ULTIMATE GUIDE

Making Money During an Economic Crisis

TRADER ON THE STREET

Introduction

The Crash of 2020

March 9th 2020, was one of the darkest days for the stock market that people had seen in years. The Dow Jones saw one of the largest point plunges in U.S. history with only two other historical drops, the 1928 drop that plunged American into the Great Depression, and the drop in 1987. Unfortunately, the drop was not an isolated incident. Within seven days of the initial drop, the stock market plummeted two more times on the 12th and 16th.

The unexpected drop left many investors nervous and wondering how they can better prepare themselves for a similar decline in the future. Below is a guide that can help you not only understand what happened and why, but provide you with the knowledge and tools to better prepare yourself in the event a similar drop occurs in the future.

The Impact of COVID-19

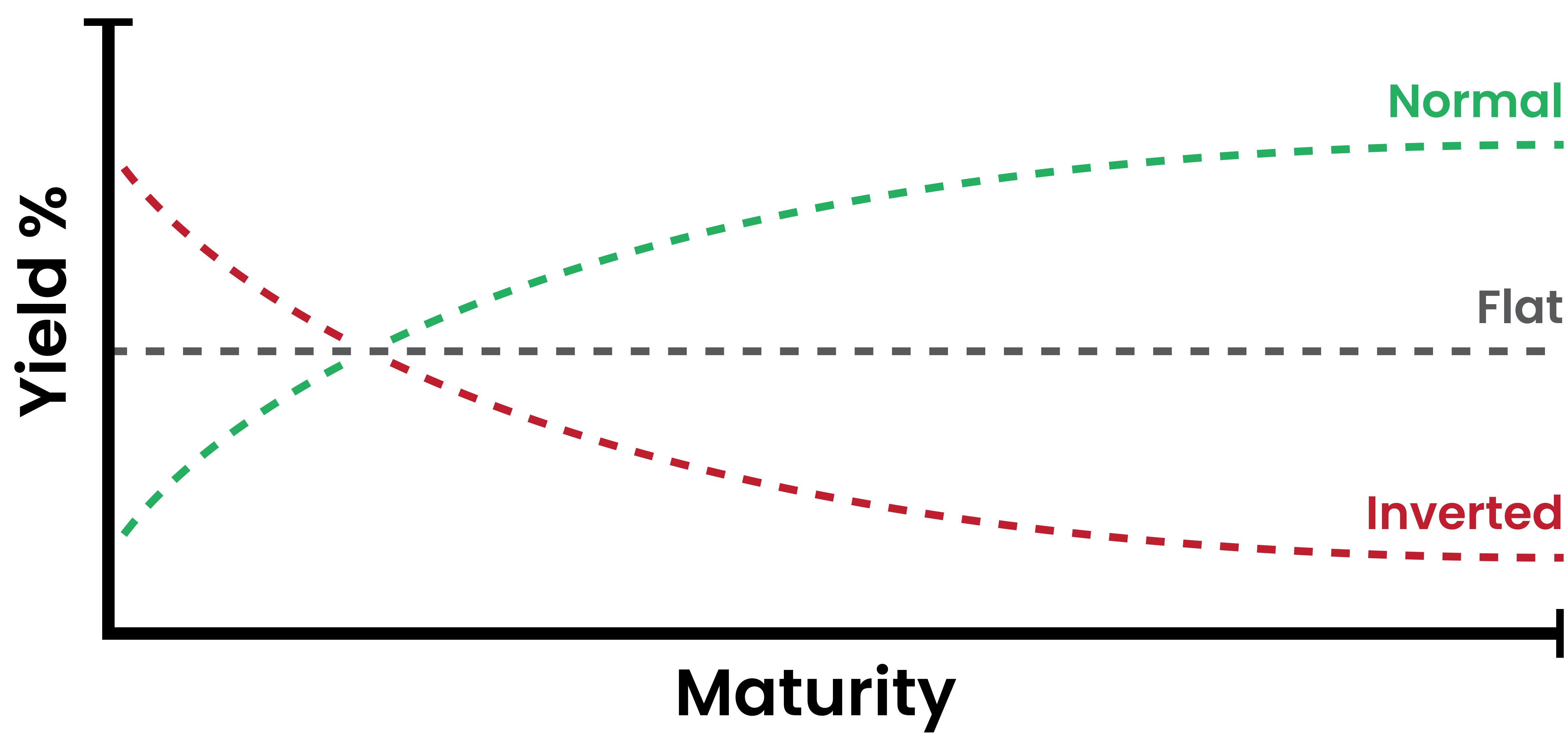
So what led to the crash of 2020? Fear of the global impact that the novel COVID-19 coronavirus pandemic would have on markets. Though the SARS virus boasted a much higher death rate years before in 2003, the rapid spreading of the coronavirus led the WHO to declare the virus a pandemic. The virus provided the catalyst that, coupled with current economic stresses, pushed the market to a terrifying low.

Signs of a Recession

An Inverted Yield Curve

An abnormal situation can occur where the rates on a short-term Treasury bill are higher than the Treasury 10-year note. This results in an inverted yield. In short, it means that the risk in the near future is higher than what is expected in the long-term future. Most investors put their money in short-term investments when they aren't expecting a high rate of return on their money in exchange for only having funds tied up for a shorter time frame. They know if they allow their money to be tied up for longer, then they are more likely to get a higher return on investment. With an inverted yield curve, the opposite happens, meaning they will make more on the shorter-term investments than on longer ones where they have time to grow.

Types of Yield Curves



Could a Recession Be on the Horizon?

Why is the inverted yield curve so threatening to investors? An inverted yield curve tends to be the signal of the beginning of a recession, as was the case in 2008 2001, 1991, and 1981. In an economy already reeling from a significant drop, a recession will bring down a second hammer on the economy, which may make it even more challenging to recover. Historically, pandemics will slow the economic growth of an area as more people are home due to illness, or caring for sick loved ones and children. Sometimes people will stay home for fear of catching the virus as well. The COVID-19 virus has taken the slow down to a whole new level as many states are now implementing stay-at-home orders, shuttering businesses across the country. With the drop in the market and businesses remaining closed, a recession seems inevitable.

What is a Recession and How Long Does it Last?

A recession occurs when economic activity is on the decline. A recession is marked by high levels of unemployment, a significant drop in consumer spending, drops in income, businesses going under, and a constantly dropping stock market. While recessions are common in economies, drastic ones can be much more difficult to recover from. A downswing in the economy will be referred to as a recession when there is negative growth of a country's gross domestic product for at least two consecutive quarters.

There is no set time limit for recession. Some recessions are as short as a few months while others are as long as several years. The economy will be said to be out of the recession as economic growth begins to pick up. The longest recession in the U.S. occurred from 1873 through 1879, spanning more than five years, while the shortest lasted six months from January 1980 until July 1980. Though the U.S. rarely faces a prolonged recession in more modern times with the last lengthy recession being the Great Depression, which only spanned 20 months.

The Pattern of Recessions

Most recessions start with a decline in consumer spending and a drop in corporate earnings. Less money is being put into the economy, and as corporations have difficulty pulling through financial strain, many will go bankrupt, and others will lay off a significant number of their workers. As unemployment rises, consumer spending will continue to drop, loans can go unpaid, and homes can fall into foreclosure. This will, in turn, cause more businesses to fail and create an unending loop.

With people ordered to stay home during the pandemic, consumer spending is expected to continue to drop. This, along with the recent market crash and businesses having to suspend operations, seems to be the perfect storm for an impending recession, and many economists are scrambling to keep up with constantly changing predictions to determine the extent that the recent pandemic may have on the economy. For example, the New York Federal Reserve has already felt the need to lower the estimated GDP to 1.7% in the first quarter, from 2.1%.

Growth is not expected to only drop in the U.S. but around the world as well, with the Organization for Economic Cooperation and Development estimating a fall of the overall global growth of 1.5% during the year after previously estimating growth rate increase shortly before the pandemic.

Could a Recession in 2020 Lead to a New Depression?

While a recession can be terrifying to many investors, depression is a far worse outcome that could result from the crash of 2020, though few people are predicting that it might occur, which may help you to breathe a little easier. While this can provide some comfort, depressions never tend to be properly forecasted, and seem to become apparent only when they are in full swing.

Unlike a recession, a depression is a more severe and prolonged downturn in the economy and one that can be significantly harder to come back from. Often referred to as an extreme recession, a drop in GDP of more than 10% is often considered a depression. Luckily depressions are not frequent, but when they do hit, they are accompanied by extreme levels of unemployment and overall deflation. When depression occurs, investments will decrease as consumer confidence drops, ultimately causing the economy to grind to a halt.

A depression can be characterized by not only high levels of unemployment, but also drops in available credit, lowered productivity and output, bankruptcies, prolonged negative GDP growth, debt defaults, reduced commerce, bear markets, asset volatility, falling currency value, low inflation or deflation, and a higher rate of savings, though there are often fewer people in a position to save.

The good news is that the 2020 crash is highly unlikely to result in a depression for many reasons. The first being that there have been multiple laws and government agencies that have been put in place following the Great Depression to help prevent its recurrence. Another reason economists don't believe that depression is probable is that the Federal Reserve is much more aware that stimulating the economy during these trying times is important and has a variety of methods to help do this. Some options include lowering interest rates and pumping credit into the global system, which can restore confidence in bankers who will be more willing to lend. The last protection against a future depression is the policy rate targeting to prevent deflation, a key factor in depression and fiscal stimulus which will be covered in greater detail.

Monetary Policy

What is Monetary Policy and Why is it Important in Tough Economic Times?

Monetary policy is important as it is used as a way to manage both the cost and availability of money so that a healthy economy can be promoted. The organization that is tasked with creating and implementing monetary policy is the Federal Reserve. There are two main goals that Monetary Policy is designed to achieve. The first is to focus on stable employment and sustainable output. The second is to keep prices low and stable to control inflation. When these goals are met, long-term interest rates are moderated.

To achieve the goals set by the monetary policy, the Fed will start by setting a target for the key interest rate, which is known as the federal fund rate. It is this rate that financial institutions will be able to charge each other for loans obtained in the overnight borrowing market. Along with creating the rate for financial institutions, it will also serve as a benchmark standard for other short-term interest rates. It can influence credit conditions as well.

The Federal Reserve will use several tools in its arsenal to help keep the federal funds near the target rate. Even though the Fed does not have the power to control inflation, employment, output, or long-term interest rates, it can affect all of these indirectly by controlling the federal fund rate. One way of doing this is by requiring

all institutions that make deposits to hold a minimum balance at a Federal Reserve Bank. Also, their policy actions can alter the supply of reserves in the banking system. If there are more funds in the system, then the fund rate will lower, as there is more supply than demand.
Again, even though the Fed can not directly affect inflation, they can utilize monetary policy to increase the federal fund rate, which can indirectly keep in-

What are Open Market Operations?

Another popular tool used by the Fed to create its monetary policy is open market operations. The process of open market operations involves the sale and purchase of United States government securities on the open market with the goal of aligning both the federal fund rate and the publicly announced target set forth by the FOMC. To pay for these trades, the reserve accounts at the banks will be credited if they are responsible for selling the securities. By doing this, they are creating money, which will put downward pressure on the federal fund rate as a result of supply and demand. This can cause lower interest rates on the short-term market, which can encourage both businesses and consumers to spend, creating stimulation in the economy.
The Fed may also choose to sell government securities if the target for the federal funds is raised. To do this, the Fed will collect payments from banks and withdraw money from their reserve accounts. By doing this, the supply of money in the banking system is smaller, which will push the federal fund rate higher. This can lead to higher interest rates to slow economic activity and reduce the pressure for inflation.

What is the Discount Rate and How Does the Fed use it?

The Federal Reserve Bank will charge eligible financial institutions who borrow funds from them on a short-term basis a discount rate. This rate is not determined by the supply and demand of money, but is instead set by the Reserve Bank board of directors and subject to approval by the Board of Governors. The discount rate will always be higher than the target of the federal funds rate. While the discount window, as it is often referred to, can be used as a source of primary finding in some situations, it is most often used as a secondary or back-up funding source. It will more likely become the primary funding source when borrowing on the federal funds market sees an interruption. The Fed will then be used as a last chance lender.

What You Need to Know About Reserves

Every financial institution that acts as a depository financial institution will need to have a percentage of all of their money deposited set aside as reserves. This can be done through having cash on hand or an account balance at the Reserve Bank. The requirements for these reserves will be set by the Fed, and the same standards will be utilized by savings banks, commercial banks, credit unions, savings and loans, and any U.S. branches at foreign banking institutions. It is these reserves that will provide funds for financial transactions through the Federal Reserve, such as checks, electronic payments, and currency exchanges.

Even though reserve requirements are rarely used as a tool for monetary policy, it does support it as it will create a predictable demand for loans in the federal funds market. In many cases, banks will actually borrow in those markets to meet requirements set by the reserve. By having predictable bank reserves, the Fed will have a greater ability to influence the fund rate through its use of open market operations.

In an attempt to help stave off the damaging effects of the recession in 2008, Congress chose to grant the Fed the ability to pay interest to the depository institution on the reserve balances they were holding. This was done to create a floor beneath the federal fund rate since institutions were not willing to loan money to each other when the rates were significantly lower than they could earn by simply keeping the reserves as a deposit with the Fed.

This attempt by the Fed to stimulate the economy left a large amount of reserves in the banking system with a federal fund rate of zero. After the Fed sees improvement in the economy, the Fed can use its ability to pay interest on these reserves to tighten the policy without the need to significantly reduce the supply in the reserves. They can simply raise the rate on the reserve, which will push market interest rates upward since the banks will not wish to lend money to the public at a rate that is less than they can earn when holding the reserves at the Fed.

Fiscal Policy

The Political Tool to Influence the Economy

The Fed is not the only entity that can influence the economy. Congress also can drastically affect the economy of the country through the use of spending and taxation, which are two of the primary components that make up fiscal policy. Fiscal policy, paired with monetary policy, helps to influence the economy by affecting money supply and interest rates. All fiscal policy is designed to ultimately promote healthy economic growth. For economic growth to be considered steady, it should grow an average of 2 to 3%

each year while keeping unemployment less than 4.5% and inflation around the target rate of 2%.

Types of Fiscal Policy

Two types of fiscal policy exist. The most commonly used is expansionary, which is designed to stimulate the growth of the economy. It typically follows the contraction phase when the need to pull the economy out of recession arises. With this type of fiscal policy, Congress will use its powers to either spend more, cut taxes, or do both at the same time. Ultimately they want to give consumers more money to increase consumer spending and, in turn, promote hiring by businesses to keep up with demand.

While both spending and cutting taxes can be part of the plan, there is a debate as to which method provides the best stimulation. One side prefers tax cuts so that businesses can expand and hire a larger workforce, hopefully promoting long-term employment for those previously unemployed. The other group says that spending on public works, food stamps, and unemployment benefits will work better as it provides consumers with more money to spend, which will require businesses to produce more. Expansionary fiscal policy can only be done at the federal level since state and local governments are required to keep a balanced budget.

On the opposite end of the spectrum is the contractionary fiscal policy, which is not as commonly used as it is designed to reduce inflation and slow economic growth. This type of policy must be used cautiously as it can cause a long-term and damaging effect on the consumer standard of living, in the same way a recession can. In this situation, spending will be reduced, and taxes are increased. Because of the negative impact, it has on voters, this is only typically done by politicians who are not seeking out reelection.

One hindrance with the government using discretionary fiscal policy is the fact that the budgeted money going to mandated programs is continuing to rise as the population ages.

Monetary Policy or Fiscal Policy

Which is More Effective?

There are many reasons that some prefer changes in monetary policy when the economy is facing tough times as it directly changes the supply of money. If interest rates are higher, the economy can be quickly slowed down. When they are lowered, the supply will expand, and the economy can drastically pick up sometimes quickly enough to avoid a recession.

Another reason that monetary policy can be considered more effective is that the rates can be raised or lowered at the regular meetings with the committee without having to go through a lengthy legislative process. This can allow the impact on the economy to take effect in as little as six months. Ideally, Congress would coordinate their fiscal policy when the Fed changes the monetary policy, but this is not often the case, as Congress members need to put their focus on their constituents first and foremost.

The main drawback to relying on fiscal policy is that existing laws will first dictate how money in the budget needs to be spent, leaving less and less each year in their discretionary fund.

What Has History Taught Us About Depressions?

Even though many Americans can't remember the Great Depression, most will agree that it was one of the toughest economic challenges that the country has faced. In fact, the Great Depression showed us how quickly the economy could turn and how much hardship it would cause citizens that it caused us to create significant policy changes. Prior to the Depression, the economic policy in the country was fairly laid back as many felt that America was so strong it would continue to surge into the future. At the time, politicians greatly feared interfering with capitalism and a free market economy as these were the foundations on which the country's economy was based.

The Great Depression showed that intervention was needed, and Roosevelt utilized economic theory to create the New Deal, in an attempt to drag the country out of the depression. The theory followed the principles that spending by the government could possibly increase consumer demand. He utilized expansionary fiscal policy to create projects for workers, such as building roads, bridges, and dams. This put more than millions of workers back to work, providing them with an income that they could put back into the economy. His New Deal worked, and the country pulled itself out of the Great Depression by 1934 when the economy increased by 10.8%. After a few years, the president then used a contractionary policy by raising taxes and cutting spending to decrease the economy by 3.3% in 1938 to reduce the risk of inflation and help to balance the budget. Another expansionary fiscal policy enacted as America entered WWII helped to put the final nail in the coffin of the chapter in America known as the Great Depression.

How Were Americans Affected by the Great Depression?

Understanding the history of one of the greatest economic collapses in America will help us gain a greater understanding of why economic controls are so important to sustain the American way of life. It is important to understand how the president helped pull the country of trying times, but even more important to see how the devastation affected Americans in their day-to-day life. So what was life like during the Great Depression? For many Americans, it was one of the darkest periods of their lives. But for others, it was a time where they prospered and thrived.

For example, Michale J Cullen came up with the idea that would change life as Americans knew it. He came up with the idea of the modern supermarket. He capitalized on the new technology of home refrigeration and created a chain of stores that would generate an exorbitant revenue. Charles Darrow, who found himself out of work after the crash of 1929, created a game that would become beloved by Americans, Monopoly.

While these names may be unfamiliar to most, some people have become synonymous with wealth during the Great Depression. One of those people was Howard Hughes. While many people remember him for his numerous eccentricities, he was able to weather the storm and create one of the largest aircraft companies as well as become a supplier for defense, making a fortune as the country entered into WWII. Another American well-known for growing his wealth to untold highs during challenging times was J. Paul Getty. The oil tycoon created an empire that made him a billionaire many times over with a simple inheritance investment of $500,000.

Joe Kennedy is also a name well associated with success during the Great Depression. Unlike other investors, he knew when to get out of the stock market, and his timing paid off big time as he avoided the effects of the crash by pulling his money out and investing it in real estate ventures, movie studios, and liquor, generating profits that would lead his family to extreme wealth for generations,

While many people with strong business acumen and a penchant for great ideas were able to not only stave off disaster during the depression but also increase their wealth exponentially, there are many people who struggled to keep their homes and feed their family. Millions were out of work or had lost all of their money when the market collapsed. Having been previously successful and living a comfortable lifestyle, many people had begun to expand their credit in the years leading up to the crash in an attempt to increase standing or grow their business. Unfortunately, for many businesses, this credit reached a critical point, and when they were unable to repay the debt, companies went under, laying off workers. The housing market also plummeted, and the banking industry all but collapsed.

Companies That Thrived During The Great Depression

There were some industries that also saw growth during the depression, while others faltered. communications, transportation, shipping, defense, metals, and oil, all provided needs that consumers and businesses required even in hard times. Another thriving industry was real estate, and those who had paid cash for land and houses saw significant gains.

The Distinguishing Factors Between These Two Extremes

So what was the major distinguishing factor between those who saw a rise in wealth and those who lost virtually everything? Debt. Both people and business were comfortable in the thriving economy and continued to spend, securing additional debt to fund these needs, while failing to keep enough cash savings to be able to assist them when times got tough.

So What Can You Do to Prepare for the Tough Economic Times Ahead?

Since two of the most significant factors that affected Americans during the depression were debt and a lack of savings, we can learn from history what needs to be done with money to prepare for the unexpected. The first is obviously to reduce debt. Owing creditors when there is a downturn in the economy, and your job is at risk can put you into a rough situation rather quickly. Start a plan to pay down debt, before focusing on purchases that are considered wants instead of needs. A major debt for many Americans is a mortgage. While many people cannot pay cash for their home, they can reduce this debt quicker, by ensuring they have a proper down-payment to start out with a large amount of equity. You can also buy when the interest rates are low and choose a repayment option that is a shorter period of time. Not only will this pay your home down quicker, but grow the equity quicker as well.

The second step to better prepare yourself for tougher times is to build your liquid cash stockpile. Savings are essential, and while it is beneficial to grow savings as high as you can, you should always have at least six months of expenses on hand to prepare yourself for the event of a job loss.

Finally, it is crucial to invest smarter. Even though the market has seen a recent crash, stocks are not cheap in the same way they were during the Great Depression. That doesn't mean you should avoid investing. Typically investors are looking for an average five year annualized return rate between 12-15%, and currently, the return rate for the next five years is expected to be around 10%, which is not bad when the average savings rate is only around a quarter of a percent.

That doesn't mean that the market is not still volatile. Since the half-life of stocks with a high volatility rate is between five and six weeks, it is expected that things will normalize in around three to four months. You may do best to make a tiered purchase into the market every three to five weeks using good information. It is also advisable to buy stock so that you can re-balance your portfolio, which can help you turn your bond gains into cheaper stock.

Value Investing

A Point About Value Investing

While you may be on the hunt for a great deal to take advantage of the wayward market, it is vital to proceed with caution. Many of these deals may seem great from the outset, but the truth is some could be traps. For example, cruise and airline stocks may seem like a good deal, but with the uncertainty of travel and the pattern that the virus may have across the globe, makes it risky. You may also be tempted to invest in oil companies while the price is down, but their bonds are actually pricing them for possible bankruptcy, though this risk is not reflected in the stock.

Looking for value now may not be the best stance to take as many of the high net worth investors are positioning themselves to wait and see how the pandemic plays out, which means there is no counterbalance to the negative feedback loop leading to selling creating more selling.

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