

A Note To Our Clients Regarding Recent Market Volatility

March 13, 2020

It's been an eventful week, and we're writing to provide an update on our thinking regarding developments in financial markets. Recent communications from our firm have been intended to keep clients updated on our business continuity and management strategies during the COVID-19 outbreak. Our goal in this note is to focus on the investment implications of recent developments in global financial markets.

While we remain cognizant that this is a healthcare crisis rather than a financial crisis and we remain in an evolving and highly fluid situation, we would like to point out three broad trends that have recently emerged in the financial markets:

- The price war that broke out between oil-producing countries last weekend is a significant negative development for US energy producers and for the US economy. The US is a service-based economy and a net exporter of energy these days, so a drop in energy prices is not the uniformly positive development that it once was.
- Credit and liquidity conditions have deteriorated noticeably. Between the potential for defaults by US energy producers and a sudden demand for cash from businesses with unexpected cash flow shortfalls, liquidity is in high demand at the moment. The bond market has actually declined slightly this week as everything except US Treasury bonds has been under pressure from forced liquidation.
- The elevated stock market valuations we cited as a risk factor in our 2020 market outlook may not have fully abated. Stocks have declined precipitously along with interest rates, but so have economic and profit expectations. While valuations are beginning to look enticing by some measures, we remain uncomfortable putting significant cash to work in risk assets at this time. Financial markets can be irrational on both the upside and the downside and we are not counting on valuation alone to provide a floor to the stock market.

When we consider these three trends along with the inherent uncertainty of the COVID-19 outbreak, we cannot help but remain cautious on the short-term outlook. There is no doubt the situation could get worse before it gets better. The duration and extent of this downturn hinges heavily on the ability of the federal government to provide a decisive short-term fiscal backstop for the people, businesses, and markets that have been interrupted by this crisis.

Finally, while we consider the onslaught of negative news flow this week, it is important to put financial market movements in context. The stock market remains above the lows of late 2018, and valuations of stocks and bonds outside the Treasury market are becoming increasingly attractive. We do not know exactly how or when this crisis will end, but we do know that it will end. Capturing the likely rebound in financial assets as the crisis does end will be impossible unless our clients remain invested. As a result, we remain tactically cautious, but with an eye towards the long-term investment opportunities that are developing. Our clients' portfolios remain biased towards high quality investments with lower equity exposure than normal. We believe we have made appropriate adjustments to our investment strategies to tackle the short-term challenges in front of us, while keeping client portfolios aligned with longer-term goals. As always, if you have questions or are re-evaluating those longer-term goals, please feel free to call us – we're here to help as we balance near-term risks against the potential long-term rewards increasingly available in today's markets.

The F.L.Putnam Investment Management and Advisory Team