GARDECAPITAL

FLASH REPORT

Navigating the Perfect Storm
March 2020

There is simply no other way to describe the events of the last month but *The Perfect Storm*. Since World War II, we have experienced 12 economic recessions, or about one every 6 years after 1945. In most of the downturns, with the exception of World War II, a large portion of the global population remained unaffected. Even in the Credit Crisis of 2008, plenty of people went to work every day unimpeded and carried on a normal life. In the "Corona Crisis" we are living in a whole new world. Every citizen of every country has had to rethink the way they do business, socialize with other people, and acquire the supplies necessary for daily living as the coronavirus has swept the globe. There has never been a truer maxim than "We Are all In This Together".

Extreme Volatility

For investors, these are difficult times indeed. The all-time high for the U.S. stock market came just a little over a month ago on February 19th. The S&P 500 index of large U.S. companies closed at 3,386 that day. On Friday March 20th, the S&P 500 closed at 2,305, a 31.9% decline from the peak. It seems that the world has changed virtually overnight.

The Chicago Board Options Exchange (CBOE) created an index to measure volatility in the S&P 500 called the VIX. We can use the VIX to get a gauge of market risk and investor sentiment. In times of stress, the VIX will show higher readings. On March 16th, the VIX closed at 84. Never in the history of the index have we seen a closing value that high. Our closest comparison was the Credit Crisis when the VIX got slightly over 80 at one point. Since 1990, aside from these two periods, we have rarely seen a reading above 45.

As in the Credit Crisis, in times of extreme uncertainty, we see assets flow out of almost every category that contains risk in search of any form of perceived safety. This has resulted in some surprises for many investors. Here are a few examples of the current disconnects in the market:

- While the U.S. large cap stock market has declined 31.6% during this period, small cap U.S. stocks have declined 41.6% from peak to trough.

- Many categories of bonds that in most situations would be considered a bastion of safety have been shunned in favor of cash and U.S. Treasury bonds.

- In a world where we thought Treasury bond yields could not go any lower, we have seen the 10-year Treasury bond yield move from 1.57% on February 19th to a low of approximately 0.5% at one point before settling closer to 1.0% as investors have been driving prices upward. Most other categories of bonds have seen price declines including high yield and investment grade corporate bonds, mortgage backed securities, and even municipal bonds.

- Due to the lack of liquidity in the municipal bond market, many municipal bonds have seen extreme deviations from the normal pricing patterns.

- Investors will also notice a deviation in bond fund performance relative to bond benchmarks as the benchmark indexes use a pricing approximation to measure value that often does not adjust in real time to market pricing.

Bear in mind that we often observe this sort of behavior during periods of extreme volatility, but larger than normal market moves coupled with the prospect of a virus that has been difficult to contain in most countries has caused many investors to feel once again that their fortunes and their futures are adrift without a paddle.

What Can We Control?

At moments like these, it is helpful to recall another time-tested maxim, "This Too Will Pass". During the Credit Crisis, the S&P 500 lost approximately 50% of its value over an 18-month period. Could we see that sort of market behavior or worse in this situation? Absolutely. At a minimum, we would expect the volatility to continue until we get more clarity on the prospect of reducing the spread of the virus.

Even if we are not selling into this panic, we have no control over what other investors are doing, and we don't know the near-term outcome. But we get through these periods by addressing the things that we have control over.

As many are hunkered down riding out the storm, there is a frenzy of entrepreneurial activity afoot. At this moment, there are millions of people around the globe working on new vaccines, sourcing materials to produce personal protective equipment for health care providers, and reengineering factories to produce ventilators and other necessary supplies. Many businesses are reinventing processes to work remotely that will make us even more productive when this storm clears. Unfortunately, there will be some lasting economic damage from this crisis that will take a long time to repair, but the human spirit is strong, and we will continue to see it on display as we move forward.

For investors, here are some things to focus on that we do have control over:

- Determine Near Term Cash Needs – It may be important for some investors to set aside a portion of funds that are necessary for spending within the next year and make sure that those funds are not exposed to capital markets.

- Review and Update the Financial Plan – Without a roadmap, there is no hope of getting to the destination (at least not on purpose). The financial plan helps establish clarity on risk and stress tests the portfolio for market situations like these.

- Maintain Balance in Your Portfolio – Getting comfortable with higher levels of volatility can be the biggest challenge for some investors. While being in cash sounds like a good thing at the moment, the low or non-existent rates of return on cash or fixed income instruments alone will not be enough to satisfy the long-term goals of most investors. Finding the right mix of stocks, bonds, and cash in the portfolio is extremely important.

- Rebalance and Tax Loss Harvest – The process of rebalancing and maintaining a target allocation has helped investors through all prior crises, and we don't expect this one to be any different. For taxable accounts, it is highly advisable to realize tax losses in portfolios which can offset current or future gains. As part of our portfolio management process, we do these all for you.

We are all in this together, and your Garde Capital team is here to help. One thing we know is that all investors are unique, and we have different needs and tolerances for risk. There is nothing more beneficial than having conversations in this environment to establish priorities and find solutions.

Most importantly, no matter what the long-term strategy, it is as critical as ever to remain healthy. Losing large amounts of sleep worrying about a portfolio is not a recipe for health and wellness. We are happy to discuss your situation any time so please feel free to reach out.

Hoping you and your families are staying safe and healthy!

Your Garde Capital Wealth Management Team

Acknowledgement: This article was published by Garde Capital, Inc, a Seattle based Registered Investment Advisor that provides wealth management solutions to individuals and families, nonprofit organizations, and corporate retirement plans.