

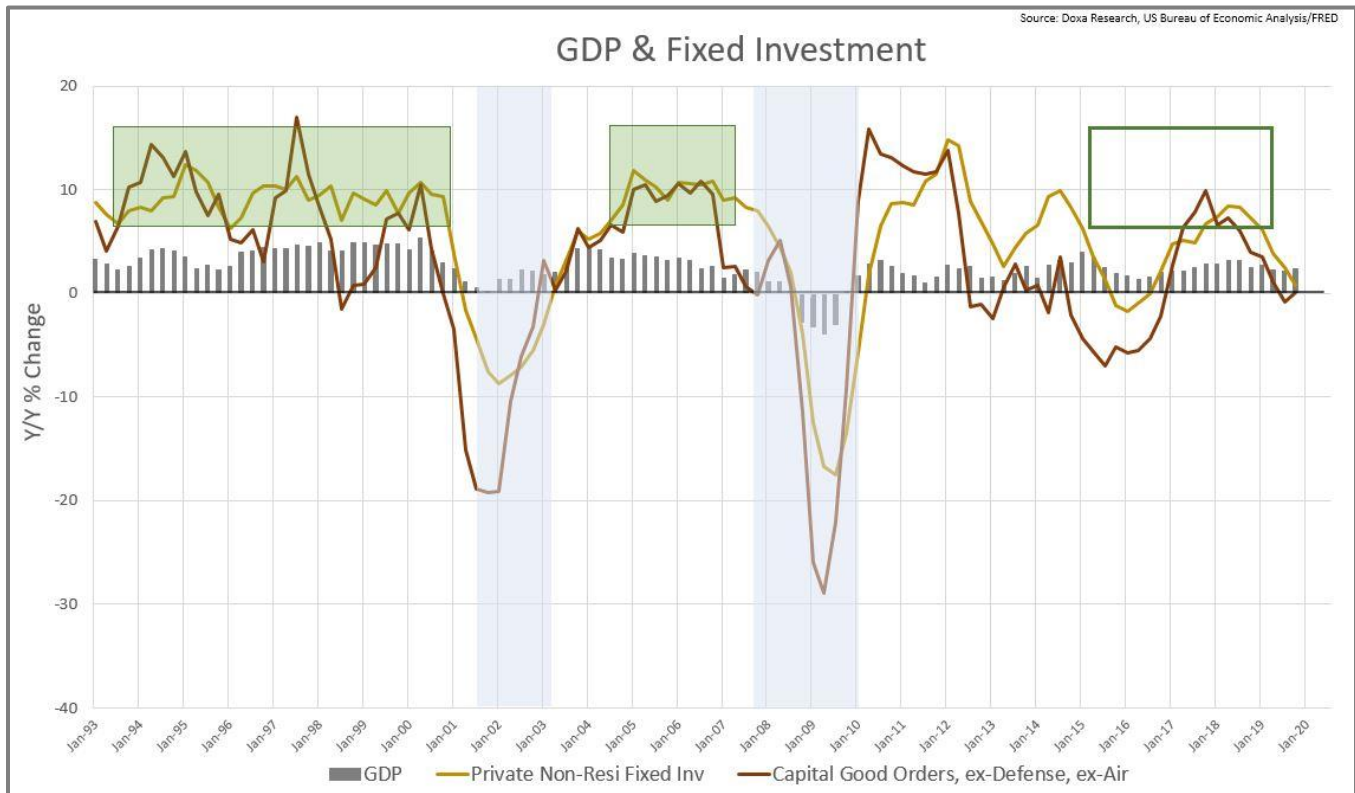
Economic activity across most Western countries is grinding to a halt. Three weeks ago, everything was rolling – today it is stopping. Will this cause a recession? We'd argue that it already did, starting this week. But this isn't a normal recession in our view, hence the title "This Time is Different". The normal recession playbook doesn't apply. **We are seeing a human crisis create financial stress. Normally, a financial crisis creates human stress.** This absolutely changes how we think about markets, portfolios, and recoveries.

We are fiduciaries over our clients' capital, not epidemiologists or virologists. We have no better insight than anyone else on this subject. We will not pretend to pontificate on either case numbers or daily market swings. We are in unprecedented times: this week marks the third worst week in history for stocks. March 12th was the second worst single day in the US market since 1987, and market volatility is rivaling the extremes of 2008. **Should we panic about our portfolios? Absolutely not.** At Doxa, we are portfolio managers, asset allocators, and financial planners. Let's focus on what we know best: 1) what's in front of us economically, and 2) how to view your portfolio.

What's in front of us economically?

Normal recessions are caused predominantly by a combination of four things:

- 1) Excess investment: this is the biggest factor to us. In each of the past two recessions, 2001 (telecom & tech) and 2008 (housing) – investment dollars poured into a broad asset until it became unsustainable and collapsed on itself. In this cycle, we haven't seen sustained excess investment as we did in priors **(chart next page, green boxes)**. This doesn't necessarily affect recession severity, but matters in recession length. With no excesses built up, we have nothing to unwind. With the sudden stop created by the virus we could see a large gap open up due to a lack of investment, providing the economy with a lot of firepower when activity resumes.
- 2) Excess leverage: our economy goes through both mild and severe recessions. What do severe recessions have in common? Excess leverage built on top of the excess investment from above. This time around **banks are very, very well capitalized and households have de-levered for a decade**. Their balance sheets are strong. We are not saying that no leverage exists anywhere. This demand shock will cause bankruptcies, and some businesses undoubtedly are over-stretched. We are saying that we **cannot** see these being systematic, and ample buffers are in place. **This is very good.**



- 3) Too tight monetary policy: what causes excess investment with excess leverage to tip over? Usually money gets too tight. This means that interest rates are too high because inflation gets too high, etc. (*i.e. the 1970 recession*). This one is simple: interest rates have barely been above 3% at any time over the last decade. Inflation isn't a problem. Capital is cheap. Capital is abundant. **This is very good.**
- 4) High commodity prices: this is the outlier of the group as its not related to the other three, and is probably most comparable to today's situation. In the 1979 & 1990 recessions, an oil price shock hit the economy and ground things to a halt. This creates a demand halt as a major input of the economy suddenly becomes unattainable. The severity can be sharp but vary across industries, and the length is dependent on how fast the exogenous event is back to normal. **We are along these lines.**

We are experiencing a historic demand shock (faster & more widespread than the commodity shocks above). Financial markets fell 28% in 16 trading days, *the fastest 20%+ drawdown ever recorded*, but we are also seeing economic activity falling at an extraordinary pace. **Yes, it's crazy.** In crazy times our reaction tends to migrate to what we experienced previously – it's 2008/2009, *"it's happening again, financial crisis, sell everything."* As laid out above, the variables aren't there for that kind of crisis. **Demand has quickly contracted and while that certainly creates financial stress, our system is much healthier to support that stress.** With that said, here are our thoughts on the path forward:

- 1) Travel, leisure, entertainment, and restaurant businesses are majorly impacted. **Those that are great operators and have strong balance sheets will be able to weather the storm.** Smaller, leveraged pure service businesses will have a hard time. When activity returns we won't go out and order two steaks to make up for the one we missed while staying at home. *This is lost revenue.* However, we will remodel the bathroom that we were planning to remodel this month but delayed. *This is pent-up demand.* Lost revenue businesses will go into crisis mode (*see point 4 below*). Pent-up demand businesses will be financed well to make it through.
- 2) More importantly, non-salaried employees become the focus of this crisis. Luckily, when activity returns so will the jobs – our main focus should be on mitigating the impact from the loss of revenue of those hourly employees. 17 million people work in the accommodation and food service industry, 13 million people work in retail, and 2.5 million in arts & entertainment.¹
- 3) We'll note that **consumption isn't technically stopping, it's shifting.** Food deliveries will explode. Supplies need to be transported. A lot of stores need to remain open – and orders still need to be filled, especially online. Web traffic in Northern Italy over the last week (when the lockdown took effect) was up by 40%. Seattle was higher by 30%. These shifts will cause major dislocations, but it is important to note that these temporary dislocations can be managed.
- 4) The dislocations brought about by these spending shifts & halts will be further mitigated by fiscal policy. **This is not an option - it is required for this type of crisis.** Germany kicked us off with the bazooka today, readying 550 billion euros and stating that it will do whatever it takes to backstop its companies from the virus. The European Commission also indicated they are ready to green-light widespread fiscal measures. The US won't be far behind. **These widespread, large fiscal measures are necessary for us to be constructive. They are the only measures that will shorten the duration of this recession** by providing a floor underneath the lost revenue workers and businesses.
- 5) Finally, the biggest fear markets can have is a complete global shutdown. This week that fear was alive. We'll note that activity doesn't seem to be halting all at once *everywhere*, but rather all at once *somewhere*. Although overlooked, it is important for total economic activity. While Seattle and NYC are ghost towns this week, Charlotte and Jacksonville are doing fine. The EU is shutting down this week, while China is roughly 80% back to business. None of these relationships are 1 for 1, but the point is that activity isn't going dark all at one time. **It's staggered, and staggered stops are better than full global ones in terms of activity.**

¹ Of course, not all of these folks are at risk at losing their job. Roughly 10% of them went unemployed in the 08/09 crisis. Doubling that to 20% today puts our peak unemployment rate near 6% - the same rate of change in unemployment as the 1990 recession.

How to view your portfolio, always (not just this month).

Why do all those dynasty real estate families have ‘forever wealth’? The kind of wealth that their kids live on, and their kids’ kids? It’s because they can’t panic sell a building when things get crazy and the price doesn’t flash in the yard every day with a gain/loss next to it. No matter how badly they may want to on a particular day, they can’t sell it that fast. And when they do sell an asset, they always exchange it for another one. They are never completely out of the market, no matter what. They aren’t trading or making quick sentiment investments, **they are owners.**

A stock portfolio is a collection of businesses where each one represents an ownership share. As business owners, we aren’t persuaded by price swings or even bad exogenous shocks to just “quit and go home” because our daily or weekly value went down. Just like the big real estate dynasties, their properties = our shares of businesses.

The secret those families hold is that this mentality requires a high-quality portfolio. They didn’t grossly overpay for a building and they didn’t allocate too much to the “stretch bets” that may not pan out. We feel the same about our portfolio of businesses at Doxa Capital. When we make an investment – *or rather become an owner* – we are looking for the best business operators in their respective sector with a management team who are premier allocators of capital. **These businesses have the balance sheet and operations to weather unexpected storms.** This allows us to be calm and disciplined in turbulent times like the present.

Lastly, in a [note from late 2018](#) we talked about never being “all-in or all-out”. Long term investing is done on a sliding scale, sometimes being more defensive and sometimes being more offensive. Throughout the past few notes we’ve been rather conservative which has served us well. While still early in this new exogenous shock, the time is coming to start playing offense. The current market drawdown (*peak to trough*) is already larger than 8 of the last 13 recessions dating back to 1929.

Usually we are trying to fix the financial crisis that is causing human stress. Now we have to fix the human crisis to calm the financial stress.

This time is different.

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