JMK Jurika · Mills & Keifer
Private Wealth Management

Special Investment Update

March 9th, 2020

To our clients and friends.

Greetings from the flight deck.

The financial markets have hit another significant air pocket on a combination of coronavirus (Covid-19) fears as well as a sharp collapse in the price of oil over the weekend.

The collapse in oil prices is a result of Saudi Arabia and OPEC failing to reach an agreement to curtail oil production with Russia. As a result, oil prices fell more than 20% over night sending shock waves throughout financial markets, and especially in the energy and financial services sector.

Because global markets are increasingly connected and driven by computerized trading, the size and speed of market moves both up and down tend to be larger and faster than in the past. In a little over two weeks, the markets have wiped out most of the gains of 2019.

Just because the moves are faster and more dramatic, they still reflect the same underlying economy, which is what ultimately matters. It is important to keep a calm and rational head, tune out most of the noise and focus on common sense and facts. While market declines are painful and troubling, corrections and recessions are a normal part of market and economic cycles and also create opportunities for new investment.

With that in mind, we wanted to share a few of our current observations:

First, our clients' portfolios are already defensively positioned relative to our long-term allocation models. We trimmed stock exposure at year-end as well as in the past few weeks and also added to some defensive positions such as Gold that have helped to offset some of the declines in stock prices. We also have a defensive reserve of cash for new investment when we feel that there is greater clarity with respect to the coronavirus, and/or stock prices fall to a point where it makes sense to start stepping back into the market with new investment.

Second, whether or not we have a recession, economic growth in the near term is slowing. If there is any good news, it is that before this storm hit our shores, the U.S. economy was on a

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strong footing with decent levels of growth, high levels of employment and a healthy consumer and housing sector. **Our hope is that this downturn is short-lived, but we prefer to err on the side of caution.**

For now, the number of new cases of coronavirus is likely to expand rapidly within the United States, and this will dominate headlines and imaginations. But, part of the cause of this increase is that we are testing more people and producing more results. So, the testing data needs to catch up with the actual infected population. At some point, we would hope to see the number of new cases plateau and taper, as it has in China. This will certainly bring relief to markets (and everyone), but we are optimistically at least several weeks away from this point. Even after the number of new cases starts to subside, it will take a while for things to return to normal, and not everything will bounce back equally. Tourism and air travel are likely going to be depressed for quite some time.

Third, it is important to remember that perceived and actual risk and opportunity are often inversely proportional to one another. The general perception is that stocks are risky, and bonds are safe, especially on a day like today. But, with the interest rate on a 10-year government bond now at 0.5% and the yield on the S&P 500 at over 2%, bonds are arguably very expensive, and stocks are getting more attractive. Over the next 10 years, you are almost certain to lose money owning Treasury bonds (especially accounting for inflation) and very likely to generate an attractive return owning stocks. This is not to say that stocks are without risk or look like a bargain yet on an absolute basis, but it underscores the case for owning stocks over the long-term and buying more of them as they come down in price.

Fourth, not all sectors of the economy will be impacted equally by the coronavirus or the decline in oil prices. With respect to Covid-19, a lot will depend on the measures that are implemented to curb the spread of the virus, but it is already having an enormous impact on transportation, hospitality and other service industries. Meanwhile, even if there is a recession, biotechnology and other healthcare companies should see increasing demand for their products and services. People will do more work online, rely on the internet for shopping, social media to stay connected and streaming services for entertainment. Technology and other digital-oriented companies may therefore continue to do well despite an economic slowdown. Conversely, energy companies are likely to have a difficult road ahead, especially those that are highly indebted. Banks may also have a tough time if they have significant loans to the energy, hospitality, transportation or other impacted sectors.

Market sell-offs often tend to be monolithic events where everything gets sold indiscriminately regardless of fundamentals. They therefore can provide opportunities to buy good things on sale. We continue to focus on investing in areas of long-term growth and if the market offers us an opportunity to do so at an attractive valuation level, we will start to increase exposure to these areas. We may end up being early and prices may fall further, in which case we will have the opportunity to increase our exposure further. It is more important to focus on valuation, fundamentals and long-term return expectations than to pick a near-term market bottom.

Fifth, problems tend to beget solutions. In the United States, the popularity of presidents and their chances of re-election typically hinge on the health of the economy and financial markets. Presidents that preside during economic and market downturns do not tend to get re-elected. Despite record levels of partisan discord, it would be in both party's interests to come out with a large fiscal stimulus package to stabilize markets and provide help to those who are directly impacted by the Virus and resulting economic slowdown. We would hope to see something along these lines announced soon. In a whirlwind of noise and uncertainty, people are looking for competent and reassuring leadership, constructive action and help. It remains to be seen if Washington can and will rise to the occasion. At the very least, the current coronavirus scare will elevate healthcare as a key issue in the upcoming election.

Finally, the sun will come up tomorrow, and the next day, and the day after that. It may feel like the sky is falling, but a lot of what is going on in the markets and the world is a strong reaction to a large amount near-term uncertainty. The coronavirus threat will eventually peak and pass and life will go on. Oil prices will stabilize as well. Meanwhile, with historically low interest rates, it's a good time to refinance your mortgage.

Periods of instability inevitably move towards periods of stability and a new equilibrium. There will likely be helpful policy responses from the US and European Governments to help re-stimulate economic growth as there have been in China. Economic growth will return, and stocks will rebound. We just need to pass through some more stormy weather first and it is unclear how long that will take or how much near-term damage may result. As always, it is important to take the long-view.

So, in the meantime, keep your seatbelts fastened and know that we are here riding through it all with you and making course adjustments as needed.

Please don't hesitate to call if you would like to speak and thank you for your ongoing trust and confidence.

Warm regards,

Karl

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