ACCRETIVE WEALTH PARTNERS

Accretive Q1 2020 Letter – Stimulus Policy Response

Policy Response

The most important response is the public health response. We are not qualified to speak intelligently about the nuances of the public health response, so we will not, but we do believe a well-executed response should result in better health outcomes for the nation, and that would be good for the economy in the long run. The more effective the response, the sooner we can get a handle on the economic ramifications and the markets can begin to look through the economic damage to a recovery.

There are two types of responses that we can speak intelligently about, and they address the economic shock. Those two responses are fiscal and monetary.

The monetary response comes from the Federal Reserve. The Fed, in coordination with other central banks, has been swift and robust in heading off a financial crisis. Chairman Powell dusted off the playbook from 2008 and then added some new plays to it. As the virus's impact on the market began to stress the system, they sprang into action by aggressively cutting rates, setting up lending facilities, setting up commercial paper facilities, and launching QE infinity. The stimulus bill has also capitalized the Fed with $500 billion to lend up to $4 trillion to US companies. These are just the most notable moves, but they also issued joint statements with other regulators instructing banks to essentially "work it out with your borrowers". The banks going into this were very well capitalized and ready to weather a severe shock. The last time they needed to be rescued, and this time their regulators are telling them to take one for the team.

The fiscal response comes from the Federal Government, which has also been robust. Congress passed a few different rounds of relief and legislation aimed at supporting the health care system, furloughed/dislocated workers, small businesses, affected industries and the broader economy. The most notable is the CARES Act, which provides over $2.2 trillion of stimulus. The good news is Congress and the White House got their act together pretty quickly to pass meaningful relief, but the bad news is these things take time to implement and they may be back for more stimulus to help control the collateral damage. As we write this, politicians are already discussing a fourth (and fifth) round of stimulus in the House and the President is suggesting a $2 trillion infrastructure bill. The US government has pulled out a financial bazooka and will likely keep firing it until it is no longer necessary. It is a war time spend, but it reflects the reality that we are at war with the virus. In the end, we feel confident that policy makers will spend enough cheap money to blunt the effect of an extreme contraction in GDP running from mid-March through the end of the war. We think the prevailing attitude can be summarized as "Do. Whatever. It. Takes."

Our Investment Thoughts as the Virus Spread

In mid to late January, we began to hear more about what is now called Covid-19. We thought it might weigh on global trade a bit, disrupting supply chains from China in particular, and if it resulted in a slowdown, we would get more easing from the Fed.

As we got into late February, it became clearer that the virus would be more disruptive than we initially thought. We attempted to jettison equities that we thought had real balance sheet risk in a recession. However, we were also of the opinion that the more significant the impact, the more significant the policy responses would be. At that time, we did not see a shutdown coming let alone consider all the ramifications of a large quarantine on the US and Global economies.

March came roaring in like a lion as it became clearer that more was required to combat the virus than practicing good hygiene and keeping a safe distance from others. The first three weeks (in markets) reminded us of the Global Financial Crisis: emergency actions from the Federal Reserve announced Sunday evenings before the Asian markets opened, emergency press conferences, and emergency legislation. Congress seemed to be at least a week behind in their measures, as a $750 billion bill became $1 trillion, then $1.8 trillion, until finally we got the $2.2 trillion bill.

What We Think Now

We think the United States will win the economic war on the virus. We believe the US has several key advantages that other economies struggling with the virus do not have. The federal government borrows in its own currency at low rates, a capability that most emerging markets do not have. The US population is generally younger and still growing, unlike the EU or Japan. The entrepreneurial spirit of its citizenry results in the US economy being fundamentally more dynamic than the rest of the developed world.

Globalization has been in slow decline since the Global Financial Crisis and this may have the effect of speeding that up. This could hurt all the countries that disproportionately benefitted from globalization. The good news is that the United States, with all its resources, can operate quite well as a fairly closed system. We would not be surprised to see companies build supply chain capacity in the U.S. and/or in North America as a result of this experience, particularly in higher value goods like pharmaceuticals and technology.

Compared to more authoritative governments we think that the United States may have had some disadvantages in initially confronting and combating the virus, but we believe it is the best positioned to handle the economic effects.