Some Thoughts on the Coronavirus and Investing

There is no doubt that the coronavirus pandemic is "scary stuff" as Warren Buffett has acknowledged; but we also agree with Mr. Buffet's advice that "I don't think it should affect what you do with stocks." Panic-driven approaches to investing are based on the same human psychology that leads to the panic buying of toilet paper and water at Costco. As famed investor and teacher Benjamin Graham said: "[I]nvesting isn't about beating others at their game. It's about controlling yourself at your own game."

The rapid spread of the coronavirus has caused a great deal of volatility in the stock market and driven some investors to move out of stocks and into Treasury bonds. We think that is a mistake, because in our view, bonds have two big dangers. One is inflation risk which can dramatically reduce investors' purchasing power. We don't know when inflation will show up, but we do believe that all the money printing by governments cannot run indefinitely without consequences. Unfortunately, as indicated by the huge volume of negative-yielding bonds outstanding, many investors are oblivious to this risk. The other major danger we see with bonds is credit risk. With all the low-interest financing available, many highly indebted companies and governments remind us of the proverb: "If they say the sky is blue, bring an umbrella if you go outside to check."

In a recent interview with CNBC, Mr. Buffet expressed his continued faith in stocks relative to Treasury bonds. As Barron's described the interview:

> Buffett was also unfazed by the coronavirus, saying …, 'It makes no difference in our investments. There is always going to be some news, good or bad, every day. If somebody came and told me that the global growth rate was going to be down 1% instead of 1/10 of a percent, I'd still buy stocks if I liked the price, and I like the prices better today than I liked them last Friday.' He may like them even better now.
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> He compared the 10-year Treasury to a stock 'trading for 70 times earnings that can't increase its earnings for 10 years.' This calculation involves taking the inverse of the 10-year yield, then 1.4%. The effective price/earnings ratio on the Treasury is up to 85 now, with the yield down at 1.2%. The earnings yield on stocks – the inverse of the P/E ratio, is more than 5%.
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> 'If somebody came to you with a stock and said, you know, 'This is a terrific stock. It sells at 70 times earnings. The earnings can't go up for 10 years,' you'd say, 'Well, explain that to me again,'' Buffett said.

Of course, at times like these, owning stocks takes fortitude. We view stocks as a roller coaster and believe we will do well so long as we don't jump off. While it would be nice for stocks to always go up, you cannot have a universe without gravity. While we certainly aren't gamblers willing to take any risk at all in hopes of making a "big score," we believe that investors who are completely risk averse also court disaster.

We do not think we or anyone else can predict stock market moves – as Mr. Buffett puts it: "*No one* can tell you when [stock market moves] will happen. The light can at *anytime* go from green to red without passing yellow." Likewise, we do not like our success to hinge on broad macro calls, because it's way too easy to get them wrong. Even John Maynard Keynes, one of the greatest macro thinkers of the past hundred years, reportedly did a poor job timing his investments to macro calls. According to an article in the *New York Times,*

> in the 1920s [Keynes] tried to time stock picks. But his returns were low, and he took a big hit in the market crash of 1929. In the 1930s, he shifted toward a long-term approach of buying stocks with good long-term potential and holding onto them indefinitely… his returns improved.

Public reaction to the coronavirus highlights both that fear is contagious and that man is not a particularly rational being. Smartphone notifications and non-stop media greatly reduce focus and exacerbate irrationality. Richard Thaler, the Nobel Prize winning expert on the interplay between human behavior and economics, recognized this when he said:

> I was on a morning talk show once, and someone asked what my advice would be the next time there's market turmoil. I said, 'Well, it would be to switch off this network and leave things alone.' I was not invited back.

Investors should slow down, focus, and think, in which case they will likely concentrate on the business fundamentals of the companies they own. Nothing about the coronavirus changes our view that the United States has a superior economic system. Investing in American business has been an excellent strategy since the time of Benjamin Franklin, and we believe it will continue to be a good approach for many decades to come.

Or, in the words of A.A. Milne (the creator of that wise bear, Winnie the Pooh), "Don't underestimate the value of doing nothing!"

As always, please call or email us with any concerns.

Be well,

Chris

Things to Note

Past performance is not a guarantee or a reliable indicator of future results. Equities may decline in value due to both real and perceived general market, economic, and industry conditions. Bonds may decline in value due to market, interest rate, issuer, credit, and inflation risk. Investing in foreign denominated and/or domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. Commodities contain heightened risk including market, political, regulatory, and natural conditions. There is no guarantee that these investment strategies will work under all market conditions or are suitable for all investors and each investor should evaluate his or her ability to invest long-term, especially during periods of downturn in the market.

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