

I'm Scared. That's a Reason to Buy.

The true contrarian only buys when it makes him feel physically sick to press the buy key



it's easy for an investor to be paralyzed by fear, and panic is visible everywhere.

PHOTO: BRYAN SMITH/ZUMA PRESS



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The true contrarian only buys when it makes him feel physically sick to press the buy key. At the moment I not only feel sick at the idea but want to disinfect the keyboard before using it. Does that mean it's time to buy?

The standard contrarian approach says it is. Panic is visible everywhere. [Markets have crashed](#). Critical money markets are functioning only because central banks have stepped up with rescues bigger in many cases than in 2008. Creating money to directly finance government spending is being seriously discussed. Supermarket shelves are empty, and unemployment claims are soaring.

In spite of all this, Congress has repeated the 2008 mistake of putting partisan concerns above passing a large rescue package, [leaving it to the Federal Reserve](#) to take action.

Yet, doom-laden scenarios are much worse. Even the good outcomes now involve weeks of some form of lockdown, months of social distancing, a massive overhang of government debt, unemployment and failed businesses, and a constant risk of the pandemic resurfacing, as well as [large numbers of deaths](#).

If more pessimistic views about the spread of the virus and how the health system copes prove correct, it could lead to widespread insolvency, government nationalization of vital companies, and markets—if they work at all—melting down.

At the extreme, troops on the streets and stripped foodstores are staples of novels and movies about societal breakdown (one spot of good news: no zombies in real life).

Faced with all this, it's easy for an investor to be paralyzed by fear. Too much about both the virus and the government response are unknown, so forecasting is guesswork. In such an environment it's easy to assume the worst.

Yet it's also possible to come up with relatively positive views. The widespread use of new, rapid tests could allow governments to be far more specific with their quarantines. Antibody tests could allow those who have been infected to return to normal life (assuming post-infection immunity and little mutation of the virus, both supported by early work but far from certain).

Progress may be made with putative cures long before a vaccine is ready. And the economy could bounce back once lockdowns are lifted.

Importantly for shareholders, Congress is almost certain to get its act together eventually, just as in 2008, and pass [a multitrillion dollar rescue package](#).

Cheapest Are Cheaper

The valuation of cheap, or 'value,' stocks is far lower than that of the wider market.

Price-to-book ratio



Note: Through Friday
Source: Refinitiv

12-month forward price-to-earnings ratio



Source: Refinitiv

Valuations suggest the market expects many troubled companies to fail, but also that the survivors will do OK. Cheap stocks are increasingly being priced for failure, with the [S&P 500 Pure Value Index](#) trading at seven times 12-month-forward estimated earnings, close to its 2008 low. Since cheap stocks tend to be the companies already facing problems before Covid-19, this is the place likely to be hit by the earliest bankruptcies.

The rest of the market remains much more expensive by both price-to-earnings and price-to-book measures: Overall, the [S&P 500](#) is merely approaching its average since 1871 on Prof. Robert Shiller's 10-year price-to-earnings ratio.

This year's earnings aren't particularly relevant, given so much depends on whether there is a rapid rebound or long slump, but they may act as some sort of baseline for bargain-hunters. The S&P as a whole isn't yet an obvious bargain.

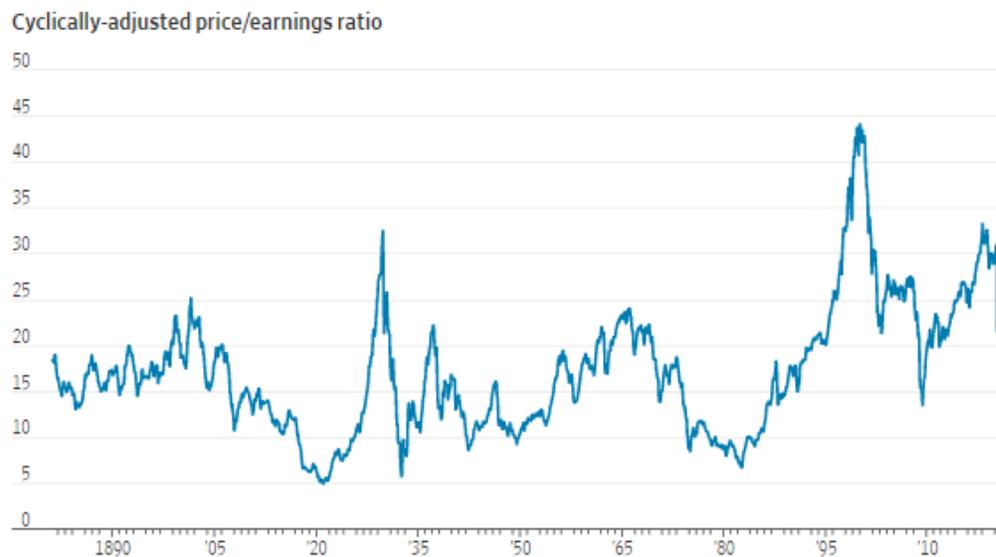
Will it get cheaper? My guess is yes. As Research Affiliates founder Rob Arnott says, peak fear might come when deaths in the U.S. are up 10-fold or a hundredfold, and the health system is completely overloaded.

Cheaper, Not Cheap

Measured against 10 years of earnings, the S&P 500 has been much cheaper in the past.

Cyclically-adjusted price/earnings ratio

Sources: Prof. Robert Shiller, *Refinitiv*Note: As of 3 p.m. GMT Monday March 23, 2020



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