

March 20, 2020

## What do we do now II?

Every January, highly respected Wall Street analysts publish their predictions for how the US stock market will perform over the upcoming year. Every year their predictions look about the same, generally they predict a positive return of somewhere between 2% and 8%. These kinds of predictions are often referred to as “Goldilocks” predictions: not too hot and not too cold, instead a nice comfortable range. Virtually all these predictions huddle close together, there are almost never outliers. This makes sense, because accurately predicting the future over a short period is incredibly difficult, if not impossible, and no one wants to look foolish compared to the rest of the pack.

Most people would agree that short term predictions about the stock market are worth very little, and no one should commit significant dollars to this kind of guesswork. No one has a crystal ball. However, something changes *dramatically* when collective predictions turn negative. When faced with a negative event, we are much more inclined to believe the gloomiest outlooks.

All humans are predisposed to something called “negativity effect”. The reason we do this is straightforward; we all hate loss more than we like gain. This hatred of loss is further magnified when we are under periods of stress. Academic research suggests most of us hate loss 5 times as much as we like an equal gain. This is not rational, but it does frame our actions.

Here’s the point I want to make. If we accept that short term predictions under normal circumstances are unhelpful, negative predictions are just as ineffective in just the same way. We don’t necessarily *feel* this is true, but that is because we are so heavily influenced by the negativity effect.

There is a major positive in all of this and it is something that is largely overlooked right now. Below is a graph of Google search trends for the word coronavirus. This maps the popularity of searches for this term. Prior to mid-January no one was searching for this word. I have placed a red dot on the graph when Wall Street analysts made their predictions for the year. None of their predictions would have included the fallout from the coronavirus. How could they? It hadn’t been a widely known issue yet. But that is exactly the point. The reason their predictions are ineffective is because they only included known information at the time. As soon as coronavirus showed up their predictions became meaningless. This is good news!



The reason it is good news is because all the negative predictions about where the coronavirus is taking our economy also only include information we already know. Humans are uniquely creative and are highly adaptive. There are many critical changes coming to this storyline which have yet to be uncovered. We should expect innovative therapies, beneficial government programs, surprising triumphs and shocking revelations. We cannot accurately model any of these things, because they have not yet taken place. But we can be sure, many positive changes will occur between now and the end of this crisis.

One of my favourite WSJ columnists recently wrote the following:

The Great Depression brought unimaginable financial pain. It also brought us supermarkets, microwaves, sunscreen, jets, rockets, electron microscopes, magnetic recording, nylon, photocopying, teflon, helicopters, color TV, plexiglass, commercial aviation, most forms of plastic, synthetic rubber, laundromats, and countless other discoveries.

Same for World War II, which is responsible for both the most risk and the most rapid invention of any six-year period in history. The war began with troops on horseback. It ended by splitting an atom in half.

Writing in 1952, Historian Frederick Lewis Allen describes the burst of scientific progress that came during the war:

*What the government was constantly saying during the war was, in effect: "Is this discovery or that one of any possible war value? If so, then develop it and put it to use, and damn the expense!"*

The war gave rise to everything from penicillin to radar to nuclear power. All of those ideas had been largely discovered, at least on paper, before the war. But the life-or-death urgency of the situation sparked rapid refinement and deployment, in some cases generating the kind of technology advancement you might expect to occur in a generation into literally a few months.

The most important innovations are born from panic-induced necessity more than cozy visions. That's been true for a long time, and I can say with high confidence that it's true today.

This week I spoke with two of our largest positions (representing 22% of our total portfolio) and both have been very active over the past month. Coming into this crisis, they both had a significant amount of cash (30% of their fund in one case) and have been actively deploying it into some of the companies that will undoubtedly profit from the types of optimistic situations I mention above. Both investments aim to take advantage of other investors inability to see past the short term.

I believe as we eventually exit from the coronavirus dilemma, we will be surprised at how many negative stories we should have discounted and how optimistic ones should have had our attention all along. There are real challenges to be addressed, but we will get through this. We are investing with this cautious but optimistic view in mind.

I am here to help. Please contact me if you have any questions or concerns.



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