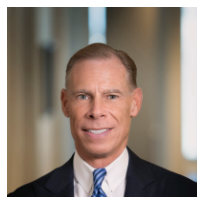


# MARKET LETTER

MARKET PERSPECTIVE



SECOND QUARTER 2020



## GIMME SHELTER

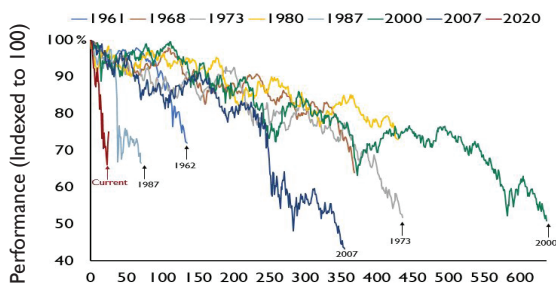
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First and foremost, we hope this finds you and yours well, and extend our concern and empathy to those whose health and livelihood have been jeopardized by the virus. Amid accelerating efforts to “flatten the curve” of COVID-19, financial market disruption has ensued, quickly erasing early-year gains and sending stocks from all-time highs into a bear market in just 16 trading days ... a bear market descent that is unprecedented in its velocity.

### The Most Rapid Decline in History Magnitude and Duration of Major S&P Declines



Trading Days from Peak to Trough

Source: Strategas

As reported U.S. infections have accelerated, policymakers have responded in scale. To ensure that a public health crisis does not turn into a *financial crisis*, the Fed has become the lender of last resort, resurrecting global financial crisis-era programs like zero interest rate policy, quantitative easing and liquidity support for money market mutual funds.

These and other measures are helping businesses reduce financing costs during a time of unprecedented demand shock, while also ensuring the integrity of the banking system and capital markets.

Fiscal policy is becoming increasingly hands-on as well. With passage of the \$2 trillion coronavirus stimulus bill, Americans will receive direct cash payments, federal loans and grants will be made to help impacted businesses finance their shutdown, and additional unemployment benefits to furloughed workers. For investors holding discounted stocks, the old adage applies — *investors stop panicking when central banks and governments start panicking*.

As importantly, we realize that the U.S. economy is being artificially repressed to combat the virus. When victory is achieved, we believe people will return to work, economic activity will rebound and stock prices will recover. Structurally, the U.S. economy is sound — we have a dynamic and mobile workforce, new technology to drive productivity gains and a free market adept at fostering innovation.

Bond valuations have become rich after offering effective ballast to investment portfolios, creating an overweight to fixed income. To rebalance accounts, we anticipate selling bonds and adding to stocks. With bearish sentiment and increasingly attractive equity valuations in place, the catalyst for implementation will be peaking infection rates. After all, we cannot control a black-swan event like coronavirus, but we can control our reaction to it.

Founded in 1975, Ferguson Wellman is a privately owned registered investment advisory firm, established in the Pacific Northwest. As of January 1, 2020, the firm manages over \$5.96 billion for more than 848 clients that include individuals and families; Taft-Hartley and corporate retirement plans; and endowments and foundations with portfolios of \$3 million or more. West Bearing Investments, a division of Ferguson Wellman, serves clients with assets starting at \$750,000.

INVESTMENT EXCELLENCE  
LIFELONG RELATIONSHIPS

Everything we hear is an opinion, not a fact. Everything we see is a perspective, not the truth. – Marcus Aurelius



## A NEWTONIAN PERFECT STORM

Dean Dordevic, Director  
Alternative Assets and Portfolio Management

*“There will be liquidity available, whatever we need to do, whatever the Fed needs to do, whatever Congress needs to do, we will provide liquidity and this will be an entire ... whole-of-government approach ...”*

- U.S. Treasury Secretary Steven Mnuchin<sup>1</sup>

As we moved into the middle part of February, the U.S. economy was humming along just beautifully. The stock market was making new all-time highs on an almost daily basis. The employment report had just come in with 273,000 newly created jobs, and the unemployment rate hit 3.5 percent, a 50-year low. The growth was across the board, with gains in the healthcare segment, restaurants, government and very robust gains in hiring for new construction. Wages were on the rise too, with average hourly earnings rising 3 percent over the past year. For the first time in history, there were *more jobs available than there were people looking for jobs*.

From the low reached on March 9, 2009 to the peak on February 19, 2020, the market had advanced nearly five-fold (with dividends) over 11 years. Yet it took the S&P 500 only 22 trading days to fall 35 percent from its record-high reached on February 19. This was the fastest drop of this order of magnitude in history. The second, third and fourth fastest pullbacks all occurred during the Great Depression-era from 1929 through 1934. The longest bull market ever, had come to an abrupt end.<sup>2</sup>

The reason of course, was the spread of the coronavirus. Rapidly circling the globe, it spans 171 countries at the time of this writing, and has been declared a pandemic by the World Health Organization. Disruptions in daily life have ricocheted around the globe. In a desperate effort to stop the spread of the virus, governments worldwide have acted aggressively to suppress economic activity.

As such, entire segments of the economy have ground to a complete halt. The result being an instant bear market followed by all-but-certain recession (two back-to-back quarters of negative GDP).

Since 1929, the S&P has suffered 14 bear markets, defined as peak-to-trough losses of 20 percent or more. That being said, bear markets result in declines of 39 percent on average, and last about 19 months. In 2020, this occurred in 16 trading sessions. If this one feels particularly bad, it's because it is. We've had a decline almost on a par with a typical full bear market cycle in just about ... *three weeks*.<sup>3</sup>

Over the last 25 years, there have been seven virus-related market episodes. While there were market dislocations during these episodes, none of these infections were as contagious as the current coronavirus. While the ebola outbreak in West Africa was more potentially problematic, it was contained quite quickly and a wider contagion was avoided. With this history as background, it's easy to see why governments globally were perhaps lulled into a state of relative complacency.

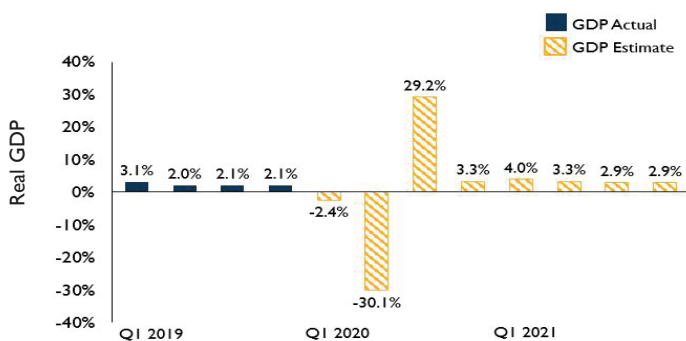
Recessions are usually organic affairs. That is, excesses accumulate in the system usually after a relatively long business cycle, and then, are often accompanied by a bursting bubble. But recessions provide an important function since they cleanse the system of excess, and most importantly, set the stage for an economic cycle to begin anew. The current cessation of economic activity we're experiencing doesn't meet that traditional standard, however. This since it's entirely ... *self-imposed*. Legendary investor Sir John Templeton once said that the four most dangerous words in investing are, “It's different this time.” So, when we choose to fly in the face of Sir John's sage words, we do so with an extraordinary degree of trepidation, since more often than not, he's been on the right side of history. That being said, it really is ... *different this time*.

It is perhaps due to the fact that the instruments being employed by our financial mandarins are so very blunt,

*Never let the future disturb you. You will meet it, if you have to, with the same weapons of reason which today arm you against the present. – Marcus Aurelius*

that we find ourselves drawn to *physics*, rather than *economics* for guidance. While the study of college physics is a distant memory, I do recall with some clarity Sir Isaac Newton’s third law of motion. Elegant in its simplicity it says that for every action, there is an equal and opposite reaction. Not unlike what one encounters when *loading a spring*. This is a near-perfect analogy for what’s transpiring in our global economic system at the moment. We are *choosing* to defer demand in a manner that is both massive in size and without precedent. Some of that foregone demand will, of course, be lost forever, but most of it will rapidly accumulate as *potential energy* (that is, future demand). Of this we have no doubt.

### For Every Action, There Is an Equal and Opposite Reaction



Source: Morgan Stanley

So it seems to us that with this in mind, there are three considerations of paramount consequence. First, we need to get from here to there. That is, we need every backstop imaginable to bridge the gap for folks that will be instantly unemployed and without a paycheck. Second, we need to make sure that the wheels of the financial system remain well-oiled and completely functional. To that end, and as of this writing, Congress has passed legislation that will provide the necessary temporary aid to make sure that those that are unemployed are not under

duress or cast adrift. This package will be in the trillions of dollars. So too, the Federal Reserve has pulled out all the stops and has “loaded their bazooka” and aimed it squarely at the financial system. With some tweaks, their playbook from the last financial crisis is now very much at play. They’ve done in *14 days* what took *14 months* during the financial crisis. The liquidity provided by the Fed will likely eclipse that of what was expended in 2008 and beyond. Without any doubt, government is doing *whatever it takes*.

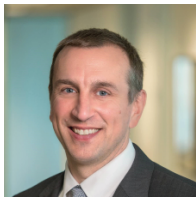
Last, and perhaps most important, the curves that map the rate of global contagion need to bend. This process has already begun in some countries, most notably China. We understand from speaking with managements of many U.S. companies in China (e.g., Apple, Adidas, Nike, Starbucks, Yum Brands, etc.) that while business is not entirely back to normal, it has indeed improved greatly and is nearly back to normal. As of this writing, Apple, for example, has reopened all of their 47 stores in China. This is good news since it would suggest that the rate of infections in the U.S. is somewhere between 8 and 12 weeks behind that of China. This would be a most welcome turn of events, and a critical catalyst in our view.

What makes this episode so uniquely bizarre, is that while we know for certain what the ultimate outcome will be, we do not know when it will occur. That is, we will all eventually go back to work, life will return to normal and the consequent rebound will be of epic proportions. While there is a reasonably long contemporary history of virus-related market events, there is no playbook for this one. What we do know is that at some point, investor pessimism will peak, valuations will trough and investors “animal spirits” will return. Investor sentiment will then quickly shift from the fear of *losing* out, to the fear of *missing* out.

Most importantly, stay safe, we will all get through this together.

#### Weapons of Reason Footnotes and Sources:

1. Jeff Cox, “Treasury Secretary Mnuchin Says White House and Congress Close to Getting a Coronavirus Bill Done,” *CNBC/Markets*, Friday, March 13, 2020.
2. Strategas Investment Partners, “Weekly Market Catechism,” March 23, 2020.
3. Jason Zweig, “We’ll Look Back on This and Lie,” *The Intelligent Investor*, *The Wall Street Journal*, March 22, 2020.

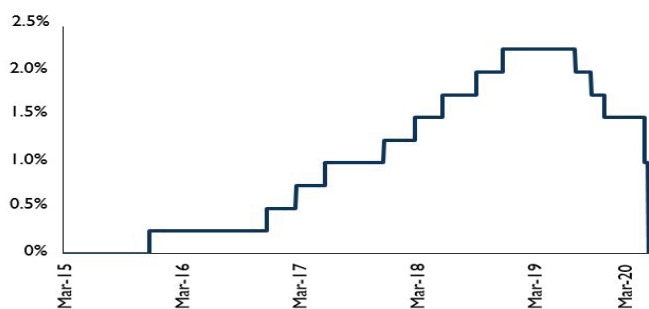


## THE EASINGS WILL CONTINUE UNTIL MORALE IMPROVES

Blaine Dickason, Vice President  
Trading and Fixed Income Portfolio Management

The Federal Reserve, along with other major central banks around the world, have taken swift action in the face of the slowdown and uncertainty due to the novel coronavirus (COVID-19). The unprecedented market disruption we've experienced in the latter half of the first quarter has been met by an equally unprecedented monetary response and stimulus. In just a two-week period in March, the Federal Reserve cut the federal funds rate by 1.50 percent to near zero and also announced an alphabet soup of backstops and repurchases (CPFF, QE, MMLF) in order to ensure the continued functioning of our financial markets. These measures, intended to ease financial conditions in the real economy, will go a great distance to ensuring that the economic rebound from the exogenous shock of COVID-19 is as strong as possible.

### Fed Funds Rate: Lower Bound

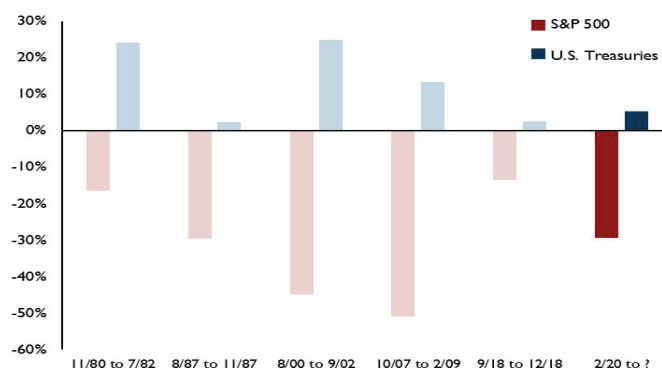


Source: Bloomberg

Policymakers have dusted off their playbooks from the great financial crisis to help inform their response to the current crisis. The primary challenge to reusing stimulus

programs from that period is their suitability for this new crisis. The one lesson that has been learned by the Federal Reserve is how important it is to be proactive and address areas of financial stress *before* they become more problematic. The current commercial paper, money market and short-term municipal bond backstops are excellent examples of critical areas of the financial "plumbing" the Fed has stepped in to defend so far. Whereas the great financial crisis was an example of market dysfunction that infected the real economy, today's stimulus efforts are intended to inoculate the financial markets and ensure their proper function to aid in our recovery.

### Treasuries Have Again Provided Portfolio "Insurance"



Source: Bloomberg

As of this writing, it has become clear that the monetary stimulus enacted to-date has been necessary and of sufficient speed and scale to staunch the coronavirus-related weakness. The Federal Reserve Act places legal limits on the extent of the response by our central bank, and therefore necessary for Congress and the U.S. Treasury to follow through with a well-designed and robust fiscal package to support our economy through this slowdown. It will need to address the short-term dislocations while also minimizing long-term distortions to market function so we can return to normalcy as soon as possible.

*Our logo features a bronze coin of Marcus Aurelius Antonius, Emperor of Rome from A.D. 161 to 180. According to historian Edward Gibbon, he was the only person in history in which "the happiness of a great people was the sole object of government." Marcus Aurelius was the author of meditations that reveal a mind of great humanity, natural humility and wisdom.*