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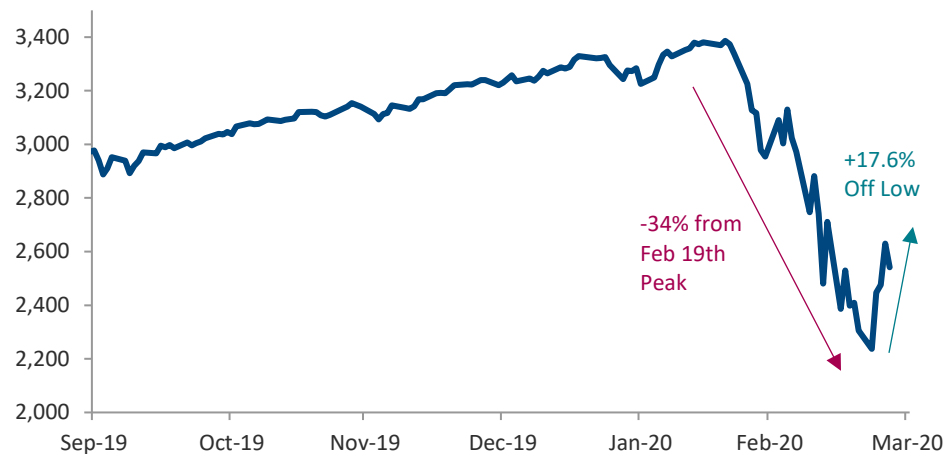
MARKET PERSPECTIVE *from the Investment Advisory Group*

The Path Forward After a Historic Market Period

What Happened

Stocks continue to move in dramatic fashion. The coronavirus shock led to investor panic and forced selling, taking the S&P 500 from a record high to a 34% decline in a little over a month's time. The selloff left the market extremely extended to the downside. And much like a rubber band that gets stretched too far, stocks snapped back with more than a 17% gain over three days, the sharpest rise since 1933.

S&P 500 Price



Source: SunTrust IAG, Factset

Our Take

Even in a bear market, there tend to be sharp countertrend moves after short-term selling pressure becomes exhausted. Selling exhaustion was evident when reviewing the broad action of market participants prior to the rally. Hedge funds and quantitative traders went from very high equity exposure to very low

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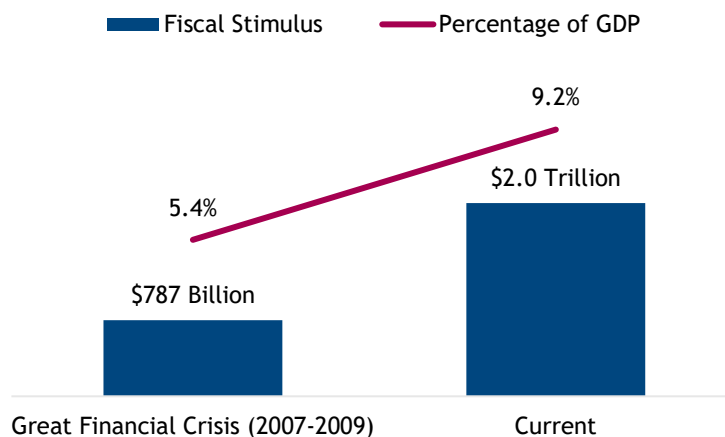


exposure. We saw the largest one-day outflow from mutual funds and exchange-traded funds in history on the Friday prior to the rally. Equity exposure of newsletter writers moved to the bottom 1% of historical readings, and the demand for downside market protection in the options market surged to a multi-year high.

Thus, as is common at extremes, when the majority of investors are leaning too far one way, the market often moves in the opposite direction. The unprecedented monetary and fiscal policy responses proved to be a catalyst for the rise in stocks. As recently discussed by our US macro strategist, the fiscal stimulus package passed by Congress is \$2.0 trillion or 9.2% of US gross domestic product (GDP). For context, the fiscal stimulus package for the Great Financial Crisis was \$787 billion, or 5.4% of GDP. Moreover, the Federal Reserve purchased \$700 billion worth of bonds after the announcement of its recent quantitative easing program; during the financial crisis, an equivalent amount of buying took about six months during the initial stages.

We are also seeing similarly aggressive and unprecedented fiscal and monetary action around the globe. Fiscal and monetary support cannot overcome a health crisis, but it can help blunt the market downside and alleviate concerns of a worst-case scenario.

Fiscal Stimulus Comparison



Source: SunTrust IAG, Bureau of Economic Analysis, Congressional Budget Office



Expectations Moving Forward: Lower, W, V-Shaped

It is impossible to say with certainty that last Monday was the final low of this bear market. History tells us that some of the sharpest short-term rallies often happen during bear markets; however, strong rallies are also common coming off of major market lows. We also know from history that the market's initial bottom often gets tested again or broken. Normally, we would place the probability of a retest of the market low somewhere around 70% to 80%. However, we think the odds of the market retesting last Monday's low are less than history would suggest, closer to 50/50.

For markets to make a new low from here, the data will likely need to come in worse relative to already depressed expectations. The market already knows that the economic data in the weeks and months ahead will be weak. The question is whether or not it will be worse than current expectations. A perfect example is last week's initial jobless claims data, which came in at a record high number—yet markets rallied on the day. The data was very weak, but investors were already braced for this bad news.

Also, the aggressive fiscal and monetary policy response underway is likely to take the worst-case scenario off the table. History also shows that markets tend to bottom about five months before the economy does. While acknowledging the potential for wider outcomes, our macro team's base case outlook is that the trough (though not back to full capacity) for the US economy will be around July or August of this year. Thus, stocks bottoming around the current time period or over the next month would be perfectly normal with historical trends.

Internal Low Likely Already Seen

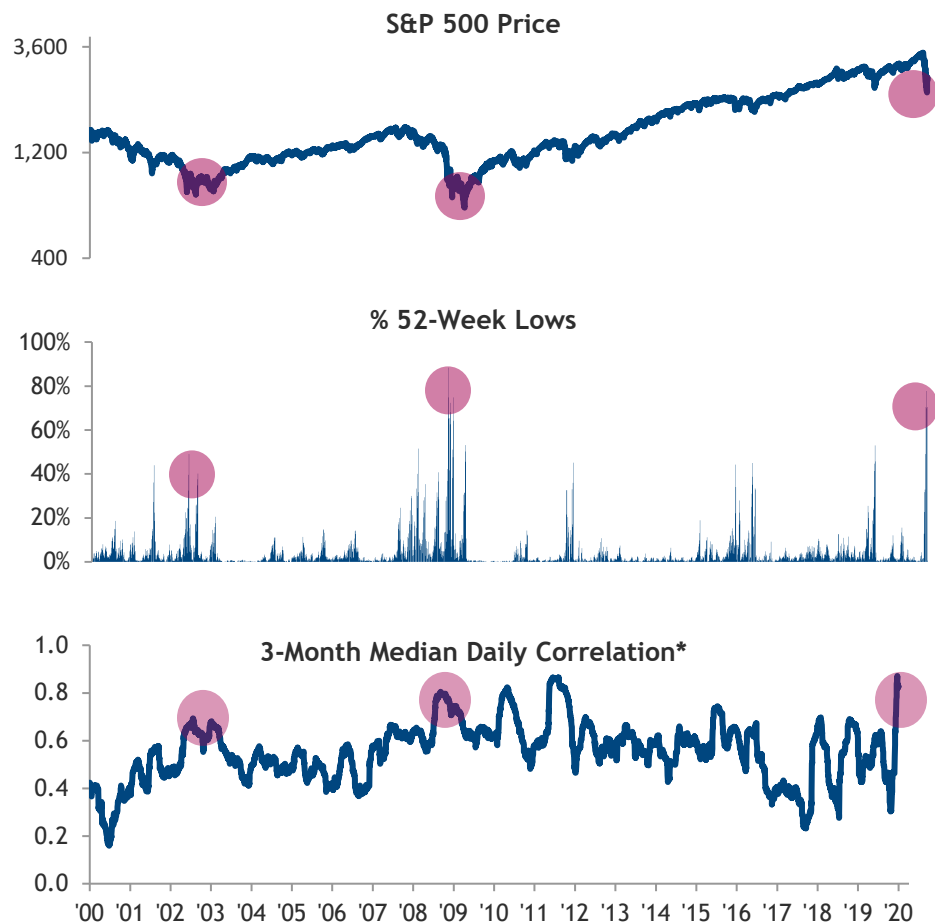
On a related note, there is a higher probability that the “internal” low of the market has already been seen. An internal low occurs when the intensity of the selling pressure as well as fear and indiscriminate selling reach a crescendo. While the overall market index may continue to decline, the movement of stocks within the index become less synchronized. Once the internal low is passed, there tends to be greater differentiation among stocks within the market. Investors start to separate the wheat from the chaff.

One way to measure an internal low is by reviewing the components within an index, such as the S&P 500, as opposed to the commonly followed index level itself.

On March 16, 78% of stocks within the S&P 500 made a 52-week low. This is the greatest amount since October 2008, during the depth of the financial crisis.



Recently, stocks were being sold off irrespective of individual company fundamentals. Similarly, the degree to which stocks within the S&P 500 were moving in the same direction, known as correlation, over a three-month period, moved to one of the highest readings in the past 30 years. This is indicative of panic selling or the old saying “throwing the baby out with the bathwater.” Following an internal low, many individual stocks will have already bottomed ahead of the overall market as investors sought out the winners and losers.



Source: SunTrust IAG, Factset; *a correlation of 1 indicates stocks are trading together in the same direction, while 0 indicates stocks are moving independently of each other.

As points of reference, following the bursting of the technology bubble, the internal low in the market occurred in July 2002. The final bottom for the S&P 500 at the index level was not reached until October of that year. Similarly, stocks hit their internal low in October 2008, not far after Warren Buffett



penned his famous New York Times Op-Ed: *Buy American. I Am*. While the S&P 500 did not see its final bottom until March 2009; there were plenty of good buying opportunities in individual stocks before that. In each of the periods after the internal low, there was a separation of winners and losers.

Also, though less common, there are instances such as December 2018 (which was not officially a bear market; however, that is semantics given markets were down 19.8%) where the internal low and the overall S&P 500 price low occur at the same time, and a V-shaped recovery takes hold.

Bottom Line

Last Monday we advised rebalancing portfolios, given how stretched to the downside the market had become and that a recession was already being priced into stocks. With the recent sharp move up in the market, we now advocate for a more gradual, averaging-in approach, using pullbacks to become more aggressive in deploying cash.

Volatility is set to remain elevated and dependent on the path of the coronavirus and its impact on economic activity. That said, we now expect more of a two-way market, as we move past the peak of indiscriminate selling.

Longer-term investors should not be waiting for an all clear or a bell to ring at the market bottom. The question is, will longer-term investors be rewarded at current levels? We believe the probabilities suggest the answer is yes. That said, for investors who contemplated selling at the recent low, now that the market has seen a rebound, this is a good time to revisit current asset allocations to ensure consistency with long-term goals and risk tolerance. Often after a shock period in the market, one's view of risk becomes crystallized.

From a positioning standpoint, we see a better risk/reward in US equities relative to most global markets given higher quality companies, favorable sector exposure, relative earnings strength and the stronger relative economic outlook. We also hold a large cap bias as these companies should be better able to navigate the environment given stronger balance sheets and profitability trends. We have a favorable bias toward the growth style, where technology is the largest sector. Although we could see a sharp cyclical snapback in value, growth is likely to show more sustained leadership given technology's more conservative and cash rich balance sheets, the increasing need of technology to conduct business, and the likelihood that investors will continue to pay a premium for growth in a subdued global economic growth environment.



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