Sailing into uncharted waters

by Andy Burish, founder and managing director of The Burish Group

As the US economy gradually awakens and changes course, investors are facing an unprecedented level of uncertainty about the outlook for their portfolios. Stock prices have rallied strongly in anticipation of an economic reopening, reflecting a belief that consumer purchasing power has only been delayed, but not destroyed.

Amid the optimism, however, you may have heard other voices drawing parallels to the difficult times of the 1930s. And, over the near term, many of the statistics will indeed look similar to that lost decade. For example, the nation's unemployment rate rose in April to 14.7%, the highest in the post-World War II period.[1] Viewed through any realistic lens, the hit to the economy from the coronavirus outbreak has been severe. The waters may seem choppy.

But while the immediate consequences for the American economy make for disturbing headlines, there are many reasons for optimism.

Major differences between our 21st century financial system and that of the pre-war decade suggest a different outcome, albeit one that is still economically challenging and far from what we expected only a few short months ago. And these differences are significant.

So what does this mean for you as an investor? In a word: plenty.

Lessons learned

America of the 1930s was ill-prepared and poorly equipped to cushion the powerful economic shock that stemmed, in part, from the stock market crash of 1929. As late as 1933, the US was still on the gold standard, which restricted the government's ability to lubricate the nation's economic engine by rapidly increasing the money supply.

At that time, the Federal Reserve was a relatively young and inexperienced central bank. The Fed possessed neither the expertise nor the monetary firepower required to arrest the downward economic spiral that took hold in the early 1930s, and that reappeared later in the decade.

In contrast, the "modern" Federal Reserve has been both bold and creative in fighting the economic consequences of the coronavirus pandemic, first by using tools dusted off from the Great Recession—including lowering its benchmark lending rate to near zero—and by implementing an array of lending facilities designed to address liquidity shortfalls in various lending markets.

Notably, the Fed recently expanded its bond-buying program beyond US Treasuries to include US corporate debt. For investors, that could mean higher bond prices, and for the economy, lower borrowing costs.

In dollar terms, the size of the Fed's interventions are staggering: Since March, the Fed has pumped over $2 trillion into the economy[1]—about 9% of annual GDP—and has signaled it will do whatever is necessary to minimize the economic damage.

Investors like you have gotten the message: The central bank has your back.

So apparently have fiscal policymakers, whose moves have diverged sharply from the 1930s. The combination of expanded unemployment benefits, small-business loans and approximate $1,200 stimulus checks (sometimes called helicopter money) has injected close to $3 trillion more into the economy. Additional legislation seems likely in coming months.

Taken together, the monetary and fiscal rescue packages could amount to over 20% of US GDP, or roughly double the projections for lost economic output this year.[2] And despite the recent escalation in trade-related disputes, global tariff rates remain far below those in the 1930s.[3]

It is also important to note that there are differences between the current downturn and that of the Great Recession. In September 2008, the financial system had nearly shut down due to nonperforming loans in a high-risk segment of the residential housing market. Investors feared for the safety of their holdings in money market accounts. Neither of those concerns are present today.

Economic lessons learned from the Great Depression led to the creation of a social safety net through such programs as social security, unemployment benefits and bank deposit insurance.

The bottom line:

While the initial economic jolt from the COVID-19 outbreak could approximate that of the 1930s, it is not clear if this will be shorter or longer lived or cause more or less damage to the nation's financial infrastructure. For example, the bank runs that characterized the Great Depression will not be reprised in the current version.

This is not to suggest, however, that economic conditions will quickly revert to pre-pandemic levels, with totally smooth sailing ahead. Even with expanded social programs and aggressive monetary and fiscal policies, the damage to consumer confidence and business and household finances will take time to repair. Shoveling money into the economic hole left by the pandemic may fill it temporarily, but the financial ground underfoot will settle over time, requiring still more government intervention and raising important concerns about how to service all that new debt.

The economy that emerges from the COVID-19 downturn will look different to investors and feel different to consumers. How different remains to be seen.

Will Americans revert to their pre-pandemic spending habits, or will they decide to increase their savings? Could social distancing further damage brick-and-mortar retail, or will shoppers return to physical stores once they feel safe in doing so? Will the trillions of relief and stimulus dollars created out of thin air eventually lead to a resurgence of inflation, and if so, what will that mean for bonds? Could the Federal Reserve actually welcome higher inflation after more than a decade of undershooting its price targets? What effect will more people working remotely have on oil prices and the clean-energy industry? And finally, what will become of travel/leisure businesses, which have borne the brunt of the economic lockdown?

The answers to these and other questions will be key to constructing portfolios that balance the need for return with the need for prudence.

At The Burish Group, we are here to listen to your concerns and help you navigate your investments through these uncharted waters. Call us to begin the conversation.

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[1] https://www.usnews.com/news/economy/articles/2020-04-09/federal-reserve-unveils-additional-2t-stimulus-to-support-states-markets-amid-coronavirus
[2] https://www.aei.org/carpe-diem/putting-americas-huge-21-5t-economy-into-perspective-by-comparing-us-state-gdps-to-entire-countries/ ($5 trillion / $21.5 trillion = 23.25%
[3] https://en.irefeurope.org/Publications/Online-Articles/article/Trade-Liberalisation-The-Challenge-of-Non-Tariff-Barriers