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INSIDE THIS NEWSLETTER

The Madness of Crowds -Article by Mark Lazar

***When the herd is all running toward a cliff, the one running the opposite direction seems crazy*— Unknown**

You would be hard-pressed to pick up a newspaper, turn to your favorite news channel, or open a web browser without seeing a terrifying headline about the Coronavirus, AKA COVID-19. I know nothing about epidemiology, but I do know thus far there have been twenty-eight deaths in the US due to the virus. While loss of life is always a tragedy, compared to the 80,000 (nearly 7,000 per month) deaths that occurred in 2017/2018 from the flu, the current epidemic seems to pale by comparison, at least thus far. However, despite the low number of fatalities, the markets (stock, bond, and commodities) have experienced extreme levels of volatility over the past three weeks.

Business schools around the world teach a concept known as the Efficient Market Hypothesis (EMH), which posits that security prices reflect all available information and expectations. The EMH assumes markets are informationally symmetrical, meaning buyers and sellers have access to the same data, and that all known information, such as past history and future expectations, is reflected in the price. If the EMH holds true, the market is currently behaving rationally based on rapidly changing expectations of economic activity, retail sales, profit margins, employment/wage data, etc.

In 1720, after losing most of his personal fortune (about $5 million in 2020 dollars) speculating on the South Sea Company, Sir Isaac Newton reportedly muttered, "I can calculate the motions of the heavenly bodies, but not the madness of men." Newton's view of the universe as both orderly and predictable may translate nicely to physics but not nearly as well to the stock market.

It's important to understand what the stock market, or any market, for that matter, really is: a price mechanism. Every day hundreds of millions of market participants—individual, retail, and institutional investors—are exposed to billions of random data points, such as corporate revenues, earnings, macro-economic data, fiscal policy changes, geopolitical events, epidemics, etc. Buyers and sellers independently gather this information and come together to create a market that ultimately determines the precise value of a share of Coca Cola, or any other security, for that matter.

I would contend markets are *long run* efficient; meaning that, over time, price and value tend to be one and the same. However, in the short run markets can be terribly inefficient, which is why we have periodic asset bubbles (stock, real estate, commodities, bitcoin, tulips, etc.) followed by subsequent corrections. Markets eventually get it right and either sell off overpriced assets or bid up underpriced assets, but in the short run a divergence between price and value is not uncommon, as Sir Isaac Newton learned the hard way.

I liken the recent stock market selloff to sitting in a crowded theater, enjoying a much-anticipated movie. In the middle of the show you notice half a dozen people heading for the side exit. A minute later, another half a dozen, followed by another half a dozen, then another. At some point you begin to scan the theater, looking for the reason. A fire, perhaps? A crazed lunatic? But there is nothing. Another half a dozen head for the exit, at which point you get up a, believing they must know *something* that you don't. Outside the theater you ask someone why they left. They answer, "I don't know. I just saw everyone else leaving, so I decided to follow."

This is *not* 2007. Stocks are cheap relative to forward earnings, housing isn't in a bubble, subprime mortgages aren't the norm, credit default swaps aren't a "thing," and US banks' are solid with tier one capital ratios healthier than they've been in years. In fact, despite the barrage of negative headlines, the recent economic data has been encouraging:

- Nonfarm payrolls grew by 273,000 for both January and February.
- Unemployment at 3.5% is at a 60 year low.
- Retail sales was up 4.4% in January versus the prior year.
- At 1.597 million annualized rate for December and January, housing starts are enjoying their fastest pace for any two month period since 2006.
- The Atlanta Fed projects U.S. GDP is on track for 3.1% annual growth rate in the first quarter.
- The NFIB Small Business Optimism Index for February ticked up to 104.5 from 104.3 in January.

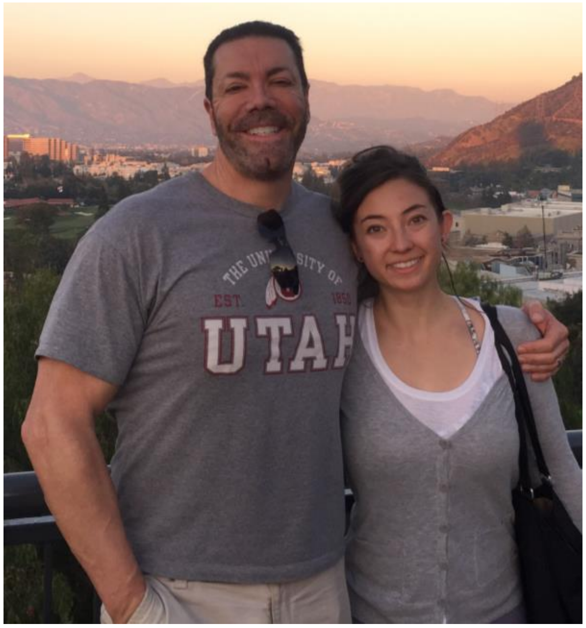
A number of people recently asked if it's wise to simply sell their stocks and wait on the sidelines until things are *better*. I don't know when the market will find the bottom. But find the bottom it will, and I suspect it happens sooner rather than later. As the chart below illustrates, in the midst of the Great Recession, the stock market found its bottom March 9, 2009. I remember keenly how awful things *felt*;

at 8.1%, unemployment hit a 25-year high, 140 banks failed that year, and systemically important banks were forced to accept a lifeline from the Treasury known as TARP. Foreclosure signs were ubiquitous, housing developments were abandoned, shopping center were littered with vacancy signs, GM was preparing to file bankruptcy, and layoffs were rampant. Yet, when it appeared things couldn't get any worse, the market found its bottom and stock prices began to rise.

Yahoo Finance

Last week Warren Buffett, arguably the most successful investor in recent history, went on a buying spree. The Oracle of Omaha doesn't attempt to pick the bottom. Rather, he isn't afraid to invest in companies he perceives are attractively priced. I don't know when the selloff is over. But I do know I'd rather emulate Warren Buffett than the madness of crowds.

Wasatch Team Updates



Mark
Mark & Savina on a recent vacation!

John
John & Shawn visiting Mexico. No Market volatility here!

Beth
Beth on a recent trip to New York City!

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