Client's Corner

You've Just Seen the Whole Movie

MY DICTIONARY DEFINES A TEACHABLE MOMENT AS A TIME when learning a particular topic or idea becomes easiest.

I'd like to suggest that, for the long-term, goal-focused investor, the period from mid-February to the moment you're reading this essay constitutes The Mother of All Teachable Moments. It was and continues to be an object lesson in just about everything you will ever need to know to pursue a lifetime of successful equity investing. Indeed, in just these few months, you got to watch the whole movie.

You'll remember that, as late as mid-February, the U.S. economy was cruising along at record low levels of unemployment, and the broad equity market—which I define as the S&P 500 Index—was regularly making new all-time highs. Then, out of nowhere, the novel coronavirus struck the planet. This fact actually embodies Lifetime Investing Principle Number One (for purposes of this essay, ***LIP1***). To wit: ***the most dramatic phenomena that strike the economy and the markets come at us out of deepest left field.***

For good and ill, these "black swan" events are forecast by essentially nobody. (Yes, there are positive "black swans" too. The greatest of the last century was the internet. Nobody saw it coming, and it changed everything wildly for the better.) Thus, no matter how much time and energy you waste trying to time the market by studying the economy, you'll never see the big culture-shaking events until they're right on top of you, by which time the market will already have reacted.

The earliest "authoritative" estimates of the virus's effects ran to millions of worldwide deaths. Reacting to this, the world in general and the U.S. in particular locked down, putting their economies into a kind of medically induced coma. The media went into an apocalyptic frenzy, trumpeting to the skies virtually every infection and every death. (And indeed the early readings were quite terrifying; we somehow missed the fact that crowding the disease's most likely victims—the elderly infirm—together in nursing homes was a deadly strategy.) Here we learn ***LIP2*** and ***LIP3***. In order: ***at the onset of any crisis, the "experts" don't know any more than anyone else does. And the media will always report the unfolding crisis as the end of economic life on the planet as we have known it.***

The lockdown led to the fastest major bear market in equities in history. In 33 days, from February 19 to March 23, the S&P 500 went down 34%. Panic liquidation of equity mutual funds and ETFs shot back up to 2008-09 levels, and the VIX—Wall Street's most widely watched "fear gauge"—made new all-time highs. However, on the said March 23, the Federal Reserve quietly announced that there would be no dollar limit to its willingness and ability to support the economy via the credit system. At that exact moment, the bear market ended—because it had gotten its essential question answered.

Hence, ***LIP4*** and ***LIP5***, respectively: ***a decline averaging about one-third in the equity market is a common occurrence; since the end of WWII, it's happened on an average of every five years. And never assume the Fed is out of ammunition; its function is to be the lender of last resort, and its ability to perform that function in a crisis is without practical limit.*** (Granted, its challenge post-crisis will be to sop up all that excess liquidity. Let's assume, for purposes of this discussion, that it knows how to do this.)

Its orgy of terror spent, the equity market proceeded to record its very best 50-day run of all time, its best 100 days since 1933, and on into new high ground. The entire history-making round trip—new high to panic low to the next new high—took six months less one day. This despite the continued absence of a vaccine and the significant lingering effects of the economic lockdown. Here we encounter ***LIP6***, ***LIP7***, ***LIP8*** and ***LIP9***. Respectively (at least historically):

- ***Bear markets end.***
- ***The subsequent recovery is often as quick and powerful as was the decline.***
- ***Neither the decline nor the recovery (much less both) could possibly have been timed by the investor.***
- ***And the equity market tends to recover long before the economic picture clears—it is, in the jargon, a leading indicator.***

Which brings us to our summary Lifetime Investing Principle, ***LIP10***—the critical idea that a reasonable person would most likely grasp, given the nine epiphanies that went before. It is as follows (again, at least historically, which is all we've got).

Significant declines in equity prices are quite common, have most often been relatively fleeting, and cannot be consistently timed in either direction. The long-term, goal-focused investor's highest-probability strategy is therefore simply to just ride them out.

To which we might venture to add a sort of ***LIP11***: you don't sell into major market panics. If at all possible, ***you buy into them***.