This Too Shall Pass

Our team has had countless conversations with clients over the last week, helping them navigate through the almost 17% sell-off in the S&P 500. But as many followed our de-risking guidance, most found themselves in a better position than they had feared.

We wrote about this type of exogenous threat associated with COVID-19 at the end of January in "The Punch You Don't See Coming." Therein, we pointed to the notion that the average return for the S&P 500 six-months following the first occurrence of prior outbreaks (MERZ, Swine Flu, Ebola, Avian Flu) was 8.5%, while the average return of the S&P 500 twelve months out was an impressive 14.2%. But we also noted that most other outbreaks occurred during the middle of an economic expansion or closer to a trough, and not at the height of market valuations, as COVID-19 has. As we also point out in our March 2, 2020 note entitled, "Fashionably Late Or Dimwittedly Early?" while markets are selling off, we have yet to witness the type of societal and market panic seen in prior dislocations. For example, post the Lehman melt-down in 2008, money market funds were worth less than $1. And following the 9/11 terrorist attacks, air travel was shut down, and anthrax letters were sent to NBC news anchors. **But we now see similar panic**.

Following a 27% pull-back from its all-time high, and a 23% sell-off YTD, **the S&P 500 currently trades at forward earnings multiple of 14.0x, versus the long-term average of 16.4x dating back to 1997** (dot-com bubble) **and 15.4x back to 2001** (9/11). Still, we would rather be late to a great party then early to a dud, so we anxiously await **"whatever it takes"** policy and stimulus initiatives by the Administration and Congress, as well as economic data that will be printed over the next week.

This Too Sall Pass | S&P Moves Following Prior Dislocation Events

			Percentage Change in S&P 500				
Dislocation Event	**Start**	**End**	**During**	**+1M**	**+1Y**	**+5Y**	**+10Y**
Fall of France	5/9/40	6/22/40	-18.2%	3.1%	5.2%	15.9%	13.2%
Attack on Pearl Harbor	12/6/41	12/10/41	-6.9%	4.5%	16.0%	18.1%	17.1%
Outbreak of Korean War	6/26/50	7/13/50	-11.1%	9.5%	42.0%	27.6%	11.6%
Eisenhower heart attack	9/23/55	9/26/55	-6.6%	1.0%	11.8%	8.5%	11.0%
Cuban Missile Crisis	8/23/62	10/23/62	-9.9%	15.5%	41.1%	15.8%	7.0%
Kennedy Assassination	11/21/63	11/22/63	-2.8%	7.0%	27.8%	12.4%	9.3%
US attacks Cambodia	4/29/70	5/26/70	-15.0%	6.4%	49.0%	9.3%	14.6%
Nixon resigns	8/9/74	8/29/74	-13.4%	-6.8%	30.6%	14.6%	18.9%
1987 market crash	10/2/87	10/19/87	-31.5%	7.1%	27.9%	17.0%	18.0%
Gulf War	12/17/90	1/16/91	-2.8%	17.2%	36.6%	17.3%	14.3%
Gorbachev coup	8/16/91	8/19/91	-2.3%	3.2%	14.5%	15.2%	3.7%
Collapse of LTCM	8/28/98	9/9/98	-2.0%	-2.0%	35.8%	1.8%	3.9%
September 11 terrorist attacks	9/10/01	9/21/01	-11.6%	11.3%	-11.1%	8.3%	8.5%
US invades Iraq	3/1/03	3/31/03	-2.1%	8.2%	35.1%	11.3%	15.8%
Collapse of Lehman Brothers	9/5/08	11/20/08	-39.1%	18.3%	48.8%	21.5%	NA
US debt downgraded by S&P	8/5/11	10/3/11	-8.0%	14.9%	35.0%	17.0%	NA
2016 BREXIT	6/23/16	6/27/16	-5.3%	8.5%	23.5%	NA	NA
Average			**-11.1%**	**7.5%**	**27.6%**	**14.5%**	**11.9%**

Source: FactSet, Putnam and NEPCG

But to put the recent sell-off in context, we have presented the corresponding move in the S&P 500 over one-month, one-year, five-year and ten-year periods, following previous dislocation events. While we expect a significant amount of volatility over the next 12-18 months, we are starting to feel that most of COVID-19 risk is priced into the market. The rub, however in our view, is the potential knock-on impact on the economy leading into the belly of the election cycle? News and media reports suggest we could be four weeks behind Europe in terms of COVID-19 transmission, and Europe could be about four weeks behind China. While we believe there is a light at the end of the tunnel, at this point, the causes of the current market dislocation has not been fully brought to bear. While we think we are close, we need some more time before we can sound an all-clear whistle. **We'd love to hear your thoughts!**