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“By The Way”

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“You never hear the bullet that gets you”

“You never hear the bullet that gets you” was the morbid saying used by soldiers in the trenches in World War I. My good friend, Rick Betts, has always used the quote in regard to financial markets. No matter how much time and effort one puts into research, it is often the unexpected piece of information that has the biggest impact on markets and individual stocks. In today’s case the Coronavirus is just such a bullet. I have written extensively over the past decade about possible factors that could derail the bull market that quintupled the S&P 500 Index. Slow growth in GDP, wars, populist protests, Brexit and disinflation are amongst the host of reasons that might have caused the market to falter, but over and over again they proved to be just another occasion to buy stocks. It is entirely possible this decline could provide the same opportunity, but at this point it just feels different and more serious if for no other reason than the severity and suddenness of the decline. From the euphoric all time S&P highs of 3386 on February 19th we have experienced a reversal of approximately 30% in less than a month. The volatility of markets during the period has also been remarkable triggered not just by natural buyers and sellers but by algorithms and machine-driven trading. I’m too old to fully understand the intricacies of the options and futures markets, but the strategies driven by terms such as delta, gamma and convexity sharply increase volatility based on mathematical formulas not on a view of the market. “If you can keep your head when all about you are losing theirs” is sage advice from Kipling but not easy to practice in times like the present.

Since the 2008 financial crisis any event that posed a problem for the continued growth of the U.S. economy and stock market has been rather quickly diffused by the easing policies of the Federal Reserve Board. By lowering interest rates or injecting liquidity into the system the Fed was able to assuage the concerns of investors and the markets resumed their upward trajectory. It has been my long-held belief that such policies played a major role in the lengthy bull market we have experienced since 2009. Investor reaction to the most recent Fed policy announcements suggest this is no longer the case. Regulated rates are now at the so called “zero bound” and massive injections of new liquidity are promised, but both statements only added to the market’s fears and resulted in much lower prices. The concern of many commentators may be becoming a reality; the Fed has lost control. It is at least fair to say that the belief the Fed could and would step in to successfully support markets seems out of date.

“This too shall pass” is appropriate commentary on the current situation, but when and how bad will it get in the meantime are questions without answers. Each day though appears to make the timeline longer. It is obvious that shutting down large sectors of the economy will have very serious consequences, and a recession appears to be a sure thing. The market though

has always been a discounting mechanism and as such should show signs of improvement as soon as there is evidence that the virus is under control. As for the economy I would think that there would be a sharp snapback as people rush to spend money and get back to a normal life, but when that might be only leaves us “looking through a glass darkly”.

The S&P 500 has shown glimmers of hope in that internal measures of strength have been recently stronger than the overall index. There is not nearly sufficient reason to become an aggressive buyer as yet but we will continue to monitor those factors, optimistic that a bottoming process is on the horizon.

Finally, as painful as equity markets are, the real trepidation I feel lies within the fixed income markets. If interbank lending seizes up or large numbers of Triple B corporate bonds are downgraded or bankrupted due to the weak economy, things will get much, much worse. Fortunately, the Fed still has powers to provide liquidity to the fixed income market and avoid such a calamity. Stay well.

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