NOTTINGHAM ADVISORS
ASSET MANAGEMENT

2020 SECOND QUARTER UPDATE

"I fear all we have done is to awaken a sleeping giant and fill him with a terrible resolve."
-Admiral Isoroku Yamamoto, *Tora, Tora, Tora*

We hope this note finds you and your family safe and healthy. Our collective hearts and well-wishes go out to all those negatively impacted by the coronavirus outbreak. While our experience tells us that markets will recover in time, the impact on our society may be more profound and last longer than many anticipate.

The first quarter of 2020 brought an abrupt halt to the longest bull market in history. After rising nearly 400% (+522% return including dividends) from its March 2009 bottom, the S&P 500 abruptly slid -20% for the quarter. Of all the possible triggers for a decline that had been bandied about among the pundits, global pandemic wasn't at the top of many lists. But that was it.

We concluded our last CIO Letter by asking the admittedly rhetorical question, Are You Ready? Nothing, however, could have prepared investors for the stunning collapse in equity prices over a volatile three-week period in February and March. Beyond equities, nearly all asset classes were impacted in one way or another as the VIX spiked to a never-before seen level of 82.7. Investor anxiety and confusion turned into a panic level seen only a few times in recorded history.

Thanks to the efforts of the Federal Reserve, credit markets avoided what appeared to be a certain meltdown. And with a $2 trillion+ stimulus package approved by Congress, an economic meltdown may yet be avoided. While the dislocation to both the domestic and world economies will be pronounced, there remains the hope that the contraction will be short-lived.

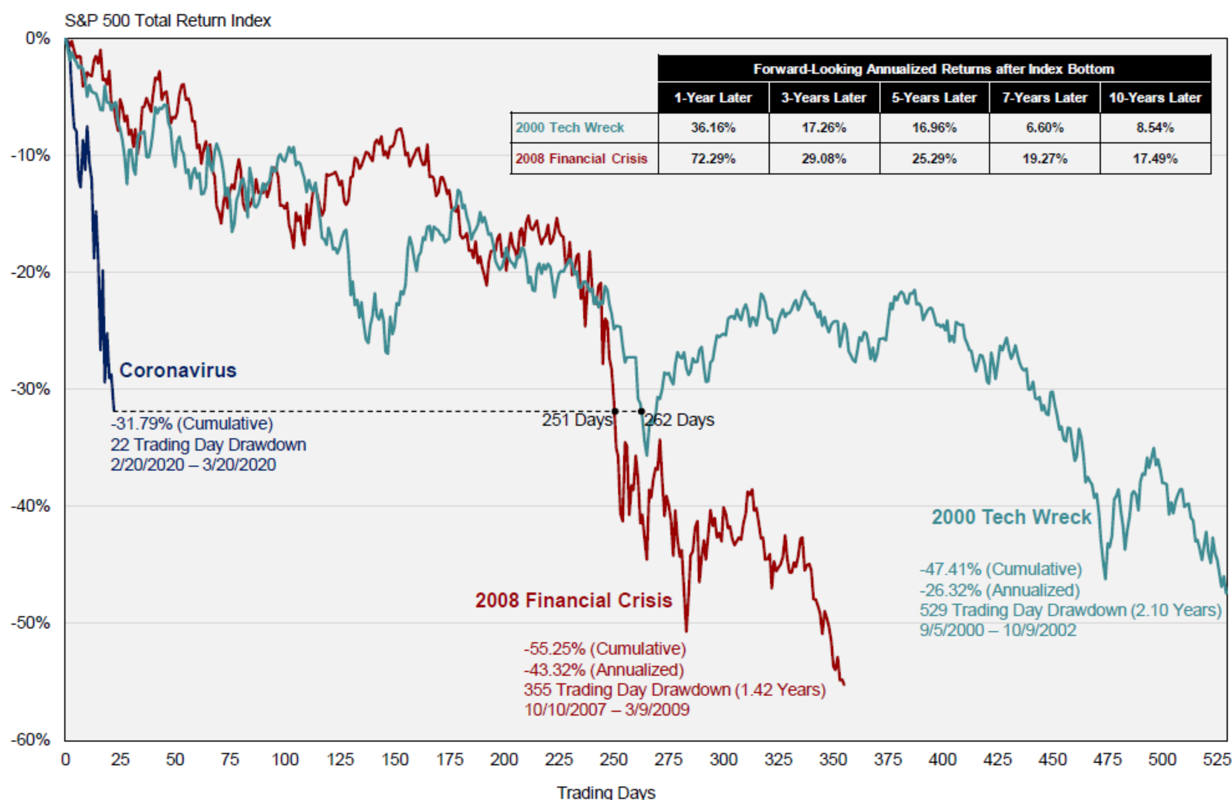
The alacrity with which the COVID-19 pandemic was priced into US financial markets remains hard to grasp. Despite its well-chronicled outbreak in China in early January, US markets continued along as if immune to pandemics. The US stock market hit an all-time high on February 19th, rising nearly 5% in 2020. Within a few weeks, the S&P 500 had fallen -35% from that high print.

The 10-year US Treasury note, which had closed the year yielding close to 2.0%, saw its price surge and yield collapse to an all-time low of .54% as investors scrambled for the safety of US government-backed debt. Demand for ultra-safe Treasury bills was so great that yields actually went negative for a period of time. As we go to press, the offer yield on the 1-month TBill is 0.0%, (we call that the "Blutarsky", after Bluto's GPA from the classic movie *Animal House*).

It seems somewhat odd to be discussing the above in the past tense, as in reality we are still in the midst of the crisis. As you may have noted, we are refraining from commenting on or making prognostications as to the timing and extent of the viral contagion – we'll leave that to the epidemiologists. No doubt, the human toll is tragic and as mentioned above our thoughts are with all those impacted. Nottingham's job is to help our clients safely and effectively navigate their financial pathway through the market turbulence.

At the risk of upsetting some of our readers by invoking the phrase "the long term", there really is no other way investors should be thinking about all the recent volatility other than as to the impact it will have on one's portfolio over the coming 5 to 10 years. Let's use a few charts (courtesy of our friends at AndCo Consulting and American Funds) to illustrate why.

Bear Markets Since 2000 - Comparing Crises
Trading Day Declines from Peak-To-Trough
S&P 500 Total Return Index



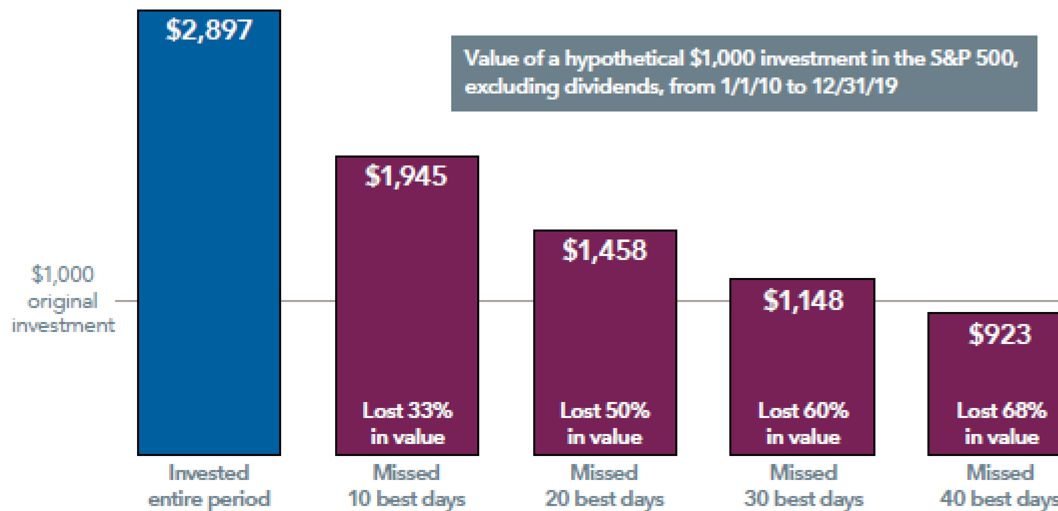
Forward-Looking Annualized Returns after Index Bottom					
	1-Year Later	3-Years Later	5-Years Later	7-Years Later	10-Years Later
2000 Tech Wreck	36.16%	17.26%	16.96%	6.60%	8.54%
2008 Financial Crisis	72.29%	29.08%	25.29%	19.27%	17.49%

Source: AndCo Consulting, using data and information derived from Bloomberg.

While we don't know when the low in the stock market will be established, we would point you to the top right portion of the above chart. This summary looks at subsequent returns after hitting the low. Who knows, the low might be in already. Maybe not. But at some point equities will recover – and possibly advance with a vengeance.

Market corrections happen and each tends to have a unique trigger. In 1987 there was something called "portfolio insurance" which helped propel the Dow down -23% in a single day. 2000 saw the bursting of the tech bubble, followed a year later by the 9/11 terrorist attacks. 2008 gave us the bursting of the credit bubble and the subprime mortgage fiasco. And 2020 has given us COVID-19.

Successfully timing the exits and re-entry's around these events is a fool's errand at best. First one needs to be correct in timing the exit (and don't forget the capital gains taxes on the way out), and secondly one needs to have the courage to get back in, hopefully somewhere near the bottom. There's a reason the market timer's hall of fame doesn't exist. As the table on the next page illustrates, staying the course, in the absence of circumstantial changes to one's personal life, typically wins the day.



Q1 Market Summary

The equity market sell-off in the first quarter took no prisoners. After investors had sold what they wanted to sell, they started selling what they could sell. This led to incredible price dislocations which triggered stock market circuit breakers on multiple occasions. Daily swings of 5%+ were the norm throughout March. There were days when stocks, bonds and gold all fell. Even the normally staid municipal bond saw liquidity evaporate and quotes for high quality bonds plunge more than 10%!

Events were happening so fast that even when we identified veritable bargains, prices dipped another 10%. And then suddenly on March 23rd, after plunging 35%, equities staged a massive 6-day rally that drove prices up nearly +20% into quarter end. Technology stocks held up best during the quarter, no doubt aided by low debt levels and strong balance sheets. Energy stocks were eviscerated as oil plunged from $66 to $24 per barrel. Bankruptcies will likely be widespread in the energy sector over the coming months.

International stocks were hit as hard as their domestic counterparts. The exception to that was the Chinese market, which had fallen precipitously near the end of 2019. Q1 saw the Shanghai Composite return –10%, outperforming most other markets. Despite our skepticism around China's published economic data, reports from Starbucks and Apple would indicate that China is indeed opening back up for business and is perhaps offering the rest of the world a timeline along which we may expect to resume some semblance of normalcy.

Within the fixed income markets, spreads blew out across non-Treasury securities as investors demanded a greater premium for owning non-government debt. Both investment-grade and high-yield debt saw spreads surge towards historically wide levels. Nottingham's positions in Treasury ETF's gained +5-10% while bank loans and emerging-market sovereign debt saw declines of –14% and –16% respectively. We anticipate these markets will rebound as the economy stabilizes and our exposures will likely remain in the portfolio for a while as yields have hit 6.0% and 7.5%.

The municipal bond market bears special mention as it suffered historic drops as liquidity vanished as selling intensified. We were lucky enough to grab a few bargains and were getting ready to "load the boat" when prices snapped back seemingly as quickly as they had fallen. Thank you Federal Reserve (begrudgingly). State and local debt remain one of the safest asset classes around, with exceedingly low default rates experienced, even during the Great Depression. Any renewed weakness will likely be met with more aggressive buying by Nottingham.

Summary – The Path Ahead

As we go to press, markets appear to have renewed their downward bias, likely due to a steadily rising death toll here in the US. Perhaps all the bad news wasn't yet priced in. Our base case is that the market became very oversold, led by panic selling, and is now trying to find a bottom around current levels. We may hover around these levels until the news flow turns more positive, at which point we would expect equity prices to rise gradually and bond yields to climb as well.

We're not exactly anticipating a V-shaped recovery (although we would be delighted with one), as the economic damage from the virus outbreak is so widespread and impactful. We do expect to see the economy gradually recover throughout 2020 and into 2021, given the amount of fiscal stimulus the economic relief package is bringing. Certain industries such as travel and leisure, as well as the energy patch, will likely see slower recoveries. Given the stimulus measures enacted, we anticipate that US equities will beat international coming out of recession and have begun positioning portfolios for that. Our tactical holdings are centered around technology, financials and the coming 5G rollout.

Most Nottingham clients have probably grown a little weary of us constantly harping on the "long term". Times like these are why we do. A loss isn't a "loss" until it's been booked. Stock prices fluctuate – usually drifting higher, but occasionally falling sharply. A steady discipline is required to capitalize on volatility. Bond prices have surged and stock prices have fallen. Who has the courage to sell some bonds and buy stocks? We do. It may not pay off next week or next month, but likely by next year, and there's a high probability that over the next 5 to 10 years, equity returns will FAR exceed bond returns. No guarantees, but I'd be willing to make that bet.

From all of us at Nottingham, we hope you are staying safe, staying sane and staying invested. This too shall pass.

Larry Whistler, CFA
President/Chief Investment Officer
April 2020

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