The Merrill Perspectives Podcast

"Coronavirus and the Markets"

With

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[Music Open]

Candace Browning: While the rapid global spread of the coronavirus has created a huge amount of uncertainty and pain. One thing is clear. We are living in unprecedented times. Certainly unprecedented in our lifetimes.

Stock prices have fallen quickly and steeply and the volatility seems likely to continue for weeks or even longer. Businesses, jobs and supply chains around the globe are being disrupted. People's everyday lives are being disrupted as well, from schools to work to travel.

In response, the Federal Reserve has lowered interest rates to nearly zero to help the economy and calm financial markets. The administration declared a national state of emergency, and over one trillion dollars of stimulus has been announced, in various forms.

So how can and should people respond? What steps, if any, can they take from here in their financial lives?

[Theme Music]

Candace: Hello and welcome to this market edition of the *Merrill Perspectives* podcast. I'm Candace Browning, head of BofA Global Research. However, history ultimately views the effects on our lives caused by the coronavirus, 2020 will be a year to remember.

So what does all of this mean? Are there practical steps people should consider taking while continuing to focus on their long-term goals?

Joining me today to share their insights are Chris Hyzy, Chief Investment Officer for Merrill and Bank of America Private Bank.

Chris Hyzy: Hi Candace.

Candace: And Jared Woodard, head of the Research Investment Committee and director for Global Investment Strategy for BofA Global Research.

Jared Woodard: Hello, Candace.

Candace: Chris and Jared, let's start with the markets. What's your perspective on what actually happened over the last few weeks and how has it changed your outlook for things like economic growth and earnings?

Chris: Yeah, Candace, if you think about it, you've got a health crisis, a financial crisis that has unfolded and then potentially an economic crisis that could occur over the course of the next few months, perhaps longer.

Those three areas have very different timing elements to them and very different magnitudes and also elements of unknown. For instance, the health side of the equation is still very unknown. And the financial and economic side of the equation is taking cue from the health and this is where it gets very difficult to assess the overall level of growth, not to mention where corporate profits ultimately bottom out at. And then you have a reaction function to all of that as it relates to volatility in the financial markets.

So putting all that together, this perspective has changed significantly in the past few weeks. It went from how do we contain a virus that's unknown and how do we support the financial markets to now, how do we not only contain the virus, how do we actually create a greater cushion for the economy and something that lasts coming out of this.

Candace: Chris, you make a very good point, which is that the heart of this problem is a healthcare crisis. And in order to solve the financial crisis and economic crisis, you need to solve the healthcare crisis. So, Jared, what are some of your thoughts?

Jared: Well one way this has been unprecedented is the speed with which this health crisis has spread around the world and it has started to become an economic and a financial problem. You had what was a supply shock first and foremost of, you know, manufactured goods and so on and global trade being disrupted becoming quickly a demand shock in which workers and consumers having to stay home means there's no supply of labor with adults or no demand, you know, on the consumer side. And that has, has turned into a problem for businesses.

As a result these completely unrelated events have now started to affect everyday businesses that had absolutely nothing to do with global trade, with financial markets or, or with anything. And I think that's why we've seen the fastest bear market in history is simply because this crisis has suddenly started to affect everyone.

Candace: So Jared, you just published a report called The Rational Investor's Guide to Coronavirus. Can you talk a little bit about what you said in that report, particularly related to the risks that we're facing now as you see them, and what are some of your biggest concerns?

Jared: Well, I think there are three risks that are incredibly important right now that policymakers are trying to address. The first one is liquidity. You've seen incredible actions from the Federal Reserve. You mentioned earlier cutting interest rates to effectively zero. And we expect that to continue. The Fed’s trying to prevent the seize-up in markets from becoming something that that really becomes a financial crisis.

I think the second risk is on the corporate side. A lot of companies have issued a lot of bonds, a lot of debt, even small and medium firms. And when the economy suddenly stops and you know, revenues aren't flowing in, that doesn't mean that corporates don't have liabilities that they have to meet.

The third, the third risk is probably the biggest one of all, which is, which is the job market. We've seen data from various states around the country just this week about the incredible numbers of unemployment claims that are being filed as, as companies have to lay off workers. And I think that's the biggest risk of all that policymakers are trying to address. And so that's why you have Congress and the White House talking about providing income to households as fast as possible, tax cuts and other measures to try to help workers get through this period without defaulting on their debts or, or not having the resources that they need.

Candace: I think you're right about, that if this started as a health care crisis which we can work to solve and will get solved over time, what we really need to focus on is people not losing their jobs. If we can keep employment going, it will have very positive effects on both the economy and ultimately financial markets.

Jared: Policymakers are trying to hit pause on the financial system so that everyone doesn't default on obligations that aren't their fault. I think on the jobs front as well, if you do get liquidity out to households in a really timely way we can keep some economic activity going and keep people, you know, liquid long enough to get through this.

The real concern I think is with companies, especially small and medium sized firms who maybe don't transact with the financial system quite as much or don't have as deep relationships. And so I think the big challenge for policymakers is to come up with policies soon to help the smaller firms get over this period.

Candace: Let's switch gears a little bit here and dive into steps that investors can take to actually survive this. One of the most important questions that we hear from clients during times like this is why should I stay invested? Which seems to be a really sensible question.

I mean, it can seem very rational to pull out of the market when stocks are in a freefall and your 401k is going down every day and sometimes back up every day. So Jared, why isn't getting out of the market a rational response?

Jared: Well, I think the biggest reason is that in a period of uncertainty that uncertainty cuts both ways. And we know historically that some of the biggest gains and biggest rebounds, some of the biggest up days come after the biggest down days.

Since 1929, since the Great Depression, in the 24 months after a bear market, S&P 500 total returns have averaged 27%. And I think that's a compelling reason to look for upside in the future. The missing out argument, which I think is just as important, since the 1930s, if you missed the 10 best days of every decade, you made 91% in equities. If you didn't miss those days, if you held on, instead of 91%, your returns were more like 15,000% because of compounding and so on.

So there's really meaningful gains to be had by not getting out when all of your intuition and emotion tells you that you should. I think that most of us, most regular investors have as much upside uncertainty as downside here. And history, if it's any guide at all tells us that this is a moment to hold on more than anything else.

Candace: So Chris, I think that ties in really nicely with what I want to ask you about, which doesn't this all just really come back to knowing what your goals are, you know, as well as understanding your tolerance for risk? So if investors are panicking, is this a time for them to revisit or create a long-term roadmap that can help them get through the difficult times?

Chris: Yeah, I think you said it very well. From our perspective, goals based asset allocation starts with the objective one has over the long term and having a well-diversified portfolio based upon a rational risk and return expectations. And then as you build that portfolio to meet those long-term goals you build it on a basis of consistency over time, through some of the most difficult times, and then coming out of it. And we're seeing that unfold right now.

So we have three main messages going into what are the most painful and stressful times like we're witnessing right now and then coming out of it. Number one, diversification can show some of its greatest benefits in the most difficult times. Number two, having a disciplined plan with rebalancing episodes as capital market activity continues to unfold. And being methodical about it over time and through time, not at a point in time.

And then number three, reassess that plan consistently as capital market activity in the short term continues to unfold and help determine whether or not you're off goal or not. Those three things would be our message to investors, whether it's a individual, a family, a small institution or those just investing for the first time.

Candace: So, Chris, that all makes a lot of sense to me, particularly for people who are investing for the long term, but there's one group of investors that I'm particularly interested in your views on and those are investors who are already retired or are about to retire.

Should they be more concerned about the volatility and how should they be looking at their portfolios and acting in this period?

Chris: Yeah, for those about to go into retirement or already there in terms of their life cycle of investing, first and foremost given the lifestyle changes that are occurring before our eyes, it's important to access the needs. Number one, your expense needs, consumer spending that you currently undertake right now in your daily life and see whether or not your goals or objectives need to change.

And then the second step would be, is to examine your portfolio with an advisor and an advisor can help you work through the needed changes potentially in a portfolio that you need to make based upon any changes that you may have had to the initial step. And in some cases, this may mean you have to either increase risk a little bit on a calculated and a disciplined basis by shifting some of your fixed income, which is now at all-time record low yields, or at least it was a month ago and very close to that now.

So your income production coming out of what traditionally is an income production vehicle called fixed income has lessened substantially. So assess your ability to increase risk slightly in the equity side of the equation, perhaps through very high-quality dividend producing investments that will potentially help you increase that income over time.

And that gets me to the last point, which is that also needs to be a consistently reassessed as we work through this. So it's a fluid conversation, it's a fluid plan, it needs to be disciplined and in some cases an increase in risk to pick up extra total return that simply is not there in the asset class that once produced it.

Candace: And as Jared noted Chris, oftentimes, or I guess almost always after periods of volatility like this and even economic recessions, there are very strong returns in the equity markets.

Chris: Yes, and the one additional point that I point to, people try to find bottoms and there's this famous quote that nobody rings a bell and tells you it's a bottom. And so many people try to decipher when that is rather than understanding that investing is about over time and bottoming processes in markets take weeks if not months.

And as you assess the components of what builds a bottom coming out the other side as Jared noted is a portfolio that's designed to take advantage of what recovery that does unfold. And that's where some of the greatest returns can be accessed.

Candace: Okay. So, so Jared, what areas of the market actually look attractive to you at this time?

Jared: Well, Chris hit on a great point, which is the value of traditional fixed income investments today is in some ways the worst ever. I mean, Treasury bonds give you very little return. Even investment grade corporate bonds which I've seen some losses lately and yields have risen a bit, still historically don't look, you know, that compelling.

More importantly than all of that I think is the idea of a shift away from a traditional 60, 40 allocation where you rely on government bonds to generate income and equities for your upside. We think it's time of to think a little differently about that and to rely more on a more diverse set of assets than just those Treasuries and large-cap equities, both in order to hit income needs, but also to participate in growth upside.

Once we get through this crisis that out on the other side, you know, the policy mix is gonna look so different. When we think about the next five or 10 years, et cetera, that I think the traditional asset allocation model might serve investors really poorly. And this might be the perfect opportunity to start thinking about and having conversations about how to reposition for the future.

Candace: Well, we understand that we're in the middle of a crisis now and we are coming up with a lot of policy responses to that crisis and we ultimately will get through this. But my question is, are there going to be any long-term impacts on our habits and our lifestyle as a result of this?

Do you have any, Jared or Chris, preliminary thoughts on that?

Jared: I think the most important change is the change that we're already seeing within policy making. You know, there's been a lot of dry powder left, a lot of spare capacity kind of left unused by, especially Western governments, over the past decade or two in the United States. What you're seeing now, what's very encouraging is the realization that they can and should do more, much more. And this is bipartisan in the United States.

You're finally for the first time seeing in both the United States and in Europe to some extent in Japan, policymakers who otherwise were real opponents of this way of thinking, thinking more about how government and business can work to find a secure and stable ways to operate an economy in the future. And I think that's why it's such a fertile and exciting opportunity for a longer term investor to, to pay attention to how these shifts might happen.

Candace: Chris, do you have any thoughts on the long-term impacts?

Chris: When you think about what your question was in terms of how has potentially lifestyles changed or things like that, I look at it this way. There are new industries that are born during crises because the element of regular life tends to get upset, unsettled, and then new things are developed.

The strong companies can weather the storm and come out the other side and develop new things and the weaker companies generally have a tough time to do that. And then there are new companies and that's where venture capital comes in. And you mentioned the supply side. Clearly the supply chain disruption is something that is going to continue to unfold and will likely have to be dealt with, particularly in a dual supply chain world coming out of all this. One led by China, one led by the U.S.

And then you look at the health sciences market. Now they've always engineered technology with biology. But that is likely to converge in three ways that we haven't seen aggressive enough before, it's unfolding already, which is technology, computer science and biology together. And those three convergences is what potentially could create a stronger, much more robust health sciences a world.

Candace: My last question, what is the one key piece of advice you would leave our listeners with as the markets continue to be volatile over the next weeks and months ahead? And Jared, I'm going to start with you.

Jared: Maybe if I could give some non-market advice, which is just to take care of each other. I mean, what, what makes our economies valuable, makes them grow, is ultimately the people and the relationships among those people that that allows to work, you know, all together to produce things that are good, and panics happen, you know, from time to time.

There are lots of books written about market panics and financial crises. Very few people ever write about the people who, who work to be calm, you know, and the way that calmness and that discipline can actually spread in a really positive way. I think the more we have at that, even at the level of individuals, the better positioned we'll be to come out of this as soon as we possibly can.

Candace: Chris?

Chris: You know, Jared said it really well. I would add to it, I think at the outset because of the very serious health situation that's going on, it's important to step back, try to exhale and figure out what's most important in one's life.

And then on a financial side, it's important to, we say this a lot, but have a disciplined plan, have it ready and in times of stress, in times of market distress, like now, be ready to act on that plan as the capital market activity and volatility comes and goes.

At most fearful times generally has been one of the most important times to begin to reassess and invest back into the asset classes that have been harmed the most. And then as that plan unfolds, continue to reassess that with your advisor, so you can make sure that you are on goal or adjust when you're not.

Candace: On that note, we'll leave it there. Chris, Jared, thank you so much for your insights. I know we're all going to be very closely watching this situation over the coming weeks and months.

And thank all of you for listening to this market edition of the *Merrill Perspectives* podcast. My cohosts have been Chris Hyzy, Chief Investment Officer for Merrill and Bank of America Private Bank, and Jared Woodard, investment strategist with BofA Global Research. And I'm Candace Browning, head of BofA Global Research.

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