# INVESTOR CONVERSATIONS DURING DISRUPTIVE MARKETS

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The market disruption over the past four to five weeks has been disconcerting, but it has also presented potential opportunities for valuable introspection.

When discussing current conditions, there are several broad observations and several very specific ideas that can benefit your clients.

**Broad Market Observations**

1. **This is not 2008.** Yes, the market collapse has been terrible and, in terms of the speed of decline, somewhat unprecedented. But banks, corporate America, and American households are in a much stronger fiscal position now than in 2008. We are not witnessing a fundamental collapse of the economy, the banking industry or the global capital markets. What we are witnessing is widespread fear over a pandemic and the corresponding uncertainty it is creating with investors. It may get worse before it gets better, but we believe *it will get better.*

2. **Health concerns vs. economic concerns.** There was an interesting piece in the *Wall Street Journal* a few days ago (by Holman Jenkins) comparing the coronavirus to the "regular" influenza virus. It did not focus on the *medical or pathological* differences, but on the public and policy reaction differences instead. Specifically, the "regular" flu virus comes around every year and kills roughly 10–15K people annually. We accept that and don't threaten our economic growth by trying to prevent its spread (other than with the usual commonsense measures we take at the individual level). With this virus, however, we have, from a *policy response and public reaction perspective*, swung the pendulum completely the other way. We seem willing to cripple our economic growth in an attempt to minimize the spread of the virus. We suppose there could be an academic debate over whether that is a good or bad policy decision, but people are not interested right now in academic discussions; they are frightened and want to see a massive policy response. The rapid steps taken by local governments and U.S. society as a whole add considerable pressure to the federal government to deliver a meaningful policy response sooner rather than later.

3. **China, South Korea and (hopefully) Italy illustrate that the spread of the virus can be contained with extreme "social distancing" measures, but at the expense of massive hits to personal freedom and economic growth and activity.** Here in the U.S. we seem to be headed in the same direction, with one important distinction: Our "social distancing" activities are taking place at the *individual, local and private sector levels* (e.g., the NBA and NHL, college campuses, concert and conference cancellations, etc.) rather than as the result of a national "top down" command and control mandate. We actually take comfort in that; individuals and organizations are electing to do the right thing.

4. **Our expected outcome?** We believe this may get worse before it gets better, both in terms of the spread of the virus and in terms of economic disruption. The continued spread of the virus and the ongoing oil war between Russia and Saudi Arabia will significantly impact Q1 and Q2 gross domestic product (GDP) and earnings, and we may hit another "downdraft" if we begin to see a rise in credit

downgrades and defaults among weaker capitalized energy companies over the near term.

5. **But we *do not* believe** that all this negativity represents a recessionary collapse of the U.S. economy. What we are witnessing and experiencing is painful and anxiety-provoking, but we believe *it will pass*.

**Recommended Courses of Action:**

1. **Be aware, be attentive, but do not be afraid.** Well-diversified investment portfolios are built with full market cycles in mind, in the *expectation* that periods like this will occur. Many investors became complacent over the course of an 11-year bull run, and though the speed and magnitude of the recent decline is unusual, *market declines are normal*. Market timing is notoriously difficult, and we do not recommend "moving to cash," thereby locking in recent losses that we believe may recover over the course of the next 12–24 months. **Stay diversified, stay liquid, but stay invested.**
2. **Actively seek to avoid common behavioral investment mistakes.** In times of stress, many investors default to behaviors that can harm long-term performance. One example of this is home country bias, or reallocating to what seems to be a more known and comfortable market: your own. In this recent market downturn, however, many emerging markets have relatively outperformed the U.S. markets, illustrating the potential benefits of a globally diversified portfolio. A second example is the gambler's fallacy, in which investors believe they will "know" when to get into and out of the market. But this is almost universally false. Market timing is extremely difficult, and the empirical evidence suggests that individual investors are particularly bad at it. The better approach is to remain disciplined and stick with a long-term portfolio that was constructed to ride the waves of volatile markets.
3. **If you are sitting on cash, pay attention for possible reentry points.** Given the U.S. monetary and (what we assume will be) fiscal response and self-imposed "social distancing," we believe the current panic will recede as we head through the second quarter, and attractive buying opportunities will present themselves. Equity valuations have fallen precipitously, and credit spreads have blown out, suggesting potentially attractive investment opportunities at some point in the future.
4. **If it makes sense for your clients, actively encourage mortgage refinancing.** Rates are at historic lows, and a smart refinancing can put real money back into investors' pockets.
5. **Engage in active tax-loss harvesting.** Many investment positions may currently be "underwater." Rather than "wait it out" or panic and move to cash, actively seek to tax-loss harvest by swapping out of existing losing positions and into similar ETF positions. The losses are pocketed for offsetting future gains in the portfolio, and the investor remains fully invested. After the 30-day wash rule period has passed, investors can swap back into the original position or, if they prefer, stay with the new position and maintain both their desired allocation and exposure objectives.

These are the times when your clients need you the most. Keep them informed, keep them calm, keep them invested and identify opportunities for turning market turmoil into proactive and positive results.

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## DEFINITIONS

**Gross domestic product (GDP)** : The sum total of all goods and services produced across an economy.

**Core Earnings** : Income generated by the company's daily operations rather than one-time events or market fluctuations.

**Recession** : two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemploymen.

**Diversification** : A risk management strategy that mixes a wide variety of investments within a portfolio.

**Bullish** : a position that benefits when asset prices rise.

**Liquidity** : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

**Volatility** : A measure of the dispersion of actual returns around a particular average level. .

**Valuation** : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

**Credit spread** : The portion of a bond's yield that compensates investors for taking credit risk.

**Tax Loss Harvesting** : Selling securities at a loss to offset a capital gains tax liability. Tax gain/loss harvesting is typically used to limit the recognition of short-term capital gains, which are normally taxed at higher federal income tax rates than long-term capital gains.

**Wash-Sale Rule** : An Internal Revenue Service rule that prohibits a taxpayer from claiming a loss on the sale or trade of a security in a wash sale. The rule defines a wash sale as one that occurs when an individual sells or trades a security at a loss, and within 30 days before or after this sale, buys a "substantially identical" stock or security, or acquires a contract or option to do so.