Evolution of Angeles' Economic and Market Assessment

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Two weeks ago, I wrote that the pandemic would likely follow similar paths as previous pathogens, causing a marked drop in economic output followed by a swift rebound. Declines of 10-15% in equities could be expected, without any material impact on long-term trends.

It may be apocryphal, but there is the story of a government official interrogating the famed economist John Maynard Keynes. The official became exasperated that Keynes had changed his position on a topic. Keynes reportedly replied, "When the facts change, I change my mind. What do you do, sir?"

More than the facts changing, shortly after writing *Put Down the Gun*, deeper concerns began to emerge; concerns related less to the immediate effects of the pandemic itself, which are still mostly unknown, than to its longer-term implications. To be clear, no one knows the extent this pandemic will spread. The first-order effects are already material to the global economy, and its impact could be orders of magnitude greater, or not.

The obvious initial impact is seen in travel and tourism, which represent about 5% of US GDP, four-fifths of which is domestic. There is another 2% or so of GDP in group entertainment (casinos, concerts, movies), and these areas are bearing the immediate hit to revenues. We have yet to see the full impact of the disruption, as inventories of manufactured goods and consumer products are worked down and will not be replaced with new supplies.

At this point, most economists are estimating economic growth in the US will move toward zero in the coming months, but short of a prolonged contraction that would mark a recession. That may or may not be right, but misses the central fact that the economy is going to weaken considerably in the coming months.

The degree of slowdown is important for investors. Historically, equity markets decline around 20% over a few months, and then fully recover a few months later, when the economy slows but maintains positive growth. A full-blown economic contraction leads to a more considerable (30%) decline, with recovery taking more than a year.

Neither scenario warrants a permanent shift in strategy for long-term investors. But this does not mean there are no concerns. Immediately, there are many unknowns about the path of the pandemic and its impact on lives and economic activity. Beyond the first-order economic effects—reduced travel, supply dislocations, etc.—are the second- and third-order effects that could alter our economies and societies in myriad ways, positively and negatively. For example, enhanced technological adoption may accelerate, thus boosting productivity. But perhaps consumers will, at the margin, be more reluctant to spend, and economic growth may trend lower.

We have encountered global pandemics in the past. SARS (2003) took 774 lives in two dozen countries. In the winter of 1968-69, a "Hong Kong flu" killed 34,000 people in the US, and in the winter of 1957-58, nearly 70,000 Americans were felled by an "Asian flu." This coronavirus seems unlikely to take as many lives, but no one knows. Its path will determine the magnitude of economic disruption, and we will act appropriately as the facts change.

We are not maximum bearish, as we don't see the prevalence of structural problems we saw in previous major bear markets, such as extreme valuations or levels of financial leverage. We expect to see a period of higher volatility and will watch developments closely. We are not inclined to "buy this dip," but neither to abandon our strategic approach.

We will respond to near-term data, but we are planning for the world after the pandemic. We may return to *status quo ante*, that is, back to normal-trend growth. But we see a higher likelihood that this pandemic has altered our behavior, and economic activity, well beyond its eventual containment, with far-reaching implications and consequences. More on these thoughts in future letters.

Please let us know if you have any questions or concerns, or if we may be of help to you in any way. Please take appropriate precautions for yourselves and your family. We are ever grateful for your trust in Angeles.

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