We hope that you and your families are safe and comfortable given our current circumstances. This is not easy, especially for restaurant workers and others affected by various government mandates. We know there has been a human toll from this and hope it will be limited in all aspects. We trust this will pass and our wonderful private health care companies and government agencies will quickly develop vaccines and therapeutics.

We all see news stories and statistics from multiple sources. The infection rate, mortality rate and the potential burden on the health care system are debated, modeled, and discussed, and there is surely a measure of mis-information flying around the internet. Nothing about the impact on the health of Americans or on our health care systems is knowable with 100% accuracy. We are starting to see some statistics that indicate the immediate economic impact of government-mandated shutdowns. Again, there are models, estimates and debates but it is not possible to predict the duration of the shutdowns or the long term impact on the economy with a high degree of certainty. What we do know is markets have continued to trade with higher volatility. Commodities, foreign currencies, bonds, and stocks have all experienced extreme moves in reaction to the shutting down of a large swath of our economy.

Because of the risk of rising long-term yields, are we not only staying with ultra-safe bonds, we are also maintaining a relatively short maturity schedule.

The bond market

has been over-valued for some time. Please refer to our March 16 commentary below for more detail on how various segments of the bond market have performed. Going forward there are two big picture issues. First is deteriorating credit quality. The universe of "investment grade" bonds is heavily populated within the lowest categories. Insurance companies, pension plans, individuals, and now the Federal Reserve own "a ton" of these and often thru an index fund that includes them all. We are starting to see an avalanche of downgrades. A normal week will have one or two downgrades and one or two upgrades. Last week there were 69 downgrades by Moody's bringing the year-to-date total to 180. Every single index fund, insurance company and many pension plans need to sell these bonds when they are downgraded below invest-ment grade. We are not sure what the Federal Reserve policy will be. Even though yields in many segments of the credit markets have spiked, we feel it is too early to take risks with bond portfolios. There is a high degree of uncertainty for future revenues and earnings of every bor-rower. That includes state and local governments and the federal government revenues.

Which leads to the second issue. How much more can the United States borrow and how much more can the Federal Reserve monetize before there is a significant negative impact on the purchasing power of the U.S. Dollar? We don't know the answer. Smaller countries without a reserve currency have major problems as in Argentina and Turkey. More developed countries like Japan have pushed the envelope for years without major dislocations. The Federal Reserve chairman Jerome Powel says: "our fiscal situation is unsustainable". This is a long-term issue that will not be resolved anytime soon. The first indication of developing problems will be a spike in government bond yields which we have not seen yet. Because of the risk of rising long-term yields, are we not only staying with ultra-safe bonds, we are also maintaining a relatively short maturity schedule.

The stock market
ran into the quarantine wall with lofty valuations and deteriorating earnings expectations. Please refer to our March 11 commentary below for details. The current situation is no better. Companies have "pulled guidance" meaning they are no longer comfortable offering forecasts on how they are going to do this year. Analysts are making "best guesses" but all forecasts today are much less confident. The stock market is flying blind given no highly-reliable anchor from earnings expectations. The fiscal stimulus from Washington falls into the "whatever it takes" realm and will have a stabilizing influence. However, we are unlikely to see confidence build in earnings expectations until there is good news on the health care front.

The popularity of indexing is working in reverse. In the rising market all companies were swept up regardless of their fundamentals. In this decline, even typically defensive sectors such as utilities, health care and real estate have been equally damaged.

Volatility
has been elevated and significant moves have occurred in record short periods of time. Consider the S&P 500 dropped 33.9% in just 24 days then gained 17.5% in a mere 4 days. We have referred to the large trading pools that quickly adjust equity exposure and tend to exacerbate market swings. One such group, the "risk parity" managers have collectively gone from 70% equity exposure to 20% over the last month. That group must be pretty well sold out. Their results have likely not matched up to expectations, and their trading could become less of a force in the markets in the future.

"We"
(the people of the United States) are in uncharted waters. However, "We" are the largest economy in the world; with unparalleled spirit, technologies, and entrepreneurial drive. We will join the rest of the world's great scientists in an attempt to defeat this pandemic. We will come through this and as Secretary of the Treasury, Steve Mnuchin recently said, "we will worry about the deficit later."

Your AAMA Team