HIGHTOWER
Westchester

Thoughts on COVID-19 and its Market Impact

As this tumultuous week wraps up, we want to provide you with some of our thoughts on the current state of the markets.

As many of you are aware, there is a large amount of uncertainty currently on display in the markets, as investors grapple with the effects of the Novel Coronavirus (COVID-19). The market's reaction on global issues such as this can generate activity in the markets that is fear-based and not fact-based and will likely be short-lived or even reversed within a short period of time once more is understood.

In addition, before we get into our thoughts, all of us at Hightower Westchester would like to express our sympathy for everyone affected by the virus.

Financial markets took a dramatic turn for the worse last week, with stock markets selling off sharply and generally indiscriminately across the globe. At the time of writing (February 29), the S&P 500 is now down almost 15% from its peak record, with the index having had one of its worst weeks since 2008.[1] It took just six days for the S&P 500 to fall more than 10% from a record high into a correction.[1] That is one of the quickest corrections, ever, according to data from Deutsche Bank Global Research.[2]

Market interest rates have retested their record low levels amid safe haven demand for bonds. Stocks did rally late in the day from their lows of Friday, after Federal Reserve Chairman Jerome Powell said the central bank is monitoring the virus and will act as appropriate, adding that the "fundamentals of the economy remain strong."

The risk appetite for investors has essentially evaporated over the past week, as U.S. stocks have given back all of their 2020 gains and then some. Many have grown concerned regarding the potential economic impact that the virus can have on economies around the globe, and rightfully so. At this point, some of this remains to be seen, as we continue to learn about the severity of the virus and the overall impact on business activity.

The spread and increase in the number of cases is no doubt alarming and raises concerns that this epidemic (an outbreak of disease that attacks many people at about the same time and may spread through one or several communities) is on the verge of turning into a pandemic (an epidemic that spreads throughout the world), which would carry broader fallout. But, with that said and as mentioned above, this is where some context is warranted.

Consensus forecasts for Chinese GDP for the first quarter have been cut from the 5.9% year on year(y/y) expected at the beginning of the year to below 4%. It should be noted that analysts currently expect a sizeable bounce back in Q2 of around 5% y/y, though calling for a V-shaped recovery at this stage seems premature given the slower-than-expected pace of manufacturing recovery. Travel restrictions are now in place in Italy and South Korea following the increase in cases. We are likely to see economic downgrades in both regions, although the magnitude is unclear at this stage.

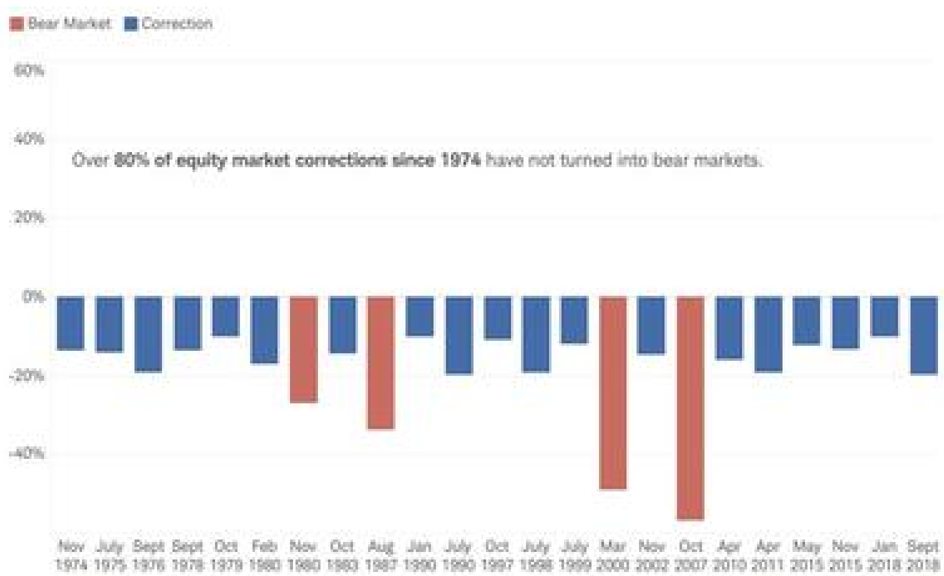
There may be some impact to valuations in the short-term as investors seek safer assets; however, over the medium-term, investors should remain focused on any disruption to earnings growth in the coming quarters.

Markets have taken some comfort from the signs that policy makers will be quick to respond with supportive policies. In Asia, for example, the focus has been on supporting businesses. In the developed world, and more specifically the U.S., the Federal Reserve now has more than two rate cuts of 0.25% priced in for the remainder of the year.

On this note, it appears that the fear in the marketplace is less a function of a real fundamental shift in the global economic backdrop and more a product of fear itself. More specifically, barring any sort of mutation or material escalation of the threat (which has still not reached pandemic level as per the World Health Organization), the impact related to this outbreak is not likely to generate significant permanent disruptions.

When a stock index falls by more than 10%, it is often said to have entered "correction" territory. That's a neutral term for what feels like a nerve-wracking drop to many investors. What does a correction mean? Most consider a correction to have occurred when a major stock index, such as the S&P 500 index or Dow Jones Industrial Average, declines by more than 10% (but less than 20%) from its most recent peak. It's called a correction because historically the drop often "corrects" and returns prices to their longer-term trend.

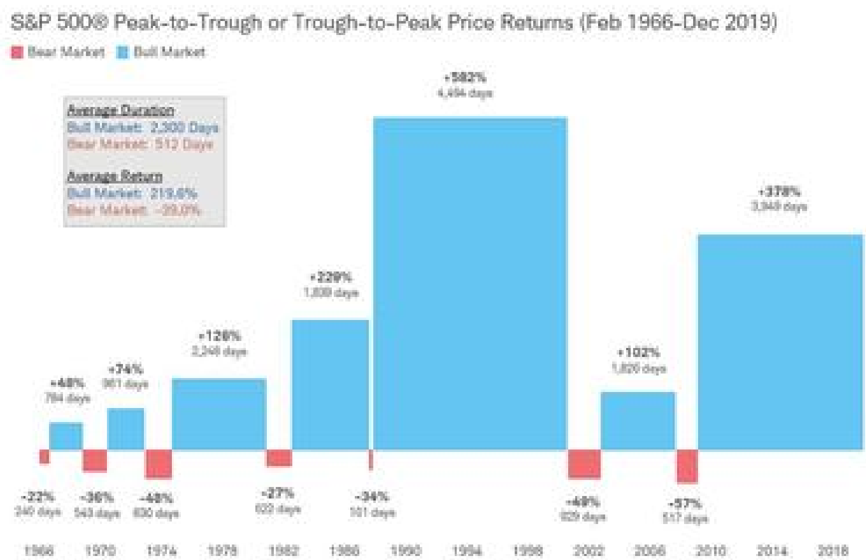
Nobody can predict with any degree of certainty whether a correction will reverse or turn into a bear market. However, historically most corrections haven't become bear markets (that is, periods when the market falls by 20% or more). There have been 22 market corrections since November 1974, and only four of them became bear markets (1980, 1987, 2000 and 2007).[1]



Source – Morningstar Inc.

But what if it really is the start of a bear market? We all know that this bull market cannot go on forever. While they can be scary, bear markets are a part of long-term investing and can be expected to occur periodically throughout every investor's lifetime.

However, it's important to keep them in perspective. Since 1966, the average bear market has lasted roughly 17 months, far shorter than the average bull market (see chart below).[1] They often end as abruptly as they began, with a quick rebound that is very difficult to predict or time. That's why long-term investors are usually better off staying the course and not pulling money out of the market.



Source – Morningstar Inc

So, with all of that said, what should you or we do now? Well, to start, worrying excessively about a bear market is counterproductive but being prepared for one is always a good idea. We, at Hightower Westchester, have built diversified portfolios for this type of market scenario, albeit every market is different. This includes diversification by region but also by asset class; a mix of stocks, bonds, cash and alternatives.

Here are some additional steps that we take with our clients to make sure they maintain the appropriate asset allocation for their goals:

- Review your risk tolerance. It's relatively easy to take risks when the market is rising, but market downturns sometimes can be a wake-up call to consider adjusting your target asset allocation. We consider how much loss you have the emotional and financial capacity to handle.
- Rebalance regularly. Market changes can skew your allocation from its original target. Over time, assets that have gained in value will account for more of your portfolio, while those that have declined will account for less. Rebalancing means selling positions that have become overweight in relation to the rest of your portfolio and moving the proceeds to positions that have become underweight. It's a good idea to rebalance at regular intervals.
- Finally, understand what your investment goals and time frames are for your investment funds. If your time horizon is longer than 5-7 years, then having equities in your portfolio can make sense. If you are saving for a short-term need, and/or are on a regular withdrawals schedule from your accounts, then

having an adequate amount of cash or other short-term low volatility investments makes sense.

While it is far too early to assess the impact of the coronavirus on global economic activity and corporate earnings, our base case is that economic activity begins to return to normal by the second half of the year. First quarter macroeconomic and earnings numbers will be poor, but the full year growth rates are likely to be reasonable.

For investors, fear is a central premise that can cause panic. While we do not diminish the recent events, we take solace in the fact that our strategies and asset allocations are protecting our clients when others are seeking shelter. This is something we've been preaching about since…well forever.

Timing the stock market is an impossible task. We do not pretend to be able to know when the market will go up or down and we don't believe anyone should. That is why we've designed our portfolios and strategies accordingly. With the market drawdown over the past week, we recognize the shock factor for our clients, but we hope this letter, along with future touchpoints provides some comfort as you know that we're focused on protecting your hard-earned money. As always, if you have any questions regarding your investments with us, please feel free to contact us anytime.

As John Templeton once said, "there will always be bull markets followed by bear markets followed by bull markets." This is not the first time we have been through markets like this and it will not be the last.

To discuss this commentary further, please contact us at 914-825-8630.

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1) Morningstar Inc
2) Deutsche Bank Global Research