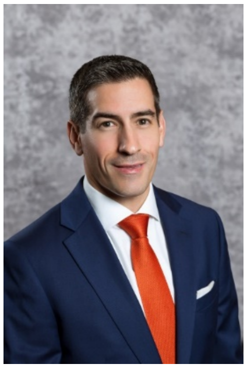

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MARKET PERSPECTIVE *from the Investment Advisory Group*

Stress Testing Our Assumptions

What Happened

Markets are dealing with a trifecta of issues: continued coronavirus (COVID-19) concerns, a collapse in oil prices and flaring tensions with North Korea. Investors had already been struggling to grapple with the potential economic fallout from COVID-19, and events over the weekend injected additional uncertainty. Consequently, global stocks are trading down about 7%, the 10-year US Treasury yield is trading to a fresh low near 0.5%, and oil prices are down about 20%.

Our Take

This is not a great way to celebrate the 11-year anniversary of the S&P 500's bull market that kicked off on March 9, 2009. Nonetheless, while it is likely to be a bumpy road ahead, the weight of the evidence in our work suggests stocks should be higher a year from now, even if the short-term path is less clear.

Monday is on track to be the sharpest one-day decline for the S&P 500 since August 8, 2011. That drop also occurred on a Monday and followed the credit rating agency downgrade of US Debt. The 2011 analog is one we have used as a comparison to recent market action. During that period, stocks also saw dramatic price swings, and this was the last time stocks averaged a daily change of more than 3% over a 10-day period. Uncertainty and fear were also high then. Notably, volatility stayed elevated over the next several months, but stocks were up 25% a year later. Still, investors are growing increasingly concerned about a potential recession, while a recession did not occur in the comparison period of 2011.

It is important to note what is being priced into stocks at current levels. The S&P 500 is now down about 18% from a record high reached just a few weeks ago. For context, this 18% decline compares to a median drop of 21% and an average drop of 28% during recessions since World War II. Effectively, markets are already pricing in a 60% to 80% probability of an impending recession. This is higher than our macro team's base case outlook, which acknowledges rising risk but places the odds of recession at less than 50%.

However, let us stress test our assumptions and assume that the US economy does enter recession. Also, as a guidepost, let's hypothetically assume the total decline for the S&P 500 from the February 19 high is 28%, consistent with the average decline during recession. Undoubtedly, that would be painful for investors. However, it is also important to understand that once stocks find their low during a recession, a year later markets have climbed an average of 32% and a median of 37%. Said another way, even if we were to see further weakness near term, markets would still be up double-digits from today's level a year later, if past precedent holds. Of course, there is no guarantee that history will repeat itself, and this time, the outcome may be worse. However, we believe this offers a reasonable framework for investors to gauge the risk/reward.

Recession Dates		S&P 500 Returns Around Recession (%)		
Begin	**End**	**Peak to Trough Decline**	**1-Year Later From Trough**	**2-Years Later From Trough**
Nov-48	Oct-49	-21%	40%	60%
Jul-53	May-54	-15%	39%	84%
Aug-57	Apr-58	-21%	29%	39%
Apr-60	Feb-61	-14%	31%	12%
Dec-69	Nov-70	-36%	45%	57%
Nov-73	Mar-75	-48%	21%	41%
Jan-80	Jul-80	-17%	37%	17%
Jul-81	Nov-82	-27%	58%	48%
Jul-90	Mar-91	-20%	4%	12%
Mar-01	Nov-01	-37%	-14%	3%
Dec-07	Jun-09	-57%	68%	84%
Average		**-28%**	**32%**	**42%**
Median		**-21%**	**37%**	**41%**

Data Source: Factset, SunTrust IAG

This outcome is consistent with several studies we have shared in recent reports. After intense selling periods, markets often see short-term overshoots and dramatic moves in both directions. However, stocks have tended to climb strongly when looking out over the next 12 months. That's why in our work, instead of trying to pick a short-term bottom, we focus more on the risk/reward.

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Also, on the other side of these concerns, investors will likely be left with much lower interest rates, more savings from mortgage refinancing, extensive global monetary and fiscal support, and stock valuations which imply improved longer-term returns for equity investors.

With fear high now, investors are content holding potentially lower returning long-term assets, such as US Treasury bonds, for their perceived safety and potential capital protection. Simply from a diversification standpoint, an allocation to high quality bonds still makes sense to deal with uncertain outcomes; they have risen 3% during this corrective phase alone. That said, at some point, as fear fades, investors will likely shift their focus back to seeking assets with higher long-term return potential. For those investors who can stand the much higher volatility of stocks, we see more value in equities. For example, the S&P 500's dividend yield is now above the 30-year US Treasury yield for the first time since the financial crisis. Moreover, as the rubber band stretches to an extreme on the downside, the snapback will likely be sharp as fears subside.

Bottom Line

The collapse in oil prices and North Korea's provocations add another layer of unexpected risks to the market. Uncertainty and fear are high. Market price swings are set to remain elevated as many investors and leveraged players were likely caught offside by the market decline and the collapse in the oil markets.

However, the weight of the evidence in our work suggests that even if there is a recession and deeper interim market selloffs, stocks are more likely to be higher from current levels a year from now. Accordingly, for investors who are properly allocated in accordance with their risk tolerance, have a longer-term outlook, and can stomach further overshoots, we would recommend staying the course and also consider rebalancing portfolios to take advantage of the lower prices now available in equities.

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