# Quarterly Newsletter - April 2020

April 15 2020

Dear client,

First and foremost, we hope this letter finds you and your family in good health. We have clients in over 30 states, so our concerns are truly nationwide. Here in Massachusetts, we continue to operate with rotating staff and remote access, but all is well. Please, everyone, stay healthy!

The COVID-19 virus has brought the world's economies to a halt. On February 19th the S&P 500 reached its all-time high. Then in only twenty-two days it fell 30%. The fastest 30% drawdown in history. Just like that, the longest bull market on record came to an end. It's likely we are also in a recession. The technical definition of a recession is two consecutive quarters of decline in GDP and is declared by an organization called the National Bureau of Economic Research (NBER) so we won't ?officially? know until summer at the earliest assuming the first and second quarters meet the criteria.

Could this lead to another Great Depression? The unemployment rate that sat at 3.5% in February has already jumped to what many calculate will come in around 13% and some estimate it could get close to 25% ? levels not seen since the 1930's. While we cannot say for certain, we do find a depression unlikely. The Federal Reserve was in its infancy in 1929 and when faced with a collapsing economy it did nothing. It watched the money supply shrink as there were runs on the banks by panicked individuals who lost confidence in the institutions. With less money on hand, banks could not loan to businesses causing companies to shut their doors. This increased the number of unemployed and spiraled the economy further downward. This inaction is in stark contrast to what we have seen over the last few months where the Fed was quick to drop interest rates to zero and started up quantitative easing again. Their response has been faster than it was in the 2008 financial crisis. This was followed up by Congress passing the stimulus bill that is sending $2 trillion into the economy with a willingness for additional relief packages if needed. The government is doing all it can do to increase the money supply so businesses can keep their lights on until we return to ?normal? times.

Which begs the big question, how long before we return to normalcy? That of course is unknowable. A year ago, in our January 2019 letter, we said ?when it comes to placing their money, investors don't care about the past, they want to know the future. And the future is chock full of uncertainty ?.? That couldn't be more true today but it remains that the market is forward looking, discounting future expected cash flow of companies. The market is very efficient in gathering information and processing expected future returns, with good news, expectation of future company profits increases and so does the current stock price. As we have seen in the past, the stock market will likely show signs of recovery well before we have returned to normalcy. The market appears to like what the government response has been so far, even though the number of COVID-19 cases continues to rise as well as the number of unemployed. Markets had already factored these figures in when they fell in March. Of course, if unemployment figures surpass what the market expected or the virus lingers longer than anticipated, the markets will fall again so we don't know if this is just a ?false bounce,? a sustained bear market or a reversal point.

Bear markets are inevitable, they are part of the economic cycle. We have attached a graph that shows the different bear markets (defined by a 10% downturn) since 1926. There has been a total of sixteen. The biggest one, the Great Depression, we have already discussed. Others include troops returning home after World War II in the 1940's, economic slowdown and the ?Asian flu? during the 1950's, the Cold War and Vietnam War in the 1960's, the oil embargo in the 1970's, stagflation in the early 1980's and the market crash in 1987, the first Gulf War and Asian currency crisis in the 1990's, and the tech bubble and financial crisis in the 2000's. In fact, you can start in 1900 and every decade there was a major economic and/or political upheaval event. These bear markets lasted anywhere from 2 months to 34 months. All of them at the time monopolized the news and shook many investors out of the markets. But every time the markets recovered.

?But this time is different.? Yes, in some ways that's true but we also heard that during the financial crisis and other times. We have seen similar events in the Spanish Flu and the Asian Flu but where it's ?different? is those were in different economic times with less of a global impact. The biggest difference between the bear markets of the past to this market is we know how they ended. We do not know how or when this will end and that creates a lot of anxiety.

?You don't rise to the occasion; you sink to the level of your training.? ? Greek poet Archilochus

The implication is that, in times of great stress, the best approach for success is sticking to a set of fundamental principles. For our investment method, those principles include patience and discipline. That discipline had us doing a lot of rebalancing trades over the last several weeks ? selling bonds and buying falling stocks. The last time we had done this much rebalancing was in 2008.

It is tempting to get out of the markets. Sell everything. Go to cash and wait for calmer days. But that could be costly. Nearly half of the S&P 500's strongest days occurred during a bear market. Another 28% of the best days took place in the first two months of a bull market when it was not clear a bull market had even begun. Miss out on these days and your long-term return drops. Investor Shelby Cullom Davis stated, ?You make most of your money in a bear market, you just don't realize it at the time.? We agree because during bear markets you are buying at discounted prices. While it may take time to reap the benefits, if you believe in our capitalist system then the rewards will come.

A final thought. We read a lot of articles and opinion pieces, roughly half say things will get better while the other half says things will get worse. By definition, one of these two ?forecasts? will be correct. Don't be surprised months from now when some pundit or political commentary claims they are a genius for calling the correct outcome. In our view, they got lucky on a 50-50 bet. No one knows the future.

It's that time of year again when we are required by law to send you our Privacy Policy statement and inform you that our SEC disclosure document, form ADV, has been updated and is available upon request. Call us and we will send you a copy. The form is also available on our website for electronic download.

Stay safe.

Jim, John, Richard, Mary, and Ryan