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INSIGHTS

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HISTORY LESSONS FOR HISTORIC TIMES

By Deron McCoy, *CFA®, CFP®, CAIA®* | **Chief Investment Officer**

REVIEW

Wow! The ancient saying, *"may you live in interesting times"* certainly has taken on dark overtones of late. After collectively enduring Q1, we can now also say that we are living in 'historic times' – albeit at some considerable social distance from one another. As our profession is related to finance we will stay in our lane, but we'd be remiss in not acknowledging that our hearts are with those who are directly suffering or who have been personally affected by this unfathomable global pandemic.

Q1 was one for the record books—in so many ways. The quarter started with a health crisis in China which besides the tragic human toll, negatively impacted global supply chains and manufacturing companies everywhere. Come late February, the virus had migrated worldwide. And by mid-March, amid the worst pandemic in over a century, the only viable solution (until a vaccine could be developed and brought to market) was to limit human-to-human contact through social distancing.

According to Goldman Sachs estimates published for the last week of March *"more than half of the U.S. and a third of the global population is under some form of lockdown."* This global lockdown has effectively shut down consumer demand and with it, the entire services side of the economy. With both manufacturing and services simultaneously hit, economies around the world came to a grinding halt.

The health crisis then morphed into a liquidity crisis, as global investors sold anything and everything to flee to cash at a record-breaking clip. U.S. stocks thus moved from a 52-week (and all-time) high on February 19th to a 52-week low on March 23rd. In fact, in those five short weeks, the S&P 500® fell 33.9%, marking the fastest 30%+ drop from a record high in history.

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With a selloff of that magnitude over that short a time period, it should be of little surprise that it was accompanied by huge and historic daily moves. According to Goldman Sachs, in the week-and-a-half period from March 9-18, U.S. stocks moved *"by at least 4.8% in every session, a streak comparable only to periods during the Great Depression"* with *"three consecutive days of moves +/- 9% for the first time since 1929."* Furthermore, the S&P 500 closed lower by 7.6% or more on three separate occasions during that stretch including a massive 12% one-day swoon on March 16—the third biggest drop on record (outdone only by a 12.3% plunge during the Depression and the 20.5% crash in 1987).

But in a strange twist (and a clear reminder to investors to not hit the sell button based on emotion alone), the record-setting moves were not confined to the downside. The subsequent bounce was also historic. According to Bespoke Investment Group, *"the subsequent 5-day bounce (+17.4%) was the second-best we've seen in history,"* trailing only a similar 5-day period which occurred in November 2008.

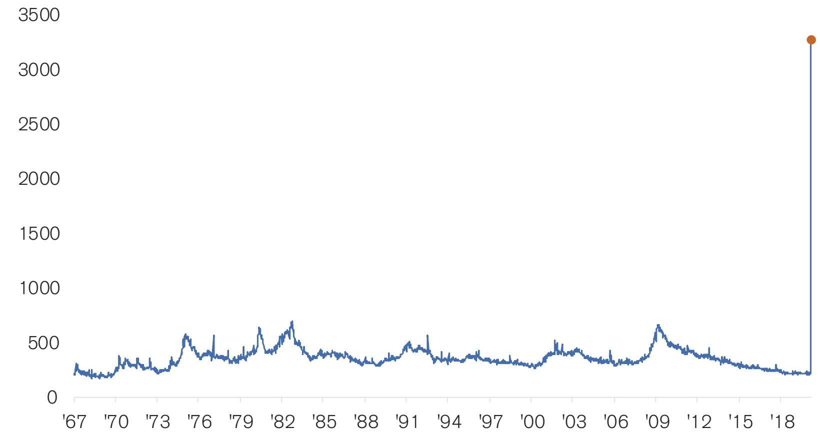
By the end of the quarter, the Dow Jones had posted its worst month since October 2008 and its worst Q1 ever. The broader S&P 500 didn't fare much better! According to Strategas, the index posted the *"worst quarterly performance since 4Q '08, and the 5th worst quarter of the last 75 years (3Q '74, 4Q '87, 4Q '08, and 2Q '62 only worse)."*

And the pain was not confined to stocks, with both bonds and commodities experiencing historic volatility.

In what feels like a lifetime ago, the yield on the 10-year Treasury bond started the year at 1.91%, only to fall to 0.39% by mid-March (and the yield on the 30-year bond falling below 1%). Investment grade corporate bonds fell in the quarter as well, but lower rated High Yield bonds fell further. This was due in large part because many issuers in the 'junk bond' index come from the energy sector where the price of Crude Oil posted its worst quarter ever—falling 67% to close at $20.48 (moving back to 2002 levels, or according to MacroTrends back to 1947 levels after adjusting for inflation).

Historic moves in stocks, bonds and commodities gave way to historic economic data late in the quarter. First came horrific data from OpenTable showing plummeting restaurant reservations. But the entire services and manufacturing economy can best be encapsulated in jobs. And here, "horrific"

Initial Jobless Claims (Seasonally Adjusted, '000s) Since 1967



Source: Bespoke

was an understatement. The weekly Initial Jobless Claims not only broke records from the stagflation of the 1970s, the double-dip recession of the early 1980s, and the Great Recession of 2008—but it cleared them all by a factor of nearly 5x. New claims came in at a previously unheard of 3.2 million (the prior record was 695,000 in October 1982, while the highest during the Great Recession was 665,000 according to First Trust) only to break through 6 million in the first week of April. Unfortunately for the economy, bad economic data seems to be just starting.

PREVIEW

It's important to recognize that the economy and the stock market are two different things – with the former reporting real-time results while the latter looks ahead to the future. While this selloff has been lightning fast, the magnitude of the decline has been in line with longer-term bear market averages. So where do we go from here? No one really knows the future—especially when dealing with a novel virus and its unknown future. But we do know history and can use its lessons as a guide.

LESSON 1: THE SPANISH FLU

The worst pandemic in recent history was the 1918 Spanish Flu (which cost the lives of 675,000 Americans). While it did indeed spawn a recession, at only 7 months in duration it was the shortest recession on record! Note that while the 1980s did have a 6-month recession, it was part of a larger

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double-dip recession so it is not a proper guidepost. If the 2020 recession started March 1st, then a seven-month slowdown would bring us to the end of September. History also reveals that, on average, stock markets trough around four months prior to the end of a recession. Combining the two suggests that the market bottom would occur in June. One could argue, however, that life moves considerably faster nowadays. In no prior recessionary period could an investor sell 500 stocks in 0.01 seconds for $0 commission…all while sitting in his or her car at a stoplight. Perhaps today's markets would bottom earlier—say six months before the end of the recession. That would be April. Hey, that's today!

LESSON 2: THE THREE BAD BEARS

According to Goldman Sachs, there are three different kinds of bear markets, *"each type a function of different triggers and has distinct characteristics."*

US Bear markets & Recoveries since the 1800s
S=Structural, C=Cyclical, E=Event-driven

S&P 500 - Bear Market					Time to recover back to previous level		Volatility	
Type	Start	End	Length(m)	Decline(%)	Nominal (m)	Real(m)	Peak to trough	Trough to recovery
S	May-1835	Mar-1842	82	-56	259	-	13	17
C	Aug-1847	Nov-1848	15	-23	42	-	8	9
C	Dec-1852	Oct-1857	58	-65	67	-	19	25
C	Mar-1858	Jul-1859	16	-23	11	-	21	15
C	Oct-1860	Jul-1861	9	-32	15	-	31	17
C	Apr-1864	Apr-1865	12	-26	48	-	14	8
S	Feb-1873	Jun-1877	52	-47	32	11	11	11
C	Jun-1881	Jan-1885	43	-36	191	17	9	11
C	May-1887	Aug-1893	75	-31	65	49	10	12
C	Sep-1902	Oct-1903	13	-29	17	22	9	10
E	Sep-1906	Nov-1907	14	-38	21	250	15	11
C	Dec-1909	Dec-1914	60	-29	121	159	9	12
C	Nov-1916	Dec-1917	13	-33	85	116	12	12
C	Jul-1919	Aug-1921	25	-32	39	14	15	10
S	Sep-1929	Jun-1932	33	-85	266	284	30	20
S	Mar-1937	Apr-1942	62	-59	49	151	20	10
C	May-1946	Mar-1948	21	-28	27	73	14	12
E	Aug-1956	Oct-1957	15	-22	11	13	9	9
E	Dec-1961	Jun-1962	6	-28	14	18	15	9
E	Feb-1966	Oct-1966	8	-22	7	24	10	8
C	Nov-1968	May-1970	18	-36	21	270	9	10
S	Jan-1973	Oct-1974	21	-48	69	154	15	11
C	Nov-1980	Aug-1982	20	-27	3	8	12	20
E	Aug-1987	Dec-1987	3.3	-34	20	49	45	13
C	Jul-1990	Oct-1990	3	-20	4	6	17	14
S	Mar-2000	Oct-2002	30	-49	56	148	19	11
S	Oct-2007	Mar-2009	17	-57	49	55	32	16
E	Feb-2020	Mar-2020	1	-34	-	-	80	-
Average			27	-37	60	90	20	14
Median			17	-33	39	49	15	12
Average Structural			42	-57	111	134	22	15
Average Cyclical			27	-31	50	73	14	14
Average Event Driven			8	-29	15	71	32	12

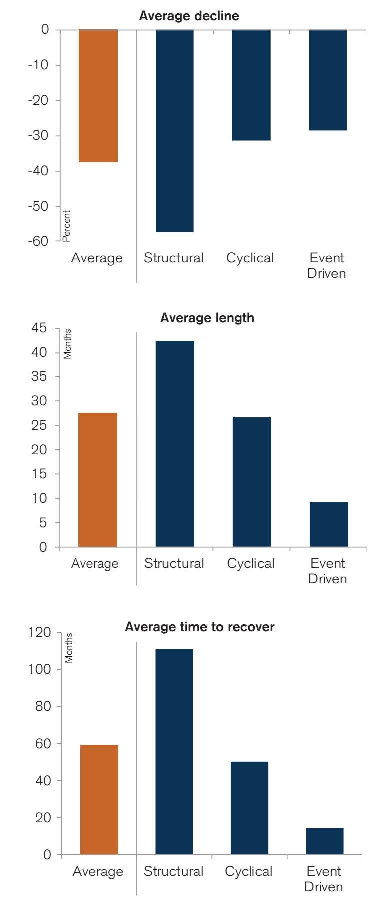
Source: Robert Shiller, Datastream, Goldman Sachs Global Investment Research

Structural bear markets Triggered by structural imbalances and financial bubbles. Very often there is a 'price' shock such as deflation that follows. There have been 7 such bear markets since 1835, with an average decline of 57% and an average recovery period of 111 months.

Cyclical bear markets Typically a function of rising interest rates, impending recessions and a fall in profits. They are a function of the economic cycle. There have been 15 such bear markets since 1835 with an average decline of 31% and an average recovery period of 50 months.

Event-driven bear markets Triggered by a one-off 'shock' that does not lead to a domestic recession (e.g., a war, an oil price shock or an emerging market crisis). There have been 5 such bear markets since 1835 with an average decline of 29% and an average recovery period of 15 months.

US Bear markets & Recoveries since the 1800s
SPX down 34% since peak on February 19, 2020



Source: Goldman Sachs Global Investment Research

With the current selloff reaching its nadir around -33.9%, the ensuing question is whether or not this is a structural bear market that will lead to further selling. Goldman Sachs opines that,

> *"we consider this to be an event-driven bear market, but with the difference that we expect the economic impact will be severe…as severe as any we have witnessed in the past—but the relatively healthy private sector balances going into this episode, coupled with unprecedented and swift policy support, means that these risks are at least reduced, in our view."*

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LESSON 3: THE REBOUND

Again, we can look at history to see what precedent there is for a bounce after historic monthly and quarterly declines.

In the month of March, the S&P was down 12.51%. According to Bespoke Investment Group, since WW2 after a 10%+ monthly decline, *"over the next nine months (which would take us through year-end) the S&P has averaged a gain of 17.74% with positive returns 90% of the time. And over the next year, the S&P has averaged a gain of 17.61% with positive returns 90% of the time. The only time since WW2 that the S&P has fallen 10%+ in a month and not been up over the next nine months and year was following November 1973."*

S&P 500 Monthly Declines of 10%+ Post WW2

Date	% Chg	1st Day of Next Mth %	Next Month %	Next 3 Mths %	Next 9 Mths %	Next Year %
Sep-46	-10.15	-0.27	-0.80	2.27	1.67	1.00
Nov-48	-10.61	1.76	3.05	-0.88	3.19	8.88
Nov-73	-11.39	-2.15	1.66	0.27	-24.81	-27.08
Sep-74	-11.93	-0.24	16.30	7.90	49.81	32.00
Mar-80	-10.18	0.09	4.11	11.90	32.98	33.22
Oct-87	-21.76	1.57	-8.53	2.10	8.03	10.79
Aug-98	-14.58	3.86	6.24	21.56	35.99	37.93
Sep-02	-11.00	4.00	8.64	7.92	19.53	22.16
Oct-08	-16.94	-0.25	-7.48	-14.75	1.93	6.96
Feb-09	-10.99	-4.66	8.54	25.04	49.05	50.25
Mar-20	-12.51	?	?	?	?	?
	Average	0.37	3.17	6.33	17.74	17.61
	Median	-0.07	3.58	5.09	13.78	16.48
	% Positive	50.0%	70.0%	80.0%	90.0%	90.0%
Avg. All Other Periods		0.14	0.64	2.02	6.26	8.45

Source: Bespoke

In Q1, the S&P fell exactly 20%. Again, according to Bespoke, *"Since WW2, it was just the 5th quarterly drop of 20% or more. Notably, in the six months and twelve months following the prior four quarterly drops of 20%+ since 1945, the S&P was higher every time. Over the next year, the index was higher by 10% or more every time."*

CONCLUSION

Thank you for entrusting us with the privilege of helping you navigate these historic and 'interesting times.' Rest assured that we are constantly monitoring and analyzing events in real-time. And while upcoming health and economic data will likely be brutal, keep in mind that it may not necessarily translate into capital markets which often move to a different saying—*"this too shall pass."*

IMPORTANT INFORMATION

SECTOR	DEFINITION
Stocks	Investments in stocks of small companies involve additional risks. Smaller companies typically have a higher risk of failure, and are not as well established as larger blue-chip companies. Historically, smaller-company stocks have experienced a greater degree of market volatility than the overall market average.
Alts.	Investors should be aware that there are risks inherent in all investments, such as fluctuations in investment principal. Alternative investment strategies do not assure a profit, cannot protect against losses, and may involve additional risk.
Int'l	Non-U.S. securities markets involve possibly greater risk of political instability and greater currency risk in addition to having been more volatile. These risks can be accentuated in emerging markets.
Commod.	The price of commodities, such as gold and currency, is subject to substantial price fluctuations of short periods of time and may be affected by unpredictable international monetary and political policies. The market for commodities and currency is widely unregulated and concentrated investing may lead to higher price volatility. Foreign currency trading carries a high level of risk and can result in loss of part or all of your investment.
Bonds	In general, the bond market is volatile as prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.
Low Quality	Lower rated debt securities, sometimes called junk bonds, carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal.
Treasury	Treasuries are debt securities issued by the United States government and secured by its full faith and credit. Income from treasury securities is exempt from local and state taxes.