CLARO ADVISORS

Claro Market Insights
What happens when the world stops spinning?

As the Covid-19 virus has reached across the globe, it literally has the health of everyone in its grasp. Global economies have come to a complete stand still, businesses have shut their doors and people are sheltering at home. Not only are we all now concerned for one another's health and the health of our loved ones, but we are also concerned about our employment, our personal needs and our money. As the virus has harmed the health of many, it has also negatively impacted the financial markets with almost no asset class being immune. Within stocks, the **S&P 500** and **Dow Industrials** fell -20% and -23% respectively during the quarter. The technology dominant **Nasdaq** fared only a little better, slipping -14% as many of its constituents represent the new "stay at home" economy. **Small Cap stocks,** as measured by the Russell 2000 index, sold off precipitously and were down -30% as they are among the most vulnerable to a shutdown. Meanwhile **International Developed and Emerging Markets** were down -23% and -25% respectively on fears that the virus will cause lasting damage to some already fragile economies. Bond indices held up a little, but for the most part did not escape the carnage as investors sold anything and everything to raise cash. Oil got absolutely crushed as two of the world's largest oil producers (Saudi Arabia and Russia) picked a peculiar time to get in a sandbox fight and flooded the market with oil supply. With demand falling at the same time, it caused the price of oil to drop like a stone in water from $60/barrel to $20/barrel. Alternatively, gold and cryptocurrencies such as Bitcoin actually rose a little during the quarter as investors sought other types of safe havens amid historical volatility.[1]

Financial Market Data					
	March	March	Q1	2020	1 Year
U.S Stock Markets	Closing Price	Monthly	Quarter	YTD	Return
S&P 500 Index Price	$ 2,584.59	-12.5%	-20.0%	-20.0%	-8.8%
Dow Jones Industrials	$ 21,917.16	-13.7%	-23.2%	-23.2%	-15.5%
NASDAQ Composite	$ 7,700.10	-10.1%	-14.2%	-14.2%	-0.4%
Russell 2000 Index	$ 1,158.32	-21.6%	-30.5%	-30.5%	-24.8%
International Stock Markets	Closing Price				
MSCI EAFE Index	$ 1,558.48	-13.9%	-23.5%	-23.5%	-16.9%
MSCI Emerging Markets Index	$ 832.02	-17.3%	-25.4%	-25.4%	-21.4%
U.S. Fixed Income	Closing Price				
90 Day T-Bill	$ 203.17	0.2%	0.5%	0.5%	2.1%
Barclays Aggregate Index	$ 2,297.24	-0.5%	3.3%	3.3%	9.0%
Barclays Municipal Index	$ 1,269.15	-3.2%	-0.2%	-0.2%	4.3%
	Closing Price				
Gold	$ 1,575.24	0.1%	4.7%	4.7%	21.6%
Oil (WTI Spot)	$ 20.32	-13.2%	-26.8%	-26.8%	-66.2%
Bitcoin	$ 6,405.91	-8.7%	19.1%	19.1%	54.3%

Nobody expected such an abrupt end to one of the longest and most profitable bull markets in history. Everything seemed somewhat normal midway through the quarter as the S&P 500, Dow Industrial Average and NASDAQ Composite all reached all-time highs around mid-February. What happened next was unprecedented as we experienced one of the sharpest and quickest selloffs in history as markets lost more than -30% in less than 30 days and finished with the worst first quarter performance in market history and a top 10 all-time worst quarters. What a challenging start to the new year and the new decade.

[1] https://ycharts.com/indices

Mandated Recession

With people under a government issued mandate to shelter at home in most states, economic activity has all but ceased. It's basically a forced recession, but one that can be overcome for the health and well-being of everyone. In order to withstand the economic shock, the Federal government has taken serious steps to provide support through fiscal stimulus. The $2 Trillion Coronavirus Aid, Relief, and Economic Security Act (Cares Act)[2] should help provide a bridge for people whose income has suddenly disappeared or greatly lessened. The Treasury, through the Small Business Administration (SBA), is also providing support of $350 Billion to those businesses that need a loan to support their payroll and other expenses. The Federal Reserve has opened the tool shed to provide relief to the credit markets which became dislocated when institutions came to sell most everything credit related in order to raise cash. The Fed learned in the 2008 financial crisis that, although not desirable, it can be a "buyer of last resort" and add those undesired credit securities to its balance sheet in order to provide liquidity to the marketplace. The Treasury authorized the Fed to purchase $125 Billion daily last week of not just Treasuries, but commercial paper (CP), Asset Backed Securities (ABS), Mortgage Backed Securities (MBS), municipal bonds, corporate bonds, preferred securities, and even exchange traded funds.[3] Fiscal and Monetary policy are going "all-in" to provide liquidity and supply, not to stimulate spending (the demand is simply not there with a mandated shutdown), but rather to keep things going through a "Government to Main Street" lending facility.

This is a mandated recession and the Fed and Treasury are essentially guarantying the contracts (bonds) and replacing the income to help get us to the other side. Will it work? It should. It's obviously not desirable, but a crisis situation demands a bold reaction. In a sense, the Fed is taking on a lot of the risk that the companies and banks cannot and giving the economy time to repair. We are fortunate to live in a large enough and healthy enough economy that can withstand such a shock. Hopefully it will be short-lasting, but we should understand that these things don't get fixed in a matter of a month or two. There will be economic damage, whether it's unemployment or bankruptcies. It will take time for things to feel normal again, but eventually it will.

The only caveat when you have large government intervention is that, when it's all over, the government needs to equally exit the industries that it has provided support to in order for human ingenuity and "animal spirits" to once again drive economic growth. Our nation and economy have been able to grow through the years by allowing our people and companies to create, to innovate and grow. Our people work hard in all industries, clearly in healthcare, technology, manufacturing, the service industry and financial services. Hopefully this will be a wake-up call, for those who needed it, to appreciate everything that we have, including family, friends and others, and to believe in what we can accomplish by working and saving our hard-earned money, in particular for a "rainy day". Throwing money at the problem as a country has been our solution for the past few recessions and we have to be more careful in adding debt and leveraging the growth that we have endured over time. It reminds me of the Warren Buffet quote that "'In God We Trust' may be imprinted on our currency, but the hand that activates our government's printing press has been all too human".[4]

Investor Reaction

What do investors do during times of crisis? In our previous letter we alluded to seven New Year's resolutions for investors in 2020. The 7th one we listed was "Don't let emotions cloud your judgement". This couldn't apply any more than it does right now. By nature, we are emotional creatures and fear is one of those emotions. When times seem most uncertain, fear can cause us to panic and do things that we normally wouldn't do. As markets

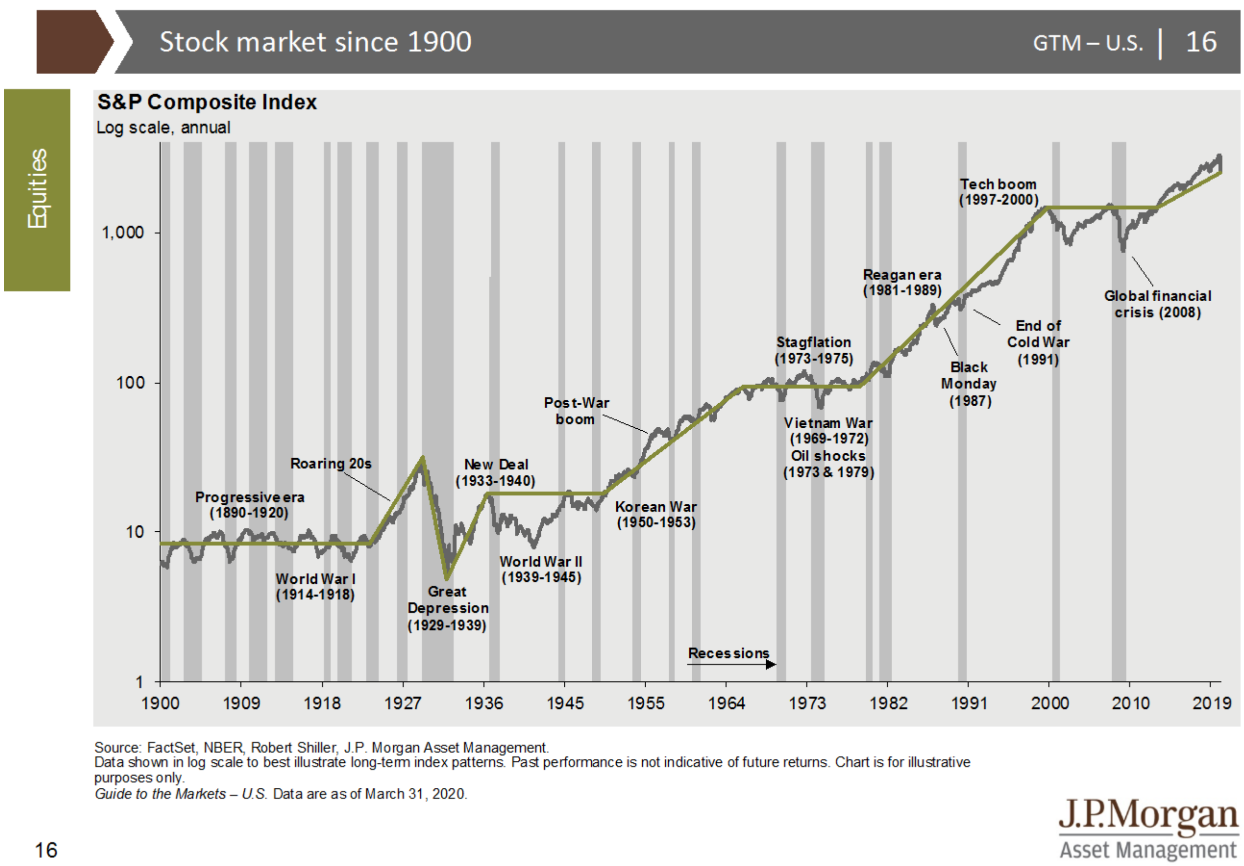
[2] https://www.congress.gov/bill/116th-congress/senate-bill/3548/text

[3] https://www.federalreserve.gov

[4] https://www.berkshirehathaway.com/letters/letters.html

have been volatile and we fear they might go lower, we may be inclined to "run for the hills" and sell our investments. This often proves to be a huge pitfall to investors. Yes, we might miss out on some additional market volatility to the downside, but typically by the time we decide to sell it is often far too late. This same fear drives us to be late again on our buying decision as well. Consequently, by the time we feel comfortable again to invest, we likely will have missed a significant amount of upside. The end result is investors are more often harmed by their emotions when it comes to investing.

As difficult as it is to endure, "staying the course" has more merit than trying to time the market. There have been plenty of instances in our past history to prove that we eventually get through each crisis and come out better on the other side. If you need the money in the coming months or year, then you should have that money in short-term, more liquid securities anyway. But as long as you have time to withstand the duration of an economic shock or recession, you will be rewarded in the long run when the economy turns the corner and starts to expand again.



The Bottom Line

We wish you and your family good health, safety and peace during this time. We remain hard at work navigating your portfolios through this challenging period to ensure that your financial goals and plans remain intact. Feel free to reach out at any time to check in and update us on how you are doing and if you need any guidance. We are here and ready to help and wishing you and your families all the best!

Michael Mullin, CFA
April 2, 2020