BRENTON POINT
WEALTH ADVISORS

March 13, 2020

In lieu of our regular monthly research piece, we are continuing to provide you with more regular briefings on our analysis of markets and the environment as they evolve.

Current Implications for Asset Classes

Through Wednesday, the stock market decline was looking to us like a normal bull market correction. Conditions included a loose Fed combined with bullish extremes in volatility and sentiment. These conditions indicated a low point in the stock market was near, despite the coronavirus. Economic outlook signals showed the economy might slow--conditions consistent with prior stock market declines in this cycle, like 2011, 2016, and 2018.

We reached a tipping point on Wednesday night with the Presidential address to announce closing of U.S. borders to Europe. While some fear is historically bullish for stocks, it has now reached a point that a liquidity crisis and a recession are real risks. Therefore, we have reduced our ratings on all stocks from a bullish 5 to an average equity 3 rating, until there is further economic clarity on these risks.

Current Conditions

Liquidity Risk: Credit spreads are a good indication of a properly functioning bond market and measure the ability for companies to fund operations. As volatility persists, the risk of credit drying up increases. Bloomberg News reported this week that companies are calling in their bank lines of credit, as if the funds may not be available in the months ahead. High yield spreads broke above 6% last week, indicating investors were selling debt of leveraged companies (normal spreads are around 3%) . **This is our best indicator for the risk of a liquidity crisis.** A liquidity crisis combined with a sharply slowing economy risks a snowball effect with debt defaults and an economic recession. In the table below you can see bear markets combined with recessions are more severe.

S&P 500 Bear Markets

S&P 500 Index Returns No Dividends

No Recession Cases

	Peak	Decline	Months	Recession
1.	12/12/1961	-28.0%	6.5	No
2.	2/9/1966	-22.2%	8.0	No
3.	9/21/1976	-19.4%	17.7	No
4.	8/25/1987	-33.5%	3.4	No
		-25.8%	8.9	

Recession Cases

	Peak	Decline	Months	Recession
1.	8/2/1956	-21.6%	14.9	Yes
2.	11/29/1968	-36.1%	18.1	Yes
3.	1/11/1973	-48.2%	21.0	Yes
4.	11/28/1980	-27.1%	20.7	Yes
5.	7/16/1990	-19.9%	2.9	Yes
6.	3/24/2000	-49.1%	31.0	Yes
7.	10/9/2007	-56.8%	17.2	Yes
		-37.0%	18.0	

- Since 1950, bear markets during recessions averaged 37% declines over 18 months
- Bear markets without a recession declines averaged 25% over 9 months

Please also read the important disclosures at the end of this report.

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Chart 1: High Yield Spread vs. Recessions

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The Federal Reserve: The Fed has indicated they would do whatever it takes to provide liquidity to the market and economy.

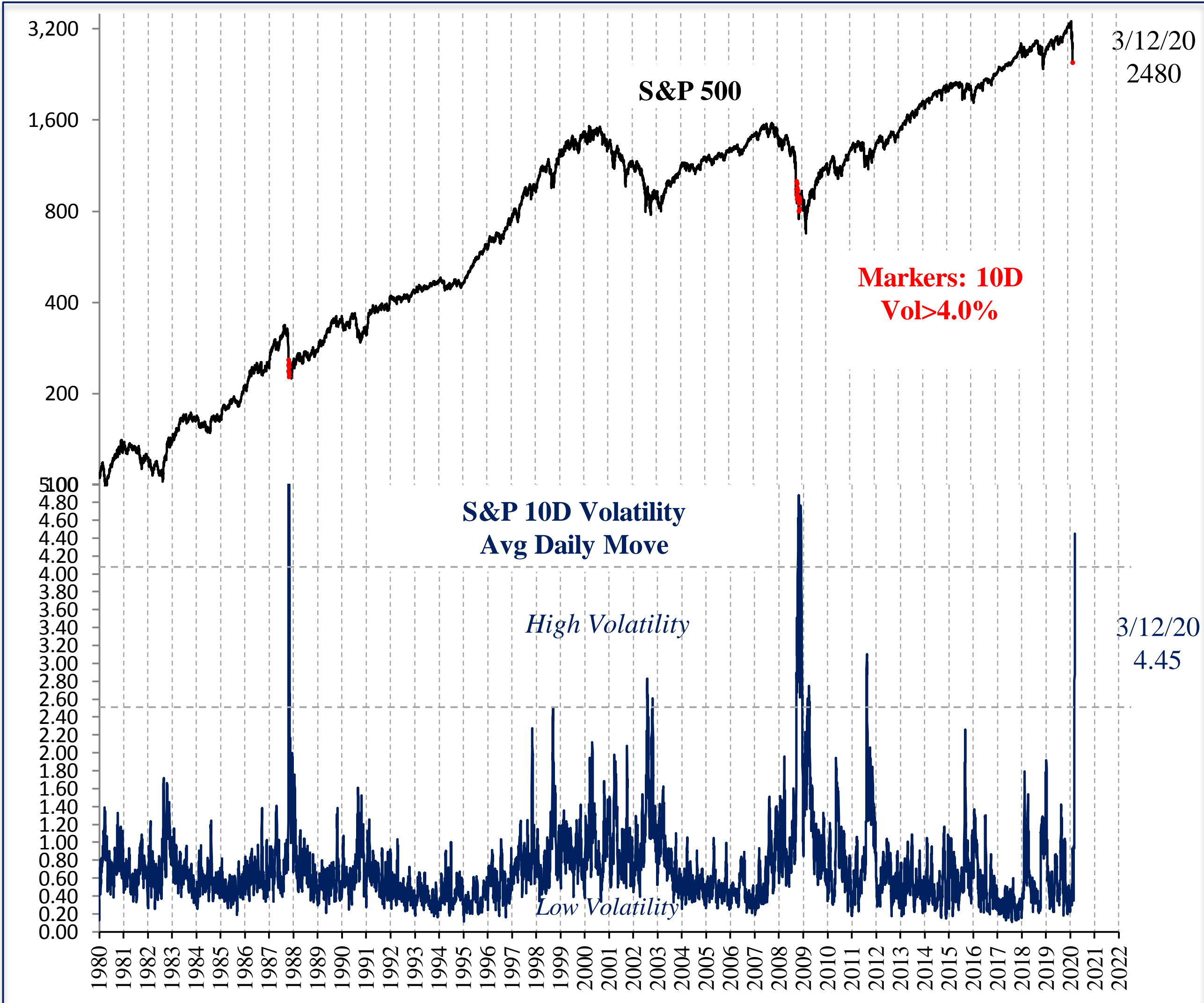
Recent Fed Actions:

- 3/2/20: Emergency interest rate cut by 0.50%
- 3/12/20: $1.5 trillion of temporary liquidity of overnight repurchase operations (repo's) and expand buying $60 billion a month in Treasury bills to other maturities

How much lower can the S&P 500 go?

The market volatility is extreme by any measure. **For perspective, the S&P 500 has moved an average of 4% a day for the last two weeks, 13 times the norm of 0.3%.** It's the highest since 2008, and before that 1987, a once in 11-year event.

Chart 2: S&P 500 Volatility: Highest Since 2008 - 1980 – March 2020



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In addition, the S&P 500 is down 25% within the last month, one of the biggest one-month declines on record. However, larger one month declines occurred in 2008 (-30%), 1987 (-33%), and 1929 (-43%).

Chart 3: S&P 500 Max 1 Month Decline: 1950 – March 2020

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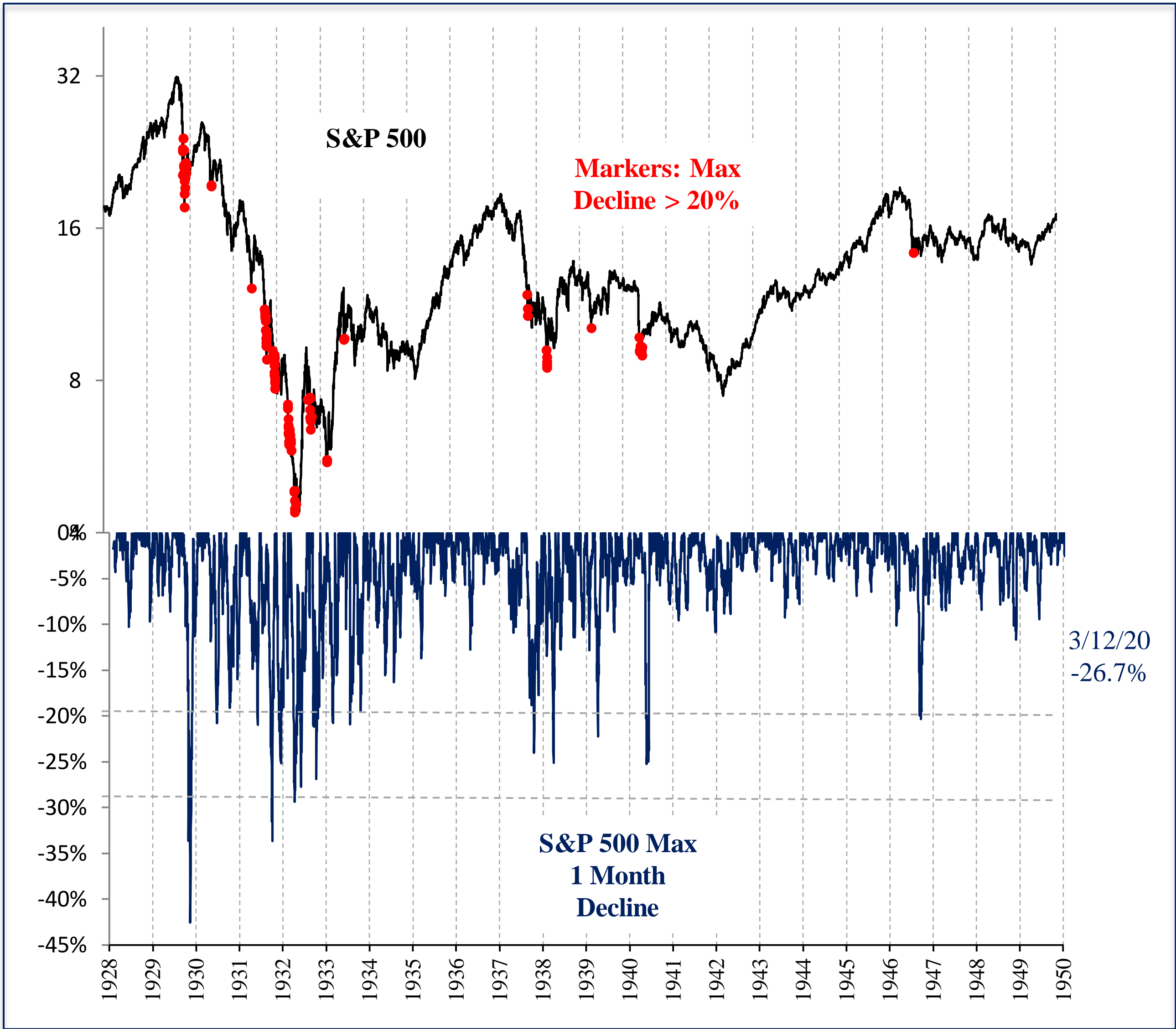
Chart 4: S&P 500 Max 1 Month Decline: 1928-1950



Relief Rallies

In studying prior stock market declines like 1962, 1987, and 2008, there is a reliable pattern of snap back 10-15% rallies over just 2-3 days. When this happened in those prior cases, the market then declined back to the low. It is not something we are necessarily responding to by making portfolio changes, but it is important to be aware of the pattern. The tendency is for investors to buy that first rally, which can be expected to reverse quickly. Today may be the start of one of those rallies.

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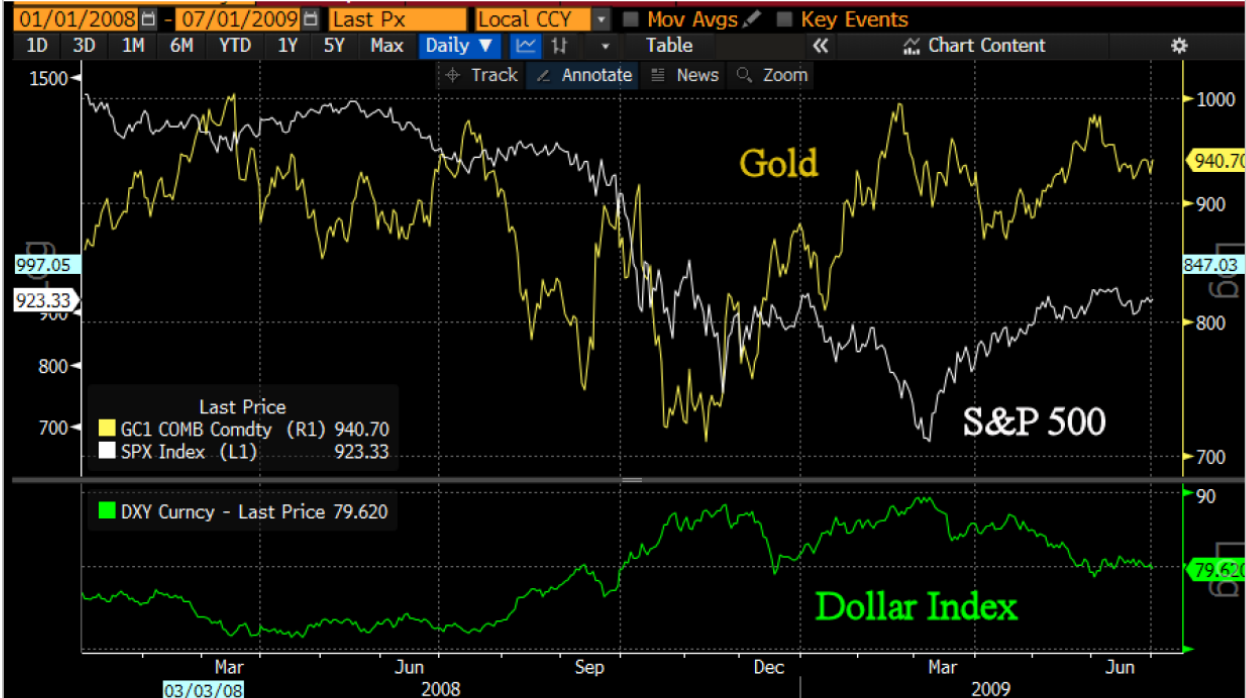
Gold Rating Cut

We cut our gold rating from a bullish 5 to a neutral 3 based on the 2008 comparison when gold declined 25% from the high as stocks declined and the dollar rallied as it has done so far this year. A loose Fed is bullish for gold if the dollar declines, but in this sort of stock market volatility, the dollar has rallied in a flight to safety, and this has become a risk for gold.

Chart 5: Gold: 1/2008 – 7/2009



Going forward, we will continue to closely monitor for additional signs of a possible liquidity crisis. These signs would include companies defaulting on debt or going bankrupt, continued volatility in stocks, and economic news which confirms expected weakening.

Michael Schaus
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