HALLMARK
CAPITAL
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Market Update
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The speed of this market downturn has been unusual, largely because the drop in economic activity did not occur from typical end-of-cycle overinvestment, but from an external (biological) shock. While past decades have seen various epidemics, this is the first time that health officials and governments have so strenuously worked to contain the spread of a disease. This may be a rational response, but the longer societies are forced to hunker down, the larger the economic ripple effects will be. While the initial economic effects were supply issues, as production out of China came to a halt, this has been replaced by a demand problem. Consumers are now restricted from normal activities and businesses have been ordered shut. No modern economy, outside of war, has experienced such a sudden stoppage of entire industries. Americans spend over $1 trillion annually on hotels and restaurants and we're confident that the numbers are similar across the EU. The revenues from those establishments not only go to their employees' wages, but to pay rent, buy food and supplies, pay state and local taxes, etc. Their employees are generally hourly workers who are unlikely to have the savings on hand to get by for an extended period without a paycheck. Without an income, they will cut their spending, which will affect other industries. The longer the shutdown, the more damage and the more time needed to repair it.

In response, the federal government is working to enact an unprecedented large fiscal stimulus to get payment directly to citizens and industries. This follows the extension of sick leave benefits and unemployment insurance. The Federal Reserve Bank has aggressively cut interest rates to near zero and established numerous facilities to support credit markets.

Once it becomes clear that the worst of the epidemic has passed, the economy will begin to recover. People are willing to go along with these changes because of the necessity, but the desire to travel, dine out and be entertained are unlikely to be greatly diminished. The savings rate should be increasing as consumers have been forced to cut back and eventually the savings from lower gasoline prices will flow through to consumer's pockets. Consumer spending should snap back, once we are allowed to be out and about in society again.

The stock market should take its traditional role as a leading economic indicator and the market recovery could be as strong on the upside as it has been violent on the downside. The amount of monetary and fiscal stimulus being injected into the system should have more of an effect once the markets are convinced that the worst has passed. The timing will depend upon when health officials become convinced that the spread of the disease has been sufficiently contained. Unfortunately, without better testing we are unlikely to know for several more weeks. Drug companies are testing several compounds that may prove to be effective treatments. It is likely the Food and Drug Administration will fast track approvals, which would be a big step in stopping the virus.

Our sense remains that this downturn will be severe, but relatively short. We have confidence that society will act in a way to protect itself from the disease and that science will provide better treatments. That should provide a way to return to more normal activities and a stronger economy.

Business operations are uninterrupted at Hallmark Capital Management. We've maintained and tested our business continuity plan in preparation for such disruptions. Do contact us if we can be of service during this challenging period.