NORTHEAST SEQUOIA
PRIVATE CLIENT GROUP

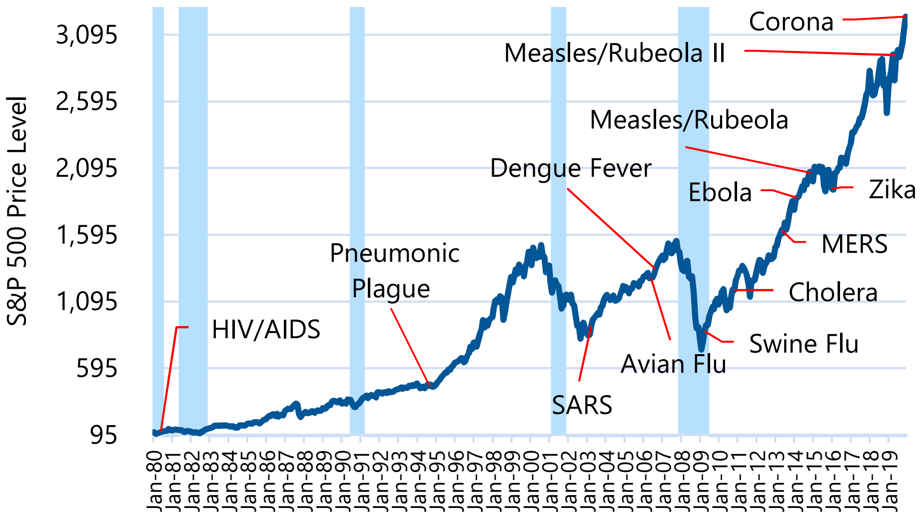
# The Punch You Don't See Coming

While our economic outlook has proven relatively accurate, we have been eating crow for the better part of 6 months with a more conservative view on market valuations. But we are now starting to notice others moving to our more cautious market bias, identifying the same red flags, and even sharing in our market calls. Nonetheless, the S&P continues to grind higher, providing investors with almost a 15% annualized total return over the last three years. But as we always point out to clients, ***it is the punch you don't see coming that typically knocks you out.*** Hence, the concern revolving the Novel Coronavirus may be the uppercut that allows markets to take a beat, rationalize valuations **and provide investors a more palatable entry point.**

But before we move on, we need to emphasize that the latest Coronavirus is a severe health threat, which has already resulted in the loss of life; as of this morning, there have been 213 deaths, with the spread of over 9,809 cases in over 20 countries. And according to the World Health Organization, Coronavirus is now a global emergency, with cases expected to increase tenfold over the next week to 10 days.

So it is understandable why clients are concerned and are wondering about what impact, if any, the Coronavirus may have on sentiment, global growth, and ultimately their investment portfolios. Therefore, we have looked at market reactions to past epidemics/pandemics for some guidance on what to expect going forward.

Market Performance Through Previous Outbreaks




Source: CNBC and NEPCG

According to data compiled by CNBC, which we have illustrated herein, there have been 12 other outbreaks starting with the AIDS virus, first discovered in June 1981. Further, the average return for the S&P 500 six-months following the first occurrence of each of these outbreaks, was 8.5%, while the average return of the S&P 500 twelve months out was and impressive 14.2.%. **However, a closer look at the data suggests that most outbreaks occurred during the middle of an economic expansion or closer to a trough, and not at the height of market valuations. This implies that previous recoveries were in part, attributable to broader economic and market up-trends.** For example, following the SARS outbreak of 2003 which took place shortly after the 2001 recession ended, the S&P rallied 15% in 6-months and was higher by 20% one-year out. Following the Swine Flu, which occurred at the nadir of the 2007 Global Financial Crisis, the S&P rallied almost 19% in 6-months, and over 35% during the subsequent year. **When removing these two outbreaks alone, the resulting average 6-month and 12-month S&P return drops to 6.8% and 11.0%, respectively.** So, the latest Coronavirus may result in greater near-term downside for equity markets compared to prior outbreaks, especially given: 1) our belief the market is overvalued, 2) the stealth incubation period of the virus, 3) reports that China's was less than forthcoming regarding earlier cases, and 4) the timing of the Chinese New Year and corresponding delayed opening of the Chinese stock market. As a

result, we remain comfortable in our near-term conservative portfolio recommendations/bias and believe that any significant downside in equity prices will provide investors with an ideal entry point. ***We'd love to hear your thoughts!***