

The Outlook: March 17, 2020

Not different. Not worse.

“This time it’s different. This time it’s worse!” We are all inclined to feel that way, as we’re actually living through the most nightmarish moments of a market crash—especially crashes driven by genuine panics, like our current “Virus Crash” and the last panic-driven crash: the “Great Financial Panic and Bank Run” of 2008 – 2009. The two red arrows, down there, point to the middle of those two nightmarish plunges, today and 11 years ago.

Two Big Problems and Two Panics.



As we noted yesterday, today's Big Problem always feels new and unfixable, hence terrifying. And while we're living through each new “Big Problem,” we are informed by a lot of the investment world's eminent authorities that it certainly is new and unfixable. (They don't generally use that word, but they do very much wish to leave that impression—that it's “unfixable” for at least a long time.)

We investors must always do two things in response:

1. We must look deeply into the nature of the latest Big Problem, and decide for ourselves how unfixable it may be, based on facts and reason; and
2. We must remember the last “unfixable” problem or two—because perspective helps us think straight.

At Outlook we sum up the facts and reasoning, so far, this way: “It's a virus. It will follow a curve: rise, peak, decline. Its real danger lies not with the working population but with the sick and elderly, for whom

dramatic protections are generally easier to sustain. Its fatality rates will turn out to be much lower than any of the early statistics.” And finally, “the steep economic damage being caused by today’s drastic slowdown in activity will be fully reversed, beginning as soon as activity starts up again.”

Now let’s glance back at that last “unfixable” problem in 2008 – 2009. Is “The Virus” different, and worse?

We’ll be emphatic on this. “Different?” Certainly. “Worse?” Not even close.

The Great Calamity and Panic of 2008 – 2009 was like injecting a combination of coronavirus, swine flu and Ebola into the living, breathing global credit market. The paralysis which swiftly followed was “unbelievable,” except that it was happening in front of our eyes. A paralyzed, panicked global credit market meant “Depression,” not “Recession,” if it lasted. And while we were all living through that red-arrowed plunge, we were hearing countless versions of “This is unfixable!” from a really amazing list of experts.

They weren’t talking nonsense—not obvious nonsense anyway. Their strongest arguments came down to “How do you restore confidence and trust in a global credit market which has just seen those things shattered from top to bottom?” It was the \$64,000 Question, and the worried experts’ answers came down to, “We’re not sure, but it’ll take years and years regardless.”

It didn’t . . . for two main reasons:

- Around March of 2009, Congress signaled it would eliminate the “mark to market” accounting rule it had imposed years earlier, to stop companies like Enron from falsifying their financial statements (by holding worthless assets at inflated, old values.) Government mistakes are, unfortunately, always capable of derailing whole economies, if the mistakes are awful enough. Mark to market accounting was awful enough. It made banks wipe out their own capital by reporting giant losses, as the market knocked down the values of perfectly sound assets while panic was running the show. That was “Short Sellers’ Paradise,” as they happily knocked down one asset after another, from mortgage-backed bonds to bank common stocks, knowing they were feeding a vicious circle with all assets spiraling into cliff-dives.

It took about 9 months of economic carnage before Congress finally admitted the mistake . . . because nothing else was working. The market stopped falling instantly, near enough, and began our 11-year Bull Market. And the global credit market began to function again in amazingly short order.

- The free market responded to rock-bottom prices which screamed “Buy Us!” to every investor and speculator with cash, and some nerve. Outlook’s favorite example was the AAA-rated pools of mortgage-backed securities which were the crème de la crème of that industry. In early 2009 an investor could buy such pools of mortgages—entirely made up of loans with 50% down payments and which were showing zero defaults or late payments after the year of Calamity—at 50 cents on the dollar, or so. That price made sense if every wealthy homeowner in America was going to “leave the keys” and walk away from their homes because the 2009 market value of those homes might have been at or below their mortgage amounts. And there were eminent experts informing us that’s exactly what all those homeowners would do.

Even before Congress finally faced up to the mark-to-market mistake, investors and speculators with cash and nerve were beginning to buy those screaming bargains. Yes . . . “the cure for low prices is low prices” no matter how long and agonizing the wait might be.

The Virus Shutdown is a Big Problem . . . but it’s just not in the same league as 2008’s Big Problem, which wasn’t “unfixable” at all.

This story does leave us with the need to face a hard fact, though. As the story of the Great Calamity made clear, “Government” is quite capable of doing a lot of harm to any economy, from the Third World to America. The Virus Shutdown is the source of the damage at this moment. It makes sense, at this moment . . . for a little while. It will stop making sense after a while, because the economic damage will spread and deepen, very fast. Then “Government” around the world will face an inevitable hard choice, with a hard tradeoff: deepening and worsening the economic damage versus minimizing the harm from the Virus itself. All governments will eventually choose to lift the burden from their economies; but they’ll come to that decision at different speeds and different times. That forecast won’t derail the economic and market recoveries, but it will slow them down to some degree which is mighty hard to nail down, today.

But even that hard fact doesn’t change the outstanding truth about the market today. It has knocked down the values of a great many solid companies to prices which are screaming “Buy Us!” right now. (Or, “For heaven’s sake, hold us!” when we haven’t the cash lying around to buy.) That is what we’re doing at Outlook, as usual.

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