

Market Insight

March 2020

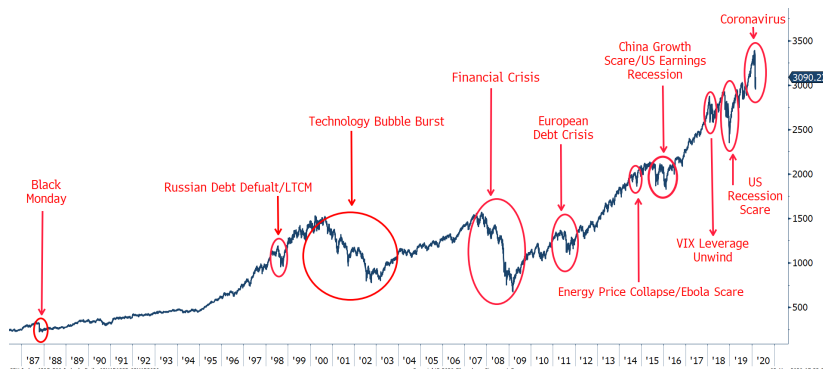
This is Not About the Coronavirus. We've Been Here Before. Nothing Profitable is Comfortable.

This is not about the coronavirus. We are experiencing a period of heightened volatility in equity markets, and we've been expecting this for some time. Equities have been priced for perfection, with historically low levels of volatility and very low yields for high yield bonds—altogether a sign of complacency on behalf of investors which typically precedes corrections in asset prices and heightened market risk. We are also in the midst of a Presidential election which will likely introduce uncertainty and volatility into markets. In preparation for this environment, we remain diversified and we have positioned portfolios to favor parts of the market which we observe as being relatively undervalued. Specifically, we are overweight government bonds, U.S. value equities, small cap companies, and foreign equities. Many of these “unloved” assets are underpriced relative to the “loved” or crowded parts of the investment landscape. Therefore, we expect a higher margin of safety, or more downside protection relative to the global equity market.

We've been here before. The exhibit below plots the value of the S&P 500 Index since 1986. We can observe a total of 10 periods of market stress over a period of more than 30 years, many of which were deemed a “crisis.” While these bouts of market volatility felt unnerving at the time and some lasted longer than others, in looking back at these market corrections, it's clear that staying the course was a winning strategy. It's also clear that the losses experienced at the time pale in comparison to the capital appreciation that ensued over the long-term.

Nothing profitable is comfortable. It's usually hard to foresee the next “crisis,” as was the case with the coronavirus. While it's difficult to forecast how this is going to evolve and impact the global economy, it's likely that the uncertainty alone will plague the economic outlook and lead to more volatility in the foreseeable future. There is no doubt that this is already impacting global supply chains and it's likely going to have a large effect on the global consumer, but the duration and impact on economic growth is hard to quantify at this time. Equity and corporate bond markets have yet to offer an attractive value opportunity, indicating that the worst is likely not priced in and there is a reasonable likelihood of more downside risk in the near-to-intermediate term. While the economy may experience a “U” shaped recovery, the rebound in asset prices is often “V” shaped. Therefore, we remain invested and we are not tactical because we know that markets typically overreact and are very difficult to time. Getting out *may* seem like a clear decision, but getting back in is usually the challenge that leads to missed return opportunities. We recognize that volatility often creates opportunity, and as a result, we are disciplined about rebalancing our portfolios as prices fall, buying our losers and selling our winners. Nothing profitable is comfortable.

Historical market corrections of the S&P 500 index



Source: Bloomberg

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