RThoughts – Market Update – February 27, 2020

This week global equity markets have been experiencing significant volatility in the wake of the spreading pandemic Coronavirus which has now captured the concern of investors.

As of this writing U.S. equity markets as measured by the S&P 500 index and the Dow Jones Industrial Average have declined from their recent highs approximately 11.00% (high of 3393) and 11.50% (high of 29,568) respectively. (1) This decline has been swift and violent as these markets were experiencing all-time highs just a couple short weeks ago.

As stewards of clients' investment capital we are in the business of identifying and pricing risk in the securities markets. For this reason we have been preparing for this increased volatility for several months now and have continued to lower the risk profile across accounts by increasing cash levels and other measures – even before this recent bout of anxiety regarding the Coronavirus has surfaced.

This is not the first time markets around the world have dealt with the uncertainties from a potential pandemic virus. As a point of comparison, over a 38-day trading period during the height of the SARS virus back in 2003, the S&P 500 index fell by 12.8%. During the Zika virus, which occurred at the end of 2015 and into 2016 the market fell by 12.9%. (2)

We entered the year with higher than normal defensive characteristics in the tactical accounts we manage on your behalf. This was manifested with higher cash balances and lower net equity exposure. Earlier this week in our tactical equity strategies we have added to our already existing position in gold and continued to lower our overall net equity percentages to the U.S. markets.

We view the Coronavirus as an exogenous event – one which derived externally from the United States - and as such it was almost impossible to anticipate. Its' impact – both here and outside the U.S. – are at present unknown and therefore adding a tremendous amount of uncertainty and angst to equity markets all over the globe.

Our strategy in times like these is to continue to monitor the events and adapt the portfolios accordingly to the facts as we interpret them.

Irrespective of the virus we have been concerned for several months now with the valuations and the narrowing of the market (a limited number of companies participating in the market returns) as well as the overall "euphoric" attitude of market participants.

Also on our list of concerns is an "inverted yield curve" (2 year U.S. Treasury interest rates HIGHER than 10 year Treasury interest rates). Inverted yield curves at times in the past have been harbingers of potential recessions 6 to 24 months in the future. (2)

Adding to our market concerns at present is the selling by Corporate Insiders who have recently been selling their internal companies' holdings with more than 4.5 sells to every buy. (3) In our opinion this level of selling is indicative of these executives' opinion of a heightened valuation of their company shares.

All of these concerns have been reflected in our portfolio composition prior to entering this period of heightened volatility.

For greater explanation and color on our outlook on these issues please find the link to our latest newsletter – RThoughts Winter 2020 – which was penned in mid-January.

In summary, we entered 2020 with a generally defensive stance and this has proved to be somewhat prescient as we have entered this period of heightened volatility and uncertainty. We also must remember that while performance is no guarantee of future results, 10% to 15% corrections are historically commonplace throughout the history of the U.S. equity markets.

As we detailed in the winter edition of RThoughts, "over the past three years the S&P 500 Index has experienced only 6 individual months of negative returns…..Six negative months out of 36 is evidence of below average volatility within the U.S. equity markets." (4)

Moving forward we will continue to adhere to our disciplines and strategies and will adjust the "dimmer switch of risk" accordingly based on the principles of supply/demand and relative strength.

As always if you have any concerns or questions please feel free to reach out to one of us.

"The crime is not being unable to predict something. The crime is thinking that you are able to predict something." Billy Beane, Moneyball.

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Sources and Footnotes

(1) Thomson One Market Monitor – February 27, 2020.
(2) First Trust Advisors – "Time to Fear the Coronavirus?" – February 25, 2020.
(3) Cypress Capital, Market Outlook, Mark T. Dodson, CFA – February 21, 2020.
(4) Policy Based Investing – January 6, 2020.

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