Market Update from F.L.Putnam March 20, 2020

To counter the economic shock from the virus, the federal government is putting forth the most stimulative fiscal and monetary measures that this country has ever witnessed. Several actions by the President, Congress, and the Federal Reserve should temper the downside during this shut-down period. These actions include the Federal Reserve cutting the Fed Funds rate to zero to improve cost of funds and supporting the liquidity of the monetary system by establishing a commercial paper funding facility. The Fed has committed to significant quantitative easing measures in government bond markets, with hints that these may be extended to other parts of the bond market to support corporations and municipalities. Similar measures are also being pursued by the European Central Bank and other monetary bodies around the world.

As to fiscal policy measures, the President has pledged to continue to keep pushing more federal spending until the economy recovers. Programs being considered include providing funds to impacted businesses to support them during the shutdown period. Measures to directly send checks of $1,000 to $2,000 to individuals are also being considered to provide instant assistance to individuals and families (there may be income caps to determine eligibility). Bailout packages for the most severely impacted industries are also on the table, including airlines and the cruise industry. These dramatic measures show the deep commitment of the government to lessen the severity of the downturn and hopefully allow the nation to heal more quickly.

A major concern over the last two weeks in bond markets was deteriorating liquidity, with Treasury yields rising and prices moving lower along with riskier asset classes. Federal Reserve actions including purchases of Treasury and Agency bonds as well as reinstatement of liquidity facilities from a decade ago began to take effect by the end of the week, with yields falling and overall liquidity improving. A properly functioning bond market should help provide a solid point of reference for other asset classes, so recent actions should be seen as a positive for overall market functionality.

Despite some improvement in government bond market liquidity, the stock market as measured by the S&P500 declined 15%, the largest weekly drop since 2008. From the top just a few short weeks ago, the market is down 32% and is now extremely washed out from a technical standpoint. This technical setup is highly conducive to explosive rallies. For example, the number of stocks on the New York Stock Exchange making new 52-week highs as a percentage of total new highs and lows reached just 2% this week, a historically low level. In fact, it's only reached this level four times in the past 30 years. The last time it was reached was back in the fourth quarter of 2008, as markets were trying to find a bottom during the Great Financial Crisis. After the new high/new low ratio finally reversed up in January 2009, the Standard & Poor's index rallied almost 30%.

One hopeful sign in this week's action is that the market *did* seem to begin to differentiate between long-term winners and losers late in the week (rather than simply taking everything down monolithically). For the first time since the decline began, several large "market leaders" began to stabilize and even improve off the bottom. Microsoft, Wal-Mart and Amazon are good examples. While the broader stock market itself has yet to stabilize, the action this week suggests it may not be long before it does.

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As markets have gyrated in recent weeks, we have taken a number of actions. The most important has been the decision to slow our typical rebalancing and implementation processes to allow equity exposure to drift lower as markets declined. This is a tactical decision that we are constantly reevaluating, and we will resume rebalancing when we have more concrete evidence of market stabilization.

We also made some changes related to the deteriorating credit environment mentioned in prior notes. With increasing pressure on funding markets, we shifted clients into government money market funds, although this was quickly rendered moot as the Fed stepped in to backstop money market funds.

Credit market disruption has also created some interesting long-term investment opportunities. For example, we have increased our targeted allocation to Treasury Inflation Protected Securities (TIPS), which offer a slightly positive return over inflation in an environment where the nominal 5-year treasuries yield a paltry 0.50%. High quality tax-exempt municipal bonds also seem to be attractively priced, with AAA-rated bonds backed by dedicated essential revenues (such as water and sewer revenues) yields more than three times treasury yields (they normally yield closer to 80% of treasuries because of their tax exemption).

For clients investing in individual securities, municipal bonds are just one example of high-quality securities getting swept up in the market tumult. Many high-quality stocks are also declining along with their more vulnerable peers and we are making adjustments where we can identify opportunities to upgrade the quality of our holdings and improve portfolio risk and/or return potential.

Lastly, in an environment where uncertainty is extremely high, there is one action that we are confident will yield some benefit for our taxable clients: tax-loss harvesting. We are beginning the process of swapping securities for similar investments where tax losses are available for our individual clients, which will reduce capital gains taxes over time.

Our company's investment strategy has always been focused on making high quality investments on behalf of our clients. We have sought to make thoughtful allocations to grow and protect our client's assets through diversification across different markets. We have limited the size of an investment in any given company to reduce company specific risks and have worked to build portfolios aligned with the long-term goals and objectives of every one of our clients. We believe that has been the right approach and we will continue to operate this way as we go forward. In volatile market environments, the definition of quality changes very rapidly and in the upheaval caused by a rapid downturn virtually all investments perform in like fashion. However, once the panic begins to subside (we have seen signs that this is beginning to occur) there will be a clear opportunity to reposition portfolios and we have begun to do so. Our team will remain vigilant in its efforts to get each of you and each of us collectively through this incredibly difficult time.

F.L.Putnam Investment and Advisory Team