

Howard Marks, Co-Chairman of Oaktree Capital Management, joined MOI Global members for a LIVE Q&A session at our special event, Intelligent Investing in Crisis Mode 2020.

Read Howard's investment memos related to the COVID-19 crisis:

- April 14: [Knowledge of the Future](#)
- April 6, 2020: [Calibrating](#)
- March 31, 2020: [Which Way Now?](#)
- March 3, 2020: [Nobody Knows II](#)

*The following transcript has been edited for space and clarity.*

**John Mihaljevic:** Howard, please provide your assessment of this crisis.

**Howard Marks:** I wish for different circumstances, but I have no control over that. This pandemic is obviously one of the major events in the history of my investment career, which now spans 51 years, in the history of investors in general, and the history of the world. Two weeks ago, I put out a memo titled "Nobody Knows." It felt especially important at the time to say that. We still don't know how far the virus will go, how many people will be affected, what the effect on business will be, or how far the market will go in response. I think it's extremely important, as an investor, always to acknowledge what you don't know. In the last couple of years, I've been using a quote from Mark Twain, who said, "it's not what you don't know that gets you into trouble. It's what you know for certain that just ain't true." I firmly believe that a statement beginning with "I may be wrong, but..." or "I don't know, but..." is unlikely to get people into trouble.

This has significantly impacted economic activity. Most countries are shut down. Stores, restaurants, bars, airlines, cruise ships, movies, and conferences have all had some diminishment of their activity, if not a total dead stop. I feel bad about the business owners and the workers. According to one estimate, we're probably looking at about one million job losses in the month of April. These people don't have any resources. Maybe they'll get unemployment insurance or the government will do something special. Going into it, we talked a lot in the States about the fact that something like 50% or 60% of all Americans can't respond to a \$400 emergency. The emergency is here, and if half the people don't have \$400 and lose their jobs, there will be great hardship.

Most people are estimating a severe decline in GDP in the second quarter, not in the first, which is interesting. Goldman Sachs, for example, has minus 5% in the second quarter but then plus 3% in the third and plus 4% in the fourth. What I'll say is that nobody knows. I would love to see a quick restoration of economic activity. The markets have already responded severely, down 30% from the February 19 high, as of last night. We don't know what that means, but most big declines are down 50, plus or minus. With regard to this particular decline, the evidence on where the stock market stood at the high is very mixed. The P/E ratio was about 19 compared to the post-war average of 15 or 16 to a 20% high. In 2000, it was 32, double the norm; 19 makes it expensive but not ridiculous. The Shiller

cyclically adjusted P/E ratio shows it to be very high. The Buffett ratio of stock market value to GDP shows it to have been essentially at an all-time high, matching 2007.

We have mixed signals. I think the market was a little high but not anymore. It's probably not at a giveaway level either. S&P earnings have been revised, in Goldman's case down to \$1.58 from \$1.73. You put a 15 multiple on \$1.58, and you essentially get about where we are. Fifteen is normal. It's not depressed or panic levels. We could get to panic levels, but I can't know that for sure. At any rate, when you're down 30%, the one thing you know is that it's a lot cheaper than it was a month ago.

There's a lot of pessimism, not necessarily undeserved. The market has switched from being ruled by optimism to pessimism. I think that if you have money, it's reasonable to spend some of it here. I'm not saying it's the bottom. Finding the bottom is always a fool's errand, and, by the way, nobody can say if this is or isn't the bottom, by the way. Things are on sale. Does that mean there won't be further markdowns? It does not, but I do think it's worth spending some money today.

**Mihaljevic:** The market may not be at a giveaway level, but some sectors do seem quite beaten down, such as travel. There is also oil and gas, where another dynamic is playing into what's already a bad situation. How are you looking at sectors that seem to have been crushed completely?

**Marks:** I'm not familiar enough with any specific industries or sectors to have an authoritative opinion, if there is such a thing today. When we go from the general to the specific, I would tend to trust what I say less. Having said that, everybody knows.

Let me back up. When my son was in college studying investing, he would come to me with bright ideas, saying, "We should buy this company because it has a good new product." My answer to him was always the same, "Who doesn't know that?" This is the operative question for the value investor, who makes his good money by finding value that other people haven't found. If everybody has found the value and priced it into the stock or bond, you're not getting a bargain. You want to find things other people haven't figured out.

Now, it's bad news. It's value in reverse. You say that travel, for example, has been at ground zero of the problem. Who doesn't know that? Everybody knows that. The hotels, the cruise ships, and the airlines are terrible. They have taken a huge knock. The most naive of investors would say today, "The outlook for the travel industry is terrible. We should get out of the stocks." The question is whether everybody knows that the outlook is terrible. Has everybody priced that terrible outlook into the stocks? Is it too late to get out? Is it time to get in? Has the bad news been incorporated, inadequately reflected, or excessively reflected? That's the question. The mere fact that these industries are at ground zero is not a sell signal. If there is staying power, I would look at those industries just as well as I would look at an industry relatively protected from the virus and its effects.

Energy has been a mess. The price of oil hit a high of \$110 in 2014 or 2015, and then in January or February of 2016 (if I remember correctly), it plunged to \$27. That was a lot cheaper, but nobody could say it wasn't going down. When it hit \$27, a lot of people said it

was going to \$10 or zero. Oil has been in a real problem situation ever since then. It bounced up into the \$70s when things settled down, and OPEC got the supply-demand relationship under control. Now, it's down again. The last price I heard was \$28. Is it going to \$75 or to \$10?

This is not virus-related although diminished economic activity will reduce demand and tend to hit the price. This is a supply-demand situation, and it is actor-specific. In other words, the Saudis cut production to keep the price up, but the Russians did not. The Saudis then said, "Well, if you're going to produce all you want, then we're going to produce all we want, and we're going to hurt you by cutting the price," which is what they've done. That's why the price is in the \$20s. What's next? Who knows? Will the Russians capitulate? Maybe the Saudis will capitulate and say, "You know what? We don't want to sell oil at \$28. We're going to restrict the production again." Nobody knows.

Having said that, what's the outlook? Have the reductions in the outlook been inadequately or excessively reflected in the price? These are the questions a value investor asks. It would be silly to say, "The oil industry is a mess. We won't invest" because we should be willing to invest wherever the price is too low, and the psychology is too negative.

**Mihaljevic:** When thinking about how bad it can get for stocks or whether this is, in fact, an opportunity, to what extent does the level of Interest rates figure into this? What's the case for bonds here? When you've got interest rates so low, it would seem that stocks do provide the better yields going forward.

**Marks:** As I said in that memo, you've got the 10-year Treasury selling at less than 1%, and the S&P yields more than 2% and has growth potential. The earnings yield is 6%. I said it would be crazy to sign up for a 0.5% yield return for 10 years when you could buy stocks that yield more, and the dividends should grow over time. I still believe that. The point is that we all talk about the P/E ratio, and we have to think about the E/P ratio. We have to take the price-earnings ratio of 16/1 - or about 15/1 today - and flip it, 1/15. A 15th is equivalent to a 6.7% yield on the S&P 500. Everything else being equal, the lower yields go in the environment, the lower the demanded yield, earnings yield, or dividend yield on stocks can go. In other words, the lower the E/P ratio, the higher the P/E ratio. A higher P/E ratio suggests a higher stock price.

In theory, lower interest rates justify higher stock prices, and that is probably one of the elements that caused the stock market to come back. Only 11 years ago, the market hit its low. The S&P was 666, as I recall, on March 9, 2009 versus 2,400 today. One of the things the US and other governments did was take interest rates down. If you get zero or negative by putting your money in a bank, you tend to say, "I'll go out and buy some stocks or corporate bonds instead." It was this interest rate cutting that brought prices back.

**Mihaljevic:** To what extent are you concerned about things like the high share of passive investing, machine trading, or similar things exacerbating the current situation?

**Marks:** That's not top of mind for me because the passive investment fund will be less likely to sell emotionally. It doesn't have emotions. There are no people. That will only be a

medium for panic. If people were going to panic in other circumstances about active investing and withdraw their money from the market or take it away from their managers or their funds, then they'll do it now with regard to their passive funds. I may be missing something, but I don't see it as a differentiator.

**Mihaljevic:** Since your last memo came out, I hope we have learned a little more about the situation. Do you think we can look ahead to the end of the tunnel here and say we have social distancing flattening the curve, we should be able to tell that this won't last, and we will have an opportunity to return to the previous situation?

**Marks:** It all depends on whether you want an optimistic or a pessimistic gloss. First, it certainly seems that we are doing testing, distancing, and quarantining, so maybe we can bend the curve so that the new daily cases stop growing. It seems possible. Number two, we might get a vaccine. Number three, there's hope that this disease doesn't like warm weather. There's a reason why flus and things like that are seasonal diseases. They tend to happen in the winter. Bacteria like hot weather, and viruses like cold weather. We hope this one follows the pattern. If you look at the seasonal diseases that have come up over the last few decades, it does seem that they last through the cold weather and die out in three to six months. That's what the optimist would say, and it's all quite reasonable. The pessimists would say, "Who knows? We have to husband our resources, and we don't want to turn optimistic before the bottom." I would say in the hope that it's a three- to six-month thing and that prices are reasonable, we're going to put some money out.

By the way, I'm not talking about Oaktree. We don't buy stocks for the most part, so nobody should claim I'm saying that Oaktree is doing it. I won't tell you what Oaktree is doing, so you shouldn't base what you should do on what I'm doing, but that's certainly a reasonable position to take. Given the weight of the opinion that it's a three- to six-month thing and the fact that the market is down 30% from a not ridiculous high, it's probably reasonable to spend some money here. However, neither I nor anybody else can tell you that this is the low. Some people will try, but they can't do it, of course. The other thing is that nobody said they could tell you it's not going lower, or that the disease is not going to get worse, or that it's not going to take more than three to six months. So, nobody can justify spending all their money here. I think you can't justify spending all your money, and you can't justify not spending any of your money. That's my opinion.

**Mihaljevic:** In terms of a cyclical versus defensive exposure, how are you looking at that?

**Marks:** It depends. As I've been saying in recent years, the most fundamental, religious question about investing is which is more important to you - to maximize your gain or to assure protection from loss. The more you say, "I want to maximize my gain," the more aggressive you want to be at a point in time. The more you say, "I want to protect against maximum loss," the more defensive you want to be at a point in time. That is always the key tradeoff. You can't do both. If you want to be sure of limiting your losses in the months ahead, you would go with defensive, whatever defensive is. In the new age, defensiveness is a little hard to find, but utilities, telephones, food, and the necessities of life are defensive. By the way, in usual times, the toll roads are considered defensive, but they're not very defensive if everybody stops driving. The point is that if you want to emphasize downside

protection, you will go defensive. If you want to maximize recovery potential, you want to go with cyclical in the expectation that there'll be big gains when they come back. There's no right answer. Every investor has to spec out for himself or herself which is more important, maximizing gains or minimizing losses.

**Mihaljevic:** Do you think there will be a permanent behavior change in people and businesses as a result of this episode? Do you believe there will be things five years from now that people or businesses do differently?

**Marks:** I guess so. One of my favorite quotes from John Kenneth Galbraith is, "One of the two outstanding characteristics of the financial market is its shortness of memory." These things tend to get washed away. I can tell you that in the fourth quarter of 2008, after the Lehman bankruptcy, when everybody was predicting the end of the financial world, I thought that risk bearing would be extremely slow to recover. However, it recovered within two or three years, largely because of the government actions. I probably tend to overstate the changes these traumas have.

Somebody said yesterday, "I think people will stop shaking hands. It's a crazy pagan custom we have. Why should people touch the hands of strangers?" Maybe. Who knows? For many years, my wife has been saying, "Why are you going on that business trip? Why don't you just phone it in, do a conference call or a video call or something like that?" We've all cancelled all of our travel, and everybody is making do with electronic communication. That could be a permanent change. If we were at 100 months ago in terms of in-person travel, and if we're at zero today, which I think we are, the interesting question is whether we are going back to 100 or 75. If we go back to 75, what does that mean for airlines and hotels? What does it mean for electronic communication facilitators like Zoom?

Right now, it feels like the end of life as we know it. The answer is probably not. It will probably be over in six months. In 12 months, we'll have a vaccine. We'll come back from where we are now. I can't guarantee you we're going all the way back to where we were.

**Mihaljevic:** Howard, thank you very much for your time. I truly appreciate you sharing this perspective with our members.

**Marks:** I hope it's helpful to your members. Take care, John.

#### *About the instructor:*

Since the formation of Oaktree in 1995, Howard Marks has been responsible for ensuring the firm's adherence to its core investment philosophy; communicating closely with clients concerning products and strategies; and contributing his experience to big-picture decisions relating to investments and corporate direction.

From 1985 until 1995, Mr. Marks led the groups at The TCW Group, Inc. that were responsible for investments in distressed debt, high yield bonds, and convertible securities.

He was also Chief Investment Officer for Domestic Fixed Income at TCW. Previously, Mr. Marks was with Citicorp Investment Management for 16 years, where from 1978 to 1985 he was Vice President and senior portfolio manager in charge of convertible and high yield securities. Between 1969 and 1978, he was an equity research analyst and, subsequently, Citicorp's Director of Research.

Mr. Marks holds a B.S.Ec. degree cum laude from the Wharton School of the University of Pennsylvania with a major in finance and an M.B.A. in accounting and marketing from the Booth School of Business of the University of Chicago, where he received the George Hay Brown Prize. He is a CFA® charterholder.

Mr. Marks is a Trustee and Chairman of the Investment Committee at the Metropolitan Museum of Art. He chairs the Investment Committee of the Royal Drawing School and is Professor of Practice at King's Business School (both in London). He serves on the Shanghai International Financial Advisory Council and the Advisory Board of Duke Kunshan University. He is an Emeritus Trustee of the University of Pennsylvania, where from 2000 to 2010 he chaired the Investment Board.