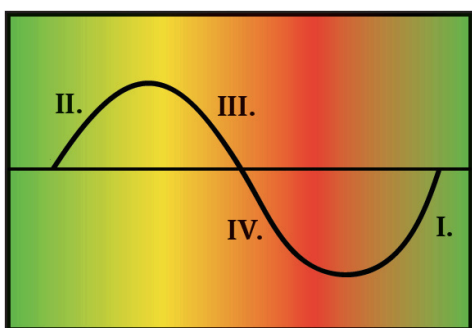


Month in Review

The S&P closed down -11.1% in March as the draconian measures taken to slow the spread of Covid-19 brought the economy to a standstill. “A Decade of Ignoring Risk Is Confronting Face-to-Face an Exogenous Shock” proclaimed a Bloomberg headline as the markets seized up in a liquidity squeeze not seen since Lehman. In rapid fire succession, the Federal Reserve announced measures to backstop virtually everything in a de facto nationalization of risk. After two weeks of chaos, the Fed’s promise of open-ended Quantitative Easing (QE) and pledge to buy commercial paper, corporate bonds and ETFs succeeded in slowing down the forced liquidations, allowing stocks a chance to recover. It’s time to check our indicators to see how the unprecedented events of the past month have affected them. I have provided a brief summary of my thoughts on the market going forward.

I. CREDIT CYCLE

Phase IV: Contraction



Financial conditions plunged and credit spreads soared as the fear of potential wide-spread defaults spurred a “dash for cash”. The steep market drop mirrored the deep cuts to growth forecasts. Goldman Sachs lowered their GDP estimate to -6% in the 1st quarter and -24% in the second, and Brian Wesbury at First Trust thinks earnings for the period could be down 60%-80%. The extraordinary policy response by Congress and the Federal Reserve means that the conditions are in place for a rapid recovery when the infection rates peak. All efforts must be focused on bringing those rates down--the physical and economic health of the nation depends on it.

II. RISK LEVEL INDICATORS



US STOCKS: HIGH

The Risk Level is **ELEVATED** for Large Cap US Stocks and **HIGH** for Small Caps. The key issue is how deep and how long the recession of 2020 will be. No one knows how low earnings will go so we have to look at other indicators for clues. One of those is the Volatility Index (\$VIX) which has peaked in advance of every bear market bottom since its inception in 1993. The VIX peaked at 85.47 on March 18; if that high is not exceeded we can start counting down to the final low in the stock market. Mark Hulbert, senior columnist for MarketWatch, found that the average lead time is 75 days so he wagers the bear market could end by June 1. Our short-term Swing Indicators are mixed so there is no clear signal yet that the downtrend has run its course.

INTERNATIONAL STOCKS: HIGH

The Risk Level for **International Stocks** is **HIGH** but there are signs of improvement, especially in China, where coronavirus transmission is down to nearly zero and economic activity is beginning to rebound. In fact, the MSCI China Index has been outperforming the S&P 500 Index since February. A durable recovery is far from assured but it is encouraging that as the lamps go out in economies around the world, they are starting to come on again in China.

US HIGH QUALITY FIXED INCOME: LOW

The Risk Level for **US Fixed income Quality** is **LOW**. Treasury bonds have been the big winner in the recent market turmoil but that may be changing. In last month’s “Looking Ahead” section we advised keeping an eye on US Treasury yields, oil prices, and Chinese stocks to gauge the risk to global growth. All three collapsed as investors woke up to the fact that a coronavirus-induced, deflationary recession lay straight ahead. Today, Treasury yields are testing the lows, but oil prices and Chinese stocks show signs of stabilizing. The markets will likely turn up before the economy does and these three asset classes may lead the way.

III. LOOKING AHEAD

Playbook: Green Zone - Defense

In times like these, I really appreciate technical analysis. Defined by Investopedia as “a trading discipline employed to evaluate investments and identify trading opportunities by analyzing statistical trends gathered from trading activity”, I liken it to flying a plane by the instruments when you’ve lost the horizon. Investing today feels like flying blind. Until the economy reopens, traditional metrics like GDP forecasts and earnings estimates are no more than guesses. Fortunately, technical analysis provides tools we can use in any environment. One of the most important is the concept of overbought and oversold. All other things being equal, when a market is overbought risk is higher and when it is oversold risk is lower. When it is completely washed out, as it is today, it is in the “Green Zone” [hat tip Dorsey Wright & Associates]. The Green Zone doesn’t mean that prices can’t go lower—they often do. But the best buying opportunities come from the Green Zone as occurred in 2002, 2008, 2011, 2016, and 2018. The defensive team is still on the field but the offensive team is warming up. It’s time to start building a shopping list!

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