Eagle Strategies LLC

The Eagle Edge

Quarterly

MARKET & ECONOMIC OUTLOOK

March | 2020

On the Radar Screen

1. **Fundamental data on which we typically focus has taken a distant back seat** to the effects of the COVID-19 pandemic and efforts to contain it, both in terms of public health policy and economic responses.
2. **It is difficult to envision a durable recovery** without a medical solution in sight. Of relevance are clinical trials of antiviral medications; progress on the development of a vaccine; wide availability of tests for both the virus itself and antibodies indicating acquired immunity; a better understanding of the transmissibility of the virus; measures of the effectiveness of different forms of social distancing; and clarity around when these measures can be gradually lifted.
3. **The pace of policy implementation** and early indications of its impact must be monitored closely. Credit spreads and rates in overnight lending markets provide a good read on the health of financial markets whereas new unemployment claims and forward earnings guidance will shed light on the extent of damage incurred by the real economy.
4. **How people and businesses feel about their current situation** and their expectations for the future will have a significant bearing on activity levels and market pricing. Watch surveys of sentiment.

Insights from Multi-Asset Solutions' Portfolio Managers

"There are decades when nothing happens; and there are weeks when decades happen." – Vladimir Lenin

"Now at this very moment, I knew that the United States was in the war, up to the neck and into the death. So, we had won after all!" - Winston Churchill. Remember when children did their learning in schools? And employees worked in office buildings? And investors bought the dip? Those were our halcyon days, mere memories for now. Welcome to the new age of the Coronavirus.

In the BC (before COVID-19) era, we applied ourselves to the understanding of economic trends, shifts in business activity, and the implications for capital markets. That feels a bit quaint at present. We've experienced a regime shift, and the econometric data currently available tells us little about the likely state of the world a few weeks from now. What matters most is the character of the pandemic and the responses to it. And the unfortunate truth of the matter is that we are all operating in a vacuum of useful data, at least insofar as the pathogen itself is concerned. Critical variables are as unknown to us as they are to the public at large: How comprehensive and rigorously enforced must social distancing measures be to suppress the spread? How long must they remain in place to be effective? When the time comes, will we see those restrictions rolled back in their entirety and economic activity revert to BC norms, or will they be only partially relaxed? We simply don't know.

Where we have far greater, although still imperfect, visibility is regarding the government's efforts to throw the economy a lifeline. The policy response has been nothing short of breathtaking. On the monetary front, the Fed has deployed its entire arsenal of war-fighting tools designed in the fog of the '08-'09 financial crisis; they've flooded global financial markets with dollar liquidity; they've put a floor under investment-grade credit via unlimited QE; and they've telegraphed much relaxed regulatory

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Insights from Multi-Asset Solutions' Portfolio Managers

oversight. The other shoe to drop came from Congress – a fiscal support package unprecedented in terms of size and scope. But will the full force of America's political institutions be enough to counter a near full stop by fiat in business activity?

What happens when an unstoppable force meets an immovable object? We are about to find out.

"Wait for that wisest of all counselors, Time." – Pericles. We've asked more questions here than offered declarative statements. That surely must be a Freudian reflection of our uncertainty as to where things might head next. Saying that extreme volatility is likely to persist is so obvious as to be trite – the sun will rise in the east, after all. Our sense is that, volatility is likely to be more pronounced to the downside than to the up. Even before COVID-19 entered the picture, the economy was subject to several pre-existing conditions that left it vulnerable to any number of potential crises. Excessive leverage and weak earnings trends were chief among our concerns. Speaking in early January, one member of the Multi Asset Solutions (MAS) team likened the prolonged economic expansion to an enfeebled, geriatric nursing home resident, vulnerable to catching a cold that develops into pneumonia. That was accidentally and eerily prescient. We certainly didn't have any reason to believe it would be a virus that would prove to be the catalyst of a recession, but we were concerned about the potential for economic trauma. Now it is upon us.

Leverage and earnings quality issues loom large. With revenues falling off a cliff for weeks, possibly months, many firms are looking at an existential crisis. The government is making a Herculean effort to come to the rescue, but they can't (and shouldn't) save every firm. The process by which we learn which businesses live to fight another day and which don't will be messy. We'd prefer to sit it out, to the extent we can. As such, we remain underweight both equities and speculative-grade credit; we favor large-cap stocks over equity in small and mid-size enterprises; and we maintain full or near-full duration within the investment-grade portion of our fixed-income holdings despite yields already being very low.

"There are old pilots, and there are bold pilots, but there are no old, bold pilots." – Arthur Williams. We have an active position in equities and credit relative to our benchmark, but we would be remiss not to point out that the size of those positions is quite small. When the market is volatile, swinging wildly, the penalty from being wrong is large. It is appropriate in such conditions to shrink positions toward your benchmark (strategic allocation). We've also become very attentive to drift in our portfolios, rebalancing with greater frequency than is typically required. Now is not the time to be a hero and swing for the fence...

About Risk

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Past performance is no guarantee of future results. An investment cannot be made in an index

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