

The Global Pandemic

The pain is palpable for the globe, our country, the world's citizens and risk assets. Never have we felt so truly unsafe.

The market numbers

38% - the amount the S&P 500 fell from the February highs to the March lows, the fastest drop of that magnitude in American history.

25% - the size of the rebound from the end of March to April 9, a response to the speed and size of government actions, some flattening of the COVID-19 curve, and technical oversold conditions.

81% - the level of market volatility at its peak, one of the highest in history. Markets easily moved 5 to 9% a day during this period, both up and down. Quite a few individual stocks saw 20% moves in a day.

Our Government's response

With fears of depression dancing in their heads, the US Federal Reserve has flooded the market with liquidity by buying commercial paper, corporate debt, mortgage debt, municipal bonds, junk bonds, and more, while Congress is providing trillions of fiscal stimulus with small business loans, money for healthcare and checks in the mail. These actions have been uniformly applauded and have no doubt kept markets working and even recovering. But all these programs cost money which begs the obvious next question. **How are we going to pay for it all?** A look at history is instructive. We seem to have only a couple of choices once we recover:

1. Reduce government spending
2. Increase taxes
3. Grow a lot faster
4. Inflate away our debt

Given the physical and political limits of #1 and #2, they don't look like sufficient solutions. Growing faster is hampered by our massive debt and aging demographics. So, inflating our way out of the problem is likely a part of the government's solution.

How does our longer-term thinking affect portfolios?

If history is our guide, equities may be the best choice in an uncertain and inflating world, with gold as a hedge against fiat currencies. We favor secular growers most often found in healthcare, technology and communications. We also believe gold miners in addition to the commodity as a hedge would be prudent. (Remember, in 1933 President Roosevelt prohibited the private holdings of gold coins, bullion, and certificates.)

How do we get to the other side?

The tricky part is how to get to the long term! Our debt and money supply have grown dramatically for years and yet the Fed failed to reach its 2% target inflation. The reason is likely due to several factors, including technology, globalization, and the low velocity of money (the rate at which money is exchanged in the economy). We can think of a number of potential causes of inflation going forward including: deglobalization, not so "just in time" inventory, supply chain bottlenecks, and labor shortages due to demographics and lack of immigration. We just don't know when this inflation will occur. In the interim, we believe it would be prudent to increase equity and gold exposure if these markets pull back, once again reflecting the consequences of the pandemic. Upgrade your portfolio with companies that have good balance sheets, large addressable markets and good unit growth. As markets rebound initially, the hardest hit sectors may shoot up the most, but as time goes on the stocks at the scene of the wreckage typically underperform.

An unintended tragedy of this pandemic is what we have left to our children

As Sheila Bair writes in an op-ed on CNBC (<https://www.cnbc.com/2020/04/13/op-ed-overreliance-on-the-fed-is-compromising-millennials-future.html>):

"Overreliance on the Fed has "financialized" our economy. Every time we get into trouble, we look to the Fed to make it cheaper to borrow, even when too much debt is the cause of the trouble, as it was in 2008. The Fed provides cheap funds to the financial sector, in turn, lends cheaply to consumers and businesses. But this cycle is not sustainable and with each credit boom and bust, our economy becomes less stable.

More than any other group, (the millennials') futures have been compromised by our perverse reliance on financialization.

Perhaps they can help us achieve a new paradigm where the financial sector plays a supporting role in real economic growth, instead of dominating the center stage.

Where the markets reflect real value, not debt-infused bubbles. Where stimulus — when it's needed — is transmitted to Main Street, not Wall Street. And where a more sustainable future is guaranteed for us all."

Our children's futures depend on it. Stay safe!

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