First Quarter 2020 – Investment Commentary

WEST SHORE BANK

Overview

Unprecedented. Unchartered. Uncertainty. These are some of the adjectives used to describe the impact of the coronavirus (Covid-19) in the second half of this quarter on our communities, our way of life, the economy, the markets, and the government's mitigation response.

This year started where last year left off with an economy growing at a modest albeit slowing pace, a historically strong labor market, high consumer and business confidence, and stock markets frequently reaching new all-time highs on the prospect of a rebound in corporate earnings growth.

With stock markets having already priced in expected renewed earnings growth, fundamental valuations were stretched and trading well above their historical averages. Any perceived hiccup that could potentially slow the economy or earnings growth would likely put downward price pressure on stock markets. Well, that hiccup reared its viral head in late January and took hold of the markets on February 20th sending stock markets sharply lower for the remainder of the quarter and bond yields to all-time lows as investors flocked to the safety of treasury bonds.

As the quarter ended, stock markets posted their best weekly gain in some 80 years as investors anticipated the passage of the CARES Act helping to lessen the blow of the market's plunge. Despite the rally, stock markets closed sharply lower for the quarter although investment grade bond markets may have helped to somewhat cushion the blow for those in diversified portfolios.

Table 1 – Index Total Returns – Period Ending March 31, 2020

Equity	1-Month	3-Month	YTD	1-Year	3-Year	5-Year	10-Year
NASDAQ	-10.03	-13.95	-13.95	0.70	10.39	10.70	13.67
S&P 500	-12.35	-19.60	-19.60	-6.98	5.10	6.73	10.53
Dow Jones Industrial	-13.62	-22.73	-22.73	-13.38	4.42	6.86	10.00
MSCI Developed	-13.35	-22.83	-22.83	-14.38	-1.82	-0.62	2.72
MSCI Emerging	-15.40	-23.60	-23.60	-17.69	-1.62	-0.37	0.68
S&P 400	-20.25	-29.70	-29.70	-22.51	-4.09	0.56	7.88
Russell 2000	-21.73	-30.61	-30.61	-23.99	-4.64	-0.25	6.90
Fixed Income	**1-Month**	**3-Month**	**YTD**	**1-Year**	**3-Year**	**5-Year**	**10-Year**
Barclays Aggregate	-0.59	3.15	3.15	8.93	4.82	3.36	3.88
Barclays Inter Gov't/Credit	-0.44	2.40	2.40	6.88	3.79	2.76	3.14
Barclays Municipal	-3.63	-0.63	-0.63	3.85	3.96	3.19	4.15
Barclays High Yield	-11.46	-12.68	-12.68	-6.94	0.77	2.78	5.64

Unprecedented

Remember, it wasn't that long ago the China trade deal was signed, the impeachment trial of President Trump concluded, Joe Biden's presidential bid was miraculously salvaged, and one could easily get their hair cut or highlighted.

During the period of late-January to mid-February, even though the total number of people affected by this virus was assumed relatively low at the time, the reported spread of this virus globally heightened investor angst. Stock market volatility rose slightly during this period as investors struggled to assess the true extent of impact Covid-19 would have on the global economy. The S&P 500 hit an all-time closing high on February 19th at 3,386.15 and then fears associated with Covid-19 escalated quickly gripping the nation and the world.

The swiftness and severity of impact on the markets from Covid-19 and the actions taken by federal and state officials to mitigate the spread of Covid-19 is unprecedented. From February 20th to the end of March, stock and bond markets set many records and closed a couple as well:

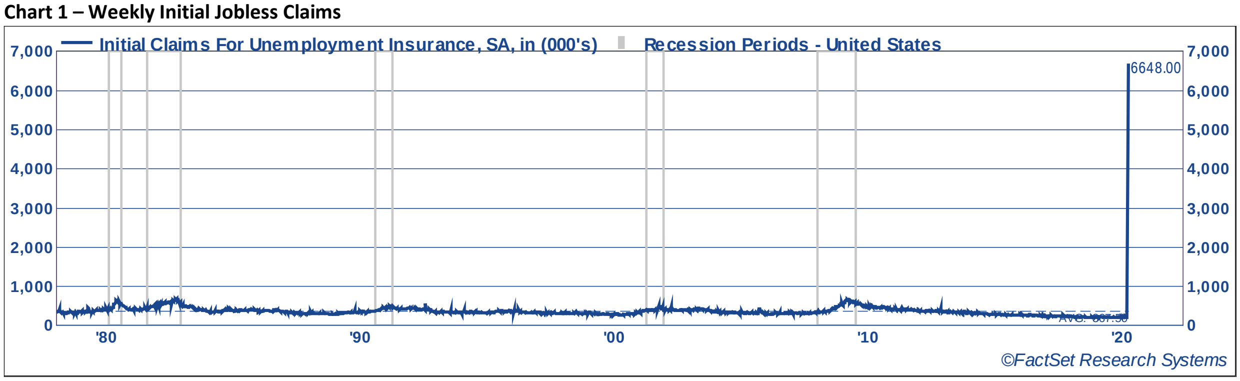
- Fastest S&P 500 market correction in history – a price decline of >10% in six trading days
- Fastest S&P 500 bear market in history – a price decline of >20% in sixteen trading days
- End of the longest bull markets in history for the S&P 500 and DOW which started in March 2009
- Largest single daily $ point gain(s) in history for the S&P 500 (7) and DOW (6)
- Largest single daily $ point decline(s) in history for the S&P 500 (5) and DOW (6)
- VIX Volatility Index set an all-time high closing of 82.69 on March 16th besting 80.74 in Nov 2008
- On March 9th, it was the first time in history the entire Treasury bond yield curve closed below 1.0%
- On March 9th, lowest closing 10-year (0.50%) and 30-year (0.92%) treasury bond yields in history
- Worst quarterly oil price percentage decline in history declining -66%
- The level of excitement in finding and buying a package of toilet paper reached all-time highs

Unchartered

Typically, an economy moves into a recession over a period of time with economic data gyrating between weakening good and increasingly bad data trends. Voluntary and involuntary confinement actions taken at the federal, state and local levels to combat the spread of Covid-19 has sent the economy into unchartered territory. It is akin to turning off the water supply to an otherwise healthy economic garden. The longer the water supply is shut off, the more the economy withers, and the harder it will be for regeneration.

To give some historical perspective on the magnitude these government actions have taken on the economy, look no further than the weekly jobless claims chart to get the first glimpse of coming ugly data. In the past two weeks industries, factories, and businesses shut down, and almost ten million people have lost their jobs.

Chart 1 – Weekly Initial Jobless Claims



Reviewing the five previous recessions since 1980, which includes Stagflation, 9/11, and the Great Recession, the prior record for weekly jobless claims was 695,000 back in October 1982. For the weeks ending March 21st and March 29th, 3.3 million and 6.7 million have filed for unemployment insurance respectively. This pushes the U.S. unemployment rate into the 10% range which will likely move higher from here. Hopefully, many of these job losses prove to be temporary as the economy bounces back later this year.

The weekly claims chart illustrates the coming profound contraction in economic activity. Additionally, the fluidity of the Covid-19 virus along with prolonged confinement mandates has served to raise level of uncertainty and rendered the exercise of economic forecasting most difficult.

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Uncertainty

Economists have been frequently slashing 2020 second-quarter and full-year GDP estimates over the past few weeks. Revised GDP forecasts are all over the board with second-quarter GDP declines ranging from -10% to -40% and full-year GDP downward revisions ranging from -2% to -10%. From these wide-ranging forecasts, it is obvious the severity and duration of this contraction remains unknown and this uncertainty has hammered capital markets.

In response to the expected severe slowdown in economic activity, the Federal Reserve took aggressive actions to thwart a lengthy recession and maintain adequate credit market liquidity. The Fed lowered the target rate range to 0.0% - 0.25% from 1.0% - 1.25%, and instituted a quantitative easing program whereby they will begin purchasing $700 billion of treasury ($500 billion) and MBS ($200 billion) bonds. The Fed has also temporarily eased capital requirements on banks to encourage lending and implemented several mechanisms used during the financial crisis including TALF, MMLF and CPFF.

In addition to the Fed, Congress passed the Coronavirus Aid, Relief and Economic Security Act (CARES) unleashing an unprecedented $2.2 trillion economic relief and stabilization package. This wide-reaching act provides rebates to individual taxpayers, temporarily expands unemployment insurance coverage, offers loan support to small businesses and corporations, and enhances support to the health care industry in the battle against the virus, listing just a few of the many support mechanisms in the CARES Act. Make no mistake, this is an economic stabilization act and not a stimulus act, and given the extension of the social distancing mandate to April 30, the likelihood of an additional support package(s) is rising.

Just as the longest bull markets in history came to an end a couple of weeks ago, the longest U.S. economic growth run in history will come to an end later this year. With the majority of states instituting shelter-in-place orders, and the rest of America in voluntary lock down via social distancing, the economy is "plummeting-in-place". The longer these orders remain in place, the greater the severity of economic impact, and the slower the road to economic recovery.

This is not the first time, nor will it be the last, the nation and Michigan will face difficult challenges. While the severity and duration of Covid-19, and the speed and depth of an economic recovery remains in question, the resolve, will, perseverance and resilience of the American people is not in question. As is always the case, we will adapt and emerge from this crisis stronger than ever. Stay safe, stay healthy, and all the best to you and your family.

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Sources: FactSet, U.S. Department of Labor, Federal Reserve and U.S. Congress