Client Update: February 25, 2020

Concerns relating to the spread of the Coronavirus have been impacting equity market volatility.

The rise in confirmed cases of Coronavirus (Covid-19) outside of mainland China has led to heightened fear and concern of further spreading of the disease. While the vast majority of the now 80k reported cases exist within China, the disease has spread to 30 countries. Most recently, a rise in reported cases in major cities in Italy has led officials to cancel cultural and sporting events and close schools. Photos of tourists and residents in Europe wearing protective masks have further heightened anxieties.

In addition to concerns of the toll the disease may have on "at-risk" individuals in the population and the tragic loss of human life, anxiety has carried over into financial markets sentiment. The key investor concerns have been related to supply chain disruptions for manufacturers, particularly within technology industries that source components from China, as well as demand erosion for travel-related and other services companies. The negative impact these supply and demand changes will have on global GDP is difficult for economists to estimate given limited ability to forecast the spread of the disease. As with any uncertainty, investors tend to react by reducing exposure to risk assets and seeking the stability of "safe haven" assets such as U.S. Treasuries and gold. These fast-moving shifts between asset classes create higher volatility in stock markets, and lead to lower interest rates on fixed income securities as their prices are bid up. As U.S. stocks pull back for a fourth consecutive trading session, the VIX Index (also known as the "fear gauge") which tracks volatility of the S&P 500 index has risen above its long-term historical average, although it hasn't come close to historical highs reached during the last financial crisis. Both the 10-Year and 30-Year U.S. Treasuries have reached new all-time low yields this week due to this "flight-to-quality". Trading by speculators trying to constantly stay a step ahead of fund flows tends to exacerbate these types of swings, now faster than ever thanks to the technological "advancements" in algorithmic trading done by computers rather than humans.

As with any important change in world events that may impact economic growth and company profitability, the team at Plimoth Investment Advisors is continually digesting news flow and information as it becomes available. While the Covid-19 Coronavirus is a new disease, the reaction by market speculators is not. Members of the Plimoth team have decades of experience managing portfolios through disruptive world events of this nature.

The Covid-19 situation has at least as many differences when compared to the Severe Acute Respiratory Syndrome (SARS) epidemic in 2003 as it does similarities. The sheer number of reported cases and deaths is significantly higher, although for now the spread is far less global in scope than SARS as the majority of cases are centralized within China. Both diseases are believed to have originally infected humans in wet markets in China where live and dead animals are sold. The rate at which the diseases spread from person to person however has been much more rapid with Covid-19. Similar travel-related concerns and demand declines currently at play were in effect at the time of the SARS outbreak. After an initial short-term pullback of approximately -5.5%, the S&P 500 stood at a level 15% higher six months after the initial disease notification provided by the World Health Organization in 2003. Air travel volumes returned to normal shortly thereafter. Of course, there were numerous other dynamics impacting equity markets at that time including the U.S. invasion of Iraq and cheaper equity valuations in an earlier part of the still prevailing economic expansion. The S&P 500 also generated double digit returns within six months following outbreaks of the Avian Flu in 2006 and Swine Flu in 2009. We most certainly do not expect markets to mirror these situations, however lessons taken away from past events can have value in framing related situations.

As previously communicated, portfolios under our management have (in general) been positioned with a modestly defensive posture, both in terms of asset allocation and the high-quality nature of securities held. That positioning continues by holding securities with an added margin of safety that comes from recurring income from blue chip dividend paying stocks, preferred stocks, real estate investment trusts (REITs) and bonds. Additionally, we have taken steps to reduce exposure to companies in which revenues are likely to be impaired for some time due to declining consumer demand. For example, we exited the position held in Carnival Cruise Lines across all portfolios earlier in the month. In addition to these defensive portfolio management measures, we are also looking for attractive opportunities that tend to be created in periods of fear and overreaction.

While we continue to digest new information, we maintain a focus on long-term portfolio positioning and results. Overreacting to short-term volatility spikes is not a prudent strategy for the long-term compounding of capital over time. We have witnessed many market disruptions in the past and have found that we and our investors have been best served by maintaining a disciplined approach to portfolio management driven by pragmatic analysis.

Of course, as new information becomes available, you can rest assured that we will be discussing and interpreting it to the best of our abilities and overlaying judgement from years of experience to make the most prudent decisions on behalf of you, our clients. Should you have any questions relating to your account(s), please feel free to reach out to your Investment Officer or Wealth Management Officer.