Investment Update on Volatile Markets

While market volatility is always a bit unsettling, it makes sense to take a step back and consider the big picture calmly and rationally. With respect the current fears surrounding the coronavirus epidemic, we believe that ultimately this will be a relatively transitory event. History has shown that similar epidemics (SARS, bird flu, Ebola, etc.) can cause some short-term volatility in markets, but they very rarely are the catalyst for a longer-lasting broader economic slowdown or recession. Nevertheless, stock valuations had become elevated even as earnings growth was slowing before the virus problem showed up. Therefore, further volatility is not only possible, but likely, in the near-term future.

Given the fact that U.S. equity markets had become expensive, our investment team made several proactive decisions toward the end of 2019 and into early 2020 to mitigate risks in client portfolios. For example, we eliminated higher-risk junk bonds from the majority of our portfolios in favor of longer-term Treasury bonds and Treasury Inflation-Protected Securities (TIPS). Not only are these investments holding up better than the broader market, but they have increased substantially in value during the past several weeks. In addition, our portfolios were being rebalanced in mid-February by reducing equity exposure (which had performed well up until that point) and increasing fixed income exposure (which has held up well since that point). In general, our individual stock portfolios have been positioned more defensively than the broader market, as we have over-weighted sectors like utilities and real estate and under-weighted sectors like financials and industrials. We also have positions in commodities and market-neutral mutual funds that have helped to provide diversification and mitigate risk.

Here are a few things to help keep everything in perspective. Even with the recent decline in markets, the S&P 500 is still up in excess of 20% since the end of 2018. Also, the yield curve actually steepened last week despite the drop in stocks, and should steepen further with today's 0.5% cut in the Fed Funds rate by the Federal Reserve. A steeper yield curve is typically a sign of stronger growth expectations going forward. Lastly, China and Hong Kong were two of the best performing global stock markets last week. This should be encouraging given that China is ground zero for the coronavirus and its impact on the global economy.

As always, long-term investors should trust in the power of diversification and disciplined risk management while resisting the temptation to give in to emotional fears driven by market volatility.

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