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ASK FORSTRONG:

IS THIS 2008 ALL OVER AGAIN?

CORRECTIONS, CORONAVIRUS AND CRISIS - NO TIME TO PANIC

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Speed Read:

- This is not a repeat of 2008.
- Once more, with feeling: COVID-19, though a deep human tragedy, will be a transitory shock.
- The world is now experiencing the largest stimulus since 2009. Lower interest rates, lower oil prices and loaded fiscal bazookas will lead to a V-shaped recovery.
- Fear is a poor adviser. Selling into a panic is rarely rewarded.

Blood is in the streets. And the biggest fear over the last decade — a repeat of an economic fallout like the global financial crisis — is trending hard right now. For over a decade now, clients and industry colleagues have repeatedly asked our team about another 2008. And we have repeatedly countered that the big surprise is that this will not occur any time soon.

But does recent market action challenge that view? In some ways, this feels just like 2008. US long bonds just delivered their best 2-week performance since the Lehman Brothers meltdown (if you squint hard enough, you can see the current yield of 0.99%). Global stock markets are regularly tripping exchange circuit breakers. A meeting between OPEC and its allies collapsed over the weekend, causing Brent crude prices to plunge more than 30%. And, apparently, families are now fighting over toilet paper supplies (pro tip: don't google the footage).

We are now in the grips of a full-blown financial market panic. The major risk is always the same: people's reactions to panic can amplify the real economic pain, causing a vicious feedback loop into financial markets. Reflexive risks are even higher today with a spreading virus. Event cancellations, reduced travel and tourism, and other economic interruptions will produce ugly numbers in the coming months. Many businesses will remain stuck in the ICU for some time.

Crucially, the US is also set to see a steep rise in coronavirus cases in the coming weeks. The figures should be similar to Italy's — less than 1 in 10,000 will be infected. But statistics are hardly relevant here. Fear is in the driver's seat. And, as we have recently written, the rise of social media has allowed hysteria to be transmitted more effectively. Misinformation has gone viral and digital channels are now clogged with fake news (see "Straight Talk On COVID-19").

Yet, the idea that this is similar to 2008 rests on a few flimsy pillars. In fact, there are crucial differences:

No Major Global Imbalances

To start, there are no major imbalances like the ones we saw in the runup to the global financial crisis. The biggest macro story since 2008 has been the unwinding of massive private sector excesses in the two major growth regions of the world: the US and Eurozone. Deleveraging has now occurred in these regions. The household sector is in much better shape than prior to the crisis. Banks have cleaned up their balance sheets. And globally, aggregate imbalances in these economies have now diminished substantially. No credit unwinding threatens the entire financial system. This also remains true for emerging markets who have built up significant buffers to protect against another 1990s-style balance of payments crisis.

COVID-19 Will Be A Transitory Shock

COVID-19, though scary, will be a temporary phenomenon. As my colleague Wilfred Hahn wrote last week ("The End Of Civilization As We Know It?"), epidemics are transitory shocks. Of the nine major epidemics since 1983, all had stock market recoveries afterwards. The average S&P 500 surge was 16.3% within six months of the nadir of the crisis.

This is very different from credit-driven recessions which can alter the economic and financial landscape for years to come — whether this is in changes to capital spending (like the period after 2001) or changes in investor behavior (like the investor skittishness since 2008).

China is a case in point. The country has become a leading indicator of events that can follow the outbreak if dealt with correctly. What many may not recognize is that China's response has been the most aggressive in the world (even praised by the World Health Organization). The containment strategy is now a success. The number of infected people is now falling sharply.

Of course, this has come at a steep economic cost. A large part of the economy was shut down for more than a month and first quarter GDP will be deep in contraction territory. Yet Chinese policymakers acted swiftly, lowering interest rates and launching the most aggressive fiscal package since 2009. Unsurprisingly, China is now recovering while the rest of the world remains in a downturn. And, quietly, China's stock market is outperforming its developed market counterparts.

Bringing The Sugar Early: Policy Stimulus Has Become Pre-Emptive

Looking ahead, Western governments will now be under pressure for more drastic action. Nothing can be ruled out at this stage. Even the Fed needs to do more (apparently 50 basis points wasn't enough). We would not be surprised to see both the Fed and ECB start to make large scale purchases of equities soon.

Yet the big lesson from China is that fiscal policymakers must take a "shock and awe" approach to stabilize economies and market expectations. This is key to prevent a virus-driven contraction from cascading into a longer lasting recession. And fiscal action is new in the post-crisis period. Central bankers have carried the entire policy burden since 2008. The fiscal bazooka is now being loaded.

Investment Implications

This is now the fourth market decline in the post-crisis period where recession seemed imminent (for those counting: 2011 EU debt crisis, 2015-2016 oil collapse, 2019 trade wars and now coronavirus). Investors should recognize that these near-death episodes — what our investment team has dubbed "born again bull markets" — serve as a kind of system re-boot, providing lower interest rates, better valuations and decreased investor expectations. Ultimately, this reset extends the life of the cycle. The latest episode will be no different.

To be sure, there could be more blood. But more broadly, the aftermath of coronavirus will see a return to healthy economic growth. Interest rates are the lowest ever, oil prices are the lowest in years and, now, we have serious stimulus entering the system. That means the recovery will be of the "V shape" variety. Stocks will rally before this takes place (investors should tattoo this on their foreheads: financial markets are discounting mechanisms, quickly pricing in future probabilities before they occur).

These are not normal times. But, it's hardly 2008. Most definitely, the smart money is not stressing over toilet paper supplies. Rather they are readying to buy deeply discounted financial assets. We are doing the same.