SPECIAL UPDATE

A market commentary.

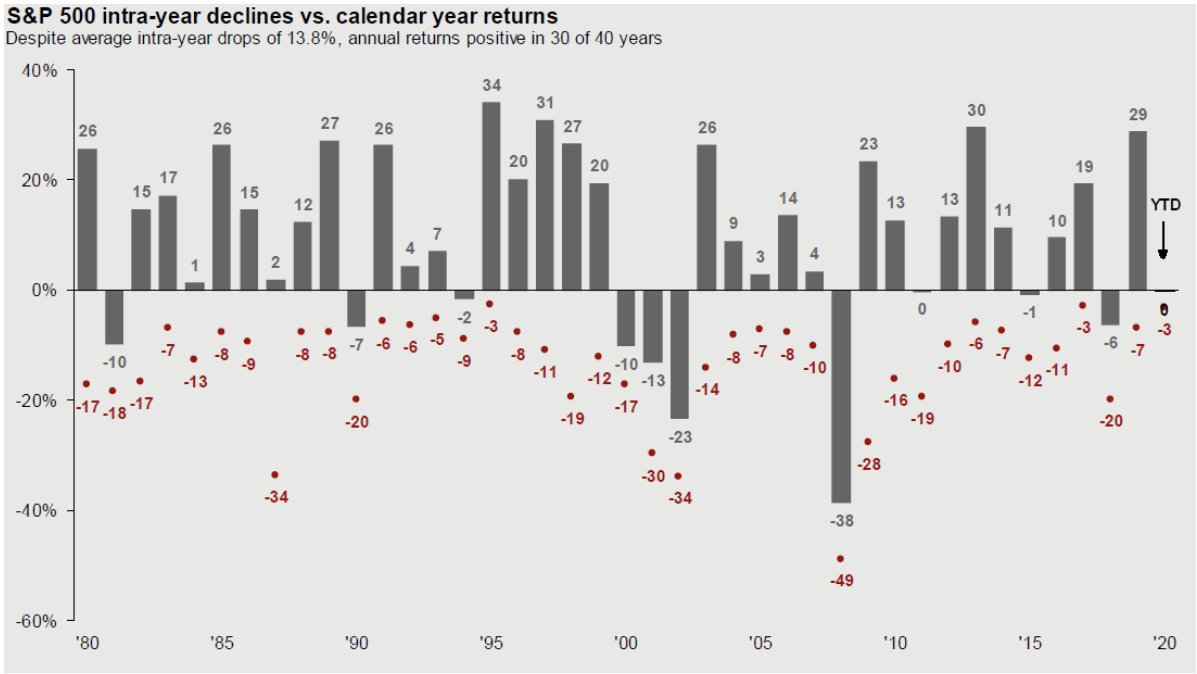
Friday, February 28th, 2020

"Stock Market Enters Correction – What Should Investors Know"

The stock market is having its worst week since the financial crisis. There is no sugar coating the losses, over $2 trillion in market cap has been erased in just a handful of trading sessions. As of this morning, the S&P 500 was nearly 15% off its intra-day all-time high from just 8 days ago. This has been the fastest 10+% correction ***from an all-time high*** in the history of the S&P 500.

We do not have any special knowledge of the novel coronavirus. It would be disingenuous to suggest we do. What we can provide is some context to this correction and what should matter for investing implications.

For starters, corrections are a normal part of owning stocks, regardless of the catalyst. There is no free lunch in investing, and the long-term returns of stocks are earned by assuming the good comes with the bad. The S&P 500 has averaged an intra-year drop of nearly 14% annually since 1980 and is up nearly 28-fold since.



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

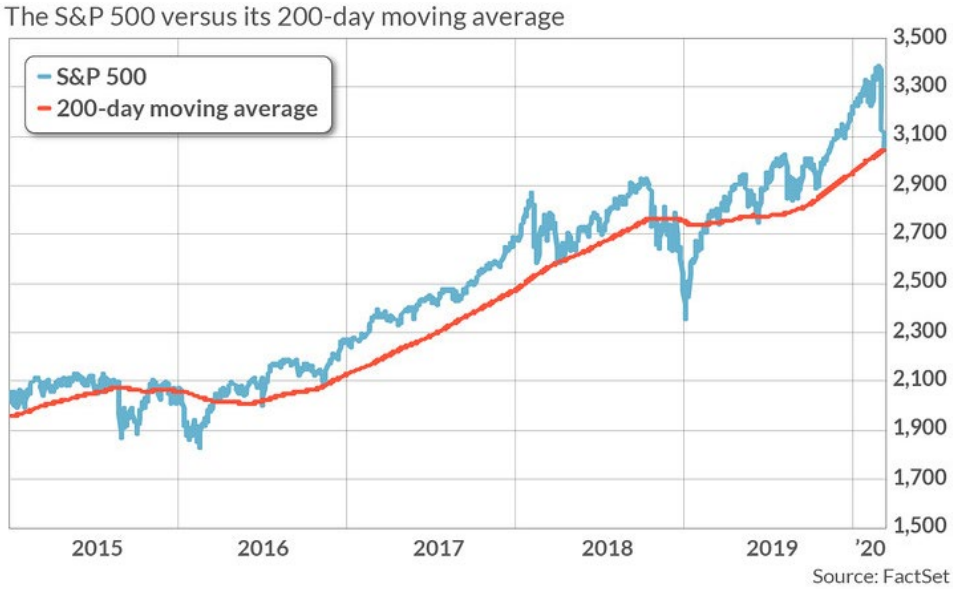
In every one of these corrections, the risks felt real and the downside appeared relatively unbounded. That is because regardless of the catalyst for stock market corrections, it always feels more extreme in the moment than in retrospect. Losses also tend to come in chunks while growth occurs more slowly over time.

In historical cases of viral outbreaks (i.e. SARS, MERS, Ebola), the corrections have also been very sharp, but so have the inevitable recoveries. H1N1 caused over 12,000 deaths in the U.S. and 100's of thousands globally in 2009, but it happened when the market was already at the depths of the financial crisis, so it is hard to know what the direct fallout would have been had the economy not already been at a stand-still and had stocks been trading near all-time highs like they were just last week.

In the case of coronavirus, the news came at a time of relative complacency and healthy market momentum which is why we have taken the elevator, not the escalator, down this week.

We think it is important to understand that backdrop leading up to this correction. While we wouldn't say investors were overly euphoric as of last week (as evidenced by all the money flowing into bonds), stocks had experienced a strong rally over the past 14 months and volatility was relatively dormant. Here are some points to consider:

- The 15% correction in the S&P 500 only brought us back to price levels from mid-October of 2019, less than 5 months ago.
- Through Thursday's market close, the S&P 500 was still 24% above the lows from late December 2018 despite this recent selloff.
- Stocks were relatively "overbought" relative to technical levels as of late January. A simple way of looking at that is comparing the S&P 500 to its 200-day moving average. It is not uncommon for the index to correct when it gets far above this moving average trend line.



In other words, the relevant risks needed to be priced in and the rubber band had a long way to snap back.

There is undoubtedly going to be an impact to the economy from the coronavirus. Companies like Apple and Microsoft have already guided down expectations stemming from the slowdown in China. Supply chains are being disrupted and should containment strategies spread in the U.S., activity will surely slow, posing a risk to what has been resilient consumer spending. Some of this lost business, like in the cruise and airline

industries, will be lost. Other consumption we believe will be pent up so it is very likely that we see a bounce back in the second half of the year should containment and travel restrictions become relaxed again.

Most importantly, many investors are wondering what, if anything, they need to do with their portfolios. We think we will look back at this correction like we do all others as a transitory event, but the fact is there is an uncertain element of this that we cannot and should not try and forecast. Any plan worth the paper it is printed on should always take into account that type of uncertainty, which is why you maintain diversification, so you don't have to make choices like this at inopportune times.

The average investor most often underperforms the market, not because they pick the wrong stocks or funds, but because they make poor timing decisions on when to get in and out of the market. Selling after stocks are down 15-20% and then buying back in when the risks have passed is one way to do that. There is no "all clear" bell that rings on Wall Street and stocks often quickly price in both the correction and recovery before the data or news flow have a time to catch up.

We think investors should be aware of the risk they have in their portfolio and use this week as a reminder of what risk they are willing to take. That is why we utilize the Riskalyze® software as a core tool for our client reviews so our clients are always aware of the risks they do own and are willing to take. As always, we are advising our clients to stick to their long-term plans and try to ignore the short-termism of the daily news flow. In time, this too shall pass.

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