The Long & Short of It

Quarterly Newsletter
First Quarter 2020

Mr. Market: Shaken and Stirred

Uncertainty returned to Mr. Market during the first quarter of 2020 with a certain result. Stock markets and most risk assets declined sharply in a flight to the perceived safety of cash and US Treasuries. Much remains unknown about what is happening and what will take place, except: we are experiencing an historic global event that will be spoken of for generations. COVID-19, the virus and the response, is like a viral 100-year flood.

It would not be wise to be dismissive of such a highly transmissible virus. The number of cases could become staggering—mind-numbingly so, enough to overwhelm the world's healthcare systems several times over and make outcomes of COVID-19 and other afflictions worse still. Not discussed broadly is the grim reality of the aftermath: potential complications and new preexisting conditions for innumerable survivors, many of whom will have these for the rest of their lives. Yet human creativity and the tenacity to find solutions should not be discounted. As value investors in particular, we rely on this belief in human problem-solving. Solutions will be found, though too late for some, and the world will press on.

Difficult Choices

The Hobbesian choice faced by the world is whether to suffer economic decline and deprivation today to reduce the speed of the spread and minimize the death rate. There is no good outcome, only one that may be less devastating than others. We pray for better outcomes: for healthcare workers, for effective treatments, and for a vaccine. There are so many things for which to pray.

With the economy reshaped in the image of social distancing, people must wait a few weeks to see the impact on the spread of the disease…and the economy. It is not the same as quarantine (China) or targeted quarantines (South Korea). One cannot even be sure the degree to which the economic slowing is due to any governmental mandates or suggestions, as many have chosen to modify their lifestyle, and slow the economy, out of respect for, or fear of, the virus. That behavior may sustain to some significant degree even if government were to suggest people get back to normal. A culture that demands instant results and reporting is essentially being made to watch a slow-motion train wreck. Several billion people worldwide watch as the numbers update, like drivers rubbernecking the same accident all across the globe. Other information continues to come out each day, but there remains so much that just cannot yet be known.

Remarkable is the complexity of the effort and the uncertainty that creates. Look at testing alone. "There are no tests." "There are tests, but they are expensive and hard to get." "You have to have symptoms and have been around someone who had COVID-19." "The test does not work well." "New tests are coming." "New tests exist, but are not available in your area." "New tests are in your area, but only for those with symptoms and the tests take seven days for results, which is really too late." "Drive-through testing exists, but only for first responders and healthcare workers."

While testing will continue to improve, this conundrum is enough to make one's head spin and it is a mere microcosm of the pandemic. The media (or what once was appropriately called the "news" but is no longer) is in a feeding frenzy as it reports on Congress, the Administration, the Federal Reserve, governors, mayors, healthcare officials, company leaders, treatments, vaccines, emergency responses, flattening the curve, hoarding, stimulus, infrastructure, etc. One commentator pointed out yet another dynamic worth observing among public officials: the desire to contain the blame more than the virus. "Political distancing" is the new term.

Where from Here?

So, what is known that matters for investors? Storylines for individual companies have changed, quite dramatically for many. Some will not survive. For a few, the changes will be fleeting until they return to business as usual. For others, they may permanently benefit from the changes as they innovate in new directions. Like everything else about this crisis, this fluidity is fast-moving and complicated.

On a macroeconomic level, politicians prefer inflation to people and businesses going broke. The Federal Reserve began to provide unprecedented liquidity in September 2019, well before COVID-19 got its start. And it is now providing massive liquidity through new and expanded policies that would have been considered simply out of bounds by central bankers of the past. But Chairman Powell does not appear to be restrained by all of the concerns and risks that held back the creativity of his PhD-wielding economist predecessors. He allowed Yellen's accommodative policy to continue too long and then overtightened, and then was forced to move to unprecedented stimulus…and now this. As Jim Grant summed it up in his *Almost Daily Grant's* on March 23: "Watch out, Mr. Market. Uncle Sam is buying you out."

Congress jumped on the bandwagon with the $2 trillion CARE Act, which promises to be just the beginning of assistance with stimulus, infrastructure, and more of everything to come. They will pick winners and losers with taxpayer money while the vast sums conjured by the Federal Reserve will be used to buy Treasuries to fund deficit spending and keep mortgage, corporate, and municipal debt markets afloat. We essentially have a potential healthcare crisis that will hopefully peak anytime between now and the end of next winter, and a government-funded economy for the next eight weeks with more on deck.

The picture that comes to mind is of an overloaded cart with a loose wheel. As the cart begins to wobble, you have the sense that something bad is very likely to happen. You cannot grab the axle to stop the calamity, so you just have to pick a spot to stand and hope you can catch something valuable as it falls off…and that this something valuable, or anything else coming off the wagon, does not crush you.

One Step at a Time

In investing, it is always difficult to know exactly where to be and when. Successful investing is an exercise in making incremental adjustments to take advantage of those situations when pricing does not make sense and where vulnerabilities or growing risks can be identified. As we said, this moment is especially fast-moving and complicated. Yet we have our eyes wide open and are focused on protecting our client's interests through the course of this storm. We seek for them to sleep well, stay safe, and contribute where they can while moving up a notch on the "purchasing power" ladder. With volatility comes opportunity, if one is willing and able to make it a friend. We remain focused on the traditional pursuit of investment management, where the message has always been: "Mr. Market. You look so shaken. How can we help?"

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