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# Market Commentary

**January 2020**

## THE MARKET AND ECONOMY

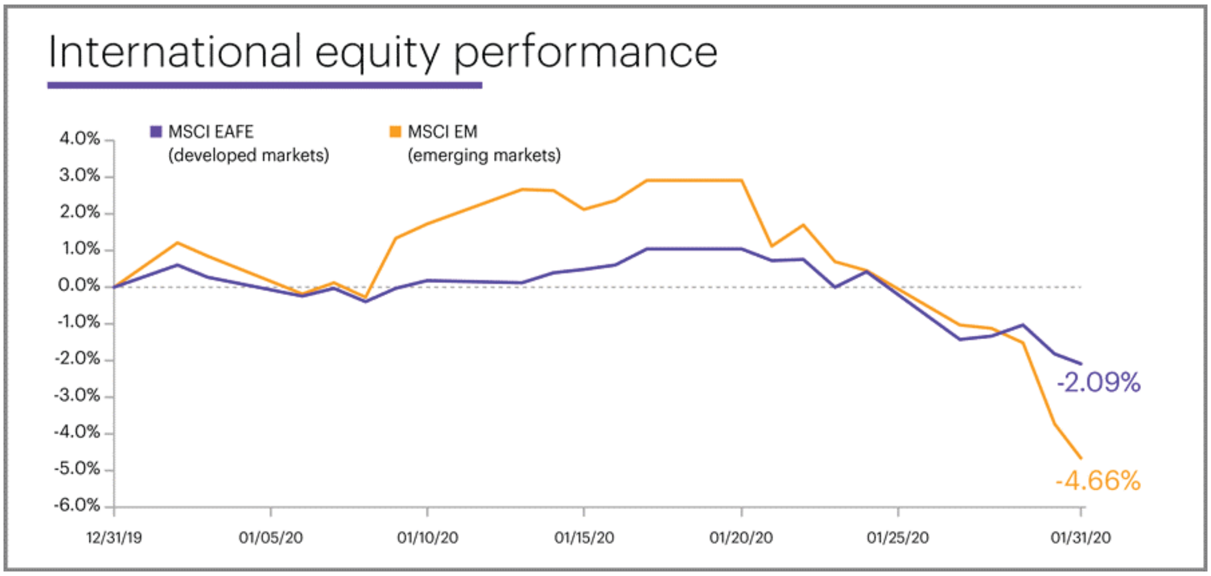
**The market continued its 2019 run to begin the new year, but it turned out to be a tale of two halves as the month came to an end.** The S&P 500 was up over 3% on the month as of market close on January 23rd, only to finish the month relatively flat at negative 0.04% in part due to late month scares from the coronavirus.[1] The first half performance of the index can be attributed to the quick de escalation of tensions between the United States and Iran, along with the January 15th signing of the phase one trade deal between the United States and China. The Dow Jones Industrial Average (DJIA) finished the month down 0.89%, while the NASDAQ Composite (IXIC) finished the month up just over 2%. The NASDAQ composite suffered a similar end of the month drop like the S&P 500 did, but the NASDAQ performed slightly better in the first half of the month up nearly 5% as of market close on January 23rd.[2]

Below is a chart of the leading world stock market indices. While the S&P 500 continued to lead the pack, emerging markets (MSCI EM) was hit the hardest falling almost 5% on the month.

| 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Jan 2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| MSCI EM 79.0% | MSCI Asia ex Japan 19.9% | US S&P 500 2.1% | MSCI Asia ex Japan 22.7% | Japan TOPIX 54.4% | US S&P 500 13.7% | Japan TOPIX 12.1% | UK FTSE All-Share 16.8% | MSCI Asia ex Japan 42.1% | US S&P 500 -4.4% | US S&P 500 31.5% | US S&P 500 -0.0% |
| MSCI Asia ex Japan 72.5% | MSCI EM 19.2% | UK FTSE All-Share -3.5% | Japan TOPIX 20.9% | US S&P 500 32.4% | Japan TOPIX 10.3% | MSCI Europe ex UK 9.1% | US S&P 500 12.0% | MSCI EM 37.8% | UK FTSE All-Share -9.5% | MSCI Europe ex-UK 27.5% | MSCI Europe ex-UK -1.0% |
| UK FTSE All-Share 30.1% | US S&P 500 15.1% | MSCI Europe ex UK -12.1% | MSCI Europe ex UK 20.0% | MSCI Europe ex UK 24.2% | MSCI Europe ex UK 7.4% | US S&P 500 1.4% | MSCI EM 11.6% | Japan TOPIX 22.2% | MSCI Europe ex UK -10.6% | UK FTSE All-Share 19.2% | Japan TOPIX -2.1% |
| MSCI Europe ex UK 29.0% | UK FTSE All-Share 14.5% | Japan TOPIX -17.0% | MSCI EM 18.6% | UK FTSE All-Share 20.8% | MSCI Asia ex Japan 5.1% | UK FTSE All-Share 1.0% | MSCI Asia ex Japan 5.8% | US S&P 500 21.8% | MSCI Asia ex Japan -14.1% | MSCI EM 18.9% | UK FTSE All-Share -3.2% |
| US S&P 500 26.5% | MSCI Europe ex UK 5.1% | MSCI Asia ex Japan -17.1% | US S&P 500 16.0% | MSCI Asia ex Japan 3.3% | UK FTSE All-Share 1.2% | MSCI Asia ex Japan -8.9% | MSCI Europe ex UK 3.2% | MSCI Europe ex UK 14.5% | MSCI EM -14.2% | MSCI Asia ex-Japan 18.5% | MSCI Asia ex-Japan -4.4% |
| Japan TOPIX 7.6% | Japan TOPIX 1.0% | MSCI EM -18.2% | UK FTSE All-Share 12.3% | MSCI EM -2.3% | MSCI EM -1.8% | MSCI EM -14.6% | Japan TOPIX 0.3% | UK FTSE All-Share 13.1% | Japan TOPIX -16.0% | Japan TOPIX 18.1% | MSCI EM -4.7% |

Source (3)

Similar to the S&P 500, both the MSCI emerging and developed markets indices started the year off on a rather positive note. What a lot of the public doesn't realize is that China is considered an emerging market and the country is in the MSCI EM index. As you can see below, MSCI EM started the year off solid with a quick increase around the time of the phase one trade deal, only to drop over 7% with the news of the coronavirus. We will touch on the coronavirus later in the reading, but this illustration shows just how fickle the stock market can be as it relates to headlines




Source (4)

As nearly all the largest world stock market indices finished the month on a negative note, investors began to flee to safety. The Barclays U.S. Aggregate Bond Index finished the month up 1.92% as investors sought fixed income.[5] Thus, driving up bond prices which in turn drives down the yield, flattening the yield curve. A flat yield curve means that those with money to loan are willing to accept the same interest rate to loan their money short-term as they would if they loaned it long-term. It's generally a sign that investors are worried about the macroeconomic outlook.

While macroeconomic fears have crept into the minds of investors due to the coronavirus, the U.S. economy remains on solid ground. The economy grew at an annualized pace of over 2% in the fourth quarter of 2019.[6] With this moderate growth, and little change to strong employment numbers, the Federal Reserve decided to leave rates unchanged which came as no surprise.[7] Fourth quarter U.S. earnings season is in in the thick of it as just under half of the companies have reported, with many doing better than expected.[8]

The quick rise in tensions between the United States and Iraq at the beginning of the month along with the news of the coronavirus at the end of the month remind us that headline news can cause volatility in the markets at any time. However, the U.S. economy is still in an overall good place, and the fundamentals of U.S. companies did not change because of the coronavirus scare. With both equities and fixed income having solid years in 2019, recent equity market volatility, and fixed income around all-time highs, diversification among asset classes in your portfolio is now more important than ever.

# CURRENT EVENTS UPDATE

## EUROPE

### ECB

As previously discussed, Christine Lagarde became the new president of the European Central Bank in 2019. The ECB is the central bank for the Eurozone (19 member states from the European Union). The ECB is tasked with monetary policy decisions for the Eurozone like the Federal Reserve (The Fed) is tasked with them for the United States. In late January, the ECB did not make a rate policy change, but president Lagarde did launch a strategic review. This is the first review for the ECB since 2003 and will cover more than just setting rates. The review will last for much of 2020 and cover things such as inflation targets, climate change, and digital money.[9] It seems as though Lagarde is beginning to set the table for her time as president of the ECB.

## Brexit

On January 31st, 2020, the United Kingdom officially exited the European Union. However, this is not an end to the Brexit saga that has held a firm place in the news since 2016. A transition period has begun, and it will last for the next 11 months as the EU and the UK will need to negotiate a new trade agreement.[10] These talks are likely to be arduous, and the media is likely to continue discussion of Brexit without a trade agreement. The odds of this happening are unlikely but talks of the agreement will keep Brexit in the headlines for much of 2020.

# CHINA

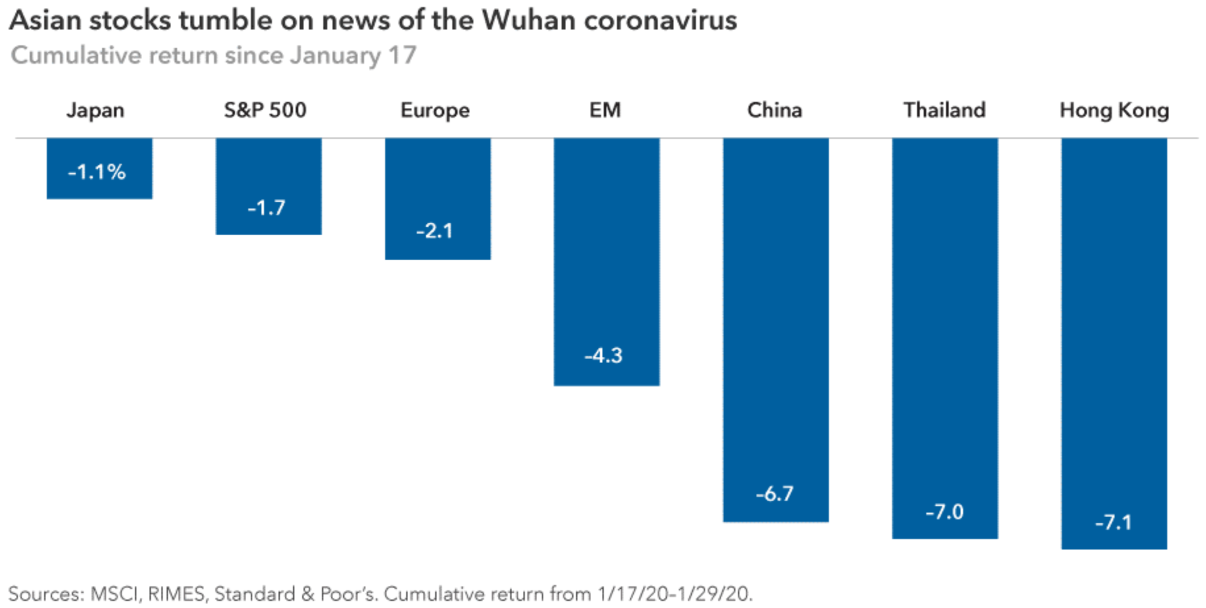
## Phase One Trade Deal

The long-awaited signing of the phase one trade deal between the United States and China occurred on January 15th.[11] While this is good news and was received quite positively from markets both in the United States and internationally, there are still issues that remain. Tariffs are still in place and issues remain with transparency into China regarding the management of their currency. Phase two of the trade deal is next, but it is likely to be much more challenging. Phase two was originally thought to remove all tariffs, but recent news at the end of the month states that this phase could be split into two parts with phase “2A” removing only some of the tariffs.[12] This is a situation that will continue to be monitored but the signing of phase one was a step in the right direction.

## Coronavirus Update

On December 31st of 2019, China alerted the World Health Organization to several cases of pneumonia in Wuhan. On January 5th, they ruled out the possibility of a reappearance of the 2002-2003 SARS virus, and on January 7th they announced identification of the new coronavirus. The first death in China was announced on January 11th, and the first death outside of China (Philippines) was announced on February 2nd. The United States is up to at least 11 confirmed cases, the most being in California with 6.[13] As of February 5th, China has reported just under 500 deaths and over 20,000 infected.[14] The outbreak of the coronavirus has sparked fears in not only the general public, but also caused a month end scare to the markets.

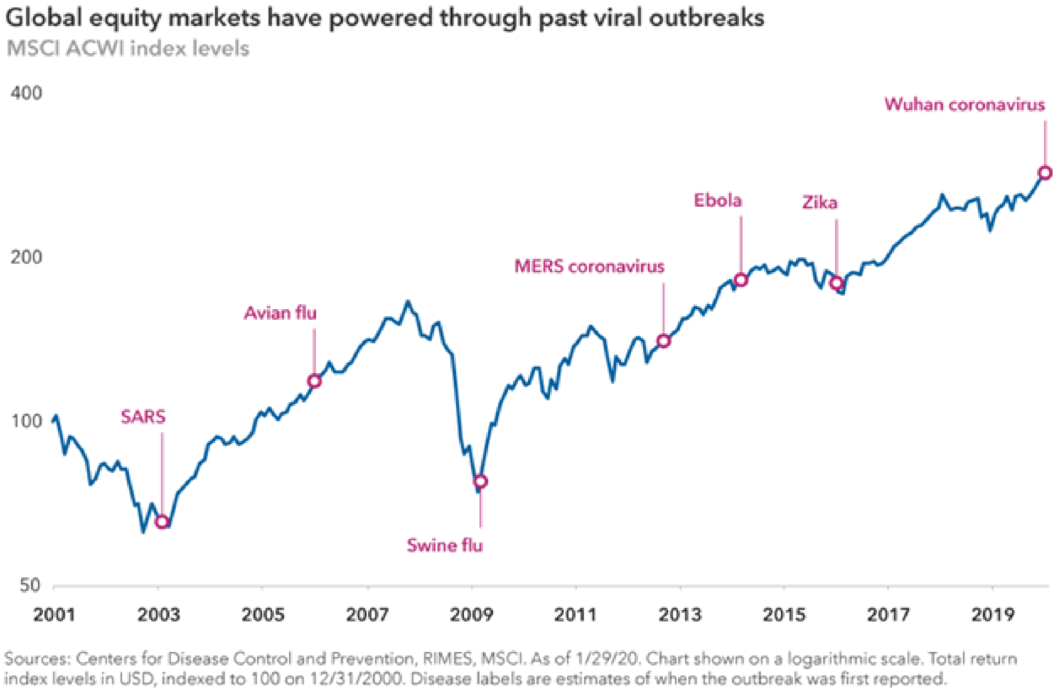
When the media took hold of the story on January 17th and reports began to spread, the markets started to decline. Chinese and Hong Kong markets were hit heavily, while Thailand took the largest hit outside of China as it relies on the country for tourism.




Source (15)

U.S. markets felt the effect of the coronavirus as well. Companies that do business in China, such as Starbucks, are beginning to close stores. U.S. airline companies have cancelled flights to the country, and there is also fear of supply chain disruption to some well-known companies like Apple (AAPL).[15]

With news of potential drugs being tested and the initial public panic subsiding, markets have already begun to rebound during the first week of February.[16] Global equity markets have persevered through previous outbreaks: SARS in 2002-2003, the “bird” and swine flus, Ebola, and most recently Zika.



Source (15)

With technology advancements, the general public has quicker access to their portfolios than they had in the past, and the recent downturn at the end of the month is evidence of that. What’s important to realize though is that “market psychology is often highly predictable during times of crisis as investors tend to overreact to distressing news” according to Steve Watson, Hong Kong based portfolio manager for the Capital Group. He was in Hong Kong during the SARS crisis and compared the two situations, “The initial uncertainty is extremely high, and it is a difficult time for a lot of people, but once the initial panic is over and the outbreak is contained, the following market rally will be quite powerful.”[15]

Assuming the outbreak is contained, Capital Group U.S. Economist Jared Franz believes global and United States economic growth will likely both experience a V-shaped recovery. “U.S. economic fundamentals remain sound, labor markets are resilient, and the Federal Reserve stands ready to take action as needed,” according to Franz. “The coronavirus looks to be a modest but temporary restraint on U.S. economic activity via secondary channels of impact but should not derail my growth expectations of roughly 2% in 2020.”[15]

As with many crises, opportunities for value are created. There is a transitory negative event that occurs causing a mature company’s stock price to fall, but the fundamental financial information of the company remains the same. These events are where true value investors earn their profit. They take advantage of the drop in price, knowing that the company will return to its value when the event passes, and in this case, when the outbreak is contained.

It’s important to maintain a disciplined approach to investing with a well-diversified portfolio. Fear sells, and the media will continue to fuel the fire. There will be a lot of opinions that you read and hear, but it’s important to maintain sound judgment and rational thought. As evidenced by previous outbreaks, they rarely have a long-lasting effect on the economy. There will be short term panic and volatility, but based on history, the market should recover in due time. The early February performance is already showing signs of improvement as the S&P 500 was up nearly 3% after two full trading days.[1]

1 https://us.spindices.com/indices/equity/sp-500

2 https://www.investing.com/indices/major-indices

3 https://am.jpmorgan.com/gb/en/asset-management/gim/adv/insights/market-insights-monthly-market-review-january-2020

4 https://us.etrade.com/knowledge/library/perspectives/market-happenings/monthly-perspectives-january-2020

5 http://performance.morningstar.com/Performance/index-c/performance-return.action?t=XIUSA000MC

6 https://www.cnbc.com/2020/01/30/us-gdp-q4-2019-first-reading.html

7 https://www.marketwatch.com/story/fed-holds-benchmark-interest-rate-steady-sees-economy-growing-at-moderate-pace-2020-01-29

8 https://insight.factset.com/sp-500-earnings-season-update-january-31-2020

9 https://www.irishtimes.com/business/economy/ecb-makes-no-policy-change-as-lagarde-launches-strategic-review-1.4149113

10 https://www.bbc.com/news/uk-politics-50838994

11 https://www.bloomberg.com/news/articles/2020-01-15/u-s-china-sign-phase-one-of-trade-deal-trump-calls-remarkable

12 https://www.cnbc.com/2020/01/21/mnuchin-tells-wsj-that-phase-2-of-china-trade-deal-may-not-remove-all-tariffs.html

13 https://www.businessinsider.com/wuhan-coronavirus-us-cases-health-risk-2020-1#the-first-coronavirus-case-in-santa-clara-county-was-confirmed-on-friday-3

14 https://www.aljazeera.com/news/2020/01/timeline-china-coronavirus-spread-200126061554884.html

15 https://www.thecapitalideas.com/articles/coronavirus-impacts-markets

16 https://fortune.com/2020/02/03/coronavirus-vaccine-testing-in-china/

Returns are based on the S&P 500 Total Return Index, an unmanaged, capitalization-weighted index that measures the performance of 500 large capitalization domestic stocks representing all major industries. Indices do not include fees or operating expenses and are not available for actual investment. The hypothetical performance calculations are shown for illustrative purposes only and are not meant to be representative of actual results while investing over the time periods shown. The hypothetical performance calculations for the respective strategies are shown gross of fees. If fees were included returns would be lower. Hypothetical performance returns reflect the reinvestment of all dividends. The hypothetical performance results have certain inherent limitations. Unlike an actual performance record, they do not reflect actual trading, liquidity constraints, fees and other costs. Also, since the trades have not actually been executed, the results may have under- or overcompensated for the impact of certain market factors such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. Returns will fluctuate and an investment upon redemption may be worth more or less than its original value. Past performance is not indicative of future returns. An individual cannot invest directly in an index.