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“By The Way”

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“It’s what you know for sure that just ain’t so”

I believe it’s safe to say that no one predicted the speed and strength of this so-called relief rally. From the low of March 23rd, the S&P 500 has risen 33% in less than two months and this in the face of terrible news about the pandemic and the economy. While it is accurate that the big 5 of Microsoft, Apple, Amazon, Alphabet (parent of Google) and Facebook have played a major role in the strength of the Index, market internals have also been supportive of the rally. None of these measures have been spectacular but all have been very solid; advances versus declines, upside versus downside volume, renewed strength in small cap stocks, and participation by a majority of issues (breadth). Of concern though, NYSE composite volume was not great indicating a lack of commitment to the bullish cause. We are just this week starting to see some signs of weakness as Monday’s breadth turned negative with a ratio of 2 to 1 declining stocks to advancing and 3 to 1 down volume to up. Personally, I would like to see the market check back in the short term and build a more solid base for the future. Given the strength of the rally it is unlikely that we need to go back to the March lows, but a decline of 10 – 15% coupled with divergences that showed internals were stronger than the overall averages would provide more support if we are to challenge the old highs come the fall.

I don’t have to tell you there are numerous and undeniable negatives that would derail that outlook and we must be prepared to react and change our position. It is never possible to fully comprehend what the market is discounting, but in my opinion investors are currently overly optimistic. A decline in the near term would put us on more solid footing to assess the future.

The pandemic and consequent lockdowns have turned global economies into something of a disaster. In the U.S. the unemployment rate has risen to 14.7%, which has wiped out in just a few months the entire growth in employment of the past decade. Unfortunately, the lion’s share of those job losses has come at the expense of low-income workers. However, government support programs are keeping people’s heads above water or even in a better situation than when they were working. Goldman Sachs has gone so far as to suggest personal income statistics may actually improve this year. It is interesting and somewhat disturbing that average hourly income increased significantly last month because there were a lot fewer low wage earners in the formula. If this economic malaise persists and higher paid white-collar workers join the ranks of the unemployed, the amount of federal support required will be staggering. There is not sufficient evidence to panic yet and as we learned post the global financial crisis of 2008-09, many seemingly obvious negatives never came to pass such as a second wave of mortgage defaults and state and municipal bankruptcies. Nonetheless, our economic problems are severe, and this is no time to go whistling by the graveyard. Everything depends on when we see a post pandemic recovery and what it will look like. For me, the recovery need not be spectacular, but it must be broad based and look to be long lasting. It helps to have global central banks preaching the "we will do whatever it takes" sermon and if the two parties in Washington can stop fighting and continue to provide fiscal support, we might just get through this.

As I thrashed around trying to make sense of the world and where we are all headed, I stumbled across a review of a book published just this March titled "Radical Uncertainty". The title definitely resounded with me as an apt description of how I was feeling in my search for answers. While written before the current pandemic broke out, strictly by happenstance the concepts discussed and approaches proposed to deal with such an event, ring very true. The book is an academic exercise of over 550 pages (I've only read reviews) written by two accomplished scholars of economics and finance. Mervyn King has amongst his many credentials a 10-year period as the head of the Bank of England and draws on his experiences in that post. John Kay was the first Dean of the Oxford University Business School and a regular contributor to the Financial Times. The basic theme is how does one gain the confidence to manage uncertainty when outcomes and probabilities are impossible to predict or forecast. The authors allow that risk can be measured but state that uncertainty can't. As this applies to the current pandemic, the fact it is unique does not allow for modeling or learning from past experience. So what are we to do? King and Kay would suggest the answer lies in building a strong narrative based on the best assumptions we can make with the current information at hand. That sounds patently obvious, but the real trick is to develop a strategy that allows for alternate futures and that can very quickly adapt to new and unpredicted events. If we know our assumptions, we can tell when they are wrong and adjust our narrative. There's the rub. It is human nature to search for information that proves our own case and ignore that which suggests our outlook is incorrect and must be changed. Unfortunately, the President of the U.S. is the perfect example. Obviously, there is a lot more depth to a book of 550 pages, but it strikes me as providing a useful approach in dealing with the current environment. Hard and fast forecasts are impossible, useless and probably dangerous whether to our health or finances. As Mark Twain supposedly said, "It's what you know for sure that just ain't so" that gets you into trouble. Have the best outlook you can muster but be prepared to change as circumstances warrant. Here are two of my favourite quotes from the book that I offer without comment; "the pretense of knowledge" and "the audacity of pessimism".

My personal narrative and assumptions continue to reflect a positive bias despite all the ugly headlines, while I try to remain realistic and flexible. King and Kay tell me to prepare for alternate outcomes. Some concerns that would change my narrative include: the virus gets worse or reopening causes a severe spike in cases; trade or currency wars escalate; unemployment insurance and government support are overwhelmed; the Fed can provide liquidity but doesn't have the tools if corporate and personal solvency become a major issue. These are some of the "known unknowns" but as Donald Rumsfeld said it's the "unknown unknowns" that get you.

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