MARKETS IN TURMOIL

CORONAVIRUS, THE FED AND WHERE MARKETS GO FROM HERE

PGIM




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KEY TAKEAWAYS

- **The coronavirus outbreak, and a surprise 50-basis-point rate cut from the US Federal Reserve, have fueled market volatility and uncertainty.**
- **Despite this, a recession is not a foregone conclusion. If it happens, it's likely to be short in duration.**
- **PGIM experts believe that thoughtfully rebalancing portfolios during this period can capture value.**

"The coronavirus poses evolving risks to economic activity."

It was that relatively mundane statement that accompanied Tuesday's anything-but-mundane announcement from the Federal Reserve that it was slashing the fed funds rate by 50 basis points.

In a string of ongoing surprises surrounding the increasingly ubiquitous virus, the Fed's decision may have been the biggest to date. At least in its timing. It was further evidence that the unrelenting spread of the coronavirus has the world reeling and has left investors grappling with market volatility not seen since the global financial crisis more than a decade ago.

Not surprisingly, investors have many questions surrounding the rate cut and the impact of the virus on global economies and on financial markets. In light of that, PGIM, the $1.3 trillion asset management arm of Prudential Financial, Inc. (as of 12/31/2019), held a call on March 3 to address those concerns and offer guidance on what may influence markets going forward. The call was hosted by Cameron Lochhead, the global head of PGIM's Institutional Relationship Group, and featured senior investment professionals from three of PGIM's autonomous businesses: Ed Campbell, Managing Director and a Portfolio Manager at QMA, Mike Collins, Managing Director and Senior Portfolio Manager at PGIM Fixed Income, and Warren Koontz, Managing Director and Head of Value Equity at Jennison.

Of course, no one knows with certainty how the coronavirus will progress, and the fate of global markets is similarly unknown. But the panelists, all of whom have experience through multiple business cycles, agreed that keeping a long-term perspective is vital as the uncertainty surrounding COVID-19 plays out.

"We build our portfolios one stock at a time, from the bottom up, so this creates an opportunity for us," said Koontz. "We've been handed the chance to find stocks that are down 10% or more from where they were just a few days ago, so we've been asking our analysts to present ideas now that can give us a wonderful investment over the long term."

Campbell agreed, despite the fact that the recent elevated levels of volatility seen in global markets is not likely to fade anytime soon.

"Last year was generally a tranquil year, so this all feels jarring by comparison," he said. "But we've seen similar spikes in volatility during this long bull run – the fourth quarter of 2018 was one of them. We're going to see the push and pull of the virus – the impact of the outbreak itself and the tools policy makers are using to combat it – which will likely create a lot of ups and downs."

> *"When you have these volatility events if you simply wait for things to settle down, equity and credit markets tend to perform well."*

Speaking of those tools, the timing of the Fed's move speaks to the unusual nature of the outbreak and the turbulence it has caused in recent weeks; it was the first inter-meeting cut by the Fed since the global financial crisis, and it was coordinated with other rate cuts and stimulus from central banks around the world. It also came just two weeks before a regularly scheduled meeting of the Federal Open Market Committee on March 17 and 18.

"The Fed effectively had six rate cuts left that it could have made, and they just did two of them," Collins noted. "Given the big snapback in the markets on Monday, March 2, I thought they might give it a little more time to see it play out over the next two weeks, so this is unusual. But there's definitely a coordinated global effort underway with central banks to provide stimulus, whether with rate cuts or quantitative easing."

The economy may take a hit … but this isn't 2008

One of the biggest questions on the minds of investors is whether or not the fallout from the coronavirus will lead to a global recession. Indeed, recent data out of China suggest that country's manufacturing and services sectors are in contraction, and the full impact of efforts to contain the virus are not yet reflected in global economic numbers. Of paramount importance to the health of the worldwide economy is how long it takes for the outbreak to be contained.

"We came into the year calling for U.S. gross domestic product growth of 2%, and we are sticking with that for now," Collins said. "We may see first-half growth close to 1% and second-half growth closer to 3%. But this is very different from 2008, when it was difficult to predict how the credit crisis would play out. Current volatility may continue until the contagion stops escalating. Today, we have more confidence that these sharp market selloffs are buying opportunities, certainly in the credit markets. Credit spreads have widened, but the moves have not been unusual, they are just coming off tight levels, which makes it seem more extreme."

Campbell doesn't discount the chance of a recession, but believes that, should one arise, it's likely to be short-lived.

"It's certainly not a foregone conclusion that we get a recession, but in the space of several weeks we've gone from economists predicting a minor impact on the economy to a recession being around the corner," he said. "The Fed has moved decisively so the policy response is encouraging. And we know, eventually, the virus fears will peak. So I think any recession would probably have a V-shaped recovery. Remember, in 2018 markets were pricing in a high probability of recession, which did not come to pass, and we saw a 20% drawdown on the S&P 500. We may not be there yet but this is going to create buying opportunities."

More specifically, Koontz says valuations among money-center banks remain very attractive, even in the face of Fed rate cuts, saying they're generally better capitalized than at any time during his three-decade career.

"You will see volatility in these names but the big banks have invested heavily in technology. They've also brought down the number of bank branches, and they're more efficient," he said. "They're starting to return capital in terms of buybacks and increased dividends, and they continue to gain share relative to non-money-center banks. I don't see that going away anytime soon."

In fixed income, Collins pointed out that he and his team, on a weekly basis, score each global market sector on a zero-to-10 basis. While Collins has become somewhat more cautious in the near term, the long-term scores have actually improved.

"Considering all of the easing and liquidity injections from global central banks, including both developed and emerging market central banks, we believe emerging markets debt is a relatively attractive part of the global fixed income marketplace right now. Even with a mild global recession, we believe all the stimulus in the pipeline could lead to outperformance in higher-beta credit sectors, and I'd put emerging markets right in there."

Don't try to call the bottom

In April of 2018, PGIM's Institutional Advisory & Solutions Group published a paper examining how stocks and bonds perform before, during and after major volatility events. Based on the findings, investors would be well-served by staying the course through the current volatility. The panel believes that's likely to hold true through this bout of uncertainty.

> *"You don't need to call the bottom here, but if you intelligently rebalance your portfolio you can capture a lot of value that way."*

"When you have these volatility events if you simply wait for things to settle down, equity and credit markets tend to perform well, even better than before the volatility spike," Campbell said. "You don't need to call the bottom here, but if you intelligently rebalance your portfolio once the dust settles, you can capture a lot of value that way."

A replay of the call can he heard at pgim.com/marketevents

留意事項

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