COVID-19 UPDATE
Bear Markets & Recovery Periods

April, 2020

The COVID-19 pandemic of 2020 has been unprecedented for everyone and brought challenges, such as "social distancing" that most of us thought was not possible in the world we live in today. We continue to be faced with uncertainty about the duration and severity of the health crisis and its impact on the global economy. At the start of the year, the U.S. economy was at a 50-year low unemployment rate and still experiencing the longest tenured GDP expansion in its history. An abrupt shutdown of economic activity in early March to contain the spread of the coronavirus resulted in record high market volatility and a significant surge in unemployment claims. For example, the average daily move in the U.S. markets was 5%, volatility not experienced since the Great Depression era. Volatility will persist as long as containment measures remain in place and there is more clarity around the medical picture of the new virus. Economic and corporate earnings data released over the coming months will rapidly deteriorate, which is a deep contrast to projections made at the beginning of the year. Historically, most bear markets have started gradually, pricing in increasing evidence of general economic imbalances or because we are approaching the end of a market cycle. This time, it only took 20 trading days for stocks to reach bear market territory, defined as a drop of more than 20% from the most recent equity market peak, making it one of the fastest developing bear markets in history.

Not all bear markets are created equal, there are three different types: secular, cyclical and event-driven. Secular or structural bear markets stem from long-term growing economic imbalances such as the buildup in household debt during the Great Financial Crisis of 2008. Cyclical bear markets typically are associated with the late stages of an economic cycle, where interest rates increase to a point that it restricts consumer spending and corporate profits fall, ultimately hurting investor sentiment. Event-driven bear markets, which is what we are experiencing today, are driven by an exogenous shock such as war, an oil price shock, or technical dislocation. No previous event-driven bear market has been caused by a global pandemic outbreak so there are no comparisons that we can draw from the past. The circumstances and speed under which this bear market started certainly are unique, but recessions and bear markets are a normal part of investing. Bear markets tend to be a temporary phenomenon and markets have shown resilience over the long term. It's important to look at history to help guide us through these periods of uncertainty.

Since 1929, there have been 10 bear markets with average losses of about 39%. Bear markets have generally appeared every 6 years, but they are shorter in duration than bull markets. 9 of them were associated with a recession which is defined as two consecutive quarters of negative GDP growth. Most importantly, even though the severity of bear markets has varied, stocks have generally recovered with the strongest returns taking place in the early months of the rebound. Black Monday in October of 1987 was marked by the biggest daily loss in U.S. stock market history, and the Global Financial Crisis of 2008-09 was the deepest since the Great Depression of 1929. In both instances, markets demonstrated an ability to recover from the negative news and the 1, 3- and 5- year subsequent returns were positive. The long-term rewards to investors that have endured the short-term pain have been significant. The chart below shows the 5 biggest market declines and subsequent five-year period returns.

		9/7/29-6/1/32	3/6/37-4/28/42	1/11/73-10/3/74	3/24/00-10/9/02	10/9/07-3/9/09	Average
	Decline	-86.22%	-60.01%	-48.20%	-49.15%	-56.78%	
S&P 500 12-month returns† after low	1st yr.	137.60%	64.26%	44.43%	36.16%	72.29%	70.95%
	2nd yr.	0.52	8.96	25.99	9.91	18.08	12.69
	3rd yr.	6.42	31.08	-2.86	8.51	6.10	9.85
23 Positive periods	4th yr.	56.68	32.19	11.79	15.11	15.74	26.30
2 Negative periods	5th yr.	16.52	-19.89	12.82	18.06	23.65	10.23
	Five-year average annual total return	35.93	19.96	17.39	17.15	25.30	**23.15**
	Value of a $10,000 investment in the S&P 500 at the end of the five-year period	$46,401	$24,841	$22,293	$22,067	$30,890	$28,322

Source: American Funds

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Emotionally, sudden bouts of volatility can be unsettling, however they are part of a well-functioning market. Behavioral finance tells us that it is in our human nature to feel the pain of loss twice as much as the benefit of a gain, which is defined as loss aversion. Therefore, the general advice when faced with an emergency in any aspect of our lives is to remain calm and not react emotionally. This also applies to retirement planning. Responding to these turbulent times by abandoning long-term plans can have adverse financial consequences. It is difficult to time the markets and investors usually miss out on the largest upward movement that take place off the bottom of market declines. If the participant's current financial situation allows, maintaining discipline during these periods can be key to achieving long-term retirement goals.

The concerns around the health crisis and the tragic human cost associated with the pandemic is not to be discounted, and the consequences of our economic system being shut down are being felt by millions of Americans, especially those working in service-related industries. Close to 22 million unemployment claims have been filed just over the last few weeks and the unemployment rate is expected to soar to 10% or higher. The current health crisis has shifted priorities for many employees who are now faced with making extremely tough financial decisions, possibly because they or a family member may have been diagnosed with COVID-19, or their financial situation might have adversely been impacted due to a loss of job, lack of child care or reduced income. Employees in this situation who may have no emergency savings, are taking advantage of the penalty free withdrawals from their retirement savings based on the CARES Act provisions. Additionally, some of the hardest hit employers experiencing a reduction in workforce are considering making temporary plan design changes that were originally put in place to encourage higher savings. Depending on the level of impact that the health crisis is having on your business operations, we can work along with your recordkeeping partners to help you develop a communications strategy in light of the current situation and the recent market volatility. Timely messaging and continuing participant education efforts during this time are important to help employees navigate through these periods of uncertainty.

As we have discussed during our regular investment review meetings, offering a wide range of asset classes with varying risk and return profiles is key to providing diversification for participants. Shifts in market leadership usually take place during bear markets and although we do not recommend making changes to asset classes in the lineup based on these market dislocations, it is a best practice to evaluate your investment offerings based on investment styles and market capitalization in the equity markets, exposure to active vs. passive investments, and participant's level of investment knowledge. For example, emerging markets tend to perform worse than developed markets during market downturns, value tends to outperform growth, and large cap stocks hold up better than small caps. Although some of these factors haven't played out year to date, having gaps in certain asset classes can impact overall investment performance over the long term. Additionally, active managers tend to have flexibility compared to passive managers and depending on their investment mandate, may provide better downside protection during volatile periods. It is important to consider both management styles depending on the asset class. As part of our service model, we revisit these conversations annually by conducting asset class benchmarking and evaluating gaps and redundancies in the investment lineup.

As your dedicated investment advisor, we will continue to follow the monitoring guidelines set in your IPS document and notify you of any material changes regarding the investments in your plan during our regular retirement plan oversight reviews. We are regularly communicating with the asset managers and are actively assessing any changes occurring in their respective portfolios in light of this volatility. If there are significant shifts from their original mandate or concerns with any other qualitative factors that our Research Team monitors, those changes will be presented by your dedicated investment consultant during the retirement plan oversight meetings. Following a prudent process for making investment decisions and documenting those decisions are important fiduciary responsibilities and apply under any market conditions.

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