier but seems due to a poorly prepared health care system.

In the US, people seem resolved to a 2-plus week "shut down" to our lives. Other than some panic buying of certain products, the American people appear to be coping and cooperating with today's realities. Virus test kits are being mass produced and new rapid test kit systems are being fast tracked by the FDA. All of our best medical technology companies are working on a vaccine which I believe will be fast tracked and approved by the FDA in time for next winters flu season.

Conclusions:

I believe that the selling occurring the last 2 weeks is mostly leveraged players, Quants and other algorithmic based trading systems and not the long-term investor. I remain on watch listening and reading the latest news, market activity and economic indicators. I will be upgrading and adjusting portfolios accordingly. Please do not hesitate to give me a call to discuss the above analysis and try not to watch the hourly moves in today's markets which can often be quite gut wrenching. Have a good weekend.

Sincerely,

J. Britt Hughes

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