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April 22, 2020

Coronavirus Update #7: Is It Finally "Different This Time?"

"Adhere to your purpose and you will soon feel as well as you ever did. On the contrary, if you falter and give up, you will lose the power of keeping any resolution, and will regret it all your life."
- Abraham Lincoln, "Letter to Quintin Campbell" (June 28, 1862)

My inbox has more than a few inquiries—I've not forgotten you—that resemble this: "John, hope you and your family and Team Bodnar are safe. *(We are, thankfully.)* Wow, some sell-off, huh? (*Yes, it was the quickest 30% sell-off ever. I love living through history, don't you?)* Should I change anything? *(No, unless your goals and objectives have changed.)* Because I am sure you agree, this time really is different. Right?"

The History Lesson

With each tick of the clock, the economic damage caused by the coronavirus and the resulting shutdowns grows larger. It is not just businesses, small and large, feeling the pain. Educational institutions, hospitals, churches, nonprofits, and state and local governments are all finding it hard to remain financially viable.

Nationwide, our leaders have turned off broad swaths of the private sector—the ultimate and only source of income and wealth creation. Without the private sector, there is no money to pay for government, and no money to pay for schools, health care, or charitable organizations. To make up for it, the political class has resorted to an open-ended expansion of the Federal Reserve's balance sheet (and expanded their power), and government borrowing and spending increases the likes of which our country has never seen outside of wartime. And who knows, we might break the wartime record before this is over.

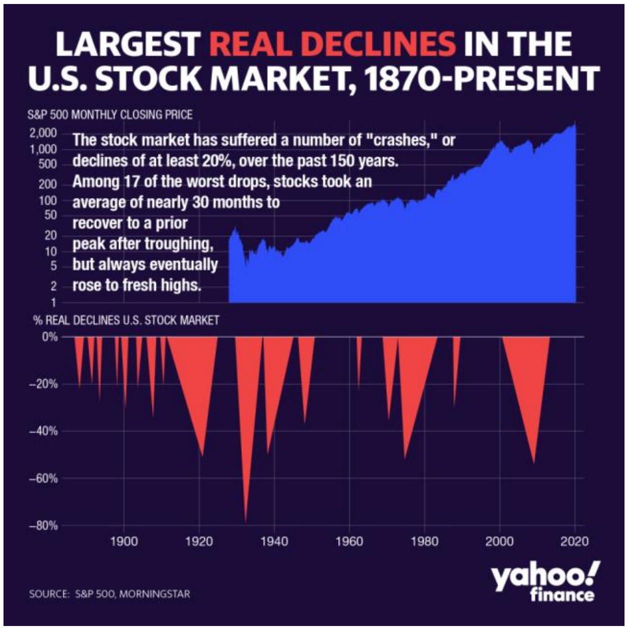
Am I finally agreeing it is "different this time?" Is there an investor alive today who can give testimony that he or she has witnessed an economy put itself into a self-imposed economic coma? I would say that is different. Or can anyone attest they have observed the broad market indexes traveling from a record high (Feb. 19) to a 30% sell-off in just 16 trading days?

If that is your criteria for "it's different this time," then you win. It is different this time. However, successful goal-oriented long-term investors do not use a criterion so narrow.

When you hear me quote legendary investor Sir John Templeton saying, "The four most dangerous words in investing are: it's different this time," Sir John was paraphrasing an older statement from the famous stock market operator, Jesse Livermore:

"I learned early that there is nothing new in Wall Street. There cannot be because speculation is as old as the hills. Whatever happens in the stock market today has happened before and will happen again. I've never forgotten that." - Jesse Livermore

There have been 17 bear markets (stock market sell-offs of 20% or more) since 1870. If you study the history of those sell-offs, you will learn that each felt like a seminal event at the time.



- The stock market dropped over 50% during the Financial Crisis, and the facts leading to the sell-off were indeed unique. Can anyone argue that point?

- Sept. 11, 2001. Need I say more?

- Oct. 19, 1987. Black Monday. Down 23% in one day. One day!

We can continue through the entire list of 17, but my point is that while each sell-off is "different," the aftermath is the same. When Jesse Livermore said, "there is nothing new…has happened before and will happen again," what he meant was the story remains the same, just the staging changes.

Capital markets do not sell off 30% impulsively. When the crisis appears on its regular orbit of approximately every nine years (17 bear markets since 1870, do the math), each appears to those living through them to be unprecedented and unlike anything God's green earth would ever experience again. Just as coronavirus feels like to us.

But like the cinematic masterpiece, *Groundhog Day,* the story of successful investing remains the same (just without the Sonny & Cher music). Crisis begins. Crisis grows. Panic ensues. Markets sell off. The Great Unknown(s) of the crisis begin to be eliminated. Crisis peaks, and ultimately—like every single one before it—crisis gets resolved. The economy begins to grow again, stocks resume their long-term trend upward and YOU, the patient, disciplined long-term investor, has once again been rewarded for standing herewith astride history.

On Current Events

As in 2008, many are worried that huge increases in quantitative easing and money growth, along with the purchasing of debt directly from the market, will lead to much higher inflation. To my comrades in the anarchy wing of Bodnar Financial, I too worry.

But, for today, that does not seem to be a problem. The consumer price index (CPI) fell 0.4% in March and is up only 1.5% from a year ago. On Tuesday (April 21), West Texas Intermediate (WTI) oil was trading at $11 per barrel, the lowest since the late 1990s, and 64% lower than its

March average of $30.45. This suggests another negative number for the CPI in April. (More on oil later.)

But the drop in measured consumer prices in March was not just driven by lower energy prices. Other factors included lower prices for hotels, airline fares, and clothing. What do all these categories have in common? A massive drop in customers due to the shutdown.

Sure, hotels are cheap today, but almost no one is using them. Hotel occupancy rates are down about 70% from a year ago. Sure, anyone who flies can get cheap seats, but the number of people going through TSA checkpoints is down 96% from a year ago. (Not a typo. 96%!) Clothing prices fell 2% in March, as sales at clothing and accessory stores fell 50%. Who had time to buy clothes when you had to stock up on groceries and toilet paper?!?

Normally, I am not a fan of enhanced unemployment benefits. But the severe economic contraction brought on by the coronavirus and the **government-mandated** shutdown of businesses meant to stop the disease is a completely different animal from a normal recession. It is not just that people are staying away from economic activities because of the virus—the government is *requiring* businesses to shut down, magnifying job losses across the country.

Initial jobless claims averaged 216,000 per week in the four weeks ending on March 7, before the shutdowns. That is a total of 863,000, which was exceptionally low by historical standards (especially relative to the size of the labor force). In the four weeks since, about 17.1 million workers have filed claims, blowing away previous records.

Many of these layoffs were the direct result of the government forcing businesses to shut their doors. When people are deprived of their livelihoods by government fiat, it resembles a "taking" under the Fifth Amendment of the U.S. Constitution. In this unique situation, unemployment compensation resembles a "just compensation" for that taking. Unusual times to say the least.

Interest rates will go up eventually, but do not expect a sharp rebound. After the Great Recession, the Fed did not raise short-term rates again until late 2015, when unemployment hit 5%. After the expected job losses over the next couple of months, it will be a long time before we get back to 5% unemployment. Meanwhile, having witnessed two big recessions in a row, investors will place a larger premium on safety and risk aversion than they have for the past decade, which will hold the 10-year yield down relative to the economic fundamentals we'll see in the eventual recovery.

What is different this time? We have never seen an economic shutdown that was self-imposed. The ability of people and governments to panic into giving up fundamental rights changes nearly every economic calculation. How do economists model risk in the future?

A Quick Comment on the Latest Headline: OIL

For those of you alarmed by the headlines, "Oil plunges below zero," do not be. It is a temporary phenomenon brought on by the collapse of oil demand due to the global economy being put on life support. As the chart below shows, it is only the front-month oil contract (yellow) that has plunged. The contract that comes due December 2020 (white) has actually been rallying since its March 18 low.

Figure 1: Oil Contract Chart

The problem is a lack of storage. Oil traders and speculators, whom were long the front contract, had to get out of their position (i.e., sell) since they have nowhere to store the oil that will be delivered to them per the terms of the about-to-expire contract. So, they had to pay for storage. The price of oil per future contracts has remained relatively stable, averaging about $30 per barrel.

A Few Personal Comments

The key right now is to save lives, then to begin safely scaling back the lockdown to return to some semblance of normal life as soon as possible. At this point, that still seems weeks away. Our only defense is to avoid getting the disease, and that is why we are all hunkered down and wearing masks whenever we go out. During previous flu epidemics, 9/11, World War I and II, we were able to go about our daily lives in a reasonably normal way. We were never confined to our homes.

Some believe when the crisis ends, everything will quickly return to what life was like in January, but there will be lingering effects. Byron Wien from Blackrock put it right. He thinks the recovery will look like a square root sign, a “V” at the beginning, and then a gradual recovery.

Our office is open, but only Danielle (our newest employee) is physically on-site. The rest of us have been working remotely for a month and have no idea when our lives will return to normal. I think what all of us can be sure of is that some aspects of our lives will undergo profound change.

Here are a few ideas, in no particular order:

- Jobs and income for many will be impacted negatively by the lockdown. Even those of us still drawing paychecks will want to have more of a savings cushion and more cash on hand. We are also likely to keep more food in the house.
- Vacation plans are likely to be, at least for a while, less venturesome. Little foreign travel, more time at destinations we can drive to and get home from without worrying about flight disruptions and crowded airports.
- Get ready for hospital and medical center capital campaigns.
- Hospitals will need to stockpile more personal protective equipment.
- Almost all our generic drugs are produced abroad. Production of these drugs and thousands of other component parts and finished goods will be brought back home, particularly technology products.
- Expect a change in government attitudes toward pharmaceutical companies. Expect to hear less inflamed rhetoric against the drug industry in this presidential campaign and beyond.

- With unemployment reaching historic numbers, issues like climate change, inequality, and immigration may not be addressed for a while. The media is totally focused on medical and economic issues.
- Globalization is in the hot seat. Manufacturing has been outsourced to the lowest-cost producers wherever they might be located, keeping inflation low. Low oil prices should keep inflation in check for a while.
- Remote learning using the internet was underutilized to educate more people at a lower cost. The cost of private college has risen 20 times in the last half-century. Expect changes.
- Companies are learning that face-to-face contact, while desirable, is not always necessary. This should result in more virtual meetings and less travel, saving time and money. There is, however, no real substitute for a physical meeting with a client.
- Globalization created a world that was interdependent with an increasingly free flow of ideas and commerce. And that was good for everyone. The train has left the station for more authoritarian regimes that rule by edit. Stay tuned.
- In 2019, China accounted for one-third of world growth. The first and second largest economies in the world, the U.S. and China, must find a way to work together in the future.

As we look ahead, life will be different and for a time more subdued. We have been forced to think about the importance of friends and family, and to put material things in perspective. As Honest Abe wrote in his letter to Quintin Campbell: adhere to your purpose and you will feel better. 😊

Be safe, wash your hands, and do not believe everything you read on Facebook.

Now Get Outside and Garden,

John Bodnar, CFP®, CIMA®

These are the opinions of Bodnar Financial and not necessarily those of Cambridge, are for informational purposes only, and should not be construed or acted upon as individualized investment advice. Oh yeah, and past performance is not indicative of future results. My lawyer wanted me to tell you that.