Why every HCM Client has a Risk Profile

I received the following email from a client yesterday:

"What is the HCM plan for surviving this disaster?

U.S. economy deteriorating faster than anticipated as 80 million
Americans are forced to stay at home
Already, it is clear that the initial economic decline will be sharper
and more painful than during the 2008 financial crisis."

It was accompanied by the following article from the Washington Post which I have edited, including highlighting some of the hyperbole:

U.S. economy deteriorating faster than anticipated as 80 million Americans are forced to stay at home

Already, it is clear that the initial economic decline will be sharper and more painful than during the 2008 financial crisis

By **David J. Lynch** and **Heather Long**

March 20, 2020

The U.S. economy is deteriorating more quickly than was expected just days ago as extraordinary measures designed to curb the coronavirus keep 84 million Americans penned in their homes and cause the near-total shutdown of most businesses.

In a single 24-hour period, governors of three of the largest states — California, New York and Illinois — ordered residents to stay home except to buy food and medicine, while the governor of Pennsylvania ordered the closure of nonessential businesses. Across the globe, health officials are struggling to cope with the growing number of patients, with the World Health Organization noting that while it required three months to reach 100,000 cases, it took only 12 days to hit another 100,000.

The resulting economic meltdown, which is sending several million workers streaming into the unemployment line, is outpacing the federal government's efforts to respond. As the Senate on Friday raced to complete work on a financial rescue package, the White House and key lawmakers were dramatically expanding its scope, pushing the legislation far beyond the original $1 trillion price tag.

With each day, an unprecedented stoppage gathers force as restaurants, movie theaters, sports arenas and offices close to shield themselves from the disease. Already, it is clear that the initial economic decline will be sharper and more painful than during the 2008 financial crisis.

Next week, the Labor Department will likely report that roughly 3 million Americans have filed first-time claims for unemployment assistance, more than four times the record high set in the depths of the 1982 recession, according to Bank of America Merrill Lynch. That is just the start of a surge that could send the jobless rate spiking to 20 percent from today's 3.5 percent, a JPMorgan Chase economist told clients on a conference call Friday.

Estimates of the pandemic's overall cost are staggering. Bridgewater Associates, a hedge fund manager, says the economy will shrink over the next three months at an annual rate of 30 percent. Goldman Sachs pegs the drop at 24 percent (as detailed below). JPMorgan Chase says 14 percent.

"We are looking at something quite grave," said economist Janet L. Yellen, the former Federal Reserve chair. "If businesses suffer such serious losses and are forced to fire workers and have their firms go into bankruptcy, it may not be easy to pull out of that."

Little more than seven months before the presidential election, President Trump already is looking past the crisis and promising a swift recovery. "We're going to be a rocket ship as soon as this thing gets solved," he said Thursday. "… We think it's going to come back really fast."

Most economists expect the economy to begin climbing out of its deep hole in the second half of this year. But those forecasts depend upon the pandemic being brought under control and the United States and other governments enacting policies that prevent lasting harm to factories and financial arteries. Even if all that happens, the economy will be smaller at the end of this year than it was at the beginning, according to Bridgewater, Goldman and JPMorgan.

The truth is no one knows what will happen months from now. No one on Wall Street or in Washington has any experience dealing with the kind of complex threat that has suddenly materialized to upend American life — a global health scare that is strangling the economy and disrupting financial markets.

Individual workers and their families — many only recently recovered from the economic cataclysm of 2008 and 2009 — are already feeling the effects. The unexpected economic shock has put millions of Americans living on the precipice of ruin. ...

U.S. officials are deliberately engineering a sharp recession to blunt the spread of a fatal disease for which there is no cure, definitive treatment or vaccine. Governors in Florida, New Jersey and Nevada on Friday all took or indicated they would take significant action to limit activity outside the home.

The only way to interrupt the viral blitzkrieg is to implement social distancing. But keeping friends and co-workers apart is a recipe for crippling the consumer spending that drives 70 percent of the $21 trillion economy. ...

Dean Baker, senior economist at the Center for Economic and Policy Research, said a depression would involve a more protracted period of unusually low activity than what seems likely.

"Everything depends on how long we are effectively locked down," he said. "If it's just two to three weeks, then it need not be this bad. But if we locked down for most of the quarter, then we are looking at a really bad story."

The sudden turnabout in U.S. economic fortunes is without historic parallel. As 2020 began, the U.S. economy had been expanding without interruption since the middle of 2009. The jobless rate was near a half-century low, and the stock market was headed toward a record high.

Now, the economy is screeching to a halt and the stock market is in free fall. On Thursday, the Big Three automakers said they would close their factories through March 30. Real estate agents have canceled open houses. Marriott, the largest hotel company in the world, is closing its hotels and furloughing thousands of workers. ...

On Wall Street, the bloodletting has continued almost without interruption. After a brief respite Thursday, stocks sank again on Friday. The Dow Jones industrial average closed at 19,173.98, down more than 913 points, or 4.6 percent. Since reaching an all-time high on Feb. 12, the Dow has lost 35 percent of its value (slightly above average for bear markets since WWII).

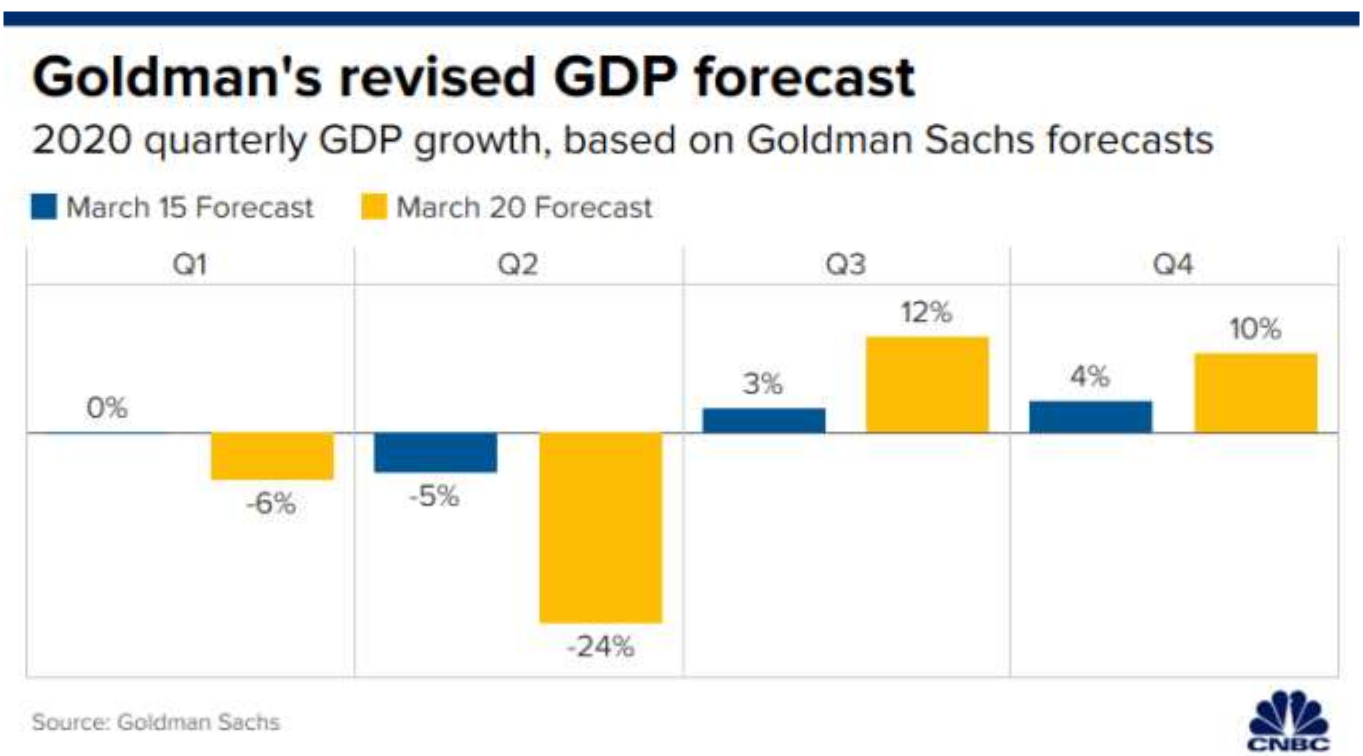
"Get out, get out while you can before they shutter the whole darn United States," Chris Rupkey (Someone we've never heard of), chief financial economist for MUFG (working for a firm we've never heard of), wrote in a note to clients. "A stunning reversal of fortune for the best economy in history to the worst economy in history in not even two months. The fastest recession in history. With no one spending a dime, it will stay that way a long, long time." (is being quoted by what is supposed to be one of our country's three greatest newspapers.) ...

The actual current forecast from Goldman Sachs as reported by CNBC Friday:

Goldman Sachs economists on Friday forecast an unprecedented 24% decline in second quarter gross domestic product, following a 6% decline in the first quarter, based on the economy's sudden and historic shutdown as the country responds to the coronavirus pandemic.

The economists then expect a bounce back of 12% in the third quarter and 10% in the fourth quarter, but unemployment will surge to 9% (not 20%). They also expect GDP to contract by 3.8% for the full year on an annual average basis, and 3.1% on a fourth quarter over fourth quarter basis.

Just five days ago, Goldman economists had expected the economy to trough with a decline of 5% in the second quarter after a flat first quarter. They had expected a resurgence in the second half and full year growth of 0.4%.



While I acknowledge the suffering that many American's are, and will be, experiencing, comparing what is currently being forecasted to the Great Recession is not responsible journalism. My response:

The HCM plan is as follows:

1) Don't panic. Bailing out during an event like this is the best way to guarantee financial losses.

2) Continue following the Investment Policy Statement (IPS) portfolio guidelines we discussed in December .... Your IPS had a maximum drawdown ratio versus the S&P 500 of 0.85. As of Friday, from peak to low the S&P is down 33.47% while your portfolio is down 29.21%, which is a ratio of 0.87. The riskier positions in the portfolio are performing better than expected, and the less risky positions are performing worse. As a whole, your portfolio is in line with what we planned for in the event of a market downturn like this.

3) Remain vigilant for opportunities. While I would not recommend shifting your risk profile in the midst of this bear market, Warren Buffett's advice is especially relevant: "Be fearful when others are greedy and greedy when others are fearful." For HCM Clients focused on Capital Appreciation, we will likely be adding positions this week.

4) Don't try to time the bottom. The stock market could've bottomed last week. The market could bottom 20% lower from now in several weeks. I don't know, and neither does anybody else. This is why it is important to invest for the long-term.

Best,
Devin