February 2020 Monthly Market Update

Global stocks fell in January after sentiment turned negative late in the month, largely driven by fears over the rapidly spreading coronavirus. Broader developed market indexes were up 2.5%–3% through January 20 but fell more than 3% through the end of the month as the severity and growing number of cases gained traction in the media. Investors started worrying about the potential impact the virus could have on the economy, particularly in China. China makes up a growing share of the global economy, now more than 17% of global GDP in U.S. dollars, up from 3.4% just two decades ago. The S&P 500 was barely negative in the month, while European and emerging-market (EM) stocks fell 3.1% and 5.5%, respectively.

January Benchmark Returns			
	MTD	QTD	YTD
EQUITY BENCHMARKS			
Vanguard 500 Index	-0.1%	-0.1%	-0.1%
iShares Russell 1000 ETF	0.1%	0.1%	0.1%
iShares Russell 1000 Value ETF	-2.1%	-2.1%	-2.1%
iShares Russell 1000 Growth ETF	2.3%	2.3%	2.3%
iShares Russell 2000 ETF	-3.1%	-3.1%	-3.1%
Vanguard REIT	1.2%	1.2%	1.2%
iShares MSCI ACWI ETF	-1.4%	-1.4%	-1.4%
Vanguard FTSE Developed Markets ETF	-3.0%	-3.0%	-3.0%
Vanguard FTSE Europe ETF	-3.1%	-3.1%	-3.1%
Vanguard FTSE Emerging Markets ETF	-5.5%	-5.5%	-5.5%
FIXED-INCOME BENCHMARKS			
Vanguard Total Bond Market Index	2.1%	2.1%	2.1%
Vanguard Intermediate-Term Tax-Exempt	1.6%	1.6%	1.6%
iShares TIPS Bond ETF	2.1%	2.1%	2.1%
ICE BofA Merrill Lynch U.S. High Yield Cash Pay Index	0.0%	0.0%	0.0%
S&P/LSTA Leveraged Loan Index	0.6%	0.6%	0.6%
ALTERNATIVE BENCHMARKS			
HFRX Global Hedge Fund Index	0.4%	0.4%	0.4%
Bloomberg Commodity Index	-7.4%	-7.4%	-7.4%
SG Trend Index	0.9%	0.9%	0.9%
3-Month LIBOR	0.2%	0.2%	0.2%

The mounting fears led to positive gains for fixed-income markets. Interest rates in the United States dropped across much of the curve. Three-year U.S. Treasury rates fell nearly 30 basis points, while the 10-year rate dropped almost 40 bps. The U.S. Treasury curve inverted again during the last few sessions of the month—the 10-year rate closed the month lower than all shorter-term points on the curve. Lost in all the coronavirus news was an FOMC statement in late January where the Federal Reserve decided to maintain the federal funds rate at the same level (1.50%–1.75%). Market participants are expecting the Fed will continue to lower their target rate this year. At the end of January, the CME Group published a 90% probability of a rate cut by the December 2020 meeting, a 60% chance of two or more rate cuts, and zero probability of a rate hike this year. Falling rates resulted in a 2.1% gain for the U.S. core bond market, while the 7-10-year Treasury bond market returned 3.5%. U.S. high-yield bonds were flat in January and floating-rate loans were slightly positive (up 0.6%).

In our most recent conversations with portfolio managers and strategists, one of the comments we kept hearing is that the market is "priced to perfection." What that essentially translates to is that any positive expected outcome in the capital markets is already priced in - any negative or unforeseen surprise could force a sell-off. When looking at possible risks for 2020, the coronavirus was not one of them. Because of that, it has been a big talking point over the last few weeks.

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In speaking to, and reading commentary, from various investment teams, the sentiment is that while this is an economic shock, it should be short lived. One of the biggest reasons for the sell-off is worries about a slow-down in global growth, as China accounts for about one-third of the global economic growth, more than the combined share from the US, Europe, and Japan. The big driver of that growth is the Chinese consumer. With many staying home as a result of the virus, the growth in the manufacturing and retail sectors are going to slowdown, which would affect not only Emerging Market Equities but U.S. and European ones as well, as many of the multinational U.S. and European corporations derive a significant part of their revenues from China. Fortunately, the virus has been contained to only one province and has not spread as much as initially feared.

Given some time to process what has been going on, from an economic standpoint, the new coronavirus is unlikely to have a lasting, long-term effect on global economies. Economic growth bounced back (or was largely unaffected) from other global health emergencies (e.g., SARS, bird flu, swine flu, MERS, Ebola, and Zika virus to name a few recent cases). Even while China plays a bigger role in global growth than in previous decades, their government's response to control the coronavirus's spread has been much more extensive than in the past and therefore likely to have a bigger near-term negative economic impact.
In addition to business shutdowns, quarantines, and travel restrictions, the Chinese government is responding to current events with additional monetary stimulus—which we've seen have a positive effect on markets in recent years. The People's Bank of China has said it will inject upwards of $173 billion of liquidity into the markets and provide credit support to companies affected by the virus. Fiscal stimulus to support the Chinese economy is also likely, as happened during the SARS outbreak.

If the new coronavirus doesn't have a meaningful impact on the long-term economic prospects, further selling and cheaper prices would increase expected future returns and could result in an opportunity for investors with a long-term outlook. We'll continue to monitor the situation closely and have on-going conversations with our underlying portfolio managers to stay informed and on top of the subject.

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