Wednesday, March 18, 2020

Good Afternoon,

In this crazy world we're now in, news comes fast and it's hard to put things in perspective – especially for investors. Last week I provided some comments from Brad McMillan, Commonwealth's Chief Investment Officer. Today I thought I would forward his latest blog that I found very helpful.

How to Think About the Coronavirus Pandemic: The Big Picture
Posted by Brad McMillan, CFA, CAIA, MAI

"With everything that is happening in the world, now is a good time to step back and think about where we are and where we might be going. There is a tremendous amount of information available. But what's missing is a framework for that information that would help clarify the big picture.
What I want to do today is outline how I see that big picture, which will hopefully provide a framework to understand where we are headed. In the next couple of days, I plan to go into more detail on the individual components.

Breaking down the news
First, we have to break down the news. There are three different issues that we need to consider, and the news often conflates them. The issues are (1) the virus itself and the pandemic, (2) the economic impact of the pandemic, and (3) the financial market implications of that impact. By considering them individually, we can gain some clarity.

The virus itself. The base question is whether the virus is controllable or not. And the answer is yes. In the absence of restraints, the virus will spread—as we saw in China, in Italy, and in the U.S. But when proper restrictions are put into place, it can be brought under control. This idea has been proven in China and South Korea, and Italy is now reportedly stabilizing. Here in the U.S., we understand what has to be done, and we are now doing it. This is the end of the beginning.
Unfortunately, we are not out of the woods just yet. Everyone now knows what to do and why, as well as what the stakes are. If we just stay home, things will eventually get better. But there is usually a lag of about two weeks between the time that restrictions are put into place and when new cases stabilize. So, we can expect the news here to get worse for a while. We are likely past the point of maximum danger, but we are not past the point of maximum impact. Even as the rate of spread slows, expanded testing will make it look like things are getting worse. Expect to see that story in the headlines.

The economic impact. The economic damage is certainly real. But going forward, the question is whether the next year will look like it did after 9/11—or like 2008.
Right now, the resemblance to 9/11 is much greater. The pandemic is an outside shock to the economy, which has generated fear and will slow consumer and business spending, much like 9/11. As such, like 9/11, the economic impact could pass once the fear does. That is the base case: real damage, but then a recovery as confidence returns. The economic impact will, however, likely be worse than after 9/11. The slowdown in spending is very likely to be worse and longer lasting this time, which could (over time) turn the 9/11 into another 2008.
This scenario is something we must keep in mind, but whether it happens will depend on whether government policy is sufficiently supportive to both workers and businesses affected by the drop in demand. Here, the news is good. The Fed acted fast and hard to provide monetary stimulus. Unlike 2008, the Fed has clearly stated it will do what it needs to do in order to avoid a crisis. The federal government is also in the process of responding with economic support. While that process is not yet complete, signs are that any necessary support will be available, minimizing the chances of another 2008. There will be economic damage, but with proper policy support, it is likely to be limited.

Financial market implications. Finally, when we look at the markets, we see a clear expectation that the pandemic will continue and that the economic damage will be substantial. While that still may end up being the case, policy actions both here and around the world have made that substantially less likely in the past week. Signs are that the pandemic will be brought under control and that the economy will get enough support to weather the storm. Make no mistake, there will be damage. But from a market perspective, the question will be whether the damage is greater than markets now expect, or less. Signs are that the damage will be less, which should support markets going forward and eventually enable a recovery.

What happens next?

The crisis is not over. We can certainly expect the headlines to keep screaming and even get worse over the next couple of weeks, which could keep markets turbulent. We know, however, what is needed to solve the problem and that those measures are largely in place. By keeping the framework discussed here in mind, we will be prepared for those headlines and able to see the gradual improvement underneath them.

This is a difficult time for everyone, and worries are surging. Although those worries have allowed for the necessary policy changes to solve the problem, worry is always difficult. As we move forward, keep in mind that while the concerns are real, so is the policy progress. In the not-too-distant future, we are likely to see the virus brought under control here just as we have seen in other countries. Keep calm and carry on."

Thank you for staying calm when it feels like everything is upside down. Stay healthy,

Wade

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