The Great Repression 2.0

seekingalpha.com/article/4341771-great-repression-2_0

David Alton Clark, seekingalpha, May 1, 2020

Summary

The recent cascading 35% waterfall crash due to the global pandemic is unprecedented. The 23-day downdraft ranks as the fastest documented decline of this magnitude in history.

A ferocious bear market has emerged from hibernation after an 11-year slumber. The 30 million jobs lost over the past month account for all job gains since 2009.

The current calamity hearkens back to the 1982 recession, which held the record for the highest unemployment rate since the Great Depression until now.

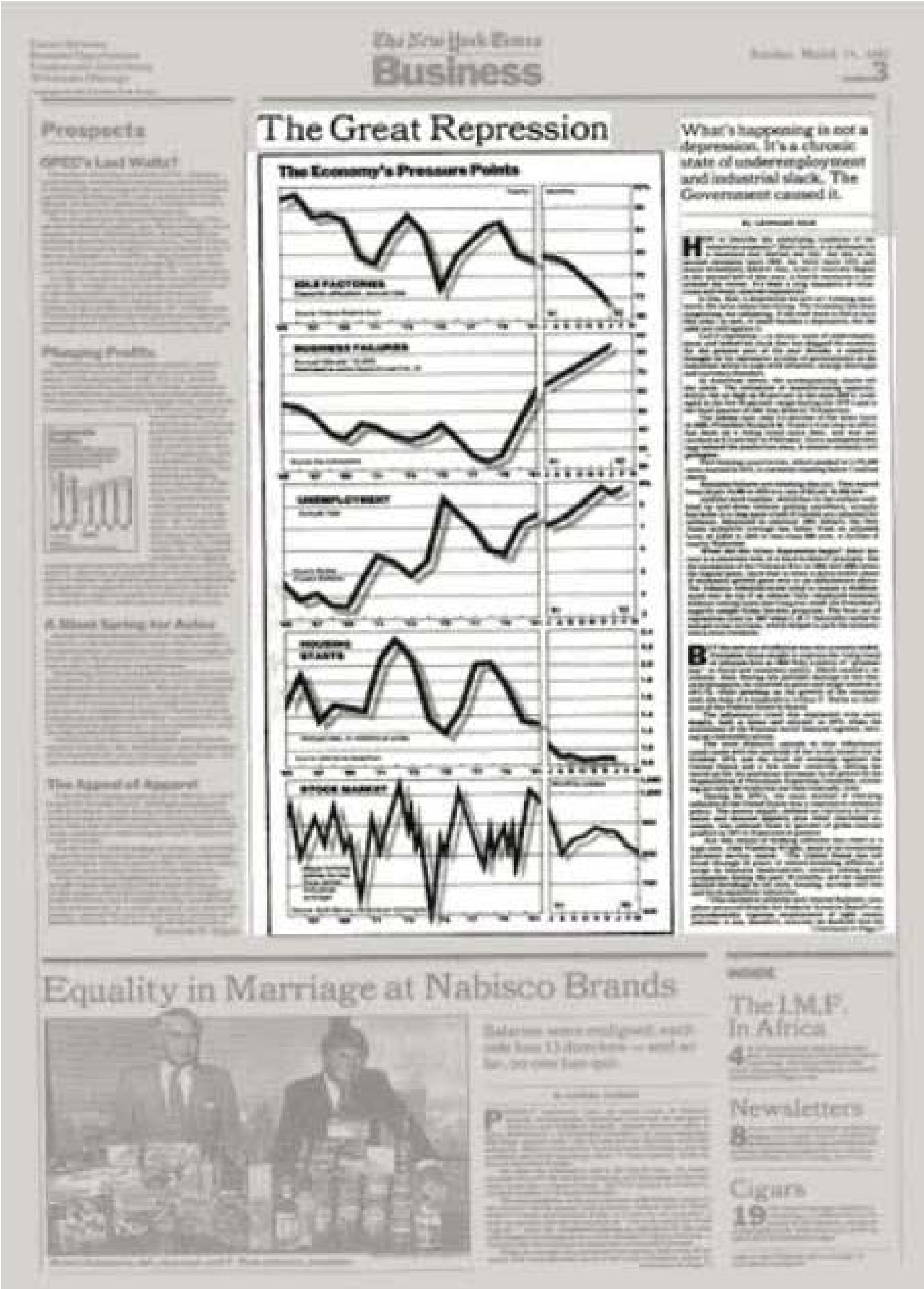
The recent unbridled rally equating to a 50% retracement of the downdraft seems unsustainable.

In the following piece, I give my take on where we are in the current cycle and my present investment strategy.

The 1982 recession occurred for much different reasons, yet the outcome was very similar - extreme unemployment. The 1982 recession was the worst economic downturn in the United States since the Great Depression prior to the Great Recession of 2008. Unemployment in the 1982 recession was widespread. Manufacturing, construction, and the auto industries were hit the hardest. Three-fourths of all job losses were in the residential construction industry and auto manufacturing, which ended the year with 22% and 24% unemployment, respectively. I had just begun my first entrepreneurial venture as a framing subcontractor building apartment complexes. One Friday, everything stopped on a dime. We never got paid for the last floor we framed.

What's so frightening is the current state of employment is much worse. Including the 3.8 million reported Thursday, 30 million jobs have been lost in just the last month. This is worse than the Great Depression. The number of jobs lost accounts for all the job gains since 2009 and then some. Essentially, we have been thrust back 10 years in time to the beginning of Great Recession.

The title of the piece gives homage to the *New York Times* business section byline from March 1982.


The New York Times

Business

Prospects

The Great Repression

What's happening is not a depression. It's a chronic state of underemployment and industrial slack. The Government caused it.

The Economy's Pressure Points

IDLE FACTORIES

BUSINESS FAILURES

UNEMPLOYMENT

HOUSING STARTS

STOCK MARKET

Equality in Marriage at Nabisco Brands

Salaries were realigned; each side has 13 directors — and so far, no one has quit.

INSIDE

The I.M.F. In Africa 4

Newsletters 8

Cigars 19

I hearken back to the “Great Repression” title because the current recession was self-imposed due to the COVID-19 pandemic. The US economic powerhouse has been truly repressed by the draconian measures taken to stay the spread of the virus. Even so, it’s not all bad news. Some industries have flourished in the current environment. What's more intriguing is the market has rallied more than 30% off the lows and is within 15% of the recent all-time highs as of this writing. Many ask, “How can this be?” In the following piece, I will lay out my perspective of the current macro state of affairs and provide my thoughts on how to approach investing in such uncertain times.

Current Macro Environment

The latest self-induced bearish barrages of negative economic impacts are unprecedented. Here's a list of the current challenges as I see them.

Challenges

- The level of uncertainty is off the charts. Nearly every company reporting has withdrawn guidance. This may cause major disconnects on a go-forward basis regarding earnings expectations.
- The 30 million jobs lost is unprecedented. The US consumer was the backbone of the economy. Now, many are out of work. And those who aren’t are not in the spending mood.
- Even when the economy is allowed to reopen, it will be purposely shackled to only 25-50% due to continuing social distancing standards.
- The impacts are occurring all across the globe. Supply chains have been broken or extremely stressed in all areas of business.
- The lifting of home quarantine protocols may cause a second wave of the COVID-19 virus, effectively shutting down the economy for a second time.
- People are afraid. Even though restaurants and other going concerns reopen, the consumer may not show up for fear of getting sick.

The bottom line is, I don’t see things getting back to the way they were for a long, long time. Maybe never. This appalling ordeal may very well change the way we interact as people and do business forever. Curiously, the market has been able to bounce back convincingly as of late. The market has bounced off the low and rebounded over 30% in recent weeks. The following is my explanation.

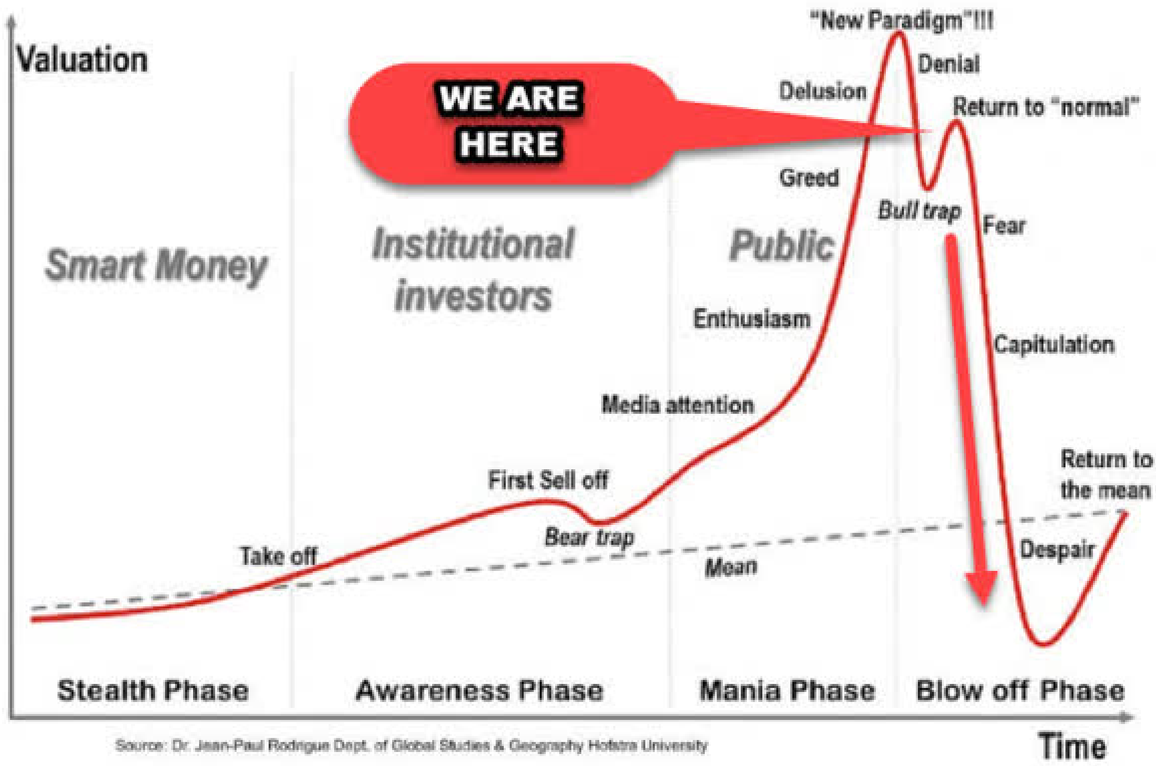
What’s driving the rally?

After 40 years in business, I have experienced a multitude of bull and bear markets and economic cycles. Here's how they more often than not have played out, in my opinion.

The Three Phases

Bear markets tend to unfold in three major phases. The first phase entails a massive selloff due to some type of exogenous event, the COVID-19 pandemic in this case, and overshoots to the downside as investors panic and sell out at the bottom.

Second, once stocks become extremely oversold, shorts begin to cover and eager investors from the sidelines jump in buying up seeming steals created by the carnage. This phenomenon provides the proverbial dead cat bounce *(where we are now).*



Finally, another downdraft occurs as reality sets in regarding the major damage done to the economy and the earnings potential of companies. The first two phases of this bear market have occurred in record-breaking fashion. The really bad news has yet to be realized.

The analogy of a tsunami seems quite apropos. A great earthquake has occurred far off shore, deep in the ocean (the pandemic). It still appears to be a small wave as it travels toward shore, as the water is so deep (the Fed providing unlimited liquidity). Yet, once it nears shore, the wave rises up and crashes onto the shore, devastating everything in its way (reality sets regarding major economic impacts). This development induces stock prices to reset lower. Let me explain.

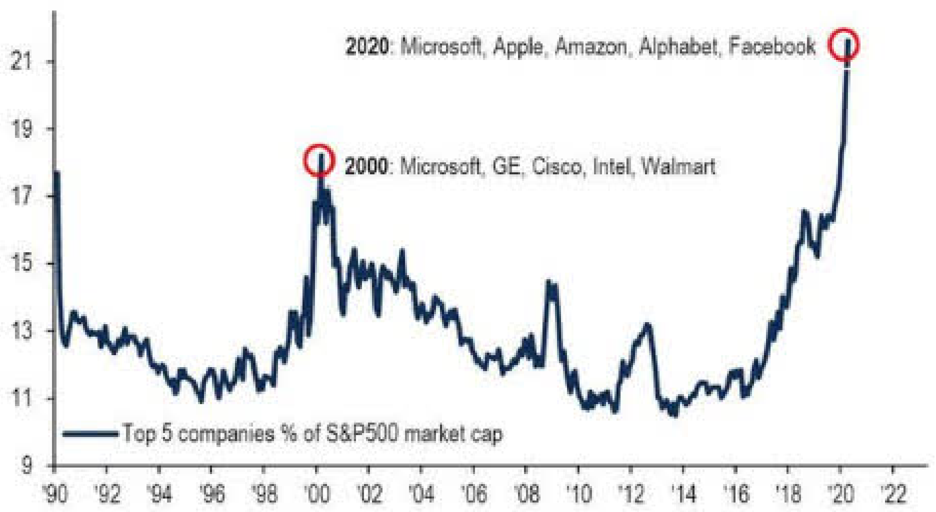
Stocks reset to lower levels

Over my 40 years, I have seen the ranges stocks will trade in change drastically over time. After the past 10-year run, many investors may have grown accustomed to the price ranges certain stocks will trade for and perceive a much lower stock price as an immediate bargain, not realizing we have crossed the Rubicon into a new paradigm.

Even though a stock is down 50% from its previous high, that doesn't make it an instantaneous bargain. In fact, it may actually be even more expensive at the new lower price. The present value of a stock is based on future earnings, not past. Moreover, future earnings of companies are presently in dire straits at best and utterly uncertain at worst. The uncertainty regarding future performance of companies, coupled with the extreme disconnect between the market and the economy, has increased equity risk exponentially in my book.

Furthermore, the rally is extremely concentrated in a select few market powerhouse stocks. This is another telltale sign the rally is unsustainable. These stocks are seen as neo safe havens. The S&P 500 is now more concentrated in the top five largest stocks than at any time in history. See chart below.

Chart 2: S&P500 now more concentrated in the 5 largest stocks than ever



Source: BofA Global Investment Strategy, Bloomberg

We all know what happened the last time we were in this precarious predicament. It wasn't pretty, a little thing called the Dot.com bubble. Now, don't think I've forgotten about the Fed. Let's take a look at its current actions.

Fed put in full effect

The Fed has been responsible for most of the gains over the last 10 years, as well as the recent rally. It has actually pumped in more QE into the market over the last month than it did the entire time before. The Fed has boldly gone where it has never gone before.

Think about that. That's astounding to me. The only problem is, it's a case of diminishing returns, I'm afraid. I fear the effects will be short-lived. What's more is, there are limits to what the Fed can do.

Limit to the Fed's Powers

Chairman Powell made that abundantly clear in during his news conference yesterday. He stated they could only do so much and that fiscal stimulus will be needed to ensure economic recovery.

> *"It may well be the case that the economy will need more support from all of us if the recovery is to be a robust one," Powell said at a virtual news conference on Wednesday following the central bank's latest policy decision. "Will there be a need to do more though? I think the answer to that would be yes."*

Interestingly, Powell has never reference fiscal stimulus previously. Basically, he's saying it will take some action from Congress to get us out of this mess. Unfortunately, I don't see that happening. So, what do we do? Here's my current playbook.

Current playbook

I was fortunate enough to get to the sidelines in early February. I was already wary of the current macro set-up and advised my subscribers to raise cash. After the news President Trump banned travel from China, I went to 100% cash. I learned my lesson a long ago not to try and predict outcomes when visibility is zero. It's akin to gambling. Better to get to the sidelines and pick up the pieces in the aftermath.

I have taken a small portion of my portfolio and used it successfully to trade the market's extreme volatility over the past couple of months. I just sold out of my long positions in Gilead (GILD), Delta (DAL), Noble Energy (NBL), and Wingstop (WING) bought just off the lows. I feel the rally has reached an inflection point. We are currently resting just below the S&P 500's 200-day SMA. The market has rebounded nicely. Nevertheless, the 200-day SMA lies just overhead. This should provide strong resistance regarding any further advancement as well as the 61.8% Fibonacci Retracement Level.

(Source: Author's chart)

When the market trades above the 200-day, it provides support, and when it trades below, it provides resistance. For this reason, I will wait to see what happens, gathering more information before opening any new positions. I'm still not making any long-term hold investments at this juncture.

Wrap-Up

I see a major disconnect between the current level of the market and the reality on the ground presently. The recent selloff and recovery has happened in record fashion. Many of the after-effects haven't had time to come to fruition. One of my abiding investing principles is patience. **Patience equals profits.** I will wait for the inevitable pullback prior to pulling the trigger. Patience and discipline are what dictates success. Once the market pulls back and uncertainty regarding the fate of the virus has diminished, only then will I begin to rebuild my long-term hold portfolio. What does that look like regarding the virus?

We need to see declining COVID-19 infections, development of a vaccine/therapeutic, lifting of forced-shutdown protocols, and testing/tracing capabilities so people will feel confident they won't get sick. At highly uncertain and volatile times such as this, I'm laser-focused on capital preservation rather than appreciation. I'm an investor, not a gambler. In my next piece, I will detail some of the top picks on my watch list I'm looking to buy once the coast is clear. Thanks for your time and consideration.