JMK Jurika · Mills & Keifer
Private Wealth Management

Special Investment Update

February 27, 2020

To our clients and friends.

The financial markets have finally decided to worry about the Coronavirus (Covid-19) and its impact on global economic growth. Over the past week, investors around the world have sold stocks and other risk assets en masse and rushed into safe haven assets like gold, Treasury bonds and cash. From their peak last week, global stock markets have declined more than 10%, marking the sharpest decline in markets since the end of 2018.

The hope that the virus was mostly contained and limited to China went out the window when a rash of new cases presented themselves in Japan, Italy, and Iran. A new case was reported yesterday in Northern California, the first case in the U.S. of unknown origin.

The virus now seems to have gone global and while the number of current cases outside of China is relatively small, nobody really knows the degree to which its spread can be contained going forward or what measures may be necessary to do so.

Our expectation is that the virus will continue to spread outside Asia and will impact economic and other activity around the world. Like an approaching hurricane, it is likely that people will sensibly want to hunker down until the storm passes.

Also like a hurricane, it is difficult to predict its path and the actual scale and scope of potential damage. Prevention and precaution are clearly in order.

And, like a hurricane, it will eventually pass, and life will return to normal. As such it represents a temporary, rather than permanent setback for the global economy.

The latest estimates are that Covid-19 could decrease global GDP growth by 1% this year, but its impact will hit certain countries and industries more than others. China, the source of the virus has already suffered a significant hit to economic activity as entire cities have been quarantined. As a result, we are seeing disruptions in global supply chains, especially for businesses who manufacture and source their products in China. It remains to be seen whether similar measures will be necessary in Europe or here in the United States.

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One of the challenges with a situation like this is the interrelationship between perception and reality. With 24-hour news coverage focusing on the spread of the virus, the perception of the problem will likely be much worse than the reality. While on the television news it may seem that the whole world is getting sick, in reality only a small percentage of the population will likely contract the virus and only a small percentage of those that contract the virus will get seriously ill. But this perception will likely create an environment of precaution and fear, which in turn will translate into cancelled trips, meetings, trips to the shopping mall and a temporary decline in overall economic activity.

Our hope is that the virus can be contained and will not spread in any significant way in Europe and the United States, but this is not our base case, and we think it makes sense to err on the side of caution. Our base case scenario is that global economic growth will be significantly impacted for a quarter or two, before rebounding. We also think that the virus will impact the rest of the world more than the U.S. since the U.S. economy is more self-contained than European and Asian economies.

Portfolio Strategy:

Our strategy and advice to clients can be distilled into the following three ideas:

1) Stay conservative in the near term
2) Stay invested and take the long view, and
3) Look for opportunities to reinvest.

We were concerned about overall valuation levels towards the end of last year and did some selective trimming of higher growth positions and added to our defensive positions. In addition, we added exposure to Europe on the belief that an upswing in global growth would benefit Europe and Emerging markets more than the U.S.

Now with the Coronavirus spreading through Europe, our outlook for Europe has changed and we have sold the position that we added last year. We have also done some additional trimming of higher growth names that had a very strong start to the year.

We are also continuing to monitor all of the core holdings in client portfolios to make sure they are working as expected.

Although the U.S. stock market has declined 10% in less than a week and is likely oversold in the near term, it is vulnerable to additional downside if the U.S. economy appears to be slowing significantly. It is too early to tell if this will happen, but it seems probable to us. We therefore think that it is prudent to maintain a more defensive overall position and monitor the situation closely as it evolves.

Your portfolios are highly diversified and designed to weather and persevere throughout the inevitable storms that come along. The history of the stock markets is full of disruptive events from left field that cause temporary turbulence in markets, including wars, terrorist attacks, recessions, viruses, and bursting of dot-com and real estate bubbles. The stock market has endured all of these slings and arrows and inevitably recovered and risen to higher levels. It is therefore important to stay invested for the long term.

Despite the recent decline, stocks are not a bargain yet and a cloud of uncertainty is likely to hover over markets for some time. Governments can address the economic impact of the virus with monetary and fiscal policy, but it remains to be seen how effective this may be. Low interest rates or fiscal stimulus can't kill a virus, but they can at least help support markets in the near term and provide fuel for recovery as the threat of Covid-19 passes. The main factor driving markets will be the degree to which the disease spreads or is contained, especially in the U.S. and Europe.

Over the longer term, we continue to think stocks represent the most attractive asset class to grow and preserve the purchasing power of your capital, especially when bonds yield next to nothing. Additional declines in stock prices from here only makes them a more attractive investment for the long-term. We will take advantage of opportunities as they present themselves to increase equity exposure.

In the meantime, we expect markets to remain volatile and highly driven by the 24-hour news cycle. Please know that we are monitoring the situation closely and are here to speak with you at any time if you would like to discuss this or any other aspect of your portfolio.

Warm regards,

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President
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