CURRENT MARKET NEWS

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As evidenced by yesterday's historic market plunge, economic and related risks have increased materially over the past 72 hours. On the economic front, countries such as Italy are taking drastic action to control the virus spread. While such actions may ultimately weaken the outbreak, they come at an economic cost in the form of delayed or cancelled investment on the part of both consumers and businesses. Survey data suggests that individuals are indeed becoming more cautious, which will bleed through into reduced 2020 spending. Restaurants, hotels, transportation services and theme parks will likely be the hardest hit. Compounding coronavirus worries was the news this weekend that OPEC+ efforts to restrain supply collapsed in a game of high stakes poker. Markets were roiled when Saudi Arabia launched a preemptive price reduction to clients, causing oil prices to plummet and straining the high yield bond market (which includes a good preponderance of energy related companies). While balance sheets across the sector as a whole are in better shape than they were during the oil price collapse of 2015/2016, the price decline will severely challenge weaker firms.

With these recent events the odds of a recession have increased both globally and in the U.S., though the U.S. is better positioned to weather the storm than many of our international peers. Why? The economy was on the upswing heading into the virus outbreak. For example, payroll growth averaged over 200,000 per month since September, and it is feasible that employers may be reluctant to quickly reduce headcount given the tight labor market. In addition, the global easing cycle drove down mortgage rates over the past year, which has been a benefit to consumer cash flow (and the housing market). This is on top of gradually improving consumer balance sheets over the past several years. As can be seen from ***Charts 1&2***, the U.S. savings rate and debt service burden are in a much better position relative to that seen prior to the two most recent recessions.

Chart 1:

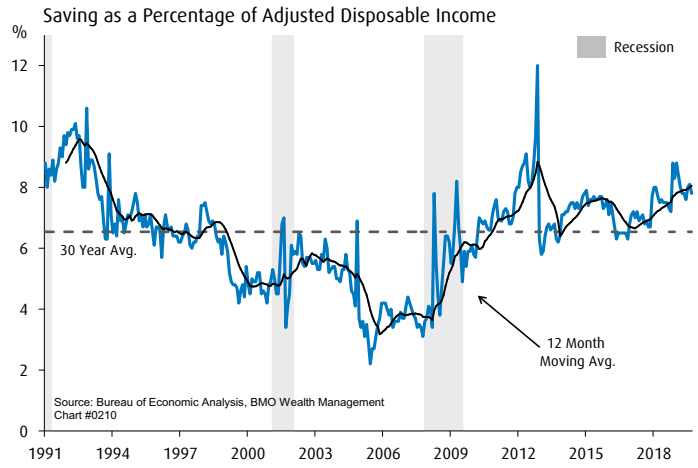
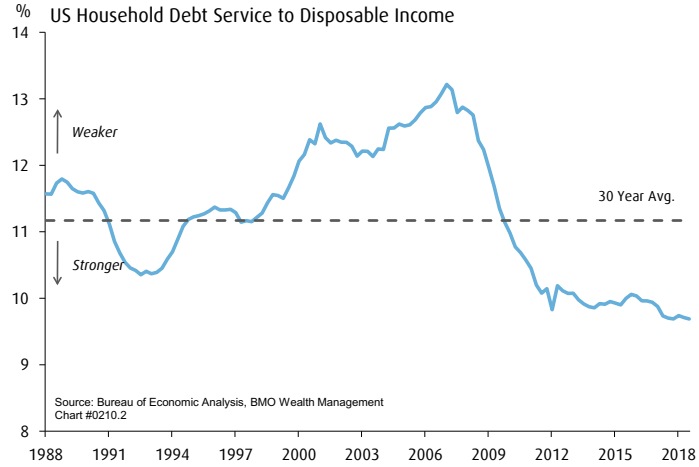


Chart 2:



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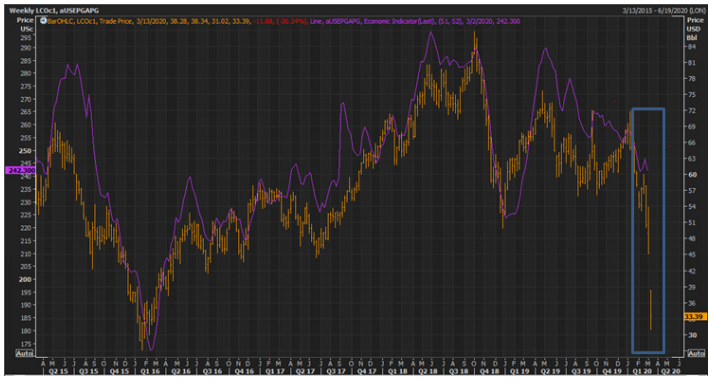
The reduction in oil prices will also add cash flow to consumers' pockets in the form of lower gasoline prices ***(Chart #3)***. However, as the world's largest oil producer, the U.S. has significant capital expenditures, loans, and jobs tied to the energy sector. On net, we believe the drop in oil prices below $40/barrel is a negative for the U.S. economy.

Chart 3: Oil (orange/right hand scale) vs. Gasoline (purple/left hand scale) show that gasoline prices could fall under $2.00 soon.



Source: Bloomberg

Should we fear a bear market? With the S&P 500 down close to 19% from its recent peak, we may indeed soon hit the magic 20% threshold. Though painful, equity selloffs of 20+% have occurred every 3.6 years on average since 1928. The last bear market occurred in early 2009, though we came extremely close to one in the fourth quarter of 2018 as recession fears spread. ***Chart #4*** details all bear markets since 1929. The median decline was just over 30%.

Importantly, a bear market does not always indicate an economic recession. Indeed, there have been 25 bear markets since 1929, but only 14 recessions during that time (source: NBER). By some measures, including online prediction markets, there is now a greater than 50% chance that the U.S. economy will have a recession during President Trump's first term. If that were to take place, Chart #5 provides some context on S&P 500 returns during past episodes. The average fall has been 24%, which is not far from the current decline. The most important consideration from the graphic, however, is the historical post-recession performance - which has a decidedly positive skew at each post bottom horizon (3, 6, 12, 24 months).

Chart 4:

S&P 500 Bear Markets

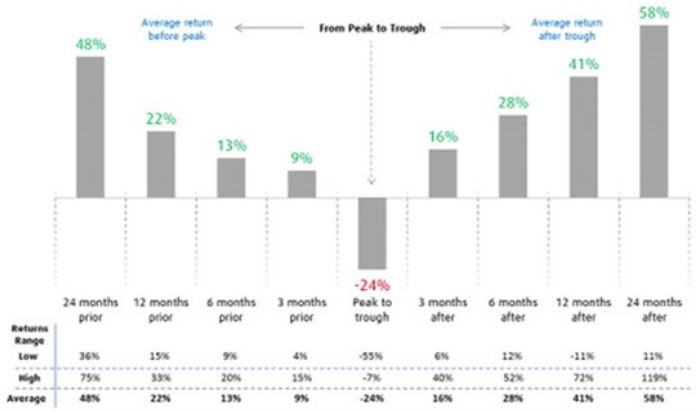
*Bear market defined as 20% or more decline

Peak Date	Trough Date	% Loss	Number of Days**
9/7/1929	11/13/1929	-44.7%	67
4/10/1930	6/1/1932	-83.0%	783
9/7/1932	2/27/1933	-40.6%	173
7/18/1933	10/21/1933	-29.8%	95
2/6/1934	3/14/1935	-31.8%	401
3/6/1937	3/31/1938	-54.5%	390
11/9/1940	4/8/1939	-26.2%	150
10/25/1939	6/10/1940	-31.9%	229
11/9/1940	4/28/1942	-34.5%	535
5/29/1946	10/9/1946	-26.6%	133
6/15/1948	6/13/1949	-20.6%	363
7/15/1957	10/22/1957	-20.7%	99
12/12/1961	6/26/1962	-28.0%	196
2/9/1966	10/7/1966	-22.2%	240
11/29/1968	5/26/1970	-36.1%	543
1/11/1973	10/3/1974	-48.2%	630
11/28/1980	8/12/1982	-27.1%	622
8/25/1987	12/4/1987	-33.5%	101
3/24/2000	10/9/2002	-49.1%	929
10/9/2007	3/9/2009	-56.8%	517

**Number of days includes weekends and holidays
Source: Yardeni Research

Chart 5: Equity Markets and Recessions
(S&P 500 total return from 1945-2019)

Despite losses during recessions equities have historically recovered from the bottom to provide favorable returns over time.



Source: Bloomberg; BMO Wealth Management
Market Data through period ending 12/31/2019
For general information only. Market conditions and trends will vary. Past perfromance is no guarantee of future results.

Of course, while historical comparisons are helpful, every event is unique. As such, we are spending considerable time thinking about what could provide some stability in the current case. From a policy perspective, these factors include more central bank easing and more fiscal stimulus (potentially coordinated between governments). We expect action on both fronts in the near future, and the case for fiscal policy in particular should now be clear. In fact, as we write this the Wall Street Journal is reporting that President Trump will be meeting with Republicans in an attempt to put together a series of "major proposals" to combat the looming economic fallout (https://www.wsj.com/articles/trump-white-house-officials-to-discuss-coronavirus-economic-response-plan-11583764176?mod=hp_lead_pos2). This would be a welcome development should a bipartisan agreement be reached.

As we discussed on our call with Dr. Adalja last week, we also continue to watch for signs that consensus suggests a "return to normalcy" policy is the best option for dealing with the virus, but to date the focus remains on containment. COVID-19 data continues to come in at a fast and furious pace, with green shoots emerging in some areas despite negative overall headlines. In particular, we are monitoring South Korea, which tests more than 10,000 people per day and provides the best set of data for review. It is worth noting that their mortality figure continues to trend near 0.7% which, while still representative of significant human suffering, remains much lower than the 2-3% figure quoted in other forums. This is good news for the intermediate term, but the near term path of the U.S. and global markets will likely be driven by the virus spread and oil price war between Saudi Arabia and Russia – both of which are difficult to predict. If there were ever a time and need for worldwide government action, this is it.

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