BRIEF MARKET INSIGHTS

MARCH 11, 2020

What's Affecting the Markets?

Given this period of heightened volatility in the financial markets and worrying headlines, we understand and appreciate investor concerns. The precipitous drops in recent days have been due in large part to the ongoing spread of COVID-19 (coronavirus) and its economic impact, but also to collapse in oil prices. Company managements are struggling to assess the impact of the virus on their revenues and profits for 2020. Global economic growth is clearly slowing. While the U.S. economy is resilient, it may also be hit by the virus. Although we can't provide with certainty how markets will behave in the near future, outlined below are some of our current observations and market implications.

Market sell-off triggered by Coronavirus outbreak

- Uncertainty surrounding the spread of the Coronavirus, and the potential impact on global manufacturing and in turn global GDP, has triggered a -18.9% sell-off in the S&P 500 Index from its peak on February 19th, 2020.
- Mixed messaging from the White House and national health agencies are causing confusion and fueling fears/uncertainty.
- Volatility will likely continue in the short term until the spread of the virus appears to plateau. We anticipate numbers to be on the rise in the interim as more test kits become available and more cases can be identified.

Stock market valuations remain reasonable

- Current valuations are no longer contingent upon an earnings recovery. Multiples so far have expanded amidst depressed earnings. The potential for further accommodation by the Fed in the form of lower rates or open market operations plus fiscal stimulus could be enough support to prices levels, and give us reason to believe that valuations are not a concern at this time.
- On Monday we cut our forecast for the S&P 500 revenues growth to 3.5% from 6.5% which was slightly faster than the longer term 4% growth rate. We also lowered our 2020 earnings forecast to 4.5% from 7.5% and annual profit margins remain flat at 11.5%. We think the financial research community has some catching up to do and will continue to lower their Q1 and Q2 estimates.

A pause in OPEC negotiations with Russia fueled further pressure on oil markets

- OPEC recommended extending proposed oil supply cuts throughout the duration of the year.
- Russia chose not to participate at this time, sparking a price war as Saudi Arabia began discounting prices in retaliation.

Impact of lower oil prices on consumption may be limited in the short term

- The price of oil should begin to stabilize soon. Investors for the time being are focusing on the negatives of lower prices, namely the prospect of pockets of financial distress and lay-offs, rather than the positive income effects for consumers. It is difficult to predict precisely when the price might find a floor, but when the price of WTI fell below $40 per barrel in 2008 and 2015, it stayed there for a very short time - only three or four months. We are forecasting a tentative recovery in the second half of the year, above $45 per barrel.

- Traditionally, lower oil prices provide relief to consumers and helps support investment by non-energy firms. However, in the short term, the support to consumer spending may be offset by limited discretionary spending as a result of the Coronavirus outbreak.

In our opinion, the probability of a recession remains below 50%

- In an attempt to be proactive, the Federal Reserve reduced rates by 50 basis points and raised the possibility of two more cuts this year.

- Interest rates remain at historical lows with the 10yr trading around 0.50%.

- The labor market is strong, as wage growth is rebounding and new jobs are created.

- Manufacturing activity in China is resuming, although we are mindful that it remains below the level of normalcy.

We maintain a resilient long-term outlook on the markets

Looking ahead in the short-term, we anticipate that the global measures taken by governments and companies will slow the spread of the virus and allow health care systems to manage the COVID-19 cases. We also believe that as economically disruptive as this health crisis currently is, its direct impact will likely be felt over the next few months rather than years – this is positive news for the economy and financial markets overall.

As unsettling as recent market turbulence has been, patient long-term investors understand that periods of short-term volatility are inevitable and remain calm. We can't predict when things will turn or by how much, but our expectation is that by staying the course investors will be rewarded with positive returns when markets normalize in the future. We consider these times an opportunity to focus on rebalancing equity portfolios and begin shifting balanced portfolios toward greater equity exposure.

We thank you for your continued trust in us, to navigate through good times as well as periods of heightened discomfort. Please do not hesitate to contact us if you'd like to discuss your portfolio or any changes in your financial situation.