PRATO CAPITAL

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What's Different This Time?

In conversations with our clients over the past two months, we have had variations on two common themes being voiced:

*"**Is it different this time?**", and "**Should we try to time the bottom of the market?**"*

"Is it different this time?"

Sheltering in place, working from home, and seeing many local businesses closed, at least temporarily, makes this feel quite different. We hope to never again see counts of infected and deaths scrolling across our television screens. Because this pandemic is a health crisis, it is different. But, for the equity markets, a more accurate question may be *"What's different this time?"*

As the equity markets price in all available information every day, stock prices will change. In 2019 as mostly positive information was priced into equity markets, the S&P 500 climbed over 30%. Since February we have seen market declines, market gains, and volatility as new information of the coronavirus pandemic is being priced into individual stocks, and expectations have changed. Although the cause of this market disruption may be different, the equity markets are reacting and functioning very much as in the past albeit with more volatility which is to be expected in this situation.

Should we try to time the market?

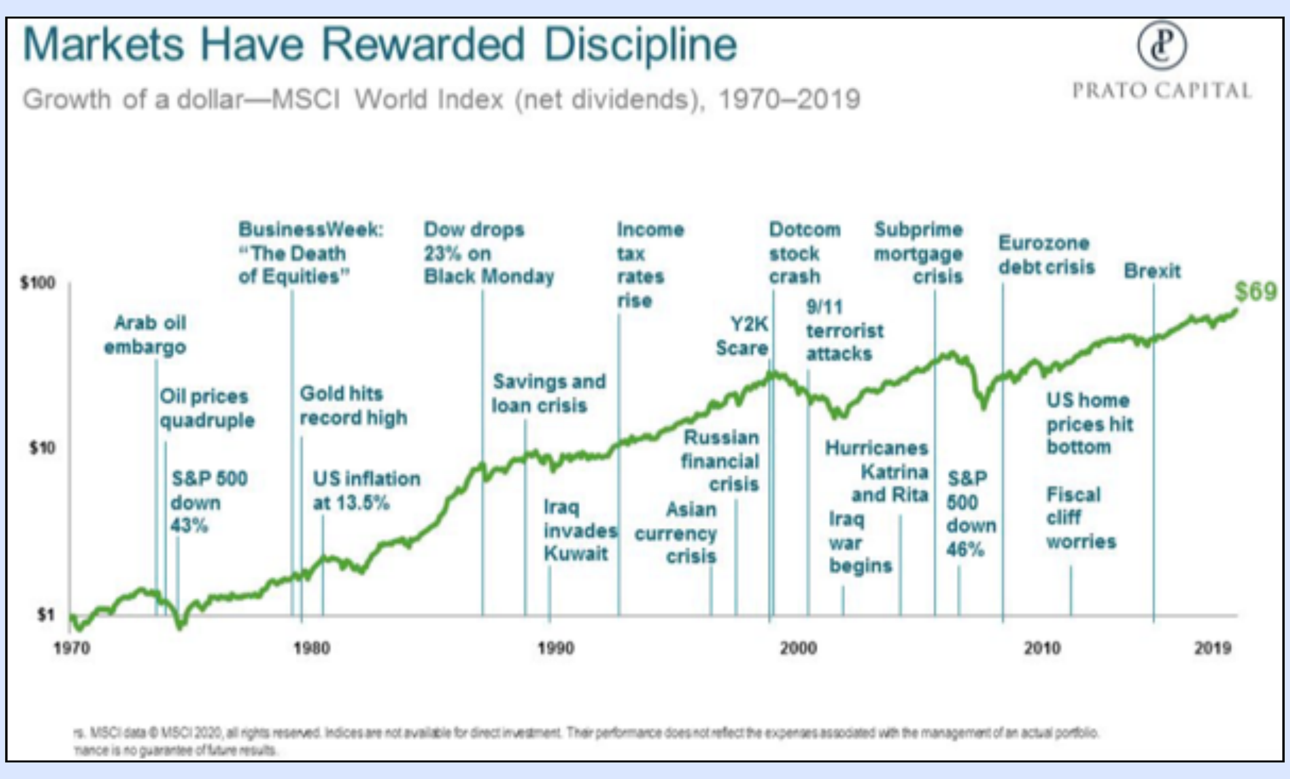
History serves as a guide for us at Prato Capital. Looking back over past stock market disruptions can often show long term trends that may be applicable today and in the future as well. Over the past 100 years, there have been many disruptions to the economy and the stock markets. Our country has seen some tough times to include a Great Depression and a Great Recession, a World War and a Cold War, dot-com and housing bubbles, both high and low inflation, and a savings and loan crisis to name just a few. Through these different events, investors have seen both bull and bear markets as a regular part of investing. And for all of them, the same question was asked… *"Should we try to time the market?"*

When we look at the last 50 years, the case for a long-term outlook is apparent. Since 1970, there have been six bear markets and the total return of the S&P 500 was still about 10.5% annually to the end of 2019[1]. This is just in the US. Since most of our clients have portfolios with a globally diversified portfolio, we should look at global equities also.

Exhibit 1 below shows some news headlines charted with the growth of a diversified global stock index, the MSCI World Index since 1970. Even with the six US bear markets, this index has risen 69-fold in 50 years.

"What's different this time?"

Exhibit 1: Markets Have Rewarded Discipline



In a perfect world, there would be a bright neon sign signaling the end of a bear market and the start of a new bull market. This would be the perfect way to time the bottom and get all the gains that lie ahead for the next bull market. Unfortunately, we only see that neon sign in hindsight. We do not know if the S&P 500 has hit bottom or if it may decline some more. But, if we use history as a guide, we see the stock market rises quickly after the bottom does pass. **Exhibit 2** below shows the returns of the S&P after bear markets. On average, the first six months after a bear market accounts for 59% of the first-year returns of the next bull market and 41% of the 3-year returns. Missing the recovery at the beginning can be very costly.

Exhibit 2: Returns After Bear Markets of the S&P 500

Dates of Bear Markets	Returns After 6 Months	Returns After 1 Year	Returns After 3 Years
9/1929 - 6/1932	53.0%	121.4%	117.7%
3/1937 - 4/1942	24.6%	53.7%	96.8%
5/1946 - 6/1949	22.8%	42.1%	79.9%
8/1956 - 10/1957	9.8%	31.0%	37.8%
12/1961 - 6/1962	20.5%	32.7%	58.8%
2/1966 - 10/1966	22.1%	32.9%	27.2%
11/1968 - 5/1970	22.8%	43.7%	55.8%
1/1973 - 10/1/1974	30.9%	38.0%	55.3%
11/1980 - 8/1982	44.2%	58.3%	83.2%
8/1987 - 12/1987	16.3%	21.4%	45.7%
7/1990 - 10-1990	27.8%	29.1%	56.0%
3/2000 - 10/2002	11.5%	33.7%	54.0%
10/2007 - 3/2009	52.7%	68.6%	102.6%
Average	**27.6%**	**46.7%**	**67.0%**

Conclusion

The cause of the stock market declines may be different this time, but the markets have reacted the same as in the past. All available information is being priced in as quickly as possible and markets are functioning normally. The expectations now are different than they were in December and it is shown in values of the stock market indices. As much as we like to see markets always rise, we expect there will be times they do not, and that expectation is built into our client's Financial Life Plan. A Financial Life Plan built around our client's expectations using a portfolio based on their risk tolerance makes a better investing experience and a less stressful financial life.

"This is first and foremost a public health crisis, and the most important response is coming from those on the front lines in hospitals, emergency services, and care facilities. We watch in collective awe and gratitude as these dedicated individuals put themselves at risk in service to others and to our nation."[2]
-- Jerome Powell, Chair of the Federal Reserve System

And to all the essential workers we have as clients, and those we don't, we say "Thank you".

Please be safe and stay healthy.

Thinking of you always,
Gregory, Gabriella, Brian, Chris, and Samer

[1] S&P 500 return from January 1970 to April 15, 2020 is about 10.3%.

[2] Jerome Powell, Chair of the Federal Reserve, At the Hutchins Center on Fiscal and Monetary Policy, The Brookings Institution, Washington, D.C. (via webcast), April 09, 2020. www.federalreserve.gov/newsevents/speech/powell20200409a.htm.

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