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The S&P 500 Posted Its Worst Quarter Since December 2008, Elevating Risk Management Needs For Institutional Portfolios

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The first quarter of 2020 will most certainly be remembered in history as an extremely difficult time not only from the global coronavirus pandemic, but also from the speed at which the economy halted. Though the impact is ongoing and still being measured, we have experienced a record speed drawdown in the stock market, exacerbated by the oil conflict that drove asset performance broadly lower with many record setting losses, spiking volatility and rising correlations. However, unprecedented stimulus seems to have alleviated some of the pressure, and there were a few bright spots in performance.

The S&P 500 lost 20.0% in the first quarter. It was the worst quarter for the index since December 2008, when the index lost 22.6%, and it was the 9th worst quarter on record since Q1 1928. All three months in the quarter were negative with respective losses of 0.2%, 8.4% and 12.5% in January, February and March. The last time all three months in a quarter were negative was in Q3 2011, which is relatively rare happening in just 33 of 369 quarters or 8.9% of the time.

Perhaps what is more interesting is how the other assets performed. Many of the assets, particularly in the energy sector, posted their worst quarter in history. Oil dropped 66.5%, impacting the natural resources heavy countries, like Brazil, Colombia and Australia, represented by Brazil IBOVESPA Index, Colombia COLCAP Index and S&P/ASX 200 index, that each posted their worst quarters in history with respective stock market losses of 51.2%, 45.2% and 34.0%. However, mid and small companies in the US, represented by S&P MidCap 400 TR and S&P SmallCap 600 TR, also suffered their worst quarterly losses in history with negative returns of 32.6% and 29.7%, respectively. Other asset classes that lost big were real assets and high yield, represented by the S&P Real Assets Index and

Bloomberg Barclays US Corporate High Yield Total Return Index Value Unhedged USD, which coincided with rising correlation to the S&P 500, reducing the diversification benefits they are known for. The good news is that bonds – especially treasuries, mortgages and TIPS – and gold as well as managed futures, represented by Bloomberg Barclays US Treasury Total Return Unhedged USD, Bloomberg Barclays US MBS Index Total Return Value Unhedged USD, Bloomberg Barclays US Treasury Inflation Notes TR Index Value Unhedged USD, Generic 1st GC Futures and S&P Strategic Futures Index Total Return, held up to their reputations as solid diversifiers and volatility reducers.

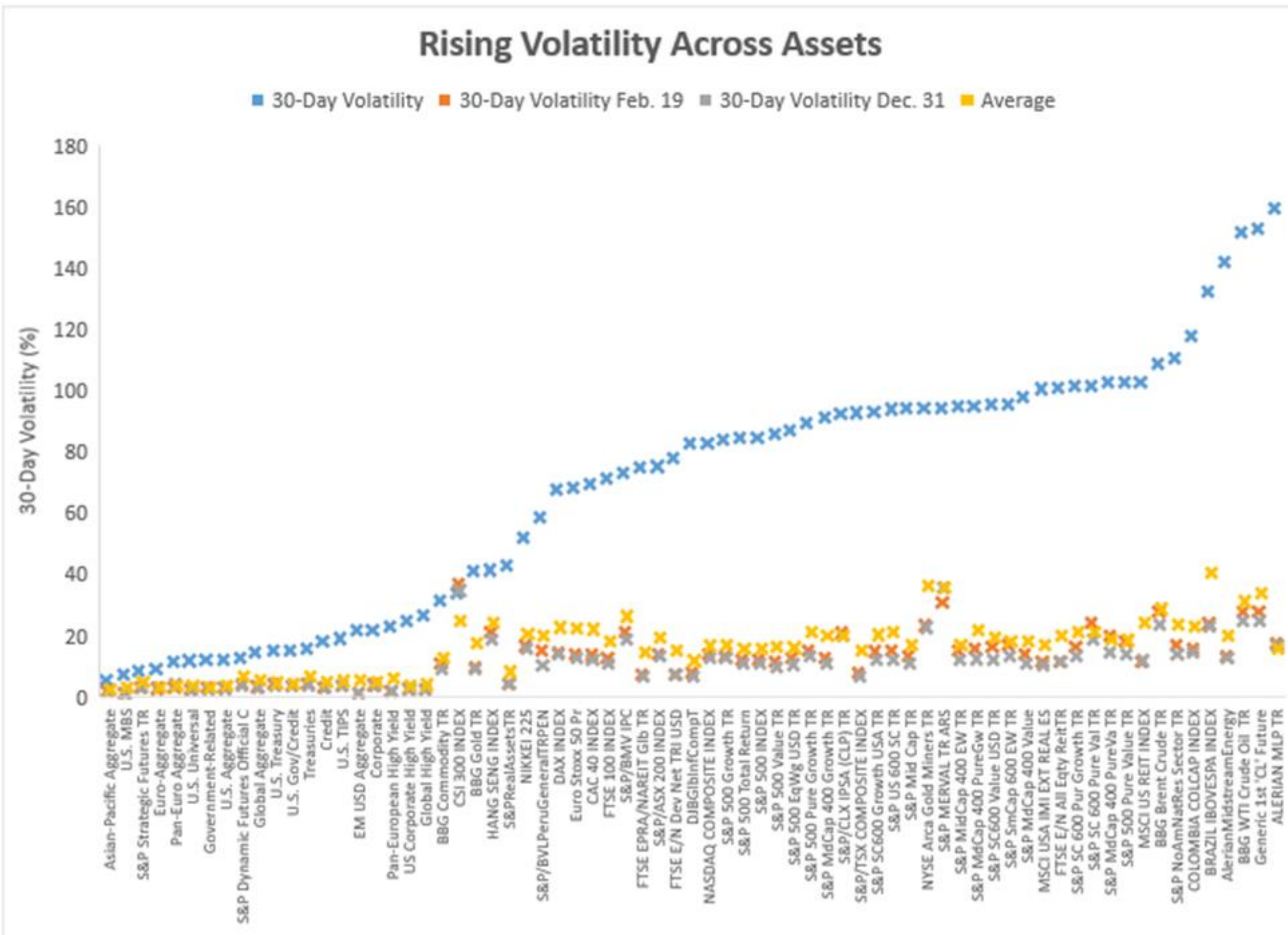
Exhibit 1: Q1 2020 Asset Class Returns and Worst Quarterly Rankings

Index	Q1 2020 Return	Worst Quarterly Rank	Index	Q1 2020 Return	Worst Quarterly Rank
BBG WTI Crude Oil TR	-66.5%	1	US Corporate High Yield	-12.7%	2
ALERIAN MLP TR	-57.2%	1	Credit	-4.7%	2
BBG Brent Crude TR	-56.3%	1	S&P MERVAL TR ARS	-45.6%	3
BRAZIL IBOVESPA INDEX	-51.2%	1	S&P/BMV IPC	-36.2%	3
S&P SC 600 Pure Val TR	-50.3%	1	CAC 40 INDEX	-28.2%	3
AlerianMidstreamEnergy	-47.9%	1	MSCI US REIT INDEX	-27.8%	3
COLOMBIA COLCAP INDEX	-45.2%	1	Euro Stoxx 50 Pr	-27.3%	3
S&P NoAmNatRes Sector TR	-43.9%	1	DAX INDEX	-26.6%	3
S&P MdCap 400 PureVa TR	-43.1%	1	FTSE E/N All Eqty ReitTR	-23.4%	3
S&P 500 Pure Value TR	-41.8%	1	BBG Commodity TR	-23.3%	3
S&P SC600 Value USD TR	-37.4%	1	Asian-Pacific Aggregate	-1.5%	3
S&P SmCap 600 EW TR	-36.4%	1	S&P 500 Pure Growth TR	-20.7%	4
S&P SC 600 Pur Growth TR	-35.2%	1	EM USD Aggregate	-9.5%	4
S&P MdCap 400 Value	-35.1%	1	NYSE Arca Gold Miners TR	-19.9%	5
S&P/CLX IPSA (CLP) TR	-34.3%	1	NIKKEI 225	-19.2%	6
S&P/ASX 200 INDEX	-34.0%	1	S&P 500 Growth TR	-14.5%	6
S&P US 600 SC TR	-32.6%	1	Corporate	-3.6%	7
S&P MidCap 400 EW TR	-32.5%	1	S&P 500 INDEX	-20.0%	9
FTSE 100 INDEX	-29.7%	1	Pan-Euro Aggregate	-1.3%	9
S&P Mid Cap TR	-29.7%	1	Euro-Aggregate	-1.1%	10
MSCI USA IMI EXT REAL ES	-29.2%	1	CSI 300 INDEX	-11.5%	13
S&P SC600 Growth USA TR	-28.1%	1	NASDAQ COMPOSITE INDEX	-14.2%	15
S&P MdCap 400 PureGw TR	-27.0%	1	HANG SENG INDEX	-15.9%	20
S&P 500 EqWg USD TR	-26.7%	1	Global Aggregate	-0.3%	37
S&P 500 Value TR	-25.3%	1	Treasuries	1.4%	40
DJBGlbInfCompT	-24.5%	1	Government-Related	0.5%	41
S&PRealAssetsTR	-20.5%	1	U.S. TIPS	1.7%	55
S&P/BVLPeruGeneralTRPEN	-32.2%	2	U.S. Universal	1.3%	56
FTSE E/N Dev Net TRI USD	-28.5%	2	S&P Strategic Futures TR	3.9%	58
FTSE EPRA/NAREIT Glb TR	-28.4%	2	S&P Dynamic Futures Official C	6.6%	61
S&P/TSX COMPOSITE INDEX	-28.3%	2	BBG Gold TR	4.5%	126
S&P MdCap 400 Growth TR	-24.7%	2	U.S. MBS	2.8%	131
S&P 500 Total Return	-19.6%	2	U.S. Aggregate	3.1%	134
Pan-European High Yield	-15.1%	2	U.S. Gov/Credit	3.4%	140
Global High Yield	-15.0%	2	U.S. Treasury	8.2%	183

Source: Graystone Consulting and Bloomberg. Past performance does not guarantee future results. Indices are unmanaged and not available for direct investment.

In the midst of the bloodbath of record breaking losses, volatility has spiked. The S&P 500's 30-day volatility ending March 31, 2020 was 84.3% up from 11.8% ending February 19, and up from 10.7% ending December 31, 2019, which was decently under the average volatility of 15.7% since 1927. On average across the asset classes, the current volatility is 4.3 times higher than average levels, and is 7 times higher on average than it was in December. This volatility is at levels that have never persisted for very long with a 21 day streak in 1987 and a 16 day streak in 1929. While the volatility rose dramatically, there was still a wide range of volatility across the assets, so opportunities to reduce risk were available.

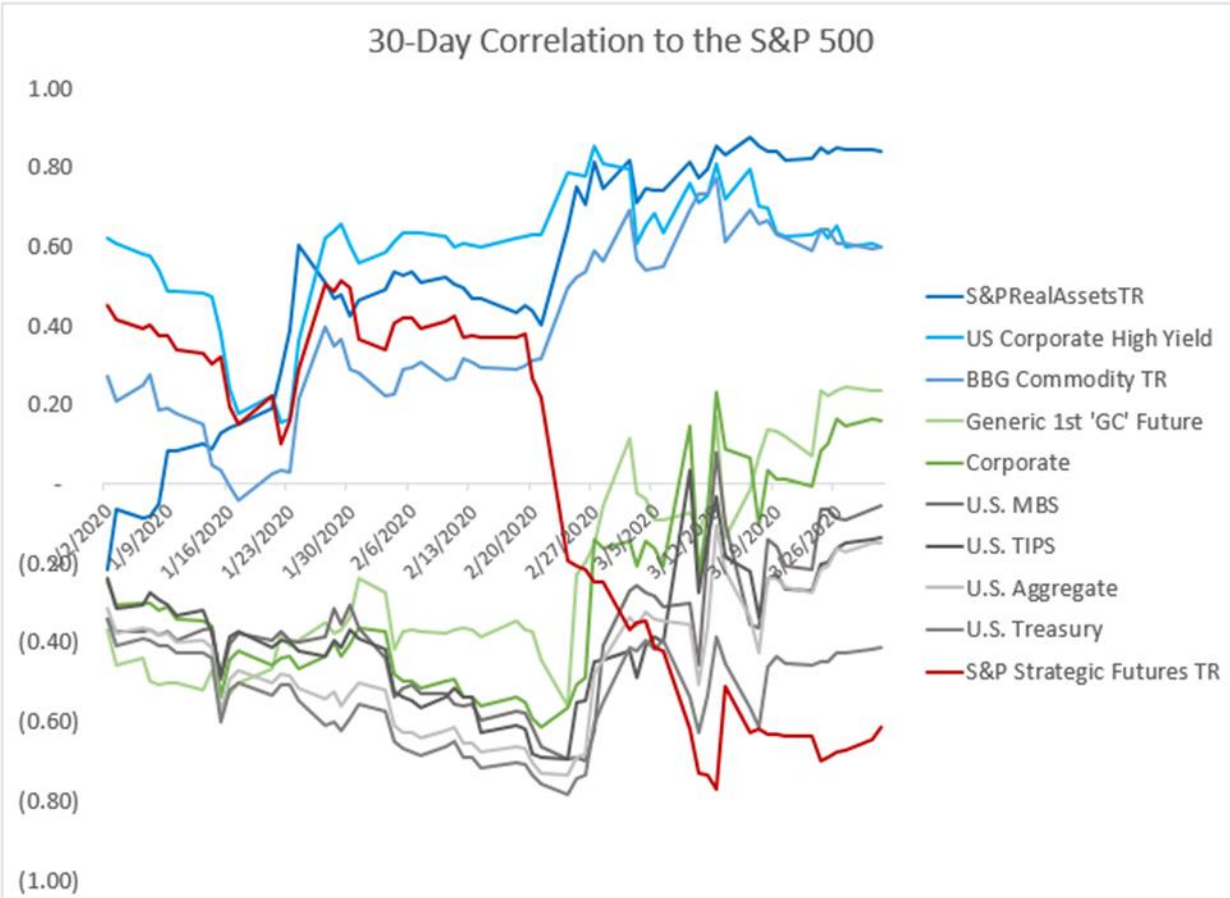
Exhibit 2: Volatility Spiked Across Assets in Q1 2020



Source: Graystone Consulting, Bloomberg. Past performance does not guarantee future results. Indices are unmanaged and not available for direct investment.

Lastly, while the volatility is currently extremely elevated, risk reduction is possible. However, it is really important to watch for changing correlations, especially from assets that are normally uncorrelated with equities with similar or slightly higher volatility levels. Exhibit 3 demonstrates a sample of assets with varying degrees of correlations. US Aggregate bonds have had relatively low and stable or falling correlations. High yield, real assets and commodity correlations have risen, while managed futures correlation was high when returns were positive and fell with the decline in equities.

Exhibit 3: Correlations of Major Assets with the S&P 500 through Q1 2020



Source: Graystone Consulting, Bloomberg. Past performance does not guarantee future results. Indices are unmanaged and not available for direct investment.

In conclusion, risk management is critical now in order for asset allocation to work to maintain plan policies. Systematically rebalancing back to target weights, keeping liquidity, income and growth needs in mind, as well as monitoring hedge ratios is imperative for long term institutional goals.

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