



Portfolio Management Memo

March 10, 2020

INTEREST RATES & OIL PRICES

In our last COVID-19 memo, we noted that “the only thing that is certain at this point is lower yields and heightened volatility for the coming months.” This has certainly been true as we have watched the virus continue to spread globally.

On March 3rd, the Federal Reserve cut rates by 0.50% and the yield curve has flattened as long-term rates have also fallen significantly. While the Treasury yield curve has not inverted, the spread between short and long term rates has narrowed. The movement in bond yields has confirmed investors are panicked, and future growth and inflation expectations have fallen.

Yesterday we saw the S&P 500 drop by 7.6% and volatility spike. The CBOE VIX Index (a measure of market volatility) hit an intra-day high of 62.12, a level not seen since December 2008 during the global financial crisis. Market action yesterday was impacted by an oil price war between Saudi Arabia and Russia. Crude oil prices dropped 35% intra-day, the largest single day drop since the end of the first Gulf War. Disagreements over production cuts, saw Saudi Arabia slash prices and ramp up production at a time when global demand has weakened. This had a cascading effect on the U.S. energy sector, which saw significant losses and helped push a fragile equity market lower.

The problem plaguing the market at this point is uncertainty, which is directly impacting volatility.

STOCKS...ONLY PART OF THE PICTURE

There is no denying that COVID-19 represents a major problem for the global economy, and that the reaction thus far has been severe. According to Bianco Research, the current market fall is one of the fastest in history. As of yesterday, the S&P 500 had fallen 19% from an all-time high in just 14 trading days. However, it is important to remember that equities are only one piece of a diversified portfolio. Your investment portfolio includes asset classes, some of which have generated gains or insulated your portfolio from equity market declines.

Cash and fixed income investments have gained in value. Year-to-date our core investment grade fixed income and municipal bond investments are up 1-5%. Cash allocations have generated small gains, and have helped limit overall portfolio volatility. Our alternative allocation has also protected capital during the current market environment. Our Hedged Equity positions, Swan Defined Risk (SDRIX) and Gateway (GTEYX) have outperformed equities. SDRIX should continue to benefit during market declines, as its long-term market hedge is now “in-the-money.” FPA Crescent (FPACX) currently has nearly 37% allocated to cash and cash equivalents. If history is any guide, FPA’s portfolio managers are likely to deploy capital as equity prices become more and more compelling. GuideStone Defensive Market Strategies (GDMZX) has helped protect capital through its defensive equity, options, and convertible bond sleeves. Gold prices have benefitted from a risk-off mentality, and the SPDR Gold MiniShares (GLDM) is up nearly 10% YTD. Even within our equity allocations, investments in momentum and minimum volatility strategies have performed better than traditional capitalization weighted index investments.

DEALING WITH VOLATILITY

You’ll Miss The Bad & The Good

When markets become volatile, many investors feel compelled to sell and move to cash. But just as many investors are slow to recognize a retreating stock market, many also fail to see an upward trend in the market until after they have missed opportunities for gains. Missing out on these opportunities can have a significant impact on your long-term returns. Investment success comes from **TIME** in the market, not **TIMING** the market.

A Little At A Time

Most people are quick to agree that volatile markets may present buying opportunities for investors with a long-term horizon. However, having the discipline to make purchases during a volatile market can be difficult. Dollar-cost averaging can help reduce anxiety about the investment process. Simply put, dollar-cost averaging is committing a fixed amount of money at regular intervals to an investment. This is an excellent time to evaluate your 401k contributions and put excess cash into the market at regular intervals.

Fine Tune

Significant market pull backs can offer opportunities to rebalance or tax loss harvest. Rebalancing will force you to sell appreciated investments and reinvest in underperforming investments. The goal is to maintain your risk tolerance while taking advantage of potential “sale” prices. Additionally, short-term market corrections provide an opportunity to potentially harvest capital losses that can offset future gains and minimize your tax bill. We will continue to evaluate our clients’ portfolios for both opportunities.

Ignore The Noise – Have A Long-term Perspective

The media often drives investors’ two most common emotions – fear and greed. While the media provides a valuable service, they typically offer a very short-term outlook. Understand that equity markets go up, and they also go down. Despite their inherent volatility, equities continue to provide the best long-term source of capital appreciation. The longer you are invested, the less volatile the market becomes and the greater the long-term returns.

Believe Your Beliefs...Doubt Your Doubts

There are no real secrets to managing volatility. Most investors already know that the best way to navigate a choppy market is to have a good long-term plan and a well-diversified portfolio. Working with BWA, you’ve got both. But sticking to these fundamental beliefs is sometimes easier said than done. In times of stress, you sometimes begin doubting your beliefs and believing your doubts, which can lead to short-term moves that divert you from your long-term goals and financial success.

CONCLUSION

It seems unlikely that COVID-19 will fundamentally and permanently change life as we know it, make the future unrecognizable, or permanently halt global business activity. Stocks may very well continue to fall in the coming days, weeks, and months, as more and more is known about the impacts of COVID-19, both from a health and economic standpoint. The question is not “will stocks fall further?” The real question, however, is if the change in equity prices is proportionate to their underlying fundamentals. Are stocks now more attractively priced, less overvalued or inexpensive? So, does this mean the decline is over? Not likely. Getting to a market bottom is a process, not an event.

COVID-19 is not likely to become the Spanish Flu pandemic of 1919 that infected 500 million people worldwide and killed an estimated 20-50 million people (roughly 1% of the world population at the time). It is estimated that the annual number of deaths during a typical flu season is around 400,000 per year globally, and 30,000 in the U.S. alone. Rather, COVID-19 will likely become a more seasonal disease that we’ve encountered in the past, developed vaccines for, and learned to live with.

If you have any questions or concerns, please do not hesitate to contact us. We understand that in times of heightened market volatility, sometimes a simple conversation can answer any questions you have and put your mind at ease. Our goal is your long-term financial success and peace of mind.