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Stay Positive

Forbes wrote an excellent article that I thought was very apropos for this current crisis we are going through. I have read countless investment, business and self-help books during my lifetime and this article really does an exquisite job in summarizing what you need to do to accomplish your business and life goals. I highly recommend that you share this article with your children and grandchildren.

Stealth Re-Opening?

The frustration of lockdown is beginning to appear. Automobile traffic is increasing and more and more people are shopping, even as the options remain very limited. A recent visit to Target at 7 PM found a relatively full parking lot and quite a few shoppers. I also passed several fast food restaurants that had at longer lines for the pick-up window. The same places that were virtually empty two weeks ago, are coming back to life. Some of the local restaurants I've visited are a little more upbeat about their business. Lines outside restaurants are not unusual. It's not easy, but if they were well established, they now appear to be getting by.

This is can be both a blessing and a curse. We certainly want to get back to business as soon as practical, but starting too soon could invite a new wave of infection. There is no playbook here for authorities and after watching Governor Cuomo for the last month, I would expect him to err on the side of caution. Apparently, we are a little less willing to cooperate.

In speaking with some friends in the healthcare field this week, several things came into clearer view that I had not realized before.

1) The most common virus transmission mechanism is touch; picking up and handling things that are contaminated. Through-the-air transmission is certainly possible, but far less common than touch!
2) The best way to protect yourself is through hygiene – washing your hands, using sanitizers, washing everything that comes into your home, etc.
3) Masks are important, but they are more to protect everybody else, than to protect you. You may not feel you need a mask, but the other people around you need you to wear it.

Obviously, within a health care facility these generalizations change, but for day-to-day life, this is how we stay healthy and keep everybody else healthy too.

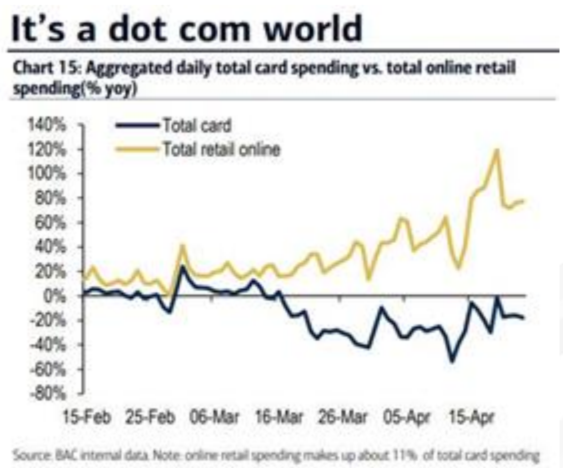
Change is the Only Constant
We are all anxious to get back to normal, but normal does not necessarily mean going back to the way it was. Some things will be forever changed. In the long term, major economic disruptions tend to do two things:

1) They accelerate pre-exiting trends. These are relatively easy to spot with a little thought, but often go unaddressed as many of us go in search of the old normal.

2) They create new trends. These are much harder to spot because there are typically multiple possible outcomes. The ingenious among us spot these trends and create new businesses, the rest of us look back in several years and say "Why didn't I think of that?"

As we begin to re-open the economy, here are a few things to think about:

Retail
Living in an 'over-retailed' area like Long Island, the on-line trend was a growing problem long before COVID. Empty storefronts were already common in most communities. On-line sales have surged in response to COVID and customers previously hesitant to use on-line retailers have been ushered into the on-line world. On line sales have been steadily taking market share from brick and mortar stores for years, but this pandemic clearly accelerates that trend. Once you realize how easy it is, it's hard to go back.

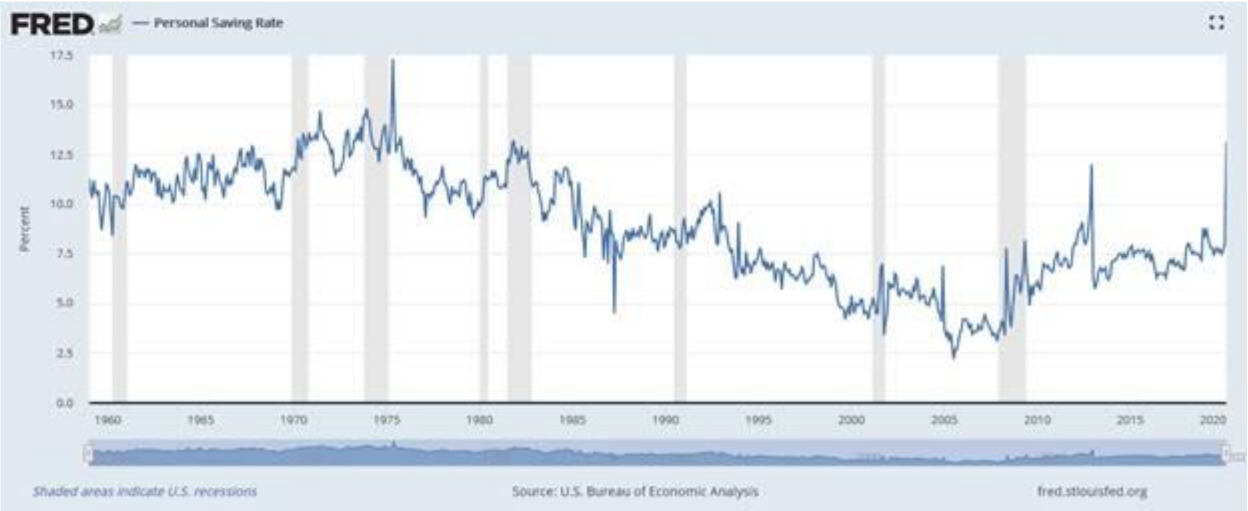


This does not come without repercussions. The data implies that many small, local retailers will not be returning, or if they do, their tenure will be brief. That presents lots of longer-term complications for landlords facing a shortage of tenants and ultimately local governments that depend on property taxes for funding. The long-term challenge will be to re-purpose the unused retail space for other uses. The landlords and local governments with vision will be the ones to thrive. But one thing is very clear, the suburbia that we know will need to adapt with greater speed. It's an evolution worth watching wherever you live.

The Savings Rate is on the Rise

The repetitive expansion and popping of economic bubbles has had a very negative impact on the wealth of the middle class, which is still down by about 15% to 20% since the Great Recession.

According to a [report by the Federal Reserve](), as we entered this crisis, 4 in 10 Americans didn't have enough money saved to deal with an unexpected $400 emergency expense, such as a car repair or broken household appliance. They'd have to put it on a credit card or borrow from family or friends to cover it.



That means that a large swath of the country that was unprepared for a relatively small economic disruption is now experiencing a very large economic disruption and that could change their habits over the long run. The savings rate has already shot up. That is not surprising as having most of the economy shut down makes it harder to spend money. However, we would not be surprised if this savings trend became more permanent, just as the great depression of the 1930's permanently altered the spending and buying habits of that generation.

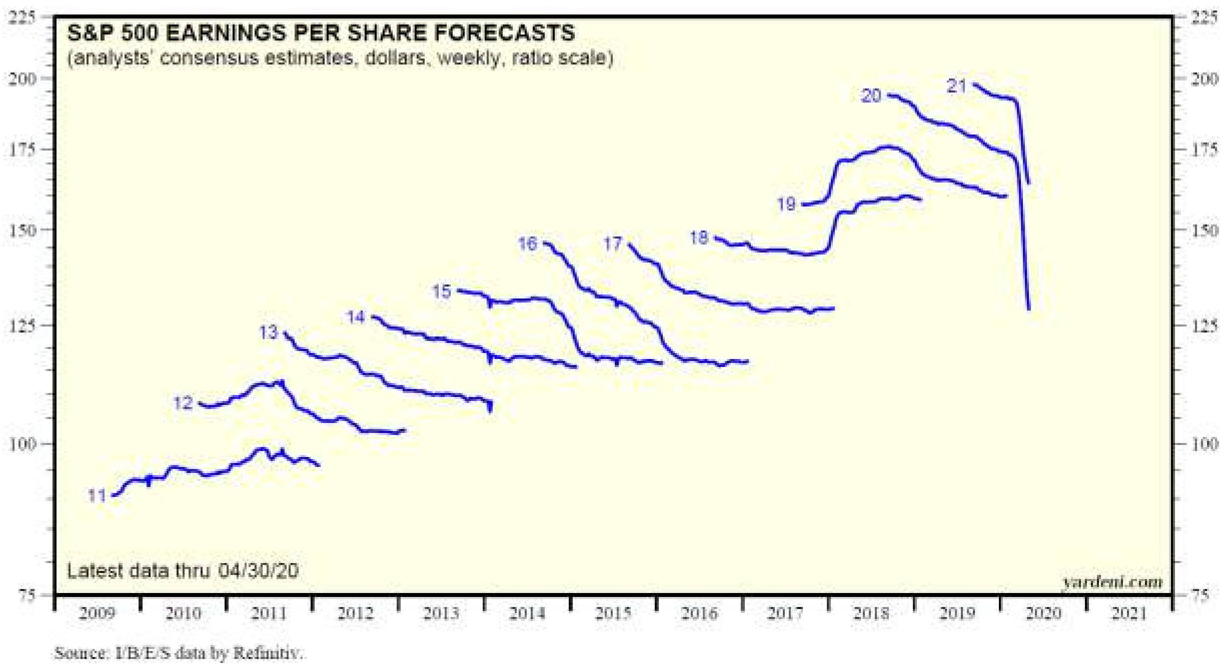
An increased savings rate is one of those good news/bad news stories. On the positive side, a higher saving rate will enable consumers to be in better shape in the future when these inevitable surprises arrive. Once you understand how quickly things can get very bad, you understand that having some savings can be a valuable thing. At the individual level, a higher savings rate is a very good thing. In addition, a higher savings rate allows more resources to be invested in the economy. That increases productivity, which is the mainstay of our economic growth. So stronger savings definitely has its advantages.

On the negative side of the ledger, more savings also equals less spending. Consumer spending is roughly 70% of GDP, so a large increase in the savings rate implies a crimp on economic growth in the near term. This trend would be particularly painful for those businesses serving the more discretionary needs of society and makes recovery that much more difficult. As always, striking a reasonable balance will be the trick.

Earnings Are Down, The Market is Up.

The old saying on Wall Street is that the Market "climbs a wall of worry", meaning that market has a tendency to seemingly overlook negative factors and keep rising. This week, after a short break, the market has resumed its upward trend that began after the March 23rd low. The market has certainly been climbing a wall of worry.

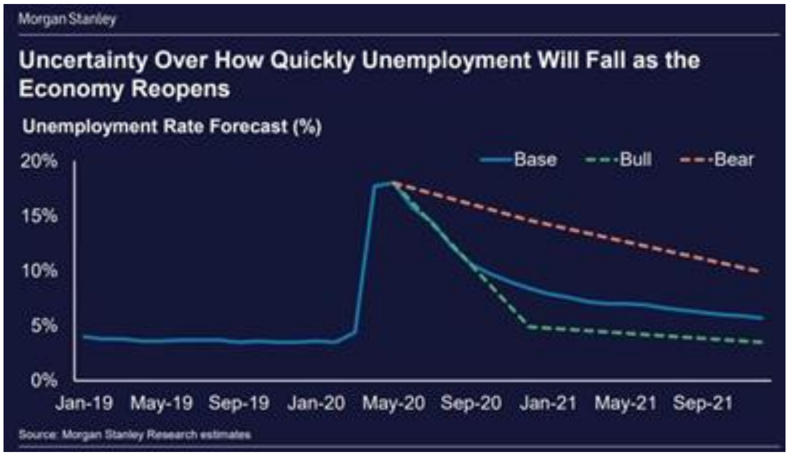
We have said repeatedly that the stock market is a discounting mechanism and as such it takes expected future events into account. As a result, the market typically appears resilient when it anticipates stumbling blocks to be temporary. Clearly the market's message over the last 7+ weeks has been precisely that -- this is a temporary situation. Typically, we view the market valuation through the lens of earnings and the price multiple of those earnings, the P/E ratio. Normally the earnings of the market are reasonably predictable, and certainly much more predictable than any single company. This year is clearly different. The chart below shows consensus earnings per share estimates for the S&P 500 and it is quite clear that 2020, as a result of COVID, is an outlier. However, the 2021 estimate, while certainly lower, is still anticipating next years' earnings to be a bit higher than 2019. At current levels the market is roughly 10% lower than at year end 2019. Poor earnings in 2020 are already baked in and the market is beginning to look ahead to 2021. After a panic fall, this pretty clearly explains why the market has rallied from the March low.



Source: I/B/E/S data by Refinitiv.

The risk from here is that the optimism that currently pervades the market is misguided. That could be caused by any number of things, and a relapse of COVID would be a prime candidate. A second shut down would be major problem for 2021 earnings and logically take the market down several rungs. The further up we go, the greater that risk, so a market pause at current levels makes sense. Technical indicators also indicate a pause here is likely. The market closed the week at a 61.8% Fibonacci retracement from the lows, and like last week, appears to be holding up as a point of resistance for the market.

Longer Term Recovery; Shorter Term Potential for Downside Volatility
Our conclusion is that market is fairly priced as long as the optimism about recovery remains intact. Further upside should logically require some further advancement of the recovery story. If we had to hazard a guess (which we don't), we'd wager that the next move is probably down. While the market is not exactly priced for perfection, it's priced for a very optimistic view of the world. We just don't see this ending as easily as that. How fast we recover will in large part be a function of how fast unemployment can be reduced. The chart below from Morgan Stanley depicts the bull, bear and base cases rather clearly. The market today is reflective of a bias toward the bull case. If the base case begins to change for the worse, it is likely to be quickly reflected in the market.



Fortunately, our methodology does not require us to make these judgements. We have a plan and are invested for the long haul.