COVID19 Silver Linings Playbook: Synchronicity

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Today is March 27, 2020. One month ago we wrote in our piece COVID19: The Good, the Bad and the Ugly, "Markets hate unexpected bad news, but when the bad news is quantifiable, investors assess impact, react accordingly, and move on. What causes panic and significant and persistent market drawdowns is uncertainty. The lack of reliable and/or complete information creates a void to be filled with worst case scenarios and, worse, fabrications and conspiracy theories, that lead to indiscriminate selling… Past experience tells us that it is never good to join a panicked, indiscriminate selling response. However, it does appear quite likely that the COVID19 virus will trigger at least a short-term global recession and disrupt global supply chains for an extended period of time."

Everything that we wrote on February 27th is still valid now, and the fallout of the COVID19 crisis is starting to materialize. The Global economy is in a recession, perhaps at the beginning of the sharpest downturn in living history. This week, the *Economist Magazine* had a cover graphic of the globe with a "Closed" sign hanging on it, a picture that tells a thousand words about our current situation.

SYNCHRONICITY DRIVES US TO THINK BROADLY ABOUT A FUTURE THAT WILL LIKELY LOOK VERY DIFFERENT.

What makes the COVID19 crisis so exceptional and unprecedented is that it is happening, with just a slight lag, all over the world at the same time. The pandemic, and its economic fallout, have spread to every nation on earth. With all other global crises we have experienced in modern human history, including both World Wars, the Great Depression, the Spanish Flu pandemic, and the GFC, there have been significant variations in severity and timing lags that allowed for some, of the world's economic regions to function at any point in time, and pick up some of the slack for others. With Synchronicity, there is literally no place to hide. Economic forecasts keep declining as the world comes to terms with the lack of containment and exponential case growth of COVID19 worldwide. This in turn threatens the economic health of the few countries like South Korea, Taiwan and Singapore that have seemingly successfully contained the virus and avoided lockdowns by using rapid testing rollout and big data tools to track and manage outbreaks.

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Overwhelmed by the distracting and incessant COVID data and analysis of COVID impacts, we find one way to cope is to take comfort in the wise words of great Philosophers. The one that comes immediately to mind is Seneca, who said, "our fears are always more numerous than our dangers." With that in mind, we felt it was time to start thinking more deeply, and with broader perspective, not only about how much our fears might be clouding our judgement of the dangers we face, but also about how this synchronous global communal experience will impact the future of EVERYTHING.

Predicting the future is impossible. Those whose future predictions prove to be eerily accurate are often beneficiaries of survivor bias, but sometimes they get it right because they are able to think outside of past and current trends and consensus Broad-based, multiple scenario analysis using historical modeling can help gain insight into the future, but the unprecedented synchronicity of today's crisis means that lessons from history are only somewhat useful for modeling the future. This gives us wide berth for thinking about a future that will likely look very different from our recent past, and one where understanding the future lies in thinking outside the extrapolative box where investors typically confine themselves.

Confined to our homes, without the physical camaraderie of our communal spaces, we are advised by public health officials to take care of our mental health by exercising, meditating, and keeping some semblance of perspective. In keeping with the classic movie title of our last COVID19 piece, and in keeping with importance of mental health in this crisis, we have decided to title this series of thought pieces about investing in a post-COVID world after another wonderful film, *Silver Linings Playbook*.

SYNCHRONICITY REVEALS THE NEED FOR A DIFFERENT APPROACH TO INVESTING

Starting with the industrial revolution, the optimization boom has driven innovation and created a virtuous cycle for capital and economic growth, generating incredible wealth for nations and individuals. Investors have rewarded companies for operating at the margin, without incurring the costs that contingency planning creates. Voters have rewarded politicians for slashing taxes and therefore any marginal "fat" in governments, with contingency planning the first to get cut. The Synchronicity of the COVID19 crisis reveals the vulnerable underbelly of this relentless drive of efficiency, productivity, and "fat" trimming. Do more with fewer employees, automate, eliminate redundancy and overlap, make all costs variable, optimize your balance sheet (i.e. give cash back to shareholders and lever up), just-in-time delivery, eliminate empty hospital beds, close small rural hospitals, eliminate medical equipment crisis stockpiles… Reducing any form of slack in a system is an excellent marginal profit decision, but is terrible in a crisis, when that contingency slack would otherwise provide resilience and buy time to adapt. Normal efficient markets allow price to settle supply/demand imbalances. But what happens when you have no supply and/or no demand? There is no efficient price setting, with most prices settling at too low, too high, or arbitrary levels. Throwing liquidity at such a circumstance, as central banks and policymakers are doing around the world, is therefore highly inefficient and probably only marginally effective, but it is the only tool we have that can be summoned on short notice.

Wait, the title here refers to **Silver Linings**! One clear silver lining of Synchronicity is that it forces rapid, collaborative action. Complacency is not an option. We find ourselves in the perfect game theory experiment that should lead to collaboration because the game is repeated every day, and all players quickly discover they benefit from collaboration while all lose from going it alone. We can and do see irrational actors at very high levels making policy mistakes. However, generally decentralized policy and decision-making allows for simultaneous testing and sharing of a multitude of creative ideas, both in treating COVID as well as in dealing with its economic fallout. We are so fortunate that this pandemic did not happen 20-30 years ago, when it would have spread just as easily and rapidly, but information networks were much less robust, information took much longer to disseminate, and big data and AI were still mostly whiteboard material. Now, data from policy and treatment experiments can be shared instantaneously, to be duplicated and confirmed or negated, which means that the world can build a COVID19 toolkit on the fly that adapts constantly to changing needs and experience. This is one of the most significant greatest silver linings of the current catastrophe.

It's absolutely the case that we are flying blind to some extent because we didn't write a playbook for this crisis, despite an abundance of accurate expert modeling, prognostication and planning, realistic (non-Zombie) fictional literature and films, and a broad-based understanding about how a global pandemic might unspool. But perhaps because of this widespread, though neglected, base of understanding, combined with the incredible tools we have at our fingertips, we are writing and adapting a functional playbook for COVID as we move forward, and rapidly correcting our myopia. How similar or different the post-COVID markets are from our pre-COVID world depends on how rapidly we are able to mitigate the crisis as one global humanity. The longer the crisis lasts, the more dramatic the change from pre to post.

Stay tuned for the next installments of our COVID19 *Silver Linings Playbook*, where we will examine investing for a post-COVID world. We plan to look at:

- What questions are being asked and what behaviors are already changing as businesses, governments, and households come to terms with COVID?
- How is consumer psychology changing?
- What are the ESG implications of COVID? Does it accelerate or brake sustainability initiatives?

Of course, as has been the case so far, the rapid pace of change may shift our focus. We look forward to sharing our thoughts and hearing yours.

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