HARWOOD
FINANCIAL GROUP

Market Update

March 20, 2020

"May You Live In Interesting Times"

This 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 the only thing that matters, the only thing that will reverse this situation is some sign that we are winning the war. There are two developments that need to happen to turn the tide:

Testing

The first is testing. We are seeing the importance of testing in South Korea right now. This is critical because the more people get tested, the sooner we can keep active cases away from people who don't have the virus. We are about to see a massive rollout of testing in the U.S., and this is good.

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, Ebola – they all followed that pattern. So does seasonal flu each year.

Testing speeds up Farr's Law. The more people we test, the faster we get to a resolution. I'm looking for (1) a deceleration in active cases, and (2) an acceleration in closed cases. The first indicates reaching a peak (left side of the bell curve), and the second indicates the decline (right side of the bell curve).

This is happening in China and to a lesser extent in South Korea. But the U.S. is a couple weeks behind both, so we should expect to continue to see an acceleration here (again all depends on testing). Until then, these self-directed quarantines in NYC, CA, and WA should help to speed up Farr's Law.

Stimulus

The second is stimulus (fiscal response). The government slammed the brakes on our economy. They now have to figure out a way to get it started again.

I believe these $1,000 checks will have no material effect. Furthermore, a $1.3 trillion package is probably 25% of where it needs to be. Maybe even less. What people need, what businesses need is insurance. They need to know that everything will be ok when they are allowed to leave their homes and go back to work. This is going to be very expensive, and there will be those who game the system. But it has to happen.

The idea of business interruption insurance is gaining traction. Basically, the government will provide insurance to any business who promises to keep 90% or more of its employees employed. If they did this, it would solve most of the crisis overnight. I simply must assume the government is considering something like this because what they have proposed so far is inadequate.

Have little fear that such a package will cripple our economy. Sure, it will force us to run a large deficit for a while, but if executed properly, it could end up being as advantageous as TARP and other programs that saved industries (and subsequently made the government a positive return on investment). Furthermore, these would not be bailouts. This would be a bridge to get them through something they did not cause.

What Next?

Thursday's market activity was noteworthy because it was the first time in several days that trading and volatility looked "normal." The daily change was one-tenth of the least volatile day of the preceding eight sessions[1]. That is a big drop off in one day. Friday was the quadruple witching, which can cause strange behavior on elevated trading volume. Back that out and we may have just seen back to back days of normalcy.

I'm not saying the market has for sure turned a corner. Like I said above, we need a sign that we are winning the war. But it could indicate that the panic has subsided. Back on Monday, the market was rattled because the Fed cut rates and NYC shut down bars and restaurants. Hours later San Fran ordered residents to stay inside. Lots of press. Lots of panic.

Fast forward to Thursday evening and we got word that the entire state of CA must stay inside. If people panicked when San Francisco locked down, then closing the entire state should have resulted in even greater panic. But it didn't. Friday's trading showed no signs of such behavior. Theoretically worse news produced less panic.

Think about it this way. After a few rounds in the ring, you learn how to take a punch. Friday could have been a sign that investors are becoming used to these headlines. While this is good (in a weird way), the media is too smart to let this happen. Just watch how extreme the headlines get from here. They will just up the dose (although I'm skeptical that it will work).

The bottom line is that if the market hasn't turned a corner, perhaps the panic has subsided. Bear markets tend to be very concentrated (most of the pain happens over the course of a few days). Stocks may go down some more, but I'm doubtful we'll see what we saw over the last 10 days.

Disclosures