Investment Committee Meeting Recap - 3/16/2020

The Investment Committee met on Monday afternoon to recap research activities and priorities, following an eventful day in the markets. Here is a meeting summary:

Investment Committee Meeting Recap

3/16/2020, 5:30pm ET

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On Monday afternoon, the Investment Committee met with an expanded attendee list, including members of the Investment Group, Investment Strategists, Wealth, and Asset/Liability teams. The meeting was convened to recap research activities and priorities following an eventful day in the markets. We appreciate the human/health impact and disruption of COVID-19; the comments below focus on the investment perspective.

Summary:

- Our immediate focus is on short-term funding markets (the "plumbing" of the financial system), as we evaluate signs of stress relative to aggressive policy action from the Fed. The Investment Group maintains a laser focus on the health of the funding markets. At this time, and in part thanks to the Fed's additional liquidity announced on Sunday, the plumbing is working. The Due Diligence team has sought updates and valuable perspective from our asset management partners (including short term fixed income and Stable Value managers).

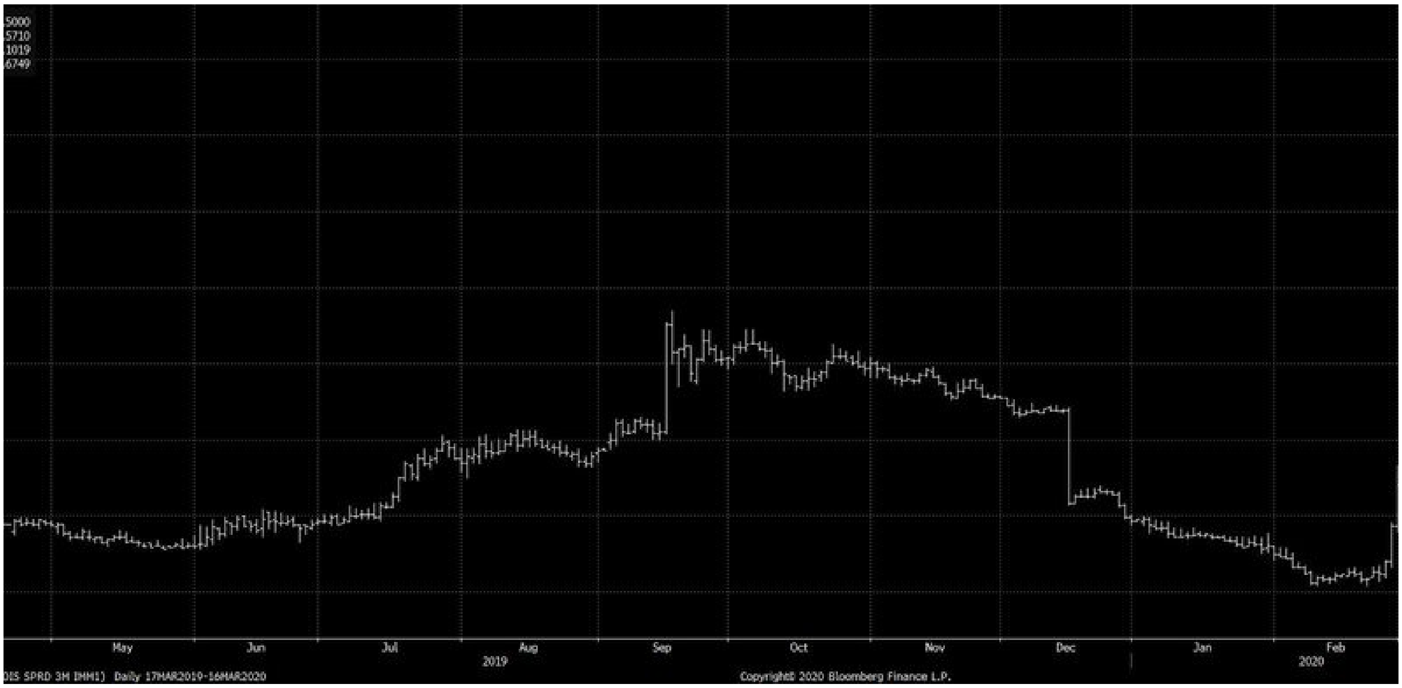
- With renewed confidence in the short-term funding market as a base, we will shift more attention to uncovering opportunities. Even as we plan for the worst, we will also plan for the best.

- Extreme volatility is a symptom of low liquidity. The U.S. banking system is in a strong position today, however regulatory changes intended to bolster bank strength following the financial crisis had the follow-on effect of reducing capital from the dealer side of banks. Investors headed to the exits found smaller doors.

- We may have not yet witnessed the end of liquidity-fueled volatility, or the worst of COVID-19 news flow. Much uncertainty remains. However, remember the advantage held by long term investors, as market dislocations create pockets of opportunity, and time-tested tools such as asset class diversification and portfolio rebalancing create mechanisms to capture this opportunity.

Discussion:

- We continue to examine short-term funding markets (e.g. repo's and Commercial Paper) for signs of stress. After demonstrating weakness late last week, the Fed's aggressive actions within the repo market and QE5 announcement appear to have restored relative calm through a massive injection of liquidity. The chart below illustrates this via the FRA/OIS spread (the rate difference between forward-rate agreements and overnight index swaps) which moved to its highest level in almost two years, before coming in after the Fed's aggressive action.



- While the repo market has benefitted from fast-acting Fed actions, there has not yet been action to support the Commercial Paper market. The Fed's Commercial Paper Funding Facility (initiated in 2008 and closed in 2010) would require collaboration between the Fed, Treasury and congress before action.

- Conversations today between the Due Diligence team and leading asset manager partners (e.g. Fidelity, PIMCO) affirm that the short-term market is functioning in an orderly fashion, although risks remain elevated in corporate credit.

- Similarly, for defined contribution clients, the Due Diligence team spent the day in conversations with our Stable Value Managers. This space appears to be healthy and functioning as expected, with strong Market/Book ratios and wrap providers providing capacity.

- As we become more comfortable with the nature of risks, we will shift more attention to uncovering opportunities due to dislocation across asset classes, whether credit, equities (size, sector and geography), and alternatives. Even as we plan for the worst, we will also plan for the best.

- Record-breaking volatility is a symptom of low liquidity. The U.S. banking system is in a strong position today, however regulatory changes intended to bolster bank strength following the financial crisis had the follow-on effect of reducing capital from the dealer side of banks. This reduced market depth and the ability of dealers to intermediate between buyers and sellers at extreme volumes. Investors headed to the exits found smaller doors. We are watching volumes closely for signs of stability, as investors get back on-sides with their risk positions.

- 2019's strong returns were driven by flows (investor appetite), with very little contribution from fundamentals. Today, the flows have reversed, exacerbated by "forced selling" by investors without a choice, in the face of a potent combination of fundamental shocks (abrupt slowdown in global demand, and an oil price war).

- We may have not yet witnessed the end of liquidity-fueled volatility, or the worst of COVID-19 news flow. Much uncertainty remains, including duration (will the virus continue into or return in the Fall?), and the severity of second-order impacts on businesses, employment, and wealth effects/sentiment.

- In contrast to "forced sellers," long-term investors maintain a structural advantage, as market dislocations create pockets of opportunity. And time-tested tools such as asset class diversification and portfolio rebalancing create mechanisms to capture this opportunity.

Please contact Sam Kirby or Christine Safarikas with any questions.