March is the Cruelest Month, Not April

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We wrote most of this memo over the weekend, on the heels of historic market volatility. Then, Sunday night, the Federal Reserve announced its latest round of quantitative easing, which sent us back to the drawing board. Likely, many will not review this until later in the month. Given recent events, the data might not reflect the current environment. However, the real goal (as usual) is to suggest how to think about the developments and offer our view. So, please read this memo as of Wednesday afternoon, and let us show you how we evaluate all that is happening.

Coronavirus (COVID-19)

As of March 17th, the World Health Organization (WHO) has logged 184,000 confirmed cases with 7,500 deaths related to Coronavirus. Nearly 82,000 confirmed cases originated from China, with 3,400 deaths. However, over the past two weeks, the number of confirmed cases has decelerated. This is likely due in large part to the aggressive quarantine measures undertaken by the Chinese government. By contrast, Italy has reported an acceleration in cases, and it is beginning to place strict travel restrictions on citizens. At this point, the U.S. likely has 3,500 cases with 58 deaths attributed to the Coronavirus. While tragic, the loss of life has not driven volatility. Rather, the uncertainty of how quickly it spreads, of how many people it will affect, and what the effect will be on the economy has motivated this turbulent market. As to the first two, we are not epidemiologists. As a result, our opinion would only be a guess. To date, only 20% of those contracting the virus have experienced something described as more than "mild" symptoms, and the fatality rate has been 2-4% of those infected. We do not believe that the U.S. will see a large outbreak; however, given the fatality rate, it might mean thousands will perish.

The Centers for Disease Control and Prevention (CDC) has estimated that the current flu season has resulted in 41.5 million illnesses, 485,000 hospitalizations and 36,000 deaths. Overall, the CDC estimates that the flu has killed an average of 36,500 people annually since 2010. Globally, the WHO estimates that the flu kills 290,000 to 650,000 people per year.

It appears that markets are more focused on the impact to the economy. Given the factory closures, restriction of travel and distributions to the supply chain, it would be naive to think that Coronavirus would not have an impact on overall GDP. The reason for the economic impact is understandable, but the collective economic impact cannot be accurately quantified given how much of the current situation is unknown. At this point, there are as many forecasts as there are forecasters. The most consistent view is that the U.S. economy will see a half-percentage point reduction in GDP attributed to the Coronavirus. In addition, the weak first quarter may spread into the second quarter. However, the second half of the year will be increased by a commensurate amount that was lost in the first half, as spending is postponed but not gone.

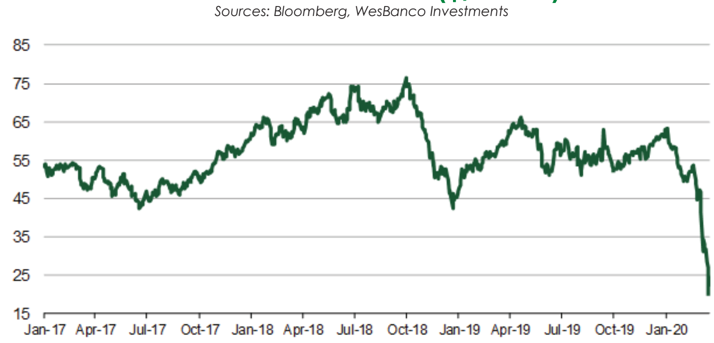
It is important to note that the U.S. economy was on firm footing prior to the acceleration of the Coronavirus outside of China. In February, nonfarm payrolls were nearly 100,000 better than consensus expectations, and these pushed the U.S. unemployment rate to its lowest level since December 1969. The ISM Manufacturing and Non-Manufacturing Indexes remained in expansionary territory, rebounding with the signing of the Phase 1 trade deal with China. In addition, the U.S. consumer saw solid wage gains leading to strong spending levels.

Energy Markets

The slowdown in overall economic activity has led to an increase in energy stockpiles around the globe. The price per barrel of West Texas Crude oil stood at $60 at the start of the year. As the impact of Coronavirus closed production in China, hampered travel plans and slowed spending, the price of oil dropped to $50 per barrel. However, prices tumbled 30% on March 9th, briefly touching $28 per barrel. The drop followed a failed Organization of the Petroleum Exporting Countries (OPEC) production cut meeting from over the prior weekend. A series of production cuts over the past three years ultimately failed to boost the price of crude but led to a considerable erosion of OPEC's market share. As a result, it is likely that increased production will leave a fragile oil market now sharply oversupplied.

The steep decline in the price of oil helped push equity markets down by the largest percentage decline since 2008. It is important to note that this drop will act like a tax cut for U.S. consumers. According to the Energy Information Administration (EIA) in 2019, the U.S. consumed 142.23 billion gallons of gasoline, for an average of 389.68 million gallons per day. If the current price war lasts a year, each penny per gallon that the gas price declines will be equivalent to a $1.42 billion consumption tax cut for the U.S. economy. Based on Monday's decline in oil, estimates for the price of gasoline are expected to drop by 70-80 cents per gallon.

West Texas Crude Oil ($/Barrel)
Sources: Bloomberg, WesBanco Investments



The Federal Reserve

On March 3rd, the Federal Reserve surprised markets by announcing a 0.50% cut in the Federal Funds rate. Equity markets initially moved higher; however, as the trading day wore on, they sold off from early gains, particularly as the markets realized that monetary policy can only do so much to stimulate the economy. The Federal Reserve will be required to walk a fine line over the next several months, as many are looking for additional rate cuts in subsequent meetings. Over the past several months, U.S. economic data pointed to an acceleration in domestic growth. That was confirmed by January and February economic releases; however, their preemptive cut was to head off the (likely weak) March data. Economic releases from China this week highlighted the country's economic weakness. Manufacturing survey readings, production levels and auto sales all reported levels that were on par with the Great Recession. Given China's place within the global manufacturing supply chain, we would anticipate that a number of companies will report part shortages.

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Economic Outlook *(Cont'd from pg. 1)*

The Federal Reserve's easing did not lessen the pressure on Treasury yields. Over the past several days, the 10-year Treasury has fallen to its historical low. Reaching an intra-day low of 0.3137%, that was well below the 1.8771% posted at the start of the year. The global "risk off" trade, paired with negative rates across the world, intensified the downward pressure on the 10-year Treasury. We are beginning to see a coordinated attempt from a number of central banks to cut rates and stimulate the global economy. Over the past several weeks, nearly two dozen central banks have lowered rates and increased liquidity programs, and they have stated they will use all available tools and act as appropriate.

US Treasury Rates – 10-Year (%)

Sources: Bloomberg, WesBanco Investments

Historically, the normal rate cut program covers roughly 500 basis points. When the Federal Reserve began the current rate cutting program, the upper bound for Fed Funds stood at 2.50%. There is uniform insistence that they will not cut rates into negative territory. As a result, we know that they will not have room for a normal rate cutting cycle. Further, the market is calling for another 0.50% cut, moving the upper end of the Fed Funds rate to 0.75%. If the impact of the virus is temporary to economic data, how quickly will they raise rates? And if it is more impactful, is 0.75% enough to fight off the recession?

Strictly speaking, the preemptive deployment of rate cuts did little to stabilize markets and left little in the tank to support the economy should economic conditions worsen.

Then, on Sunday March 15th, the Federal Reserve Open Market Committee (FOMC) used its bazooka and cut interest rates to a target range of 0.0% to 0.25%. The dramatic action of a 100 basis point cut was on top of the 50 basis point cut on March 3rd. In less than two weeks, the Federal Reserve has lowered interest rates by 150 basis points in an effort to stem the effects of the Coronavirus. That was not the only round in its bazooka. On that Monday, it would begin another round of quantitative easing by purchasing $500 billion in Treasury securities and $200 billion in mortgage-backed securities. In addition, it reduced the primary credit rate for the discount window and reduced the reserve requirement ratios for deposit liabilities. Each of these moves are seen as helping banks meet funding and liquidity needs, while trying to stimulate lending.

That, as well, failed to calm markets, as Dow Jones posted its third largest one-day decline on record. We continue to believe the Federal Reserve will maintain its vigilance in markets in an effort to provide support as needed. The coordination with other central banks and the latest cuts are an effort to provide liquidity, so that the current Coronavirus-related slowdown does not become a solvency issue.

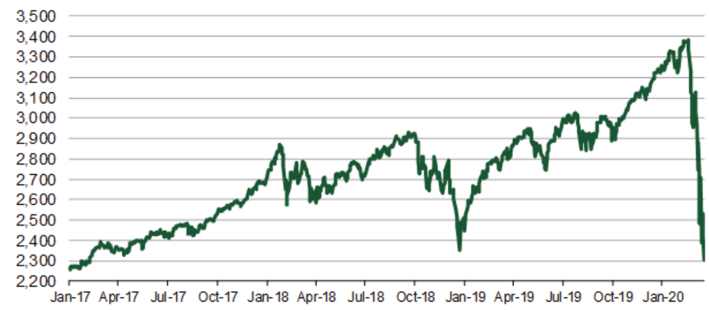
Equity Markets

Over the past several days, we have had two questions: Is now the time to buy, or is now the time to sell? Generally, periods of weakness in equity markets are not the time to sell. Over the past several years, our methodical portfolio management process has had clients reduce equity allocations back to a targeted range and use the proceeds to fund distributions or increase fixed income.

The more common question has been: Is now the time to buy? Our answer has been more nuanced: It's probably a time to buy. Data from several different sources highlights that investors are not very good at market timing. There is no bell ringing in the bottom of markets, and it usually ends not with a bang but a whimper.

S & P 500 Index

Sources: Bloomberg, WesBanco Investments



At the start of 2020, the S&P 500 Index was trading at a trailing Price-to-Earnings (P/E) multiple of 21.4x. That briefly rose to 22.3x on February 19th, which was nearly 27% above the long-term average. With the sell-off in equities, the S&P 500 Index is trading more in line with the long-term average. Thus, equities are closer to being fairly valued, assuming that earnings do not materially change compared to prior estimates.

As a result, it is probably a time to buy equities. Valuations are in line with long-term P/E, economic data in January and February pointed to an acceleration in growth and the U.S. consumer appears to be on solid footing. However, we cannot make the argument to spend all your cash, given the widespread uncertainty and potential impact of negative future events. Our process has been to look at how much we want to hold in equites at the bottom (whenever that is) and invest a portion at current levels. If equities move dramatically higher (like in December 2018), we will be glad we added to portfolios at the lower prices. However, if equities move lower from here, we will be delighted to have the cash and discipline to buy more.

Conclusion

As we highlighted above, the fluid environment has more unknown unknowns than known knowns. As a result, a number of data points that we have laid out might be significantly different two weeks from now. But it is important to note that our team routinely reviews "worst case" scenarios and evaluates risk tolerances to ensure that we are properly positioned. Our systematic investment process resulted in portfolios being rebalanced back to targeted ranges as the decade long bull market in equities moved higher.

The strong U.S. economic data posted early in the quarter has been overshadowed by the uncertainty around the Coronavirus outbreak. The result is an indeterminate figure for first and second-quarter GDP. Should the quarantine measures undertaken across the globe moderate the spread of the virus, we would expect demand to quickly snapback. There are reasons to be constructive and consider that the chances for a V-shaped recovery in the second half are possible. Inventory supply chains are lean but not broken, and any resumption in orders could be rapidly filled. After six weeks of severe disruption, new infections in China appear to be declining, and the markets there have started to normalize. As well, global policy organizations and health officials appear to be accelerating coordination efforts.

In this period of uncertainty, please feel free to reach out to us for more up-to-date thoughts on the current economic and financial market situation. And remember, like we tell our kids, wash your hands, cover your mouth when coughing or sneezing and don't use so much toilet paper.

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