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This Too, Shall Pass

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Seeking Inspiration:

Quite a while ago, we shared with you what is considered to be the actual history of the phrase "May you live in interesting times." As a reminder, it likely did not originate in China, and it was not an expression of well-wishes. Another such missive seems apropos for the times.

Very likely you've heard the phrase, "This too, shall pass." Indeed, this is on the tongues of investment professionals and public policy makers of all stripes. But you have perhaps never seen the full quote, and you may not be aware of who is credited with having introduced the phrase into the public lexicon. So here it is:

"It is said an Eastern monarch once charged his wise men to invent him a sentence to be ever in view, and which should be true and appropriate in all times and situations. They presented him the words, "And this too, shall pass away." How much it expresses! How chastening in the hour of pride! How consoling in the depths of affliction!"

Abraham Lincoln

While it would be typical of PIM to end a communication such as this with something inspirational, we wanted to begin today's letter by reminding everyone that no matter how grave this situation appears to be, it won't last. Businesses and communities will reopen, capital markets will return to former highs and beyond, and hopefully the social fabric will be stronger as a result.

PIM Staff Logistics:

Effective Monday, March 23rd, most PIM staff will begin working remotely. We have taken this step to support the overall social distancing strategy being asked of us all. Certain PIM leadership plan to work from our offices until further notice. We fully expect to maintain the high level of responsiveness and service to which you are accustomed.

Markets & Economics:

A week ago, when the S&P 500 was trading near 2,400, we suggested that the market had begun the process of finding a bottom. That support level has been breached a couple of times this week, among much sound and fury, including during the very end of trading today. Irrespective of continued volatility, we maintain our view that the market is nearing a lower bound at approximately current levels. We also suggested that the next step for the Federal Reserve would be to bring the overnight rate to zero and begin quantitative easing. Both policies were enacted last Sunday. We're not clairvoyant. There is an established, proven playbook for how policy makers need to respond to a crisis.

It may come as no surprise to learn that we are in a global recession. In our unofficial view there are three characteristics of a recession, two of which are unavoidable and one that deserves special attention due to the nature of the crisis. A typical recession is: 1) a deep downturn in economic activity, 2) that spreads into a majority of the economy, and 3) lasts for at least 3-4 quarters. The public health policies required to fight the

virus have created conditions that meet the first two requirements. However, if China's experience thus far is any guide, the duration of the crisis will be less than 3-4 quarters.

Many in the US population have been under a soft version of house arrest for a few weeks, so the idea that the economic impact of the virus will be limited to six months appears to be lunacy. However, policy makers globally are moving faster than ever before to provide support to the private sector; the response thus far is larger than it was during the financial crisis. Unlike that period, during which bad actors were the targets of financial bailouts, it is far easier today for the public to accept economic policy interventions that support people and firms that are not at fault for their current circumstances.

China's experience with the virus may provide a view into the likely path of our own economy. This week China released official economic data for the month of February, during which its economy was largely closed in order to control the spread of the virus. GDP fell for the period by the largest rate on record. Now that the virus is under control, overall output appears to be back to 90% of normal. This is a rough guess, as the most current data is based on cell-phone tracking and carbon emissions. Both the work stoppage and restart were as volatile as we've ever seen outside of war-time periods.

This past week was notable for the extreme swing in the US Treasury market. The ten-year Treasury has traded with yields as low as 0.70% and as high as 1.25% over the past five trading days. This level of volatility for the most liquid security on the planet is historic. Investors sold US Treasuries, long considered a safe haven, for even safer US dollars in order to pay bills, generate needed cash, or in some cases to meet margin calls. Even high-quality municipal bonds experienced price swings not seen since the financial crisis.

It is vitally important to realize that every investor, from your neighbor to the largest institutional investor, is working under different considerations and timeframes. If the Saudi sovereign wealth fund (the Public Investment Fund of Saudi Arabia) is selling US Treasuries because they need the cash to cover the short-fall in oil sales, it doesn't mean that Treasuries are suddenly risky. It means there is someone who needs cash today at almost any price, and Treasuries are the world's piggy bank.

Upcoming:

We have conviction that we will survive this market storm and return to normal. The Fed's firehose of liquidity is starting to have its intended effect, the forced selling of safe assets has begun to ease, and equity market volatility has dropped significantly over the past two days. The large discretionary investors we have mentioned before, such as pension funds, endowments, balanced mutual funds and wealth funds, are underweight equities by approximately 800 billion dollars globally. These investors will help support equity markets over the coming weeks and months.

There will likely be a peak in COVID-19 cases in the next two weeks as the quarantine restrictions show results. We believe this is a precondition to recovery. The Federal government is currently debating a massive stimulus plan at levels we've never seen before. This plan will help provide the bridge needed to get our economy through the worst, but don't be surprised if another smaller version is needed in May. The pieces of recovery are beginning to coalesce. March came in like a lion, let's hope it goes out like a lamb.

Our best wishes for a happy and relaxing weekend.

Personal Investment Management, Inc.