Boston Trust Walden
Principled Investing.

Investment Commentary

March 31, 2020

A Note to Our Clients

Our world has changed in ways few of us thought possible just a month or two ago. In light of this new reality, we begin this commentary by extending our sincere hope that you and your loved ones are well, and that everyone remains healthy in the months ahead. Thus far, all of us here at Boston Trust Walden remain free of any symptoms of COVID-19. And thanks to the technology we embraced years ago as part of our business continuity planning, nearly all of us have been able to work remotely but seamlessly since mid-March.

As investment managers, and not virologists or epidemiologists, we have no more insight into the path of the COVID-19 disease than what we have learned by following public health and media reports or reading a fraction of the vast literature now being produced. Perhaps the most unsettling aspect of current circumstances is that not even our health experts can predict with confidence the path of the virus. Much will depend on the success of mitigation efforts as our health care system mobilizes and awaits the arrival of essential supplies and equipment to perform critical work. We share the hope that flattening the infection curve is successful in saving as many lives as possible.

Rather than offer further detail on the medical and mitigation aspects of COVID-19, our objective here is to share our views on the likely economic and financial market impact of the virus, as well as the related policy responses. We also provide commentary on how we have shifted positioning of client portfolios to better reflect the new risks of the current investment environment, while retaining the ability to participate in the inevitable economic and stock market recovery, whenever that may occur.

Financial Markets

Total Returns through March 31, 2020

US Stocks	1st Quarter	1 Year
Standard & Poor's 500	-19.6%	-7.0%
Russell 2000®	-30.6%	-24.0%
International Stocks		
MSCI World Ex-USA	-23.3%	-14.9%
MSCI Emerging Markets	-23.6%	-17.7%
US Fixed Income		
Bloomberg Barclays Gov't/Credit	3.4%	9.8%
US Treasury Bill	0.6%	2.3%

After making an all-time high on February 19, the S&P 500 Index quickly sold off as investors began pricing in the grim economic consequences of COVID-19. In just over a month, the Index lost a third of its value. The decline was historic in its speed. Stocks fell far faster than during the Financial Crisis, dot-com bubble burst, Arab oil embargo, or Great Depression. (Notably, however, the market lost considerably more ground in each of those instances than it has thus far in the current downturn). In fact, only the bear market of 1987, highlighted by Black Monday, is on par with the current experience in the speed of the market's decline. But the impetus for each of these declines was vastly different in character from the current one. Each was marked by economic excesses, whether related to household borrowing, corporate financial leverage, or market valuations. Today's dislocation is unique, as the government has effectively shut down much of the economy to mitigate the spread of the virus. Even prudently run, otherwise stable corporations have seen their business prospects and share prices punished. As such, our investment discipline, which favors the stocks of financially strong companies with sustainable business models, has, in this short period, failed to shield most portfolios as much as we may have hoped. With the benefit of a modest recovery during the period's final week, stocks, as measured by the S&P 500, declined 20% for the quarter. All told, the Index ended March 2020 roughly where it stood in mid-January 2019.

Meanwhile, bonds also failed to provide the degree of protection they have in past market crises, though the Bloomberg Barclays US Government/Credit Bond Index did post a modest positive return for the quarter. Credit spreads widened sharply for high and low credit quality bonds alike. Even the normally staid Treasury market experienced price swings typically reserved for speculative stocks. Energy markets faced more dire circumstances as oil prices cratered to an 18-year low of $20/barrel. Energy producers faced peril on two fronts: a profound demand shock from the virus and extra supply being pumped into the market as part of Saudi Arabia's and Russia's ill-timed oil price war. Though there are positive attributes such as lower gasoline prices for consumers, low oil prices put additional strain on highly leveraged energy companies and the lenders that have extended financing to them.

Investment Perspectives

Without miraculous improvement in the path of infections or an effective cure or vaccine, we are likely to experience a precipitous contraction in economic activity in the weeks and months ahead. Double digit annualized declines in GDP and unemployment rates not seen since the 1930s are expected. Far more difficult to forecast is the duration of the downturn. That will depend on when people will be able to safely return to their jobs. On this question, public health experts are analyzing data, debating the effectiveness of "shelter in place" policies and even considering ways in which some individuals may be able to return to their normal routines relatively soon while those at greatest risk remain in some form of isolation. These are important decisions. More will be learned as the disease progresses and the data is scrutinized. On this, we would simply suggest that whatever policy is best for mitigating the disease is also best for sustaining a durable economic recovery.

Despite the current crisis, we remain optimistic that the economy and the financial markets will ultimately rebound, although the timing and path remain highly uncertain. Massive financial support is now being provided by the federal government. The so-called stimulus bill (which is more of a giant bridge loan than stimulus) passed by Congress on March 26th was a critical step. This was the third piece of legislation addressing the virus and its fallout, and it will likely be followed by additional fiscal support as needed. Equally important, the Federal Reserve has virtually unlimited ability to support banks and provide liquidity to financial markets. The Fed has quickly initiated powerful programs, relying on many of the tactics developed during the Financial Crisis. Neither the US Treasury nor Federal Reserve is likely to exhaust their financial options. At this time of crisis, we agree that more economic support is better for both the near- and long-term health of the country.

Portfolio Positioning

During the past several weeks, as economic prospects deteriorated, we assumed a more defensive investment position in multi-asset portfolios. At this time, the asset mix reflects a reasonable balance between the clear near-term economic risks and our confidence that the economy and stock market will rebound eventually. In this uncertain environment, we are also paying particular attention to client objectives in maintaining ample levels of portfolio liquidity. Across strategies, we have also made changes in the composition of equity portfolio holdings. Our goal in this is to avoid those businesses that are at greatest risk of sustaining permanent damage during the current crisis, as well as those whose valuations, we believe, imply overly optimistic future growth. We are also identifying investment opportunities where indiscriminate market selling may allow us to acquire the financially strong businesses we prefer at newly attractive prices. We remain alert to the evolving economic and market climate, and are prepared to reposition portfolios accordingly.