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This Year We Already Have a Bear Market & a Bull Market — What Next?

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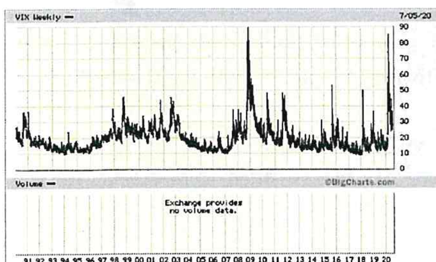
The volatility that we have experienced this year is truly amazing, only rivaled by the "Great Recession" of 2008. We have had the sharpest and yet extremely short-term "Bear Market" due to the Covid-19 virus and the artificial recession imposed by government shutdown of the economy. This has been followed by one of the most intense recoveries or "Bull Markets" in history due to government and central bank stimulus programs. All of this has taken place in the first six months of the year. So now let's first look at volatility. What is it and how is it measured? Then, let's look at the factors that could determine the direction and the volatility of the markets for the second half of the year.

Volatility is defined by the "Dictionary of Finance and Investment Terms" as the "characteristic of a security, commodity, or market to rise or fall sharply in price within a short-term period." Volatility is generally measured by what is called the VIX Index. The same Dictionary defines the VIX Index as "short for the Chicago Board Options Exchange (CBOE) Volatility Index, which measures trader's expectations of volatility in the stock market by tracking bid/ask quotes on the Standard and Poor's 500 Stock Index. ... The CBOE terms the VIX an 'investor fear gauge.'"

The graph shows how dramatic the VIX was in 2008 and in 2020. Notice that on the 30 year graph even the dot-com bubble burst and the "9/11 terrorist attack" in 2001 did not spike like our two more recent "Bear Markets." In summary, it is safe to say that market volatility has been dramatic and a testament to the fact that government policies have the power to move markets, at least in the short to intermediate terms.



The major "Bear Markets" in history have either been caused by or made worse by Federal Government or Central Bank mistakes.

1. **The Great Depression** – a 90% drop in market value over a four year period.
   a. The government imposed the Smoot-Hawley tariffs which made the global recession much worse.
   b. The Fed raised rates instead of lowering them and decreased the money supply instead of increasing the money supply. In a 2002 speech, Ben Bernanke, a member of the Fed Board of Governors who would go on to become the Chairman during the 2008 financial crisis said: "Regarding the Great Depression, ... we did it. We're very sorry. ... We won't do it again."

2. **The 1973-1974 Bear Market** – a 45% drop in slightly more than 23 months.
   a. The government – Watergate (Nixon forced to resign) and inflation out of control after the collapse of the Bretton Woods international monetary agreement. Bretton Woods pegged gold at $35 per ounce but the dollar was losing value and the government was forced to stop selling gold at $35. This created global monetary instability.
   b. The Fed aggressively added to the money supply which exacerbated the inflation problem.

3. **The dot-com bubble burst 2000-2002 Bear Market**—a 49.1% drop over a 30 month period.
   a. The government – no discernable glaring error except allowing the dot-com mania to get completely out of control and threaten the economy.
   b. The Fed, under Alan Greenspan, misjudged the Y2K Impact (the new millennium beginning and the un

certainty as to what would happen to all of the computers that were not programmed for the four-digit year entry) impact. He was afraid that there would be a run on the banks and created enormous amounts of money so that the banks would not have to refuse to give people their money if they wanted it. Y2K turned out to not be a problem, but all of that money headed for the stock market and contributed to further the dot-com mania. When Greenspan realized that he slammed on the brakes, he increased inter est rates and decreased the money supply too rapidly thus triggering the market crash.

4. **The Great Recession of 2008-2009 Bear Market**— 56.4% decline over 17 months.
    a. The government - made numerous mistakes including lax mortgage qualification requirement ments and then buying or guaranteeing those mortgages. Also, lax supervision of the Wall Street firms that bundled these mortgages into securities that the rating agencies gave artificially high ratings to. These all contributed to the Real Estate debacle that triggered the "Great Recession."
    b. The Fed kept interest rates too low for too long which helped to increase the speculative frenzy and then sharply raised the rates which helped to bring about the collapse.

5. **The Covid-19 Bear Market of 2020** – a 35% decline in about five weeks.
    a. The government imposed an artificial shutdown of the economy which brought about the market decline. Whether this was the correct decision or not, we don't know, but it definitely took the market down.
    b. The Fed to its credit stepped-up and took force ful steps to offset the negative effects of the shutdown.

These are five examples of the impact that government and central bank policies have had on the economy and the markets. In fairness, it is important to note that government policy regarding antidotes to economic crises like stimulus plans and tax cuts are equally important on the plus side. The Fed also beneficially provides interest rate cuts and money supply increases like Quantitative Easing (QE) when needed. In summary, in the long run the markets will reflect the overall prosperity of the nation, but in the short and intermediate term the heavy hand of government and central banks can have a significant influence.

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OUTLOOK
The Second Half of 2020

The last six months of this year will still be volatile but hopefully not anything like the first six months. There are known market-influencing factors, plus and minus, that will battle it out and there is one big factor that will come in to play in November.

On the plus side we have an economy that is reopening and gaining momentum. The pace of recovery is exceeding expectations, the June jobs report showed almost 5 million jobs created which was a new record. Retail sales have been growing substantially and the ISM manufacturing report showed strong gains. Also, there is a growing possibility that the politicians will push through one more large stimulus bill, probably in the $1 trillion to $2 trillion range which will further strengthen the economy and be good for the stock market.

On the negative side we have the eruption of many more Covid-19 cases and the slowing of the lifting of restrictions in some states. More mask requirements and restaurant and bar closures threaten to slow the pace of the recovery. Also, social unrest is impacting the recovery in some cities.

The pluses and minuses will battle it out through the summer, but as Labor Day approaches the attention will shift to the election. Our plans at this point from a purely strategic standpoint without political bias is to watch the trend and change our investment stance accordingly.

In the near-term we still feel that the plus factors outweigh the negative. As we get through the summer we will have to see how the political winds are blowing and which direction the heavy hand of government is heading. As always, as things change we will have to adapt accordingly.

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