

THE STOCK MARKET'S FIVE STAGES OF GRIEF

Jeff Weniger, CFA, Director, Asset Allocation

Divorce, death, job loss. Psychiatrist Elisabeth Kübler-Ross says the first thing we do is deny or ignore the problem.

As denial fades, anger sets in. Then bargaining, where you appeal to a higher power or promise yourself some behavioral change in a futile attempt to ameliorate the pain. Then comes depression. And finally, acceptance.

The Covid-19 shock is the Big One, maybe bigger than September 11. I say that with full recollection of being 20 years old, watching the second plane crash into the World Trade Center and thinking a military draft would be announced.

Six years before, *Outbreak* had hit the box office. Until Covid-19, it didn't have the staying power of contemporaries like *Titanic*, *Pulp Fiction* or *Saving Private Ryan*. It was a big enough hit though, generating about as much box office revenue as *Braveheart* and *Nine Months*, both of which made the rounds that same year, 1995. Beyond Dustin Hoffman, Rene Russo and Morgan Freeman, *Outbreak* had another cast member: an Ebola-like virus inside the United States. We went to the movie theater, watched the world go haywire and asked, "Can you imagine?" And then we moved on.

Large-scale terrorism, pandemics and nuclear war have been on the radar for generations. But until now we had largely been able to avoid the latter two in scale.

Think about the last one, nuclear war. From the 1961 Bay of Pigs fiasco, when Soviet nukes came close to launching into Miami from Cuba, to today's ever-present threat from North Korea, the world has for generations been one button push away from that kind of catastrophe.

Before Covid-19, the biggest modern-day surprise was 9/11, which in retrospect was somewhat predictable if we hadn't been in collective denial. Experts had been warning about Al-Qaeda, but the public didn't listen.

Consider the world of 2001. Terrorism was nothing new. The Troubles had rocked Northern Ireland for 30 years, so much so that MI6, the British intelligence agency, is to this day one of the most sophisticated organizations of its kind. The rest of Western Europe was no stranger to renegades sowing fear either—think of Marxist revolutionary Carlos the Jackal offing French intelligence agents and bombing OPEC's headquarters in Vienna in the 1970s. Or consider what was happening in Germany, which caught fire from both Marxists and neo-Nazis in the decades before September 11.

Airplane hijackings and bombings weren't even novel by the time the Towers were attacked. Maybe the biggest headline of 1988 was the death of 270 people in the downing of Pan Am Flight 103 over Lockerbie, Scotland. That attack was orchestrated by Libyan dictator Muammar Gaddafi.

The World Trade Center as a target was already known, as was the group that was targeting it. Al-Qaeda bombed it in 1993, trying to make the Towers collapse with a truck bomb in the basement. The operation was a failure—“only” six died. But the world didn’t take Al-Qaeda seriously, even after that internationally relevant attack.

We moved on, with blinders.

Two years after the 1993 Twin Towers attack, white supremacist Timothy McVeigh followed the script, putting a truck bomb in Oklahoma City’s FBI building, killing 168.

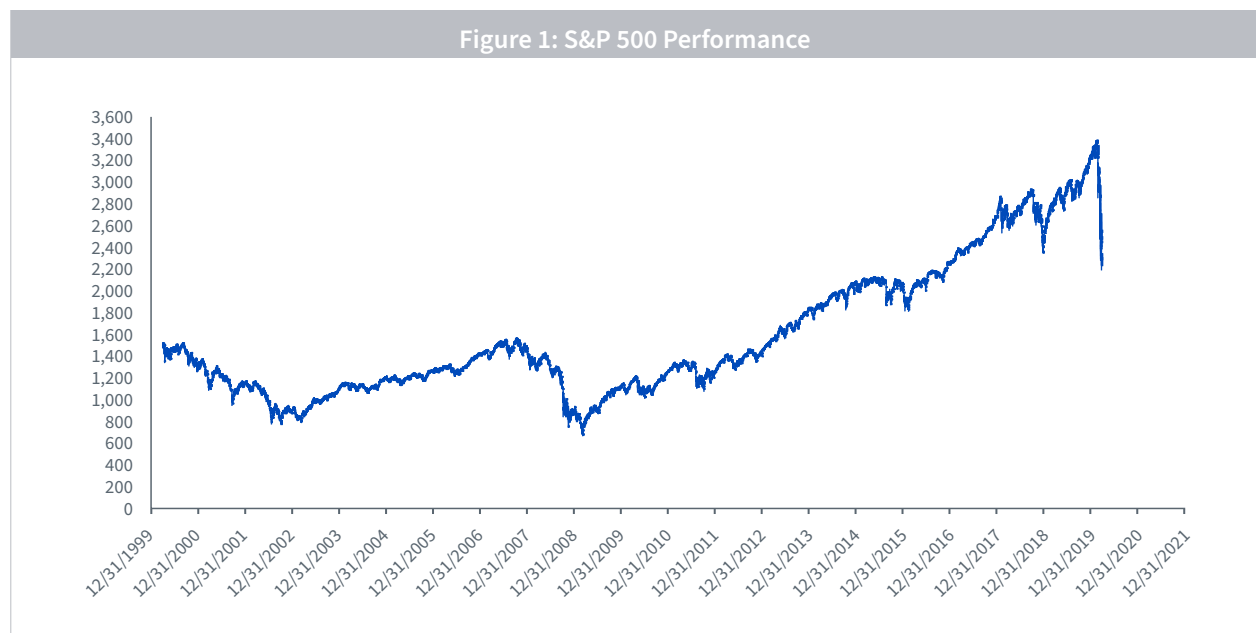
Then, in 2000, we ignored Al-Qaeda’s bombing of the *USS Cole*, walking right into the year 2001 with most Americans having never heard the name Osama bin Laden.

That is **Stage 1: Denial**.

SARS, MERS, avian flu.

They were all preludes to the Big One: Covid-19. Foreseen, predictable, ignored. While September 11 marks a stage in the transition from a 1990s stock market dominated by U.S. stocks to a 2000s stock market dominated by emerging markets, Covid-19 could be that type of catalyst for today’s market. This time around it would be from the 2009–2020 dominance of U.S. stocks to a new leader in the 2020s: emerging markets.

Consider that it took 50 days after China’s first report of the bug to the World Health Organization for Stage 1 to end; it did so on February 19, the day the S&P 500 peaked at 3,386. But emerging markets, whose largest component is China, had already been tripped up in January, and it wasn’t like the asset class entered 2020 in a state of ebullience that could compare to that of the S&P 500. To wit, while the S&P rallied 15.1% from its global financial crisis low on March 9, 2009 to February 19, 2020, the MSCI Emerging Markets Index returned “just” 7.9%.



Sources: WisdomTree, Bloomberg, 12/31/99–3/27/20. Past performance is not indicative of future results. You cannot invest directly in an index.

While the stock market’s denial ended, Wall Street’s economists have only started to move on. As late as mid-March, many were still calling for second-quarter U.S. GDP¹ growth, but late March brought estimates of deep red ink. However, the consensus is wrapped around a “V-shaped” recovery in Q3 and Q4, an assumption that is far from assured.

Figure 2: Wall Street Expectations, U.S. GDP Growth

U.S. GDP Forecasts (QoQ, SAAR)					
As of	Contributor	Q1/2020	Q2/2020	Q3/2020	Q4/2020
3/27/2020	UBS	-2.1%	-9.5%	2.1%	6.7%
3/26/2020	Amherst Pierpont	-0.7%	-15.0%	15.0%	2.7%
3/26/2020	Goldman Sachs	-5.7%	-24.0%	12.0%	10.0%
3/26/2020	Wells Fargo	1.2%	-14.7%	-6.3%	4.1%
3/25/2020	Bloomberg Economics	0.5%	-9.0%	1.0%	4.0%
3/25/2020	TD Bank	-1.9%	-27.0%	12.8%	9.0%
3/24/2020	Nordea	-	-18.4%	-	-
3/20/2020	Morgan Stanley	-2.4%	-30.1%	29.2%	3.3%
3/20/2020	Barclays	1.5%	-7.0%	0.0%	1.0%
3/20/2020	JPMorganChase	-4.0%	-14.0%	8.0%	4.0%
3/20/2020	UniCredit	1.1%	-1.5%	0.5%	1.8%
3/19/2020	Bank of America ML	0.5%	-12.0%	3.0%	4.0%
3/19/2020	Deutsche Bank	0.6%	-12.9%	4.4%	5.2%

Sources: Bloomberg, WisdomTree. A seasonally adjusted annual rate (SAAR) is a rate adjustment used for economic or business data, such as sales numbers or employment figures, that attempts to remove seasonal variations in the data. Most data is affected by the time of the year, and adjusting for the seasonality means that more accurate relative comparisons can be drawn between different time periods.

Stage 2, Anger, clicked in when the public began to focus on the Trump administration’s inability to exit Stage 1.

Interestingly, the sheer number of preppers indicates that there are untold millions for whom Stage 1 never even comes; they are on the lookout for crises and ready themselves accordingly, with regularity, commencing many crises in Stage 2.

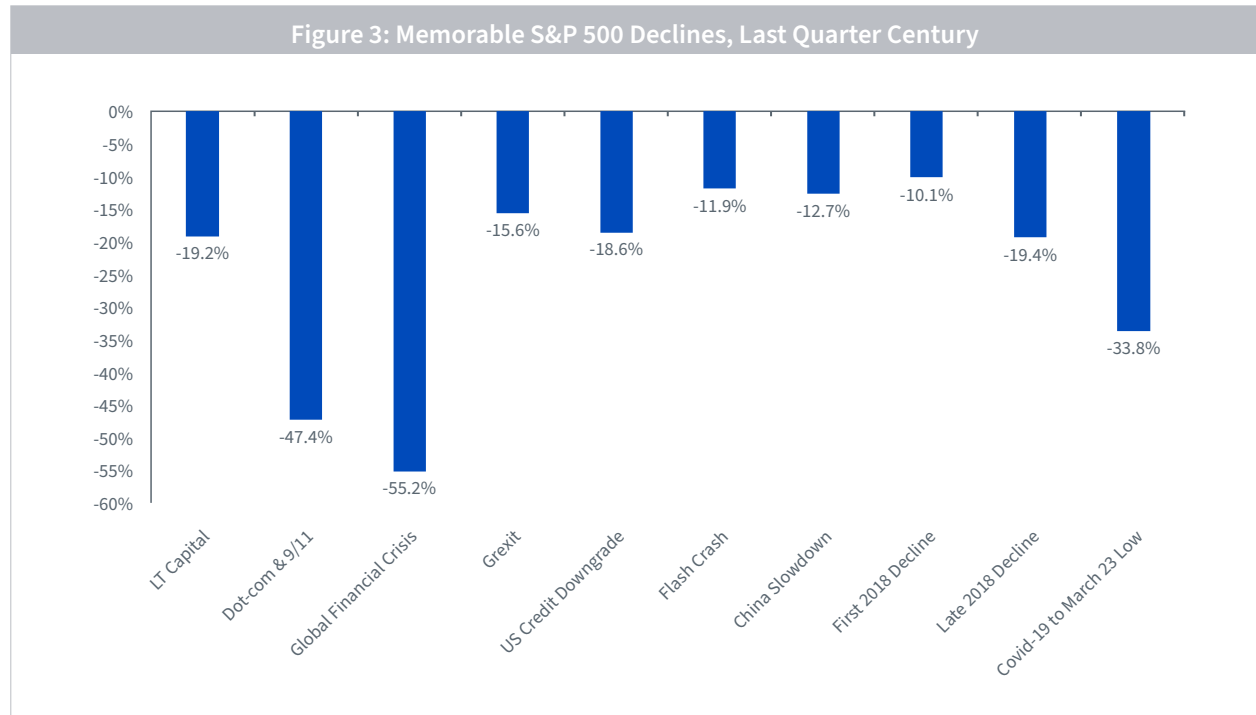
Some bought their first face masks back in bird flu days. Maybe they grabbed a few krugerrands when Bear Stearns was buckling and a few more when they saw pictures of bricks thrown through Wachovia’s windows 13 years ago.

For the public as a whole, general anger still lingers, but many are thinking about solutions to the Covid-19 crisis, indicating that the market could be at Kübler-Ross’s **Stage 3 (Bargaining)** or possibly **Stage 4 (Depression)**.

¹ Gross domestic product (GDP): The sum total of all goods and services produced across an economy.

Figure 3 shows the S&P 500's nine most memorable declines in the last quarter-century. At its deepest, this plunge exceeded seven of them but still fell far short of the losses in the dot-com blowup and the global financial crisis.

Because the decline is only about a month deep, and the market hasn't halved, a reasonable psychological conclusion is that we may be in either **Stage 3: Bargaining** or **Stage 4: Depression**, but not yet at **Stage 5: Acceptance**.

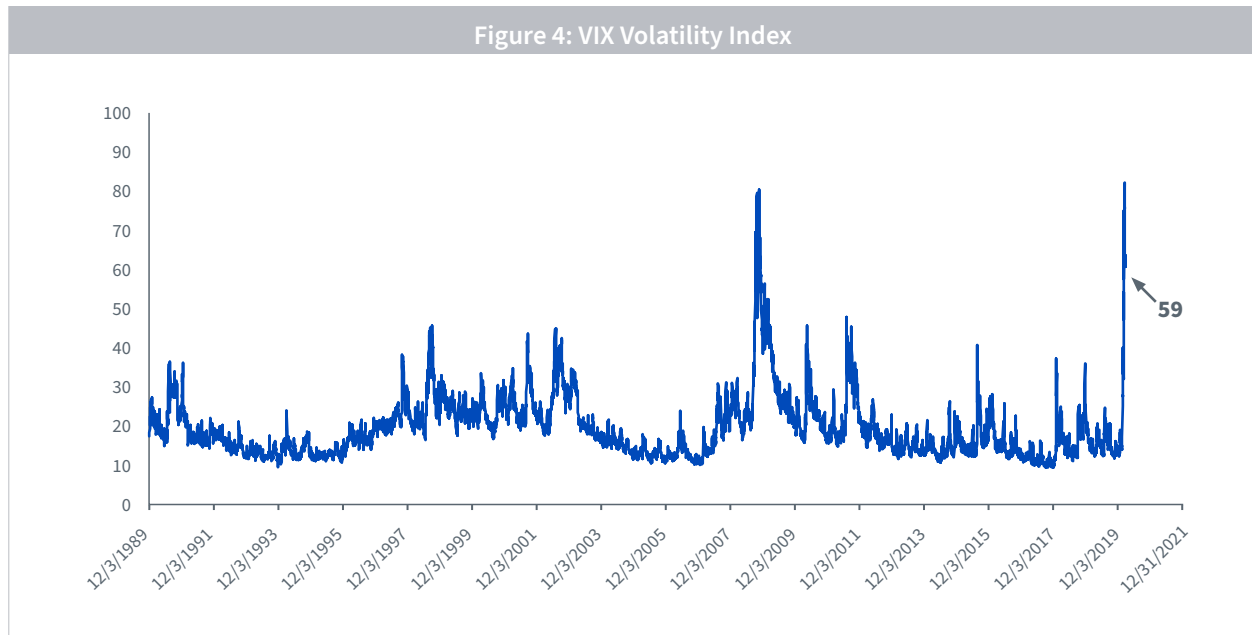


Sources: WisdomTree, Bloomberg, 12/31/1989–3/23/2020.

One way to think about the market not yet being in the final grief stage is to consider volatility, which has yet to come back to Earth.

At 59, the popular VIX index of equity market volatility remains in the stratosphere, having surpassed the Lehman high at the worst of the Covid-19 panic.

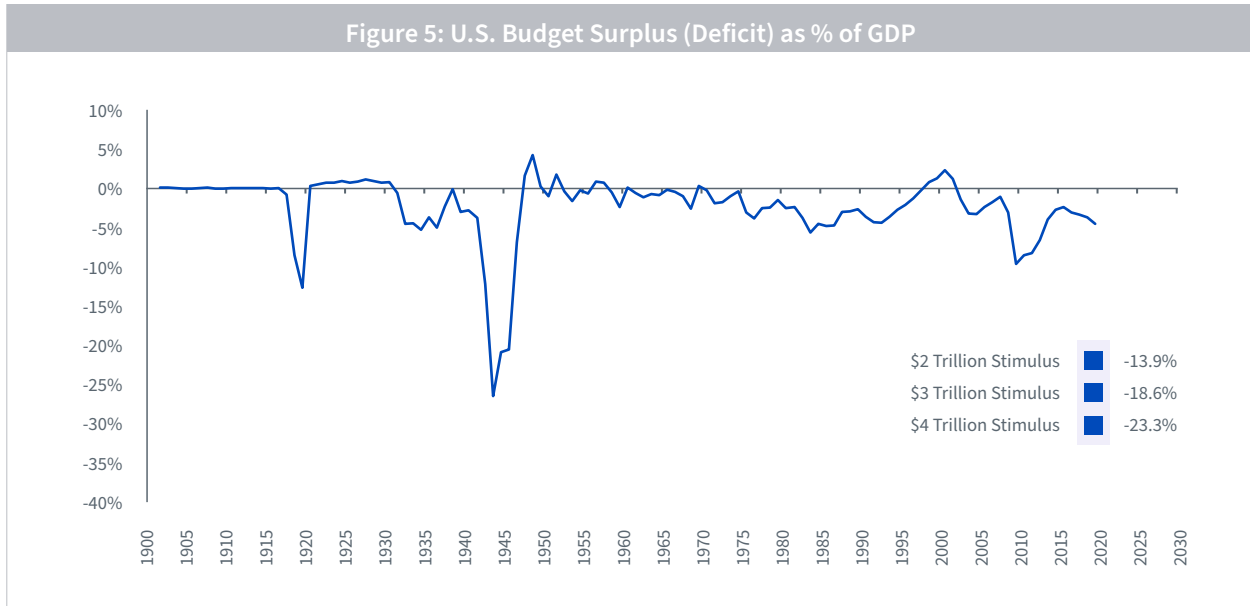
To reach Stage 5, we don't need to see volatility go back to absolute complacency, just to some level that demonstrates fear but not outright panic. That area is perhaps around 20 or 25.



Sources: WisdomTree, Bloomberg, 1/2/1990–3/30/2020.

Past **Stage 1: Denial** and **Stage 2: Anger** but not yet in **Stage 5: Acceptance**, is the market in **Stage 3: Bargaining** or **Stage 4: Depression**? We'll go with the latter for four reasons:

- 1) Stage 3: Bargaining** probably came when society said, “If we just quarantine, it will go away,” and many countries chose that course of action. Whether the problem goes away is another question.
- 2)** Many of the most logical people I know have gotten to Stage 5: Acceptance, but others remain in various other stages. It takes a critical mass to go through all stages for a true recovery to occur. That hasn't happened.
- 3)** In our personal lives and professional interactions at WisdomTree, we haven't come across many who have sold a ton of their equity holdings yet, so the hope that this is a “really bad October 1987” does not seem to be the case. Hardly anyone has truly thrown in the towel.
- 4)** Wall Street is still penciling in relatively benign data. The total size of U.S. fiscal stimulus is—as it stands now—\$2tn. For context, last year's \$1tn budget deficit was equal to 4.6% of GDP (the economy is about \$21tn). We could be looking at a budget deficit-to-GDP ratio in the teens or maybe even north of 20% this year (figure 5).



Sources: Bloomberg, U.S. Treasury, WisdomTree. 2020 figures assume revenue and nominal GDP unchanged from 2019, with outlays equal to 2019 levels plus incremental spending for Covid-19 stimulus.

THE U.S. MAY CEDE MARKET LEADERSHIP TO EMERGING MARKETS

Suppose we are correct, and the market is in **Stage 4 (Depression)**.

That does not preclude considerable further downside: If the S&P 500 were to truly blow down like it did during the 2000-2002 collapse of the tech stock bubble, the top-to-bottom decline would more than halve from its high of 3,386 on February 19.

That would put the S&P 500 in the 1,600 or 1,700 area, considerably below current levels around 2,500.

Importantly, the Covid-19 shock is unlike September 11 in a critical way: The virus hit as the S&P 500 was reaching new highs, whereas the terrorist attack a generation ago came 18 months into a bear market.

Think about what worked in the 1990s: tech stocks, the U.S. dollar, being out of commodities. But from 2000–2007, that was turned on its head. Out were tech stocks; in were gold stocks. Out was the U.S. dollar; in were emerging markets. Out were growth stocks; in were value stocks.

Something like that may emerge from this.

As we go to print, currencies like the Mexican peso and the Russian ruble have fallen off a cliff. Silver, often thought of as both a precious and industrial metal, recently touched 11-year lows. The MSCI China Index is where it stood in 1993. In contrast, the S&P is still more than a cool quadruple from the March 2009 lows, even after this nasty crash.

Vladimir Lenin famously said that “There are decades where nothing happens; and there are weeks where decades happen.”

As the market makes its way into the final stage of grief, **Acceptance**, the world that emerges may look very different from the world of a few weeks ago.

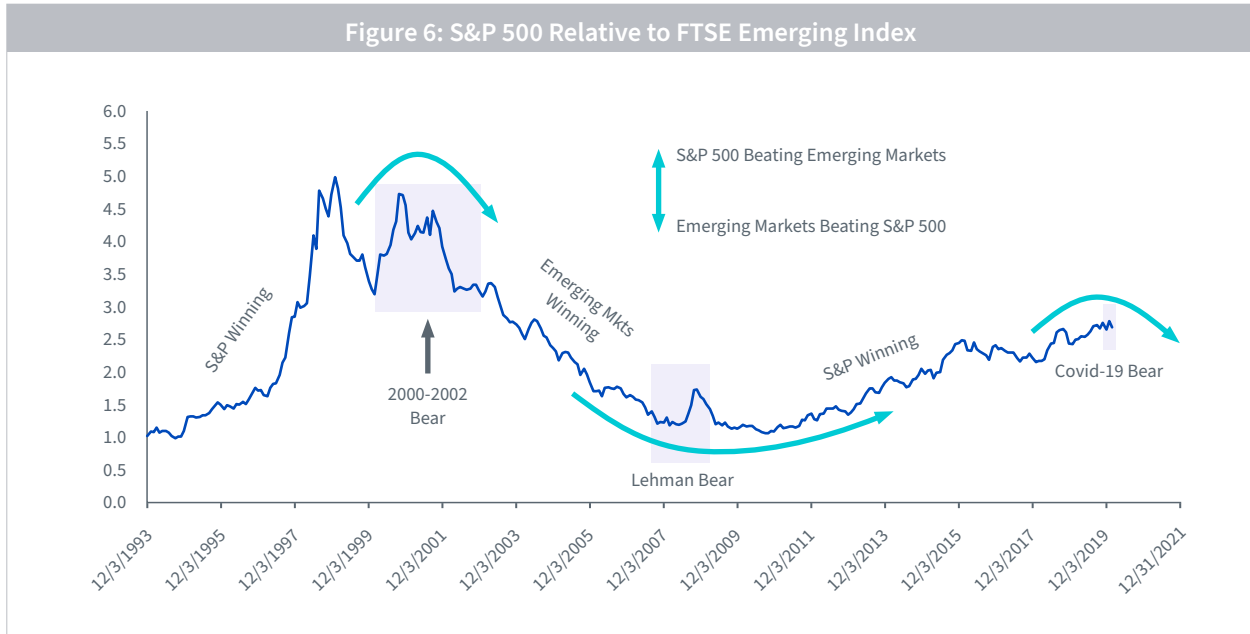
The market's winners of the 2020s may be a different lot compared to the winners of the 2010s. And it probably begins when a critical mass of us reach Stage 5.

Figure 6 shows the performance of U.S. stocks versus emerging markets. The S&P 500 dominated the 1990s, but it took a major comeuppance—the 2000–2002 bear market and September 11—to knock the market’s leadership off its perch. From 2002–2007, emerging markets took over.

The global financial crisis changed that.

Out of the rubble of 2009 came the death of emerging markets, at least relative to U.S. stocks. Ever since, this market has been all about U.S. stocks. Covid-19 has given us a different world. Acceptance of that different world, much like the shock of 9/11, may mean acceptance of different markets.

Maybe this was just the kind of intense shock that changes the stock market’s winners. If so, emerging markets could take the baton from the S&P 500.



Sources: WisdomTree, Bloomberg, 12/31/1993–3/25/2020. Past performance is not indicative of future results. You cannot invest directly in an index.



Investors should carefully consider the investment objectives, risks, charges and expenses of the Funds before investing. To obtain a prospectus containing this and other important information, please call 866.909.9473, or visit WisdomTree.com to view or download a prospectus. Investors should read the prospectus carefully before investing.

There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Funds focusing on a single sector and/or smaller companies generally experience greater price volatility. Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation, intervention and political developments. Due to the investment strategy of this Fund, it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

Neither MSCI nor any other party involved in or related to compiling, computing or creating the MSCI data makes any express or implied warranties or representations with respect to such data (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any such data. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in or related to compiling, computing or creating the data have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits), even if notified of the possibility of such.

The [MSCI Emerging Markets Index](#) is used to measure equity market performance in global emerging markets. The index captures mid- and large caps in 26 countries including China, India, Korea, Mexico, Taiwan and the United Arab Emirates. The [MSCI China Index](#) captures large- and mid-cap representation across China A-shares, H-shares, B-shares, red chips, P chips and foreign listings (e.g., ADRs). With 701 constituents, the index covers about 85% of this China equity universe. The [FTSE Emerging Index](#) is a free float market capitalization-weighted index representing the performance of around 850 large- and mid-cap companies in 22 emerging markets. The [S&P 500 Index](#) is a market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee, designed to represent the performance of the leading industries in the United States economy. The [CBOE Volatility Index® \(VIX®\)](#) is a key measure of market expectations of near-term volatility conveyed by S&P 500 Index stock option prices. It is the premier benchmark for U.S. stock market volatility.