Boyar
value group

"A great investment opportunity occurs when a marvelous business encounters a one-time huge, but solvable problem."

–Warren Buffett

April 23rd, 2020

Overview

After having hit a record high of 29,551 on February 12, 2020, the Dow Jones Industrial Average had lost more than 10,000 points, or about 37%, by March 23, 2020—and the preceding decade of relative tranquility in the stock market made this sudden shock seem even more severe. Thankfully, market declines of this magnitude are highly unusual, but since the beginning of 1950 we've seen 37 market corrections, which economists define as any drop in value of 10% or more from the previous high. On average, that's a correction every 1.87 years—making downward moves in the marketplace a bit more common than many of us might imagine.

Once the market hits a panic low, as it did on March 23, it normally experiences a relief rally, which we saw when the market had its biggest three-day gain since 1931. But as history has taught us, the market usually goes on to retest that low.

Although the low could indeed be tested, now isn't the time for panic. With many companies and sectors already having sold off substantially from recent highs (and much more than the major averages), we're expecting a dispersion in performance during any later downdraft compared with the broad-based liquidity-driven selling we saw during the initial decline. In fact, once the bottom is made, we could see a remarkable sustainable advance—and the opportunity for stock pickers to outperform in such an environment can be substantial.

In a recent *Barron's* article, Nicolas Jasinski said the following:

> *"While anyone predicting with certainty whether the Dow or S&P 500 has already bottomed out is likely overconfident, it's a fair bet that many individual stocks have already achieved their lows. During the financial-crisis bear market, the S&P 500 didn't hit its 666-point trough until March 2009. But many individual stocks didn't go below their November 2008 lows after the most indiscriminate phase of the selloff eased. The same pattern occurred after the dot-com bubble burst."*

There Has Been No Place to Hide

U.S. equity investors have had no place to hide. Through April 20, 2020, every sector has been in negative territory. **But the selloff has been far from democratic.** Some sectors have held up relatively well, but others have trailed the market meaningfully. The greatest pain has been felt in energy, financial, and industrial names, which are down 42%, 26.6%, and 22%, respectively. By contrast, health care, technology, and consumer staples shares have fared best, losing "only" 0.6%, 2.1%, and 3.1%. Interestingly, after the recent selloff in energy stocks, that sector has advanced a mere 12.6% from its March 2009 low—unlike technology shares, which have advanced a staggering 819%.

Technology Shares Have Outperformed During the Downturn

Name	% Weighting S&P 500	YTD Performance as of 4/21/20
Microsoft Corp.	5.68	11.31
Apple Inc.	4.92	-5.46
Amazon.com Inc.	4.24	29.53
Facebook Inc	1.82	-13.15
Johnson & Johnson	1.70	4.65
Alphabet Inc.	3.22	-5.26
Berkshire Hathaway Inc.	1.57	-16.66
Procter & Gamble Co.	1.28	-2.86
JPMorgan Chase & Co.	1.22	-33.07
Visa Inc.	1.19	-1.1

Alphabet's weighting combines both class A&C shares

Of the 500+ stocks that make up the S&P 500 (despite its name, the index includes just over 500 stocks), ~87 are in positive territory for 2020. The average gain for these top 87 stocks has been ~11.3%, compared with the bottom 87's staggering average loss of 53% (as of April 21st, 2020). The best-performing stock in the index has been Regeneron Pharmaceutical, which has advanced by 51%, followed by Newmont, which has gone up 37%. The worst-performing issues have been Carnival Corp., which has lost 75% of its value, and by Norwegian, which has lost roughly 80%.

The carnage has certainly not been limited to U.S. equities. Except for fixed income, which has advanced by 4.7% for the year, almost every other asset class is down substantially. High-yield bonds have lost an average of 10.7%, REITS are down 16.6%, and commodities (as measured by the Bloomberg Commodity Index) have lost 23% of their value.

What Is the Uptick in Volatility Telling Us?

The market volatility experienced thus far in 2020 has been gut-wrenching. According to Jessica Rabe of DataTrek, over the past 6+ decades, the S&P has increased or decreased by 1% on an average of 53 days a year (or a little more than once a week). In 2020 (through April 21), there have been 42 such days (and we're only in late April!). According to Ms. Rabe, Q1 2020 had 30 such days versus a Q1 average of 13 since 1958, and thus far Q2 has seen 12 such days (just 1 day below the historical Q2 average, and we're still in the first month of the quarter).

Datatrek then analyzed other periods where there were an elevated number of 1% daily including:

- *1974: Q3 (38 one percent days) and Q4 (32).*
- *1982: Q4 (30 one percent days).*
- *1987: Q4 (42 one percent days).*
- *2000-2003: Q1 2000 (30 one percent days), Q4 2000 (30), Q3 2002 (44), Q4 2002 (34), and Q1 2003 (31).*
- *2008-2010: Q1 2008 (31 one percent days), Q3 2008 (36), Q4 2008 (50), Q1 2009 (41), Q2 2009 (34), and Q2 2010 (30).*
- *2011: Q3 (33 one percent days) and Q4 (36).*

DataTrek drew some interesting observations:

> *1) When the S&P registers at least 30 one percent days in a quarter like Q1 2020, the next quarter almost always experiences above average volatility (more than +13 one percent days).*
>
> *2) Heightened volatility does not necessarily lead to negative returns. After the 17 times the S&P had +30 one percent days in a quarter before this year, the index was up 65% of the time in the following quarter: the average next quarter return was +4.3%.*
>
> *3) Amplified volatility did persist for many quarters during the dot-com bubble bursting and the Financial Crisis. In contrast, there were just two +30 one percent day quarters in 1974 amid a recession due in part to the Saudi oil embargo. There was also only one in 1982 from a short recession as the Federal Reserve used contractionary monetary policy to fight inflation. And of course, one in 1987 from the stock market crash of '87.*

They concluded by stating that one percent days are a useful indicator of how effective and appropriate Federal government/Fed policy responses are to a given set of economic challenges. 2008 and 2009 had the greatest number of quarters with +30 one percent days versus any other period due to delays in fiscal stimulus.

In their opinion, even taking into account the large-scale economic and monetary stimulus, the presence of so many 1% days is signaling that something is wrong with the market. DataTrek is looking for a reduction in the amount of 1% days to <30 a quarter as a sign that the market is confident in the policy responses.

A Thought on Bear Markets and Reasons for Optimism

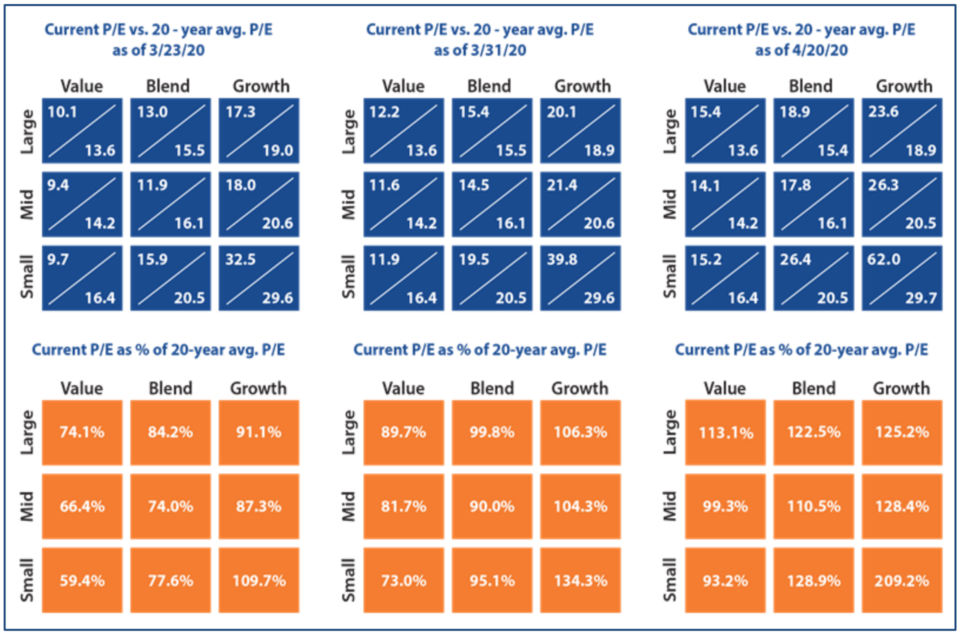
Since World War II, we've seen 10 bear markets, which brought an average decline of ~35%. During the previous bear market, which lasted from October 2007 to March 2009, the market dropped 57% (from peak to trough); not until 2013 did we reach a new high. On average, bear markets have lasted 14.5 months and taken 2 years to recover.

Most investors despise bear markets, forgetting that they're an integral part of the investment process. Downturns let investors purchase great businesses at bargain basement prices, making possible outsized returns later on. During bear markets investors often worry that "things will never improve," describing the current downturn as "the worst one ever"—and now is certainly no exception. The current situation has been made particularly painful because we are contending not only with significant economic pain but also with unspeakable human tragedy.

Despite the frightening headlines, as value-oriented investors we're excited to see how inexpensive many stocks of high-quality businesses with solid balance sheets have become. As we've noted, many of these companies' stock prices have dropped much more than the major indices have. We think it especially telling that the S&P 500 equal-weighted index is down 21.1% YTD and is selling at ~14.5x (up significantly from its low on March 23, 2020, when it had lost ~37.7% and was selling at <12x earnings) while the S&P 500 still trades at a healthy 18.1x (as of April 20, 2020) and is down a mere 12%. Clearly the mega-cap technology stocks (which are weighted heavily within the S&P 500--see chart on page 2) are hiding the pain that the "average" stock has experienced.

Source: Bloomberg Finance LP

Many of the companies we follow are selling far below what we believe an acquirer would pay for the entire business, and we believe that investors who buy these stocks at current levels will be quite pleased with their returns several years from now. **However, investors should proceed with caution considering what a remarkable advance we've seen in such a short time. (See the following chart comparing historical valuation levels for small-, mid-, and large-cap shares for the value, growth, and blend categories from March 23, 2020, the end of 1Q 2020, and April 20, 2020.) Uncertainty about corporate earnings and how soon the economy will meaningfully reopen do not (in our opinion) support such a rapid rise in share prices, and investors could have the opportunity to buy shares at better prices.** Notably, small-cap value names traded at 9.7x earnings on March 23, 2020, versus their historical 20-year average of 16.4x, ended the quarter selling at 11.9x earnings, and now sell at a more reasonable 15.2x.



Current P/E vs. 20 - year avg. P/E
as of 3/23/20

	Value	Blend	Growth
Large	10.1 13.6	13.0 15.5	17.3 19.0
Mid	9.4 14.2	11.9 16.1	18.0 20.6
Small	9.7 16.4	15.9 20.5	32.5 29.6

Current P/E vs. 20 - year avg. P/E
as of 3/31/20

	Value	Blend	Growth
Large	12.2 13.6	15.4 15.5	20.1 18.9
Mid	11.6 14.2	14.5 16.1	21.4 20.6
Small	11.9 16.4	19.5 20.5	39.8 29.6

Current P/E vs. 20 - year avg. P/E
as of 4/20/20

	Value	Blend	Growth
Large	15.4 13.6	18.9 15.4	23.6 18.9
Mid	14.1 14.2	17.8 16.1	26.3 20.5
Small	15.2 16.4	26.4 20.5	62.0 29.7

Current P/E as % of 20-year avg. P/E

	Value	Blend	Growth
Large	74.1%	84.2%	91.1%
Mid	66.4%	74.0%	87.3%
Small	59.4%	77.6%	109.7%

Current P/E as % of 20-year avg. P/E

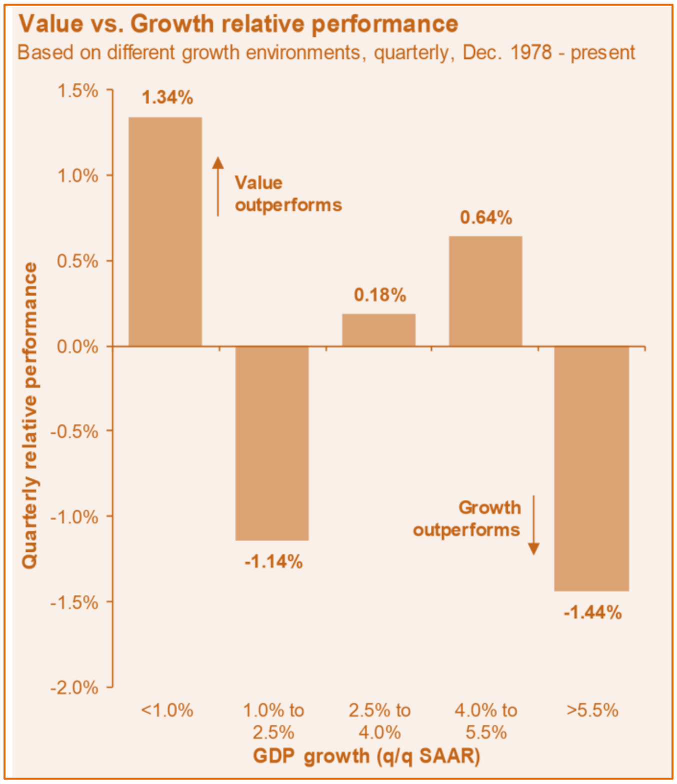
	Value	Blend	Growth
Large	89.7%	99.8%	106.3%
Mid	81.7%	90.0%	104.3%
Small	73.0%	95.1%	134.3%

Current P/E as % of 20-year avg. P/E

	Value	Blend	Growth
Large	113.1%	122.5%	125.2%
Mid	99.3%	110.5%	128.4%
Small	93.2%	128.9%	209.2%

Source: J.P. Morgan Asset Management.

Contrast these figures with those for small-cap growth shares, which traded at 32.5x versus their historical average of 29.6x on March 23, ended the quarter selling at 39.8x earnings, and now sell for a nosebleed 62x earnings.

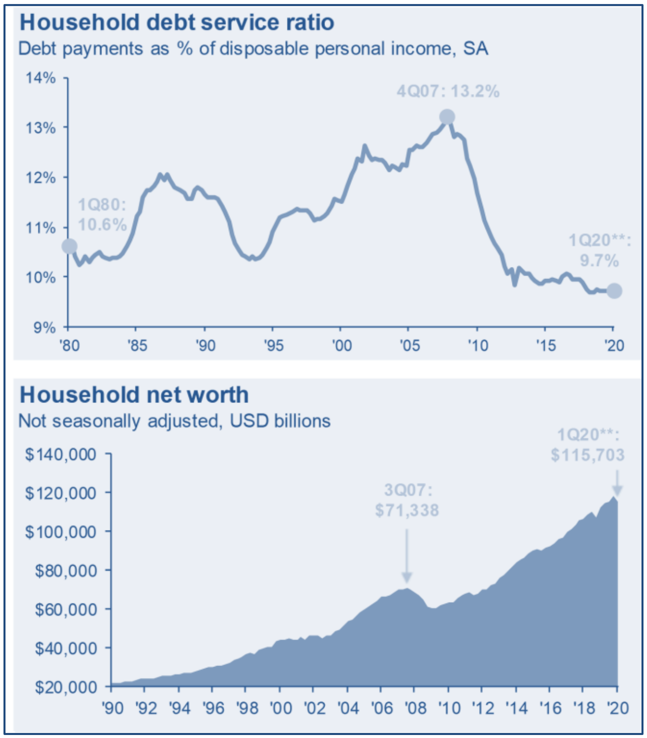


Source: JP Morgan Guide to the Markets.

Although we are bottom-up stock pickers, we can't ignore macroeconomic factors, especially at times like this. Clearly GDP will be contracting meaningfully for the foreseeable future. Historically (see the following chart) this type of macroeconomic environment has favored a value-oriented approach to investing. Since 1978, during times when GDP growth has been less than 1%, the Russell 1000 Value Index has significantly outperformed the Russell 1000 Growth Index.

No economy, let alone most individuals, can adequately prepare for a shock to the global economy like the one we're experiencing, but it's worth mentioning that the average household is in much better financial shape than it was before the Great Recession, having significantly less debt and a meaningfully higher net worth. Although we can expect much pain to come, starting the recession with a strong economy and a strong consumer should certainly help ease the blow.

What's more, the fiscal and monetary response from Washington have been nothing short of extraordinary. The amount of fiscal stimulus unleashed *thus far* has equated to roughly 10.8% of GDP. Critically, a meaningful percentage of the stimulus is being used to encourage businesses to keep employees on the payroll—or put them back on it. Although there have certainly been significant flaws with how the aid has been disbursed thus far (as well as with who has qualified for it), and despite the very real significant long-term impact of massive deficit spending and the Federal Reserve's expansion of its balance sheet, we believe that this response not only was necessary but also makes the worst-case scenario of another Great Depression (which was partially caused by a weak fiscal and monetary response) unlikely.



Source: JP Morgan Guide to the Markets.

The 9/11 and Financial Crisis Playbook for Investing Amid the Coronavirus

On March 16, 2020, we emailed you detailing our thoughts on the market, comparing the situation to investing after September 11, 2001, and during the financial crisis. In case you missed it, we've included an excerpt of that email below.

As always, we're available to answer any questions you might have. If you'd like to discuss these issues further, please reach out to us at jboyar@boyarvaluegroup.com or 212-995-8300.

Best regards,

Mark A. Boyar

mark a Boyar

Jonathan I. Boyar

The Current Situation Versus 9/11

- From a stock market perspective, comparisons to 9/11 are not entirely apples to apples: going into that horrific day, for example, the bear market was already ~18 months old. However, the level of fear of the unknown seen then, in response to terrorism by an enemy we could not identify, does have parallels with today's fears of a microorganism about which we know little. Now as then, individuals (and rightly so) are increasingly worried, if not downright petrified. The thought of boarding an airplane, congregating in public places, or taking part in the normal activities of daily life holds fear for most people. Back in 2001, the images of the falling towers were burned into our memories, and for the first-time television news ran a scrolling marquee at the bottom of our screens describing the terrifying events as they unfolded. Many in the New York area attended funerals almost daily while waiting for the next attack to strike. **Then as now, fear was rampant.** Our memories of the severity of that time might have faded with the years, but today we find ourselves amid similar levels of fear and uncertainty.

- Today the economy is significantly stronger than it was in 2001, but fear of the unknown, particularly of what will come next, is striking terror in the hearts of average citizens as well as the financial community. The indices are down significantly from their all-time highs, but so far only back to where they were in 2018. As a result, some have suggested that stocks could fall significantly further. That could very well be true (only time will tell) but saying that the S&P is back to 2018 levels doesn't come close to telling the whole story. Of particular importance, **many good businesses, particularly in the small and mid-cap area, have corrected 50%-75% from their all-time highs.** Well before the bear market began, these stocks had already begun to decrease in value significantly.

- We have pasted excerpts from our September 2001 letter to clients below that we thought you would find to be interesting:

  Amid all the hammerings investors have endured since early 2000, the market plunge after September's terrorist attacks would seem to qualify as a bottom. The Dow Jones Industrial Average fell 7.1% Monday, September 17th, the day the market reopened, and doubled the loss by that Friday, posting its worst weekly performance since the Great Depression. ***In the two weeks following, the market regained a good chunk of the post-tragedy losses*** **{emphasis added}.**

Will This Time Be Different? Investing During a Crisis is Usually a Good Bet

- Since World War II there have been nine major crises apart from the current one. These crises were precipitated by political fears, not investment ones. They include the 1948 Berlin blockade (risking another World War), Iraq's 1990 invasion of Kuwait (threatening the world's oil supply) and the 1998 Russian bond default (raising fears that a nuclear-armed nation would collapse in chaos).

- During each crisis investors felt confused, uncertain and panicky. Nothing in their experience, they believed, would help them cope with the ominous world they faced. Typical advice they got: "sell now, before it's too late. Save what capital you have left." This advice turned out to be completely wrong (see table). It is foolish to sell into a crisis.

- The table measures the performance of the Dow Jones Industrial Average, including dividends, from the first trading day after each postwar crisis to one and two years afterward. On the whole, the Dow was up smartly. The exceptions were the soviet blockade of Berlin, which occurred during a bear market that lasted until 1949 and the 1973 oil embargo, coinciding with the postwar economy's worst bear market. One year after the nine crises, stocks had a 16.4% average return.

- Of course, nobody can be so prescient as to know when the exact bottom will be reached and get 100% invested then. But even if you missed the bottoms, your gains remained impressive.

Crisis Investing

- During nine major postwar crises, the Dow Jones Industrial Average has bounced back strongly a year later, with only two exceptions.

Event	First Trading Day in Crisis	1 Year Later	2 Years Later
Berlin blockade	6/2/48	-6.2%	31.7%
Korean War	6/26/50	21.1	40.7
Cuban missile crisis	10/23/62	38.8	70.1
Kennedy assassination	11/22/63	30.2	44.8
Gulf of Tonkin	8/5/64	10.8	12.7
OPEC oil embargo	10/18/73	-26.8	-3.3
Iran hostage/oil crisis	11/5/79	22.3	16.3
Persian Gulf war	8/3/90	10.0	27.5
Russian bond default	9/3/98	47.2	53.8
Average return		16.4%	32.7%

Source: Dreman Value Management, L.L.C.

Excerpted From David Dreman's column, Forbes Magazine – October 29, 2001

Comparisons With 2008-2009

The 2008-2009 panic differed from our present situation in one important way: the problems facing the market could be solved by fiscal/monetary policy. People did not fear for their physical safety; instead, they feared the prospect of imminent economic ruin. Like today, there were fears of "contagion"—but those fears were limited to the financial system.

As a reminder of just how alarming things looked in 2008-2009, we have reproduced a timeline (from *The Wall Street Journal*) that we featured in our third-quarter 2008 letter to clients, showing how the landscape of Wall Street changed forever over the course of just 90 days.

July 2, 2008

The Dow Jones Industrial Average and NASDAQ Composite Index closed in bear-market territory for the first time in 2008. This drop in the equity markets was largely attributable to oil prices closing at $143.57 a barrel on the New York Mercantile Exchange. In addition, General Motors shares briefly dipped below $10 for the first time since the Eisenhower administration.

July 11, 2008

The Wall Street Journal reported that the Treasury Department is "not talking about nationalizing "Fannie Mae and Freddie Mac and was seeking to discount current reports that they were planning on placing one or both companies into a conservatorship. In addition, IndyMac Bank, a mortgage specialist, was seized by federal regulators. IndyMac bank had $32 billion dollars in assets and was one of the largest bank failures in United States history.

July 15, 2008

The dollar declined sharply against all major currencies. The British pound traded above $2.00 and the Euro traded above $1.60.

July 17, 2008

In an effort to raise capital Merrill Lynch sold its stake in media giant Bloomberg LP for about $4.43 billion dollars.

July 22, 2008

Wachovia swung to a loss of $8.66 billion from a net profit of $2.34 billion a year earlier. In addition, the bank slashed its quarterly dividend to five cents a share and announced it will exit the business of wholesale mortgage origination. Wachovia's President and CEO Robert K. Steel, said, "In the short-term, the entire organization is focused on protecting, preserving and generating capital; reinforcing Wachovia's strong liquidity position; and reducing risk."

July 26, 2008

Congress passed a massive housing bill. The bill included a Treasury Department proposal to increase Freddie Mac and Fannie Mae's $2.25 billion line of credit with the Treasury. In addition, the bill allowed the government to potentially take an equity stake in the firms.

July 30, 2008

The Federal Reserve announced that it would extend the date through which investment banks would be allowed to borrow from its discount window from its original September end date until January 30, 2009.

September 7, 2008

Regulators outlined the bailout for Fannie Mae and Freddie Mac, which included a takeover of each firm and a government purchase of the companies' senior preferred stock.

September 15, 2008

Lehman Brothers announced that it would declare Chapter 11 bankruptcy. On the same day, Bank of America announced it would acquire Merrill Lynch in a $50 billion all stock-transaction. In addition, the front-month crude-oil futures contract settled below $100 a barrel for the first time since March and closed at $95.71 per barrel.

September 16, 2008

The board of directors of AIG approved the $85 billion rescue of the insurance giant where the government agreed to take an almost 80% equity stake in the company.

September 18, 2008

Kraft Foods replaced AIG in the Dow Jones Industrial Average.

September 19, 2008

The Dow Jones Industrial Average increased over 400 points over reports that the federal government was considering a mechanism similar to that of the Resolution-Trust to allow banks and other financial institutions to take toxic assets off of their balance sheets. On the same day, the Security and Exchange Commission temporarily banned short selling in 799 financial stocks. In addition, the Treasury amid concerns that some money market funds were "breaking the buck," announced a plan to insure the holdings of any eligible publicly offered money-market fund.

September 21, 2008

Both Morgan Stanley and Goldman Sachs announced that they would become bank holding companies.

September 23, 2008

Legendary investor Warren Buffett invested $5 billion dollars in perpetual preferred stock in Goldman Sachs. In addition, Goldman Sachs announced an equity offering on the same day in order to raise additional capital.

September 25, 2008

In an FDIC forced sale, JP Morgan purchased the deposit base and some branches of troubled bank Washington Mutual.

September 29, 2008

Citigroup in a deal facilitated by the federal government acquired the banking operations of distressed banking giant Wachovia. Subsequently, Wells Fargo made a counter-bid for Wachovia. On the same day the house rejected the $700 billion dollar Wall Street rescue package causing the Dow Jones Industrial average to fall over 750 points.

September 30, 2008

The Dow Jones Industrial Average soared more than 485 points on investor anticipation that a rescue plan would be resumed in Congress

IMPORTANT DISCLAIMER

Past performance is no guarantee of future results. Investing in equities and fixed income involves risk, including the possible loss of principal. *The S&P 500 Index is included to allow you to compare your returns against an unmanaged capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of the 500 stocks representing all major industries.* The Russell 2000® Value Index measures the performance of small-cap value segment of the US equity universe. It includes those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. *The S&P 1500 Value Index measures value stocks using three factors: the ratios of book value, earnings, and sales to price and the constituents are dawn from the S&P 500, S&P Midcap 400 and the S&P SmallCap 600. The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ. The volatility of the above-referenced indices may be materially different from that of your account(s), and the holdings in your account(s) may differ significantly from the securities that comprise the above-referenced indices. Your results are reported gross of fees. The collection of fees produces a compounding effect on the total rate of return net of management fees. As an example, the effect of investment management fees on the total value of a client's portfolio assuming (a) quarterly fee assessment, (b) $1,000,000 investment, (c) portfolio return of 8% a year, and (d) 1.50% annual investment advisory fee would be $15,566 in the first year, and cumulative effects of $88,488 over five years and $209,051 over ten years. This material is intended as a broad overview of Boyar Asset Management's, philosophy and process and is subject to change without notice. Account holdings and characteristics may vary since investment objectives, tax considerations and other factors differ from account to account.*