"Stay Logical"

Market Commentary – April 2020

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The third estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 2.1% in the fourth quarter of 2019. Past economic data has much less meaning, however, since global economies have been hijacked by the coronavirus (COVID-19). In an effort to help limit the spread of COVID-19, the federal and state governments have deemed it worthwhile to shut down major portions of the U.S. economy. Governments worldwide have acted similarly. This has caused an unprecedented "induced coma" for the U.S. and global economies. 2020 Q1 GDP will be hit, but January and February were *relatively* normal. The economic disaster firmly took hold in March. We will get our first glimpse at Q1 GDP in late April. The real shock, however, will be in late July when we get the advance Q2 GDP reading. Estimates are all over the map, with some projecting GDP to contract by -30%! To give some perspective, GDP contracted by -8.5% in 1930, -6.4% in 1931, and -12.9% in 1932 (this period was aptly dubbed the Great Depression).

Staring at an economic tsunami, the Federal Reserve has unleashed the equivalent of a nuclear bomb to attack the *economic* effects of the virus. On March 3, the Federal Open Market Committee (FOMC) cut its benchmark federal funds rate by 0.50% to a range of 1.0% to 1.25%. Financial markets continued to plummet. On Sunday, March 15, the FOMC held an emergency meeting and slashed the federal funds rate to a rock-bottom 0% to 0.25%. They also launched a massive $700 billion quantitative easing program. Amazingly, this program was supplemented on March 23 with "QE Unlimited", where the Fed will "purchase Treasury securities and mortgage-backed securities in the amounts needed to support smooth market functioning". Congress has also approved an unprecedented $2.2 trillion round of fiscal stimulus in the form of various programs (unemployment insurance, cash payments to individuals, forgivable small business loans, and more). To help put these dollar amounts in perspective, 2019 GDP was $21.7 trillion.

The ubiquitous nature of news and social media has spread the *fear* of COVID-19 faster than the virus itself. Americans have been told to "flatten the curve" with COVID-19, which is accomplished by handwashing (has this ever been a bad idea?), social distancing, and staying home. COVID-19 is very real and its effects are devastating, even terminal, for some. However, people are seemingly ignoring the fatality rate, defined as the number of deaths divided by the number of people with the illness. We know every single person who has died of COVID-19, so the numerator is known. What we do *not* know, however, is the denominator. As testing for COVID-19 and its antibodies becomes more available, we will likely find that the denominator is much larger than we ever dreamed. This is ironically good news, as the fatality rate would, by definition, shrink. Remember that COVID-19 is not Ebola, which has a 90% death rate. Why is society reacting as if COVID-19 is Ebola? As of March 21, the CDC estimated 39 million cases, 400,000 hospitalizations, and 24,000 deaths from flu in the U.S. this year. Why isn't this in the news?

Technical factors of the market are bullish (more demand than supply), while fundamentals are attractively priced – therefore, we are bullish on the market. The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) over the next 12 months is $165.09, which implies a price-to-earnings (P/E) ratio of 15.7 with the S&P 500 at 2,585. The earnings yield (E/P) of 6.39% represents attractive value relative to the 10-year U.S. Treasury note yield of 0.70%. Stocks are dirt-cheap!

The S&P 500 collapsed -25.8% in the first 23 days of March, before rebounding up 17.9% from the intraday low of 2,191. This intraday low now becomes an important level of support for technicians. Sometimes market lows are tested, but not always (e.g., the March 2009 low was never tested). Our cash positions are allowing us to buy stocks being thrown away by investors who are panicking or forced to sell to cover margin loans and other debt. This is when we earn our return on cash. Forget about timing the market; stay logical, recognize that stocks are on sale, plug your nose, and buy…incrementally. We then need to be patient to allow the investments time to grow.