Wednesday, March 11, 2020

Good Afternoon,

This update will be longer than normal. I hope you will have time to read it all. **Brad McMillan**, Chief Investment Officer at Commonwealth, wrote an interesting blog today and I will borrow from it here for your review.

Global stock markets have already priced in a very bad case scenario based on the unknown impacts of the coronavirus. As I write this note, US stocks have declined 20% from their peak, the definition of a Bear Market, and thereby marking the end of the longest Bull Market in history. This looks like a crash-doesn't it? According to Brad, "*From the middle of it, perhaps so. It certainly is scary and raises the fear of even deeper declines. The March 9 (Monday) decline was particularly disconcerting. Looking at the situation with a little perspective, however, things may not seem so scary. We saw a similar drop in December 2018, only to see markets bounce back. We also experienced similar declines in 2011, 2015, and 2016. In every case, it seemed the expansion was over, until the panic passed. It is quite possible that the crash of 2020 will end the same way*."

When will things turn around? There is no way to answer that question. The US is behind the curve in preparing for coronavirus, especially when it comes to the availability of testing. Do not be surprised if the number of US cases multiplies rapidly as test kits become more readily available and more people are tested. Then look for new cases to level off as 'social distancing' (keeping people away from gatherings, businesses, schools, travel, as well as self-quarantine, etc.) begins to have an impact. The control of the virus spread is possible (see South Korea), but at what cost? The social, economic and stock market ramifications are real, but temporary. The ultimate loss in economic activity will depend on the severity of the outbreak and the need to shut down large segments of the US economy. The good news is that heading into the crisis the US consumer is strong and the banking system is well-capitalized, suggesting that growth will rebound once cases peak.

What can we compare this to? According to Brad, **"***Looking back at history, we also see this pattern applies to previous epidemics, including the Zika virus, the H1N1 flu, SARS, and MERS. Each virus emerged, exploded around the world, and then faded, with markets panicking and then stabilizing. Most recently, this is the pattern we saw in China itself around the coronavirus, and it is likely the pattern we will see in other markets over the next couple of months. Reacting was the wrong answer. That is likely the case now as well*."

Beyond health concerns, what should we be watching for? Brad sees further trouble "*if news about the virus really shakes consumer and business confidence, to the point that people stop spending and businesses stop hiring. If that happens, the economic damage could exceed the medical damage, which would certainly affect markets. The good news here is that, again, the data so far does not show significant damage. Hiring continues to be strong, and consumer confidence remains high. Unless and until that changes, the economy will continue to grow, and the market will be supported. Like the number of new cases, this data will be what we need to watch going forward. Even if we do see some damage—and the likelihood is that we will—markets are already pricing in much of it. Again, the likelihood is that things will not be as bad as expected, which from a market perspective is a cushion. There may be more downside from here, as significant uncertainty remains.*"

As stock valuations drop closer to the lows seen in recent years, further declines become less likely. The markets just went on sale, with valuations lower than we have seen in over a year. Unless your long-term plans have changed, these are not the prices at which we want to sell. Regarding the constant stream of news, should we pay attention? Yes, we certainly should—but to the data, not the headlines. As we've mentioned, the data on hiring and confidence remains positive, even if the headlines do not. We have seen this show before, an important reminder as we weather the current storm.

Be smart, wash your hands, and have great week.

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http://www.commonwealth.com/RepSiteContent/weekly_comm/commentary_redirect.htm

As always, if you would like to discuss this or anything regarding current market conditions or your portfolio, feel free to contact me at any time.

Enjoy your week.

Wade

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