



Timely Insights into Markets and the Economy

I nvestors Q uarterly

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Equities

- Where to start? Although *March Madness was officially cancelled by the NCAA*, apparently March decided to launch global madness instead. In less than two months, we have seen equities go from new all-time highs to a Niagara-like fall! The rapid spread of the COVID-19 virus has precipitated a *national emergency*.
- For the record, I am not a medical person; and so I *spend more time to listening to reports and updates than commenting on them*. Might be good advice for all of us.
- Mark Twain once wrote, "History doesn't repeat itself, but sometimes it rhymes." Long story short, *keep that in mind* when you hear stories in the media. This is not 1929, 1987, 2001 or 2008, although *we will circle back on 1987*. In fact, the only market *panic related to a bug was Y2K*, when computers were supposed to crash at the beginning of a new century. *Turned into a Y2Yawn*.
- Back to 1987, which I remember all too well. *Computer trading* was gaining steam in the financial markets and traders who had access to the NYSE computers *created an unfettered wave of selling* resulting in the largest one-day loss in history, until recently.
- The *latest turn of misfortune* for investors, once again *comes from a short-term trading strategy* that targets volatility, specifically in the VIX Index (or fear index). Simply put, trading algorithms trigger buying and selling of options based on the degree of fear (or greed) in the market. This *created a cascade effect* and we now find ourselves searching for a bottom. Our [Relative Value](#) (click link to view) suggest the *market is grossly oversold!*

Fixed Income

- Meanwhile, there is a link between what we have been experiencing in equity markets with events in the credit markets. Yes, it is that *liquidity thing* again.
- During the *2008 financial crisis*, liquidity became an issue after Congress activated an accounting rule it had recently passed called *FAS 157 Mark-to-Market*. The bottom line is that it *drove buyers out* of the mortgage market, leaving no one to bid for bonds. The *economy and equity markets promptly crashed*.
- *This time*, it was the use of leverage, not only in *traditional margin trading*, where investors borrow funds to increase equity holdings. However, we have also an increase in the investment community where *leveraged Exchange Traded Funds (ETF's)* had gained popularity in recent years.
- All these strategies work fine, until they do not. Enter the *Algo and Alternative Investment traders, whose computers try to predict* the impact of volatility on other strategies. I believe these strategies *created a cascade effect*, forcing leveraged ETF's to sell which in turn triggered margin calls on leveraged investors and finally scared individual investors to *storm the exits*.
- All of this is taking place against the backdrop of a global pandemic. There is a debate going on about the ultimate *human costs of COVID-19 versus the economic costs*. My sense is *they are interconnected*. We will get through the medical emergency. Academic medicine and private market ingenuity should see to that. The longer-term economic fall-out remains to be seen, but historically, innovations lead to new technology and industries.
- The *Fed has returned to a policy of accommodation*. Washington has responded to the emergency with the largest stimulus in history. If we are not already in recession, will these actions lessen the financial and economic impact? I hope that the answer is yes. Speaking of recession, did our proprietary [Recession Predictor](#) (click link to view) send out a *false signal in August?* It peaked at 97.15 on August 28, 2019. Close but no cigar? Models are just models. Models also need to be modified, which is one of the things on our plates right now.

Conclusions

- The world and the markets are a lot different than they were a few short months ago. The future has not been cancelled, only changed. I am heartened, but not surprised by the number of clients calling to ask what we are buying down here. *Good for you!*
- I was sufficiently spooked by the spike in the recession predictor last year to *hold a larger cash position than normal*; and so we can take advantage of a growing list of attractive plays. Until next month, *stay strong, stay brave and mind those social distancing rules*. Maybe try social media distancing as well...Stay tuned!

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