

Informational commentary from Pacific Asset Management LLC, investment manager for certain U.S. fixed income options within Pacific Life variable annuities.

## COVID-19'S CURRENT IMPACT ON MARKETS

Dominic Nolan, senior managing director of Pacific Asset Management, provides his analysis below of the markets currently battered by the COVID-19 pandemic. In this fluid economic environment, it's important to note that these are his views as of March 11, 2020.

As of close March 11, 2020, equity markets are down more than 20% from their peak, ending the longest bull market in U.S. history. In addition to equities entering a bear market, credit markets continue to be strained. The World Health Organization stated COVID-19 has reached a pandemic level, and news that companies such as Boeing, Wynn, Hilton, Blackstone, and Carlyle portfolio companies are drawing down bank lines fueled investor fears. Today reflected a change in market tone relative to previous sessions, as liquidity took priority over valuation.

### Orderly

On March 10, 2020, risk assets were seemingly sold in an orderly fashion. When comparing equities, leveraged credit, investment-grade credit, short-duration assets, and U.S. Treasuries, the drawdown was significant, but the relative levels were orderly. We saw heavier strains with energy and COVID sectors (I define these as travel, leisure, and retail), which is consistent with the macro backdrop. In a nutshell, it was a de-risking day.

### Disorderly

March 11, 2020 was a different story. While risk assets sold off, there was strain in the Treasury market and short-end of the curve. U.S. Treasury yields moved higher, with the 10-year moving higher by 12 basis points (one basis point equals 0.01%). Investment grade credit was down more than leveraged credit. In particular, the short-end was weak. This backdrop is more consistent

with liquidity strains than de-risking objectives. In periods when liquidity is the greater concern, investors will liquidate their lowest risk, highest-quality assets.

To use a euphemism, broad markets are still in "price discovery" mode. In other words, investors are not sure what the proper compensation for risk should be at this time. This is due in large part to the fact that underwriting how bad the economy will get, for how long, and how quickly a recovery could occur is almost impossible. Information is changing at such a rapid rate, with significant leverage points, resulting in reactions that are much more pronounced than usual.

### A Recession is Already Priced In

In less than a month, weak markets became stressed markets, which quickly evolved into cracked markets, and may be transitioning into panicked markets. My inference here is that we have not gone through a true panic yet, but things are certainly cracked (I also do not know if we will get to a panicked market, but it sure feels that way). At this time, risk markets are pricing in a recession. Whether this will be an official recession is unknown, as expectations for a negative, second-quarter, gross domestic product (GDP) print are baked in, while expectations for a weak third quarter are increasing. As an anecdote, bank loans levels suggest an implied annualized default rate of around 9%. Meanwhile, forecasted defaults are edging higher to 5%.

## Over the Next 10 Days

I expect the number of U.S. residents infected with the Coronavirus to increase substantially as test kits are rolled out. The good news is mortality rates should decrease (since the denominator is larger), the bad news is many more cities and states will declare public-health emergency status, which will generate more panic headlines. From a policy standpoint, a fiscal stimulus package is expected to be announced and more cuts from the Federal Reserve should help stem liquidity concerns and promote economic support. Markets are currently discounting a 75-basis-point cut this month.

We know credit is certainly weak, but it does not mean the companies we lend to are. We have an experienced, seasoned, stable, and committed team shepherding these assets. We have been through times like these and stick to what we know. History has also shown that once the dust settles, the opportunities created in these times tend to reward the steadfast and agile hand.

We do not expect volatility to subside anytime soon. There will most likely be continued pressure and stress on the front end of the curve for liquidity purposes (investors that need liquidity typically sell their best/highest dollar assets). We are cognizant of this and are moving daily to adapt.

---

This publication is provided by Pacific Life. This commentary reflects the views of the portfolio managers at Pacific Asset Management as of March 11, 2020, are based on current market conditions, and are subject to change without notice. These views represent the opinions of the portfolio managers and are presented for informational purposes only. These views should not be construed as investment advice, an endorsement of any security, mutual fund, sector, or index, the offer or sale of any investment, or to predict performance of any investment. Any forward-looking statements are not guaranteed. All materials are compiled from sources believed to be reliable, but accuracy cannot be guaranteed. Sector names in this commentary are provided by the Funds' portfolio managers and could be different if provided by a third party.

All investing involves risk, including the possible loss of the principal amount invested.

*Pacific Life is a product provider. It is not a fiduciary and therefore does not give advice or make recommendations regarding insurance or investment products.*

Pacific Asset Management is a registered service mark of Pacific Life Insurance Company.

Pacific Life refers to Pacific Life Insurance Company and its affiliates, including Pacific Life & Annuity Company. Insurance products are issued by Pacific Life Insurance Company (Newport Beach, CA) in all states except New York and in New York by Pacific Life & Annuity Company. Product availability and features may vary by state. Each insurance company is solely responsible for the financial obligations accruing under the products it issues.

Securities are distributed by **Pacific Select Distributors, LLC** (member FINRA & SIPC).

VACI657-0320W

2 of 2



THE OFFICIAL SPONSOR  
OF RETIREMENT™