Argent Capital Management LLC

Market Overview – March 2020

March was a tough month for the market, down nearly 14%, and closed a very difficult first quarter of 2020, falling over 21%. What seemed so promising coming into the year, improvements outside of the United States, indications that the manufacturing economy within the U.S. was strengthening, were quickly dashed by something that seemed more like a bad Hollywood movie than real life – COVID-19.

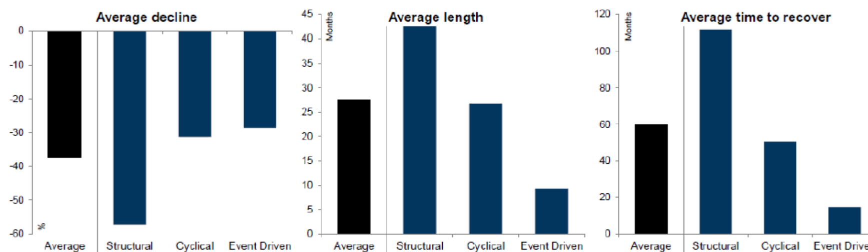
The last week of the month saw unemployment claims jump to a weekly record of 6.6 million. Only recently one of the complaints we and the markets had heard was that businesses would grow more if only they could find more people. How quickly things can change. Expectations now are that the unemployment rate, which was running at a 50 year low of 3.5%, will soon eclipse the peak of the Great Financial Crisis of 2007-2008 at 10%.

Perhaps adding insult to injury, on March 10th the Saudis announced they would increase oil production by 20%. This was in response to the Russians not agreeing to an OPEC+ production cut. The Russians, likely not to be bullied by the Saudis, responded in kind, announcing that they would boost production by 20%. The price of crude oil, which had started the month at a little over $47 per barrel, closed the month at $20.50 per barrel, a drop of nearly 60%. Good for us drivers of cars, not so good for any oil company, oil service company or any of the many related industries.

Where are we today? I am going to trot out our 'Rule of 20' which says the market's price earnings ratio – what investors should pay for earnings in twelve months – equals 20 minus the yield on the 10-year Treasury bond. The yield on the 10-year U.S. Treasury bond was 0.7% at the close of March. The simple math, 20-0.7, implies that the market should be trading at 19.3x forward earnings. Instead, the market was trading at approximately 15x forward earnings at the close of the month. This suggests that the market is undervalued by over 20%. One of the problems with this valuation metric is the moving target of earnings in 12 months. To put some context around that, at the end of last year consensus earnings expectations for the S&P 500® Index for 2020 stood at $177.33 per share. At the end of March earnings expectations for the year had fallen to $159.72, or a drop of nearly 10%, and those estimates continue to fall. We should get some clarity from publicly traded companies in April as most report their first quarter 2020 earnings, but certainly business is getting more difficult for most companies today.

What will happen next is much like earnings expectations for the market – a *moving target*, with updates that are generally worse than prior estimates. Investors are looking for a flattening of new cases of COVID-19, with the thought that flattening means a peak and after a peak the world will improve. So far we have not seen that flattening, although investors are looking at China as a potential roadmap for the rest of the world.

US Bear Markets and Recoveries since the 1800s



Source: Goldman Sachs Global Investment Research

The chart at the left looks at historic bear markets:
The chart shows the average decline, length and time to recover for structural, cyclical and event driven markets. Structural bear markets are characterized by those created by imbalances and financial bubbles, very often followed by a price shock like deflation. Cyclical bear markets are typically a function of the economic cycle, marked by rising interest rates, impending recessions and declines in

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profits. We would argue that we are living through today falls under the 'event driven' category, defined as an exogenous event that brings down the economy. If that is the case and if history proves as guide, then we should realize a shorter bear market than most. In the meanwhile, we at Argent are looking for opportunities to upgrade our strategies to buy truly great companies trading at a discount and take full advantage of the pullback that the market has presented us.

We have great clients and what is most important to us is that our clients stay safe and that they know we at Argent are working for them. If you have any questions please call or email us. These are very tough and unusual times, but everyone at Argent is here for you and would welcome the opportunity to help you in whatever way we can.

We have four successful equity strategies – Large Cap, Small Cap, Dividend Select and Mid Cap. If you have questions on any of these options, please call us.

Sincerely,

Ken Crawford
Senior Portfolio Manager

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