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Chris provides financial planning, investment planning and full implementation services to about 100 families.

We are pleased to welcome new clients. New clients should have $1 million or more of investable assets.

This Time Isn't Different, Version Covid-19

"On the ground, as it were, the advisor must still deal with the unfocussed dread as it serially alights, and momentarily focuses on, the chosen terror of the day, be it the China crisis, the Euro crisis, the Japanese nuclear crisis, the dollar crisis, the inflation crisis, or, when nothing else seems to be going the wrong way on the planet – **a new-strain-of-flu crisis - always ephemeral, but always useful in an apocalypse-starved pinch."**

- Nick Murray, 'Dread Is Not An Investment Policy' April 2011 (emphasis added).

Instructive, and humorous, that a new strain of flu was used as an example of a crisis du jour. Is it different this time? – Ed

This essay is written as the Covid-19 Flu pandemic reaches hysteria proportions in late March 2020. My goal today is to provide some perspective, reinforce your courage, and so to help you stand against the current perception of looming disaster sweeping the globe. It's actually an hysteria I've only seen a few times in my entire career…

Sympathy for the Patients

Please understand dear readers that I am sincerely sympathetic to the people involved and especially the patients at the heart of this year's flu pandemic. These things – wars, pandemics, ethnic cleansings, terrorist attacks, high interest rates (1982) or currency destruction (Venezuela 2017), and so on – are humanitarian disasters most definitely worthy of our sympathies and action. Even influenzas: SARS, Swine Flu, Bird Flu, and the 'normal' seasonal flu that kills 15,000 - 60,000 people annually in the US are tragedy for the loved ones affected, and they deserve our attention.

Different This Time?

A bear market is when people who believe that this time is actually different sell their shares of great companies, urgently and despondently at panic-low prices; these shares are bought, gratefully, by investors who know that this time is most definitely not different. In this regard, all bear markets are the same.

The 2020 bear market set upon us with unusual suddenness and ferocity. The S&P500 dropped from an all-time high just under 3500 on a nicely established uptrend and economic clear blue skies February 19 to below 2400, a decline of over 1100 points or about 32% in just 30 days (at time of writing).

Share prices of great companies have been hammered. Bank of Montreal is down 42%, CIBC 33%, SunLife is down 38%, and Manulife is down a shocking 48% in just 30 days. Thompson Reuters, a data and news company whose business will likely do very well through a work-from-home lockdown, is down more than 26% (data to 3/18 unless noted otherwise).

All asset classes have been hit hard. Even government bonds, the traditional safe asset class, has seen prices fall as people have sold anything they could to get cash. Corporate bonds, as measured by the Vanguard Corporate Long Bond Index ETF dropped more than 25% on speculation that corporate defaults would be as bad as 2008. (Fortunately by comparison, your corporate bond funds are down 7-14% - still a severe drop for the 'safe' part of your portfolio.) Your March statements could be ugly.

These sellers are desperate, on three levels. First, people sell in fear of the future, not realizing the costly futility of trying to time entry and exit from markets. Secondly, funds and ETFs are then forced to sell assets to meet these redemption requests; they will often sell high quality liquid (easy to trade) assets such as government bonds and bank stocks.

Third, margin loans collateral are short term loans whose collateral is the investments themselves - falling directly with markets, so investors facing margin calls often sell stock to raise cash. The result is a self-fulfilling downward cascade of selling…

What makes these price declines even more remarkable is that there is little connection between a worst possible case flu scenario and the financial condition of these companies. These declines are pricing in a scenario like the financial crisis of 2008, which destroyed the financial system in the US and came very close to destroying ours as well. As we will see below, a catastrophic outcome from the Covid-19 flu pandemic requires more extreme assumptions than the data or common sense allow.

In 2008 the financial system machinery, which provides the economic oxygen to the economy, completely seized. It had to be disassembled to understand the problem, the problem had to be fixed, and then the system put back together. All of this was both necessary and involuntary. There was no choice.

Today, a flu virus, which at this point seems more virulent but much less potent than SARS, (although more potent than seasonal flu), is prompting a severe, but temporary, policy response.

The economic data will certainly reflect an economic full stop. But it is a policy-induced stop, and as soon as the flu curve flattens out, public policy will reverse and everybody will be back at work. Airlines, low-income, some self-employed people will warrant some fiscal assistance, but the underlying structure of the economy will be undamaged and we will snap back to full-employment. The economy was running just fine before (except Alberta), and everyone will be eager to get back to their daily activities.

My guess is travel, restaurants, pubs, gyms – everything that's been closed – will be chock full of people desperate to catch up on what they've missed. In the meantime, grocery stores, on-line deliveries, and similar businesses are booming.

It Isn't Different

It is important to recognize that these things occur regularly in the scope of recent history, and experience teaches us that the economic effects are transitory and often localized.

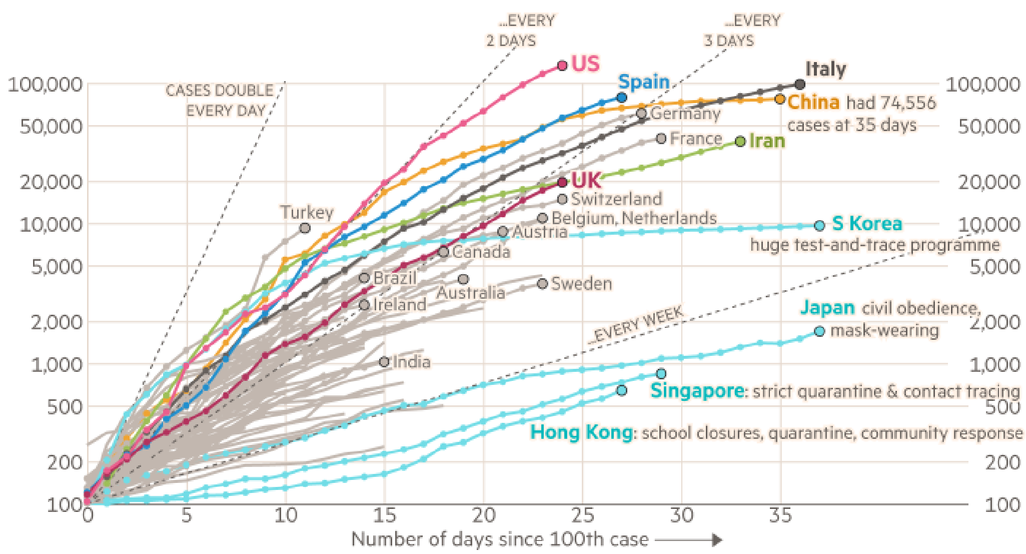
For instance the 1968 flu pandemic, called Hong Kong or H3N2, killed an estimated 1 million people worldwide and 100,000 in the United States, most of whom were over 65 according to the CDC.

Most people have never heard of the 1968 flu. (It originated in Southeast Asia, as many influenzas do, because people and ducks spend a lot of time together in rice paddies, according to Scientific American and my late father, an immunologist and Professor of Medicine). There was a bear market at the time, but it's just a guess that it had more to do with fighting a war in the Viet Nam rice paddies.

The charts below show the case trajectories and fatality count by country, starting from the date of the 100th case and the 10th death. China's case trajectory and fatality rates are now almost flat, meaning that the cumulative total number of cases and fatalities has stopped increasing. In other words, no new cases or fatalities.

Country by country: how coronavirus case trajectories compare

Cumulative number of confirmed cases, by number of days since 100th case

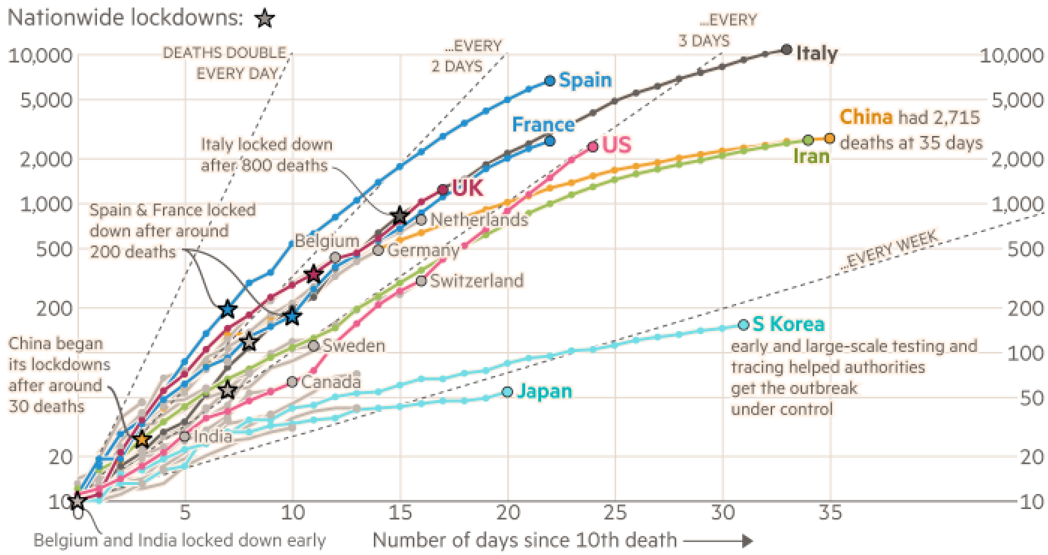


FT graphic: John Burn-Murdoch / @jburnmurdoch

Source: FT analysis of Johns Hopkins University, CSSE; Worldometers; FT research. Data updated March 29, 19:00 GMT

Coronavirus deaths in Italy, Spain, the UK and US are increasing more rapidly than they did in China

Cumulative number of deaths, by number of days since 10th death



FT graphic: John Burn-Murdoch / @jburnmurdoch
Source: FT analysis of Johns Hopkins University, CSSE; Worldometers; FT research. Data updated March 29, 19:00 GMT
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The critical thing here is that China's total caseload has peaked at fewer than 80,000 cases, and only 2,700 deaths, out of 1.4 billion people. Hubei province, where Wuhan is, is lifting the quarantine. The FT reported (March 20) that large-scale manufacturing operations (Volvo, Nike, and others) in China are back to normal.

The US is at Day 17 from their 100th case, while China is at Day 33, only 16 days ahead of us in Covid-19-speak. The US has 160,000 cases and only 3,000 deaths. The US fatality numbers are still rising fast, but the point is that they will flatten out.

Clients know that I do not pretend to see the future, but if China's experience thus far is any guide, today's Covid-19 panic will pale beside even the 1968 flu. Here's why:

If the absolute numbers of infection and fatalities in the US are 3x as bad as China's, which is unlikely given that the US has less than one quarter the population and probably better healthcare, it would still be fewer than 10,000 fatalities, which is a small fraction of even the normal seasonal flu, which kills 15,000-60,000, never mind the 1968 toll.

Maybe we'll get to 100,000 victims in the US, in which case the Covid-19 pandemic will be the equal of a pandemic we've never heard of. But even that looks unlikely, at this point anyway.

To get 100,000 victims, the US fatalities experience would have to be 10 times greater than China's, with ¼ the population. I don't pretend to be an epidemiologist, but I do know a bit about modelling, and to think the US will be 10x as bad as China requires assumptions that aren't on the radar. Ten times the fatalities of China would actually be 40x as bad in per capita terms. It's a stretch of the imagination, from the current picture, to get from 3,000 deaths today, anywhere near 100,000 deaths.

But say it actually was that bad. A US fatality rate of 100,000 it would be only 50% greater than the high end of the range for seasonal flu, which, to repeat, kills between 15,000 and 60,000 annually in the US. **And nobody cares about the seasonal flu.**

It's already abating in China, which is a month or so ahead of us.

Here's the thing: as soon as the markets begin to sense that Covid-19 will be managed successfully and the end of the world avoided, the markets will begin their recovery. And as we saw in 1982, 1987, 2003, and 2009, the markets' recovery can be very sharp. The moment markets begin to sense that Bank of Montreal profits will not be materially damaged, bank share price declines of 40% will evaporate like dew in the Arizona sun.

We could well see a 'buying panic', as my friend Leon Tuey used to say.

And the Covid-19 Flu Bear Market of 2020 will be over, fade into the past, and join its many friends in the pantheon of bear markets past.