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As of this writing, global economic activity has come to a halt and governments across the developed world have responded by utilizing the 2008-2009 Great Financial Crisis playbook more dramatically than anyone could've anticipated. Both in the US and abroad, the scale of market intervention, and in some areas outright nationalization, is unprecedented in peacetime history. Under such circumstances, we think it's fitting to quote Lenin, of all people, to describe our current moment in time. "There are decades where nothing happens, and there are weeks where decades happen."

In the end we believe these early rounds of stimulus programs will not be enough to avoid a protracted and severe recession. Ultimately, the fiscal programs announced in the last few weeks, as enormous as they are, will not be considered stimulus at all, but rather the life support needed to fight off a disastrous deflationary spiral of bankruptcy and default in every corner of the economy. While the media reinforces that we are, thankfully, nearing the end of the acute period of pain and suffering related directly to the virus, the struggle to reopen and reinvigorate the economy will be a different battle with unforeseen challenges.

Since the S&P 500 bottomed on March 23, a mere five weeks after reaching an all-time high, revised earnings and economic estimates from the large brokerage firms have reflected a return to normalcy with respect to consumption and investment within a few quarters, under the assumption that the Treasury and Federal Reserve will run the printing press to no end. Although it's now clear that financial markets will be given as much

central bank support as they need, the recovery from 2008 has shown that financial market support does not necessarily translate to stimulus in the real economy, particularly when optimism is in short supply. The widespread use of just-in-time global manufacturing will be put into question and supply chains will be reconfigured entirely against a backdrop of uncertain trade policies; millions of service sector jobs will be lost and never return; individual states, which cannot finance liabilities with deficits like the federal government can, will need to figure out how to pay surging unemployment claims, and banks will need to work through the ambiguities of how they'll actually recover inevitable losses from new government-backed loans. Bureaucracy and patchwork policy will surely hinder the recovery process.

We like to think about bear markets occurring in three stages: 1) "this is all temporary!" 2) "this is worse than anyone could've expected!" and 3) "this is never going to end!" The time to add risk to investment portfolios lies somewhere between 2) and 3). A surprisingly high percentage of the largest daily gains in the S&P 500's history, some of which we've seen in recent weeks, have happened early on in bear markets, well before the realizations of economic gravity and debt cycles kick in. In the coming months and quarters we expect to see growing evidence of disorderly deleveraging in the global non-financial private sector, which in turn will weigh on risk assets and, in time, should present more attractive opportunities to add new equity positions in our portfolios. We have no doubt that our country will, in time, bootstrap its way out of stagnation.

Before we dive further into our outlook, let's take a moment to review the prevailing conditions of the global economy and financial markets in the weeks leading up to the February 18 stock market peak, before the market was blindsided by the Coronavirus and the Russia/Saudi Arabia-led oil supply shock.

In what had been the longest bull market in history, the S&P 500 had a total return of ~400% between March 2009 and February 2020; inflation data was weakening (after peaking at a mere 2.4% this cycle); corporate debt levels were the highest in history; over 50% of the investment grade bond market was rated BBB (only one notch above junk); the Russell 3000's EPS growth at the end of 2019 was negative and the lowest it had been since the 2008 recession; protectionist trade policies and geopolitical uncertainty were deterring new capital spending; and a tight and frustrated labor market were increasingly pressuring corporate profitability. If not for the Fed's early 2019 pivot back to accommodative monetary policy and corporate stock buybacks, which totaled

$5.4 trillion since 2009, the market would likely have already been in decline before the arrival of the virus.

Fast forward to today, the collapse in aggregate demand due to the virus has most economists forecasting US GDP declines in the region of 25-40% for the second quarter. For comparison, it took the US economy four years following the crash of 1929 to see a 25% GDP decline. The unemployment numbers are equally staggering: over the last four weeks, 22 million Americans filed for unemployment insurance. James Bullard, President of the St. Louis Fed, recently remarked that it's now conceivable that the unemployment rate could reach 30% by the summer.

Let's not forget the US consumer is the single largest source of demand in the world economy, and the trajectory of this recovery will depend on the health, habits and optimism of American households over the coming quarters. The initial data is sobering: on April 9, the University of Michigan's consumer sentiment survey revealed a collapse in confidence 50% greater than the next largest decline (2008) in the survey's history. If households respond to today's uncertainty like they did in the aftermath of the 2008 crisis, by reducing debts and saving, what had been a stagnant economy prior to the virus could turn out to be worse.

Roughly 80% of Americans work in the service sector (retail, restaurants, real estate, education, and entertainment) which has been hit the hardest by the lockdown and will also experience the slowest recovery. Brick and mortar retail had already been under intense pressure from online competitors, and this lockdown will push many businesses to extinction and permanently change the landscape.The $1,200 stimulus check on its way to 80 million Americans is equivalent to the median monthly mortgage payment and will not last long for those who have little to no savings and an abundance of auto, credit card, and student debt. Sadly, this describes nearly half of American households.

Our emphasis on defensive large cap equities (utilities, telecom, consumer staples, and pharmaceuticals), Treasuries all across the curve, and sizable cash reserves have fared us well since the stock market peaked in February. By comparison, cyclical/economically-sensitive large cap stocks, small-to-mid caps, international developed, emerging markets, and commodities have been hit the hardest. We expect quality and safety will continue to outperform while expectations "catch-down" to reality.

We have written many times about the implications of the global dominance of the US dollar. This dominance has never been as apparent as it is today: there is a massive shortage of US dollars on balance sheets of international banks, which made loans to US subprime borrowers in dollars without having a US depositor-base to match. In response, the Federal Reserve has re-opened the swap lines that were created in the 1960's, and used several times since, to pipe dollars to central banks of ally nations in times of distress. Adding to the demand for dollars are emerging market borrowers who have issued trillions in US dollar-denominated debt in order to make their

loans more marketable on the international stage. They too are reaching for dollars and facing devastatingly higher borrowing costs as the dollar appreciates against their local currencies. The phrase "cash is king" has never been as true as it is today.

Emerging market countries play a vital role in today's global economy, but unlike much of the developed world they do not have a central bank to fall back on. Nearly half of the countries in the world (90) have applied for IMF assistance since the outbreak began, and the World Bank is warning of catastrophic setbacks in commodity exporting countries throughout Africa and Latin America. Whether these countries will receive the support they need to avoid outright depressions is yet to be known.

Looking further ahead, we expect the 40-year disinflationary cycle that began with the Reagan administration will eventually come to an end, and inflation will once again emerge as a global phenomenon. Our country is arguably as politically divided as it's been in any of our lifetimes, but the one thing leaders on both sides of the aisle agree on is that more spending is needed, irrespective of deficits. In our next video, we'll explore what this new post-virus paradigm might look like, and ways in which we'll look to capitalize on the next wave of American growth when it inevitably arrives.

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