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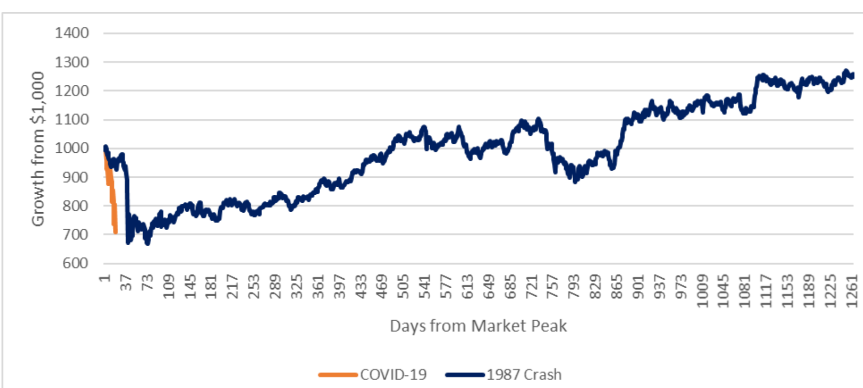
HOW DOES THIS PERIOD COMPARE TO PAST TURBULENCE?

Investors are apprehensive as markets have retreated over 29% in a matter of weeks. The prospect of a massive blow to the global economy from COVID-19 has led to a period of high volatility and downward momentum. For the curious, it's a natural question to ask: how does this downturn compare to other periods of stress that we have seen throughout recent history? Specifically ask how this compares to the Great Recession, 2001 or even 1987.

The truth is this is not 2008. What we are experiencing is an acute shock, rather than a severe recession triggered by significant structural failures in the economy. Entering this period, the U.S. economy appeared on solid footing. We stated in our 2020 outlook that *"despite the cautiously positive outlook, 2020 will likely be a turbulent year. Although the consumer remains strong, existential events could result in decreased consumer and business sentiment, causing an earlier than expected slowdown."* At that time, the existential threat was not a known threat, but rather the recognition that unknown threats to the economy exist. Unfortunately, the existential event which we mentioned is here and it arrives in the form of a pervasive virus that has spread throughout the globe.

What we saw in 2008 was the result of years of poor lending practices, high levels of leverage and speculative investing that caused a contagion effect which rippled throughout the world's economy. The excess that we saw in the economy was so extensive that the impending downturn took over a year and a half to work itself through the system. What we are seeing now is an acute shock which is more appropriately comparable to markets in 2001 or even in the 1987 market crash.

In the graph to the right you can see the similarities between the current market environment we are seeing, and that of 1987.



Source: Morningstar

The period of stress in 1987 was led by the infamous *"Black Monday"* where markets retreated over 20% in one trading day. Although losing a fifth of the market's value in one day seems unimaginable, we are not far off at this point as we have had losses of 7%, 9% and 11% in three of the last six trading days. These losses have contributed to a historic 29% loss since recent highs.

What Caused the Crash In 1987?

The 1987 market crash was not the result of a financial crisis and was not due to a degradation of underlying fundamentals. There are arguments to exactly what the initial catalyst was, but the downturn was likely due to rising interest rates, falling oil prices, an escalation in tensions between the United States and Iran and a tax on potential mergers. What turned the situation from a bad day on Wallstreet to *"Black Monday"* was the recent implementation of algorithmic trading. Algorithmic trading resulted in rules-based systems that decide how to pick stocks, when to place trades and when to utilize volatility as a variable for decisions.[1]

Although the economic backdrops are different, the velocity at which markets have declined are similar. We can attribute some of this to how prevalent algorithmic trading is today, especially with the growth of passive investing over the past fifteen years.

What Caused the Crash In 2001?

The downturn in 2001 was a continuation of the bursting of the dot com bubble. In short, dot com ventures had accumulated an enormous amount of investment heading into the 21st century. As the realization occurred that many of these companies were not viable businesses, stocks came crashing down leading to a prolonged recession starting in 2001. Although this downturn was led by degradation in business investment and productivity, the 9/11 attacks also occurred in this period. Travel and consumer sentiment were extremely low in the days, weeks and months following the attacks. This led to a 15% decline in a matter of days.

[1] *Algorithmic trading uses pre-programmed rules or instructions to trade. The system accounts for time, price, volatility, volume and other market conditions.*

How Do These Two Compare?

While neither event is entirely synonymous with what we are experiencing now, it is reasonable to conclude that we are witnessing a mix of the two. The volatile decline of markets coupled with the uncertainty around the future prospects of consumption, mobility and well-being of U.S. citizens. The good news is that in the long run, following each downturn, we witnessed an increase in global and domestic productivity as well as a sharp increase in market prices. See the 1, 3 and 5-year returns following the bottom of each market shock.

Period (after bottom of shock)	Cumulative	Annualized
1987 Crash – 1 year	25.8%	25.8%
1987 Crash – 3 year	39.9%	11.7%
1987 Crash – 5 year	84.6%	16.6%
2001 Crash – 1 year	-22.5%	-22.5%
2001 Crash – 3 year	-2.4%	-0.8%
2001 Crash – 5 year	7.8%	1.9%

As we navigate through the choppy waters ahead, it is important that you view the recent market volatility in the context of a long-term investor. LAMCO's team is continuing to monitor the situation closely. We are looking for opportunities to hedge risk where possible and upgrade asset holdings at lower prices.

For more information, please call **407.585.1160**

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