Market Update from Thrivent

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U.S. markets continued their strong rebound on hopes a more than $2 trillion rescue plan will keep the U.S. economy afloat and bolster the fight against the coronavirus pandemic. The S&P 500 stock index rallied for the third consecutive day after plunging more than 34%. The S&P posted a 6.2% return and now is up 17.6% from Monday's close. European and many emerging markets stock indices also rose.

The rebound is not surprising, as markets had been technically oversold. Also, rallies within a bear market are common before establishing a durable rally. The Great Financial Crisis of 2008 witnessed rallies up to 25% before establishing a bottom in the market.

We expect continued volatility as many unknowns remain, including the course of the pandemic. Cases are still rising and there's uncertainty about the extent of the resulting economic slowdown. We continue to advise a disciplined approach, with long-term investors incrementally adding exposure on meaningful dips.

Fixed Income

Fixed income markets continue to stabilize, with high-yield and investment-grade bonds also rallying for the third day in a row. Treasuries yields fell with continued large-scale purchases by the Federal Reserve. One significant positive sign is a resurgence in new bond issuance as companies seek to raise cash and fund future obligations. Investors took advantage of more attractive valuations, buying more than $30 billion of investment-grade bond new issuance today. Companies such as Target, Home Depot, NVIDIA, Morgan Stanley and Wells Fargo tapped the market for funding.

As a result of the economic slowdown, many businesses face sharp drops in sales, which can stress their finances. For example, Ford Motor Co. yesterday joined a growing list of investment-grade companies that have been downgraded to high yield, which is considered below investment grade. Ford has approximately $36 billion in bonds that will be downgraded. More downgrades are expected, which can stress markets, but can also provide attractive investment opportunities. Historically, downgraded bonds—called "fallen angels" in the high-yield market—have collectively produced favorable long-term returns as selling pressures result in attractive valuations.

Economy and policy

The U.S. Senate passed a $2.2 trillion economic aid package last night to aid households, businesses and health care organizations that have been affected by the coronavirus pandemic. Highlights include:

- About $290 billion in payments to individuals and families. ($1,200 per adult; $500 per child, with the amount starting to phase out at income of $75,000 for individuals or $150,000 per couple.)
- $376 billion in loan forgiveness and subsidies for small businesses.
- About $260 billion to increase unemployment insurance.
- $150 billion in aid for hospitals and other healthcare organizations.
- Funding of $454 billion to enable an emergency Federal Reserve lending program to businesses, and state and local governments. The Fed expects to make more than $4 trillion in loans with that funding.
- Other areas include aid to distressed industries, such as airlines; tax breaks; food assistance; and funding for coronavirus research, including a vaccine.

The bill now moves on to the House of Representatives, where passage is expected. The stimulus should lessen the severity of the economic and health crisis, but a hard growth downturn still is expected.

U.S. economic data continued to deteriorate. A record 3.3 million people filed unemployment claims last week, shattering the previous record of 695,000 in 1982. Unemployment is expected to continue to rise in the near-term as more businesses cut back their operations.

Coronavirus

The news on the battle against the coronavirus continues to be mixed. The number of new cases increased in both Italy and Spain, which are at the center of the European outbreak. Both countries now have more deaths than China. The U.S. now leads the world in known cases, with more than 82,000, but ranks sixth in deaths. New York has seen an increase in hospitalizations leading to concerns that hospitals will fill up. Twenty states now have some form of a statewide shelter order while another 14 have orders in parts of states.

On the positive side, China recorded its second consecutive day of no locally-originated coronavirus infections. The country continues to restart its economy.

Testing for exposure and immunity is one suggested alternative to the widespread shelter-in-place orders. If people test positive for antibodies to the coronavirus, an indication of immunity, then they could return to work. The hope is that gradually more people could work and go out, providing a viable exit strategy from shutting down large parts of economies. Whether this is a practical option remains to be seen.

Low for long

Interest rates have fallen sharply this year with the economic slowdown, uncertainty over the coronavirus and a massive flight to quality assets, such as U.S. Treasuries. The Federal Reserve helped fuel the decline by cutting the lower end of its target rate to zero, or down 1.5% on the year. The 10-year Treasury rate has settled in around 0.80% after hitting a record intra-day low of 0.31% earlier this month.

What do we expect going forward? In a nutshell, continued low rates in the near-term and probably for years to come. Most economists are expecting the economy to slump significantly before rebounding strongly by the end of the year, but much uncertainty remains about the course of the coronavirus pandemic, and thus the economy.

The Fed has clearly stated it intends to keep its target rate at zero until it is confident the economy has weathered the storm and is on track to regain maximum employment, in addition to hitting its inflation target, which is 2%. That will likely take time--possibly years. After the financial crisis, the Fed kept its target rate pinned at zero for seven years.

The crisis will damage many households and businesses as income plummets while debt obligations largely remain. To encourage the flow of credit, the Fed will need to keep rates low for a long period of time. The Fed also will push down rates to battle the risk of deflation and achieve its 2% inflation goal. Deflation would devastate debtors, as the amount owed wouldn't change but income would drop. Getting inflation to perk up likely will take time. Inflation has hit 2% or higher less than 10% of the time since the Fed adopted that goal in 2012.

One way to assess where rates might head from here is to look at the futures market. Fed Funds futures predict no change through next year, with a bit more than a 50% probability of one 0.25% rate increase in 2021. Also, interest rate forecasts by economists call for the 10-year Treasury bond yield to remain well below 2% into 2022. Once again, low for long.

What we don't expect is for the Fed to adopt negative policy rates like Europe and Japan have done. Fed officials have been clear; they don't think negative rates are effective and can do more harm to financial markets than good. Markets, however, have taken yields on short-term Treasuries slightly negative. The yield on the three-month Treasury bill dipped as low as -0.22% this week as investor demand for safe, short-term assets surged. Preservation of principal has become paramount for many investors.

While we think rates will stay low, there is a growing chance longer-term rates could rise more significantly. This is not our base case or probable in our opinion, but a risk to monitor as the economy rebounds and U.S. deficits swell with increased spending. The U.S. government, in the coming year and beyond, will need to issue trillions of dollars of Treasuries. That could pressure rates higher in tandem with a stronger economy post-crisis. Counterbalancing forces pressuring rates lower include strong global demand for safe assets, expected moderate long-term economic growth, and slowing population growth globally.

Don't forget the Fed either, which pledged to buy Treasuries along with mortgages to steady markets and hold down rates to ease credit conditions. Through yesterday, the Fed already bought more than $500 billion in Treasuries. At the Fed's current rate of buying $75 billion a day, it would take only about a month to cover the more the $2 trillion in spending for the expected Congressional stimulus package. The Fed isn't expected to keep up that torrid pace. It is expected, however, to do whatever it takes to keep rates low and support both markets and the economy.

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