

The Outlook: March 30, 2020

3 Big Questions. “Dim Outlines” of the Answers.

It’s not easy to talk about the “Virus Crisis” without spilling over into politics—because what we’re most interested in, as investors, is how deep the economic damage will be and when our capital will restore its value. Those answers, as we’ve noted a few times lately, rest completely on an intense political decision which must be made all over the world by political leaders—sooner or later. Their decisions will be made “under fire.” They’ll be intensely criticized no matter which choice they make: back to work, or stay in the lockdown. Regardless of the criticism, one choice will be right and the other wrong—and the only way for all those leaders to know which is which is to get as close as they can to the underlying truths about the “Virus Crisis.”

Those truths will be clear a year from now, when many more genuine facts have become obvious and calm studies have been done; but they won’t be perfectly clear in the fairly near future—which is when the decisions will have to be made. The politicians on the hot seats certainly deserve sympathy . . . though at the same time, this is the job they signed up for.

As we investors wonder about “how deep the damage, and when we’ll have money again,” we must build up our own judgments about those “underlying truths” concerning the Crisis. “Facts are stubborn things.” Those underlying truths will absolutely become pretty obvious eventually, just as the underlying truths about every market crisis and panic become obvious, later. Half the mortgages in the U.S. were not going to default in 2008 – 2009. JP Morgan Bank was not going to fail. Neither was Caterpillar, Cummins, Texas Instruments or too many others to name. Those truths were completely visible in the midst of that panic, and they were the key to making good investment decisions as we all sat on the “hot seat” back then. Let us see, then, if we can point out even the dim outline of what will turn out to be the “key underlying truths” today.

We need three “Big Answers” to three “Big Questions.” (They’re the same answers the political leaders need.)

1. How deadly is the Virus?
2. How contagious is the Virus?
3. How much economic damage will be done by the lockdowns, each passing week—and how reversible will the damage be?

The 3 answers will be brief . . . because we can only see “dim outlines” now. But what are the most obvious things we can say about those outlines today?

1. **How deadly?** “Mortality rates” around the world range from Germany’s 0.8% to America’s 1.7% to Spain and Italy’s shocking 8% and 10%, with the “world total” at 4.6%. But the “dim outline” of the underlying truth is not framed by any of those numbers, because “How deadly?” means “How many of those infected will die?” Nobody knows that answer, because no country is testing random samples of its population—the only possible way to guess at the actual number of infections, hence the true mortality rate. Common sense—and a growing number of eminent scientists and doctors—can only say one thing, emphatically: “The infection numbers

are much larger than the “positive test numbers” . . . so the Virus is “much” less deadly than all the headline numbers shouting for our attention.

Then, what is the “dim outline?” *This is not the Plague or the Spanish Flu.* It’s nothing good . . . but it matters, that it’s very far short of the Plague or Flu.

2. **How contagious?** Nothing but a dim outline here, also. The skyrocketing “positive tests” reported every day in New York, Italy and everywhere else sound like they answer that question . . . but they don’t. Science is like that. In the U.S., 526,000 tests were administered last week—an amazing number when we think back just a few weeks. 12% of tests have been running positive; 88% negative. But 12% of 10,000 tests is a tiny number compared to 12% of 526,000 tests . . . hence the “skyrocketing cases” which the headlines tell us about every day. (In the daily newspaper dropped on Outlook’s driveway, we’ve seen exactly one reference, one day, to the total number of tests given—which was literally buried in the last paragraph of the inner page of the headline story. And the journalists left it to their readers to do the arithmetic to compute the 12% positive and 88% negative rates.)

And what is the “dim outline?” On this Question, it’s so foggy we can’t even see a dim outline yet. The only way to know “how contagious” was to do those random samples before the lockdowns. Now, every contagious disease is a lot less contagious. But we actually have exactly one “laboratory test” suggesting an answer. The poor Diamond Princess cruise ship, carrying 3,711 mostly British passengers, ended up with 712 cases . . . and everyone on board was tested. That’s a 19% infection rate—which is startling, given that those 3,711 passengers mixed freely for a long time, before the crisis came to light. Even more startling: 10 deaths among the mostly elderly passengers, which is a mortality rate of 0.3%.

So the most we can say about the truth’s “dim outline” on the “How contagious?” question is, “We don’t know yet . . . but we have solid evidence telling us to be very careful about jumping to the worst possible answer.

3. **How much damage, and can it be fixed?** Not long ago we mentioned that “everyone understands getting sick, but almost nobody understands the economy.” (Emphatically including most of the political leaders in those hot seats.) We’re not geniuses, at Outlook, who “understand the economy” while nobody else does. It is so vast and so filled with incomprehensibly big numbers that it’s hard for the best among us to understand. But perhaps we have a sense of it, from 44 years of watching and thinking about it. The “dim outline” of this answer is: “The tidal waves of damaging ripple effects, from fairly complete economic shutdowns, will be staggering. A good example of how hard it is to get our minds around the damage came from economist Brian Wesbury. His first forecast of the “Virus Shutdown” damage was a 10% second-quarter drop in GDP . . . which was a stunning number. Only a couple of weeks later, Mr. Wesbury is at “20%, or more, who really knows?” Other eminent forecasters—like Goldman Sachs—are at 30%, also with a dollop of “who knows!”

“All the gold in Fort Knox can’t plug that hole” was a recent remark from one analyst, “and the \$2 trillion stimulus package is a drop in the bucket.” As human beings, we all have a hard time actually comprehending really big numbers—but that’s what is needed to begin to understand the damage, pain and suffering triggered by each passing week of an economic “shutdown.” With each passing week, though, we will be seeing statistics which begin to clarify that “dim outline.”

Can it be fixed? Yes indeed, if government—when the time comes—stands back and lets the free market economy tackle it. So far it looks like that’s how it will mostly be done, in this country. But the time needed to fix it will depend on how much damage is done, meaning how long the shutdown lasts. The “dim outline” of that economic recovery looks, to Outlook, like it must be a gradual, “U-shaped” curve instead of the “V-shaped” bounceback we’d all like. Why? Because no matter when the U.S. begins to end its Virus Shutdown, the rest of the world is very likely to be slower.

At last, what about the market, and the return of our capital to something resembling “health?”

As Mr. Wesbury said a couple of weeks ago, the market historically turns up 3 to 6 months before the economy does . . . in general. That kind of “turn up” is especially likely to be strong when a panic has created values which really deserve the “Twilight Zone” label. We had a taste of that for 3 days this week. At Outlook we’d bet we’ll have to wait a while for the next taste—or at least for anything like a solid lunch or dinner, rather than just a taste. But it will be worth the wait—which is certainly the only “right” choice for us as investors.

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