First Hawaiian Bank
MARKET UPDATE

March 25, 2020

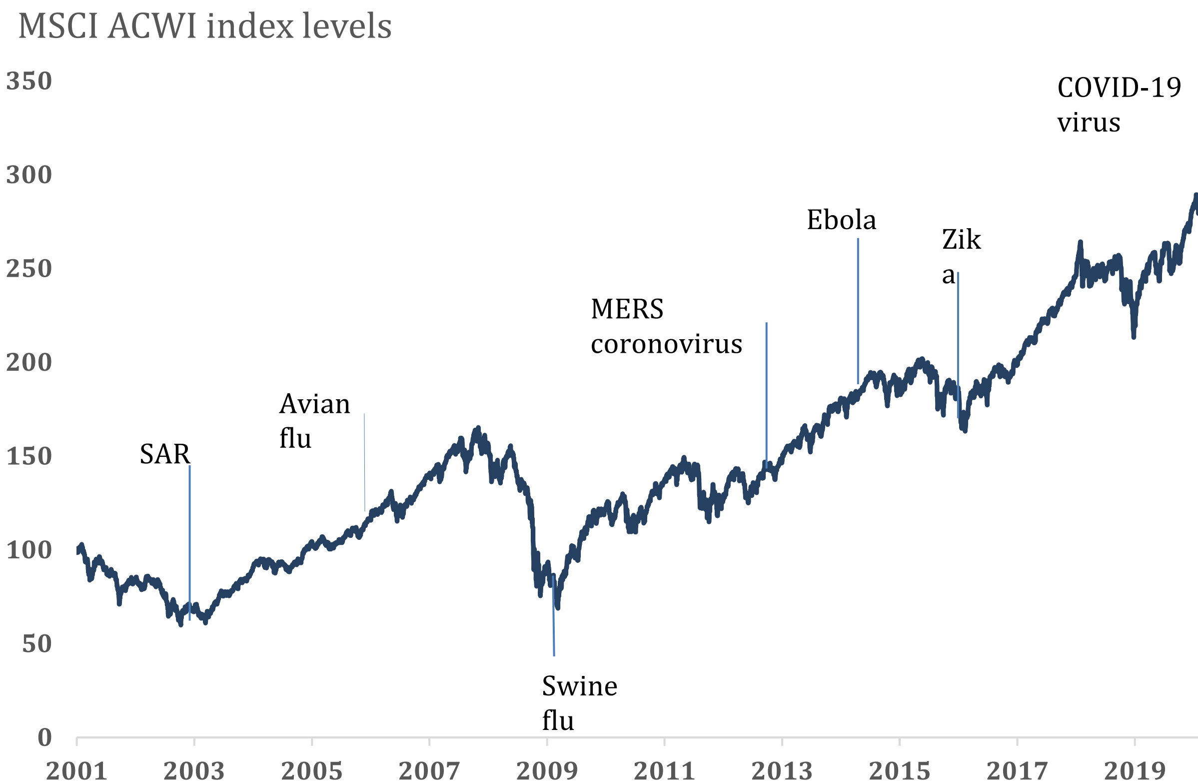
KEY POINTS

- The COVID-19 public health crisis is metastasizing into an economic and financial crisis that has pushed stocks deep into bear-market territory.
- Aggressive monetary and fiscal stimulus are hopeful signs, but in our view any stock market recovery will be fragile until we see a peak in new U.S. coronavirus cases.
- Although there is a great deal of near-term uncertainty, we encourage investors to look through the volatility, maintain a long-term perspective, and stick to a disciplined investment strategy.
- There is no reliable way to identify a market bottom, and investors who sit on the sidelines risk losing out on periods of meaningful price appreciation that follow downturns.

The COVID-19 public health crisis is metastasizing into an economic and financial crisis that has pushed stocks deep into bear-market territory. Today the S&P 500 Index is down about 27% from the recent peak, albeit up 11% from the two days ago, when stocks were back to levels last seen in the Obama administration. Investors have flooded into safe-haven assets such as U.S. Treasury bonds, driving yields to record lows. At the same time, stresses are becoming evident in parts of the bond market, such as mortgaged-backed securities (MBS), municipal bonds, and corporate bonds, as investors gauge the impact of the now inevitable sharp decline in economic activity.

However, among the deluge of frightening news that seems to grow by the hour, there are some hopeful signs. The Fed, having already cut short-term interest rates to near zero, is being very aggressive in providing support to businesses and financial markets, including through large-scale bond purchases. Monetary policy can set the stage for growth once employees can return to work and normal consumption behavior resumes, but can do little to help the sharp decline in economic activity that is occurring right now. Importantly, Federal lawmakers are releasing a very substantial fiscal stimulus package totaling, it appears, about two trillion dollars, much of it designed to have almost immediate impact. The market's euphoric reaction to the bill over the past two days is a huge collective sigh of relief that Capitol Hill is delivering the fiscal measures so necessary to blunt the effects of the unfolding economic slowdown. Necessary, but not sufficient. For at root, this is a public health emergency—it is difficult to imagine returning to any sort of economic normalcy while the spread of COVID-19 continues to accelerate. In our view, any stock market recovery (such as that seen over the past two days), will be fragile until we see a peak in new U.S. coronavirus cases. A best-case scenario would be a peak in the next few weeks, as near lock-down conditions slow the outbreak in New York, California, and other hotspots. It seems more likely, however, that U.S. new case numbers will continue to rise for longer, if only because of relatively slow implementation of widespread testing for the virus. But we cannot rule out a more dire scenario, which would incorporate continued outbreaks with associated disruption to normal daily life until after a vaccine is developed and deployed sometime next year.

So, the outlook remains highly uncertain. However, rather than argue that the worst is behind us, or that the market is panicked and irrational, we want to put the current decline into historical context and provide recommendations for navigating periods of extreme market volatility.



Take a Long-Term Perspective

Market downturns are a frequent and inevitable part of investing. Since 1927, the S&P 500 has experienced thirty-four corrections of between 10-20% and twenty bear markets with declines of greater than 20%. Since 1950, bear markets have occurred about every six years. Although past performance cannot guarantee future returns, every previous downturn has been followed sooner or later by recovery and new market highs. Each bear market is gut wrenching at the time, but looked at from a broader historical context, appear as mere blips in a general pattern of exponential growth. The great long-term returns of the stock market (e.g., up 85X between 1980 and 2019) incorporate every one of these pullbacks.

Standard & Poor's 500 Index Downturns (1950-2019)

Size of decline	-5% or more	-10% or more	-15% or more	-20% or more
Average frequency*	About three times per year	About once per year	About once every four years	About once every six years
Average length+	43 days	112 days	262 days	401 days
Last occurance	August 2019	December 2018	December 2018	December 2018

* Assumes 50% recovery of lost value

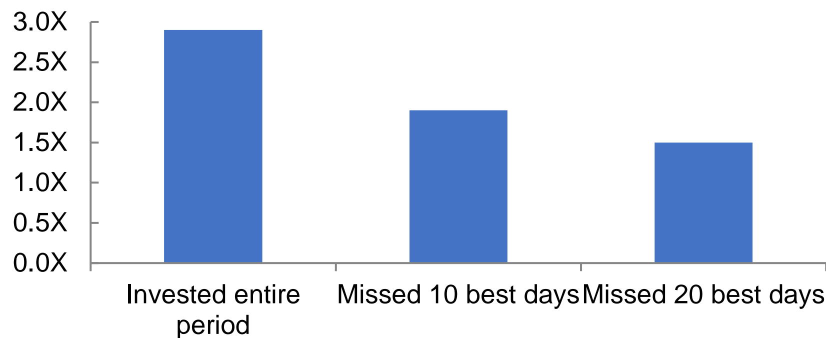
+ Measures market high to market low

Source: Capital Group, Standard & Poors

Be Disciplined

Investors generally hurt themselves by trying to time the markets, i.e., by attempting to jump in and out of investments based on near-term expectations. Markets are for the most part quite efficient, but voluminous evidence from the field of behavioral economics shows that individual investors frequently make irrational, emotional decisions, particularly during periods of market stress. The end result is that investors, battered by losses and fearful of further declines, often sell at just the worst time—when prices are near their low point.

Even subtracting emotion from the equation, there no reliable way to identify a market bottom, and knowing when to get back in is just as difficult as knowing when to get out. Experience has shown that being out of the market on even a few days of sharp increases can have a negative impact on long-term returns. Investors who sit on the sidelines risk losing out on periods of meaningful price appreciation that follow downturns. From 1929 through 2019, every S&P 500 decline of 15% or more has been followed by a recovery with an average return in the first year of 54%.



Source: The Capital Group

The rational alternative to market timing is to adopt an investment plan and to stick with it. Such a plan should incorporate investment goals, with investment "buckets" appropriate for each goal. For example, money needed for near-term expenses like tuition payments should be invested differently from retirement saving needed for the long term. The plan should also incorporate asset allocation targets and periodic rebalancing (effectively buying what has become cheap and selling what is expensive), which lowers average acquisition cost.

Stay Diversified

Most people are familiar with the concept of portfolio diversification, which is a fancy way of saying, "don't put all your eggs in one basket." To protect against big swings in the market, it is necessary to diversify not just by company, or by industry, but also by asset class. The key to minimizing portfolio risk is to combine asset classes that perform differently under different market and economic conditions, smoothing returns and lowering risk. During the financial crisis of 2008-09, and so far in the current downturn, high-quality government bonds have been nearly the only counterbalance to the generalized downdraft in equities and other risk assets.

Final Thoughts

The U.S. economy was on a solid footing as we entered 2020, suggesting that the economy should be well-positioned once we emerge from the crisis. Although there is a great deal of near-term uncertainty, we encourage investors to look through the volatility, maintain a long-term perspective, and stick to a disciplined investment strategy.