CAPITAL MARKETS UPDATE—COVID-19 AND RECENT VOLATILITY

March 12, 2020

Global markets continued their slide this week and are now in bear market territory. In our view, the best thing to do in moments of extreme panic is sit tight—which is uncomfortable. We recognize what's right for tomorrow isn't always easy today. Please lean on your Investment Counselor for support. You'll also hear from us more regularly in the period ahead—via your Investment Counselor, written communications and other client service personnel.

Current market fears seem fanned by the unnecessarily draconian actions of a spectrum of organizations, corporations, governments of all sizes and forms domestic and globally. What officials are doing across the globe to stop community spread of COVID-19 amounts to a halt of private business and economic activity. This has made recession more likely than our assessment just days ago, but it isn't a foregone conclusion. Whether we get a recession or not with this bear market hinges on if COVID-19 subsides with the normal flu/cold season in the coming weeks. If the virus recedes quickly, this bear market may be brief, we avoid recession and the subsequent market recovery will move us to new highs faster than almost anyone can envision. However, if COVID-19 lingers and corporate, government, and other institutional responses continue to disrupt economic activity beyond a few months, recession is certain. It is impossible for us to say how long or how bad that recession will be, but we'll continue to monitor and work on it.

The well-intentioned "social distancing" organizations are implementing today, including the canceling of professional sports seasons, major public events, travel bans and school closures, likely have little impact on the spread of COVID-19. There is already community spread in most states and countries. We simply can't lock everyone in their homes. Containment isn't possible. Those most susceptible to COVID-19—predominantly the elderly and those with preexisting health conditions—will still be affected, regardless of those decisions. However, the economic damage by halting all of that private business activity is real. Worse, there are unintended consequences. The knock on effects may endanger other lives. For example, because of school closures, doctors, nurses, emergency medical technicians, and others critical to public health and safety may have to leave work to take care of their children, rendering them unable to care for people who need their help—which probably has nothing to do with COVID-19.

The reality is, particularly with the extreme level of caution at the moment, it is far more likely the virus will pass through much of the world as fast or faster than happened in China, which appears to be getting back online and working again (a fact widely underreported in the major media at the moment). Paradoxically, the extreme cautions people are taking today will reduce the mortality rate caused by similarly transmitted, larger-volume infectious diseases—the Peltzman Effect. Yes, there will be some who are tragically impacted, but for the vast majority of the western and developed world, COVID-19 itself creates very little direct damage. It is the secondary effects resulting from institutions, corporations, and government decisions that are more troubling, will do greater economic harm and must be watched very closely from here. Worryingly, if it persists it also creates new untold laws of life.

Phone: 800-550-1071
Fax: 650-529-1436

It's ironic that, while corporations, governments and other institutions around the world induce unnecessary paranoia in containment efforts, they also are likely to far overshoot with stimulus designed to give them the appearance of riding to the rescue. That means a massive wave of liquidity and other mechanisms could hit the global economy in the near future and provide another tailwind. But those things won't all hit at once or immediately, and they don't much blunt the immediate impact of halting economic activity today. They take time. We've already seen some action from the European Central Bank and the US Federal Reserve—but a lot of that served to scare people more than provide re-assurance. In these situations, it is common for people to await a savior of some kind—be it central banks or governments. However, saviors have never been necessary for markets and economies to recover. We need a lack of the economic disruption that we have today, not a savior.

At this juncture, the duration of this downturn is more important than magnitude and is entirely dependent on if COVID-19 ebbs quickly or lingers longer. As we indicated in our earlier note, we think algorithmic trading has exacerbated the magnitude of volatility—making these moves all the scarier. Huge negative volatility feels never-ending while it is reverberating, and that could go on. But it will end. COVID-19 will eventually pass and with it, the mass disruption of economic activity. Such windows of time as these volatile weeks or even a few months more can matter little when you look ahead six months or a year. Steep, downward volatility doesn't last as long as it feels and the snapback feels impossible in the moment, but arrives and takes many by surprise with its speed.

As we've previously explained, steep drops and the ensuing rebound form a "V" shape on a chart. In our view, we've experienced the large part of the left side of the "V," and the snapback ahead forms the right side. Once you're fairly far down the left side of the "V," the recovery is not long after. The duration of the spread from one side of the bottom of the "V" to the other is very short. The dismal nadir of late 2008's fall and 2009's recovery that jumpstarted a new bull market was a classic "V"-shaped fall and snapback. As was Q4 2018 and the big 2019 thereafter. This period has been rougher and likely more frightening for many, but it can end similarly in our opinion. If COVID-19 goes away with the normal flu cycle—now just a few weeks from ending—it would be a very happy outcome for all. And that is possible. If that comes to pass, then current market volatility is much closer to the end than the beginning right now. There have been plenty of +20% market falls in history that have rebounded fast with little or no lasting economic damage.

Regardless of how the COVID-19 saga ends, there is a bright future nearby. The world is able and ready to adapt and prosper, as it was leading into this episode and will after. The period just ahead will be turbulent and repeatedly test even the strongest-willed. It's impossible to know whether this ends tomorrow, in a few days, or weeks, but it will pass and relatively soon. There will be recovery and a brighter day. The world will move on and faster than you may think. While the cause of all this is highly unusual, the market will do what it always does: move ahead of the economy and see the better future long before the headlines. This isn't the time to capitulate. Capturing the swift rebound—the right side of the "V"-shaped recovery—is crucial to getting where you want to go. That rebound is likely to arrive sooner than later. If you wait for confirmation of recovery or some "all clear" signal, you will miss it entirely.

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We know volatility is scary and, for many, COVID-19 is a very personal fear. As we wrote a week ago, the human cost of the coronavirus is undoubtedly tragic, but our responsibility as your investment adviser is to assess economic and market impacts and position portfolios relative to our forward-looking views. While we continue to monitor this situation carefully, please know that you and your loved-ones' well-being remains a foremost concern. Please reach out to your Investment Counselor if there is anything we can do to help.

We appreciate your continued trust and patience. As always, thank you for being valued clients.

The Investment Policy Committee

Aaron Anderson, Ken Fisher, Bill Glaser, Michael Hanson and Jeff Silk

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