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

May 3, 2020

What Do We Know Now?

As lockdowns are lifted, we will enter a new and uncertain coronavirus era. Its contours are unclear, but the political support for stopping economies and sequestering citizens is ending fast.

Things in the asset markets have calmed down since the extraordinary turmoil that characterized March. The quiet, such as it is, is largely the result of the Fed's actions of which I wrote in my last notes. As for the coronavirus, lock-downs remain in place in most states in America and are slowly being lifted in Europe and elsewhere. It appears that in all developed countries the mortality of this coronavirus is 0.1% or lower for healthy young people. Had this been known eight weeks ago, the world might not have begun this medically-induced economic coma. But, there it is. This was not known and most countries--Sweden excepted--shut things down to save lives. We shall see what happens as things reopen, whether, as there has been in Singapore, for example, a second wave of illness and what will emerge from a second wave. The recrudescence of illness aside, what will the economy look like? There has been hope for a V-shaped recovery, whereby, after the detonation of coronavirus-shutdown, comes a swift and sharp recovery to where things were before. Hopes for a swift economic recovery have, along with the Fed, impelled stocks higher in recent weeks.

How likely is a V-shaped recovery? As I see it, a low probability. Although healthy young folks don't die from this, how willing will the young and healthy and the compromised oldsters be to return to crowded cinemas and opera houses, to ride subways, to go to ballparks, to go back to favorite restaurants? And will the 30 million Americans who have applied for unemployment benefits in recent weeks soon be re-employed and drawing their accustomed paychecks? To the extent they do receive their former levels of income, how much more will they save and how much less will they spend? A lot, I think. Saving more and spending less is a good thing for lots of folks and lots of companies, but not so good for economic growth.

The investment questions are these: did we enter another bear market for stocks on February 19th? Was the 35% decline to March 23rd the first leg down? Has the S&P's 35% recovery to April 29th been the first counter-trend bear market rally? (That counter-trend rally, as I characterize it, still leaves us, if you do the arithmetic, 13% from the Feb 19 high.) The answers are not to be known for a while, but the very high probability is that we began a new bear market in February and we began a new recession (or worse) then or in March when lock-downs began. I have been looking closely at the history of bear markets of the last century, of recessions, and of the depression of the 1930s. The lessons are clear: Bear markets persist for a long time; during them come significant rallies; then come deeper declines. There is an unhappy interplay of hope against fear that persists for years; when optimism and hope finally disappear, then comes the recovery. As I see it, the stock market and the hopes for the V-

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shaped economic recovery make it clear that optimism is high; until despair is the prevailing view, we are not at the end of this bear market. The swiftness and the depth of the decline in economic activity in these recent weeks are unprecedented, at least in the 20th and the 21st centuries. It is somewhat alarming to note that regaining the level of the high in the stock market in 1929, before the that terrible bear market and the depression, was not accomplished until 1954, a bit more than 35 years from the 1929 high. Oops.

The depression of the 1930s and the accompanying bear market are not the templates for this economy and this stock market, although the economic contraction now is likely to surpass all the recessions since that time. Economists (think John Maynard Keynes), our government and the Federal Reserve learned some things from the 1930s: As we have observed in recent weeks, Congress and the Fed have delivered some swift and impressive actions. (Thus the optimism for a V-shaped recovery.)

Despite forceful and swift actions by Congress and the Federal Reserve, economic activity has fallen off a cliff. Restoring reasonable growth and providing income again to citizens will take a very long time.

There will be no V-shaped recovery and the bear market will worsen and persist.

Core's investments. The rally in the S&P from the March lows recovered much recently lost ground, but Core did not attempt to join that party. We retained our investments in long-term Treasury bonds and in gold. Note that long-term Treasuries always rise in price and fall in yield in recessions. As it happens, since 1980 or so, the total return from long-term Treasuries has exceeded that of the S&P. Results are similar for shorter periods and more recent intervals. Note also that investments in US Treasuries do not involve any risk of default or return of capital, whereas stocks.... If the total return is greater with Treasuries without the attendant risks of stocks, what's the problem? Particularly when, as was the case when the S&P reached its peak in February, corporate profits had fallen for a year and economic growth was already slowing.

The argument made against long-term Treasuries now is that prices are very near all-time highs and yields near all-time lows. As of this writing, the yield on the 'long bond,' the thirty-year Treasury, is 1.278%. How can it possibly go lower? It goes lower because the supply of Treasuries is less than the demand for them. The US will run vast deficits and need to sell many bonds. The demand for these bonds is far greater than what the Treasury will issue. We all will be saving more.

All that said, if this is a real bear market--and it is--there will come a time when we will want to put aside Treasuries and gold and pile into stocks at what are likely to be quite attractive prices. We are not there yet, but when folks take into account how severe an economic decline we have entered, then will come lower stock prices (and higher prices for our Treasuries and gold) and we will put some chips on the table. For now, we will wait and watch.

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A word about a couple of investments. We had a brief investment in high grade corporate bonds (via a security with the symbol lqd). I wrote about buying this in my last letter, but shortly afterwards, I decided again that the risk, though not a big one, was not worth it and I sold the position. We all made a bit of money on the trade. Since then and because most portfolios held large cash positions that earn nothing, I decided to invest in short-term high-grade corporate bonds with maturities up to five years. Some portfolios now hold this; others will soon. We will not get rich on this investment, the symbol for which is slqd, but we will earn a respectable rate of interest while we wait and watch.

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