February 25, 2020

Coronavirus Leads to Market Volatility

Dear Clients and Friends,

During the first two months of the year many investors were surprised to see stock prices rise amid rising geopolitical risks. However, the expanding coronavirus finally caught up with investor sentiment late last week as broader U.S. markets declined ~8% since last Friday. While there is no question that the virus is a new risk factor that will likely depress earnings during the first half of this year, we believe that much of the current uncertainty will pass and investors will look through to more normalized growth in late 2020 and into next year.

One way to estimate the potential impact of coronavirus to the markets is to review the effects of prior global health scares. Looking back at eight global health emergencies that have rattled markets since 1956, over the nine-month periods (inclusive of the three months prior to and the six months after authorities declared a global health crisis), on average stocks increased approximately 6%. With the S&P500 presently down 7% from a late January high before the virus made headlines, if the 2020 virus plays out like historical examples, we may be nearing a bottom.

We should also consider patterns of market corrections that could stem from any risk factor, domestic or international. Historically, markets fall about 5% every ten weeks. We haven't had this kind of market move since August, suggesting the S&P500 was perhaps overdue for some downward volatility.

We see relative winners and losers as companies deal with the worsening corona virus. Product-oriented companies (Pepsi, Clorox, Johnson and Johnson) likely will refill depleted inventories, but Asian-focused leisure and service companies (hotel, gaming, cruises, airlines) will likely lose profits this year and go back to trend next year. We also see greater risk for more expensive stocks, which generally carry high expectations of steady growth. So far this year we have sold some expensive technology shares and reduced exposure to utilities that were trading well above historical averages.

Looking ahead at markets and positioning, we suspect that stocks will start to recover over the next few months, in-line with historical patterns. It is possible that we have yet to see the bottom, but we expect the virus to eventually wind down as investors pivot to more favorable trends such as slow-and-steady economic growth, a truce in the trade war, and a Fed that's ready, willing, and able to cut interest rates if necessary.

As markets recover, we're taking a blended approach of keeping equities at long-term allocations, but also favoring defensive stocks such as staples, REITs, and utilities. We continue to look for investments where short-term corrections may lead to more attractive prices for high-quality businesses. As always, if you have questions about your allocation to risk assets, we encourage you to reach out to your portfolio manager directly. Thank you for your continued trust in the FBB team.

Sincerely yours,

FBB Capital Partners' Investment Committee

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