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Doom and Bloom....
Looking beyond 2020 – Part 2

Alvia Asset Partners Investment Team Insights

April 2020

Hi All,

For those that haven't had the pleasure of reading Part 1 of Doom and Bloom.... looking beyond 2020, we suggest you look back at what we had to say. Of course, if some of you have made the unfortunate mistake (deliberate action) of deleting it, just reach out as we are happy to provide it to you again.

Since writing Part 1 of Doom and Bloom .... looking beyond 2020, we felt it was timely to share our answers to the numerous questions we've receive in increased regularity. At times like this it's very difficult to get a sense of which way is up or down and it's very easy to freeze or worse, act in a panicked frenzy. So, given the underlying prevalence of which we received the below we thought it would be wise to journal and circulate our responses to these FAQs.

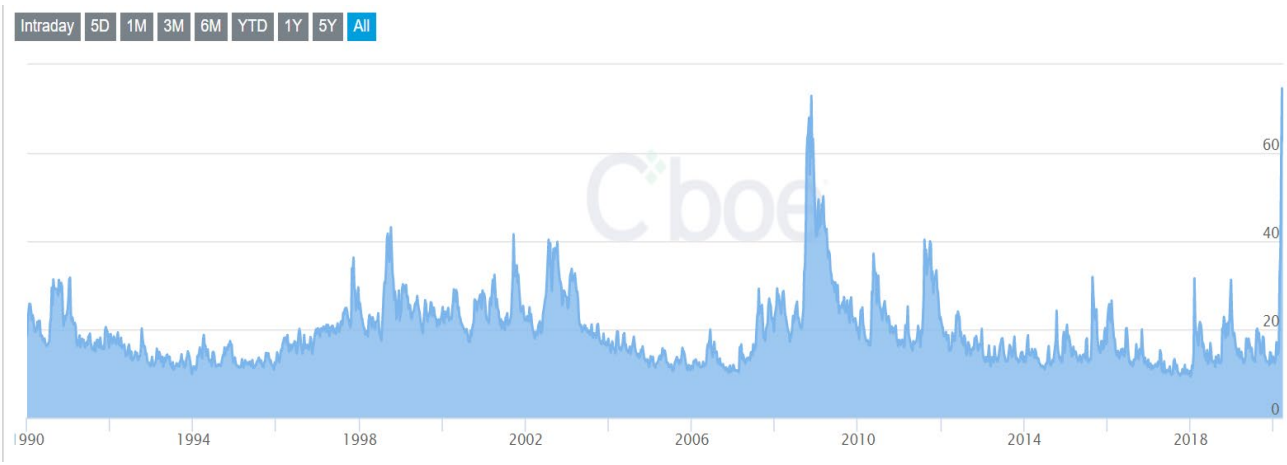
QUESTION: When will you know we have hit the bottom?

This is clearly the one question we've received on numerous occasions over the past few weeks. It's also an impossible question to answer as nobody knows for sure. However, what I do know is that during bear markets its always been worse in the teeth of it than it actually is in reality. I also know that humans and markets are incredibly resilient and always recover.

Without appearing to have an answer, we do believe that the broader market (ex- China) will take the lead from the US and it is likely looking for a sign of a peak in new daily virus cases. This is what appears to have occurred in China with the Shanghai Composite index rebounding in unison with the slowing of the new daily case rate.

Again, without appearing to have the answer, historically markets tend to recover post a peak in volatility. See below a graph with volatility represented by the VIX index dating back to 1990. From the graph, its apparent that two clear dislocations in volatility occurred during this period, the Global Financial Crisis of 2007 to 2009 and the COVID-19 crash we experienced from late February, well into March 2020.

Volatility (VIX index) back to 1990



Source: CBOE

My common response to 'bottom' pickers is that it's an impossible quest so best to set or stick to a simple plan that holds you accountable and reduces the likelihood of rash decisions. Know your budget and your timeframe and average in – there is no other way.

Allocate over time and dribble it in or stick to rebalancing programs (sell your now overweight fixed income/gold/USD and buy the equities that make you nauseous). Do not hold off – you have time on your side.

Just remember your best investment decisions tend to be the most courageous ones – not ones that you feel really comfortable with in the moment. Only spend money you don't need for at least 24 months – beyond this in the context of a portfolio you should be fine – history suggests markets will have recovered within 24 months (see below).

Forward Returns Following History's Worst Bear Markets

Total Returns for the S&P 500

Peak	Trough	Drawdown	1 Year	3 Years	5 Years
1929, SEP	1932, JUN	-86.2%	162.9%	170.5%	344.8%
1932, SEP	1933, FEB	-40.6%	98.7%	194.6%	154.6%
1933, JUL	1933, OCT	-29.8%	2.9%	120.1%	87.3%
1934, FEB	1935, MAR	-31.8%	83.8%	16.3%	84.9%
1937, MAR	1938, MAR	-54.5%	35.2%	38.2%	84.5%
1939, OCT	1940, JUN	-31.9%	8.0%	59.7%	118.8%
1940, NOV	1942, APR	-34.5%	61.2%	128.6%	144.9%
1968, NOV	1970, MAY	-36.1%	34.8%	50.6%	42.2%
1973, JAN	1974, OCT	-48.2%	38.1%	72.7%	117.5%
1987, AUG	1987, DEC	-33.5%	23.2%	55.5%	121.7%
2000, MAR	2002, OCT	-49.1%	24.4%	59.0%	105.1%
2007, OCT	2009, MAR	-56.8%	53.6%	98.0%	181.6%

TABLE: BEN CARLSON • SOURCE: DFA/BLOOMBERG

FORTUNE

QUESTION: Should I be really scared?

We do not want to discount the health impact of this virus; it is absolutely an unprecedented global health crisis and you would be sociopathic to not be concerned about the immediate health impacts. This virus is vile, it's contagious and deadly and the intervention has been immense for a reason. We all know the advice of experts of which we do not pretend to be.

Wash your hands, isolate wherever possible and minimise contact points with others irrespective of any sign of symptoms.

However, we would like to separate the virus from both the markets and the broader economy because we know that all governments are taking it very seriously (at least now) and both the human and fiscal interventions are truly remarkable. We believe that as a result of this co-ordinated fiscal response that we will get through these terrible times far more quickly than anticipated, the anxiety will lift and should result in a significant increase in most asset prices for those with a greater than 12 month view.

Sadly, however the market and the broader economy do not perfectly align and we do believe the economic impact will be significant. Globally, millions of businesses have sustained considerable damage as their sales have reduced abruptly beyond any worse case scenario and their costs such as rent, interest and wages have not – this very sadly will lead to bankruptcies. We have always steered clear of heavily indebted businesses for this exact reason, leverage works both ways.

This means that many businesses such as cinemas that manage to trade through will still never be able to recoup the lost Easter trade of 2020 and the numerous weekend nights during the lockdown – sadly their balance sheets however will incur the fixed cost overhang of this period. Furthermore, this will impact governments as they too will see a loss of tax income at the same time they are forced to incur the burden of very generous stimulatory packages which may also incorporate corporate bailouts (e.g. Qantas).

This is however where it gets peculiar for investors – as equity markets do not correlate with the economy, they continually look forward and whilst we do believe it's very likely we see a 2020 global recession/write off, we believe herein lies the market opportunity. 2020 will become the year of the earnings report with Asterix's* for 2020 – we in time will look past it and normalise for it as every business is in the same boat.

In light of all of this grim news, it's very natural to feel demoralised and afraid but it's precisely during times like this that the very best investment opportunities present themselves. Its also important to note that **all** previous crises have resulted in amazing market performance in the subsequent years – all of which have occurred from very high unemployment and economic recessionary scenarios.

Economies and markets do not run in unison – markets lead and economies follow.

QUESTION: I'd rather wait it out for a sign of economic recovery before I increased my weight to equities. Is that the right move?

Obviously, there is no problem with playing it safe but as above, markets do not correlate with the underlying economy and they look forward in anticipation of a recovery – they climb the wall of worry. Therefore, by waiting for an economic recovery you forego future returns as the markets will beat you to the punch.

Equities are a lot cheaper than they were only a short while ago and some are just obviously mispriced for their long term earnings potential. We also now have 0% short-term rates, globally trillions of dollars of stimulus running through the system (in the US alone a massive 6% of GDP) and the real potential for a 'pent up' demand driven event upon emergence from enforced hibernation.

QUESTION: What should I be buying and how?

Here is the hard part and our ultimate sales pitch – this is not the time to be passive in any asset allocation decision – this is possibly the most important time in a long while to be very active in our opinion.

As discussed, there are plenty of businesses that may never re-emerge from this period of hibernation. Its also very likely that the post virus world is very different. If a business has too much debt or it wasn't agile enough with its supply chain, it might not recover. In our opinion, it's time to refocus your attention on your asset allocation as a whole, concentrate on your entire portfolio quality and most importantly its global diversity. Buying the Australian banks for yield because they have sold off a lot is not a sound investment strategy in our opinion.

Please reach out if you would like a hand as we are more than willing to assist. Excellent long term opportunities exist and whilst it feels really bad right now, in time it will migrate to less bad, then in time to okay, then to good and eventually to great and by that time all opportunities will have evaporated as the wall of worry will be well and truly scaled.

All the best from the Alvia Asset Partners Investment Team,

Josh, James, Chris & Daniel