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This Column Is Not Brought to You by the Letter V: Macro Man

By Cameron Crise

(Bloomberg) -- You can tell a lot about yourself by the company you keep. These days, it feels like every comparison I run on the extraordinary price action of recent weeks is littered with prior examples from 2008 and the Great Depression. It doesn't exactly make for comforting reading, even with the proviso that the market is not the economy. Currently, of course, everything is responding to the exogenous shock of the COVID epidemic, which presents both a threat and an opportunity. In the near term, focus is naturally on containing the human and economic impact of the virus, but should those efforts succeed the temptation is to think that we're set up for a V-shaped bounce. Perhaps that's how things will play out, but the odds are against it.

- As markets play for a significant bounce after Monday's brutal equity session, the comparisons to prior financial crises are coming thick and fast. In some ways, though, what we're observing is unprecedented. Every month this year, the S&P 500 has been up at least 3% month-to-date, only to give back those gains and see them turn to losses on an intramonth basis. By my calculations that's only occurred 60 times since SPX price data begins in 1928, and it has never before happened three times in a row. Just because implied volatility is high doesn't mean that it's expensive!
- Obviously, we're all grappling with the impact of the virus and what it implies for the economy and markets. Significant or total lockdowns, such as we've seen in China and Italy, are going to leave a significant mark. The good news is that the authorities are starting to respond, with the Italians discussing measures such as mortgage relief and the White House mulling a payroll tax cut. The bad news is that the real locus of pain is going to be among small businesses and their employees, and they are going to be difficult to reach with the top-down tools under discussion.
- It's a cliche that every general plans to fight the last war, and every policymaker's instinct it to employ the tools from the previous crisis. Unlike 2008 or 2011, however, banks are not at the epicenter of what's going down. FRA/OIS spreads have widened a bit, but that's come in the context of falling yields across the board. That's not what you would expect to see in a solvency crisis; instead, the collapse in share prices reflects a profitability crisis thanks to the economic and policy outlook.
- In a sense, this makes the current issues more difficult to solve. It's easier to design a program to bail out or support a relative handful of large banks than it is to lend a hand to tens of thousands of SMEs. Imagine you're the operator of a small diner in Seattle or a cafe in Milan employing workers on an hourly wage. You may well need to shut up shop while the streets are deserted, but still need to meet your overheads. How do you get the credit? Probably not from your risk-averse bank. Mortgage relief doesn't help your employees if they are renting. Neither does a payroll tax cut if they aren't working and earning, because zero times any tax break yields an economic benefit of zero.
- Now, hopefully all of this can be resolved, but at this point it's just a hope. As of Tuesday morning there's still plenty of confusion about what if any measures the administration is ready to roll out, with plenty of conflicting reports. Still, I guess the hope that the authorities can pull it all off, avoid recession, and send equity markets skyrocketing higher is understandable. The next few days may be telling, and if we make fresh lows the historical precedents are not exactly comforting.
- I looked at every 20% drawdown from the all-time highs in the S&P 500 since data begins in 1928, calculating how long it took to fall that far and when the index eventually traded to new highs. I also noted the PE ratio of the index at its peak. Now, with the proviso that we have yet to fall 20%, if it does

happen over the next week or so it would represent a drop of unprecedented speed. It's worth noting that the MINIMUM number of trading days it's taken to reclaim the highs in prior episodes was 320, or roughly 15 months. The median was 704 days -- two and a half years.

PEAK	P/E RATIO AT PEAK	TRADING DAYS UNTIL 20% DROP	TRADING DAYS FROM 20% DROP TO NEW ATH
9/16/1929	#N/A	30	6526
8/2/1956	13.83	317	558
12/12/1961	22.40	119	449
2/9/1966	17.98	143	320
11/29/1968	17.97	304	850
1/11/1973	19.46	228	1959
11/28/1980	9.12	321	502
8/25/1987	22.48	39	500
3/24/2000	30.56	251	1872
10/9/2007	17.52	196	1426
2/19/2020	22.26	14 DAYS SINCE PEAK	?

- While there are no guarantees that a) we'll draw down 20% from the peak or that b) we'll follow historical precedent, currently things don't look promising. There has been a modest negative correlation (-0.44) between the speed of the drawdown and the length of the subsequent recovery, and we're looking at potentially the fastest-ever 20% decline from the highs. There is a positive correlation (0.46) between the P/E ratio at the peak and the length of the eventual recovery; last month's reading was above both the average and the median observed at the start of prior bear markets.
- For the last decade-plus, financial markets have enjoyed a lengthy party thanks to easy monetary conditions and consistent economic growth in the U.S. It may be the case that the bill has finally come due. American readers may recall the children's television show "Sesame Street," where daily episodes would be "sponsored" by integers or letters of the alphabet. Well, my people rang the letter V to try to secure sponsorship for this column. Unfortunately, it wouldn't answer the phone -- perhaps it's on lockdown.
- NOTE: Cameron Crise is a macro strategist who writes for Bloomberg. The observations he makes are his own and not intended as investment advice. For more markets commentary, see the MLIV blog.

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