

**Coronavirus, the Economic Outlook and Equity Markets**  
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**Economic Outlook**

As we noted in last week's update, we've been conducting our analysis of the economic impact of the coronavirus through a framework that consists of three channels: the first is the public policy, the public health policy channel, the second is monetary and liquidity policy and the third is fiscal policy.

Developments this week haven't been this dramatic as they were the previous week. What we are increasingly able to do, though, and what we hope to be able to do in the coming weeks, is to use these channels to better dimension the impact of the crisis, and to talk a little more specifically about how bad things are going to get in economic terms and how things might look like on the other side.

And so, there is still a great deal of uncertainty around any forward-looking analysis we might do. But that's where we are devoting our resources and we wanted to share that with you. So, what have we learned in the last week?

From a public health policy perspective, the change has not been dramatic, but it has continued to be in the direction that we would expect to see and the direction that we think is necessary. Remember that no other sort of policy innovation is going to help the economy until the public health crisis is addressed. The best available information is that social distancing and isolation and quarantine are the ways that we can best address that.

And over the course of the last week, we've seen an incremental increase in the number of states, the number of countries, the number of cities, that are taking those steps. That doesn't guarantee a particular timeline for when the worst of the crisis will be behind us, but it is at least additional movement in that direction. I would also say, and I will come back to this in a moment, that some of the measures taken from the fiscal policy side of things are also designed to help with the public health crisis. And that's good news as well.

From a monetary and liquidity policy perspective the change this week, once again, hasn't been dramatic, it's been iterative. The Fed has announced a variety of new programmes to try to support various sectors of financial markets, to make sure that liquidity is flowing and to make sure that when we do emerge from the worst of the public health crisis, the banking sector and the financial system in general will be in a position to provide support to the economy, as it hopefully begins an expansion.

One thing I do want to highlight that is new this week is that the Fed is very clearly taking its role as a global central bank more seriously than it has in the past. There have been anecdotal reports and some evidence, at least from financial markets, that there is a dollar liquidity shortage, or that there has been a dollar liquidity shortage, in other countries. And typically, the Fed wouldn't really worry very much about that because their primary responsibility is the health and well-being of the US economy.

However, over the course of this week, the Fed did take some steps to ease that dollar liquidity shortage elsewhere, specifically allowing foreign central banks to repo, or lend, their treasury holdings to the Fed in exchange for dollars. And that should hopefully

alleviate some of the dollars shortage, and it should prevent those central banks from having to sell their treasury securities, which could be disruptive in an environment where higher yields would be very unwelcome indeed. So, it is an example of the Fed being flexible and being nimble in responding to different sources of stress wherever they may emerge. We expect that to continue. Remember that the Fed has not yet even begun the process of rolling out what could be the largest stimulus programme available to it, the Main Street credit facility.

That brings me to the third policy channel, which is the fiscal policy channel. We are now able to look in a little more detail at the CARES Act that was passed through Congress late last week. Part of that bill was providing the Fed with US\$425 billion that it can lever up to use for the main street lending facility. We don't have details on that yet and probably won't for another week or so. But it is an example of policymakers recognizing that they do need to be flexible, that we don't know what the eventual size of the response needed is going to be. And by giving the Fed the ability to use up to around US\$4 trillion of ammunition to address this crisis, I think policymakers have bought themselves and bought all of us a buffer, a cushion, that that should allow the Fed to respond rapidly if the situation deteriorates further.

I mentioned at the outset that some of the parts of the CARES Act also serve a public health purpose. The obvious way that that happens is the direct impact, where there is increased funding for hospitals, medical care, and hopefully that money will be used expeditiously to provide ventilators and masks and equipment that's necessary for first responders and for medical professionals to serve their purpose in this crisis, as well as to help those who are ill. So that's one direct way that it is helping to address the public health aspect of this.

A second way that is perhaps underappreciated in the current environment is that the bill, as designed, also provides income to households. And that's really important because for many households who live paycheck to paycheck, if you don't have the ability to pay your bills, if you don't have the ability to buy food, it's going to be really hard to practice social distancing. People who are living paycheck to paycheck don't have the option of staying home. And they have to go to work whether they want to or not. And whether it's good for public health or not. So, providing a basic income there, whether it's through expanded and enhanced unemployment insurance benefits or the small business lending programs that are designed to keep people on the payrolls, in addition to addressing the humanitarian toll of the crisis, should also play a role in addressing the public health crisis. And that's become more clear over the course of this week, too.

And of course, unfortunately, what has also become clear over the course of this week or what is increasingly becoming clear is just how severe the economic disruption is going to be and just how significant the human toll is going to be. Over the last two weeks, more than 10 million people have filed initial claims for unemployment insurance, meaning that over just two weeks, 10 million people, at least lost their jobs. The unemployment rate, which was captured in the first part of March, before the crisis really escalated, rose by a full percentage point. We are not going to see the full brunt of this crisis in the March data. It's really the April data that will show it. But any reasonable expectation would tell you that well north of 10 million people will have lost their jobs. The unemployment rate is highly likely to double. It may even exceed 10 percent in very short order.

This is the most severe, the most sudden economic stop any of us have seen, any of us have witnessed. It is the most sudden economic collapse in modern economic history. And

so, these are truly unusual times that we're living through. Because they're so unusual, it remains extremely difficult to formulate a high conviction view about what happens next. Because we are seeing progress on the three policy channels that I talked about earlier, our base case remains that the crisis will pass and that the economy will recover. We believe that measures taken by the Fed will keep the financial system liquid and that that should support the economy when the fiscal stimulus kicks in.

The challenge, of course, is we don't know whether that is a matter of weeks, or a matter of months. And that's just a source of uncertainty that we're going to have to live with. We will continue to monitor the situation. But honestly, it isn't so much about monitoring how bad the situation is right now. What we need to be doing is looking for ways in which the situation could change, or monitoring the mile markers along the road, if you will, that would lead us toward change. And we're several weeks at least away from a place where I think we'll be able to see that in the data. But continuing to monitor the policy response, continuing to monitor the health of the financial system, continuing to monitor fiscal authorities willingness to do whatever is necessary; I think that those are the sorts of analytical tools that are going to make a difference now, rather than counting how many people are losing their jobs. As I said, it's, it's a terrible, terrible human toll. But we would like to be able to look forward toward a recovery, and that requires looking at a different set of things. '

### **Equity Markets**

After an initial huge sell off, we saw equity markets and stabilize to some degree last week, ending the quarter down about 21 percent, which was much better than where we had bottomed, at more than 30 percent down. But I want to be very clear that while markets have stabilized, we have to be realistic that there's likely to be uncertainty going forward and periods of volatility. Through the course of the quarter, we did see a couple of interesting things.

One, the VIX spiked actually to levels that we had not seen, really ever before and even exceeded those levels that we reached in the global financial crisis. So really an unprecedented level of anxiety in the markets at the sudden shock and the sell off and the speed with which markets corrected, was again, faster than it was even during the GFC. So, this has indeed been an extreme event and put a lot of stress on equity investors. It's also played out in ways that have been atypical in some ways. Some of the sectors that have been the hardest hit, such as energy and banks, are not that surprising. But there have been a number of sectors that are traditionally quite defensive that didn't really offer the same degree of protection as they had during prior crises. In here I'd put real estate, utilities, consumer services.

And it really came around a couple things, companies that had financial leverage, as there are concerns about their ability to refinance or cover that. And companies that rely on human to human interaction. We all know that from our personal lives with restaurants being closed and so on, but there are many businesses that rely on people coming together that are just as strongly put on hold right now and have paid for that in their stock prices.

On the other side of the ledger, there are sectors that did well as one would expect—things like food retail, not surprisingly, outperforming quite dramatically. But some areas of technology have been quite surprising in their ability to hold in there, in part because their balance sheets are quite good and in part sometimes due to industry

conditions, for instance, in semiconductors. There's a general feeling, too, that technology will be part of the solution on the far side of this crisis to, in how we get ourselves back on our feet.

We've seen similarly high volatility in the factor performances. The one factor that's had the biggest reversal has been beta or market risk in the sell off, that was the absolute worst place to be. Profitability has probably been the best across the whole cycle. And certain areas, again, that are typically defensive, like dividend yield, are not proving to be so much this time around in part, again, because some of that is concentrated in areas with higher leverage, like banks and energy companies.

But nonetheless, it is a different environment than we've been used to, and one where our active teams are needing to react to that. One thing, though, that has become clear, is that timing the market is really, really a dangerous game. With the enormous moves we've seen, the big rebound back last week, really just proves the adage that it's time in the market rather than timing the market. And it's, it's imperative that you have a longer-term perspective, and any kind of allocation that you had in place prior to this crisis, if that was the right one, that's really where you ought to be going forward as well.

So volatility, you know, for traders is fun, but for the rest of us really means trying to sit on our hands and ride this through. However, that's not what our portfolio managers need to be doing. They need to be trading in the portfolios in ways that position them best to, to ride this out. There are three phases to that, the first being survivability. And that's really where the focus was in the early days of this crisis and moving out of names that had questionable ability to ride through. Then into thinking about the companies that maybe are mispriced today based on their businesses resuming normal activities on the far side of this. But further down the road, we increasingly need to start to think about ways in which this might reshape the economy, reshape the way people go about their consumer or other behaviour, their business behaviour, and try to start to position ourselves for the companies that will benefit from that.

That still requires, I think, more clarity on how this is all going to play out. But it is increasingly part of our thinking to think through those, those third order effects, really, of who may be the ultimate winners and losers as the economy adjusts. And I think this likely accelerates some trends we've already seen in the economy around online ordering and retail consolidation and the like. And these will play out over the next few years.

So, we urge everybody to remain calm, that there seems to be some stability settling in. We all know that the peak in cases here in the U.S. is still to come. But as we have internalized that, maybe the markets can start to look through that and focus on the long-term picture. And that's really what our teams are focused on. From our performance standpoint, not surprisingly, given all I told you, the growth strategies are doing the best here, our core strategy someplace in the middle and value with its more orientation towards energy and financials, obviously was in a tough neighbourhood during this. But they're still seeing tremendous mispricing in the market. And for those with the backbone to ride it out, or the stomach, there's really a lot of opportunity there.

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