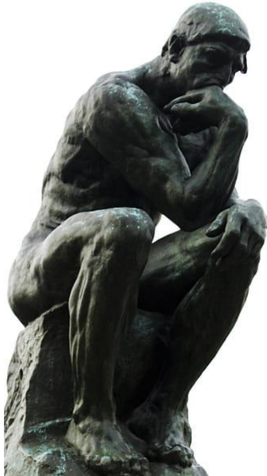
Volume 113

THE PER STIRLING
CAPITAL OUTLOOK
Performance • Perspective • Per Stirling

March 2020

There is likely no field of human endeavor where maxims and sage tidbits of wisdom are more revered and more often recited than is the case in the field of investing. Indeed, you can point to these very reports as evidence of exactly that phenomena, as we emphasize the past wisdom and insight of others in virtually every writing. Indeed, we do so for good reason, as we have often found very practical and applicable insight in so many of these adages, particularly those that have withstood the test of time, and still provide great insight to this day.



In this report, we will discuss a number of these "pearls of wisdom" that we think are particularly relevant today, and what insight they can provide into both the current capital markets environment, and the outlook for the future.

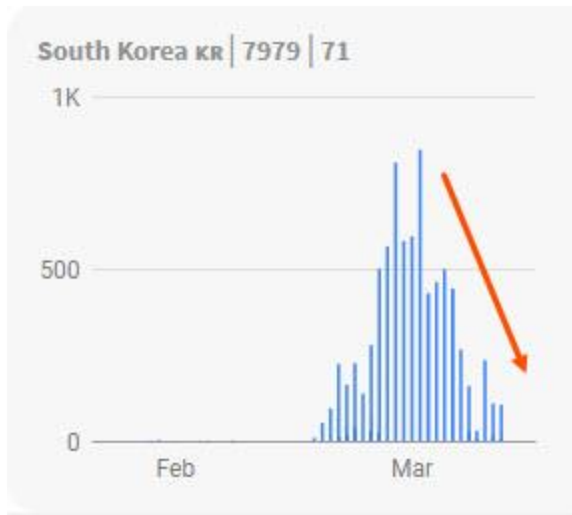
One that seems particularly timely is the maxim of unknown origin that **"The markets stop panicking once policymakers start panicking."** Indeed, we would argue that this observation is more relevant and important today than it has been at any time in modern history, with the possible exception of 2008, when the stock market cratered under an appalling example of political partisanship, and the initial inability of Congress to pass the TARP (Troubled Asset Relief Program), which was the first substantive step towards stabilizing the economy and restoring order to the financial markets during the Global Financial Crisis.

This time, leadership on the federal level has arguably been even worse. Indeed, without calling out America specifically, the World Health Organization stated that it ultimately decided to declare a global pandemic because of "an alarming sense of inaction by certain governments around the world" and Ashish Jha, director of the Harvard Global Health Institute, just described the U.S. government response as "an unmitigated disaster" and "a much worse response than Iran, than Italy, than China and South Korea."

The Federal Reserve was also somewhat slow to respond, as they continued to express their preference for deferring the use of the last few rate cuts that they had available until they saw tangible signs that the coronavirus was actually impacting the domestic economy.

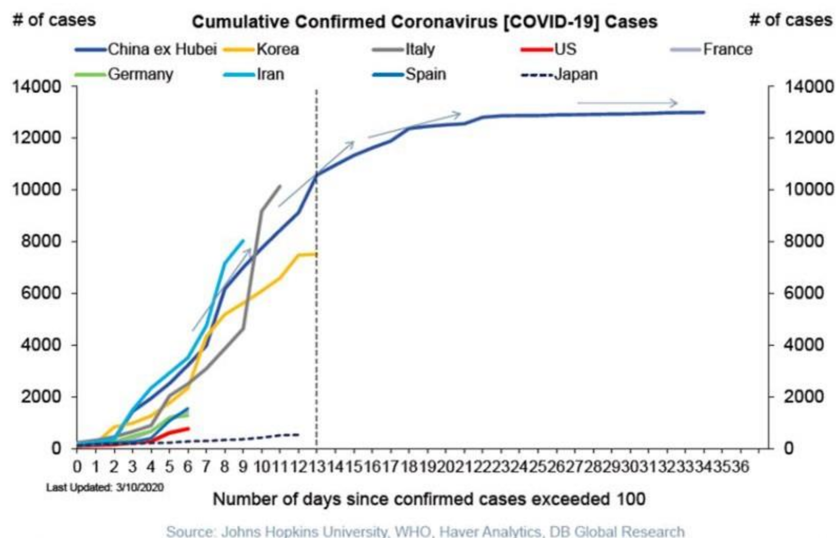
All the while, the markets continued to panic in the face of government inaction, and even federal efforts to downplay the potential risks, in an attempt to avoid panicking the financial markets. Irony of ironies!

Magnifying the cost of this inaction is the fact that countries like China and South Korea, which reacted very authoritatively to the COVID-19 virus (China through draconian quarantines and massive fiscal and monetary stimulus, and South Korea through technology, education and more modest quarantines) are already seeing a dramatic reduction in new cases of the virus. Indeed, in a remarkable twist, Apple just announced that it is closing all of its stores worldwide, **except in China!**



Fortunately, as of the end of last week, inaction and misinformation are being replaced by international cooperation and coordination, legislative and executive action, and a level of monetary stimulus that, on many levels, dwarfs even the heroic steps that the Fed took during the financial crisis. Indeed, they have just announced that they have both cut short-term rates to 0% and restarted their quantitative easing (asset purchase) program.

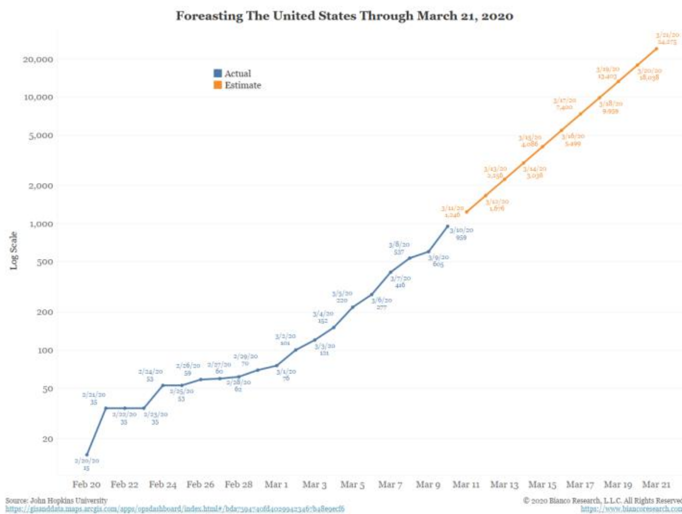
President Trump's Friday declaration of a national emergency put $50 billion of resources to work, and put FEMA in charge of the crisis, while the International Monetary Fund just announced another $50 billion dollars of aid to help primarily developing countries. The G-7 group of major world economies (excluding China and India) are also hosting a videoconference on Monday to decide on a coordinated global response to the crisis, and it looks almost certain that Congress and the White House will agree to a massive fiscal stimulus program. The policy makers are now panicking, and this should ultimately allow the financial markets to stop panicking.



The new legislation also provides for a sizable increase in testing for the virus, a fact which provides a great segue to the next relevant adage.

"Given a choice of bad news or uncertainty, investors will almost always choose bad news", as they know what it is and therefore how to reflect it into securities prices. In contrast, when faced with great uncertainty, investors have no basis on which to quantify potential risk and return, and therefore no way to rationally value securities. Historically, as we discussed in our Special Report of March 2nd, when faced with such great uncertainty, the normal investor reaction is to price in the perceived "worst-case scenario", which is exactly what we believe explains much of the recent market chaos.

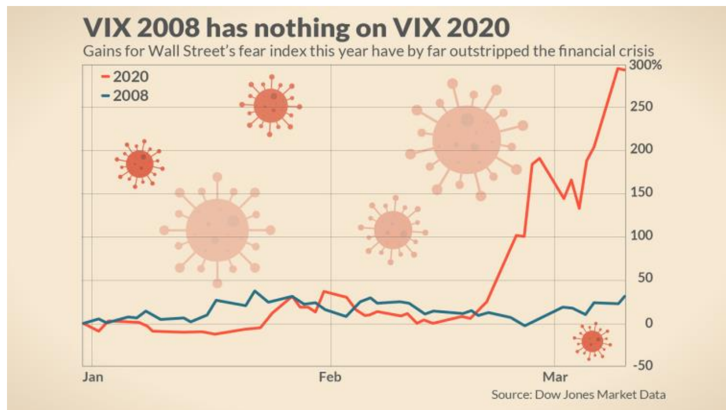
Now that testing is finally becoming more widespread in the U.S., the news is likely to get notably worse in regard to the absolute number of confirmed cases. However, while the news is almost certain to deteriorate, it is very possible that it will not be as bad as the "worst-case scenario" currently being priced in, thus potentially allowing for a rally.



Perhaps even more importantly, more information will help to replace uncertainty with knowledge (even if bad news), and that, in our opinion, should ultimately provide another catalyst to the upside, as investors will increasingly be able to quantify risk and potential return. However, while we do expect for investors to celebrate any increase in clarity, markets are also likely to remain highly volatile, as they come to grips with just how "bad" the news is likely to become.

Specifically, as domestic testing become more widespread, we certainly expect for the number of confirmed COVID-19 cases to grow dramatically, with some estimates that as many as 200 million Americans could be infected and 1.5 million could die over the course of the pandemic. Such an outcome would no doubt be a humanitarian crisis, but for some insight on whether or not it will continue to be a market crisis, we segue to our next adage.

"There are two parts to every tactical investment decision, as you need to not only correctly anticipate the most likely future scenario, but also to calculate how much of that future outcome is already reflected in securities prices."

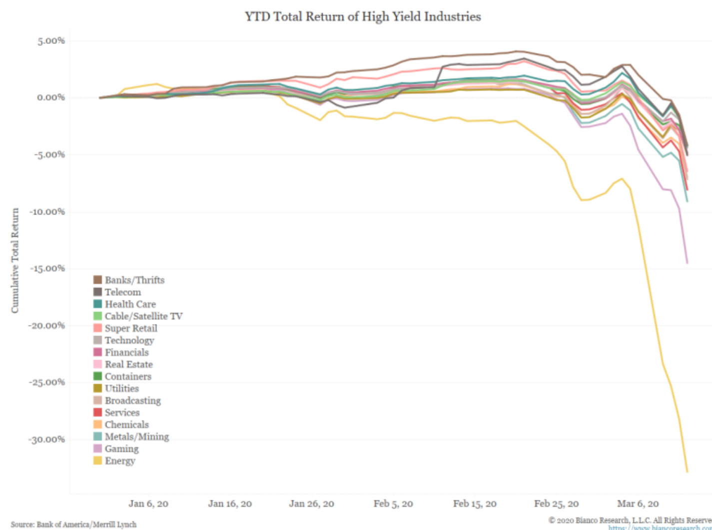


As noted above, we expect that this will likely develop into a humanitarian crisis. We further expect for it to trigger a short, sharp recession that will impact most of the global economy. However, we also strongly suspect that this is already known by the markets and already largely reflected in prices (markets almost never trade up or down on the same news twice).

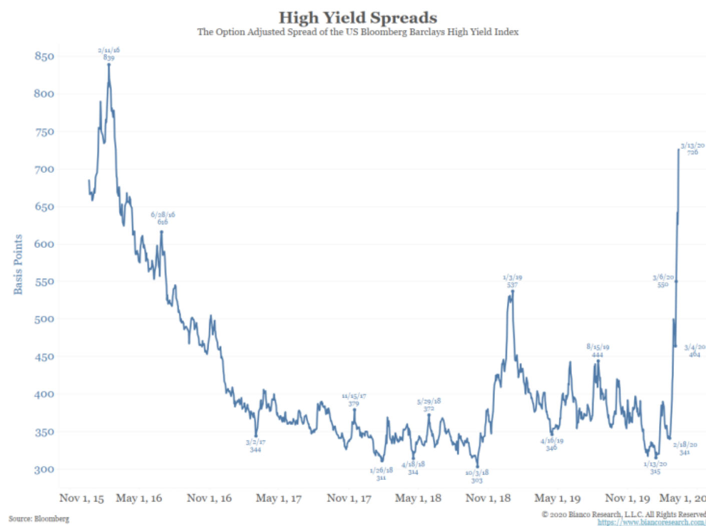
If anything, a look at the VIX "fear index" illustrates that the markets have not only already had an opportunity to price in much of this "bad news", but that they are, in fact, actually pricing in a much worse economic outcome than was priced in during the worst of the global financial crisis, which seems to us to be a fairly extraordinary over-reaction, at least, from a purely financial perspective.

Let that sink in. Investors are pricing in as much equity market risk (and arguably more damage to the domestic and global economies) today than they did during the worst disruption of the global economy and financial system since the Great Depression.

As noted, from our perspective, this seems like a vast over-reaction when you consider the likelihood that, while the news over the next few months is likely to be nothing short of terrible, this negative period is expected to be only temporary, with past coronavirus pandemics running their course over a period of approximately three months, and the financial system so full of fiscal stimulus and so fueled by 0% interest rates and deferred consumption that one can make the argument that the anticipated recession, albeit likely quite sharp, is also likely to last for only a quarter or two and be followed by a very robust recovery.

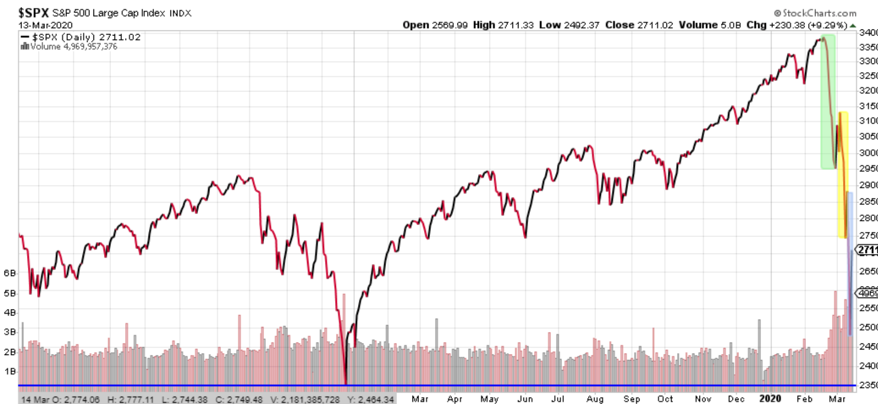


Indeed, while we suspect that much of the bad news is already largely priced into securities, we see virtually no evidence that any potential good news is yet reflected. For example, President Trump just announced that he will be refilling America's Strategic Petroleum Reserve, which he had been selling off to pay for other government programs. Such a move should help to provide a lifeline to America's fracking industry, which is being decimated by the current Russia/Saudi Arabia oil price war, and this decision could have beneficial implications well beyond the energy industry. Indeed, we attribute much of the second leg of the bear market in equities directly to this price war and its very bearish implications for the credit markets.



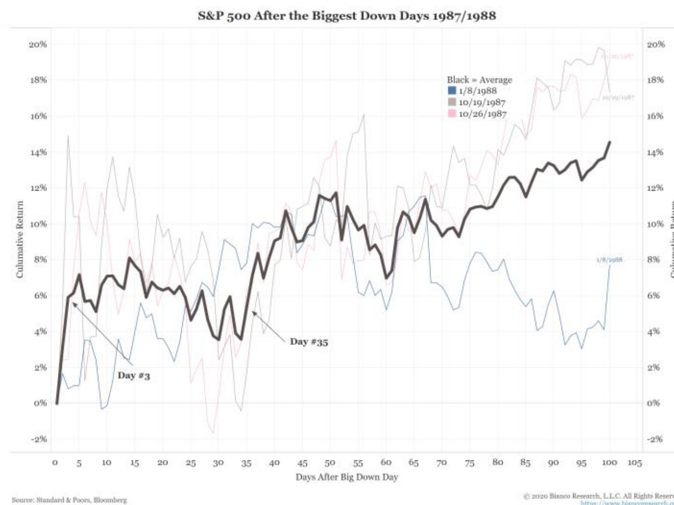
You can see above both the huge losses incurred in energy-company-related high-yield debt and the enormous jump in the risk premium (additional yield) that investors are now demanding to invest in lower-quality debt versus the highest-quality debt (a result of both recession fears and this price war). Indeed, the message of the markets is that the price war creates a fertile environment for a potential credit crisis in corporate debt (a risk that we believe is already largely reflected in equity prices). However, we similarly believe that it would be a very bullish catalyst for equity prices if either Russia and Saudi Arabia agree to curtail their excess production or the U.S. government introduces policies sufficient to support the most indebted of the domestic energy companies.

"Markets have memory." In our opinion, this historic bear market has had three distinct stages that were driven by three distinct catalysts. The first, which we have noted in green, was the market's reaction to the coronavirus, its impact on the global supply chain, and its impact on corporate profits. We consider it likely that investors will need to see a peak in new COVID-19 cases before the markets will be in any condition to recover their losses from this stage of the decline.



We maintain that the second leg of the decline, which we have noted in yellow, was a reaction to the Saudi/Russian oil price war, its implications for the high-yield debt market and the resulting potential for a credit crisis. As noted, we believe that the market could start to recover from this portion of the decline if either Russia and Saudi Arabia settle their differences or the U.S. government takes steps to stabilize the high-yield and, to a much lesser extent, investment-grade segments of the credit markets.

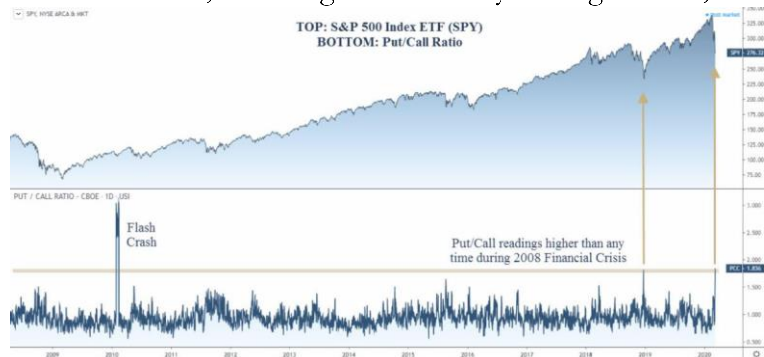
We consider the third leg of the bear market (blue) to have been catalyzed by a crisis of poor communication and poor political leadership, where the market sold off dramatically on fears that there was no one at the helm of the ship of state, only to recover approximately half of those losses on Friday when policy makers finally started "panicking".



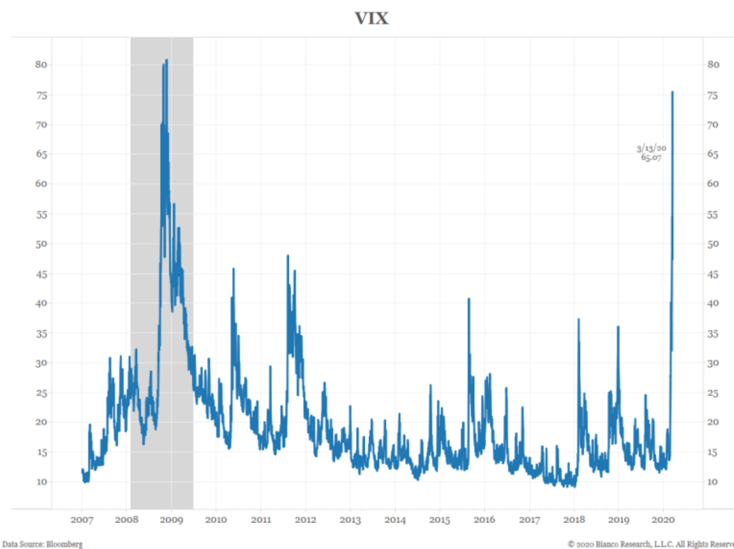
While we believe that there is a minor possibility that the lows for the bear market were put in place last week, it would be very unusual for the stock market to bottom without a successful retest of a significant prior low, which we suspect could be either around the March 12th lows of 2,488 on the S&P 500, or more likely around 2,350 on the S&P 500, which represents both the December 2018 bear market lows, and the level where investors priced the market the last time that they were convinced that a recession was imminent. Remarkably, that target is approximately 13% below Friday's close, but only 5.5% below last Thursday's close. We should note that we do not trust Friday's big rally, and attribute much of it to short-covering caused by the emergency declaration and the agreement between the House Democrats and the White House.

There is also a technical target for the S&P 500 to decline all of the way down to 2,200, but we suspect that those calculations may be overly bearish. It closed on Friday at 2,711.

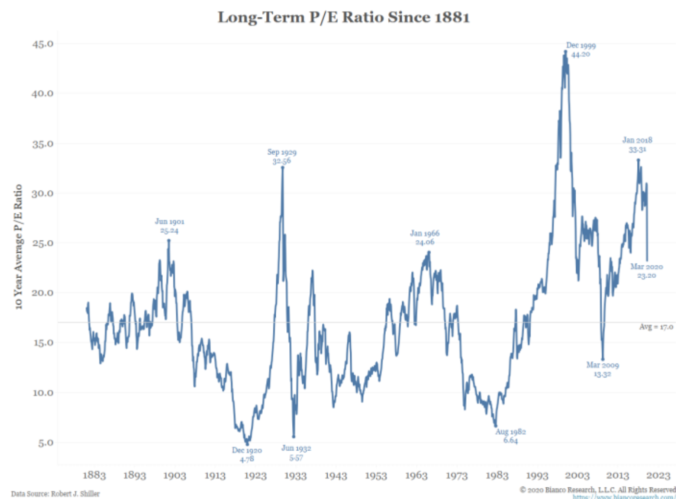
“Don’t catch a falling knife” (a.k.a. why javelin catching never became an Olympic sport): It is noteworthy that this bear market is now meeting virtually all of the criteria that one would look for to identify a market bottom, including extraordinary trading volume, clear signs of investor capitulation, distress in the credit markets, a deeply oversold technical condition, and signs of forced selling, which is normally attributable to margin calls, and which is something normally seen near the end of declines.



We are also witnessing a put-to-call ratio that indicates even more bearishness than was seen at the height of the financial crisis and a VIX “fear index” reading that now rivals those of the capitulation lows of the financial crisis. As such, we can not help but believe that the worst of the decline is likely very near in terms of time (if not also price).



At the same time, market bottoms tend to be a process rather than an event (although there are exceptions), and so there is certainly an argument for remaining patient and being willing to forego the initial stages of a rally in order to get additional confirmation that a sustainable low is in place before increasing equity allocations.



The dilemma faced by policy makers is that they will likely need to make a choice between protecting the economy and protecting the population, because the only way to significantly impact the spread of the virus is to shut down much of the economy.

Since such a move would be largely unprecedented in the U.S. (albeit with some similarities to the post 9/11 “cocooning period”), it is admittedly almost impossible to anticipate the potential economic damage that it would cause.

There is even some speculation that regulators will need to temporarily shut down the securities exchanges, if trading becomes too disorderly (something that can happen around significant capitulation lows).

Regardless, while there still does not seem to be quite enough capitulation and market chaos to call the ultimate market lows (a long shot even under the best of circumstances), we do suspect that we are setting up for a generational opportunity to buy equities.

Baron Rothschild famously stated that you should **"Buy when there's blood in the streets."** We rather like the codicil that someone added years later that **"One should however wait awhile if it is more than ankle deep, or it is your own blood".**

We will be looking for traditional tell-tale signs, such as the market's willingness to go up in the face of "bad news", for an indication that the markets have fully capitulated, and that it's safe to add to equity positions. We will reiterate that market bottoms tend to be a process rather than an event. Further, as we detailed in the recent Special Report, bottoms normally require at least one retest of a significant prior low.

Probabilities are that this is not yet the end of the bear market, but it is quite possibly the beginning of the bottoming process (or "the beginning of the end", to channel our inner Churchill).

We expect for equity markets to stop declining and stabilize once they discount the aforementioned "worst-case scenario". However, it is now looking increasingly likely that it will actually require evidence that the contagion rate has peaked before the market can launch any powerful and sustainable rebound.

The exceptions to this would be either a *rapprochement* between the Saudis and the Russians, which we believe would allow for a substantial, albeit only partial, rebound, or the discovery of either a vaccine or a cure for COVID-19. However, most guidance from the scientific community, including the pharmaceutical and biotech industries, is that such a discovery is a year or more away.

In the meantime, there are a number of promising treatments that will go to human trials over the coming weeks, and the hope is that the coronavirus will weaken as temperatures in the northern hemisphere rise and the virus runs its natural course.

We will close with a maxim from Art Cashin, who serves as the Head of Floor Operations for UBS. It was made during the depths of the financial crisis. As he noted at the time, **"Don't bet on the end of the world. You can only be right once."**

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The VIX Index is based on real-time prices of options on the S&P 500® Index (SPX) and is designed to reflect investors' consensus view of future (30-day) expected stock market volatility. The VIX Index is often referred to as the market's "fear gauge".

The Standard & Poor's 500 (S&P 500®) is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies.

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