First Quarter 2020 Commentary

In attempting to describe the first quarter of 2020, we quickly run out of superlatives. Unprecedented. Painful. Surreal. Historic. Stressful. Volatile. Scary. Unreal. We saw a new virus engulf the world in a global pandemic, with elected leaders at first calling it a hoax then declaring a national emergency the next day.

From a societal standpoint, the coronavirus has upended life as we know it. As of this writing, more than a dozen states have instituted 'stay-at-home' orders with tens of millions of Americans working from home and practicing social distancing.

The short-term impact on the global economy will assuredly be detrimental, and all sorts of markets have experienced unprecedented volatility and downward pressure on asset prices. The oil market suffered its single worst day since the Kuwait invasion thirty years ago, with oil now trading under $25 per barrel after trading above $50 per barrel just one month ago. The bond market saw 10-year Treasury bonds yielding below 0.4%, a level not seen since … ever. Let that sink in for a second. Would you ever lend money—to *anyone*—for ten years at an interest rate of just 0.4%? The stock market did not fail to play its part in the panic, entering a bear market in record time. While it typically takes eight months for stocks to enter a bear market—commonly defined as a decline of 20% from the most recent peak—this time around it took three weeks.

The Federal Reserve moved swiftly and decisively, at first lowering its benchmark interest rate from 1.5% to 1.0% in early March, then cutting it again a week later to effectively zero. Following several other interim actions, on March 23 the Fed announced basically unlimited quantitative easing. In 2008-09, the first rounds of quantitative easing allowed the Federal Reserve to purchase certain amounts of assets. The first couple of rounds were targeted at $600 billion. This latest round of easing has no such limit. Congress, for its part, passed the greatest bailout in the history of the republic, worth $2 trillion, providing desperately needed funds to some of the hardest-hit Americans.

Some Perspective on Market Downturns

If your knowledge of stock market history only extends back about a decade, until recently you may have thought that the only direction that stock prices are allowed to move is upward. However, if you take a longer view of things, you will quickly be disabused of that notion. Here is a chart of the 9 most memorable setbacks for U.S. stocks over the last 60 years:

Description	Peak	Trough	Decline	5-Year Return After Trough
Cuban Missile Crisis	Dec 1961	Oct 1962	-24%	+108%
Recession	Nov 1968	May 1970	-33%	+56%
Oil Shock	Jan 1973	Oct 1974	-45%	+121%

Recession	Nov 1980	Aug 1982	-20%	+297%
’87 Crash	Aug 1987	Oct 1987	-33%	+118%
Iraq War	Jul 1990	Oct 1990	-18%	+128%
Asian Contagion	Jul 1998	Aug 1998	-19%	+13%
.com Bubble & 9/11	Sep 2000	Oct 2002	-47%	+121%
Global Fin’l Crisis	Oct 2007	Mar 2009	-55%	+209%
Average			*-33%*	*+130%*
COVID-19	Feb 2020	Mar 2020?	-34%?	???

source: Yahoo! Finance, Inkwell analysis

These 9 drawdowns were all instigated by distinct exogenous events. They each lasted a distinct length of time from peak to trough. They each experienced a unique percentage decline, and they each experienced a unique recovery trajectory.

The one thing they all have in common, though, is that in each of the 9 instances the market did eventually recover. The average recovery was to the tune of 130%, which is slightly more than a double. For stock investors who are able to hang on until March 2025, history seems to indicate that they will be rewarded for their patience.

But we’d like to make one important caveat about this chart. On the bottom row, we put “Mar 2020?” and “-34%?” as the trough level of the current downturn, but that’s only because it’s true as of the time of this writing. In the next few weeks, the news about the coronavirus will get much worse before it gets better. Many more people will test positive for the virus, many more people will die because of it, and there is still much darkness to come before the dawn.

As this news hits the airwaves, for all we know the stock market may take another tumble and go lower than it did in March. Or, again for all we know, the market may already be anticipating all of that bad news, and the lowest point will eventually prove to have been reached in March.

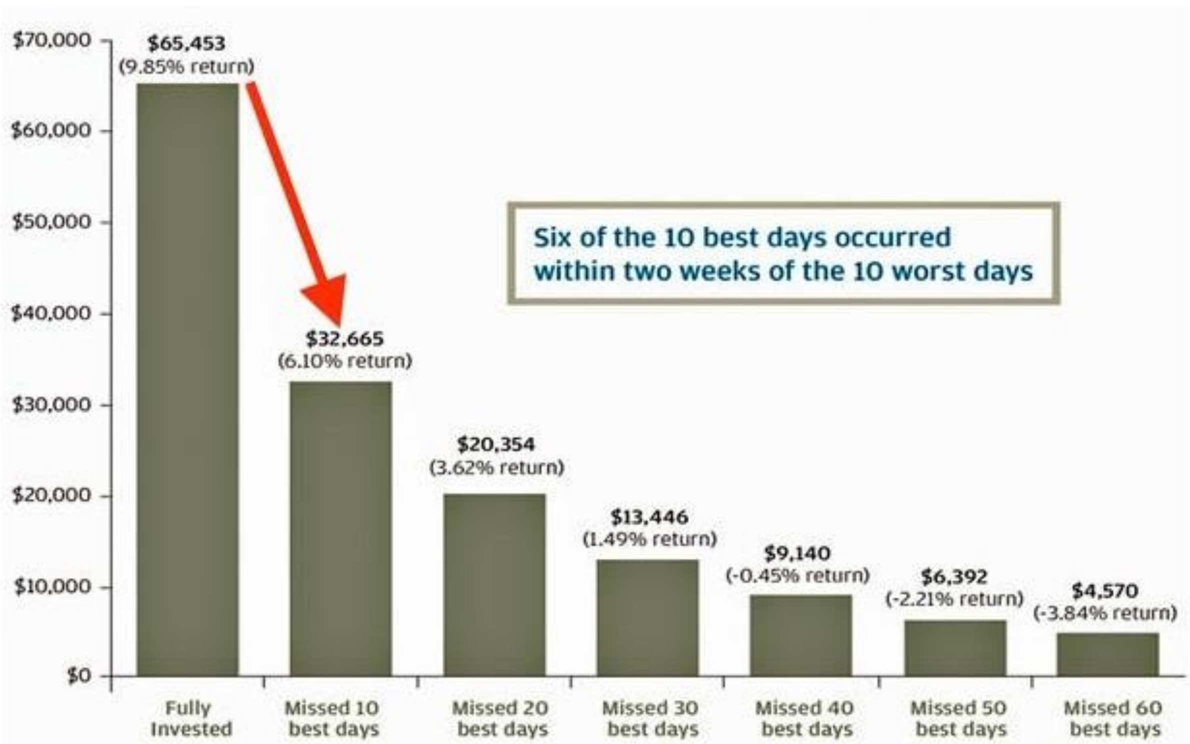
We are not equipped to play that particular guessing game. The game we are good at is deciding whether Mastercard stock is a bargain below $250, or whether Berkshire Hathaway is a bargain below $180. We believe that if we can make a series of similar decisions as those, then your portfolio will come out in a better place five years from now.

A Few Good Days Is All It Takes

But what about the idea that an investor would be better to sell everything near the top, wait for the dust to settle, and then buy back in to the market near the bottom? Well, as for selling everything near the top, one would need a time machine to be able to accomplish that. But now that we are where we are, should an investor try to get out and then get back in once the coast is clear?

JP Morgan recently did a study of what an investor would have earned by investing in the S&P 500 index over a 20-year period. The answer was a respectable annualized return of 9.85%. An initial investment of $10,000 would have become $65,453. However, if that hypothetical investor had missed out on the 10 best days—just 10 days!—over that 20-year period, her return would have shrunk to 6.10% and her $10,000 would have grown to only $32,665. Her portfolio would only have been half as big as it would have been if she had remained fully invested through all the ups and downs.

As the chart below notes, many of the market's best up days occur in the midst of severe declines. We all experienced this first-hand when the S&P 500 advanced nearly 10% on March 24, its largest one-day gain since 1933. It's days like that which really help a portfolio to grow over the long term.



source: JP Morgan Asset Management

In situations like this we always find solace in going to the words of Warren Buffett, which remind us how to react to wild fluctuations in the stock market. He said it best in his 1987 letter to shareholders:

> *Ben Graham, my friend and teacher, long ago described the mental attitude toward market fluctuations that I believe to be most conducive to investment success. He said that you should imagine market quotations as coming from a remarkably accommodating fellow named Mr. Market who is your partner in a private business. Without fail, Mr. Market appears daily and names a price at which he will either buy your interest or sell you his.*
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> *Even though the business that the two of you own may have economic characteristics that are stable, Mr. Market's quotations will be anything but. For, sad to say, the poor fellow has incurable emotional problems. At times he feels euphoric and can see only the favorable*

> *factors affecting the business. When in that mood, he names a very high buy-sell price because he fears that you will snap up his interest and rob him of imminent gains. At other times he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions he will name a very low price, since he is terrified that you will unload your interest on him.*
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> *Mr. Market has another endearing characteristic: He doesn't mind being ignored. If his quotation is uninteresting to you today, he will be back with a new one tomorrow. Transactions are strictly at your option. Under these conditions, the more manic-depressive his behavior, the better for you.*
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> *But, like Cinderella at the ball, you must heed one warning or everything will turn into pumpkins and mice: Mr. Market is there to serve you, not to guide you. It is his pocketbook, not his wisdom, that you will find useful. If he shows up some day in a particularly foolish mood, you are free to ignore him or to take advantage of him, but it will be disastrous if you fall under his influence.*
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> *...[A]n investor will succeed by coupling good business judgment with an ability to insulate his thoughts and behavior from the super-contagious emotions that swirl about the marketplace. In my own efforts to stay insulated, I have found it highly useful to keep Ben's Mr. Market concept firmly in mind.*

Conclusion

We want to conclude by getting a little personal. We want to say "thank you." Most investors know about Ben Graham's Mr. Market allegory. Most say that, of course, that's how they behave and think when they invest. But when the rubber meets the road, they become swayed by Mr. Market's depressive mood. They forget all about Mr. Buffett's advice and let Mr. Market's foul mood dictate their irrational behavior. But not you.

As our peers have been getting call after call from panicked investors wanting to sell everything, the vast majority of our clients have stood steadfast through the downturn. The few calls that we have gotten have been of support and, in some instances, to inquire about adding new money to take advantage of Mr. Market's depression. We are humbled and thankful for the amazing group of clients that we have. Thank you.

Finally, we want to leave with something positive and beautiful. We have read the poem below many times in the last couple of weeks.

Lockdown
by Friar Richard Hendrick, OFM

Yes there is fear.
Yes there is isolation.
Yes there is panic buying.
Yes there is sickness.
Yes there is even death.
But,

They say that in Wuhan after so many years of noise
You can hear the birds again.
They say that after just a few weeks of quiet
The sky is no longer thick with fumes
But blue and grey and clear.
They say that in the streets of Assisi
People are singing to each other
across the empty squares,
keeping their windows open
so that those who are alone
may hear the sounds of family around them.
They say that a hotel in the West of Ireland
Is offering free meals and delivery to the housebound.
Today a young woman I know
is busy spreading fliers with her number
through the neighbourhood
So that the elders may have someone to call on.
Today Churches, Synagogues, Mosques and Temples
are preparing to welcome
and shelter the homeless, the sick, the weary
All over the world people are slowing down and reflecting
All over the world people are looking at their neighbours in a new way
All over the world people are waking up to a new reality
To how big we really are.
To how little control we really have.
To what really matters.
To Love.
So we pray and we remember that
Yes there is fear.
But there does not have to be hate.
Yes there is isolation.
But there does not have to be loneliness.
Yes there is panic buying.
But there does not have to be meanness.
Yes there is sickness.
But there does not have to be disease of the soul
Yes there is even death.
But there can always be a rebirth of love.
Wake to the choices you make as to how to live now.
Today, breathe.
Listen, behind the factory noises of your panic
The birds are singing again
The sky is clearing,
Spring is coming,
And we are always encompassed by Love.
Open the windows of your soul

And though you may not be able
to touch across the empty square,
Sing.

Thank you again for your continued confidence and support. Be safe.

Sincerely,

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