CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

March 25, 2020

Further Comments

Coronavirus has afflicted America badly in the last weeks. Worsening conditions wreak havoc on all financial markets. The stock market has continued to fall sharply, with intermittent (and probably unsustainable) short-covering rallies. Unsurprisingly. On Monday, the market made another new low for this bear market; the S&P has now fallen by 35 percent from its high fewer than five weeks ago! This is the swiftest decline ever in stocks. More strikingly, the Treasury bond market also became disrupted; with prompt action by the Fed, Treasury market weirdness has resolved itself (for now). The Treasury bond market is the deepest and most liquid market in the world and Treasuries are without credit risk. That is, the United States will not default on its interest payments and principal repayments. Despite this, suddenly on March 10th, Treasury bond prices started to fall. The Fed stepped in and restored liquidity to Treasuries. Long-term Treasury bond prices have resumed their upward trajectory and their yields have again fallen.

The spread of Coronavirus worsens by the day. We cannot know how things will unfold in the coming weeks and months, but it is not hard to imagine that our new ways of life--staying at home while life in our cities is shuttered--will be with us for some time. The numbers of people infected, the numbers hospitalized, the numbers dying will increase in coming days and weeks. It is a new age.

As an investment matter, Core's accounts remain solidly higher for the year; the accounts Core manages are up by 11% year to date (with variations among accounts for various reasons). It was our good fortune to have avoided the stock market as we entered this year. We continue to avoid it. Our investments are in long-term Treasury bonds, gold and cash. With cash we earn nothing, but we lose nothing. We retain cash to make stock investments when this bear market ends, as, inevitably, it will. As we fall into a deep recession with both demand and supply shrinking sharply, Treasury bonds increase in price. In the extremity of uncertainty that we face, gold offers its historical role as a haven in unsettled times.

By

Jack Mayberry

Recently the disruption of financial markets turned Treasuries and gold upside down for a brief period. To the astonishment of many including this writer, on March 10th both gold and long-term Treasuries began a swift, short-lived, but steep decline. On March 9th, long-term Treasuries, as measured by the investment we hold, were up by 26% for the year to date and gold by 11%. In the view of many, myself included, the exceptional advances of Treasuries and gold made sense. Utter panic had broken out in the stock market; it had already fallen by more than 14% for the year to date.

The sudden decline in Treasuries and gold, beginning on March 10th, brought gold down by 13% and long-term Treasuries by 16%. We may read more in the days ahead about what happened in that period; we can surmise that a good deal of the selling of these assets was so-called forced selling by investors whose stock positions were falling relentlessly. Some investors who had borrowed in order to buy stocks were required to sell. Quite probably some of these investors were selling their winners--gold and Treasury bonds--because they could not sell their losing stock positions at reasonable prices. The disruptions were extremely disturbing to the Fed, not so much the lower prices, but the inability of the Treasury market to function smoothly. Extraordinary actions by the Fed in recent days appear to have dealt with the liquidity problem in the Treasury market; both Treasuries and gold have rallied considerably in this last week. Gold is close to its March 9th highs and long-term Treasuries are not far behind.

In the context of this disruption in the Treasury market, I reduced our positions in TLT, the Treasury fund we hold, by about one third. (I accomplished the sale at a price of 162, far above the 139 level that TLT reached at its nadir last week.) We still have a large position in Treasuries and I expect further gains in their prices. However, the sharp, sudden and disconcerting decline in gold and Treasuries showed that, in these extraordinary markets, even safe investments can be risky. I have increased our positions in money market funds and cash to 33%. The Treasury market is now acting rationally again, but it is foolhardy to believe that there will not be more significant market disruptions in coming weeks.

The Shape of Bear Markets. As noted above, the decline from the mid-February highs in stocks to the 35% decline as of Monday's low is the swiftest ever. The old saying is that 'they slide faster than they glide,' but this is altogether new. A typical bear market makes its way from top to bottom in over a period of more than a year and the process of forming the bottom of the bear market and beginning the recovery and advance is measured in many months. Given the extraordinary shut down of business activity and the normal lives of all of us, we must expect a deep economic slowdown, far surpassing what we refer to as the Great Recession of 2007 to 2009. If so, the decline in the stock market--and its duration--both have much further to go

Of course, things may unfold differently. If, as of Easter, as our president would like, things were to go back to normal, at least in parts of the country not terribly afflicted, then there could be swift recovery of economic activity. Epidemiologists consider it unlikely that Easter represents the date when life in America can resume former patterns. The proposed legislation just passed in the Senate is huge. More than $2 trillion will be provided by the federal government and it will be backed up by perhaps as much as $4 trillion of support from the Federal Reserve. (These numbers have never been bandied about before; I remember Everett Dirksen, the minority leader of the Senate in the sixties, making the comment 'a billion here and a billion there, pretty soon, you're talking real money.' Those were the days.)

At present, a rational long-term investor will wait patiently and will be alert. There will certainly be enormous investment opportunity when the Coronavirus crisis and the bear market in stocks come to an end. We cannot know when that will be. The best approach is to continue with the productive and relatively safe investments we now hold.

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CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

March 11, 2020

On the Right Side

There has been no good news about coronavirus, except that the Chinese seem to have contained it.

Italy tries a similar approach.

Other countries try other things. We shall see what Mr. Trump's stopping flights from Europe to America accomplishes.

When oil prices fell sharply in the past, it was said that America realized a benefit in that we paid a bit less at the gas pump.
But as shale oil production has increased to make America (for awhile recently) the biggest oil producing country in the world, we now face many lost jobs in the highly leveraged shale oil sector and reduced spending on plant and equipment.
America derives essentially no benefit form the Saudi price war.

By

Jack Mayberry

From phone calls and emails I have received from clients in the last week, it seems useful to write another letter. My views on all this change day to day as the things develop. In my recent letter, I characterized coronavirus as a 'black swan' event; it certainly is. Then, beginning last Friday, we have new unexpected event, namely the refusal by Russia to agree to further cuts in oil production as proposed by Saudi Arabia, the *de facto* leader of OPEC. The Saudis sought an agreement to cut oil production further as demand for oil fell with the general weakening of global economies, weakening that has only intensified with the coronavirus. In the side bar, see a bit about how the Saudi/Russia matter causes problems in America.

Some of the uncertainties when I wrote a couple of weeks ago have been resolved: we know now that coronavirus extends itself very widely and that in more than one hundred countries it manifests itself. The ability for scientists to identify the 'Patient Zero' in a place in which there are suddenly many infected people is clearly quite limited. We realize that the numbers of infected people is probably widely underestimated or undercounted. We see this in America now, where we do not have the means to test many people. We saw this a couple of weeks ago in Iran when reported numbers of deaths from coronavirus was far, far higher than expected given the numbers reported to be infected.

Today the World Health Organization declared this to be a pandemic, not just an epidemic. Today, Angela Merkel, Germany's Chancellor, told us that two thirds of Germans are likely to become infected by coronavirus. China imposed extreme restrictions on travel and quarantined scores of millions in Wuhan and neighboring cities in Hubei to slow the transmission of the infection. Then, in the space of little more than a week, Italy became a 'hot spot.' In the first instance, it closed off cities near Milan and in the Veneto. More recently, it has essentially put the entire country in quarantine. In Westchester County, just north of New York City, the National Guard has been brought in to a community in which a number of people in a temple fell victim to the infection. Schools, colleges, universities are closing. A Core client with one child at Columbia and another at Bard College, a bit up the Hudson, told me that Columbia had closed and sent it students home (as have Harvard and others) whereas Bard 'strongly recommended' that its students stay on campus during the spring break and not go home!

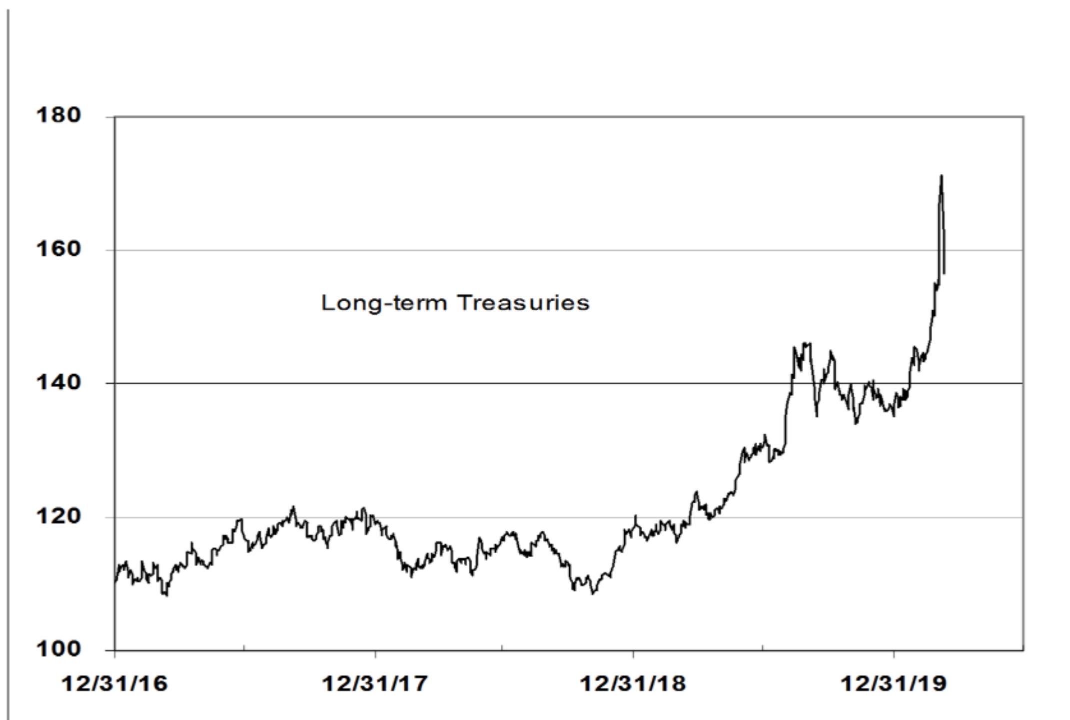
Each reader of this letter will have her or his reports on this same subject. As it relates to my investment work for you, all this means is that there is an unfold-

ing disaster spreading around the world, the seriousness of which is still unknown. The financial markets reflect the seriousness and the uncertainty. The uncertainty by the quite exceptional price volatility we see in many markets, especially in stock markets. There is a statistical measure of this called the VIX, meaning stock price volatility index. As of this week, the VIX has exceeded every previous reading except for those in October and November 2008 immediately after the collapse of Lehman Brothers, the epicenter of that financial catastrophe.

The seriousness of the coronavirus pandemic is still unknown, but many serious things are known: Supply chains for global manufacturing have been upset. Closing of schools, unwillingness to board planes and travel, closing of factories, sending workers out of offices to have them work from home, and restrictions on travel are serious impediments to economic activity and to life. The odds that we will have a recession are much higher than they were only a month ago. And, given recent sharp and deep declines in the stock market, it seems clear to me that we are in early stages of a bear market. Bear markets are infrequent: the last one ended in March 2009. But they are not brief and they do damage. We can expect a year's worth, if not more, of some nasty stock market action. This nasty action can quite readily bring prices down by twenty to forty percent from their highs in February. In the financial crisis and recession from October 2007 to March 2009, the S&P 500 fell by more than 55 percent. This one may not be nearly so bad, but it is unlikely to be much fun for stock market investors.

The chart below shows the price action in US Treasury bonds maturing in twenty years or more. This is Core's largest investment.

Treasury prices have risen; Treasury prices always rise in a recession. Despite short-term price movements, there is no reason to sell these.



Happily, Core's investments have been on the right side of things. In the last month, the S&P 500 index has fallen by more than 18 percent, while our long-term US Treasuries are up by more than 8 percent. For the year to date, Core's portfolios have advanced by more than 10 percent. (There are, of course, variations in individual accounts for lots of reasons.) Because bear markets persist and because, in bear markets, Treasury bond prices and gold prices rise, I am in no hurry to look about for what to buy in the stock market. For now, our 'safe haven' investments in Treasuries, gold and cash preserve our capital and cause it to grow.

As I wrote at the beginning of this note, I have been hearing from clients as things have become exciting in financial markets. Please do not hesitate to call or to email me. There's lots to talk about.

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CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

February 27, 2020

The Black Swan Event

Many investors were quite sanguine about the effect that coronavirus would have on economies and markets.

So much so that as recently as last week, the S&P 500 made a new all-time high. Then, oops, coronavirus spread to more than 40 countries.

The black swan appeared. Stock investors raced for the exit.

Coronavirus is the black swan event for the financial markets and the global economy. So strong has been the prevailing view that the stock market can only go up and that the Federal Reserve will prop the stock market no matter what is going on in the economy, that stocks blithely set new all-time highs only a week ago, weeks after the extent of the epidemic in China became known. In the last week in January stocks fell a bit, then resumed their upward march until February 20th. In the past six sessions, the S&P 500 has fallen by something more than 12 percent and is now down 8 percent for the year to date. Interestingly, however, throughout January and February, long-term US Treasury bonds, Core's largest investment for its clients, have continued to rise in price as their yields have fallen to all-time lows. Similarly, gold, our second largest investment, has moved smoothly and steadily higher, seen as a safe haven in this now more dangerous world. Long-term Treasuries are up by 9 percent this year and gold is ahead by 6 percent. As a result, Core's clients' accounts are markedly higher now, as the pandemic spreads, than before it emerged. Typical client accounts are up about 8 percent so far this year, although there is, of course, some variation in returns among accounts.

Given the very rapid selling in stocks in the last six sessions, they are quite 'oversold' on a short-term basis. And, unsurprisingly, long-term Treasuries and gold are 'overbought,' although to a lesser degree than stocks are oversold. It is quite reasonable to expect that in the short-term, the markets will reverse and that stocks will recover some of their losses, while bonds and gold give back some gains. However, unless, by some miracle, the coronavirus goes away suddenly, it is likely that bonds and gold will be selling at higher prices some months from now and that stocks will be lower than where they stand now.

We have made a couple of investment changes in the last month. First, we bought a small position in utilities stocks, our first investment in stocks in over a year. This is still based upon my thesis that the economy is weakening--and probably more rapidly because of coronavirus--and that investment capital will continue to flow to the safe and somewhat stodgy utilities. Folks do still need to turn the lights on, even if they are not spending and travelling as much. More recently, I sold our position in high-grade US corporate bonds. Our investment in these bonds, via an ETF with the symbol lqd, has been a good one, but I am concerned that, if the economy continues to weaken, especially with the uncertain path of coronavirus, corporate earnings may continue to weaken, even to the extent of not being able to meet their interest payments on their bonds. The risk is not a huge one, but, given that we can invest in US Treasuries with no repayment risk, it seems imprudent to hang on to the corporate bonds.

By

Jack Mayberry

One cannot know how coronavirus will develop and spread. One cannot know how it will affect economies. Caution is the best approach.

The trajectory of coronavirus is unknowable. It seems to spread easily, but the death rate for those who contract it appears to be somewhat low. Optimists acknowledge that the global economy is slowing because of its effects, but they hope for a 'V-shaped' recovery, implying that once coronavirus is 'under control,' the affected economies will rebound rapidly. Maybe. However, travel has certainly slowed, manufacturing, particularly in the affected parts of China, has stalled. Japan has closed schools; presumably parents will stay at home to look after their kids, instead of continuing work at their offices, shops, and factories. Such things will happen in country after country as the disease spreads.

Investment commentators expect the Fed and other central banks to come to the rescue, but short of developing an effective vaccine, it is hard to know what help central banks can offer. (Developing vaccines is not part of the central bank tool kit, at least as I understand it.) Coronavirus affects both supply-side economic issues and demand. Keeping people from work, disruption of just-in-time supply chains, uncertainties about the scope and extent of the disease, and impairment of companies' capacities to meet credit obligations all suppress the supply of goods and services. These in turn lessen demand for employment, cut disposable income, and lessen wealth and confidence. These matters are not readily correctable by central banks.

Core's plans. Our investments have not been adversely affected by coronavirus. Investors have turned to the safe havens of US Treasury bonds and gold in this crisis. Thus one could say that, to a degree, coronavirus has helped our investments. We cannot know how the epidemic will develop and spread; we cannot what will be its short-term and long-term economic effects; we cannot know what will be the financial market impacts of coronavirus. Thus, we will be cautious and watchful.

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CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

February 1, 2020

Priced for Perfection...
...in an Imperfect World

The sudden emergence of Coronavirus is very disruptive to China's economy. Long-term consequences are impossible to assess at this time.

The investment response so far has been to sell stocks and flock to 'safe-haven' investments like Treasury bonds and gold. This response is entirely rational and very beneficial to Core's portfolios.

By

Jack Mayberry

In the last several days, the ever-spreading Coronavirus dominates the news and the activity in financial markets. In the news, we learn of its day-to-day increasing infections and deaths. We learn of the attempts to contain it and to find the means to cure its victims or, at least, to slow its spread. Major US airlines have stopped flights into and out of China; other nations acted sooner than the US. We read of the isolation of those who may have been exposed to it. Only epidemiologists have anything useful to say on these matters and one reads that some of them declare that it is too early to make meaningful predictions.

Despite not really knowing what may happen next with all this, economists and investment firms have begun to estimate the likely effects on global and US economic activity. The isolation of large cities in China, the cancellation of travel to and from China is certain to restrain China's economic activity; this just after we learn that China's economic growth was slower in the year just ended than in any year in the last twenty-nine. Goldman Sachs, the American investment bank, on Friday projected that the effect on the US economy would be to decrease (already weak) economic growth by 0.4 percent in the first quarter of this new year.

The reaction in financial markets has been utterly reasonable. Stocks have fallen fairly sharply while the safe-haven assets like US Treasury bonds, gold, the Japanese yen and the Swiss franc, have all risen markedly. As we have written in previous letters, Core's investments for its clients have been limited to bonds (mostly long-term US Treasuries), gold and money market funds. We have avoided stock investments on the notion that prices for stocks were too high when measured by the risk they present. Thus, as things have unfolded recently, the accounts of Core's clients have appreciated: long-term US Treasuries, our largest investment, have gained some 7.7% this month, while gold has appreciated by 4.5% and achieved its highest price since 2013.

Priced for perfection. The stock market rose by a more than 25% in 2019 and, until news of the Coronavirus emerged, it had risen by another 3% in the first weeks of January. As discussed in previous letters, the rather remarkable rally has taken place while corporate profits have fallen in each of the four quarters of 2019. And, as also discussed, the price appreciation has gone on while the US economy has been weakening.

The rally in the last quarter of 2019 was powered by the Federal Reserve, which had cut Fed funds rates three times in 2019 and, more importantly, had commenced, in early October, another huge round of buying securities. This was undertaken, as we are told, to put right the repo market, by which banks lend to

Stock markets, particularly in the United States, have been priced for perfection.

Unfortunately, the world is an imperfect place.

each other overnight. Buying of Treasury bills has exceeded $300 billion so far and continues at the rate of $60 billion per month. The Fed is at pains to say that this is not a further round of Quantitative Easing--the securities buying that it and other major central banks undertook in the aftermath of the financial crisis. However, the flood of new money into the system, at a time when private credit demand from companies and households is weak, finds it way into asset markets.

Whether the rally in stocks was induced by the Fed or not, the effect has been to increase valuations to remarkably high--one might say dangerous--levels. The ratio of stock prices to underlying corporate earnings--the price to earnings ratio--has risen markedly. Ditto the ratio of price to corporate net assets--the price to book value ratio. Such measures have approached those that occurred just prior to the bursting of the so-called dot.com bubble in 2000 and 2001. Given that there is no obvious likelihood that economic activity in the US and in other developed countries will rise from today's somnambulant levels, it is hard to justify such high valuations.

Thus, one can say that the stock market has been priced for perfection. The disturbances early in January when the US assassinated Iran's General Soleimani gave a brief foretaste of how stock markets could be disturbed by external events. The Coronavirus matter is showing us in a more pronounced way how our imperfect world can throw up obstacles to a stock market priced for perfection.

What about highly priced bonds and gold? May similar points be made in arguing that Treasury bonds and gold, having themselves appreciated so much, are priced for perfection? Of course, and one can read these arguments every day. The difference is that the increase in Treasury bond prices (and the concomitant decrease in their yields) is grounded in economic realities. These include slowing economic growth, persistently low inflation with increasing deflationary pressure, and the excess of savings over the demand for credit. As for gold, how can one measure its value? The decline in interest rates on sovereign debt in these recent years means much. Gold pays no interest and costs money to store safely. The carrying costs and absence of interest payments become less significant when we note that the ten-year German *bund*, the safest security issued in Europe, offers a yield today of -0.438%. In August of 2019, more than $15 trillion bonds traded with a negative yield. We are approaching that level again in this new year.

If one wants security, that is, a safe investment that will assure you of the return of your capital, you may look to German *bunds*. But, if you buy them, you are assured to lose money because of the negative yield. In this world, the carrying costs of gold do not loom terribly large. As prickly situations arise, *e.g.*, a nasty, rapidly spreading virus; a belligerent, missile-testing autocrat in North Korea; or an angry developing nuclear power in Tehran, gold and long-term US Treasury bonds look quite appealing.

At present the world dicey enough to incline me to invest for safety and to realize the gains that will continue to arise in Treasures. The slowing economy and the world of excess savings is one that enhances the value of long-term US Treasuries. Declining corporate profits present a situation too parlous to dump money in the 'priced-for-perfection' US stock market. When the stock market does, in time, return to more attractive levels, Core will be buyer of stocks for its clients. The time may come soon or it may come late, but it will come. The economic cycle has not been repealed and stock valuations--as with many things--do revert to the mean. Let us be patient and sell our Treasuries when they become too expensive. Let us buy stocks when they become attractive in price.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

January 5, 2020

On to 2020....Buckle Up

Although the killing of General Soleimani is at the forefront of everyone's thinking, and although the immediate impact on financial markets is sharp, we take a look first at the ways by which the actions of the Federal Reserve have pushed stocks higher and lowered expectations that a recession is at hand.

The repo market is complex, but the salient point is that the Fed, since September, has pumped more than $300 billion into the financial system. Because the appetite by companies for borrowing is very low, the money appears to have flowed into financial assets.

By

Jack Mayberry

The repercussions that may follow the assassination of General Soleimani are of paramount importance to peace in the Middle East and in the world. The killing had a very sharp impact on many investment assets on Friday and, as the Monday markets in Asia open, one observes a continuation of these. I discuss this below, but first, a review of recent months.

The Fed and the repo market. As discussed in previous *Core Comments*, the actions of the Federal Reserve Board, both its three cuts in the short-term rates it controls directly and its vast and unexpected buying of short-term Treasuries beginning in the autumn, caused the stock market to rally quite strongly in the last quarter of 2019. As to the unexpected Treasury purchases, malfunction of the so-called repo market, by which banks lend to each other overnight, caused rates for such loans to spike to 10 percent in September. This part of the financial system is opaque but important. Rather than explaining it here, I point to a mid-December article in The Economist that addresses the matter. As for the year end, things functioned as they should, so, in the short term, the Fed has been successful in smoothing a suddenly unruly corner of our financial system: https://www.economist.com/finance-and-economics/2019/12/18/despite-the-feds-efforts-the-repo-market-risks-more-turbulence

In its rescue of the repo market, the Fed put some $300 billion of new money into the system. Although the Fed is at pains to say this is not a renewal of Quantitative Easing, market participants recognized this as yet another gigantic infusion of liquidity into a system in which demand for borrowing to fund corporate activity has been weakening. (In the autumn, while the Fed was increasing the money supply at the rate of ten percent annualized, commercial and industrial lending contracted by one percent.) So where does the money go? Into financial assets. Thus the strong stock market in the last three months.

Recession fears, at their peak in August and September, have subsided. This is more a hoped-for event than one likely to be realized. Corporate profits have continued to weaken; manufacturing activity in the US and other developed countries have continued to weaken; job openings have declined for six months. One could go on. There is little evidence that economies are improving. Although the US has appeared to avoid falling into a recession in 2019, the best one can say is that it is flying at stall speed.

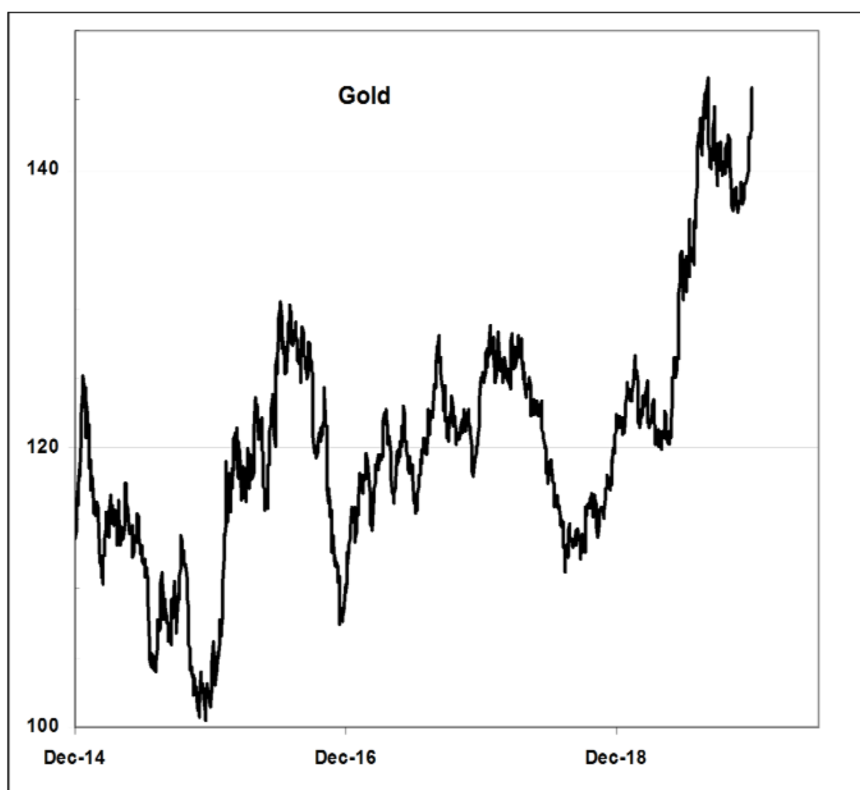
2020 begins. Although the fourth quarter of 2019 was a strong one for stocks, 2020 has not begun well. The assassination of Iranian General Soleimani by the United States on Friday morning New York time caused an immediate sharp sell off in stock markets around the world and sent investors toward safe-

The sharp increase in 'safe-haven' assets, including gold and long-term Treasuries, has given a significant boost to Core's investments. We have avoided stock investments for more than a year, keeping us out of harm's way in the aftermath of the Soleimani killing.

haven assets, notably including gold and long-term US treasuries in both of which Core has substantial investments. Iran promises retaliation and, given that General Soleimani was, by most accounts, the second most important Iranian leader, we can probably take the retaliation threats seriously.

The US stock market rallied more than 25 percent during 2019 while profits of firms in the S&P 500 declined each quarter. This suggests that stocks trade at precariously high levels. The killing heightens already elevated geo-political risk. Let us remember the six-month long riots in Hong Kong, the sharp disagreements between China and America and the nuclear threat from North Korea.

We cannot know how Iran will respond and, unfortunately, we cannot be sure that the next moves by the United States will be calibrated to foster peace. Iran has engaged in provocative actions since Mr. Trump repudiated the nuclear arms treaty negotiated by the Obama administration. Then, in response to the December 27 rocket attack on an Iraqi military base near Kirkut and the raid on the US embassy in Baghdad, comes the sudden attack on General Soleimani, with the bare explanation that further threats to US personnel were planned.



Unless something dramatically awful unfolds from this killing--and we can certainly hope that the dramatically awful will not come to pass--it is likely that effects on the markets in which we invest will be muted. But, when comes the retaliation and when comes the further slowing of the US economy, stocks will give up their high-wire act. This will provide the opportunity to invest in stocks at lower prices than now prevail. After a year in which Core invested cautiously for you and produced solid investment returns in Treasuries and gold, we anticipate an investment environment that will offer opportunity for further relatively low risk and productive investing.

A word about gold. In the last year, Core's second largest investment, after long-term US Treasury Bonds, has been gold. When we made the investment, gold was rousing itself from a significant decline and, with the view that geopolitical disturbances were rising, the case for owning gold seemed strong. As the nearby chart shows, gold enjoyed strong gains in 2019. It stuttered a bit in the autumn as recession fears faded and the Fed pumped vast new sums of money into the system. But well before Iran's havoc and Soleimani's assassination, gold resumed its upward march and, as of early Monday trading in Asia, it has exceeded its late summer highs. Another element in gold's rise is the desire of many countries, China, Russia and others, to withdraw support from the US dollar, the world's reserve currency. Gold purchases by major foreign central banks have been remarkably high in the last year. For better or worse, part of gold's strength represents anti-American sentiment. Gold's ascent will not be a smooth path, but the rather fraught geo-political environment reminds us of gold's safe-haven value.

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