Zacks INVESTMENT MANAGEMENT

Portfolio Manager Investing Insights

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4 Lessons from the Last Six Months

When 2020 started, two of my biggest event-driven, macro concerns were rising geopolitical tensions with Iran and the potential for a messy run-up to the presidential election.

Then the pandemic happened.

The ground underneath the global economy shifted astronomically, quickly, and in ways few could have anticipated. Within 30 days, the stock market had declined -30% and the economy was in a deep recession. But then, with the economic crisis seemingly just getting started, the stock market baffled many investors with its strong and "v-shaped" rebound – even as a thick blanket of uncertainty still hangs over the economy.

Needless to say, it's been one of the most interesting starts to a year in my career. Now that we're halfway through it, I think it's a good opportunity to zoom out and take stock of what happened and parse the experience for lessons and insights. Here are four of mine:

1. Risk Happens Fast, But Markets Move Faster

When the stock market peaked on February 19th, the economy wasn't yet in a steep economic recession – but it was about to be. By the time the federal and state governments had started asking Americans to limit travel, socially distance, and stay home if possible (around mid-March), the S&P 500 was already down around -30% and close to hitting a bottom.[1] Risk happens fast, but markets move faster.

The lesson for investors here, in my view, is a stark reminder that while most people assess and understand risk in real-time – based on watching the news or reading the newspaper – the stock market *anticipates* risks before they become widely known. By the time most investors realize it's a recession and an economic crisis, it's too late.

2. Event-Driven Bears are Scary but Lack Stamina

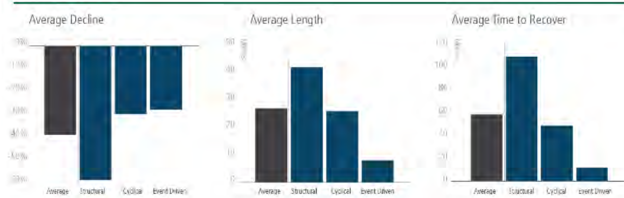
Bear markets generally fall into one of three categories:

- *Structural* bear markets are triggered by structural imbalances and financial

bubbles, often resulting in price shocks and deflation.
- *Cyclical* bear markets are part of a normal business cycle and typically commence during periods of high inflation and rising interest rates.
- *Event-driven* bear markets can be triggered by policy mistakes or any sudden shock. They typically lead to a sharp market decline but not a long recession.

So far, this episode has followed the patterns of an 'event-driven' bear market—steep, but shorter and less severe than structural and cyclical bear markets. I do believe it's possible that this event-driven bear could evolve into a structural bear if the outbreak materially worsens and stimulus ends, but the jury is still out on both.

Bear Markets & Recoveries
1800s to Current



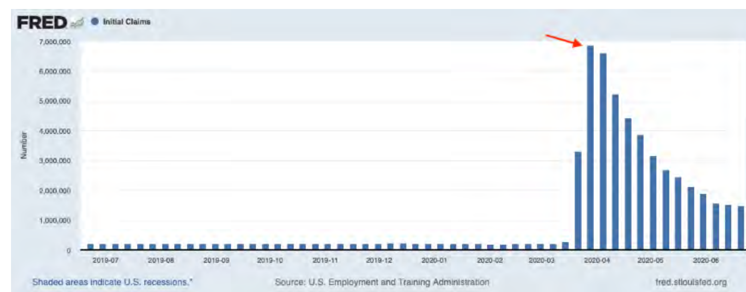
Source: Goldman Sachs[2]

3. Initial Jobless Claims are a Key Indicator for Recessions and Bears

The two charts below look at initial jobless claims, which is defined as a claim filed by an unemployed individual after leaving an employer. The top chart shows the last year, and the bottom chart looks at a period during and after the Great Recession: January 1, 2008 to December 21, 2009. The fascinating takeaway from both data sets is that the stock market bottoms at *almost exactly the time when initial jobless claims reach a peak.* This, in my view, is no coincidence – the stock market is picking up the signal that the worst of the economic crisis is over, even though it will take the job market years to fully recover.

Investors often have a hard time with this reality. How can the stock market go up when hundreds of thousands – or even millions – of Americans are still losing their jobs? The answer is that the stock market is already looking ahead by six, twelve, even two years into the future. Just like the stock market plummeted well before anyone grasped the full damage to the job market, so too does the stock market soar well in advance of the job market recovering.

Initial Jobless Claims, June 2019 – June 2020



Source: Federal Reserve Bank of St. Louis[3]

Initial Jobless Claims, January 2008 – December 2009

Source: Federal Reserve Bank of St. Louis[4]

4. Technology is King, but so is Diversification

The pandemic made even more apparent a trend that was already well underway: rapid expansion of the digital economy. Businesses and sectors that had been slow to adopt technological upgrades, enterprise software, cloud-based systems, and remote work are all scrambling to catch up. Technology helped soften the damage to the economy and the stock market, and are helping lead the recovery.

I've noticed many investors looking to tilt more heavily to technology as a result – I'd urge caution. Exposure to the Technology sector is a crucial component of any diversified equity strategy, there is no doubt about that. But now is a time to remember the merits of diversification as part of a long-term strategy. In my view, pivoting heavily to technology right now puts investors at risk of making two classic investment errors at once: chasing heat, and shifting asset allocation when your long-term goals haven't changed.

Bottom Line for Investors

Above all, perhaps the most important lesson we can take away from the first six months of 2020 is a lesson we've known all along: *don't try to time the stock market.* Risk happens fast, but the markets move faster. When investors try to react in a time of heightened emotion, volatility, uncertainty, and a stream of negative news, it leaves the door wide open to making critical mistakes. Diversification and a long-term focus are still king, but so is patience.

ABOUT MITCH ZACKS

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] Yahoo Finance, July 1, 2020. https://finance.yahoo.com/quote/%5EGSPC?p=^GSPC

[2] Goldman Sachs, Bear Essentials: A guide to navigating a bear market, March 9, 2020.

[3] Federal Reserve Bank of St. Louis, Initial Claims [ICSA], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/ICSA, July 1, 2020.

[4] Federal Reserve Bank of St. Louis, Initial Claims [ICSA], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/ICSA, July 1, 2020.

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