Corona Crash

Market crashes are often described as times of great uncertainty. This is both right and wrong. It is right in that it is almost impossible to predict what will happen the next day. However, all market crashes follow the same universal pattern. That makes the long-term outcomes very predictable.

Every market crash starts with a triggering event (e.g., coronavirus) and stretched valuations (e.g., S&P 500 after a decade of gains). The trigger event causes traders to become fearful. They start selling their risky positions. This selling causes the indices to decline which makes traders more fearful so they sell more, and so on until we get a series of steep declines punctuated by a few strong gains.

Eventually the fear abates, and traders start picking through the wreckage to find bargains. This causes prices to rise.   Eventually valuations again become stretched, and the cycle begins anew when a triggering event occurs.

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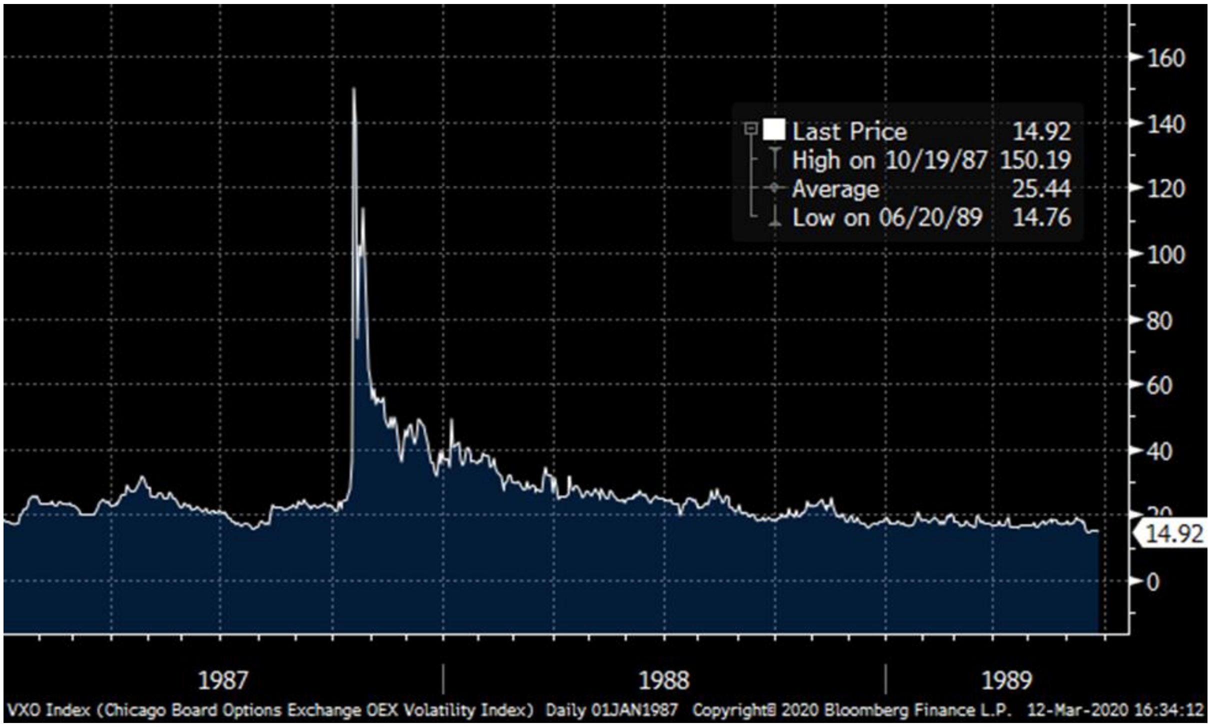
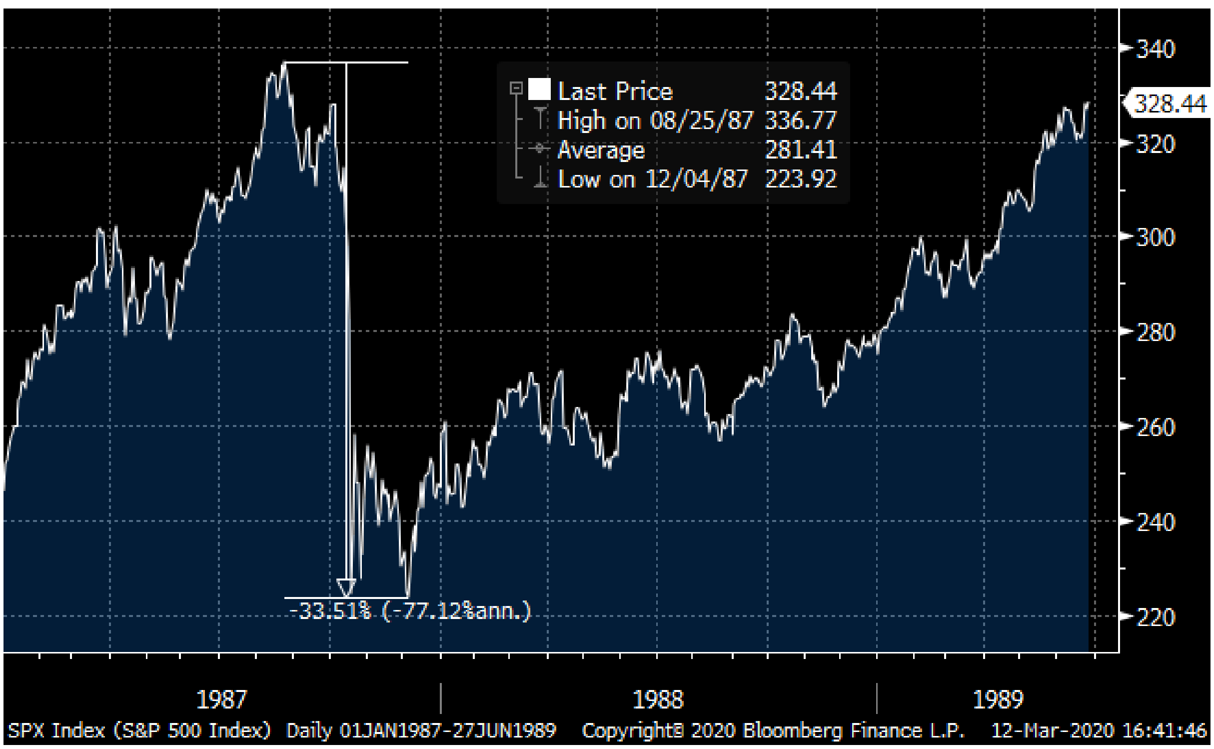
The Crash of 1987

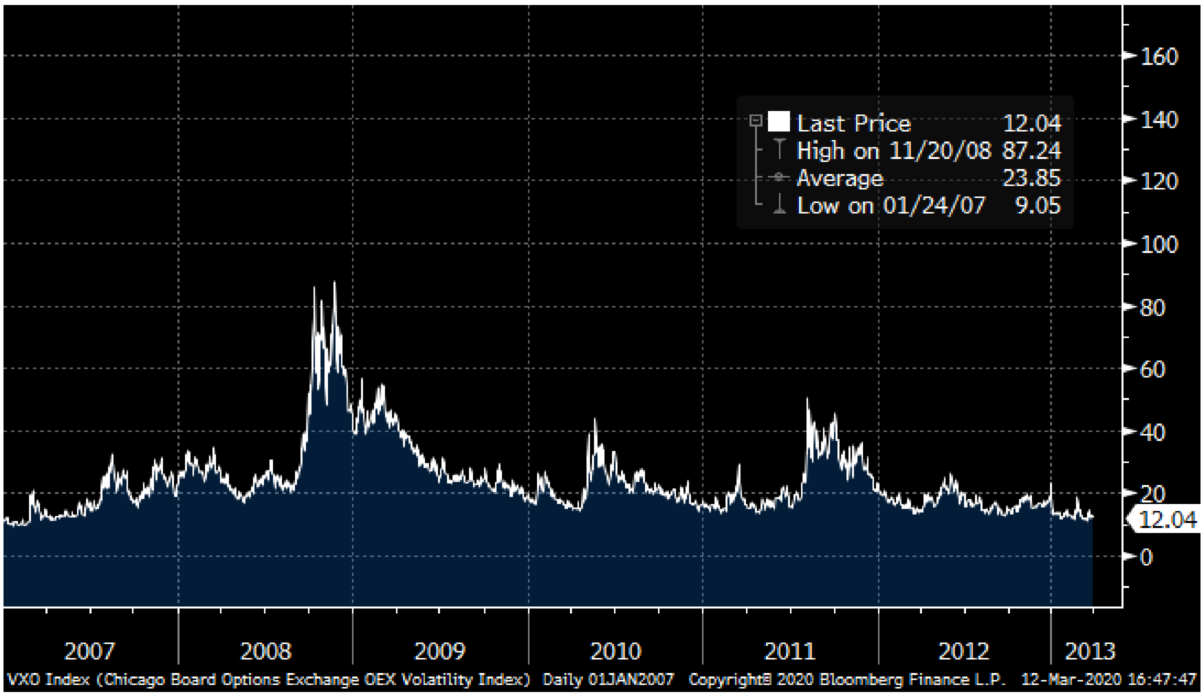
Black Monday had the highest observed fear level of 150. The S&P 500 dropped 34% from peak to trough. This crash happened over a single weekend. It took 22 months for the S&P 500 to recover.

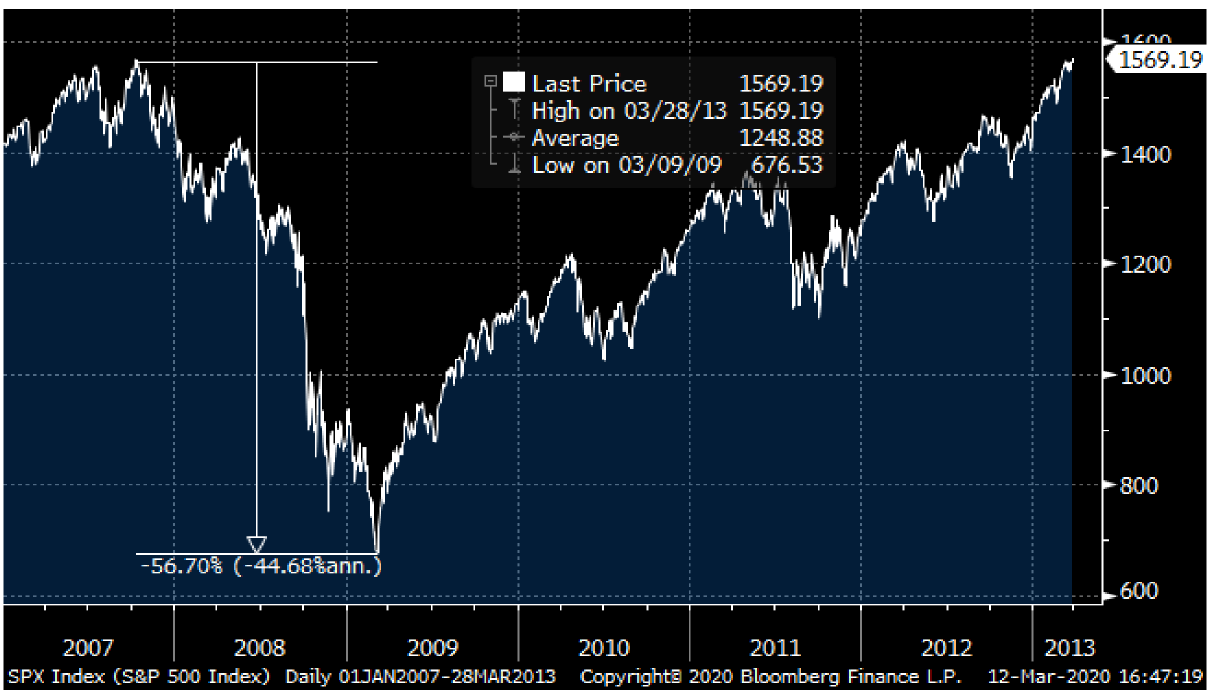




The Crash of 2008

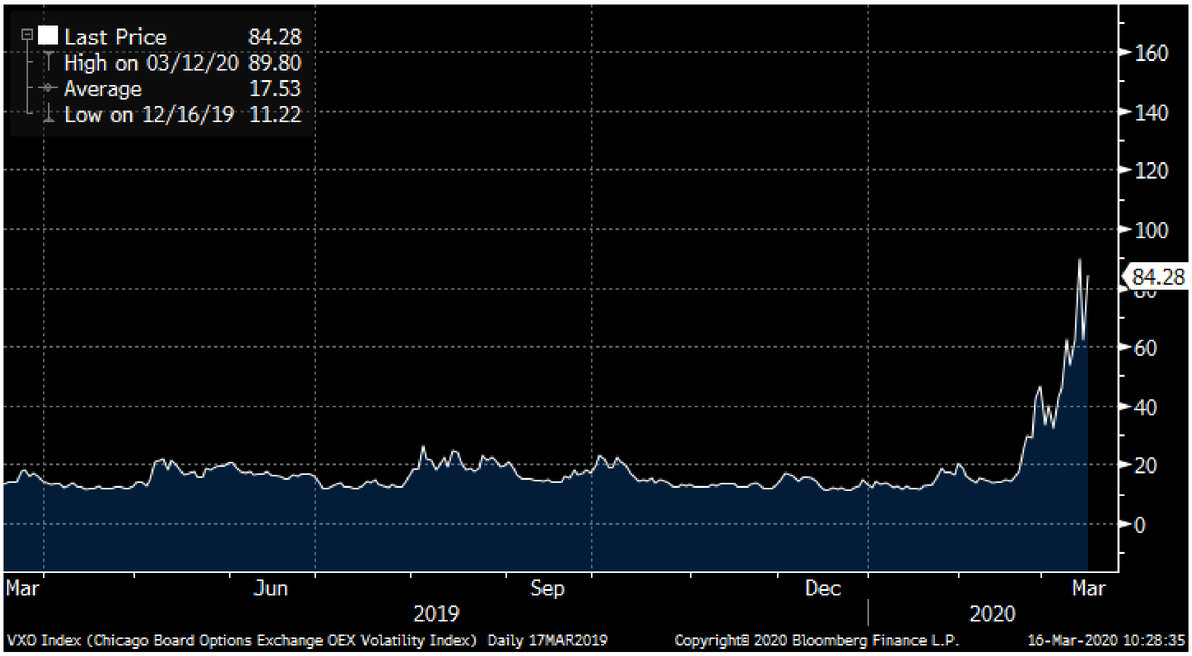
The Great Recession unfolded more slowly than the Crash of '87. It took about six weeks for the VXO to exceed 85. Fear levels rose to about 87 at the peak, and stayed elevated for around 18 months. In that time frame the S&P 500 lost 57%. As fear levels fell the S&P 500 started to recover, eclipsing its previous high after 66 months from the start of the crisis.





The Corona Crash of 2020

The Crash of 2020 is virtually certain to follow the same pattern as the two examples above. Fear levels are comparable to those from the 2008 Crash, but the Corona Crash is moving faster, taking only three weeks to exceed a VXO level of 85. We do not know how high the fear index will spike, nor do we know how quickly it will decline. But we can be confident that the fear will eventually abate and that the stock market will recover when that happens.



Market crashes are a normal part of financial markets. They feel chaotic because they shatter the status quo and replace it with wild price swings. But once we take a step back from the daily fluctuations and the screaming media, we see that they all evolve according to the same template. Wild price swings will continue while fear runs high. When fear recedes, the swings will get smaller and the market direction will turn up.

We encourage you to let the predictable market crash pattern, rather than the latest sensational headline, guide your financial decisions.

Please let us know if you have questions.

Pivot Point Advisors