



Five Rules for Investing During the Coronavirus Outbreak

Pitfalls to avoid and opportunities to seek.

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KEY INSIGHTS

- Crises are a fact of life in financial markets, and although all crises are different, there are some common threads running through them.
- Lessons to learn from past crises include ensuring that you understand everything you own in your portfolio and avoiding the temptation of trying to call the bottom of the market.
- Other lessons include remaining invested, seeking out high-quality companies (which tend to recover strongly), and being on the lookout for fallen angels.



Justin Thomson
*Chief Investment Officer,
International Equities*

Crises are a fact of life in financial markets. Over the past 30 years alone, we have witnessed the early 1990s recession, the Asian financial crisis in 1997, the collapse of Long-Term Capital Management, the 2008–2009 global financial crisis, and the 2011–2012 European sovereign debt crisis, among others. Each of these crises was different, but there were also common threads running through them. As investors, what can we learn from them to help us navigate the coronavirus pandemic?

The current situation is particularly challenging because it is not just an economic crisis, but also a health and welfare one—governments are treading a fine line between avoiding an economic meltdown and trying to prevent health care systems from being overwhelmed. This crisis is also unusual because it is so acute: The descent from a record

high of the S&P 500 Index to bear market territory has been extraordinarily swift and brutal. Further complicating the situation is the fact that the coronavirus has delivered an enormous, but as yet unquantifiable, dual demand and supply-side shock, with shortages of labor and medical supplies on the one hand and an excess supply of oil on the other. It's clearly a deeply worrying time.


Lessons From the Past


What common threads of previous crises can we see in the present one? Well, the process of de-risking has brought us the familiar pattern of sell-at-any-cost, disorderly markets and a breakdown in typically expected asset prices and correlation (shouldn't gold, for example, be going up at this point?). At the individual stock level, predicted betas have become unpredictable, as they usually do in a crisis (in other words, the mechanism of price discovery simply breaks down). This is both a


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source of frustration to investors (who cannot understand what they got wrong) and an opportunity as genuine mispricings occur. Above all, we are being reminded—as if we needed to be—that bear markets are intellectually and emotionally draining.


With all of this in mind, here are five suggestions to help you survive and ultimately thrive during this very difficult period:

 **Be patient.** Do not try to solve for the whole world at once. In crisis markets like the ones mentioned above, it is natural to look at your entire portfolio or coverage list at once and think that getting market direction right is the only thing that matters—i.e., that fundamental security analysis is pointless. This is incorrect. The better you understand your companies, the more confidence you will have investing into air pockets. These moves should ultimately be rewarded when we get to the other side of this. Stay focused and break your workflow into manageable bites.

 **Avoid predictions.** You cannot pick the bottom, so why beat yourself up about it? It is easy to start the day with optimism and get stuck in the market only to look foolish by midafternoon. Nobody, no matter what they claim, has the power of precognition—so avoid becoming obsessed with it.

 **Stay invested.** Keep embracing risk, and remain allocated. When the reversal comes (and I am not calling the bottom here), we believe it will be powerful, and the majority of the potential upside will come in a limited number of sessions, so you will not be able to get invested in time. In all of the bear market cycles I alluded to previously, the inflection point only became apparent with the passage of time. No bell is ever rung to signify the bottom.

 **Monitor quality.** Do not get anchored to the points that prices have fallen from. In security selection, we are always making a relative bet, but I recall from 2009 that it was “quality” (a subjective term, I know) that bounced hardest. The exercise is now one of selling low to buy low. Quality stocks now offer enough potential upside that you don’t need to take existential risk with leveraged balance sheets. The pattern recognition from 2008–2009 was that stocks could be multi-baggers once they recapitalized, but the dilution to existing shareholders was painful.

 **Be alert for fallen angels.** For those of you who operate in small-cap or high yield, the other pattern I remember from the 2008–2009 crisis is that of companies that were economically quite large and/or highly rated seeing their market caps (or ratings) compressed into small-cap or junk territory. These companies can present both opportunities and sources of index risk as they fall into benchmarks. After the global financial crisis, many of them soon recovered their mid- or even large-cap status.

So far, so tactical. But it is also important to be strategic. A new cycle is being set; there will be new trends and new market leadership. At this point, it is impossible to identify all of those trends, but at the very least, we appear to be in a new era of fiscal expansion. In the U.S., the fiscal stimulus announced so far amounts to around 7% of GDP and rising; in the UK, Robert Chote, the chairman of the UK Office of Budget Responsibility, recently said: “Now is not the time to be squeamish about public sector debt. We ran budget deficits in excess of 20% of GDP for five years during the second World War, and that was the right thing to do.” For these reasons, I am going to hazard a guess that the era of ultralow rates might be coming to an end.

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Finally, I should emphasize that truly great companies are rare. A 2016 study by Hendrik Bessembinder at Arizona State University, for example, found that from 1926 through 2015, just 86 stocks out of 26,000 examined accounted for 50% of the market's return. The top

1,000 companies (less than 4% of the total) accounted for 100% of the wealth creation during that time.

Opportunities to buy great companies at great prices are even rarer. We are currently at one of those moments.

WHAT WE'RE WATCHING NEXT

Like everybody else, we are closely monitoring the virus, the efforts of governments and health authorities to tackle it, and the response of markets to it. As it is impossible to predict when the bottom of the market will be reached, we continue to focus on remaining invested, keeping close tabs on everything we own, and looking for good-quality companies, including fallen angels, that should rebound strongly when markets recover.

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