Lifeworks

# Market Update

March 26, 2020

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It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of light, it was the season of darkness, it was the spring of hope, it was the winter of despair.

– Charles Dickens, A Tale of Two Cities

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# March 16-24, 2020 — The Worst Week and Best Day

March 18, 2020, marked the eighth straight day the S&P 500 closed with a move greater than 4%. Want to guess the last time that happened? Never. Welcome to history in the making.

Last week the S&P 500 fell by 14.95% and the Dow Jones was down 17.29%[1]. But, before any of us should get too worked up over a bad week, our team looked back at a century's worth of market data to see what we can learn from history.

- The market falls roughly 10% about once a year
- Every 4–5 years we have experienced a 20% drop
- Every decade the market has a drawdown of 30%+ peak to trough

So while these past few weeks have not been fun, it is good to remind ourselves that historically we see a 30%+ drop in the market about every ten years. Through Friday (3/20/2020) the S&P was down 28.33% and the Dow was down 32.41%. The last time we saw a drop of this magnitude was eleven years ago during the Financial Crisis of 2008–2009.

Some of the other notable bear markets as measured by the S&P 500 include:

- 2007–2009: down 59% over 27 months
- 1973–1974: down 48% over 21 months
- 1929–1932: down 86% over 34 months

So while the recent selling has been ferocious, this isn't the worst of times… yet.

Monday this week started down and then Tuesday (3/24/2020) we saw the largest single-day gain in the Dow since 1933[2]. Today, as we write this market update, the Dow and S&P 500 are both up. The word " whiplash" comes to mind.

## Another Busy Week at the Federal Reserve

Accept my apology in advance for the dry reading that is about to follow. Please know that I wouldn't waste your time with unnecessary information. These types of actions taken by the Fed are significant, not normal, and worth understanding (even if just at a high level) what they are trying to accomplish with these major policy changes.

Last week saw the Federal Reserve continue to take aggressive measures to provide liquidity and try to calm the financial markets:

<u>CPFF</u>[3]

CPFF = Commercial Paper Funding Facility. This program essentially allows financial institutions, banks, investment companies, brokerage firms, credit card companies, large corporations, etc… to post commercial paper (unsecured notes with less than 9 months to maturity, typically 30 days or less) as collateral for direct loans from the Fed. Interestly, the Fed will have $10 billion of loan insurance for this program courtesy of the U.S. Treasury (i.e. you the taxpayer are on the hook if/when these unsecured loans go bad). Essentially, financial institutions who need dollars (for whatever reason) can use commercial paper as collateral for loans from the Fed at very favorable terms.

MMLF[4]

MMLF = Money Market Mutual Fund Liquidity Facility. That is a mouthful. This program allows the financial institutions to get loans from the Fed at favorable terms by using municipal bonds and other "high quality assets" as collateral. In a normal market, those financial institutions would just sell their municipal bond holdings to other buyers to raise cash. The problem is that the credit markets are being hit just as hard as the equity markets and there are more sellers trying to offload fixed income (credit) assets than there are buyers. This is a clear sign of a dysfunctional market and the Fed is intervening to try to restore normal market functions.

PDCF

PDCF = Primary Dealer Credit Facility. What is this you ask? This is a program that the Fed ran during the 2008–2009 financial crisis. Essentially it allows primary dealers (firms that are direct trading counterparties with the New York Fed and whose primary job is to stand ready to buy newly issued U.S. Treasury debt every day) to post a wide range of assets as collateral for term loans from the Fed. Why am I getting this technical and talking about something only monetary policy nerds talk about? The simple answer is that this shows how the Fed is pulling out all of the stops and is doing just about everything possible (or everything within its power) to keep the financial markets liquid and functioning. As I mentioned last week, one of the most significant issues facing the financial markets is a global shortage of dollars. This shortage of dollars was driving up the value of the U.S. dollar relative to other currencies. Without this credit facility, the Primary Dealers could face their own liquidity issues and then they wouldn't be able to facilitate the buying and selling of Treasury securities in the market.

Coordinated Central Bank Action[5]

The Fed has entered into new "temporary" U.S. Dollar liquidity arrangements with other nations' central banks. These are in addition to some of the standing arrangements already in place with the EU, Bank of England, Bank of Japan, etc...

Reserve Requirement[6]

Reserve Requirements are the percentage of a bank's deposits (there are technical differences between types of deposit accounts and which banks are required to maintain reserves with the Fed, but I won't bore you with those details) that a bank is required to hold in "reserve" at the Fed. (Think of it as your bank having a savings account with the Fed.) One of the reasons why a bank is required to hold reserves is to ensure that it can meet its financial obligations in the case of sudden withdrawals by its depositors, i.e. a run on the bank.

The Fed just reduced the reserve requirement for banks from 10% down to 0% effective March 26th, 2020. This allows banks to use more of their cash deposits for lending activities and increases the liquidity in the dollar market.

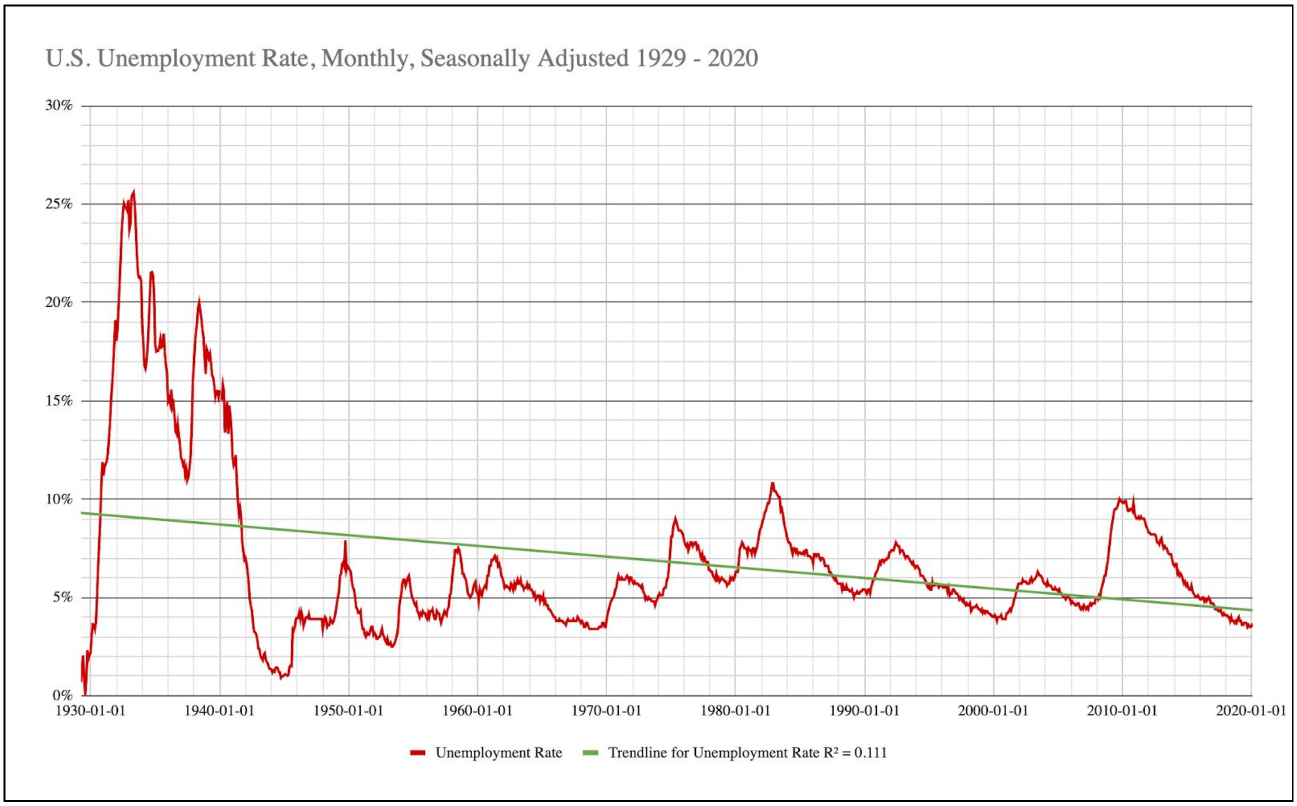
## Unemployment

Last week Amazon announced it would be hiring 100,000 employees. And it's not just Amazon. Walmart, Pepsi, Instacart, and Domino's all announced they would be hiring. It appears that these hires will be possible due to…...layoffs.

Until a couple of weeks ago, the labor market was historically tight. The unemployment rate was around 3.5%, a 50-year low.

All that changed with this virus. There are analysts predicting that one million Americans will lose their jobs, just this month. As of yesterday (3/25/2020), seventeen States have issued lockdown (stay-at-home) orders, and others have closed businesses down to just those deemed "essential". Restaurants, retail stores, gyms, construction companies, and other small businesses will be hit the hardest. According to research from JP Morgan, the median small business cash buffer is just 27 days.[7] Meaning, if the economic shutdown lasts for more than a fews weeks, many of these small businesses will not re-open.

What a contrast we see today from just a couple of weeks ago (days feel like weeks and weeks like years) when firms were having a hard time finding people to work. We have taken a 180-degree turn and now the headlines are everything from mild recessionary predictions to doomsday depression-type predictions. The scope and magnitude of layoffs will indicate the damage to the economy. If the shutdown of our economy is short-lived, perhaps less than three weeks, we believe it is likely that many of the workers laid off will have a job waiting for them on the other side. However, if the shutdown lasts for an extended period, we would expect to see temporary layoffs turn into permanently lost jobs. Here is a graph that shows U.S. unemployment rates from just before the Great Depression to the current time:[8]




## Coronavirus

From January 21 (the date of the first identified case in the U.S.) to March 24, the U.S. has confirmed 54,453 cases and has experienced 737 fatalities. For context, this means that over the past 60 days, 0.0165% of our population have tested positive for COVID-19 and 0.000223% have died from the virus.

| Est. Total U.S. Population | Current Cases (as of March 24) | % of U.S. Infected | Total Deaths (COVID-19) | % of U.S. Population Deceased from COVID-19 | Current Mortality Rate |
|---|---|---|---|---|---|
| 330,000,000 | 54,453 | 0.0165% | 737 | 0.000223% | 1.35% |

We don't share these numbers to make light of the virus or to make any prediction as to where these numbers are likely to go in the future. However, we do believe that good decisions are ones that are based on good data. The key word being "good". In our non-medical opinion, the data for this virus appears to be all over the board and probably isn't telling an accurate story. Or the data isn't yet providing experts with enough information to accurately estimate the trajectory of the virus and the economic cost.

News headlines compare the U.S. to Italy or other countries that are experiencing much higher fatalities. Or they are focusing on worst case scenario projections. We haven't seen many news headlines about Germany (31,554 cases, 149 deaths) or Israel (2,170 cases, 5 deaths)—probably because it doesn't generate as many clicks (i.e. revenue for news organizations).

It is helpful to take a step back and remember viruses are not uncommon, even novel ones (bad pun). Not long ago, the swine flu affected over a billion people worldwide, accounting for 280,000 deaths. In the United States there were an estimated 60,000,000 cases and 13,000 deaths. One year after the swine flu, the S&P 500 was up by double digits. The point is that these types of events do impact the market. However, the market will recover.

Here are some of the websites that we are using to track the coronavirus statistics if you are interested in keeping an eye on the numbers as well:

**U.S. Centers for Disease Control and Prevention**
https://www.cdc.gov/coronavirus/2019-ncov/cases-updates/cases-in-us.html

**World Health Organization**
https://experience.arcgis.com/experience/685d0ace521648f8a5beeeee1b9125cd

**Johns Hopkins**
https://coronavirus.jhu.edu/map.html

## Don't Be Driven By Fear — This Isn't The Worst of Times

Media companies make money scaring us. Their stock market "experts" make money selling newsletters, "secrets of the rich", or telling you the sky is falling and you need to buy something or sell something.

It is important to recognize that this current pandemic has a lifespan of months, not "forever". This virus will run its course as have ones before it—all pandemics come to an end. The Federal government (for better and for worse) will inject massive stimulus to get the economy back in shape. Unless there is a breakdown of society and social unrest in the streets, we will recover from this and then forget it.

It's important to check our emotions and remember that we often make decisions with our hearts and then rationalize them with our heads afterwards. Whether we like it or not, most every decision is one made out of fear or excitement; making decisions out of emotion, regardless of which one, can be a recipe for disaster.

The last time that things looked this bad in the market, we embarked on the longest bull run in the history of the stock market. While bull markets often last for years, a significant portion of the gains typically occurs during the early months of a market rally. According to a report from Fidelity[9], since 1929 the S&P 500 has gained an average of 47% in the year after the low point in the market.

Investors who run to cash during bear markets should consider the cost of missing the early stages of market recovery, which historically have provided the largest percentage of returns for their time invested.

This data should strengthen our resolve to remember that all of this has happened before. Yes, the coronavirus (COVID-19) is new—but wild stock market volatility is not. There have been plenty of steep market downturns and we've recovered from every single one.

The selling over the past few weeks has been both indiscriminate and ferocious. In many cases, stocks have given up years' worth of gains in a matter of days. Keep in mind, the actual (intrinsic) value of companies like Coca-Cola, McDonalds, Nike, Delta, Home Depot, etc...does not change by 10% in a day. Their stock prices might move that much, but the actual value of the company rarely does. When stock prices are moving rapidly in volatile markets like the one we are in now, the prudent approach is to stay focused on the intrinsic value of the company and look at it as the best of times to buy instead of the worst of times to be an investor.

Live above the grind,

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# Disclosures & Footnotes

1. Data from Factset.
2. https://www.cnbc.com/2020/03/24/biggest-surge-in-the-dow-since-1933-probably-doesnt-mark-the-bottom-of-this-bear-market.html
3. CPFF: https://www.federalreserve.gov/newsevents/pressreleases/monetary20200317a.htm
4. MMLF: https://www.federalreserve.gov/newsevents/pressreleases/monetary20200320b.htm
5. Coordinated Central Bank Action: https://www.federalreserve.gov/newsevents/pressreleases/monetary20200320a.htm
6. Reserve Requirement: https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315b.htm
7. https://www.marketwatch.com/story/small-businesses-could-crumble-in-45-days-or-less-as-coronavirus-pandemic-takes-a-toll-2020-03-16
8. Unemployment Rate 1929–1942: https://fred.stlouisfed.org/series/M0892AUSM156SNBR National Bureau of Economic Research, Unemployment Rate for United States [M0892AUSM156SNBR], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/M0892AUSM156SNBR, March 25, 2020.
9. https://www.fidelity.com/viewpoints/market-and-economic-insights/bear-markets-the-business-cycle-explained

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