# FIRST QUARTER 2020 REVIEW & OUTLOOK
# EXECUTIVE SUMMARY

April 08, 2020

## PORTFOLIO THEMES

- We continue to favor larger, high-quality companies, but our assessment of the market's future path will determine if we shift toward smaller cyclical firms.
- Unlike many past cycles where the bull market's leading category underperformed in the subsequent bear, large Technology equities have held up relatively well during this bear market. Consequently, we are not yet convinced the bounce out of this bear market will be a conventional new bull led by small value.

## MARKET OUTLOOK

- **The Duration of the Shutdowns Matter More than the Size:** The historic speed of this downturn reflects the economic impact and uncertainty arising from the unprecedented institutional response to the coronavirus.
- **Equities Likely Lead the Economic Recovery:** Equities should start recovering well before COVID-19 is gone, restrictions are removed, or the economy recovers.
- **The Eventual Recovery Should be Swift:** Sharp drops are usually followed by swift recoveries creating a "V" pattern—investors should prepare for the positive side of the "V".

Global equities fell sharply in Q1 dropping -21.4%, going from all-time highs in January to a bear market with record-breaking speed.[i] The sudden fall, combined with society's understandable worries about COVID-19's impact on their health, their loved ones and their community, has spread fear to every corner of the world—and the marketplace. Separating these emotions from market analysis is difficult but vital. While we have empathy and sympathy for those most impacted by this virus, our analysis is focused on how markets likely respond looking forward.

Never before has a pandemic caused a bear market—but never before has society responded to a pandemic by voluntarily halting economic activity. History will judge the success of these measures from a public health perspective. Regardless, though, this is a global tragedy—the illness, its human and emotional toll, and the resulting institutionally induced economic fallout.

We take our responsibility to our clients extremely seriously and, as an essential business under national, regional and local guidelines, we are working hard to ensure our clients' needs are met during these challenging times. As an investment manager, we think it is critical to look forward—and to us, that requires separating our view of the illness and the economy, then further separating these views as we analyze capital markets. Many investors excessively entangle them, thinking all three are tightly correlated and prone to parallel movement. Equities anticipate future shifts few fathom—just as Q1's rapid fall preceded any economic fallout. We are confident markets will similarly anticipate brighter days far before any data—case counts, deaths or economic statistics—show they are coming. That is, for example, exactly how equities nearly always bottom and then surge before recessions end, often a long time before.

i Source: FactSet, as of 04/07/2020. MSCI All Country World Index return with net dividends, USD, 12/31/2019 – 03/31/2020.

This downturn's speed and severity are a painful shock. Significant down days heighten panic, with many investors overly fixating on real-time momentary developments. As we look forward, our analysis is focused with the understanding that markets look beyond the next few months toward a scenario further into the 3 – 30 month timeframe that equities generally anticipate. It isn't hard to envision a post-coronavirus world that looks relatively bright. The virus's endgame is a vaccine. That will come. It will be micro-studied and widely chronicled as it evolves. But equities should rebound long before a vaccine arrives in volume within the 3 – 30 month timeframe markets weigh most.

The coronavirus wasn't even known to researchers until mere months ago—and much about it remains unclear. Beyond this, will government mandated social distancing and COVID-19 containment guidelines expire soon, or will government's around the world extend them again? Will regional and local restrictions, which cover a large portion of economic activity, outlast centralized government policy? Will infection rates fall in Europe and allow normal life to resume, or will containment efforts there long endure? How will emerging markets (EM) be impacted relative to developed markets?

These questions can't be answered now, but all have resolutions. Yet equities should increase long before those resolutions emerge. While this bear's cause is unique, the market is functioning as it always has: as a leading economic indicator. The bear struck well before any data confirmed the institutionally induced economic contraction. It will likely end similarly fast, before data hint at an economic recovery.

With almost all bear markets that have an associated recession, the recession is necessary to correct the prior expansion's excesses. The classic example is 2000 – 2002. It takes time to correct and rectify those problems, building the base for the next economic expansion. This economic contraction isn't like that. There was no broad-based excess or froth. The economy was otherwise in strong shape and the bull market vibrant.

Emerging markets behaved much like developed markets in Q1 falling -23.6% during the quarter.[ii] While some EMs (like China and South Korea) appear past the worst of the virus, many others are far earlier in the fight and data have yet to even hint at the fallout. EM governments aren't waiting to enact policy responses to the likely economic impacts. Many have announced or implemented an array of monetary moves and fiscal measures designed to alleviate COVID-19-related economic pain. For example, China approved $170 billion in tax cuts and spending, South Korea passed several measures aimed at containing coronavirus and supporting impacted businesses and individuals and Brazil approved $29 billion in planned social spending. Monetary measures have also been enacted in China, South Korea, India, Brazil and other EM countries including cutting interest rates, relaxing banks' reserve requirements and loosening lending standards.

Since we believe this is an institutionally induced economic contraction, we hesitate to approach it as we would traditional recessions. If it is a long contraction, it may be beneficial to shift portfolios into the more cyclical categories that typically do best early in economic recoveries. But if it remains a sharper, shorter contraction—and equities keep behaving as they normally would in a massive correction (which they have) rather than a long bear—then we would expect the high-quality, growth-oriented companies that led before the downturn to continue leading in the recovery. That has been the case thus far, explaining why our strategies—which emphasize these traits—held up well versus their respective benchmarks to date. However, we are monitoring this closely.

The full Review & Outlook, available in the coming weeks, will detail all of this and much more—including political developments, economic data and earnings, the global fiscal and monetary response to the economic disruptions, oil prices, interest rates and COVID-19 itself.

Most importantly, remember: While the day-to-day situation changes, markets' functioning is timeless. Equities should price a recovery long before most investors can fathom it. Panics nearly always precede better returns 12 – 18 months into the future.

ii Source: FactSet, as of 04/07/2020. MSCI Emerging Markets Index return with net dividends, USD, 12/31/2019 – 03/31/2020.

**Should you have any questions about any of the information in the First Quarter 2020 Review and Outlook, please contact us at (800) 851-8845 or FisherInstitutional@fi.com.**

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