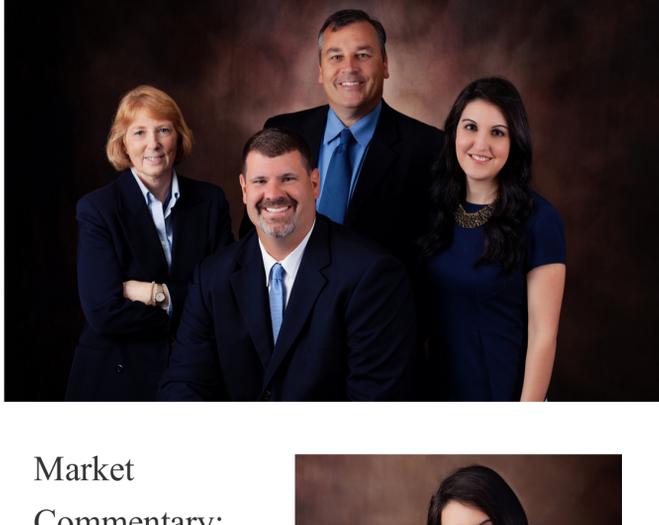


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Market Commentary: Market has 3 day winning streak, what's next?



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If you've been keeping up with my commentaries, you know that the stock market was in free fall over the last month. After hitting a record high on February 19th, it experienced the swiftest decline in the history of forever. Major market indices were down 33% - 40% in less than a month. Finally we saw a reprieve this week with the S&P 500 gaining almost 20% in three days:



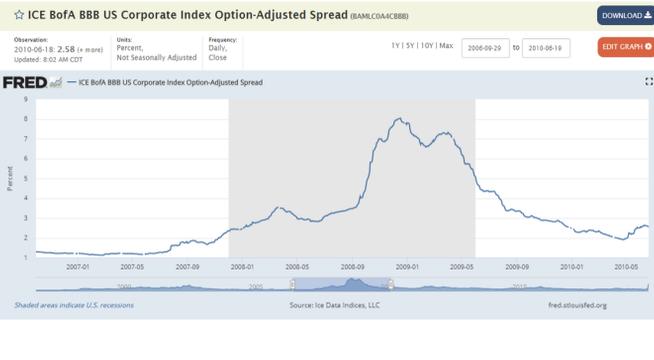
That's right, the market had its best 3-day winning streak since 1931. These truly are remarkable times.

As of my writing this on March 27th, the S&P is down over 3% today. Not surprising after climbing so far so fast. So have we found the bottom? Is the market back in recovery mode?

I would say not yet. There are a few boxes that need to be checked before we can say with any amount of confidence that the market has found a bottom. Here are a few of those boxes:

First, the credit spread. The credit spread is the difference between a US Treasury bond's yield and the yield of a bond that has a different credit quality. When credit spreads rise, that shows a lack of confidence in the bond market and an increasing fear of defaults.

Back in 2008, the corporate bond credit spread began to rise in October 2007, showing that there were problems cropping up before a recession was even on anyone's minds:



This was an early warning signal. Credit spreads continued to rise until they spiked considerably in September 2008. They didn't begin their decline until TARP was passed on October 2, 2008. At that point, corporate bonds finally found a bottom and began to rise, regaining all of their loss by the end of 2008. Stocks didn't begin to recover until 6 months later, however.

The graph below shows the S&P 500 in black/red and corporate bonds in purple. As you can see, corporate bonds bottomed in October while stocks fell another 25% over the next 6 months:



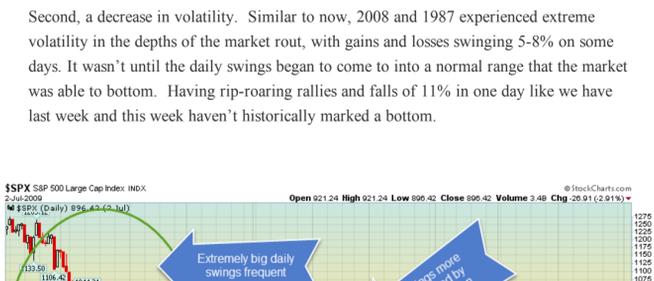
Here the credit spread now. It began its spike in earnest on March 3rd. Confidence was at peak pessimism in the bond market the week of March 16th, with all bonds, even the most secure debt, being sold off in record numbers. Typical safe havens were down as much as 20% in one week, an event not even seen in 2008. This caused the Federal Reserve to step in with aggressive asset purchases that dwarfed the amounts they've committed in the past 10 years.



Congress just passed a historical stimulus package of \$2.2 trillion, and so far the Fed's asset purchases and this new bill seem to be having a positive effect on the credit spread. This week to decline 26th. Bonds have also been recovering from their lows this week, another good sign.

Restoring confidence to the bond and credit markets is a critical step in allowing the stock market to find some footing. It will take a while, but if the credit spread continues to decline, that will be very good news for stocks.

Second, a decrease in volatility. Similar to now, 2008 and 1987 experienced extreme volatility in the depths of the market run, with gains and losses swinging 5-8% on some days. It wasn't until the daily swings began to come to into a normal range that the market was able to bottom. Having rip-roaring rallies and falls of 11% in one day like we have last week and this week haven't historically marked a bottom.



As of now, the volatility box isn't checked. We're still seeing large swings both up and down. Until we start to see regular market sessions where daily swings are below 2%, it will be hard for the market to sustain a rally in my opinion.

Third, anticipation of good news. The market is what we call a leading indicator. It historically has bottomed long before the headlines are proclaiming blue skies. That's because it's always anticipating the future; things may be grim now, but if we can see a light at the end of the tunnel, the smart money is buying when everyone else is still selling.

Right now, we just don't have enough information to formulate positive scenarios. And we won't have that information until we either find a drug effective against the virus, can anticipate the acceleration of cases, hear about companies reopening and hiring, or can see corporate earnings on the mend. We're flying blind right now with everyone's best guess because we've never been here before. Never has there been such an event that has effectively shut down the entire world. The ramifications are unknown and we won't know the full extent of the damage for months.

Where are we at this point? In our managed accounts, we've been getting more defensive since the beginning of March when we saw the credit spreads start to rise and we used the rally this week to position more defensively again. We've been utilizing buffer ETFs which help to soak up some downside risk without giving up a large chunk of upside participation. That has been a key part of our strategy as a way to mitigate risk without giving up all the reward. Once the right boxes are checked, we'll be buyers in a market that has already been significantly discounted.

For the investor reading this and doing it on your own, the best thing you can do is rebalance, take rally opportunities to sell underperforming assets and rebalance into more stable ones, and be prepared for a great buying opportunity if the stock market falls further.

-Victoria Bogner, CFP®, CFA, AIF®

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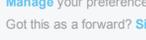
The Volatility Index, or "VIX", is a real-time market index that represents the market's expectation of 30-day forward-looking volatility. Derived from the price inputs of the S&P 500 index options, it provides a measure of market risk and investors' sentiments.

Ice Data Indices, LLC, ICE BofA US High Yield Index Option-Adjusted Spread (BAMLH0A0HYM2), retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/BAMLH0A0HYM2>, March 30, 2020.

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