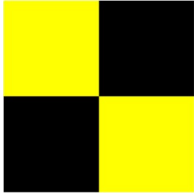




March 16, 2020



## **“(Not) Just Another Manic Monday.”**

*The word quarantine comes from a seventeenth-century Venetian variant of the Italian *quaranta giorni*, meaning “forty days”, the period that all ships were required to be isolated before passengers and crew could go ashore during the Black Death plague [epidemic](#).<sup>[4]</sup>*

Everything’s been thumped. Everything’s been disrupted. Earnings/multiple fundamentals have changed. Uncertainty rules. We started typing this Thursday and hit pause until today - we were hoping to have more clarity around the recent market volatility and what a global coordinated response would look like, we are still waiting on the former and are just now seeing the signs of the latter. Here in San Francisco, we were just ordered to shelter in place for three weeks starting at midnight. This is the new reality for us all.

While it is the frightening virus, coupled with weeks of dithering and nasty politicking, that ended the eleven year Bull market; it is the intelligent and coordinated policy response, that we hope happens, that can guide us back and let capitalism do what it does best. As armchair policy wonks, we feel the US Federal Government has stepped-up its actions and is finally taking this pandemic very seriously. There are always silly side games, but it was heartening to see Trump wear a “USA” hat versus his typical “MAGA” on Saturday’s presser. At its best, the US Federal Government is a large and powerful entity that can provide unimaginable stability to the markets and economy. We hope America brings its “A game.”

Last week, the Bull market, which no one believed in until it was too late, died. The US S&P 500, with a strong economy going into this is the relative best performer. The VIX, a measure of volatility in the US equity market, closed at an all-time high today, 82.69. It had an intraday peak of 89.53, October 24, 2008. At times, credit markets assumed their 2008 trading patterns - widening spreads, weak liquidity, and forced sellers - thankfully the Fed is doing its part with emergency rate cuts and liquidity injections, we anticipate A LOT more stimulus (fiscal and monetary) in the days ahead. We expect more big swings in either direction for the foreseeable future. We generally like to buy (and hold) when volatility is high, but even we have a tough time stomaching this short-term pain (behaviorally, it is times like these when having a plan is important). Remember, doing nothing is still doing something!



Index	Returns					Last time we closed at/below that price
	2/19 close to 3/16 close	3/6 close to 3/16 close	MTD	YTD	Today's closing price	
S&P 500	-29.53%	-19.72%	-19.23%	-26.14%	2,386.13	March 2017
NASDAQ	-29.67%	-19.49%	-19.41%	-23.05%	6,904.59	January 2019
Dow Jones	-31.21%	-21.95%	-20.55%	-29.26%	20,188.52	February 2017
Russell 2000	-38.70%	-28.41%	-29.73%	-37.82%	1,037.51	February 2016
Gold	-8.64%	-11.95%	-10.59%	-3.35%	1,468.60	May 2013
Crude Oil	-45.36%	-36.56%	-38.16%	-52.31%	28.60	August 2000
Bitcoin (USD)	-48.18%	-45.28%	-41.95%	-30.61%	5,003.75	April 2019
VIX (Volatility Index)	475.03%	97.16%	106.16%	500.07%	82.69	Never Before
UK FTSE 100	-30.92%	-20.29%	-21.72%	-31.71%	5,151.08	September 2011
German DAX	-36.60%	-24.26%	-26.48%	-34.02%	8,742.25	October 2013
French CAC 40	-36.49%	-24.47%	-26.90%	-35.07%	3,881.46	April 2011
Moscow Exchange	-27.22%	-16.64%	-18.61%	-25.57%	2,266.90	January 2017
Korea KOSPI	-22.42%	-15.95%	-13.70%	-21.97%	1,714.86	January 2010
Japan Nikkei 225	-27.34%	-18.06%	-19.59%	-28.13%	17,002.04	March 2016
Hong Kong Hang Seng	-16.60%	-11.79%	-11.74%	-18.18%	23,063.57	March 2011

Source: Yahoo Finance

One of the painful lessons we learned in 2008 was the asymmetry of percentages. It's literally one of those behavioral finance mistakes that [Daniel Kahneman](#) made famous. If you asked most people, to quickly assess, "you lose ten percent in the stock market Monday, but you make 10% Tuesday in the stock market Tuesday, how much have you made?" Many people will say you're flat. You're not. That's the pain of percentage, which we show here:

The Pain of Percentages					
Sample Dollar Amount	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00
Down %	-10.00%	-20.00%	-30.00%	-40.00%	-50.00%
Balance after Loss	\$900.00	\$800.00	\$700.00	\$600.00	\$500.00
Up %	10.00%	20.00%	30.00%	40.00%	50.00%
Final \$ Amount	\$990.00	\$960.00	\$910.00	\$840.00	\$750.00
% Needed to Get Back	11.11%	25.00%	42.86%	66.67%	100.00%

Below is where these percentages leave us today after the last six days of pain.



SIX DAYS OF PAIN (S&P 500)						
	Monday	Tuesday	Wednesday	Thursday	Friday	Monday
Balance Start of Day	\$1,000.00	\$924.03	\$969.67	\$922.29	\$834.56	\$912.07
% Gain/loss	-7.60%	4.94%	-4.89%	-9.51%	9.29%	-11.98%
Daily Gain/Loss	(\$75.97)	\$45.64	(\$47.39)	(\$87.72)	\$77.51	(\$109.28)
Balance End of Day	\$924.03	\$969.67	\$922.29	\$834.56	\$912.07	\$802.79
% Needed to Break Even	8.222%	3.128%	8.426%	19.823%	9.641%	24.566%

How many days in a row could Amazon fall 50%? Quick? It's not two. From its close today at \$1,689.15/share, it would take twelve days for its value to fall below \$1/share. In 2008, we realized Lehman could fall 20% a day for a long time.

### **What to do from here?**

We are often asked what to do from here: buy, sell, hold? And what do we buy, sell, hold?

First, wash your hands.

Next,

#### *Volatility: selling*

We have not seen volatility this high since the 2008 financial crisis. As we previously outlined, we believe selling volatility vis-a-vie put-writing on broad equity indices continues to be interesting for investors who are underweight their long-term equity allocations.

#### *China technology stocks: buying tactically*

From an opportunistic standpoint we believe China has "taken their medicine" and are now showing signs of coming out the other side of their COVID-19 crisis. China, generally speaking, is getting back to work whether that be remotely or back to manufacturing plants. Chinese technology companies should benefit from this tailwind but are not ready to stick our necks out on this call, rather we have made small tactical shifts towards these companies in favor of more broad non-US exposure.

#### *Equities: buying opportunistically*

[Baron Rothschild](#) is credited with the famous contrarian investment quote, "the time to buy is when there's blood in the streets." Blood's abound. At today's closing price of 2,386 on the S&P 500 we are back to March 2017. That's a profound loss of three generally good years! While it feels better to buy when stocks are "on sale" we still think there will be more buying opportunities at more attractive prices. Knowing we have an equal chance of being wrong on that point we continue to favor dollar cost averaging into broad equity indices during this volatile time.



### *Strategic target allocations: holding/maintaining*

We believe the greatest determinant of long-term investment results is derived from maintaining one's asset allocation - this has not changed despite 2020's efforts to convince us otherwise. We maintain excess cash for a number of our client accounts and will continue to be net buyers of equities until we reach our strategic equity allocation. For those looking to change their allocation targets to become more aggressive: we like the way you are thinking but would caution making dramatic changes to put additional risk into your portfolio at this time. The investment unknown unknowns remain high. For those looking to become more conservative: we strongly disagree if you are truly a long-term investor (10+ year time horizons). Accepting short-term volatility to achieve long-term equity returns is what we all sign up for as investors.

### **How We Win**

Saturday, we awoke worried we had not bought enough going into Friday's market jump. "Had we missed the elusive bottom?" That jump, partially inspired by a solid Trump speech (Friday), and likely executed by trading algorithms that covered shorts, seemed premature. It was only Saturday morning with our kids jumping on us in utter secluded boredom did we have the "oh boy" moment. Ask any parent with kids at home, what the next eight weeks will entail, and only then can you understand the pain our economies will suffer. R.I.P. Spring Break. We are the last to belittle anxiety, depression and fear, but it's been worse. A common internet meme has gone something like this, "The Greatest Generation sacrificed to save democracy. We're being asked to relax on our couches." We are not going to say this doesn't suck, because it does, but humanity's had far worse, so do your part. If things really go into hysteria mode, we may need to ration food, medicine, clothing, et cetera. We've done that before. In fact, while our response has been delayed, and uncoordinated, we will find a rhythm. We did in 1941. We did in 2001. We did in 2008. We will today. We need to help our most vulnerable, we need to help everyone. It's admirable to see Mitt Romney embrace his inner Yang-Gang and state: "Every American adult should immediately receive \$1,000 to help ensure families and workers can meet their short-term obligations and increase spending in the economy." We agree. It's time for Helicopter Jerome to take off!

Please stay safe. Please wash your hands. We will see you over the webcam whenever it works for you.

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