

# CORONAVIRUS OUTBREAK PRECEDENTS ADVOCATE HOLDING COURSE



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The equity market is under pressure. Following a year that saw the S&P 500 appreciate nearly 30%, investors' "animal spirits" are now being sternly tested. As of this writing, the S&P 500 has erased the modest year-to-date gain, currently down roughly 7% for the period, and slipped near correction territory. Further, interest rates have cratered, with the 10-year Treasury Note declining to a new, all-time low of 1.3% from roughly 1.9% earlier this year.

What gives? It is difficult to point to any one dynamic. But, consistent with the market consensus, we believe most of the S&P 500's recent downdraft relates to the sharp and sudden outbreak of the Coronavirus, or COVID-19, and uncertainty concerning the attendant negative impact on global economic growth. To a lesser extent, election season "chop," namely the emergence of a particular progressive Democratic candidate as the frontrunner, could also be weighing on performance and investor psyche. At any rate, it has been a while since investors have dealt with any significant stint of volatility. And, while painful, we remind clients and investors periodic market corrections, regardless of the rationale, are typically viewed as normal and, to some extent, healthy over the course of the business cycle.

We frame our discussion around the COVID-19 outbreak, which began in earnest in late January 2020 but, for many reasons, has only recently become a "market-moving" event. For perspective, the market's reaction related to COVID-19 is not dissimilar from past outbreak scares. In fact, we note the outbreak of Severe Acute Respiratory Syndrome, or SARS, which similarly traced its origin in China before spreading to other geographies, in November 2002, in part, prompted a near-15% contraction in the S&P 500 until the effect began to subside the following spring.

Granted, there are still many unknowns associated with COVID-19, such as the rate and mode of transmission, impact on the global economy, and

visibility into terminality. But, at this stage, the virus does appear to be spreading faster than past pandemics, including SARS, which could warrant a relatively more draconian impact to industries and economies around the world. Not surprisingly, many market prognosticators have begun to trim S&P 500 earnings growth expectations for the current year – some more pessimistic forecasts now point to 0% cumulative earnings growth as a result of the virus, down meaningfully from the mid- to high-single digit growth expectations prior to the outbreak.

That said, common to all past outbreaks, the negative effect, however long in scope, has been temporary. And, markets tend to “bounce back” following the initial period of fear and uncertainty. At Truxton Trust, we continue to emphasize clients and investors maintain a long-term investment philosophy and not get “caught up” in day-to-day headlines, however negative. Making irrational, knee-jerk investment decisions during tough economic times or periods of market turbulence could likely cause one to miss out on favorable market developments, which could prove detrimental to long-term portfolio performance. Case in point: looking back to the most recent market correction in December 2018, precipitated by recession fears, if anxiety forced investors to sell amid the December 2018 swoon, the funds pulled from the market missed the opportunity to recover lost ground in January which, as touched on before, continued for the duration of 2019.

While we do not know the severity of the economic impact from the virus, we believe investor expectations are, at least partially, discounted. From a valuation perspective, the S&P 500’s forward 12-month P/E multiple stands at 16.5x, slightly below the historical, three-year average of 16.8x, even after considering some haircuts to the denominator. The current multiple compares to the S&P’s 18.8x multiple prior to the outbreak. As we move deeper into 2020, we believe investors will begin to focus more intently on data points supportive of a recovery process. Given the case for slowing near-term growth, probabilities have increased that the Federal Reserve could reduce interest rates, perhaps as early as the March 2020 meeting. This action, commensurate with the onset of warmer weather, which could impede the virus’ transmission process, slowing the rate of infection, could aid the economic recovery process and bode well for risk assets.

Whether the anticipated market recovery period follows a quick-snapback “V” or longer-term “U” pattern, dynamics supportive of long-term economic growth remain in place, in our opinion, including the low rate of unemployment, steady job market gains, and wage growth in excess of inflation. All considered, we believe investors are best positioned to maximize long-term portfolio growth holding a diversified portfolio of risk assets and fixed income securities, tailored to one’s risk tolerance and time horizon. We wish all of you a great and safe Spring as we continue to search to find good long-term investments for your portfolios. ■

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