2020 SPRING INVESTMENT OUTLOOK

The record eleven year economic expansion and bull market which followed the 2008-2009 Great Recession period ended abruptly in late February as two black swan events converged. First, COVID-19 spread globally and well beyond China where it originated. Second, world oil prices collapsed as cooperation between major oil producing nations (principally Saudi Arabia and Russia) in limiting supply and thereby supporting prices ended acrimoniously with both countries declaring they would raise production and flood already oversupplied markets.

The global COVID-19 outbreak is having an extremely negative impact on economic activity with travel, retail, and broad consumer activity declining sharply and being further impacted by wholesale closings of school, government, and other institutional facilities. As a harbinger of trouble to come, February retail sales fell by 0.5% as compared with the expected 3% gain.

The over 35% plunge in oil prices has produced severe price declines in the market value of all energy related investments and brought the viability of companies with weaker balance sheets into question. The US shale oil industry, responsible for significant growth in US oil production in recent years, is a notable target of the Russian and Saudi Arabian action and some highly leveraged producers may not weather a sustained period of weak oil prices.

Compounding these developments has been the ongoing and bitter partisan divide in Washington, D.C. which is impeding a comprehensive and well thought out federal response to the issues at hand.

The popular stock market indices are now down more than 20% from year-end, hence qualifying as a new bear market, and have declined even greater from their all-time highs in February.

2020 YTD Total Returns

	03/16/20	% Change
Dow 30 Industrials	20,189	-25.1%
S&P 500	2,386	-25.8%
NASDAQ Composite	6,905	-22.8%
MSCI All Country World Index ex-USA	214	-28.7%

Outlook

Economists are now scurrying to adjust their economic models and forecasts for 2020. Prior to mid-February, consensus held that ongoing spending by the American consumer (accounting for slightly less than 70% of the economy) would enable real GDP to expand by a moderate 2% this year with corporate profits perhaps growing in the mid-single digit territory despite the slowing rate of progress worldwide. This is clearly no longer the case and with the massive closings and business disruptions, two consecutive quarters of declining real GDP now appear to be a possibility, which is the technical definition of a recession.

The question to be answered now is how long and to what depth the declines of 2020 will run. Traditional federal government policy responses could have their limitations given the large deficits and easy money policies of recent years which were used generously to keep the very long expansion going rather than holding them in reserve for when they were truly needed.

Chairman Powell's Federal Reserve moved decisively on March 3rd with an emergency 50 basis point reduction in the federal funds rate and then again on March 15th with another 100 basis point cut, bringing the benchmark interest rate to a range between 0.00%-0.25%. The Fed also announced it stands ready to purchase $700 billion in bonds and is offering a very attractive borrowing rate from its discount window for banks which need additional liquidity. While these are all bold measures, it may make little difference in the short term as business and consumer demand are falling rapidly as COVID-19 spreads. The adage of not being able to "push on a string" applies here.

Meanwhile, while some emergency funds have been released by Presidential fiat, partisan politics means more comprehensive measures remain temporarily stymied. A recovery bill will become law in due course, but there should be no expectation that it will restore the economy to its previous growth path in short order. The "perfect storm" of events negatively impacting the economy and capital markets will simply take some time to run their course.

Fiscal and monetary policy aside, there remains the issue of excessive debt in corporate America. The Financial Times recently noted that the corporate debt market of some $10 trillion is five times larger than in 2001 and roughly half of this amount is in the lowest investment grade rating of BBB. A third of this category or roughly $1.6 trillion is rated BBB- and could very well be downgraded to a high yield rating, thereby putting additional pressure on that market where spreads have already widened materially. Current recession conditions will create cash flow challenges for many fully leveraged companies and lead to bankruptcies and restructurings.

The oil price war brought on by Russia and Saudi Arabia compounds the challenges of the moment. The broadly defined American energy sector employs millions of workers and is a major component the US economy. Cutbacks across the industry will now be necessary to sustain profitability and the impact will fall heavily on many producing areas and corporate centers such as Houston, Texas. On the international side, Saudi Arabia is counting on oil to fund its transition to a more diversified economy while oil remains a major source of income for Russia. Neither country would appear to be able to endure a protracted period of weak oil revenues and this creates additional geopolitical danger in many regions of the world. Global oil demand is now expected to fall a minimum of 2% from last year's record of over 100 million barrels per day. As noted above, the US shale oil industry will be hit the hardest and this will result in failed businesses and lost jobs.

On a positive note, consumers will benefit from lower energy and gasoline prices. Less money spent on these items will act like a tax cut for the average American. Lower prices will also make alternative energy sources less attractive economically in the near term and thereby extend the reign of the oil and natural gas industry.

Political decisions will have a bearing on how quickly the U.S. exits from recession conditions. The country has a massive need for infrastructure improvements in addition to ever-growing entitlement liabilities. The scope and nature of emergency fiscal stimulus (i.e., proposals such as mailing checks to every household or cutting payroll taxes) is likely to be greater than that during the 2008-2009 financial crisis. The Federal Reserve is likely to stretch the bounds of its own policy and eventually monetize much of the incremental debt that will be used to fund the emergency programs of the federal government. While such actions will be helpful in the short run, the longer term risks to financial stability and the U.S. dollar are quite uncertain.

One meaningful stimulant to the ultimate recovery period will be pent-up consumer demand as individuals and households resume normal spending patterns and businesses rebuild inventories, which have already been drawn down due to supply constraints.

Investment Conclusion

The stock market disarray and retreat now underway has already gone a long way to closing the large gap between the very positive investor sentiment and underlying reality that has existed for some time. Regrettably, reality is likely to get worse in the months ahead as corporate profit reports miss expectations by a wide mark, thereby putting additional pressure on equity valuations. Fixed income markets are also likely to come under pressure as falling revenues at overleveraged companies make them unable to meet principal and interest payments in a timely manner. Both developments will be received poorly by investors, who became overly complacent in the longest expansion and bull market in this country’s history.

This firm’s counsel is to deploy cash equivalent reserves into the soundest long term stock investments which have retreated materially from recent peaks and have reached attractive valuation levels. Our ongoing investment research will confirm the distinctive competence characteristics, able management, and sound finances of such companies. Recovery will eventually commence from this market downturn and recession but not in V-shaped fashion given prevailing circumstances.

Fixed income investments remain notably unattractive given the flat yield curve and negative returns when inflation and taxes are considered. This could change rapidly however in specific sectors which may come under forced selling for liquidity needs by mutual funds and other financial intermediaries.

March 17, 2020

Privacy Notice

Securities and Exchange Commission regulations require that the Firm present all new clients and then, annually thereafter, to inform all its clients of its rules regarding their privacy, a key element in the investment counsel relationship. Our policy is as follows:

Wilkins Investment Counsel, Inc. Privacy Notice

Our Firm collects nonpublic personal information about you from the following sources: information we receive from you on applications or other forms, information about your transactions with us or others.

We do not disclose any public or nonpublic personal information about you to anyone, except as permitted by law.

Should you decide to close your account(s), we will adhere to the privacy policies and practices as described in this notice.

Our Firm restricts access to your personal and account information to those employees who need to know that information to provide services to you. We maintain physical, electronic and procedural safeguards to guard your nonpublic personal information.

ADV Notice

Securities and Exchange Commission regulations also require that the Firm deliver annually to clients a summary of material changes to our ADV Part 2 filing which is a narrative brochure written in plain English that contains information such as the types of advisory services we offer, our fee schedule, any disciplinary information, conflicts of interest, and the educational and business background of certain advisory personnel of the Firm. There were no material changes to the information in our ADV Part 2 filing this year. Please contact Shane Garman, Vice President and Chief Compliance Officer, at (617) 951-9969 if you would like to receive a copy of our most recent ADV Part 2 filing.