"Courage! We have been here before"

It's déjà vu all over again. With the outbreak of the coronavirus and the ensuing economic slowdown and violent market reaction, many have grown fearful of investing.

The last time it felt this way was during the Great Recession. I remember the day in August 2008 when I shared with my colleagues a classic speech from former Capital Group Chairman Jim Fullerton. This speech, delivered in November 1974 amid a prolonged bear market, provided us with much-needed historical perspective and a dose of optimism when it was in short supply.

The "Fullerton letter" as it has come to be known, has been recirculated among Capital Group's investment team at least four times in my career. My colleague Claudia Huntington, a veteran equity portfolio manager, shared it in 1987, saying, "I have been saving this speech, one of my favourites, for a time like today." I think it's been shared so often because Jim captured so well what we all know. It is always darkest before the dawn.

Over time, and in time, the financial markets have demonstrated a remarkable ability to anticipate a better tomorrow even when today's news feels so bad. The speed and severity of this COVID-19 outbreak, combined with the massive behavioural and economic consequences, not to mention the potential loss of life, will surely test the markets' resolve. The pace is much more rapid than the global financial crisis, which took 18 months from peak to trough.

U.S. stocks, as measured by Standard & Poor's 500 Composite Index, have navigated through numerous bear markets from 1936 to 2020, including The Great Depression, World War II, the Cuban missile crisis, the 1973-74 oil embargo, the Black Monday stock market crash in October 1987, the tech and telecom bubble, the global financial crisis and the coronavirus. Source: Standard & Poor's, RIMES. Data as of February 29, 2020. Chart is shown on a logarithmic scale.

We are in uncharted territory. It feels scary and terrible. It is exactly those feelings that make this speech so timeless. It's precisely when the backdrop has looked so dire that the markets have turned. It's hard to know when that turn will happen this cycle. But, based on prior experiences the market will turn eventually and that should provide some solace.

In November 1974, few people thought it was a good time to invest. The Dow had lost more than 40% from its high in January 1973. In his letter, Jim Fullerton recalled an even darker period in our nation's history — April 1942. His remarks follow.

“We have been here before”

One significant reason why there is such an extreme degree of bearishness, pessimism, bewildering confusion, and sheer terror in the minds of brokers and investors alike right now, is that most people today have nothing in their own experience that they can relate to that is similar to this market decline. My message to you, therefore, is: Courage! We have been here before. Bear markets have lasted this long before. Well-managed mutual funds have gone down this much before. And shareholders in those funds and we the industry survived and prospered.

I don't know if we have seen the absolute bottom of this prolonged bear market, (although I think we've seen the lows for a lot of individual stocks).

Each economic, market and financial crisis is different from previous ones. But in their very difference, there is commonality. Namely, each crisis is characterised by its own new set of nonrecurring factors, its own set of apparently insoluble problems and its own set of apparently logical reasons for well-founded pessimism about the future.

Today there are thoughtful, experienced, respected economists, bankers, investors and businessmen who can give you well-reasoned, logical, documented arguments why this bear market is different; why this time the economic problems are different; why this time things are going to get worse — and hence, why this is not a good time to invest in common stocks, even though they may appear low. Today people are saying: “There are so many bewildering uncertainties, and so many enormous problems still facing us — both long and short term — that there is no hope for more than an occasional rally until some of these uncertainties are cleared up. This is a whole new ballgame.”

A whole new ballgame

In 1942 everybody knew it was a whole new ballgame. And it sure as hell was. Uncertainties? We were all in a war that we were losing. The Germans had overrun France. The British had been thrown out of Dunkirk. The Pacific Fleet had been disastrously crippled at Pearl Harbor. We had surrendered Bataan, and the British had surrendered Singapore. The U.S. was so ill-prepared for a war that the cavalry school at Fort Riley was still teaching equitation, and I would guess that probably 75% of our field artillery was equipped with horse-drawn, French 75mm guns, Model 1897 (including the battalion in which I was then serving).

In April 1942, inflation was rampant. A Federal Reserve bulletin stated: “General price increases have become a grave threat to the efficient production of war materials and to the stability of the national economy.” Today there is concern about the slump in housing construction. On April 8, 1942, the lead article in the Journal was: “Home construction. Total far behind last year's; new curbs this week to cut further ... Private builders hard hit.”

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Today almost every financial journal or investment letter carries a list of reasons why investors are standing on the side lines. They usually include (1) continued inflation; (2) illiquidity in the banking system; (3) shortage of energy; (4) possibility of further outbreak of hostilities in the Middle East; and (5) high interest rates. These are serious problems.