Bell Bank
Wealth Management

EQUITY & FIXED INCOME OUTLOOK APRIL 2020

The S&P 500 reached a record high on February 19, 2020. It seems like an eternity since then. The equity market sold off 34% to 2237 by the end of day on March 23, then recovered to close at 2584 on March 31 – finishing the first quarter down 19.6%. To illustrate the market's uncertainty, mixed among the selloff in March were 3 of the 20 best days ever recorded in the equity market, according to Bianco Research. The stock market gets the award for volatility over the last five weeks, but the bond market takes a close second. In a single 24-hour period, we saw the yield on the 10-year U.S. Treasury bond fluctuate by 25 basis points (1/4 of a percent) – twice! Normally, that kind of movement takes a month or more to show up in the bond market.

Liquidity Disruption

While the bond and stock market searches for a point of equilibrium in the face of current news, it is also wrestling with a liquidity disruption. In short, this means there were more sellers than buyers. Everybody in the market wanted liquidity at once. Buyers turned defensive and wanted to hold cash. Investors wanted to turn some of their current holdings into cash. Banks were raising cash by selling municipal bonds. Insurance companies needed cash for claims. The list goes on. Investment-grade bond funds and exchange traded funds (ETFs) saw $300 billion in outflows over the last two weeks. Spreads on all types of bonds widened noticeably, resulting in near-term market value decline. Then, the Federal Reserve stepped in to provide liquidity. Toward the end of March, spreads had recovered about half of their value, and they're tightening more as we speak. There are still some dislocations in mortgage-backed bond markets (both residential and commercial), but that may be a topic for another day.

Managing Investments During a Pandemic

A common question we're asked these days is what we have been doing in investment portfolios to address the coronavirus situation. Actually, portfolio adjustments need to be in place *prior* to any specific event to make a difference. For many months before the coronavirus really began to impact us, our strategies included raising the quality of bond portfolios, adding equity exposure in more defensive sectors such as utilities, and giving preference to sectors with strong cash flows. The reality is that aside from some specific tax management strategies, it is very difficult to rearrange a portfolio in a highly volatile environment, especially one compounded by liquidity issues like we have in the market today. For example, the ETF that tracks the Bloomberg Barclays Aggregate Index was trading for several days at a 4.25% discount to its net asset value (yes, trust clients who use our model portfolio strategy also benefited from this trade).

What does the economy look like moving forward? We expect to see rapidly rising unemployment numbers, downward pressure on gross domestic product (GDP) and noticeable, downward adjustments to corporate profit outlooks. There appears to be a belief that as soon as the virus fades, the economy will pick up where it left off. We don't think it will be that simple – we can't just hit some sort of "reset" button like it's a video game. Instead, we'll have to move through lingering consequences before the economy can establish a new footing. That's going to be the reason behind more anticipated fiscal programs from Congress, beyond the $2.2 trillion package – about 5% of GDP – recently passed. When everything migrates back to normal, we expect to see demand in excess of supply for a time, perhaps bringing some inflation with it.

In the meantime, consumers are wondering when life returns to normal, when restaurants will open up, and when they can get on an airplane again and move about without any restrictions. In the investment world, getting through events like this requires patience, discipline and long-term focus. Asset allocation is extremely important. If your allocation was not properly aligned to your personal investment profile before our current situation began, the best strategy is to wait for things to recede before addressing it. Moving through times like these is like driving on an icy road – don't make any sudden moves, or you'll end up in the ditch.

Greg Sweeney, CFA
SVP/Chief Investment Officer
Tenure: 09/1992
Years of Investment Experience: 34 years
Education: Greg holds a bachelor's degree in business from the University of North Dakota and is a CFA charter holder.

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