CLUTINGER, WILLIAMS & VERHOYE, Inc.
REGISTERED INVESTMENT ADVISORS

6398 Del Cerro Blvd – Suite 3 – San Diego, CA 92120

SCOTT B. WILLIAMS, CFA, CFP
THOMAS H. CLUTINGER
KENT STONE
THOMAS M. CLUTINGER
LOUIS E. WILLIAMS JR. (1934-2008)
KARL E. VERHOYE (1931-1994)

TELEPHONE: 619-326-0900

Economic and Market Outlook

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Thoughts on the Pandemic
(This Time Is Different)

All truth passes through three stages.
First, it is ridiculed.
Second, it is violently opposed.
Third, it is accepted as self-evident.
--Arthur Schopenhauer,
Philosopher (1788-1860)

As this report is being written, the rapid spread of the "Covid-19 Pandemic is a health crisis, an economic crisis, and a financial crisis rolled into one" (*Barron's*, March 16, 2020).

The modern-interconnected world is simply not well suited for the sudden onset of pandemics.

In an article entitled, "The Great Coronavirus Crash of 2020 Is Different" (*Bloomberg Businessweek*, March 19, 2020), Peter Coy, Economics editor said:

> The Great Coronavirus Crash has been frightening in its speed and breadth. Stocks have lurched lower worldwide, with brief rallies between the falls, like wounded bulls in a corridor.

Peter Coy continued:

> "This is different. The thing that is scarier about it is you've never been in a scenario where you shut down the entire economy," Steve Chiavarone, portfolio manager and equity strategist with Federated Hermes, told *Bloomberg News* on March 16. "You get a sense in your stomach that we don't know how to price this and that markets could fall more."
>
> The scariest aspect of the crash is that, for once, it's about something real. The crash of October 1987, which featured the largest one-day decline ever, was

> a hiccup, a market malfunction that didn't even cause a recession. The crash of 2008 also had an internal cause: the popping of a debt bubble inside the financial system, which was addressable with fiscal and monetary stimulus. This crash hasn't been caused by an imbalance in balance sheets but a life-and-death struggle with a microscopic invader, the virus that causes the lung disease Covid-19. Investors are wrapping their minds around the awful reality that the pandemic is out of control. The coronavirus infects stealthily: It's too late to stop it at the border or to seal off hot spots within a nation. It has <u>spread so widely</u>, the only way to halt it now is to operate on the assumption that anyone could be a <u>silent carrier</u> [our emphasis].

For investors worldwide, the decline of the capital markets has seemed like years going by in a day.

For the present, there's no answer to the questions—<u>How bad and how long will the pandemic be?</u>

Until we can answer the questions, the level of uncertainty will remain at a greatly heightened level.

As James Picerno, financial journalist for *The Capital Spectator*, said on February 28, 2020:

> The operative question for the markets' <u>sharp refocus</u> [our emphasis] is neatly summed up by the famous line attributed to John Maynard Keynes: "When the facts change, I change my mind. What do you do, Sir?" . . .
>
> The basic issue here is that a <u>Covid-19-laced future is considerably more uncertain compared with the pre-coronavirus outlook</u> [our emphasis].

James Picerno continued:

> The market, in short, is being forced to discount a future with little if any context in modern times. It's reasonable to assume that Covid-19 will continue to spread. Meanwhile, a vaccine is probably months away. Uncertainty has spiked and so the market demands a bigger discounting factor—a bigger margin of comfort until there's more confidence for understanding what's unfolding.
>
> So, what awaits? Perhaps a long struggle to reacquaint ourselves with a risky world-risk as it always was, not as it was perceived to be via the view of the last several years to the exclusion of the long sweep of history.

Is a Recession possible? It absolutely is. The optimistic view is that the downturn will be short and the bounce-back will be strong.

Professor Greg Mankiw, of Harvard University, said on March 13, 2020, in his blog—*Random Observations for Students of Economics*: "A recession is likely and perhaps optimal (not in the sense of desirable but in the sense of the best we can do under the circumstances)."

The UCLA-Anderson Forecast is predicting a 5-10% correction to GDP (Gross Domestic Product) in the second quarter (Q2) of this year. They think there will be a bounce back in Q3.

That forecast was made in early March. Since then, J.P. Morgan released estimates of a 14% decline in Q2 (March 18, 2020), and Goldman Sachs predicted a Q2 decline of 24% for GDP, with unemployment reaching 9% in Q3. According to CNBC/ Moody's Analytics, as of March 27th the median estimate for the second quarter (Q2) is a decline of 12.9% and the average estimate is a decline of 12.5%.

If Goldman's economists are even close to being correct, that means Q2 will be the worst single quarter decline since the U.S. started measuring GDP.

Clearly, no one really knows what the full extent of the Covid-19 damage to our economy will be. But two things seem clear: first, a Recession has quickly become the base case forecast and, second, a V-shaped recovery (i.e., quick and sharp) seems optimistic.

From an interview of Ben Bernanke and Janet Yellen, by the *Financial Times* (March 17, 2020), the publication wrote:

> Ideally, when the effects of the virus pass, people will go back to work, to school, to the shops, and the economy will return to normal. In that scenario, the recession may be deep, but at least it will have been short.
>
> But that isn't the only possible scenario: if critical economic relationships are disrupted by months of low activity, the economy may take a very long time to recover [our emphasis]. Otherwise healthy businesses might have to shut down due to several months of low revenues. Once they have declared bankruptcy, re-establishing credit and returning to normal operations may not be easy. If a financially strapped firm lays off—or declines to hire—workers, it will lose the experienced employees needed to resume normal business. Or a family temporarily without income might default on its mortgage, losing its home.
>
> To avoid permanent damage from the virus-induced downturn, it is important to ensure that credit is available for otherwise sound borrowers who face a temporary period of low income or revenues. One of the Fed's principal goals is to ensure that credit is available.

Since that interview, the Federal Reserve has launched a number of steps to assist the Congressional Bills—one sponsored by the House and one by the Senate.

Senator Mark Warner (D-VA) called on Congress to go still further by providing Federally-guaranteed loans to Main Street businesses (i.e., smaller mom-and-pop businesses).

It is clear that the Administration, the Fed, and Congress have got the message: The Coronavirus-Recession is Coming.

In our view, it will not be easy to restart a modern-interconnected global economy after the health threat has passed!

The length of the recovery process critically depends on more than aid. An economy that comes to a halt will have trouble restoring staffing levels, inventories, and normal supply chains that, in turn, depend on the damage done at each level of supply.

The statement by President Trump, "Our economy is going to come roaring back" (said on March 17, 2020), seems to be overly optimistic.

Yahoo Finance analyzed Department of Labor data and found:

> After the seven Recessions from 1950 through the 1980s, it took 20 months, on average, before total employment reached its pre-Recession peak. But in the three Recessions since 1991, it has taken an average of 51 months for the labor market to heal, or 2.5 times as long.

We close with an extended, intriguing quote from Michael R. Bloomberg that appeared in a column by David Shipley on *bloomberg.net* March 19, 2020 (with our emphasis):

> One of the best ways to restore faith in the economy when the public-health emergency abates would be to ensure that it coincides with the largest investment in infrastructure in generations. I know from my time as mayor of New York that public investment in infrastructure is a highly effective way to increase private-sector investment and business activity—and inspire confidence in the future.
>
> These kinds of investments were badly needed before the coronavirus began laying waste to our economy. Now, they are absolutely imperative. And while they will not be a cure-all—none exists—they will help restore faith in the future of the country at a time when we will badly need it.
>
> We have seen this strategy work before. In 1933, President Franklin D. Roosevelt—himself diagnosed with polio, an epidemic that also led to closures of public facilities—declared, "The only thing we have to fear is fear itself." We have come to think of that famous utterance as referring to public fears about the Great Depression generally. But in fact, Roosevelt was referring to a specific kind of fear: the "nameless, unreasoning, unjustified terror which paralyzes needed efforts to convert retreat into advance."
>
> In the 100 days that followed, Congress heeded Roosevelt's call and began converting retreat into advance. Now it's time to do it again.

Both the House and Senate Bills will provide immediate help, but we agree with Bloomberg and others who call for it—a strong response to the long-awaited need for basic investment in infrastructure would help more: it would inspire!

Scott B. Williams, CFA, CFP
Thomas H. Clutinger
Kent Stone
Thomas M. Clutinger

Special Note:

Based on February data, six (6) of the seven (7) economic forecasting tools remained positive.

All indications now suggest that data from March will prove uniformly bad.

During this difficult time, when the office remains closed due to the Governor's orders, know that our business remains fully functional as we work from home. Each of us can be readily contacted as indicated below:

Scott B. Williams, cell: 619-818-8217; e-mail: sbwcwv@aol.com
Thomas H. Clutinger, phone: 970-259-1714; e-mail: sdclutinger@q.com
Kent Stone, phone: e-mail: kentcwv@aol.com
Thomas M. Clutinger, phone: 970-247-7982; cell: 951-265-8827;
e-mail: tclutinger@yahoo.com

We believe the blindsiding pain from Covid-19 will pass. Meanwhile, it is imperative that we continue to help and protect each other. We wish for all to stay well.