9 Things You Should Know About the 2020 Stock Market Crash

By Mike Whitney
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Theme: Global Economy

1– Investors are cashing in and heading for the exits

According to Bloomberg News: "Investors made their biggest dash for cash in history" in the last week. "They channeled $137 billion into cash-like assets and a record $14 billion into government bonds in the five days through March 11…..(while) money managers are liquidating en masse." ("Investors Liquidate Everything in Record $137 Billion Cash Haul", Bloomberg)

Why are investors exiting the market?

Because the psychology that drives business investment ("animal spirits") has been dramatically impacted by the coronavirus. Expectations for future prosperity have been dampened by the fog of uncertainty. When uncertainty prevails, confidence wanes and investors cash in and get out. Coronavirus is fiendishly designed to push stocks and bonds lower in response to the staggering deluge of bad news.

2–Stocks have been walloped, but consumer confidence is just now starting to drop

According to the University of Michigan, consumer sentiment fell from 101.0 to 95.9 in February. These calculations were made before the "Thursday's stock-market plunge — the worst since 1987 — and the rapid shutdown of university campuses, public schools, major sports and entertainment venues over the last 24 hours…. the data suggest that additional declines in confidence are still likely to occur as the spread of the virus continues to accelerate." (Bloomberg)

Stocks will undoubtedly reflect investor pessimism in the months ahead, pushing prices lower while the virus spreads.

3– The Fed's $1.5 trillion liquidity announcement triggered an impressive 2,000 point rally, but the policy badly misfired

On Thursday, the Fed announced that it would provide more than $1.5 trillion in short-term loans to repo market traders. Fed chairman Powell believed that this would ease tighter lending conditions in a market that is a critical part of the system's financial plumbing. Surprisingly, the demand for these short-term loans was weak and the Fed only provided a meager $119 billion. In short, the Fed did not accurately identify the source of the problem which obviously lies elsewhere.

In order to conceal its mistake, the Fed launched another round of Quantitative Easing on Friday. According to the Wall Street Journal: "The Fed announced Friday morning that it would purchase later in the day roughly half of some $80 billion in Treasury securities that it had said Thursday would be purchased over the next month." (Wall Street Journal)

In other words, the Fed fired its $1.5 trillion policy bazooka at the repo market and missed the target entirely. The next day, the Fed resumed its QE money printing operation and investors piled back into stocks. This hit-or-miss approach shows that the Fed does not completely understand the issue it is dealing with.

4–The real economy was weak even before stocks started crashing

This is an excerpt from an article at Marketwatch by economist Stephen Roach: "The problem also lies in weak real economies that are far too close to their stall speed. The International Monetary Fund recently lowered its estimate for world GDP growth in 2019 to 3% —midway between the 40-year trend of 3.5% and the 2.5% threshold commonly associated with global recessions.

As the year comes to a close, real GDP growth in the US is tracking below 2%, and the 2020 growth forecasts for the eurozone and Japan are less than 1%. In other words, the major developed economies are not only flirting with overvalued financial markets DJIA, +9.36% and still relying on a failed monetary-policy strategy, but they are also lacking a growth cushion just when they may need it most. In such a vulnerable world, it would not take much to spark the crisis of 2020." (Marketwatch)

Since the recession ended in March 2009, the US economy has experienced the weakest recovery in the post-World War II era. Now the American people will be facing an extended period of economic contraction in which deflationary pressures lead to a sharp rise in unemployment, homelessness, and financial insecurity.

5– Gold took a beating in last week's selloff

Typically, gold is a "flight to safety" asset that does well when markets are crashing, but that rule did not apply last week. According to the Wall Street Journal: "Gold…suffered its worst week since 2011, dropping 9.3% and wiping out all its 2020 gains. Silver, a more volatile precious metal, tumbled 16% and is down 19% for the year." (WSJ)

At the same time, ultra-safe municipal bonds and risk-free US Treasuries sold off hard. The reason safe haven assets sell during periods of stress is because of margin calls, that is, when a broker demands additional capital from an investor to maintain his current position in the stocks he bought with borrowed money. When stock prices fall sharply, many investors have to sell their good stocks (gold, US Treasuries) to support the bad. That is why gold got hammered last week. It is an sign that many investors are severely over-stretched and nearing the end of their resources. Many high-stakes speculators are now in big trouble.

6—Stock buybacks have plunged

Stock buybacks have been the jet-fuel that has kept the equities markets soaring to record highs before the latest virus-driven downturn. Even before the latest ructions, buybacks had significantly slowed to 2013 levels wracking up just $14 billion in January, a 30% decline from a year before. And while there are no estimations of buyback activity during the last few weeks of March, it is impossible to imagine that cash-strapped CEOs would even dream of pumping more money into shares that are falling faster than anytime since 2008. And while there is a remote possibility that the US economy will avoid recession, there's only the slimmest chance that revenues, earnings or future expectations will give corporate bosses the wiggle-room they need to repurchase their own shares rather than stockpiling the cash they might need to maintain operations during some very tough times ahead.

Bottom line: It will be very hard for stocks to rebound in an environment in which buybacks have significantly declined or vanished altogether.

7– Stocks have already dropped sharply, but the credit crunch still lies ahead

A credit crunch refers to a decline in lending activity when funding suddenly becomes available. Currently, the markets for corporate debt have frozen due to investor skepticism that these same corporations will be able to repay the nearly $10 trillion of debt they wracked up during the "easy money" days of the last decade. Many of these corporations used the money they got from bond market to enrich themselves through executive compensation and share appreciation. In other words, CEOs sold bonds to credulous investors who thought they were buying the debt of responsible, well-managed companies when, in fact, 30% of corporate debt was deceptively used for buybacks, that is, it was used to line the pockets of executives and shareholders rather than boosting productivity, increasing worker training or R&D, or building new factories and equipment.

Corporations have been engaged in the same illicit scam mortgage lenders were involved in prior to the Crash of '08, transferring trillions of dollars to wealthy executives via financial products that public really didn't understand.

Many of these companies are presently unable to get the money they need to stay afloat because the market for corporate debt has shut down. This means, they will not be able to refinance their debts which will force them into bankruptcy triggering a cascade of defaults that will severely hurt their counterparties, their lenders and the broader economy. When credit becomes scarce, the economy contracts.

8– The IMF warned that the Fed's easy money policies would lead to another crisis

This is an excerpt from Chapter 2 of the IMF's Global Financial Stability Report:

Accommodative monetary policy supports the economy in the near term, but easy financial conditions encourage more financial risk-taking and may fuel a further buildup of vulnerabilities in some sectors and countries. …In a material economic slowdown scenario, half as severe as the global financial crisis, corporate debt-at-risk (debt owed by firms that cannot cover their interest expenses with their earnings) could rise to $19 trillion—or nearly 40 percent of total corporate debt in major economies, and above postcrisis levels."

The Fed's monetary policies ignited a corporate borrowing binge that has put the country's financial future at risk. The US is now facing a catastrophe that is entirely attributable to the "emergency rates" and the relentless meddling of the Central Bank.

9– The American people are not ready for another recession

According to Zero Hedge: "Almost 60 percent of Americans have less than $1000 in savings for a rainy day fund or an immediate emergency…."

"Four in ten Americans can't cover an unexpected $400 expense according to a report from the Federal Reserve Board." (CNN)

"78% Of Workers Live Paycheck To Paycheck," says Forbes

"58 percent of Americans had less than $1,000 saved," says Yahoo Finance

"Only 37% of Americans believe today's children will grow up to be better off than they were," says Marketwatch

According to Pew Research, "Majorities predict that the economy will be weaker, health care will be less affordable, the condition of the environment will be worse and older Americans will have a harder time making ends meet in the future than they do now."

Finally, according to a MassMutual US survey, "54% of respondents think the American Dream (defined as financial security for themselves and their family) is no longer attainable."

The majority of Americans never reaped the benefits of the economic recovery and they're certainly not ready for another debilitating slump. As the data show, most people are living on the edge already and barely hanging on by the skin of their teeth. Another downturn will put them into freefall which will dramatically increase homelessness, food insecurity and destitution. The federal government should be looking for ways to soften the blow now instead of waiting for the markets to crash and the economy to shrivel. Forward-thinking leaders should be able to see the handwriting on the wall and realize that we are fast approaching zero hour, a crisis the likes of which we haven't seen since the 1930s.

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