INVESTOR ALERT

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The Equity-Price Plunge: Sanders-virus versus Corona-virus

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The two-day, 6-8% plunge in major equity indexes (and +5% boom in T-Bond values) has been attributed almost solely to the Corona-virus, but in our judgment *it has more to do with the Sanders-virus*, the risk of U.S. public policy becoming more socialist with a hate-filled, rabid anti-capitalist (Sen. Bernard Sanders) winning the White House next November. The ascension of such a vile, low-grade reprobate isn't as far-fetched as some believe; the same long odds were assigned to Donald Trump at this point four years ago, yet he won. Trump and Sanders alike are "anti-establishment" populist reprobates—certainly *not* pro-capitalist statesmen. They're also prone to hiring inexperienced, inexpert rubes as top advisors.

It's worth remembering that even *before* the recent spread of the two viruses, market-price signals (especially the inverted yield curve, May-August 2019) were, for the first time since 2007, signaling a U.S. recession in late-2020-early 2021.[1] Lately, the curve has *re-inverted*. Nothing so far in 2020 makes us believe this signal will fail.

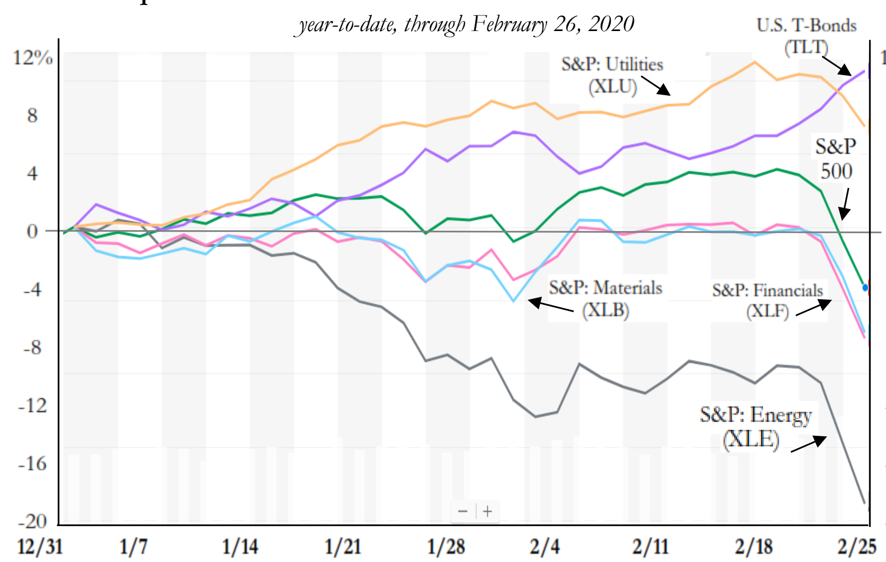
The Corona-virus had existed for a few months already amid *rising* stock prices, but reports last weekend say it has now spread globally, by more than expected. Can this alone be the cause of the on-going stock plunge, or most of it? Perhaps, but only to the extent governments (especially China, the source of the virus—which it was trying to *weaponize*) refuse to accept help from outside experts in epidemiology, and/or react badly, or overreact by constricting supply-chains, businesses, and borders. China is doing much of this, and the negative effect on trade and growth is akin to that inflicted by Trump's trade wars. In prior cases – the SARS outbreak (2003), Swine flu (2009), Zika virus (Brazil, 2015), and Ebola outbreaks (1976 and 2015)—stock indexes first dipped but within a few months *exceeded* pre-crisis levels. But today, unlike those prior cases, *the yield curve is inverted*—which suggests, this time around, no sustainable post-virus equity rebound.

Figure One illustrates year-to-date performance. The S&P 500 is down 4% so far, while the U.S. T-Bond is up 12%. When this year began, our models foresaw stocks being lower in 2020 and easily out-performed by T-Bonds. The T-Bond price boom rally has brought the 10-year yield down to 1.36%, a record low over the past half century; it lies 18 basis points below the 3-month T

Figure One

U.S. Equities Year-to-Date: S&P 500 versus S&P Sectors and T-Bonds

year-to-date, through February 26, 2020



[1] "The Recession of 2020-21," *Investment Focus*, November 18, 2019. For the prior signal, provided exactly one year before the start of the "Great Recession" of 2007-2009, see "The Recession of 2007," *Investor Alert*, December 7, 2006.

[2] "Does a Lower Term Premium Mute the Yield Curve Signal?" *Investment Focus*, June 30, 2019.

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-Bill yield of 1.55%, so the yield curve is inverted yet again—signaling more bearishness. Investors shouldn't become sanguine just because the 10-year T-Bond yield is low (and lower by 56 basis points, year-to-date).[2] This is a *flight to safety*, not a vote of confidence (in the economy). Junk bond corporate yields in the U.S. have *increased* by 30 basis points in just the past week.

The harms and risks associated with the Sanders-virus is far worse than those accompanying the Corona-virus. The spread of the latter is likely to be capped by November, but not so the Sanders-virus. Last weekend saw not just a spread of the Corona-virus but also of the Sanders-virus, as socialist U.S. Senator Bernie Sanders resoundingly won the Nevada Democratic caucus, by *more than expected*. Until last weekend it was thought (by "establishment" Democrats and betting markets) that the ultimate nominee would be the fascist Sen. Warren or "moderates" Biden and Buttigieg. Now that Sanders has won the Iowa caucus, the New Hampshire primary and the Nevada caucus (the latter with 47% of votes versus 20% for Biden), he has a much better shot at winning the South Carolina primary (February 29th) and thus most of the fourteen states voting on "Super Tuesday" (March 3rd).[3] The probability Sanders will become the Democrat nominee for president has increased significantly—and he has a decent chance also of beating Mr. Trump.

Even if Mr. Trump wins in November, the spread of Sanders-virus in 2020 will likely impact (negatively) his stance on public policy; he'll try to "inoculate" himself by adopting some of Sanders' poisonous premises and prosperity-killing policies. George W. Bush did likewise in campaigning against the left-leaning Al Gore in 2000. Aping much of Gore's platform, Bush promised (and later delivered) a massive expansion of Medicare (the prescription drug benefit-subsidy, which artificially elevated prices and led to demands for drug price controls, which both Trump and Sanders now favor) and taxpayer-subsidies to foster artificially-cheap mortgages for "sub-prime" (predatory) borrowers. We leave it to readers to recall for themselves the many painful market-portfolio consequences of such policy appeasement.

Socialism is a deadly virus; it erodes and destroys human freedom, health, labor-capital mobility, production, profiting, and prosperity *precisely to the extent it takes hold*. Worse, it's not like a disease or virus which humans prefer not to contract and suffer, but do so involuntarily, and if so, are cured by benevolent, rational medical professionals. In contrast, socialism is an *unnecessary but deliberately chosen virus*, which many "humans," historically (and philosophically), have *preferred* to its healthy, dynamic alternative (capitalism), and instead of being talked out of it or cured of it, are often *tutored and goaded into endorsing it* by malevolent, irrational social theorists, economists, politicians and demagogues.

Thus, over the past century, *much-wanted* socialism has proved far more harmful to humans and economies than *unwanted* diseases associated with biological threats. Adopted in forty nations over the past century, socialism has killed 100 million people and impoverished at least that many (and multiples more). Does that mean a Trump or a Sanders (or anyone else) will become a Lenin, a Stalin, a Mussolini, a Hitler, a Mao, a Kim, or a Castro? No, but not for lack of wishing; the point is that movement *towards* socialism is *bearish*, not bullish, for freedom, peace and prosperity.

In our view, most investment strategists and financial commentators are (and will persist in) attributing massive equity losses to the Corona-virus *rather than* the Sanders-virus because 1) they prefer sensationalist headlines and fear-mongering, 2) they know far less about epidemiology than political economy, 3) they know far less about *rational* political economy than *irrational* political economy (the kind pushed by Sanders and his ilk), and 4) they sympathize more with socialism and Sanders than with capitalism and Trump. The rational investor needn't suffer such a bias—*i.e.*, needn't *over-rate* the negative risks of the Corona-virus nor *under-rate* the negative risks of the Sanders-virus.

Many Sanders sympathizers (and a few foes) can be heard these days guessing that the worse the Corona-virus gets, and the more it spreads, the more it might boost his chance of beating Trump in November, partly because it could mean a U.S. recession and partly because he'd be seen as a better leader for dealing with a health crisis. Only a socialist sympathizer could conclude, unabashedly, that the lesson to be learned by American voters, observing socialist China leak and spread a virus, is that they too should be ruled by socialists.

Even if Sanders causes (or can't prevent) a virus, it is argued that many voters will expect his kind of political regime to be better (at curbing or curing the problem) than would a Trump regime because Sanders believes "health care is a right," that such care should be "cost-free," and drug-vaccine firms should be non-profit or abolished. That's wishful and dangerous thinking. Those views and policies make cures and human health *less* likely, not more so. Not only would Sanders (or Warren) more likely trigger crises, they'd also more likely intensify and worsen them—all the while blaming capitalism. Yet these days it may not be so difficult to find a majority of American voters ignorant and envious enough to indulge in Sanders-like wishful, dangerous thinking, thus willing to vote for socialism (or fascism).

[3] The Super Tuesday states, representing one third of the delegates needed to secure the nomination at the party's national convention in Milwaukee (July 13-16), are Alabama, Arkansas, California, Colorado, Maine, Massachusetts, Minnesota, North Carolina, Oklahoma, Tennessee, Texas, Utah, Vermont, and Virginia.

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Richard Salsman is founder, president and chief market strategist. Prior to IFI he was senior economist at H.C. Wainwright Economics, Inc. (1993-1999) and from 1981 to 1992 a banker and capital markets specialist at the Bank of New York and Citibank. Mr. Salsman has authored numerous articles and is an expert in market history, economics, forecasting, and investment strategy. His work has appeared in *The Wall Street Journal*, *Investor's Business Daily*, *Barron's*, *Forbes*, *National Post* (Canada) and *The Economist*. In addition, he has authored three books—*Gold and Liberty* (1995), *Breaking the Banks: Central Banking Problems and Free Banking Solutions* (1990), *The Political Economy of Public Debt: Three Centuries of Theory and Evidence* (2017) —plus many chapters in edited books. Salsman speaks regularly at conferences, investment gatherings and universities. He earned his B.A. in Law and Economics from Bowdoin College (1981), his M.B.A. in Economics from the Stern School of Business at NYU (1988), and his Ph.D. from Duke University in Political Economy (2012). In 1993 he earned the designation of Chartered Financial Analyst (CFA) from the Association for Investment Management and Research.

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