

Coronavirus

Market Volatility and Uncertainty

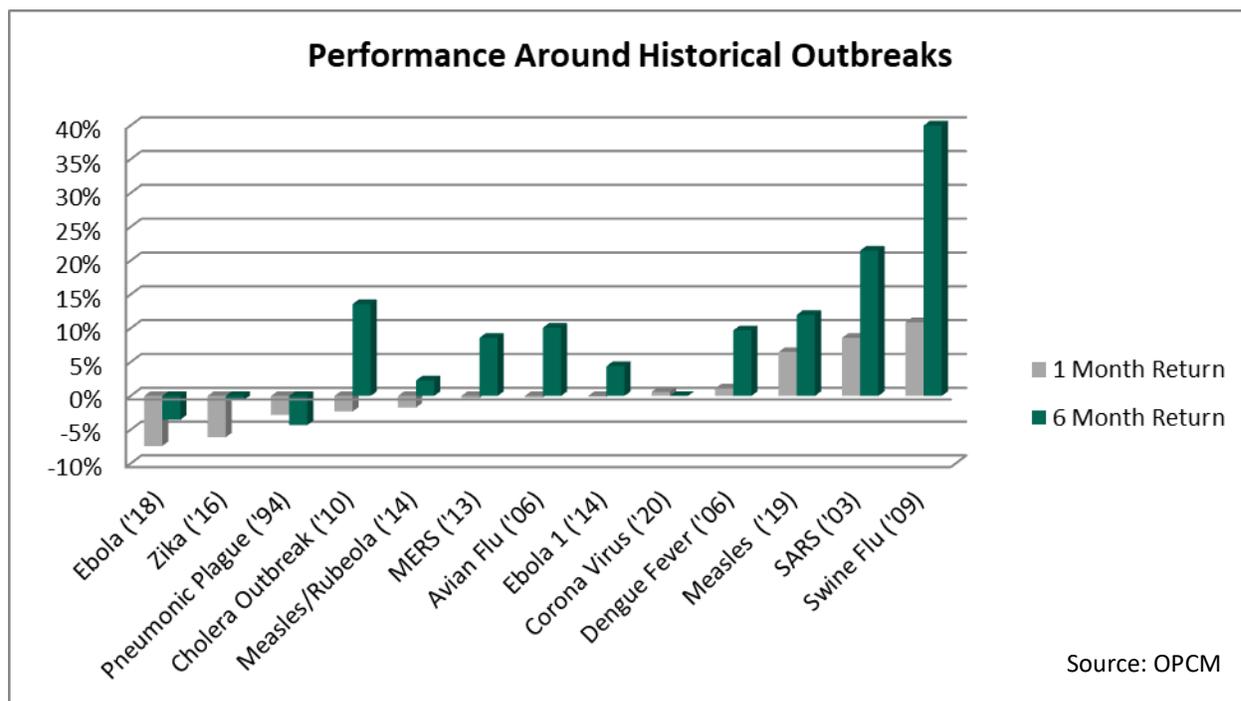
By: Osborne Partners

February 28, 2020

We hope this article provides you with information and context about coronavirus and the market volatility, as well as, highlighting how we are responding in client investment portfolios.

Market Impact:

The S&P 500 closed the week of February 28 down 13% from its high. This may seem like a rude reminder that downside volatility exists in the market, after hitting an all-time high only a week before. But since 1928, the S&P 500 has experienced a 10% correction, on average, every eighteen months, and the most recent 10%+ correction was fourteen months ago. Different factors drive downside volatility over time; this time it is driven by virus fears. Like downside volatility, virus fears are not unprecedented. Though each virus scare is unique, history suggests maintaining perspective and discipline can prove beneficial. Consider the table below:



Our response to the volatility:

Heading into 2020, we were already concerned about elevated market valuations and, as a result, had elevated cash levels in client accounts.

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On February 19, the S&P 500 traded at 19.1x forward earnings, the highest level since 2002 and nearly two standard deviations above the index's ten-year average valuation of 15.1x. The S&P 500 is now trading just below 17x forward earnings at the time of this writing.

With this market correction, we are looking to invest cash by adding to existing holdings or initiating new companies that are trading at depressed valuations due to either company-specific reasons that have been amplified by the increased market volatility, or in an overreaction to the negative effects of coronavirus on their business.

Companies on our watch list include those with minimal coronavirus exposure, company-specific and idiosyncratic catalysts, and with demand that is likely to rebound once coronavirus passes.

Coronavirus:

New pathogens are always concerning because people lack immunity to them, and specific treatments or vaccines are often not available. An additional concern specific to coronavirus is that people can be contagious while asymptomatic. This means a large portion of infected people are well enough to go about their daily business, potentially spreading it to others.

Coronavirus infections appear to cause mild illness in children, adolescents and younger adults in most cases, and potentially more severe disease in older people. In severe cases, studies suggest the virus invades cells in the lower respiratory tract and migrates to the lungs, causing difficulty breathing and the inflammation and congestion associated with pneumonia. Many of the fatalities have been in patients with underlying illnesses such as cardiovascular disease. Of confirmed cases, 81% were mild, 14% were severe and just 4.7% critical.

In Context:

As shown in the following chart, the coronavirus, also known as COVID-19 and SARS-CoV-2, contagiousness is higher than the seasonal flu. And while the early indication is that the fatality rate may be higher than the seasonal flu at 2% vs 0.1%, it remains well below that of SARS (Severe Acute Respiratory Syndrome – China 2002) and MERS (Middle East Respiratory Syndrome – Saudi Arabia 2012). For further context, consider the flu, which has infected an estimated 29m to 41m people in the U.S. this year and resulted in approximately 16,000-41,000 deaths. This compares to the coronavirus which, to date, has infected just over 83,000 and resulted in less than 3,000 deaths globally.

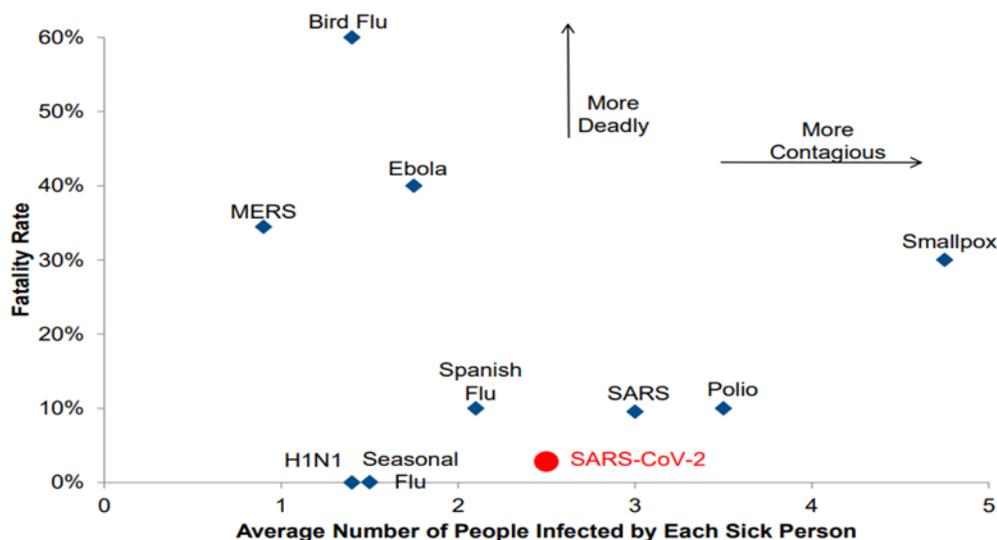
This certainly does not mean the current outbreak should be taken lightly, however we are simply framing the current situation. We will continue to monitor the virus. The investment team will add new holdings, as well as add to existing holdings as volatility increases, and investors emotions result in temporary disconnections between valuations and long-term fundamentals for certain investments.

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SARS-CoV-2 in Historical Context – Part II

Consumer and Investment Management Division 



*The averages of fatality and reproduction rates are used here. For polio and measles, data is from 2018. For smallpox, data is from the last 100 years of its existence. Source: WHO, CDC, NYT; Investment Strategy Group.

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