Perspectives

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# Buckle Up


REQUISITE
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> **Predictions are very difficult, especially if it's about the future**
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> —NOBEL LAUREATE IN PHYSICS NIELS BOHR

As we sit here today, the corona virus is still very much with us, as is much of the economic dislocation caused by the resulting lockdowns. Dr. Slaoui,[i] chief scientific adviser of Operation Warp Speed (the government task force on Covid-19), recently stated, "…I am very confident there will be, probably, two vaccines between now and December." As confident as he is, it may be quite some time yet before most of us will get access to a vaccine, and frustration will most likely persist. In addition, we are going through an incredibly hyperpartisan presidential election, with a variety of voting issues we have never had to deal with before.

So before we are further engulfed by these multiple unknowns, we want to take a moment to review what we, as investors, should have learned (or relearned) in 2020.

1. No amount of study, economic commentary, or market forecasting ever prepares us for really dramatic events, which always seem to come at us out of deep left field. Trying to make investment strategy out of "expert" prognostication (much less financial journalism) always sets investors up to fail. Instead, having a long-term plan, and working that plan through all the fears (and fads) of an investing lifetime, tends to keep us on the straight and narrow, and helps us to avoid sudden emotional decisions.

2. The equity market had a drawdown of 34% in 33 days. Investors haven't seen that precipitous a decline before, but with respect to its depth, it has already happened twice in the last twenty years[ii]—extremely uncomfortable, yet not that uncommon.

| Market Correction | Decline | Duration of Decline |
|---|---|---|
| **Tech Bubble Burst** (March 2000–Sept 2002) | -49% | 30 months |
| **Global Financial Crisis** (Oct 2007–Feb 2009) | -57% | 17 months |
| **Covid-19 Pandemic** (Feb 2020–March 2020) | -34% | 1 month[iii] |

Source: JPMorgan "Guide to Markets," October 2020

3. Almost as suddenly as the market crashed, it completely recovered, surmounting its February 19, all-time high on September 2.[iv] Even as the news concerning the virus and the economy continued to be dreadful, the market came all the way back. Historically, these declines have not lasted and long-term progress has always reasserted itself.

4. The equity market most often resumes its advance, and may even go into new high ground, considerably before the economic picture clears. If investors wait to invest before they see unambiguously favorable economic data, history tells us that they may have missed a very significant part of the market advance. We must consistently remind ourselves that volatility is the price of admission for equity investors.

Some perspective to consider as we enter next week:

1. **Earnings**. Even with the carnage this pandemic has caused, S&P 500 2020 earnings are estimated at $130/share, with 2021 estimates at $165/share. In the long run, earnings drive returns; in the short run, markets are driven more by sentiment. Looking back 10 years, the earnings and price movement for the S&P 500 are up roughly the same, +186% and +190%, respectively. As the economy starts to improve, the trajectory for earnings over the new few years should be higher, giving equities a foundation to grow.

| Investment | 2009 | 2019 | Growth |
|---|---|---|---|
| S&P 500 Earnings[v] | $56.86 | $162.85 | 186% |
| S&P 500 Price (YE)[vi] | 1115.00 | 3230.00 | 190% |

Source: NYU Stern

2. **Fixed Income**. Investors can earn .78%[vii] per year for the next 10 years (pre-tax) investing in the 10-year U.S. Treasury bond—a recipe to grow poor safely. While rates have come down, interest-rate risk has risen dramatically. If interest rates were to move 1% higher, the 10-year treasury would have a negative return of ~8.32%. There is almost no room left for appreciation in bonds and for portfolios with longer durations. The downside risk is far greater than the upside return.

| Investment | Yield | Duration | Impact of 1% Increase in Rates |
|---|---|---|---|
| 10-year Treasury | 0.78% | 9.1 years | -8.32% |
| Bloomberg Barclay Agg Bond Index | 1.17% | 5.92 years | -4.75% |

Source: Bloomberg, October 27, 2020

3. **The Federal Reserve**. The Federal Reserve's presence in the market can be summed up with two oft-used Wall Street quotes, "Don't fight the Fed" and "Bull markets don't die of old age, but rather they are killed by the Fed." The Federal Reserve's participation in capital markets today is historic. Not only have they committed to keeping rates at zero for the foreseeable future, but the Federal Reserve created 11 new financial facilities (supporting everything from money markets to nonprofit loans) that stand ready to support the market. We do need more fiscal support from D.C. as the Fed cannot send money directly to individuals. Assuming we get a stimulus package sooner than later, the Fed's dovish stance gives support for equity valuations to rise.

A word about the election. It is unwise to exit quality equity investments because of the uncertainties surrounding the election. Aside from the self-inflicted wound of incurring capital gains taxes, the chances of getting out and then advantageously back in, are historically very poor. **As investors, we must always remember that there are two investment decisions to be made in uncertain times like these: if I sell, when do I get back in?**

As we navigate the coming weeks and months, we think markets will continue to act as they always do—volatile in the short term, but upward trending in the long term.

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[i] October 5th Kara Swisher podcast "Sway," with Dr. Slauoi

[ii] JPM Asset Management—"Guide to Markets," October 22, 2020, page 19

[iii] JPM Asset Management—"Guide to Markets," October 22, 2020

[iv] Bloomberg

[v] NYU Stern

[vi] NYU Stern

[vii] Treasury.gov, October 28, 2020

[viii] Bloomberg, October 27, 2020