CIO Quarterly Commentary
1Q2020

The Surreal Impacts of the Coronavirus
Because I didn’t read comic books growing up, and today still prefer non-fiction to fiction, it feels like I’m at a big disadvantage in understanding today’s surreal environment. I might fare better if I had more experience in imagining plots to destroy people and economies with one fell swoop. Fortunately, TIFF’s investment team is a strong group of highly educated, hard-working people with different backgrounds, religions, beliefs, and ages. In my 4+ years as TIFF’s Chief Investment Officer, this group has never worked as hard as they have in the last six weeks to understand the investment environment and opportunity set. Today is not business as usual, it is business at a much faster pace, with much bigger rewards and penalties attached to each decision.

Three months ago, the world seemed relatively normal. The U.S. was busy levying tariffs on many countries, friend and foe alike, our federal budget deficit was running at a little over a $1 trillion annual pace, stocks had just finished a strong 2019 on the heels of a poor 2018, folks made their semi-monthly pilgrimages to Costco for extra supplies, dinner out was a treat, and filling up the car with gas was a little bit painful. Then everything changed. Tom Brady threw a “pick-six” and the Patriots didn’t make the Super Bowl, interest rates on treasury bonds began to move lower, and China signed a trade pact with the U.S. to buy billions of dollars of our exports, while locking down Wuhan because of some virus.

Since then, change has picked up speed – a lot. In just three months, the economy and capital markets became unsettled and volatile. We will try in this note to share our views on today’s environment and what it may presage. To do this, we will use time-tested tools to explain new ideas we are learning about. The prism through which tomorrow must be viewed is most definitely changing. We admit that much of what we believed for the past 40 years now seems trite, pedantic, and parochial.

Early in the current crisis, most investors underestimated the impact the coronavirus could have on global health and the global economy. That changed sometime in February. On February 15, 2020, the U.S. had just 15 reported cases of the virus. On February 19, 2020, the S&P 500 peaked at 3393 two days before reported coronavirus cases in the U.S. jumped from 15 to 35 and 30-year treasury yields dropped to 2% from 2.4% at year-end. Over the next six weeks or so, it became crystal clear that the world was facing a global pandemic for the first time in 100 years. During that time U.S. stocks, as measured by the S&P 500, dropped as low as 2191, and 30-year treasury yields traded below 1% - the lowest yield ever on U.S. 30-year treasuries. Approximately two-thirds of U.S. citizens have since been ordered by their state governors to shelter-in-place. Most schools are closed. Restaurant traffic across the nation has officially declined by 100% (not counting take-out) according to OpenTable. Passenger airplane travel is down by over 80%, with major airlines cancelling about half of their flights amid rumors of plans to halt all flights for some period of time. Car traffic is down by at least 30%. Combined with a breakdown in the OPEC+ cartel caused by a falling out between Russia and Saudi Arabia, this simultaneous drop in demand and rise in production is destroying the price of oil and many companies and countries reliant on the price. Exactly how it will ripple through our markets is unknown, but the ~$20/barrel price is sure to bankrupt some of the weaker players in the short...
run and cause problems in the high yield energy markets. If the 2016 oil price collapse is any guide, however, the U.S.-based survivors will pick up the pieces of the industry, becoming more competitive than before.

The result of all of this and more is certain economic decline. Many economists are forecasting a pullback in Gross Domestic Product in the quarter ended March 31, 2020 followed by as much as a 30% decline in Q2. You read that right, -30%. Never before has such a brick wall been placed in front of economic progress. Cash flow at all businesses is decreasing, and some businesses have been forced to close completely – watching their cashflow drop to zero. Earnings per share at public companies is going to fall dramatically. If we come out of the current health and economic funk and avoid the “tail risk” of a depression.

As your investment partner, we are always on the lookout for both risks and opportunities. The crisis hasn’t changed that and today we believe there are significant risks in overvalued U.S. treasury bonds. There may, however, be some opportunity in the more esoteric corners of the fixed income market where equity-like pain has been felt. There may also be select opportunities with certain hedge fund managers who are interested in raising additional capital. But, in our opinion, the biggest current opportunities are likely in the equity markets. Great equity managers can now purchase securities at prices not seen in years. Those securities look like great values if we come out of the current health and economic funk and avoid getting dragged down into a depression. As we take stock of the current opportunity set, we are very aware of the “tail risk” of a depression. We are, therefore, proceeding slowly with our own “checklist” of metrics to increase exposure to the equity market. Our list is simple. We want to see equity valuations that are reasonably attractive based upon long-term earnings power. Our target is 14-16 times 2019 earnings or about 2300-2600 on the S&P 500. We’ve fallen into that range. Second, we’d like to see the government pursue policies that can cushion the economy for several months as we move through this difficult environment. We will discuss below the significant progress the U.S. government has made on this front. Finally, we would like to see some indication that we are gaining in our fight against the spread of COVID-19. So far, we have not seen enough progress on this front, keeping us more cautious than we would otherwise be at this time.

In just a few weeks, we have seen the Fed cut short rates by 125 bps to effectively zero, with guidance that they expect to stay at this level. The Fed has flooded both banks and money market funds with cheap liquidity, re-started quantitative easing with no upper bound on the amount of bonds they might purchase, expanded the program to include the purchase of corporate bonds, provided support for new corporate bond and asset-backed security issuance, and ensured lending to small and mid-sized businesses. The Fed also set up U.S. dollar liquidity facilities for many foreign central banks. Overall, we could not have imagined the Fed unleashing so much liquidity into markets in such a short time. If something financial can help shield the economy from this healthcare/economic crisis, these aggressive actions will.
The action taken on the fiscal side is no less incredible. Over a similar period, our federal government has passed three stimulus bills totaling $2.3 trillion. These bills will provide paid sick leave, enhanced unemployment benefits, and direct payments to U.S. citizens totaling nearly $650 billion. $350 billion in small business loans may be forgiven if employees are kept on the payroll, and $230 billion will provide corporate tax breaks including payroll deferral. $500 billion will assist industries important to the U.S. such as airlines and defense, and about $550 billion will support the fight against the coronavirus and help states in their efforts. This total stimulus package represents the biggest such effort we’ve seen the government undertake in our lifetimes. The U.S. government is also attempting to allow some individuals to defer mortgage payments, rent, utilities, student loans, etc. so that the country can get back on track in a 3-6-month timeframe. It is hard to see exactly how this will all work with so many moving parts, but we do congratulate the Fed, Democrats, Republicans, and the President for enacting swift and comprehensive programs.

Given the information available, we believe the steps the Fed and the U.S. government have taken so far are the right course of action. If we can prevent our economy from falling into a deep recession/depression by spending $2-4 trillion, we will all be better off. Yes, we think even more government spending may be needed, driving the cost to more than the enormous sums appropriated to date, but probably not more than $4 trillion based upon what we’ve read and heard. The hoped-for outcome of this plan is to essentially freeze frame things for a few months until we stop the spread of the coronavirus and then start to get back to the way we were before the crisis. Fingers crossed, everyone.

Some of you may now be saying to yourselves, “hey wait a minute, just last quarter TIFF was questioning MMT (modern monetary theory) and now they are big fans?” You are right. We are not big proponents of MMT and don’t believe in handing money out to people and businesses as a general policy. To us, however, we now face the Fram oil filter choice – “pay me now or pay me later.” We think the total cost of acting now will be much smaller than the incalculable cost of an economic depression. So, for now, whether we like it or not, we’re all MMT’ers. Make no mistake, paying the bill now will most certainly require that we all pay higher taxes in the future to service the debt. If we add $4 trillion to our budget deficit this year (the “regular” $1T plus $3T to beat the virus), U.S. federal debt will jump from about $23.5 trillion to $27.5 trillion, and the deficit’s growth rate will naturally be faster as interest costs likely increase. This outcome does cause us concern. On the other hand, if we go into a hard recession or a depression that requires years to dig out of, we think things could be even worse. Americans are about to face one of the biggest and most challenging tests we’ve faced in 75 years. We are confident that we will all pull together and get through it – that’s what Americans do.

Turning back to investments, we will continue to monitor the situation closely and intensively. In particular, we are looking for the number of coronavirus tests to rise dramatically, the test result time to shrink, and a national shelter-in-place policy to become more optimistic. Best of all, of course, would be a cure for the coronavirus. In the coming weeks, our newspapers and televisions will likely be filled with tragic stories and difficult situations of overcrowding at hospitals. Fortunately, the Fed and our government have reacted much more quickly than ever expected to put in place measures to cushion our economy and give us a chance to recover quickly once we slow the spread of the coronavirus. None of this will be easy and we will all have to work together, but on the back side of all this suffering, we could see a very vibrant
economy and buoyant equity markets. In the meantime, we will continue to do our best to shepherd your capital through this difficult period and look forward to happier times and higher prices on the other side.

Lastly, when the world begins to settle down a bit, we will be challenging our investment team to answer questions such as: Will U.S. government intervention continue to grow, or will it recede? Will different geographic regions become attractive for long-term investors? Have certain consumer preferences changed permanently and how do we incorporate those changes into our processes? For example, will the value of office buildings be permanently reduced due to lower demand for office space? Will malls go extinct? Will travel ever return to pre-coronavirus levels? Will remote working environments and video conferencing take off? As fact-based allocators, we need to incorporate these and other questions and insights into our manager selection process.

Ultimately, for us to continue to exceed your expectations, we need to determine if our circle of competence has been disrupted, and if so, how to adjust. Whether it be a new strategic asset allocation, new asset classes entirely, new manager categories (i.e., ESG), or some other facet of our investment process, events like the coronavirus pandemic cause the best investment firms to re-evaluate how they are approaching markets and adding value for their clients. We continue to test ourselves and challenge each other in this regard.

We want you to know we very much appreciate the opportunity to manage your capital and help you achieve your organization’s financial goals. We are always here to assist you in any way possible, so please reach out and let us know how we can help.

Your TIFF Investment Team
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