# Market Monitor

Royal Asset Managers, LLC
April 2020 Volume XV Issue 1


## Phases of and Reactions to Market Crashes and Pandemics Share Similarities

By: Michael Alexenko, CFA

There are many similarities between the developments and reactions to health pandemics and market crashes and depending upon how you situated yourself prior to either event will determine how you might respond to the crisis.

If you think about the nature of each event it becomes clear why the reactions to them have some parallels. Both surface in what might appear to be a benign condition. There are some early warning signs that things aren't quite right followed by the uncertainty of whether a real threat exists. Next are residual phases that keep one off balance about whether things are improving or turning bleak again. In the early stage when hesitation or failure to act takes place, which are very reasonable responses, the evil is unleashed and things go bad so fast that it's impossible to raise your defenses before most of the damage is already done.

In a pandemic, nations are either in a position to control or cope with the health trauma or they aren't. If you analyze Spain, Italy and New York City they all have had terrible results from Covid-19. Most of which were caused by structural problems in their health care systems and/or the general makeup of their populations. It's difficult to come to another conclusion as to why certain areas have been so devastated by the virus while others have been able to operate with much less grim consequences. In New York City's case as with New Orleans, evidence suggests that poorly timed imprudent behavior may have contributed to their current troubles.
Imprudent behavior such as staging large public events because they are the popular things to do or loading up on stock in a market that shows some signs of being overvalued are both unwise choices. We see what has happened in two urban areas with dense populations when a contagion is in the air. In the case of investments, if one has a level of risk in his/her portfolio that is poorly matched to the actual tolerable level of risk and a market crash hits, it's little wonder that a panicked reaction will ensue.


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It's best to leave the assessment of the preparedness for a pandemic to the epidemiologists, but evaluating statistical data like mortality rates do tell us something about whether something went wrong for a certain country or area. The statistical data that needs to be evaluated in a market crash doesn't change much from the numbers we analyze for an investment portfolio's performance in normal market conditions. We might have to perform some more intense investigation as to why we are getting the results we are, but in general if I have a portfolio that is split between stocks and bonds then I should be able to determine whether my portfolio was constructed properly before the market crash. If a portfolio is far exceeding the losses of its declared strategy, then the preparedness and skill of the portfolio manager is rightly questioned.

In times of extreme market pressure there is no better measure of skillful preparation then a safe cash reserve. Nothing feels worse than to face an eroding market and knowing that you'll need cash soon when you have little on hand. If your cash balance is properly plump, then avoiding **panic** selling is much easier.

A less obvious connection between market crashes and pandemics is how you get similar actors/experts stoking fears and **panic**. There is no shortage of market pundits and business journalists that will make dire forecasts when things are looking the worst. Just like the epidemiologists who prepare research reports that show half the world dead and buried their counterparts in the investment world pronounce both the economy and the stock market on life support with little chance of revival.

Some might choose to **ignore** what is happening. In a pandemic this is hard for political leaders to do for a variety of obvious reasons. When managing assets it's impossible to do because a strategy should be in place that dictates the offense and the defense that is put into action. Prior to a market crash your defense should have already been in place. However, as in any military or athletic event, no


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# Written Plans Reduce Emotional Reactions and Errors

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defense will be completely impenetrable. The opposition is going to score points when given enough opportunities. It's best not to just stand by while the opponent keeps racking up points. Investing is a long term game/battle and the moves you execute today can payoff for years into the future.

Another response is the desire to **exploit and capitalize** on circumstances. Maybe you've identified a weakness in the opponent and throwing the long bomb is just too enticing? In the investment world the opponent is the broad market psychology. It can pay to be a contrarian and it makes a great deal of sense to buy stocks when the market is down 20%. Of course, when the market drops another 15% on top of the initial 20% drop then the contrarian hopefully didn't use his entire cash arsenal too early. Capitalizing on market conditions should always be done within the context of an investment strategy otherwise you can be tempted to keep throwing long bombs with little to show for it.

The preferred reaction to a market crash is **calm assertiveness**. Remaining calm is probably the hardest to do, but knowing what to do and when, should be written in your investment strategy playbook. Having a written plan reduces the potential errors caused by emotional reactions. If your strategy says you should be 60% invested in stocks and a market crash takes you down to 53% then it's probably time to begin to build stock positions back. This is either done by raising cash in your portfolio or tapping cash reserves that you have stored. Reaching less than 90% of a normal stock allocation is not a bad benchmark to use when deciding if it's time to start hitting the send button on buy orders. Most importantly having a plan can help you be **assertive ,** but **calm** probably remains a little more elusive.

# Market Snapshot:

## March 23rd Market Bottom Could Hold But Expect Some Choppiness

By: Michael Alexenko, CFA

Immense damage has been done to the health of the market and economy and the medicine being administered has no FDA approval. It's hard to keep count of all of the trillions of dollars that the federal government is throwing at a problem that has been thrust upon our economy by state and federal policymakers. The total could reach $10 trillion. We are now in the residual phases of the market crash and the pandemic; at least it appears so. We've experienced a historic bear market if it makes you feel any better to be a part of making history? This bear market hit a 34% decline faster than any previous event. The best estimate is that the low that was hit on March 23rd is likely to hold.

Extreme oversold conditions which are often associated with bear market bottoms culminated on March 23rd with 80% of stocks hitting new lows. In the 2008 crisis the market bottomed when 82% of stocks hit new lows[1]. If we begin to see bank loan problems caused by mass defaults by companies sitting idle past May 31st, and/or lingering rotten economic reports then the March 23rd closing low of 2237 will be in danger.

We're enjoying an Easter bunny rally that is hard to justify on a fundamental basis because we have no idea how badly corporate profits will suffer. Using normal metrics tools, we have a market trading at about 22x earnings which is a rich number. What this recent rally tells me is that the market is betting that all of the government relief money and Federal Reserve monetary stimulus will coincide with improvements in Coronavirus data. Skepticism about this needle being thread perfectly is warranted and it's probable that we have a choppy market for a while longer.

[1] *Timmer, Jurrien, Fidelity Investments – Market Bottom: Getting Closer, March 24, 2020*

Publication courtesy of:

**Royal Asset Managers, LLC**

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