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Coronavirus Update #5: A View of Tomorrow

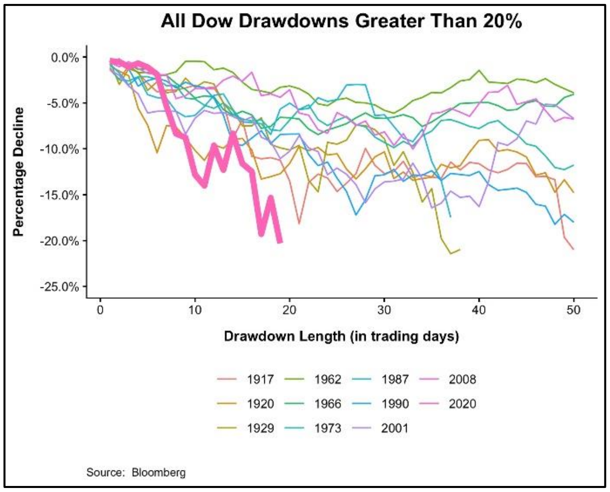
"My center is giving way, my right is in retreat, situation excellent. I shall attack."

- French General Ferdinand Foch, 1914 Battle of the Marne

History may not exactly repeat, but it does seem to rhyme. It's a newly coined version of an old saying, and I like it and have taken to using it often.

Speaking of old…I've been in this business since 1981, which means I have experienced the 1987 crash, the end of the Dot-Com era, the September 11 terror attacks, and the 2008 Financial Crisis. I feel safe in saying that—while what we are witnessing today is unique to the subject matter—the characteristics and market reaction to the phenomenon seem eerily similar to those we have witnessed before.

So, here we are again: the tide is now running out fast and panic selling has swept over capital markets, arriving at what will be characterized as the fastest bear market in history.



What Happened? (for my engineers, analysts, and other statistics hounds)

So, the bull market that began on March 10, 2009, is officially over. It lasted 131 months (2,756 trading days, and one month short of 11 years in duration). It was the 11th and longest bull market since the end of WW2, producing the second largest overall gain.

S&P 500 Market Peak: 3386 (on Feb. 19, 2020)

That bull market was a beast. It gained +529% (total return) or an annualized gain of 18.3% per year (total return), and set 255 all-time closing highs.

Then, the market began to dip. The S&P 500 fell 29.52% to 2386 on March 16, 2020. The fall was the fourth drop of at least 15%, but was the first decline of at least 20% that has occurred during the bull market that began on March 10, 2009.

The other three "near-bears" ended on:

- July 2, 2010 (off 16%)
- Oct. 3, 2011 (off 19.4%)
- Dec. 24, 2018 (off 19.8%)

In the 75 years from 1945-2020, the S&P 500 had 12 declines of at least 20%, or about one every 6.25 years. The stock market suffered its 12th bear since 1945 last week.

In the previous 11 bear markets over the past 75 years, the stock market recovered 100% of the loss sustained, going above the previous bull market high. The average recovery time from the low point in the downturn to a new high closing price was 24 months.

This one may be hard to believe: long-dated Treasury bonds (like the Fidelity LT Treasury fund that Frontier owns in its portfolios) produced a gain of 46.4% on a trailing 1-year basis as of the close of trading last Monday. That is called **diversification**, and we practice it here at Bodnar Financial.

Why Does the Market React This Way?

(This section may be a little too much *Inside Baseball* for some of you, but fight through it.)

This is one of those periodic storms that upend markets every so often (i.e., 1974, 1987, 2008, etc.). Their path, duration, and resolution depend on the causes and the response by authorities—although they usually share similarities (the rhyme).

Since the Financial Crisis, investors have been volatility-phobic, regularly overestimating risk, leading to sharp, scary market declines in 2011, 2016, 2018. These sharp declines were in response to events that conjured up visions of 2008, none of which came to pass. Instead, what we got was the greatest bull market in history, proving another old saying during this past decade: Wall Street climbs a wall of worry.

At this early stage, this market decline is acting with a speed and depth that reminds me of 1987. Thus, the perceived economic risk is considerably greater than other declines. But the real risk is still unknown.

In broad terms, we have an exogenous event—the virus—that initially caused a moderate shock to global supply by disrupting the flow of goods from China. That has now morphed into a major disruption in global demand as the virus spreads around the world and governments attempt to curtail its spread and its effect on public health by closing schools, canceling all sorts of events, banning large gatherings of people, curtailing travel and so on. The impact could be large enough to knock the global economy into recession.

Now here is the really important part: markets are discounting mechanisms. They are engaged in real-time information processing, constantly adjusting to shifting expectations and new information to create an equilibrium between supply and demand. There is no clean picture of a market—economic models are built for the classroom, not the real world.

Markets are complex and constantly changing. Those changes can be abrupt, violent, and frightening. In the past, entrepreneurs built the fastest steamship, not only to move freight, but to deliver information about the wheat harvest in the Ukraine or the supply of tulip bulbs from Holland—they wanted to have an insider ability to profit in the capital markets.

The ability of millions of dollars to move with the click of a mouse based on a tweet has changed the landscape, but it's still the same. Information has always been the lifeblood of capital markets. Sometimes good information, and sometimes disinformation.

Predictions on the full potential global reach of the virus have been very wide ranged, from relatively benign to catastrophic (i.e., 1918 flu pandemic). The economic outcomes have a similar spread, which the market MUST consider. That is part of why volatility is so high, it reflects the uncertainty and potential impact of that range of outcomes.

When the market thinks authorities don't get it—like Trump's speech last Wednesday—BOOM, new information and the market reflects that immediately with a dip.

When the market thinks proactive measures are being taken—like Trump's remarks last Friday—BOOM, new information and the markets react with a 2,000-point DJI swing in the positive direction.

The market typically overreacts to bad news. Not always, but mostly, and especially when what the economists call the "left tail" contains really bad possible outcomes. There is a survival benefit to overestimating risk in evolutionary theory. Bodnar Financial veterans may recall a prior white paper on "why it is so hard for humans to be good investors."

The NYC/New Jersey hospital system—one of the best in the world—might be slammed hard. Depending on the severity of symptoms, coronavirus patients need beds in all levels of patient care, from the ER to the ICU. The ability of hospitals to meet the sheer volume of patients is unknown. The process could look like a python swallowing a pig, or it could look like a python swallowing a whale. We don't know yet. Thus, the market volatility.

What does all this economic jargon really mean? Stock markets must price in ALL the things that can or might happen. Not just what you and I think will happen, but what EVERYONE thinks might happen. And because many more things *might* happen than *will* happen, we get these crazy swings. But, as these possible outcomes narrow, the market's accuracy greatly improves.

What Happens Next?

When markets crack like this, the bulls warn you against a failure of nerve (*Buy!*), the traders warn you against hesitation (*Do something!*), and the bears warn you against staying the course (*Sell!*).

My advice: **Imagine the future.**

Imagine how amazing the world will look in 20 years. Today we stand, not at the end of an era, but at the *end of the beginning* of the greatest technological explosion in history.

Honestly, you ain't seen nothin' yet. Today's teenagers will live in a world of designer drugs built for their own personal genome. Surgeons will be printing 3D organs, and families will be keeping in touch with loved ones using a combination of virtual reality and hi-speed internet that produces a result we can only describe as a miracle.

Now, put down this paper and think about what the world looked like when you graduated high school (*leaded fuel anyone?*), or what the office looked like at your first job (*typewriters?*), or just 10 years ago (*Pick you up at the airport? Just take an Uber, Dad*).

Many of us have been highly critical of the government response to COVID-19 at both the national and state level. Some still are. But in the past week, the complacency narrative and the "It's Just The Flu" narrative have disappeared from every politician's vocabulary. In the past week, wheels of innovation and problem-solving began turning in private companies and associations that were not turning before. And it makes all the difference in the world.

Here comes the old Bodnar optimism, and I know you won't believe me, but I tell you it is true: **THIS WILL BE OUR FINEST HOUR.**

I Know Not the Hour Nor the Day…

As the coronavirus situation continues to play itself out, as have all the previous crises that precipitated the 11 prior bear markets since WW2, it remains impossible for me to predict when and how this problem will be resolved. Likewise, it is impossible to know when and how the markets will anticipate this resolution.

I can predict, however, the media will persist in reporting this as an unprecedented crisis in the economic and financial life of the world, and suggesting that it is Armageddon.

But none of that is my true purpose on this St. Patrick's Day 2020. My purpose is to suggest—as difficult as it may be—to take our focus off the onslaught of catastrophist headlines, and put our focus where it belongs: on your goals (and those of your kids and grandkids), on the plan that you and I set out for the achievement of your goals, and on the portfolio we created together to fund your plan.

Because at the end of the day, I don't run money. I run a financial planning practice that seeks to help clients achieve their life goals with a sense of security. You can look it up…it's on the website!

Bodnar Financial (and by proxy, all of you) have elected to be guided by history as opposed to headlines. Rather than subscribe to the media's revolving insistence that "it's different this time," we respond instead with "this too shall pass."

You would not be human if you didn't experience some degree of fear at the direction of current events. The great achievement, at times like this, is simply ***not to give in to the fear***. In a very real sense, as I told a client on the phone today, my whole job is helping you toward that achievement.

A bear market is the acid test of how effective my work has been, and, the best way I know how to do that is by encouraging you to stay the course.

Thank you for being my clients. **I'm always here if you need me.**

Like General Foch, may we see in the adversity an opportunity. Use this time to fund your IRAs, 401ks, retirement plans, and 529 plans early. Increase your % contribution into your 401k, 403b, etc. for the next few months. Take advantage of the sale going on.

If you have cash that you have accumulated to take advantage of special situations….now would be that time. Take advantage of Warren Buffett's investing axiom: "Be greedy when others are fearful."

<u>I know not the hour nor the day…but a stock rally is coming.</u>

Keep Calm and Carry On,

John Bodnar, CFP®, CIMA®

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