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Winning The War

Many feel that our country is at war. If we run with this metaphor, then all that matters right now is some sign that we are winning the war. There are two current developments that could turn the tide.

It's War

"May you live in interesting times" is reputed to be a legendary Chinese curse, and it is often used in English-speaking countries during times of disorder and despair. Given the events that have transpired over the last three weeks, we are most certainly living in interesting times.

In fact, many feel that our country is at war. If we run with this metaphor, then all that matters right now is some sign that we are winning the war. There are two current developments that could turn the tide.

Stimulus

The first is the government action involving monetary and fiscal stimulus. On Monday, the Federal Reserve (Fed) delivered unprecedented monetary support by rolling out programs designed to keep the plumbing of the financial system intact.

The Fed will also lend directly to large companies, ensuring they can access the cash to stay afloat. They even announced plans to support small businesses directly, which could be critical in the coming weeks.

Typically, if the Fed wants to make money available, they use J.P. Morgan, Citigroup, and other banks as intermediaries. They give the banks the cash, and the banks make loans to companies and consumers.

However, the Fed appeared to be worried that the dysfunction in Congress and bureaucracy of large commercial banks could delay the financial support that is desperately needed. So, for the first time in history, the Fed plans to bypass the banks for emergency loans.

Days later, Congress finally answered the call and announced the largest fiscal stimulus package in our nation's history. Details remain to be heard, but these two forms of stimulus were met with two thumbs up by investors. Stocks surged higher through the week and even entered a new bull market (defined as a rise of 20% or more from a recent bottom).

But not all rhetoric has been positive. There are those who have voiced concern that the overall size of the stimulus package could cripple the U.S. for years. These criticisms appear misguided. While it will most certainly increase the deficit, the U.S. is a wealthy

country and can afford to do so (at least for the foreseeable future).

Furthermore, history has shown that our nation emerges from crises stronger. Morgan Housel recently wrote that “necessity is the mother of invention, so our willingness to solve problems is about to surge.”¹ I couldn’t agree more.

It may even end up being a profitable move by the government. The Troubled Asset Relief Program (TARP), which helped the country emerge from the financial crisis, did more than just save key industries. It also earned a positive return on investment. In December 2013, the Treasury wrapped up TARP, and the government concluded that its investments had earned more than \$11 billion for taxpayers².

What’s different this time is the intent. TARP was a bailout. This is a rescue, or a bridge to help companies and consumers survive a crisis they did not create nor fuel. Corporate America today is also stronger compared to prior crises. Companies have spent years improving their operations through cost cuts, inventory management, and better technology. These efficiencies have driven record-high margins and more

consistent profitability. They can endure far more today than in the past.

Testing

The second is testing. We are currently seeing significant increases in the number, speed, and efficacy of tests, and this is a really big deal.

Farr’s Law states that pandemics tend to rise and fall in a roughly symmetrical pattern or bell-shaped curve. It was first formulated in 1840, and since then it has been ignored in every pandemic hysteria. AIDS, SARS, and Ebola all followed this pattern (so does seasonal flu each year).

Testing flattens this bell curve because it finds those with the virus and keeps them away from those who don’t have it. The sooner we see a deceleration in active cases (reaching the peak) and an acceleration in closed cases (falling down the curve) the better. The big question is when these will happen. We can look to other countries that are “ahead” of the U.S. to create a potential range of outcomes.

South Korea has arguably done the best job because they have kept their economy running while mostly containing the virus. The government has relied on

private companies to handle over 90% of testing, and those who test positive stay home.

The country that has arguably done the worst is Italy. For decades, their government massively underinvested in their healthcare system. Italians also tend to be older and have a higher rate of pre-existing conditions due to lifestyle choices and lack of ongoing medical care.

Yet despite the vast differences between both countries, they are both following Farr's Law. It took Italy 43 days from first case to peak case and 12 days after implementing the strictest travel restrictions. Forty-three days was exactly the same amount of time it took South Korea to reach its apex³.

There is a high probability that the U.S. will fall somewhere in between these two. The U.S. has one of the best healthcare systems in the world, but they were slow to test and quarantine. If so, the U.S. would be 14 days behind Italy (as of March 24).

Simply put, testing and time are critical to winning this war. Until then, social distancing and quasi-quarantines in New

York City, California, and Washington should help.

The Bottom Line

After falling into a bear market at the fastest rate ever, the S&P 500 just recorded its quickest three-day advance in nine decades this week⁴. This surge created more than \$2 trillion in value for shareholders (ironically the reported amount in the stimulus package).

The stock market tends to be anticipatory - rising and falling based on expectations of the future. Given the recent rally, the market may soon look past the stimulus and focus its attention elsewhere.

The news flow over the coming weeks will also probably get worse before it gets better. Increased testing should show an accelerated spike in infection (because that's what Farr's Law tells us), and economic data should start quantifying the impact of shutting down the economy.

It's hard to say how the market will react because no precedent exists for this situation. Kneejerk reactions could cause investors to panic even more, or cooler heads may prevail and see this as progress.

For example, Thursday's jobless claims number skyrocketed to 3.28 million. For scale, the previous record was 695,000 claims filed the week of October 2, 1982⁵. That's a mind-boggling number to digest, but there is a silver lining.

It's unlikely that politicians are indifferent to their constituents losing their jobs overnight (their own job security may be at risk come election time). Hence, bad economic data may actually be good if it pressures the government to roll back these draconian restrictions. The sooner the economy restarts, the quicker the recovery.

The government also has a history of overreacting and then correcting. The financial crisis is a prime example. Years of lax regulation got replaced with so much regulation that banks were practically restricted from earning any profit. Over time, rules were loosened but not removed.

We may see a similar pattern soon. The Trump administration recently announced that they are considering a risk classification system for businesses. The goal is to get businesses that pose the least risk back open soon. This is encouraging because it shows that the

government recognizes the need to swing the pendulum back a little.

The bottom line is that the war is not over, but the tide could soon turn. The ball appears to be in the government's court, and history has proven their ability to fix big problems (even if they contributed to the creation of them).

Sincerely,

A handwritten signature in black ink, appearing to read "Mike Sorrentino". The signature is fluid and cursive, with a long horizontal stroke at the end.

Mike Sorrentino, CFA
Chief Investment Officer

Three Key Points

1. Fiscal stimulus and better testing are critical to turning the corner in this crisis.
2. The stock market tends to anticipate the future in today's prices.

3. The war is not over, but the tide could soon turn.

would incur fees and expenses which would reduce returns.

Sources

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