GLOBAL VALUE ADVISORS
A Division of Moody Aldrich Partners

Investment Insight
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Covid-19 Market Meltdown and Bear Market Dynamics

Equity market gyrations in the first quarter of 2020 reached extreme levels. During the quarter, size mattered as larger caps outperformed smaller caps by 8.4% in March and 9.9% YTD, measured by the MSCI ACWI Large Cap and Small Cap Indexes. Indices broke all-time highs in early February before going through the fastest collapse on record in early March as the world economy came to a COVID-19 induced halt. Massive fiscal stimulus helped to pare losses by month end.

To put recent returns into perspective and develop a sense for what might lay ahead, we looked back over the last 75 years to identify similar sharp monthly declines. The magnitude of the moves and the uniqueness of each crisis make historical comparisons difficult. Nevertheless, in analyzing the history of the **US equity market**, we can identify **11 prior double-digit monthly drops** since the end of the Second World War. The median time to recover the initial loss was 10 months.

	Monthly drawdown	# of Months to Recoup Loss	Next 18 Month Index Real Return
Sep-46	-10.1%	40	-7%
Apr-70	-10.1%	10	15%
Nov-73	-12.2%	86	-12%
Sep-74	-10.9%	3	60%
Oct-78	-11.1%	11	5%
Mar-80	-11.3%	5	10%
Oct-87	-22.3%	22	24%
Aug-98	-15.4%	4	47%
Sep-02	-10.3%	3	40%
Oct-08	-17.0%	15	29%
Feb-09	-10.0%	3	44%
Median	**-11.1%**	**10**	**24%**
Mar-20	**-13.2%**	**TBD**	**TBD**

Source: Fama French US equity universe.

Developed international and emerging markets show a similar pattern although with fewer data points.

Because the first quarter of 2020 was another painful experience for the value style, we dissected the above numbers to illustrate the size and valuation dynamics observed over these extreme market events, as well as in the 18 months following the initial drawdown.

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The table below shows the relative performance of small caps vs large caps and value vs growth stocks during extreme market declines and the subsequent rebound. Both categories are broken down by quintiles. The returns are market cap weighted.

Largest 11 Monthly Drawdowns Since 1945 - Median Relative Return

Size / Value	1 Cheap	2	3	4	5 Expensive
1 Small	-5%	-4%	-5%	-8%	-11%
2	-4%	-3%	-4%	-5%	-8%
3	-3%	-1%	-2%	-4%	-6%
4	-3%	0%	-2%	-3%	-4%
5 Large	0%	2%	1%	1%	2%

Next 18 Month Median Culumative Relative Return

Size / Value	1 Cheap	2	3	4	5 Expensive
1 Small	15%	6%	10%	9%	7%
2	11%	4%	5%	11%	8%
3	11%	10%	4%	7%	8%
4	9%	7%	8%	5%	8%
5 Large	2%	1%	-4%	-2%	-5%

Source: Fama French US equity universe, valuation quintiles defined using book to price.

The main takeaways are that, in the month of the collapse, large cap stocks tend to outperform, and play a defensive role, independently of valuations. The best performing category in the market downturn is large cap growth stocks, producing a +2% relative return.

In the following 18 months, we typically see a reversal in this trend. Small and mid-cap value companies delivered the best returns overall, with double digit excess returns. The shape of the rebound of these "smid value" companies varies from one bear market to the other, but overall, the bulk of the outperformance is typically delivered in the later part of the 18 month period of study.

When it comes to size, the month of March 2020 shows a similar pattern with massive underperformance of smaller names. A clear departure from the historical pattern is the staggering underperformance of Value stocks in March 2020 even though they entered the COVID-19 crisis with already depressed valuation levels following 12 years of a steady underperformance. Consistent with past drawdowns, large cap growth stocks were the best performing category in March, producing a +5% relative return. The table below captures these extreme dynamics:

March 2020 Relative Returns

Size / Value	1 Cheap	2	3	4	5 Expensive
1 Small	-15%	-13%	-8%	-2%	-8%
2	-18%	-11%	-8%	-6%	-6%
3	-18%	-13%	-5%	-4%	-5%
4	-19%	-19%	-8%	-5%	1%
5 Large	-17%	-7%	-2%	2%	5%

Source: Fama French US equity universe, valuation quintiles defined using book to price.

As a reminder, GVA's portfolios are focused exclusively on the cheapest 20% of investable stocks within each strategy's respective universe. All three of GVA's portfolios are currently finding better value in companies with market caps below their benchmarks' averages. In addition to being cheap and smaller, all of GVA's holdings generate strong free cash flows, have high ROEs, low debt and return capital to shareholders. GVA does not own classic lower quality value stocks. If history is any guide, GVA should be very well positioned for the next 18 months.

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