LEWIS WEALTH MANAGEMENT

Newsletter

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Executive Summary

It’s been a wild week on Wall Street. Stocks are well into correction territory on concerns related to the coronavirus.

The coronavirus is similar to the influenza virus. It originated in China and has spread to 56 countries as I write. It looks like a global pandemic and we should prepare accordingly.

Stock market corrections occur about once every 12 months. Markets are resilient and they do recover.

Panic is not an investment strategy. Successful long-term investors rebalance, they don’t go to cash. That is why they outperform investors who lose their cool under market stress.

Your investment horizon is likely much longer than the duration of this event. Stay the course.

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It’s been a wild week on Wall Street. Many investors are wondering what to do. Let’s take a look at what we know (a little) and what we don’t (a lot).

The Coronavirus

The coronavirus is similar to the influenza virus and is a close relative to SARS (Severe Acute Respiratory Syndrome) and MERS (Middle Eastern Respiratory Syndrome). The coronavirus originated in China and has now spread to at least 56 countries as I write. According to the Chinese, this virus is very contagious, but significantly less deadly than other global pandemics (for this we should be thankful). Symptoms may not show for up to 14 days, which makes spreading the virus more likely.

The Chinese say that 80% of people who contract the virus experience relatively mild symptoms, like the common cold. Some cases, however, are more serious. They also say the number of cases in China is peaking. That is a good sign. Frankly, there are more questions than answers, but those answers will come over time.

This is scary, but it’s not our first rodeo. We have dealt with other global pandemics: SARS, MERS, H1N1, Ebola, Swine flu, etc. Capital markets absorbed each and every one of these pandemics and then moved to higher levels. There is no reason to believe that the coronavirus is any different.

I’m not a medical professional (not even close), but I think we have to assume that the coronavirus will spread in the U.S. I think there will be more quarantines. We need to prepare our homes, schools and workplaces. We should stock up on necessities. We should be prepared to work from home if we can. Schools may shut for a time and our kids may be completing lesson plans at home. People will have to change vacation and travel plans. ***Whatever happens, we will adapt and adjust.*** And there is always a chance we may avoid major disruptions here in the U.S. We just don’t know at this time.

We will also find out how well our country is prepared for a pandemic. I suspect there will be issues, problems, and shortages, but we do have a robust healthcare system. It's not going to be perfect, that's for sure. Eventually, a vaccine will be developed (they are saying 12-18 months). If the virus is stable, it will be effective. It looks like we will be dealing with this for a while.

What we should not do is panic. Please, get your news and information from reliable sources, not your social media feed. Avoid conspiracy theories. Check the CDC website for information about the pandemic and be prepared. www.cdc.gov. ***I believe that the better you are informed, the more likely you will be prepared, and the less likely you will panic.***

The Stock Market is in Correction Territory

In the last week, the stock market dropped by more than 12%, which makes this an official correction. This pandemic will, by definition, reduce economic activity, and this is what is sending stocks lower. Analysts are trying to estimate the economic impact of this event. Data will start to come in and these estimates will become more and more accurate. This will help establish and stabilize asset prices. There will be supply chain disruptions and product shortages as factories are shut down, especially in China (although factories apparently are starting to reopen there again).

While it is impossible to predict when corrections will occur and what starts them, ***market behavior is somewhat predictable.*** Here is what I have noticed in the past.[1]

Every correction or bear market has a catalyst. The catalyst usually arrives when the market is at a peak (we were at record highs only a few days ago). Obviously, the coronavirus was the catalyst this time around.

After the catalyst reveals itself, the market moves sharply downward. The first sellers are sometimes hedge funds trying to avoid having a negative year. Then, a herd of panicked investors starts indiscriminately selling. This accelerates losses. If the market goes down enough, margin calls, program trades, and options trigger further waves of selling. Look for collapses in the market in the last hour of trading. It is a sign of weakness.

Then, a few brave buyers start to come into the market, enticed by bargain prices. The market may open up, or there are mid-day rallies, but more panic sellers come in and send the markets even lower. Small recoveries are staged, but often fail. Cycles come in waves.

Eventually the panic sellers are all gone. Margin calls and program and option activity are done. This is capitulation. All that are left are the long-term investors. The market finds its bottom. Buyers start to arrive in full force to take advantage of bargain prices. Strategic investors rebalance. The market quietly recovers, and it usually does so quickly.

Once the market fully recovers, the investors who previously panicked show up to buy stocks again and send prices higher – just in time for the next catalyst. Lather, rinse and repeat.

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[1] I should note here that past performance is not indicative of future results.

Perspective

Yesterday was the largest point drop in Dow history – 1190 points. But this splashy headline needs some perspective. Yesterday's 1190 drop was about a 4% decline – and this is serious. But the worst day in market history was Black Monday, October 19, 1987. On that fateful day, the Dow dropped 508 points, a 22.6% decline in the index. We need to remember that the Dow index is so much higher today (it reached over 29,000 a few days ago) than it was on Black Monday in 1987 when it closed at about 1,800. Let's keep our heads. ***In today's market, a thousand point drop is serious, but not catastrophic.***

How Corrections Work

We have been due for a correction for some time, and corrections occur more frequently than many investors realize.

Type of Decline	Average Frequency	Average Length
-5% or more	About 3 times a year	47 days
-10% or more	About once a year	115 days
-15% or more	About once every 2 years	216 days
-20% or more	About once every 3 years	338 days

Source: Capital Research and Management Company

Choices and Recommendations

As an investor, you basically have two choices: 1) you can attempt to time the market, or 2) you can stick to a long-term plan. I have written on this topic many times. ***The research is clear. Market timers underperform disciplined, long-term investors.*** A while back, Morningstar did a study that showed the 20 year performance of the average stock mutual fund was 12% per year. The average investor in stock mutual funds earned only 2%. Why? Because they were trying to time the market. They sold when markets were down and bought as they approached a peak.

A disciplined long-term investor addresses a market downturn by being prepared in advance. They are always holding asset classes that help significantly lessen the blow of stock market corrections. Bonds are often the strongest asset class when the stock market declines.

In my opinion, the correct way to take advantage of market corrections is to rebalance back to your target allocation. If you have a simple stock and bond allocation, you are selling bonds to buy stocks. You are buying low and selling high – not the other way around. Look for the best market bottom you can find and rebalance. If you are early, rebalance a second time. You do not have to get the timing exactly right.

Panic is not an investment strategy, but I am always surprised how many people implement this strategy when they are under stress. Panicked investors are initially relieved when they sell into a market correction. But this relief is quickly replaced by the anxiety of trying to figure out when to get back in. That anxiety eventually turns to disappointment and regret when they miss the recovery. I am not a fan of this strategy.

True investment discipline is measured by what we do during a crisis. For my clients, their investment horizons and goals are much, much longer than the likely duration of this crisis. The real financial risk here is not the coronavirus, but making a snap decision that will endanger the health of your long-term goals.

If you have questions or concerns about your situation, please give us a call at (855) 353-3800.

Thank you,
Austin Lewis

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