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

July 3, 2020

A Review of the Year so far...
...And a Look Ahead

The first half of this year was really extraordinary, in the real world and in financial markets. In the real world, so to call it, the Coronavirus, the once-in-a-century pandemic, governs our lives now and will probably do so for some time to come. Then came the murder of George Floyd in Minneapolis and the crystallization, at long last, of the recognition of racism and its deleterious effects in our society. We can hope that this recognition will persist longer than the pandemic and that American racism will be ameliorated.

Half way through a year with little precedent. What comes next?

Despite Coronavirus and an intense stock market panic in February and March, Core's portfolios have earned solid gains.

The first six months. As the National Bureau of Economic Research told us in June, the recession began in February, prior to the Coronavirus lockdowns. The stock market made a positive start to the year, including setting a new high in mid February before the epic and swift decline by more than one third to the last week of March. In the last week of March, the stock market and bond markets--including the US Treasury bond market, the world's deepest and most liquid market--also went berserk, indicating that, even in the Treasury market, one could not be sure one could buy or sell in a rational way. The Federal Reserve jumped into action to restore liquidity and to provide support, through massive purchases of bonds and other measures, for the entire bond market. Congress and the administration swiftly enacted legislation to transfer trillions of dollars from the Treasury to businesses and individuals to make up for income lost as the economy shut down.

These monetary and fiscal actions sparked a rebound in the stock market and steadied the bond market. Now, at the end of this remarkable first half of the year, where do things stand? Core's accounts, in the aggregate and net of the fees paid to Core, have appreciated by more than 14.5% in these six months. (There is variation among individual accounts for various reasons.) The stock market, as measured by the S&P 500, was <u>down</u> by 3.8%, after its dizzying decline and rebound. The broadest measure of the US bond market was <u>up</u> by 4.9%. Core accomplished its good results by avoiding the stock market and by investments in long-term US Treasury bonds and gold. The securities through which we make these investments appreciated in the first six months by 20.4% and 16.8% respectively. Core's accounts also held a good deal of money market funds and, in recent months, high-grade short-term US corporate bonds. These latter investments did not earn much for us, but provide safety and 'dry powder' for the investments we expect to make as things grind forward.

By

Jack Mayberry

What lies ahead. As I see it, activities of all kinds--social and economic and more--are unlikely return to pre-Coronavirus times until there is an effective and widely-administered vaccine, or at least until there is effective and widely-

Until a vaccine or at least an effective treatment, activities of every kind will be constrained.

One needs to invest carefully and slowly.

available treatment. Neither is at hand. Accordingly and in light of the recent vast increase in US new infections, I think that economic weakness will persist. Some think that the recession ended in May and that we are on the way to a V-shaped recovery. I doubt that. Things improved in May and June from the catastrophic declines in economic activity of March and April, but we are still very far from attaining pre-recession levels. Another lockdown seems unlikely, but the surge in infection across the South, the Southwest and into California put 're-openings' into reverse. Note that the rather good employment report announced yesterday is based on surveys from mid-June, before infection surges began. We shall see about the V-shaped recovery.

As for the stock and bond markets, it would be a very rare event indeed if the sharp February to March sell off was not 'tested' by a decline toward those lows. We have not had this 'test' yet, but we have had a real slow down in the advance of the S&P. In early June, the S&P moved to within 5% of its February all-time high and then fell back. It ended June 9% below the February high. It may not happen, but it would be the usual thing for the stock market to head back down to or near the March lows. Meanwhile, from the mid-March chaos in bond markets, long-term Treasuries and gold, our principal investments, continued to appreciate. At the end of June, gold prices reached their highest levels since 2012.

Given our large positions in very safe short-term corporate bonds and money market funds we hold, we have what I characterized above as 'dry powder.' I have a set of equity investments that make sense in our new Coronavirus, work-from-home lives. Of course, our long-term Treasuries represent a big source of funds to invest in stocks when times are safer and when prospects for continued low interest rates ebb.

The Fed's analysis. Last week the Fed released a significant report in connection with its 'stress tests' of the capitalization of banks in light of the Coronavirus and the recession. The Fed puts forward three scenarios from the present economic situation, characterizing these 'V-shaped,' 'U-shaped,' and 'W-shaped' recoveries. The 'V-shaped' is, as discussed above, the optimistic idea that, after the sharp recent decline in the economy, we have a sharp recovery that restores economic activity to pre-Coronavirus levels. The 'U-shaped' contemplates a longer period in which the economy crawls along at low levels before recovering. The 'W-shaped' characterizes the economy with a recovery now, then another decline as Coronavirus matters worsen again, until there comes a more lasting recovery. In each of these scenarios, the Fed expects long-term Treasury rates to stay near the lows seen in the first quarter of this year, for corporate bond yields to rise in relation to Treasuries, and for stocks to fall by 50% from June 1st levels! I don't think we will hear Jerome Powell or other Fed governors saying this aloud, for fear that their predictions become self-fulfilling prophecies, but so the Fed has written. (If you wish to read this report, not a long one, you will find it at https://www.federalreserve.gov/publications/files/2020-sensitivity-analysis-20200625.pdf).

The history of recessions and bear markets, as well as the Fed's analysis, suggest that caution should guide our investing at this remarkable time. It would have been a fruitful thing to dive into the stock market at the March lows, particularly after successfully avoiding it, as we did, during the sell off. Unfortunately, market timing is really an impossibility; it wreaks havoc on the portfolios of those who attempt it. I will continue to be guided by a longer view and will deploy capital back into stocks when things play out further in this 2020 drama.

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CORE ASSET MANAGEMENT
PO Box 1629
108 Caledonia Street
Sausalito, California 94966
(415) 332-2000 • (800) 451-2240
fax (415) 332-2151
www.coreasset.com
info@coreasset.com