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OBSERVATIONS ON THE MARKET

By Greg Denewiler, CFA

They said it was going to get worse before it gets better. It has. Now, there are predictions of not just a recession, but that we could go into a depression. The media and the 'experts' are in full out **headline** mode. With parts of the economy shutting down, it becomes extremely easy to start expecting the worst. Here is a little 'back of the envelope' calculation to see if we are about to fall into a depression eminently, with few other options.

We have a $21.7 trillion economy, with government spending representing 38%. Assuming government spending will not change, that leaves us with $13.5 that is the private sector, or, $3.4 trillion per quarter. Let us assume that parts of the economy are still functioning, online sales, food, medical and health care are strong. If the private sector is running at 50%, we have lost $1.7 trillion currently. Everyone seems to agree that we just need to get through the next several weeks, or maybe the next several months, and then we can get back to normal, Or at least we will have reached a point that we can handle the threat. The fear becomes bridging the $1.7 trillion gap.

There are 130 million households in the US. If we take out 38% of them due to some form of government employment, we are left with 80 million. If we have 50% that are still working, that leaves 40 million who potentially need help for the next three months. The average median household income in the US is $55,000. That is about $14,000 per quarter. If we just multiply 40 million by $14,000, that leaves $560 billion of direct assistance. Most of corporate America who needs help, like airlines and other businesses that have been directly impacted, will be loaned money that eventually comes back. The TARP program from 2008 paid out $426 billion, however, it received $441 billion back. It sure seems like there is a way through this crisis without ending up in a depression.

$560 billion is a lot of money. Fortunately, with interest rates at .4% for the two-year Treasury note, the annual interest cost would be $2.3 billion. That number is manageable. The Fed just needs to immediately address the liquidity concerns in the debt markets. They seem to be doing that, by just announcing a congressional bill that includes $4 trillion for liquidity. We are very fortunate that the economy has become so tied to the internet and that much of corporate America has moved to the 'cloud'. Ten years ago, this may put us into a depression. Interest rates for the 10-year Treasury in September of 2008 where 3.85%, they are currently at .9%. Oil was at $100 a barrel, currently at $22. These are costs that make it easier to weather the current storm.

The Dow as of Friday was down 35% from its high in February. It is easy to be thinking; should I get out? Assets are worth something, even if their short-term revenue is bleak. Southwest Airlines, which is a company that has a very bleak outlook for the next three months, is down 45% from its high. Its economy is now close to zero for the new term future. From this perspective maybe the stock market is where it should be. The bigger issue for the stock market is that we are at 14.3 times the last 12 months of earnings, below the 100-year average. We will recover, it is just a matter of how long it takes. It took three years in 2008. Remember though, that 10-year Treasuries paid 3.85% at the beginning of the recession in 2008, now they pay .9%. When we see daylight again, the choice of earning a dividend yield of almost 3% (dividends recovered in two years), or .9%, assuming everything stays the same (which it won't), the choice seems obvious, the market is attractive.

Some of you might remember letter number 341 in November 2019. It was about 'present bias'. This is the biggest battle we currently face as investors. The future is not going to look like the present, but by focusing on the present and over weighting what is happening currently, we discount the future. The media is going to do everything in its power to keep you focused on today. There is also a point where we either believe in the power of capitalism to solve this problem, and the government to buy the time for these solutions to happen, or we don't. Both seem to be happening now. There are obviously no guarantees as to what happens in the next few weeks, however, keeping it in perspective is critical to helping us through it.