CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

March 25, 2020

Further Comments

Coronavirus has afflicted America badly in the last weeks. Worsening conditions wreak havoc on all financial markets. The stock market has continued to fall sharply, with intermittent (and probably unsustainable) short-covering rallies. Unsurprisingly. On Monday, the market made another new low for this bear market; the S&P has now fallen by 35 percent from its high fewer than five weeks ago! This is the swiftest decline ever in stocks. More strikingly, the Treasury bond market also became disrupted; with prompt action by the Fed, Treasury market weirdness has resolved itself (for now). The Treasury bond market is the deepest and most liquid market in the world and Treasuries are without credit risk. That is, the United States will not default on its interest payments and principal repayments. Despite this, suddenly on March 10th, Treasury bond prices started to fall. The Fed stepped in and restored liquidity to Treasuries. Long-term Treasury bond prices have resumed their upward trajectory and their yields have again fallen.

The spread of Coronavirus worsens by the day. We cannot know how things will unfold in the coming weeks and months, but it is not hard to imagine that our new ways of life--staying at home while life in our cities is shuttered--will be with us for some time. The numbers of people infected, the numbers hospitalized, the numbers dying will increase in coming days and weeks. It is a new age.

As an investment matter, Core's accounts remain solidly higher for the year; the accounts Core manages are up by 11% year to date (with variations among accounts for various reasons). It was our good fortune to have avoided the stock market as we entered this year. We continue to avoid it. Our investments are in long-term Treasury bonds, gold and cash. With cash we earn nothing, but we lose nothing. We retain cash to make stock investments when this bear market ends, as, inevitably, it will. As we fall into a deep recession with both demand and supply shrinking sharply, Treasury bonds increase in price. In the extremity of uncertainty that we face, gold offers its historical role as a haven in unsettled times.

By

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Recently the disruption of financial markets turned Treasuries and gold upside down for a brief period. To the astonishment of many including this writer, on March 10th both gold and long-term Treasuries began a swift, short-lived, but steep decline. On March 9th, long-term Treasuries, as measured by the investment we hold, were up by 26% for the year to date and gold by 11%. In the view of many, myself included, the exceptional advances of Treasuries and gold made sense. Utter panic had broken out in the stock market; it had already fallen by more than 14% for the year to date.

The sudden decline in Treasuries and gold, beginning on March 10th, brought gold down by 13% and long-term Treasuries by 16%. We may read more in the days ahead about what happened in that period; we can surmise that a good deal of the selling of these assets was so-called forced selling by investors whose stock positions were falling relentlessly. Some investors who had borrowed in order to buy stocks were required to sell. Quite probably some of these investors were selling their winners--gold and Treasury bonds--because they could not sell their losing stock positions at reasonable prices. The disruptions were extremely disturbing to the Fed, not so much the lower prices, but the inability of the Treasury market to function smoothly. Extraordinary actions by the Fed in recent days appear to have dealt with the liquidity problem in the Treasury market; both Treasuries and gold have rallied considerably in this last week. Gold is close to its March 9th highs and long-term Treasuries are not far behind.

In the context of this disruption in the Treasury market, I reduced our positions in TLT, the Treasury fund we hold, by about one third. (I accomplished the sale at a price of 162, far above the 139 level that TLT reached at its nadir last week.) We still have a large position in Treasuries and I expect further gains in their prices. However, the sharp, sudden and disconcerting decline in gold and Treasuries showed that, in these extraordinary markets, even safe investments can be risky. I have increased our positions in money market funds and cash to 33%. The Treasury market is now acting rationally again, but it is foolhardy to believe that there will not be more significant market disruptions in coming weeks.

The Shape of Bear Markets. As noted above, the decline from the mid-February highs in stocks to the 35% decline as of Monday's low is the swiftest ever. The old saying is that 'they slide faster than they glide,' but this is altogether new. A typical bear market makes its way from top to bottom in over a period of more than a year and the process of forming the bottom of the bear market and beginning the recovery and advance is measured in many months. Given the extraordinary shut down of business activity and the normal lives of all of us, we must expect a deep economic slowdown, far surpassing what we refer to as the Great Recession of 2007 to 2009. If so, the decline in the stock market--and its duration--both have much further to go

Of course, things may unfold differently. If, as of Easter, as our president would like, things were to go back to normal, at least in parts of the country not terribly afflicted, then there could be swift recovery of economic activity. Epidemiologists consider it unlikely that Easter represents the date when life in America can resume former patterns. The proposed legislation just passed in the Senate is huge. More than $2 trillion will be provided by the federal government and it will be backed up by perhaps as much as $4 trillion of support from the Federal Reserve. (These numbers have never been bandied about before; I remember Everett Dirksen, the minority leader of the Senate in the sixties, making the comment 'a billion here and a billion there, pretty soon, you're talking real money.' Those were the days.)

At present, a rational long-term investor will wait patiently and will be alert. There will certainly be enormous investment opportunity when the Coronavirus crisis and the bear market in stocks come to an end. We cannot know when that will be. The best approach is to continue with the productive and relatively safe investments we now hold.

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