WELLINGTON SHIELDS & CO. LLC
Quarterly Market Strategy Report

April 1, 2020

Patience

RECORD SETTING

The first three months of 2020 were difficult for investors and the 20% loss in the S&P 500 was the worst decline since the 2008 financial crisis. The Dow Jones Industrial Average's 3-month drop of 23% was its poorest quarterly performance since 1987. But these percentages were only half the story. From the DJIA's all-time high of 29,551.42 on February 12, 2020 to its March 23 low of 18,591.93, the index plunged 37% in only 40 calendar days (27 trading sessions), exceeding in both time and percentage, the 36% decline made in 55 calendar days in 1987. In short, the global fight against COVID-19 has been an historic struggle and the decline in the US equity market has been equally historic.

THE BOTTOMING PROCESS

Statistics on the coronavirus pandemic are certain to become worse in coming weeks, nevertheless, signs that the equity market is in the process of forming a bottom are accumulating. Between February 24 and March 24 there were eight extreme trading days in which 90% or more of the day's volume was in declining stocks (90% down days). This is a simple definition of panic selling and it identifies an emotionally wrought market. Historically, once a string of 90% down days is followed by a 90% up day, it signals that the worst of the selling is over, and buyers are re-entering the marketplace. A 92% up day appeared on March 13 followed by a 94% up day on March 24. We believe the bottoming process has begun. More extremes occurred at the March 23 low of SPX 2237.40, when our 25-day up/down volume oscillator fell to its deepest oversold reading since July 2002. The July 2002 reading preceded the October 2002 low by a little over two months. Similarly, at the end of March the American Association of Individual Investors' survey showed bearish sentiment was over 50% for three consecutive weeks – the longest stretch since the four-week reading in early March 2009. Nevertheless, these signals, just like in 1987, 2002 or 2009, show that a bottoming phase is in place, but it will take time. In most cases, the process takes two to three months. And though two months can feel like eternity in an era of 24-hour news, high frequency trading, smart phone alerts and hourly updates on the COVID-19 pandemic, it is important to remember that a long bottoming process is not only normal, but healthy for the equity market.

The equity market is a discounting mechanism and it can deal with bad news better than it can with the unknown. March's perpendicular selloff was clearly fear of the unknown. This coupled with margin calls and the unwinding of leverage created a frightening environment in two very intense weeks. And while the real economic fallout of COVID-19 is still uncertain, what is clear is that economists are predicting a recession of huge proportions. Recently, Goldman Sachs' forecast for second quarter GDP fell from negative 6% to negative 24% and to negative 34% in fourteen days. And as disturbing as this forecast is, the good news is that this negative 34% GDP forecast is in the public domain and one can assume it is now discounted by stock prices. Forecasts of economic weakness and poor corporate earnings are a critical part of the bottoming process. We expect first quarter earnings season, which begins in mid-April, will be another important part of the "informational" bottoming process. Keep in mind that first quarter's

earnings reporting season and peak COVID-19 numbers are apt to coincide in the month of April and both are nearly certain to bring more bad news. Therefore, investors should expect more volatility. However, it is likely that the shock and awe stage of the bottoming process is behind us and the adjustment phase to the new reality has begun. This is when information about the economy begins to appear and bargain hunters usually tip toe back into the market.

It is not unusual for the equity indices to retrace as much as one-half of the decline during this adjustment phase. This would equate to roughly SPX 2810. And while it is too simplistic to suggest that a bottoming process is the equivalent of a trading range, we do believe there are upper and lower levels that will be significant in coming weeks. On March 23 the intra-day low of the session was SPX 2191. This is noteworthy since there is major support between SPX 2120 and SPX 2200 which was major resistance for all of 2015 and 2016. All of this implies that most of the bottoming process in coming months should be contained within a range of SPX 2200 to SPX 2800.

Any test of the SPX 2200 level will be important in coming weeks and we will be looking for a decrease in total trading volume and a less severe oversold reading in our 25-day oscillator to confirm that the lows are clearly established. Again, a bottoming phase takes time and requires patience, but knowing what to expect and having a good roadmap can make the process not only less stressful, but more profitable in the longer run.

THE STIMULUS PACKAGES

The CARES Act, or the $2 trillion coronavirus relief bill, was a good stimulus package in our view since most of the stimulus was focused on individuals and small and medium sized businesses. The goal of the bill is to keep workers and businesses financially afloat during this mandatory shut down in order to prevent evictions, defaults and bankruptcies. And though we believe most of this money will find its way back into the economy, the onus in the next few weeks is for the government to get the money quickly into the hands of consumers and businesses that need it. President Trump has indicated he would like to follow up with a "phase four" stimulus bill in the form of a $2 trillion infrastructure program. Together these two stimulus packages would equate to more than 18% of nominal GDP which is in line with the four-part stimulus seen in the two-years that followed the 2008-2009 financial crisis. However, the construction of these two stimulus programs is quite different. In 2008 the TARP stimulus went directly to banks and auto companies to bolster failing balance sheets. It was not a direct stimulus for the economy. The 2009 shovel-ready stimulus package went directly to government agencies, employed many bureaucrats, but it did little for the economy. Only the 2010 tax relief bill gave a boost to the economy by lowering FICA taxes and giving workers more take-home pay. In contrast, the current stimulus package is designed through direct deposit, individual checks, business grants and loans, to directly support the employees and businesses that need money now to pay for necessities. As a result, it should help prop up the economy during this difficult time. Simultaneously, the Federal Reserve has stated it stands ready to provide as much liquidity as is necessary to support the banks and debt markets. It has already added aggressively to its balance sheet and this is in conjunction with similar monetary stimulus programs throughout Europe. This robust combination of monetary and fiscal stimulus should not only help relieve the stress on the economy but help reduce tension in the securities markets.

MELDING MARKET TECHNICALS AND FUNDAMENTALS

The SPX 2120-2200 range was successfully tested on March 23 and is an area of good long-term technical support. Plus, this SPX 2191 intraday low discounted a large amount of the earnings uncertainty seen for 2020 earnings. Using a four-quarter estimate of $156 for the end of March, the trailing PE fell to 14.0 times on March 23 – a PE that is well below the long-term average of 15.5 times . Even after the rebound to SPX 2584.59 at the end of March, the trailing PE rose to 16.5 times matching the trailing PE seen at the December 2018 low. In short, there are many technical and fundamental signs that the market began a bottoming process in March. But as history suggests, lows are made to be tested and that still lies ahead. It will require patience.

Gail M. Dudack
Market Strategist

Disclosure: The information herein has been prepared by Dudack Research Group ("DRG"), a division of Wellington Shields & Co. The material is based on data from sources considered to be reliable; however, DRG does not guarantee or warrant the accuracy or completeness of the information. It is published for informational purposes only and should not be used as the primary basis of investment decisions. Neither the information nor any opinion expressed constitutes an offer, or the solicitation of an offer, to buy or sell any security. The opinions and estimates expressed reflect the current judgement of DRG and are subject to change without notice. Actual results may differ from any forward-looking statements. This letter is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the specific needs of any person or entity.

This communication is intended solely for use by Wellington Shields clients. The recipient agrees not to forward or copy the information to any other person without the express written consent of DRG.

Copyright © Dudack Research Group, 2020.

Wellington Shields is a member of FINRA and SIPC