1. When Will The Virus Crisis Show Up In The Data, What Will It Look Like?

On Thursday, March 26th at 8:30 AM the Department of Labor will publish data showing the first full week’s impact of the virus on unemployment. It will not be pretty. New York, New Jersey, California and Illinois (25% of 2018 US GDP or roughly 10% more than all of German GDP) are closed for business. Nearly 60% of the US workforce are paid hourly, with a concentration in the retail and hospitality sectors.

Ironically, the “best case” scenario for workers, firms and the economy is that all employees be furloughed immediately, such that they can receive unemployment benefits. This will prevent a total collapse in income and preserve crucial cash for business solvency. That said, state unemployment benefits vary greatly in value (with maximum weekly benefits varying from 4% of quarterly wages capped at $240 to ½ normal weekly pay capped at $795) and length (12 to 30 weeks) per savingtoinvest.com.

Figure 1: Weekly US unemployment insurance claims

Source: Haver and savingtoinvest.com as of March 22 2020. Note: Red arrow indicates expected increase in unemployment claims in the next week. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events.
Citi Private Bank expects that unemployment claims for this first week will be the largest ever on record, with more than two million filing. Over the next four weeks, assuming that 50% of the US is sheltered in place, we expect that there will be 10 million unemployed. And at its peak, we could imagine unemployment reaching 15-18% of the total US workforce, representing a staggering 25 million people. As discussed in our related report “What It Will Take,” we believe massive policy interventions from a quick and flexible government can mean that a large part of this employment decline could be recovered, most ideally in the year ahead.

Looking at future data, we expect that reports of small business confidence will likely fall to the worst level ever, as will expansion plans and investment intentions. Crucial areas to watch are investment, construction and trade. In many areas, construction has been allowed to continue, but projects are also being mothballed and cancelled.

2. **Which Fixed Income Sectors Are Undervalued Now?**

Bank preferred securities and US municipal bonds have been unusually impacted by these markets. US preferreds have declined nearly 30% over the last month, with some securities dropping over 25 points in a matter of a few weeks. Spreads are near 1000bp over Treasuries, with average yields near 10%. Preferreds are cheaper than US High Yield and, in our view, represent good value with well capitalized banks and “credit policy” support from central banks. US and European bank balance sheets have improved tremendously over the last 10-years. The majority of large institutions have raised capital well above the regulatory requirements. While extreme volatility is likely to persist in coming weeks or months, current valuations present attractive long-term value.

US municipal bonds have been unfairly impacted by massive ETF and fund outflows, with managers liquidating positions to raise capital in an illiquid market. As a result, muni benchmark yields have spiked to 3.5%, its highest level since 2011. However, this has occurred while UST markets are rallying, creating massive dislocations in relative yield ratios. Currently, muni yields across the curve are at least 200% higher than UST. This is even more pronounced on the short-end, where 2-year ratios exceed 600%. This has created historic value in a market that tends to be considered a high quality asset with historically lower defaults than comparably-rated corporate bonds.

![Figure 2: Municipal bond Yields Relative to US Treasuries](source: Bloomberg as of March 22 2020.)

3. **How Have Equities Behaved So Far?**

The Virus Crisis has repriced all equities, sometime rationally and sometimes not. Traditional defensives such as food and staples retailing and areas of healthcare and biotech have outperformed on a relative basis. Health care shares have historically been reliable defensive plays during downturns and recessions, having grown earnings in the last three recessions when the broader market experienced EPS declines. Weaker balance sheet companies, many of which are in the energy and hospitality sectors have greatly underperformed cash rich and low debt companies.

As is evident from the chart below, there are several areas of the market like Fintech, Cybersecurity and Dividend Growth stocks that have lost value at much greater rates than their trajectory deserves. Even Consumer Services and
Banks that are impacted most greatly by the halt in the economy are likely to recover sharply. Thus, we can see that in the rush for liquidity, value has been created for long term investors.

Figure 3: Returns for Equity Market Regions, Sectors and Themes Since February 19 Covid Collapse

![Chart showing returns for equity market regions, sectors, and themes since February 19 Covid Collapse.](chart)

Source: Factset as of March 22 2020.

Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Past performance is no guarantee of future results. Real results may vary.

4. **Equities: Are We At The Bottom?**

Equity markets have fallen 30% in 22 days, the fastest drawdown in the modern era. The swiftness of this selloff has coincided with the remarkable speed with which the global economy is contracting as virus containment measures severely curtail our lives and our expenditures. New cases are likely to continue to rise sharply across Europe and the US in the coming weeks, exacerbating an already difficult situation for hourly service workers and travel-related industries. US and some other developed governments have yet to provide the unwavering support in sufficient size that would prevent a downward spiral of job losses and curtailed spending.

Figure 4: Number of days to reach 30% S&P 500 decline

![Chart showing number of days to reach 30% S&P 500 decline.](chart)

Source: Factset as of March 22 2020.

Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Past performance is no guarantee of future results. Real results may vary.

Equity valuations have only just begun to reflect what should be a severe hit to profits in 2020. Given our pre-virus expectations for modest global EPS growth in 2020, we view roughly 20-25% of the equity market selloff so far as simply reflecting the scope of the immediate crisis. The remaining 5-10% of margin compression would bring current year price-to-earnings multiples merely back to mid-2019 valuations. A panicked overshoot would take equity markets down further. Thus, while down considerably, equities are not at crisis levels yet. Positives for the equity outlook are 1) the
quick and significant policy response and 2) the “exogenous” nature of the shock which also points to a potentially quick and sharp recovery from a low base.

Lastly, as we wrote last week, we are looking to the bond market for signs of stabilization before we can confidently call the bottom in equities. Access to credit for investors and corporations is necessary to drive a sustainable rebound in equity valuations.

5. **What Attitude Do I Need To Have To Be A Good Investor Now?**

Know yourself. If you do not have the stomach for staying invested through another 20%+ fast decline in markets, you might want to stay out of these dangerous waters. In Homer’s epic, Odysseus lashed himself to the mast, so he could sail past the fatal Sirens tempting him to ruin. If you invest in these times, know that while the rewards may be great, the temptation to stop the pain in the middle of the path could destroy years of future gains. Over more than a century of data, three years after an initial 25% drop in the S&P 500, markets were up on average 31%. In between that first decline and gains, there have been dramatic additional declines, with markets down nearly 40% in 2 cases.

**Figure 5: Duration and Depth of US Equity Market Declines Larger than 25%**

<table>
<thead>
<tr>
<th>First 25% Decline</th>
<th>Days to Trough</th>
<th>Days to Up 10%</th>
<th>Total Decline After First 25% Down</th>
<th>Return after First 25% Drop 18 Months</th>
<th>Return after First 25% Drop 24 Months</th>
<th>Return after First 25% Drop 36 Months</th>
</tr>
</thead>
<tbody>
<tr>
<td>1962, Jun-14</td>
<td>12</td>
<td>15</td>
<td>-3.7%</td>
<td>36%</td>
<td>47%</td>
<td>57%</td>
</tr>
<tr>
<td>1970, Apr-28</td>
<td>28</td>
<td>3</td>
<td>-13.7%</td>
<td>17%</td>
<td>33%</td>
<td>34%</td>
</tr>
<tr>
<td>1974, Apr-25</td>
<td>161</td>
<td>7</td>
<td>-30.5%</td>
<td>0%</td>
<td>14%</td>
<td>10%</td>
</tr>
<tr>
<td>1982, Aug-05</td>
<td>7</td>
<td>8</td>
<td>-2.6%</td>
<td>53%</td>
<td>54%</td>
<td>82%</td>
</tr>
<tr>
<td>1987, Oct-19</td>
<td>46</td>
<td>12</td>
<td>-0.4%</td>
<td>36%</td>
<td>52%</td>
<td>36%</td>
</tr>
<tr>
<td>2001, Mar-20</td>
<td>15</td>
<td>14</td>
<td>-3.4%</td>
<td>-24%</td>
<td>-23%</td>
<td>-3%</td>
</tr>
<tr>
<td>2001, Sep-20</td>
<td>1</td>
<td>14</td>
<td>-1.6%</td>
<td>-9%</td>
<td>5%</td>
<td>15%</td>
</tr>
<tr>
<td>2002, Jul-19</td>
<td>82</td>
<td>6</td>
<td>-8.4%</td>
<td>34%</td>
<td>30%</td>
<td>44%</td>
</tr>
<tr>
<td>2008, Sep-17</td>
<td>166</td>
<td>3</td>
<td>-39.4%</td>
<td>1%</td>
<td>-3%</td>
<td>5%</td>
</tr>
<tr>
<td>Average</td>
<td>58</td>
<td>9</td>
<td>-11.6%</td>
<td>16%</td>
<td>23%</td>
<td>31%</td>
</tr>
</tbody>
</table>

Source: Bloomberg as of March 22 2020.

Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Past performance is no guarantee of future results. Real results may vary.

If an investor has the constitution to weather severe volatility, history suggests there are ample opportunities to enter markets for a portion of a new portfolio at this point. And for an investor who has stayed invested and is not looking to add to positions now, we would reiterate our advice to stay invested, as in the long run, this too shall pass.

6. **What May the Cost of Bailouts be for Public Companies?**

We believe investors should be wary of bottom fishing among the hardest hit industries in this selloff, as the financial situation for many of these firms remains dire. Firms in the most distress will ultimately require government assistance to survive.

Any government support for airlines, for example, is likely to come with some investor un-friendly strings attached. There appears to be bipartisan support in the US for banning buybacks for any firm that receives government assistance.

While the airlines in particular have “only” sought $50 billion in loans, there is of course precedent for governments taking equity stakes in systemically important firms. Partial nationalization would likely involve significant dilution of common equity shares, with government stakes potentially higher in the capital structure than private sector interests.
7. **Should We Buy Travel and Leisure Stocks and These Levels?**

We do not recommend clients buy the most beaten up names in areas such as hospitality, airlines and energy at this time. This is especially the case for companies in need of government bailouts given that any assistance is likely to come with significant strings attached that may hamper their recovery and ultimate valuation. They will, at some point, rebound sharply, but many may still have impaired businesses or capital levels after the Virus Crisis.

8. **What Areas of The Equity Market Do You Favor?**

- Medical equipment and supplies companies which are experiencing a surge in demand for their products as well as pharmaceutical and biotech firms working on antiviral drugs and vaccines to fight COVID-19.
- Companies with well-established e-commerce channels are outperforming.
- Cyber and telecommuting companies are and will remain key beneficiaries of the shift to work-from-home.
- Fintech stocks focused on payments make their money from each customer transaction at the point of sale. These stocks will likely be at the forefront of the rebound once economic activity shows signs of bottoming.
- US banks entered this crisis in healthy financial condition, with much stronger balance sheets than before the financial crisis. While short-term rates at 0 present real challenges, a steeper yield curve should help support net interest margins. We see an opportunity in the well capitalized US banks many of which are down over 40% in a month.
- Firms that are cash rich and not at the center of discretionary spending, travel and hospitality will likely survive the crisis period. This is a critical element of securities selection as the duration of the crisis is still highly uncertain.

9. **How Fast Can Markets Recover?**

The ultimate equity market recovery will likely mirror the underlying economic recovery following this crisis, with the market leading economic data. If fiscal policy is able to prevent a downward spiral of credit issues and rising unemployment, global consumption should be able to bounce back sharply, with markets anticipating that rebound within a few months.

However, while not our base case, if this Virus Crisis deepens into a more intractable economic recession, we would expect the market decline to be deeper and the subsequent economic rebound to be slower akin to the multi-year recovery following the 2008 Financial Crisis.

---

INVESTMENT PRODUCTS: NOT FDIC INSURED · NOT CDIC INSURED · NOT GOVERNMENT INSURED · NO BANK GUARANTEE · MAY LOSE VALUE

This email contains promotional materials. If you do not wish to receive any further promotional emails from Citi Private Bank, please email donotspam@citi.com with “UNSUBSCRIBE” in the subject line. Email is not a secure environment; therefore, do not use email to communicate any information that is confidential such as your account number or social security number.

Citi Private Bank is a business of Citigroup Inc. (“Citigroup”), which provides its clients access to a broad array of products and services available through bank and non-bank affiliates of Citigroup. Not all products and services are provided by all affiliates or are available at all locations. In the U.S., investment products and services are provided by Citigroup Global Markets Inc. (“CGMI”), member FINRA and SIPC, and Citi Private Advisory, LLC (“Citi Advisory”), member FINRA and SIPC. CGMI accounts are carried by Pershing LLC, member FINRA, NYSE, SIPC. Citi Advisory acts as distributor of certain alternative investment products to clients of Citi Private Bank. CGMI, Citi Advisory and Citibank, N.A. are affiliated companies under the common control of Citigroup.

Outside the U.S., investment products and services are provided by other Citigroup affiliates. Investment Management services (including portfolio management) are available through CGMI, Citi Advisory, Citibank, N.A. and other affiliated advisory businesses. These Citigroup affiliates, including Citi Advisory, will be compensated for the respective investment management, advisory, administrative, distribution and placement services they may provide.

Read additional important information.
Past performance is not indicative of future results. Real results may vary
Important information, including information relating to risk considerations, appears at the end of this publication.
Views, opinions and estimates expressed herein may differ from the opinions expressed by other Citi businesses or affiliates, and are not intended to be a forecast of future events, a guarantee of future results, or investment advice, and are subject to change without notice based on market and other conditions. Citi is under no duty to update this presentation and accepts no liability for any loss (whether direct, indirect or consequential) that may arise from any use of the information contained in or derived from this presentation.

© 2020 Citigroup Inc. All Rights Reserved. Citi, Citi and Arc Design and other marks used herein are service marks of Citigroup Inc. or its affiliates, used and registered throughout the world.

www.citiprivatebank.com