PERFORMA

MARCH 2020 MARKET UPDATE

# MARKET PERSPECTIVE

INSIGHTS & REVIEW FROM PERFORMA'S INVESTMENT TEAM

## CORONAVIRUS UNCERTAINTY

When nothing else could derail risk markets, along comes the coronavirus (COVID-19). At this point, it is unclear what the ultimate human and economic impact of the virus will be, but downside risks abound. The market response has been to sell risk assets and buy the safety of U.S. Treasuries in a classic flight-to-quality trade. The S&P 500 is down -12.7% from the February 19th record close and is now down -8.27% for the year. Meanwhile, the yield on the 10-year U.S. Treasury fell 40 basis points to a new all-time low of 1.11% and is down 77 basis points for the year.

From a return perspective, investment grade bonds benefited nicely from the dramatic move lower with Treasuries[1] producing positive monthly and year-to-date returns of 2.65% and 5.16%, respectively. The broader Bloomberg Barclays Intermediate US Government/Credit Index returned 1.41% for the month and 2.85% year-to-date. There was no such silver lining for the equity markets as the selling was aggressive and broad-based. Meanwhile, the high yield bond market[2] was down slightly for the month (-1.54%) and year (-1.53%); it faired significantly better than equities thanks to the positive price appreciation from the move lower in interest rates in the broader risk off environment.

To us, the most amazing part of the recent equity market correction is not the magnitude or velocity of the price swings, but instead the instantaneous clamoring from market participants for additional Fed stimulus, emergency rate cuts, coordinated global easing and yes even another round of tax cuts from the Trump administration. What would they ask for if equity markets sold-off 20-30%? These types of reactions to a 12% market correction speaks to a much bigger issue in today's financial markets that we've been talking about for years. Namely, the markets' dependency on easy money. It's an issue. The Fed knows it, but they don't know what to do about it.

[1] BLOOMBERG BARCLAYS U.S. TREASURY INDEX; [2] BOA MERRILL LYNCH U.S. HIGH YIELD CASH PAY INDEX

To be sure, additional easing from the Federal Reserve is not going to solve the coronavirus outbreak. Additionally, they have been clear that monetary policy is on hold until there is a material reassessment to the economic outlook or inflation is significantly and persistently above their 2% target. To date, neither has happened. Of course, markets are forward-looking and pricing in the future negative impact of the coronavirus, thus asking for easing today. We do not envy the Fed's position. Trying to set monetary policy during a period of market turbulence, sparked by a novel virus that nobody knows a thing about, is challenging to say the least.

If the virus gets materially worse from here, the negative economic implications will be undeniable and unavoidable. The Fed would be forced to ease policy further, attempting to spur a stalling U.S. economy. However, if the Fed chooses to preemptively respond and the economic outcome turns out to be less dire, then their willingness to placate the markets will be on center stage. The Fed cannot afford to be reactionary at this moment. They can afford to be patient, evaluate the impact of the virus, digest incoming economic data and move when they must (rather than when the market tells them to). Of course, this path for policy would likely result in disappointment and another leg lower in equity markets and thus you can see the Fed's predicament. What the Fed should do and will do can be different things and sometimes for good reason. This might be exactly one of those situations.

We came into the year with a defensive stance, expecting the U.S. economy to muddle through 2020 and maintained the view that risks to growth remain skewed toward the downside. The coronavirus is clearly one such downside risk and we expect it to have a negative impact on corporate earnings. We're only 1/6th of the way through the year and we still have the democratic primaries, the next iteration of Brexit and the election to chew on.

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## ABOUT PERFORMA

Combining our extensive knowledge of the insurance industry with the institutional expertise of our investment team, Performa has been managing assets on behalf of captive and other insurance clients for more than 25 years. Our capabilities include asset allocation, active fixed income and equity management through diversified mutual funds and separate account portfolios. With offices in the world's largest captive domiciles, including Bermuda, Vermont and South Carolina, we are focused on delivering customized solutions to meet the unique investment objectives and liquidity requirements of our clients. We are 100% employee-owned and have $4.63 billion in captive assets under management and advisement as of January 31, 2020. Our investment philosophy is value driven and long-term in nature. Whether approaching asset allocation, fixed income or equities, our ability to be nimble, contrarian and decisive sets us apart from our peers and promotes capital preservation.

## CONTACT US


**Hamilton, Bermuda**
25 Church Street, 2nd Floor
Hamilton HM12, Bermuda

**Hugh Barit**
Chairman & CEO
(441) 295-6754
hbarit@performa.bm

**Megan Belvedere**
Client Service Associate
(441) 295-6754
mbelvedere@performa.bm

**Charleston, South Carolina**
960 Morrison Drive, Suite 200
Charleston, SC 29403

**David T. Kilborn, CFA**
CIO & President
(843) 297-4130
dkilborn@performausa.com

**Warren Miller**
U.S. Client Relationship Manager
(843) 952-7204
wmiller@performausa.com

**Burlington, Vermont**
60 Lake Street, Suite 1D
Burlington, VT 05401

**Sandi Prescott**
Head of Client Service
(802) 540-1791
sprescott@performausa.com

**John James**
Head of U.S. Business Development
(802) 540-1752
jjames@performausa.com