



INVESTMENT STRATEGY UPDATE

February 27, 2020

PANDEMIC OF UNCERTAINTY

After an uninterrupted rally in 2019, the stock market has suddenly dropped. In three days, the strong start to 2020 was wiped out. In six days, we hit correction territory, down 10% from the all-time high. By now, everyone probably knows that the triggering event of this downturn was SARS-CoV-2 (a.k.a. coronavirus), specifically its sudden and unexpected arrival in Europe. What none of us knows is how extensively the virus will spread through the world, and how impactful it will be to economic growth.

The latter point is the relevant one to us as investors. We are not medical professionals, so we have no special knowledge of what the virus will do. It appears to be more deadly than the flu, but less so than the SARS and MERS outbreaks of the past two decades. It also appears to be tricky to contain, because incubation periods seem to vary widely, and asymptomatic people apparently can be contagious. It is the novelty of this virus and the concomitant uncertainty about what its impact will be that likely has people the most worried.

And that is the crux of the current problem in the stock market. What originated in China and at first appeared to be contained there has now spread broadly, if not yet in great numbers, throughout the world. When it appeared contained, the market generally shrugged it off, with only select stocks that are obviously and extensively exposed to the disruption to Asian travel and manufacturing being affected. With the spread to new continents, the stock market began to discount a broader impact to the global economy. Companies that have just reported fourth quarter earnings are already starting to pre-announce a negative impact on their results for the current quarter. Consumers are contemplating whether travel plans should be cancelled, or even whether they want to leave the house. If enough people in enough countries decide, or are forced, to use the virus as a reason to hunker down, economic activity will be impacted. But again, there is no way of knowing yet how extensive the impact will be.

Because we don't think the outcome of this situation can be accurately predicted, we at BTR are sticking with our long-term approach to investing. While our clients benefited from the bull market of 2019, we have felt for months that it was getting a bit extended. The valuation of the S&P 500 was approaching a lofty 20 times earnings, and negative news flow seemed to have no impact. Sentiment was becoming overly bullish, which is an important contrary indicator. A correction seemed overdue. So, where warranted, we trimmed some stocks and raised cash. Now that a correction is occurring, we really can't say how much worse it might get. For all we know, this outbreak could burn itself out in a matter of weeks. If that turns out to be the case, we could be getting a terrific buying opportunity. On the other hand, if this becomes a true pandemic, we would have to contemplate the idea of global recession. Recession, at least in the U.S., has been something we viewed as a 2021 event at the earliest. If that is being pulled forward, we will reconsider our current stance.