Navigating Current Markets

March 2020

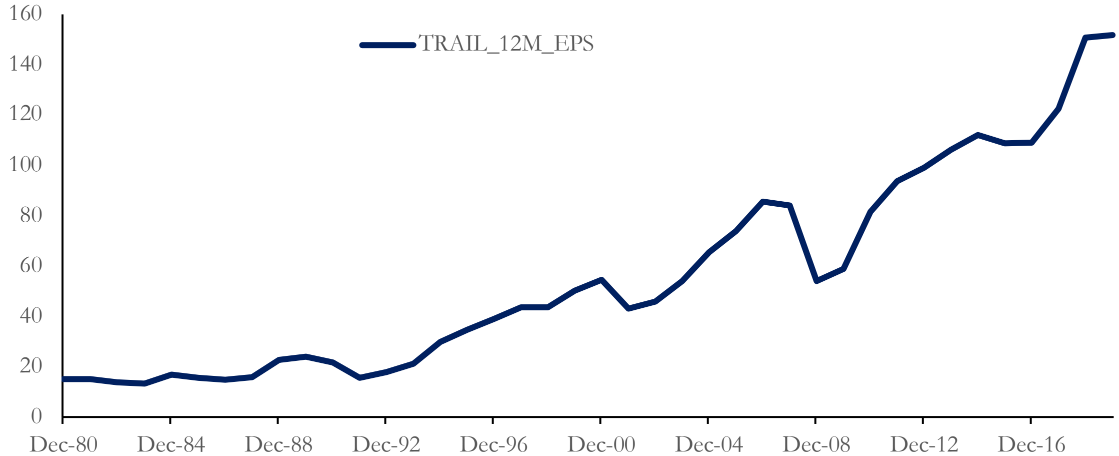
The current market environment is characterized by both extreme levels of volatility and a lack of liquidity. While investors are naturally looking at, among other things, earnings estimates when deciding to increase or decrease exposure to equities, Bloomberg consensus is still indicating a 10% increase in S&P 500 earnings in 2020. Simultaneously, the recent series of events resulted in one of the biggest declines in the market's history and prompted emergency reactions from major central banks. The analyst community is still processing the data that is arriving and evolving at a high frequency, and it will probably take time for earnings estimates to be revised. Market reaction suggests that policymakers have not succeeded to reduce the uncertainty in the system.

In times like these, investors need reference points. At Lynx, we believe that history could provide useful insights in terms of market and investor behavior.

We looked at S&P 500 history over the past 40 years, in particular, at trailing 12-month earnings and multiples applied to those realized earnings at year-end.

During that period, S&P 500 earnings increased at a **5.96%** Compound Annual Growth Rate (CGAR). As expected and similar to market return patterns over time, the chart below indicates a non-linear path to earnings increases with periods of accelerations and decelerations, and with occasional earnings recessions in between. An earnings recession is defined as a decline in nominal earnings during a 12-month period.

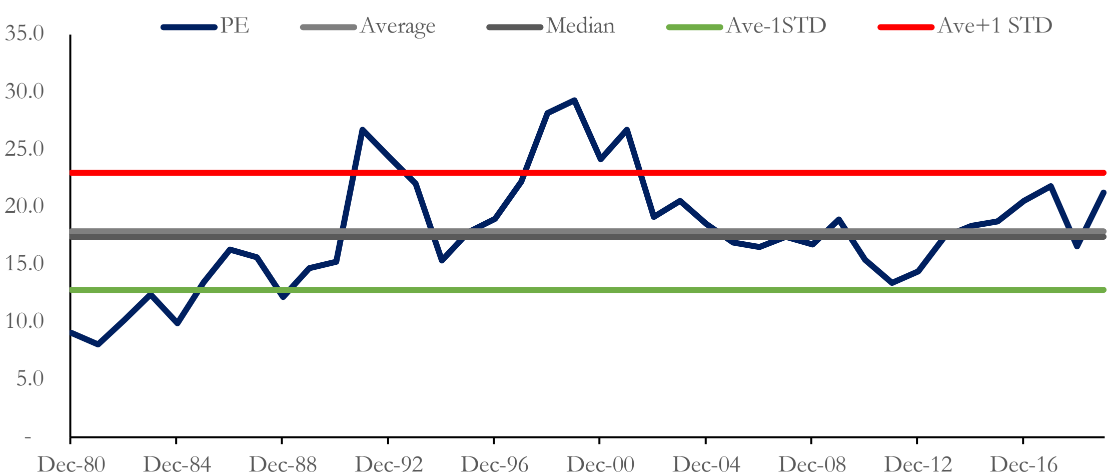
S&P 500 EPS HISTORY



Bloomberg, Lynx Investment Advisory

During that 40 year period, investors were willing to pay an average multiple of **17.9x** for past earnings and a median multiple of **17.4x**. Price-to-earnings multiples experienced significant levels of volatility, in line with periods of excess confidence or stress that have characterized equity markets during the last 40 years.

S&P 500 PE HISTORY



Source: Bloomberg, Lynx Investment Advisory

At the end of 2019, markets were trading at multiples above their 40-year averages, but not at excessive levels in statistical terms. At the end of the last year, the S&P 500 Index had earnings of $151.77 per share and was valued at a 21.3x multiple.

We found ten periods of earnings recessions during the last 40 years. During those times, the average decline in earnings was **12.5%** while the median was **7.9%.**

In addition, we identified five periods in which an earnings recession was accompanied by an economic recession. During those times, the average earnings decline was **20.8%** while the median decline was **21.3%.**

While trying to identify reference points, we applied average and median multiples on average and median declines in earnings and calculated the corresponding S&P 500 levels.

EARNINGS RECESSIONS

	Average S&P 500 Multiple of 17.9x	**Median S&P 500 Multiple of 17.4x**
Average earnings decline of 12.5%	**2377**	**2311**
Median earnings decline of 7.9%	**2502**	**2432**

Source: Bloomberg, Lynx Investment Advisory

EARNINGS AND ECONOMIC RECESSION

	Average S&P 500 Multiple of 17.9x	**Median S&P 500 Multiple of 17.4x**
Average earnings decline of 20.8%	**2152**	**2092**
Median earnings decline of 21.3%	**2138**	**2078**

Source: Bloomberg, Lynx Investment Advisory

Lynx Investment Advisory

Our conclusion is that in the current environment, investors are pricing an average earnings recession but have not yet priced in an economic recession. One important caveat in our analysis is that we have not looked at prevailing government yields which have declined to 0.8% during the period. The current rates are much lower than in previous instances and the low rates may support higher multiples due to a lack of compelling opportunities in safe, yield oriented assets.

Your Lynx team is eagerly watching for opportunities that may develop due to this extreme volatility. We are also analyzing policymakers' actions during the coming days and monitoring the transmission rate of the virus. We will reach out once we have identified compelling opportunities from a risk/reward standpoint. Meanwhile, please don't hesitate to call if you have any questions.

Peter Pavlov

March 16, 2020