CURRENT MARKET NEWS

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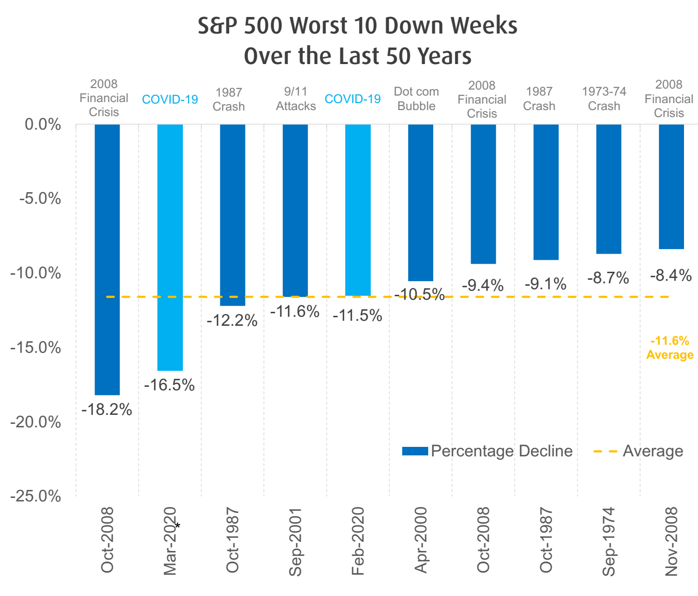
Thursday, March 12, 2020

We have always acknowledged the growth risk posed by the COVID-19 outbreak, but a new phase has been entered this week as travel bans, event cancellations and global infection counts have dominated the headlines. What was originally viewed as largely a supply issue built on a wholesale production shutdown in China has developed into a global demand shock which will negatively impact economic conditions over the next several months. The market reaction has been swift, and the selloff since mid-February has taken place with a speed seen in only a few other instances ***(chart #1)***. We now find ourselves in an unfamiliar place where economic data is severely lagging real time developments. Indeed, pre-existing U.S. labor market strength was reinforced this morning with initial jobless claims coming in better than expected at 211,000, still near multi-decade lows. Of course this figure, while a timely weekly indicator, has not yet incorporated the coming disruption.

Chart 1: The recent sell-off has been swift



Source: Bloomberg, BMO Wealth Management Strategy
* As of Week to date ending March 12, 2020 12:23 PM CST

Additional thoughts on the underlying health of the U.S. economy can be found in our "*Market Update*" from 3/10/20.

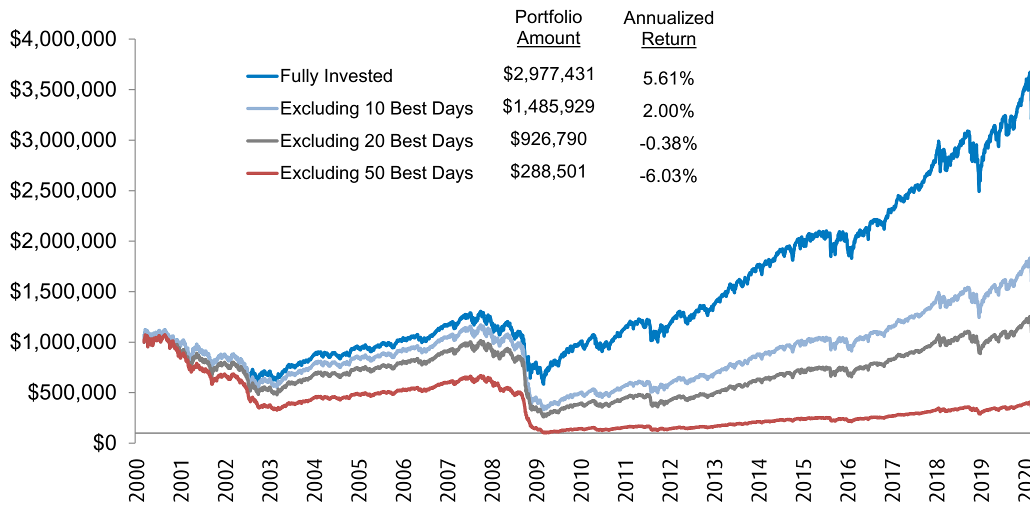
The big question now surrounds the length and depth of this demand induced dislocation. It is important to remember that markets are forward looking, so just as they have fallen while economic data remains solid, they will likely rebound long before things improve. While this event is unique from a historical perspective, we do expect help from governments around the world as they coalesce around more sweeping fiscal policy responses. The U.S. has been slow in this regard to date, but we are likely to see a trend towards more expansive bi-partisan solutions as time passes. In the absence of significantly improved virus outbreak figures, large fiscal stimulus measures are most capable of providing the market some short run solace. Additional monetary policy adjustments are also in the cards, and we look for the Fed to cut rates again next week at their March meeting (if not sooner). That said, monetary policy responses, while necessary to promote efficient, liquid credit markets are not as impactful for dealing with demand disruptions.

What should I do?

Take the long-term view

Of course, the most important question for many of our readers is a personal one. How should I respond to these dramatic events? We think there are a few options for consideration. First, revisit your plan, objectives and long-term positioning. When we construct portfolios, it is done with an eye towards risk management and volatility expectations. We model the impact of various drawdown scenarios and overlay those against historical extremes. This allows our teams to be confident about the possible experience associated with any particular approach. To date, despite the turbulent short term moves, overall results are within the bands of our downside modelling. While that may not ease the short term stress, it is a reminder that investing is an exercise in patience. Having a plan, and the discipline to stick to it, is the most important consideration during market turbulence. ***Chart #2*** demonstrates this need for patience in a more quantitative fashion. As the chart details, missing only the ten best days in the last twenty years would have cost an investor over 3.5% on an annualized basis.

Chart 2: Performance of $1,000,000 Invested in the S&P 500 - 20 Year Trailing Data Ending on March 11, 2020



Source: Bloomberg, BMO Wealth Management Strategy
As of March 12, 2020

Capitalize on the volatility

Being a successful long-term investor can also require action. Maintaining a portfolio in line with risk and return expectations takes oversight and periodic rebalancing. Large market events often provide an opportune time to reallocate funds towards desired targets. This is a way to put market volatility to work for you, as outperformers can be redeployed to out of favor areas. Other tax-specific opportunities can also materialize during market disruptions. Securities may be sold to generate losses, and the proceeds reinvested in other high conviction ideas. For those investors with taxable portfolios, this can help improve the net return over time.

A tactical adjustment

For those needing to achieve additional stability in the face of persistent market volatility, consider an evaluation of your cash position. While we came into the year believing that the economies around the world were poised for a cyclical improvement, that thesis has been severely challenged by the COVID-19 outbreak. It remains to be seen how long the uncertainty will last, so we are reviewing areas that are the most poised to struggle further should this malaise be more than a short term phenomenon. If cash buffers need to be enhanced, we would consider areas such as developed market equities in Europe and Japan. They were in a relatively weaker position heading into the outbreak, and European banks in particular could be vulnerable in a prolonged downturn. Below investment grade credit holdings are another area being reviewed, as those companies will face increasingly difficult prospects should the slowdown continue longer than expected. Stay tuned for more formal thoughts on this in the coming days.

Final note

While the next few months will undoubtedly be filled with more periods of uncertainty, it is important to remember that markets can reverse course quickly. No better example exists than in 2018 when a dramatic Christmas Eve selloff was followed by a furious market rally beginning only two days later. Yet another reminder that patience and planning are required for long term investing success. If you haven't done so already, be sure to speak with your BMO team to help navigate this period.

And, as a final comment, we wanted to pass along a chart that recently caught our eye. It is perhaps particularly relevant for income investors. The dividend yield on the S&P 500 is now further above the 10-year U.S. Treasury Bond rate that at any point in at least the last thirty years ***(Chart #3)***. Said differently, it would take an S&P 500 decline of 15%+ over the next ten years to equal the return from a 10 year treasury bond... These are interesting times indeed.

Chart 3: S&P 500 Dividend Yield vs. U.S. 10 Year Treasury Rate

Source: Bloomberg, BMO Wealth Management Strategy
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