SILVERCREST
ASSET MANAGEMENT GROUP

NAVIGATING IN THE COVID-19 STORM

To make it through 350 continuous miles of running, prominent ultramarathon runner Dean Karnazes breaks it down to small goals: making 10 more feet, to the next tree, then the next mile, etc. Investing today requires a similarly patient and long-term approach.

Numerous, significant, economic and market dislocations have transpired at warp speed. Investors face three key challenges: economic disruption and stoppage, market liquidity, and balance sheet funding. The root cause is of course the COVID-19 virus. The responses of the Federal Reserve, policymakers, the healthcare system, and public-private partnerships have also unfolded rapidly.

ECONOMIC DOWNTURN

We expect a severe, but short-term, downturn in U.S. economic conditions. As we saw in today's unemployment report, the downturn will cause massive increases in unemployment and significant revenue shortfalls. The disruption won't be universal, but it will be meaningful enough to turn U.S. economic activity steeply negative. Former Fed Chair, Ben Bernanke, who served during the global financial crisis, described the current situation as akin to a natural disaster, with a short, sharp recession and a fairly quick rebound. We agree with his assessment. While the timeline is uncertain and scary, it appears to be a disruption measured in months.

MARKET LIQUIDITY

As the market reacted severely to the anticipated downturn, the stock market decline and increase in volatility unfolded at such a fast pace that it caused liquidity and trading issues even in deep, liquid portions of the markets. For example, some fixed income segments saw asset outflows in one week, equivalent to what took place over a period of months during the 2008 financial crisis. This prompted the Fed to react forcefully with plans of an historically large size. In addition to swift cuts in interest rates, the Fed established several initiatives, including:

- Revisions to bank capital buffers to encourage lending
- Commercial Paper Funding Facility ("CPFF") to support A1/P1 commercial paper
- Primary Dealer Credit Facility ("PDCF") term funding to support primary dealers
- Money Market Liquidity Fund ("MMLF") loans against an array of assets to support money market fund liquidity, which was expanded to include short-term municipal bonds
- Actions to ease swap funding for U.S. dollars with foreign counterparts

The details are vast and complex, yet the Fed response has been swift and forceful. The interventions are making a difference, in our opinion, there has been a sense of stabilization in the trading of financial instruments. The hard work and detailed observations by our internal and external fixed income teams, as they manage client portfolios, have greatly informed our assessment and our ability to navigate this crisis on behalf of clients.

BALANCE SHEET FUNDING

The government and banks, backed by the Fed, face a critical challenge to address the balance sheet needs of businesses losing revenue during the shutdown. While details are still emerging, the government appears poised to provide funding—directly and indirectly—to help businesses and individuals weather the storm. Areas of support include small business, disrupted industries, corporate tax benefits, loans and loan guarantees, increases in unemployment support and direct spending on healthcare. Broadly, we expect a $2 trillion stimulus package (the equivalent of 10% of GDP), with the overall figure even higher after taking into account lending backed by guarantees. It is "a wartime level of investment into our nation," as described by Senate Majority Leader Mitch McConnell.

LOOKING AHEAD

As for COVID-19, while we do not know when, the curve will bend. Our current assessment is that newly diagnosed cases in the epicenter of metro New York will begin to decline in early April, with a peak in total cases occurring in late April or early May. The rapid deployment of public-private partnerships aids that effort. These measures to accelerate the provision of supplies and testing will go a long way towards defeating COVID-19. We do know that significant events such as this pandemic cause behavioral and capital allocation changes over the intermediate to long term—changes that are often not obvious in the short term. Further, responses from the Fed and Congress will lead to varying outcomes for industries, businesses, and individuals. The $2 trillion in Congressional support, along with associated lending and changed consumer and business behavior and planning will flow through the economy in ways not yet fully known.

More than ever, this is a time for active management and fundamentally-driven security selection. Relying on active, individual security selection is a good first step toward navigating this storm. The quality of companies and the difference in their balance sheets, business models, revenue outlook, and flexibility creates a wide range of risks and opportunities. On a daily basis, we hear both equity and bond managers (internal and external) discuss specific and compelling price and valuation divergences on a scale not seen in years. That represents an enormous opportunity for patient investors.

We will see significant declines in economic activity ahead, but this will turn, as we are seeing in the short-cycle data from China. As events unfold, maintaining a balanced portfolio and an ongoing awareness of risk tolerance will enable careful tailoring to client-specific objectives. Navigating the path ahead requires and rewards reliance on fundamental analysis and active management, a tailored approach to rebalancing, and patience for a reasonable time frame while taking it one step at a time.

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