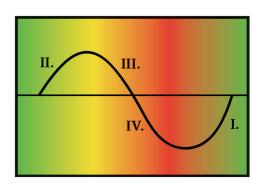


Month in Review

The S&P closed down -8.41% in February for its worst month since Dec 2018. The global manufacturing rebound that had propelled stocks higher since October abruptly stopped and reversed, leaving investors suspended in mid-air like Wile E. Coyote as the market dropped out from under them. It's time to check our indicators to see how the fastest 10% correction from a record high in the history of the stock market has affected them. I have also provided a brief summary of my thoughts on the market going forward.

I. CREDIT CYCLE

Phase III: Early Contraction



Financial conditions have tightened and credit spreads have widened as the outlook for global growth has dimmed. Recession fears have resurfaced and until more is known about the severity of the Covid19 crisis investors are choosing to sell first and ask questions later. The Credit Cycle was last in contraction in 2018, when the Fed was raising rates and draining liquidity from the financial system. This time the Fed has cut rates and flooded the system with liquidity. So far, their efforts have proven no match for the virus and credit conditions are tightening once more.

II. RISK LEVEL INDICATORS

LOW GUARDED ELEVATED HIGH SEVERE

US STOCKS: ELEVATED

The Risk Level for **US Stocks** has risen to **ELEVATED**. Damage reports from the coronavirus are just starting to come in and the situation could get worse before it gets better. Plant shutdowns and other disruptions in China are jamming global supply lines and travel has been severely restricted. The U.S. economy is likely to slow sharply until the viral outbreak is under control, but it's still unclear how extensive the damage will be. Our short-term **Swing Indicators** are negative so there is no sign yet that the correction has run its course.

INTERNATIONAL STOCKS: HIGH

The first official data for a full month of economic activity in China since the epidemic began plunged to record lows signaling a deep contraction. There is a silver lining--in 13 global pandemics over the past 50 years, once the number of newly identified cases starts to decline, which is now the case in China, economic activity and the stock market tend to quickly rebound. For now, however, the Risk Level for **International Stocks** is **HIGH** and we remain cautious.

US HIGH QUALITY FIXED INCOME: LOW

The Risk Level for **US Fixed income Quality** is **LOW**. Treasury bonds have been the big winner of the recent market turmoil. When they began to rally in early January it was an indication that trouble was brewing. In last month's "Looking Ahead" section we noted that the markets were giving mixed signals with bonds and commodities warning of a potentially serious growth shock while stocks seemed blind to the risk. As so often happens, the bond market was right.

III. LOOKING AHEAD

Growth Scare or Recession?

At this point, we can throw out the playbook from the beginning of the year that called for higher inflation, higher growth, higher yields, higher stock prices and a lower dollar. The first quarter is going to be a write-off and the hope is that it will be a "one-off" as well. Will this be just another growth scare or will it be the final straw that pushes the economy into recession? Goldman Sachs says keep an eye on Treasury bonds, oil prices, and Chinese stocks. As the effects of COVID-19 began to be felt, Treasuries rallied, oil prices dropped, and Chinese stocks declined. That pattern may be reversing. The Chinese stock market rallied 2.5% in February as the rate of growth of COVID-19 cases plateaued. That "seems inconsistent with a view that global growth risk has significantly accelerated," observes Goldman. Higher oil prices and a steeper yield curve would suggest that demand is picking up as the virus is contained and support the odds of a V-shaped recovery.

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