March 13, 2020

In this month's Insight, Nicholas Bohnsack discusses how volume and speed of information disseminated related to the virus and concomitant efforts to avoid it has created an acute economic shock with the potential to manifest into a crisis in its own right.

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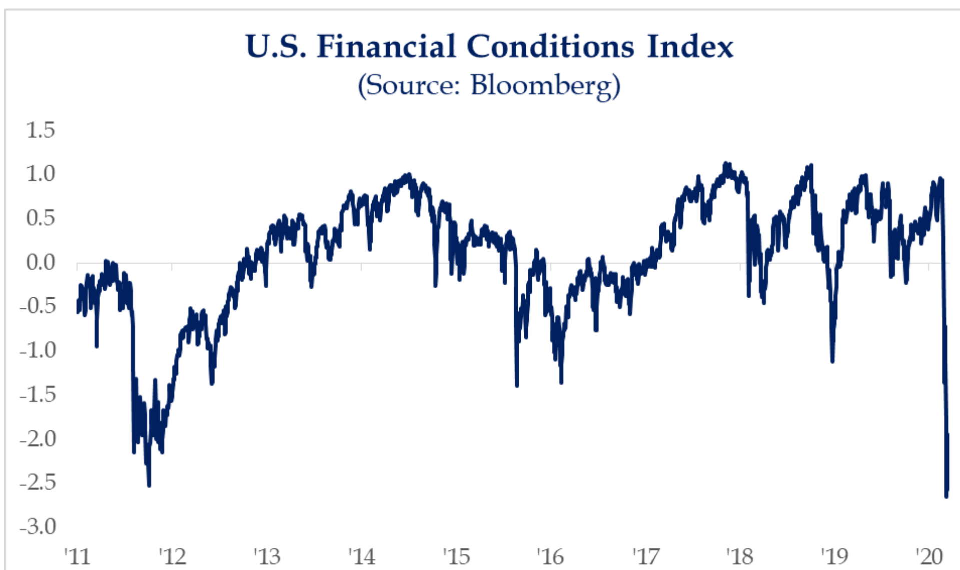
The Virus, Then the Cure…

The rapid spread of the novel coronavirus (Covid-19) has created an international health crisis. It is serious and it is tragic. Last month in this space, we postulated on the hopefully transient nature of its human health effects. Clearly, we undershot, but we would redouble our emphasis on the second point of discussion: the knock-on effects presented by the reaction to the virus. The volume and speed of information – and misinformation – disseminated related to the virus, and concomitant efforts to avoid it has created an acute economic shock with the potential to manifest into a crisis in its own right. Never in history have we evidenced the simultaneous quarantine of so many millions of people outside the envelope of war; whether mandated by the government, compelled by health professionals, or undertaken voluntarily, the stoppage of daily human activity – globally – has served to reduce economic activity to a subsistence crawl. It is only likely to get worse. Strategas has raised the probability of an economic recession in CY'20 from 20% to 45%.



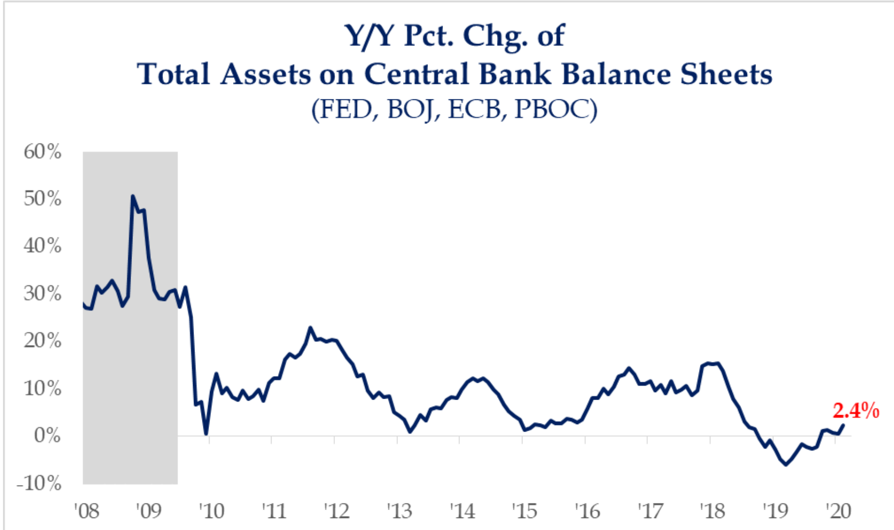
The title of our note last month was 'This Too Shall Pass,' and without being cavalier or dismissive of individual tragedy, the human health crisis certainly will. Perhaps longer than expected and certainly longer than hoped, but it will. What the health crisis has also revealed, however, are the threads of weakness and extreme woven into the global economy and bid into risk asset prices. Left alone, they likely would have been worked-out in turn. In the vacuum of an exogenous shock, they have all (or nearly all) come to a head at once. The effects of this will be evidenced well after the health-related impact of novel coronavirus begins to mercifully ebb. The sharp rally in safe-haven assets, particularly U.S. Treasuries, and the associated selloff in global equities confirms this. Whether this financial panic metathesizes to the order of magnitude of the global financial crisis – as has been suggested by the media – is irresponsible speculation, but waiting to see is a fool's errand. In periods of heightened uncertainty, we are compelled to return to first principles. With that in mind, we are inclined to navigate developments related to the novel coronavirus and economic shock with three qualifications in mind:

• We know what we don't know; the virological elements of coronavirus are well beyond our capacity to predict.
• While not always unconditionally supported among the political class, governments' generally offer proportional responses to exogenous events, and…
• …individuals will generally, though not universally, exercise an abundance of caution during periods of uncertainty.

Through this prism, we would offer five observations:

1. We have likely not seen the worst of the human impact from the spread of coronavirus. We anticipate the number of confirmed cases (and, sadly, the number of deaths) to grow in both volume and in geographic dispersion.
2. In the aggregate, 1H'20 economic and corporate data are likely to be disappointing. The equity market selloff reflects this shift in consensus.
3. Additional monetary policy accommodation – generally a demand-side salve – is unlikely to provide much assistance (i.e. within their mandate the Fed's response is proportional). The currency market suggests this remains balanced.
4. The increased size and urgency surrounding fiscal policy proposals are proportional but may lack in both their ultimate timeliness and Acura tends of target. Our clients remain skeletal whether something gets done at all. The bond and options markets are discounting this now.
5. Ironically, nationalist economic policies may help to both mitigate the longer-term fundamental drag an acute economic

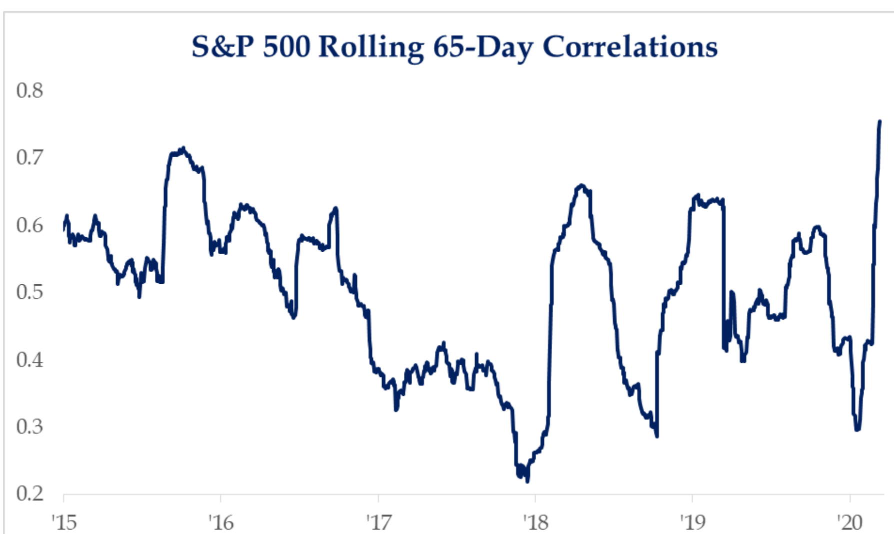
shock (softer growth, weaker profits) and support a sharp recovery when – and only when – the global consensus agrees that the health risk presented by the virus has abated.



From this vantage point, we believe investors should consider:

• That the building blocks remain in place for a late-cycle reacceleration inactivity, but…
• …the prospect of recession has risen considerably and without well-targeted fiscal stimulus and material increase of organic activity; thereafter, we fear the natural prosperities of economic gravity will manifest sooner than later.
• Given the sharpness of the decline in equity prices, we believe investors should reconsider the proposed merits of passive investing and consider the opportunities presented by high correlation drawdowns.

This too shall pass.



Strategas Recommended Asset Allocation (Mar'20)

	Equities	Bonds
Overweight	Dev AC Core EM AC Core	IG Corporates TIPS
Neutral	US LC Value US LC Core US LC Growth US MC Value US MC Core US MC Growth US SC Core	Agencies ABS/CMBS US Dollar EMD Local EMD High Yield Convertibles Bank Loans
Underweight		US MBS U.S. Treasuries

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