WASATCH
CAPITAL MANAGEMENT OF
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Now What? -Article by Mark Lazar

May You Live in Interesting Times. **Chinese Curse**

Item	Data point
S&P 500 Return YTD	-22.97%
Bond Index Return YTD	3.42%
Foreign Index Return YTD	-23.01%
Emerging Market Index YTD	-25.38%
U.S Forecast GDP 2020	-25.38%
Unemployment Rate[Lagging]	4.40%

**As of 4/5/2020*

These are certainly interesting times. Prior to the Coronavirus outbreak, the US economy was on track to grow by 2% in 2020. What a difference a month makes. The bad news is the latest forecast by Morgan Stanley estimates first quarter GDP will contract by 3.4%, followed by a second quarter retreat of nearly 38%. If correct, a recession is all but guaranteed. The good news, however, is this same economic report pegs third quarter economic growth at nearly 21%, followed by 16% in Q4.

Ronald Reagan famously quipped, *a recession is when your neighbor loses his job. A depression is when you lose yours*. The textbook definition of a recession is *two consecutive quarters of negative economic growth*, and the average recession lasts eleven months. Recessions are a normal *and healthy* part of an economic cycle, as they serve to wring out the excesses (asset prices, inventories, malinvestment, labor, etc.), and set the stage for the next economic growth period. What's different this time is that it isn't due to late-stage (economic cycle) exuberance, but an externality—not the virus, but the unprecedented policy response to a malicious pathogen. The sweeping closure of large swaths of the economy simply doesn't happen outside of times of war or local disasters.

There are no precise, quantifiable metrics for a depression, but the generally accepted definition is a long, deep, and pronounced recession. The Great Depression was the product of a credit boom combined with technical innovation, rapid economic growth, and malinvestment/irrational exuberance running head-first into injudicious monetary and fiscal policies. In other words, a recession metastasized into a full-blown depression due to misguided government policies.

The Federal Reserve, created in 1913, was still learning the ropes in the late 20s. To further complicate matters, the US was on the gold standard, which is a double-edged sword; it keeps inflation in check and restrains profligate bureaucrats, but also creates an inflexible monetary regime that binds the hands of central bankers during times of crisis. Today, when economic data begins to flag, central banks shift to accommodative monetary policy (i.e. lower interest, increased money supply, looser credit, etc.); however, in the spring of 1928 the Fed began raising interest rates in an attempt to discourage speculation in the stock market. To make matters worse, the Fed continued to raise interest rates long after the recession was in full swing in an effort to preserve the value of the dollar, further restricting the availability of money and credit for individuals and businesses alike.

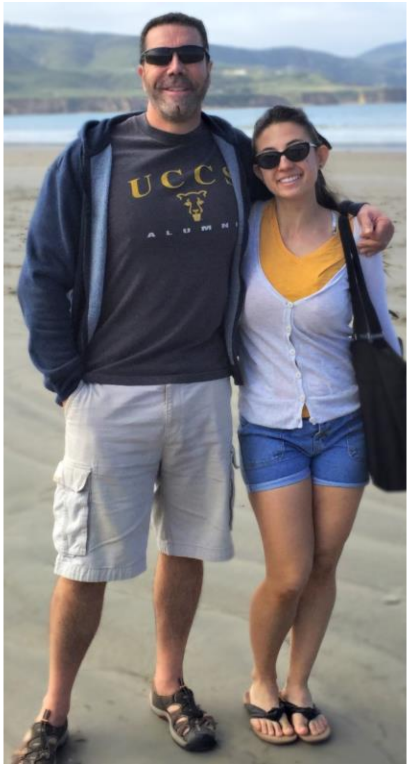
The coup de grace for the US economy was the 1930 Smoot-Hawley Tariff Act, which was intended to protect domestic industries and jobs. However, protectionist trade policies tend to elicit retaliatory measures by trading partners, and thus the trade war began without firing a single shot. Global trade flows plummeted 66%, and the world fell into a depression that would last a decade.

What's causing the unprecedented volatility and downward pressure in the markets is the lack of any meaningful goal posts from Washington. Uncertainty is Kryptonite to the markets, and creates anxiety in investors. The question on everyone's mind is, *where do we go from here?* Recession? Depression? Zombie apocalypse? If Morgan Stanley's forecast is correct, the recession, while akin to a gut-punch, will be short-lived, lasting two quarters, followed by a big jump in Q3 and Q4, due to pent-up demand, with continued growth throughout 2021.

It's important to remember that markets are forward-looking; meaning they are attempting to discount *future* revenues and profits *today*. Markets will respond long before we are able to see or feel the economy getting better. No doubt the government's $2.2 trillion stimulus will help alleviate some of the economic pain in the short-run, but it's no substitute for turning the lights back on, or at least knowing *when* the lights come back on.

Public safety is paramount, but policy measures must also be mindful of the long-term economic health of our nation. It's not the job of government to placate the markets; however, policymakers in Washington would be well-served to listen to what the markets are saying. Markets are unbiased, apolitical feedback mechanisms and politicians can learn much by the market's reaction to well-communicated policy announcements—or the lack thereof. Let's hope the coming months are a lot less interesting.

Wasatch Team Updates



Mark

Mark & Savina in Mexico in February!

John

John & Shawn get a puppy during the Shelter-At-Home period this month! Meet Stella.

Beth

Beth working at home this month!

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