

Memo to: Starvine Clients  
From: Steven Ko  
Re: COVID-19



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## **A Few Unusual Months: Part II**

On March 16, I published a note titled “COVID-19 = Coiled Springs 19.” Its intent was not so much to serve as a call-to-action, but rather to provide a voice of reason during a time of market panic. It was happenstance that the memo was released five trading days before we hit bottom. Referring to my own words, I wrote:

*If I had a lot of cash, I would definitely invest a portion of it today based on the bottom-up value opportunities created over the past three weeks of panic selling. I say that knowing full well that we may not have reached the bottom. We may have another 10% to 30% to go on the downside.*

The rearview mirror shows there was only 6% remaining to the bottom for the S&P 500 from the close of that day. All in all, in the space of only 23 trading sessions from the peak on February 19 and ending March 23, the S&P 500 plunged 34% while the S&P TSX Index gave up 37%.

At the time, China had successfully clamped down on the spread of the virus, while the rest of the world was just beginning to see the concept of compounding work its powers with virus case numbers. Since then, the planet spiraled into a lockdown unlike anything seen before. I thought at the time that a deceleration in new case numbers would be needed to provide the markets with the needed confidence to stage a meaningful comeback. That turned out to be dead wrong as it was the announcement of massive government stimulus that provided the necessary electrical shock.

### **Where Are We Now?**

As of this writing, the v-shaped market recovery has eliminated most year-to-date losses and the NASDAQ is now squarely in positive territory. The bifurcation in equities has only further increased as the large cap tech stocks continue to outpace almost everything else on a year-to-date basis; it is therefore misleading to look at index averages as a fair representation as to what’s happening in the market. The indexes don’t appear cheap after the rebound, so a critical question is how closely does one’s investments resemble the indexes? But it isn’t so easy as to say tech stocks are overhyped and don’t deserve the capital appreciation they have experienced.

Companies that have benefitted from the virus have been embraced strongly by investors. It so happens that most of the FAANG group (Facebook, Amazon, Apple, Netflix, and Google) have experienced a spike in the usage of their services since the lockdown. The next group consists of companies whose revenues may not directly receive a push from the lockdown, but whose business operations and/or cash flows have been largely unaffected due to the ability of employees to work from home. Lastly, we have the ‘COVID epicenter’ group – companies whose operations experienced a near total closure during the lockdown. This final group (think airlines, anything dependent on a retail footprint, hotels, and commercial real estate) is still down significantly from the February 2020 highs despite the sharp bounce from March 23.

## Don't Allow Anchoring and Fear to Override Logic

In the near term, there is a lot of uncertainty on the macro level and headlines. Most experts believe there will be a strong second wave of the virus in the fall, while the first wave has yet to end in most of the world. The U.S. presidential election and its result will likely be a source of wild, unpredictable fluctuation. And despite all this uncertainty, why do I posit that fixation on these unknowns is the wrong approach?

I actually believe it is harmful to one's well-being to allow fear of the unknown override investment decisions that otherwise would have been made, especially if said decisions would have been based on the 'micro' analysis of a business. This is especially topical now as the 38.5% spike off the March bottom for the S&P 500 creates the immediate impression that equities have climbed too far and too quickly. The point is that basing a key decision off the optics of the increase, which rely on one reference point (the bottom) is incomplete. And what if hindsight proves market timing to be 'right'? The irony is that success in making such a call will damage most people who get lucky. Falsely attributing skill to luck can form the basis of future decisions to make big moves in or out of cash depending on short term views of where the indexes will go.

### The Irony

It isn't 'getting it right' with tactical maneuvers during this recession that matter most for one's long term well-being. Did the investor short the market or raise ample cash before the crash? Switch to 'work-from-home' stocks in a timely manner? Aggressively invest during the darkest days? Such moves would have been beneficial to returns in the here-and-now, but beware of confirmation bias and the damage that being right or wrong with short-term hunches can do to rational conduct.

Instead, it is keeping grounded and having the right psychology that matter most for achieving long-term compounding. Think of a level used in woodworking: we are confident the positioning is level with the ground if the bubble is positioned between the two markers. The same applies to confidence in investing in that we must not allow wins to blindly reinforce previous decisions, and vice versa our 'losers' can incorrectly reinforce against thinking that may yield the opposite result going forward.

Decision	Short-term investment outcome	Reinforcement	Consequences
Bought before cliff	Down significantly	Under-confidence; regret over not timing investments better	Short-termism and thoughts on market timing may override fundamental long-term analysis
Sold before cliff	Unaffected by crash	Over-confidence; timing the market is paramount to business analysis	Short-termism and thoughts on market timing may override fundamental long-term analysis
No trading – 'round trip'	Down moderately	Missed opportunity by not having ample cash	May bias one to hold significant cash balance through the whole cycle
Bought on the way down with no short term expectations	Profitable	Impossible to pick the exact bottom	Good reinforcement provided investor does not become overconfident

## So What Should I Do?

One of Charlie Munger's maxims is 'invert – always invert'. Try to work backwards from a stock's current price (which represents a slice of owning the whole business) and impute what level of organic growth, margins, or other assumptions must come to fruition in order to justify the price. Do not fixate on share price movements, whether it be the percentage decrease year-to-date or the increase from the bottom in March. Despite the number of moving parts, can a sense of comfort be gained that the current price imputes not only reasonable expectations about the future, but moreover room for things to go wrong? Take a look, name by name in the portfolio and honestly evaluate. If such analysis is not relevant to a particular holding, why not? There should be a good reason.

If we were to visualize ourselves conversing 10 years in the future on stocks that had generated even only mediocre returns for the past decade, I am certain hindsight will show that it was a mistake to sit on the sidelines in June 2020 solely because of anxiety. Up close, seeing the market price of an investment decreasing 50% may be feel gut-wrenching. However, expand the view to a high level over decades and the pain is reduced to a bump in the road, assuming of course the company in question ends up being a *growing* concern. The benefits of staying the course from this perspective far outweigh reacting 'correctly' to short term stimuli. If one does not have the time horizon or willingness to stomach the inevitable fluctuations that are attached with equities, there are always other asset classes.

Yours in receding semi-isolation,

Steven Ko

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