Virus Epidemic Creating Fear in Markets

WHY EPIDEMIC PANICS OFTEN PROVE TO BE BUYING OPPORTUNITIES FOR STOCKS

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- **The coronavirus outbreak in China has created significant market volatility and fear.**
- **History suggests market panic related to epidemics tends to subside relatively quickly.**
- **However, RiverFront's tactical and risk teams are watching the situation closely and are ready to employ our risk management tools, if necessary.**

RiverFront has been monitoring the outbreak of the coronavirus closely and pray that health care officials can minimize the human tragedy that such an event can bring. This virus has economic consequences as well, which we will cover in this piece. An outbreak in China, the world's most populous country and 2nd largest economy, has the potential to disrupt the global economy. Chinese consumers are among world's largest spenders on cars, smartphones, and tourism. In the West, companies such as Apple, Google and Starbucks are scaling back operations due to the uncertainty, creating potential disruptions in the global supply chain.

Epidemics like this tend to prey on powerful investor emotions of risk aversion and existential dread, and this time is no different. Since January 17 (when the first instance of the coronavirus appeared in the US), global stock markets are down approximately 3.5%, led by emerging markets such as China down 3-4x that. Global industries such as steel, airlines, and luxury goods have been hit particularly hard. In light of this, we think it is helpful to put the coronavirus' ~200 deaths so far (as of Friday morning) in some perspective. In total, the CDC estimates that up to 35.5 million people in the US alone contracted the flu during 2018-2019, 490,600 people were hospitalized from it and 34,200 died.

However, the historical record suggests that panic in markets related to epidemics tends to subside relatively quickly, usually coinciding with the peak in the growth rate of reported cases (source: Goldman Sachs Portfolio Strategy Research, 1/29/20). A historical market return study of analogous global epidemics, such as the SARS outbreak in China in 2003, suggests that stock markets tend to recover within a quarter or two after headlines (see right chart, Source: Cornerstone Macro, 1/27/20).

MSCI All-Country World Index Historical Returns around announcements of epidemics

	Percent Change Since First Case				
	+1 Weeks	*+2 Weeks*	*+1 Month*	*+3 Months*	*+6 Months*
Avian Flu	0.9%	1.9%	3.3%	13.0%	5.2%
SARS	2.5%	3.4%	-0.3%	-9.5%	0.1%
H1N1	-0.4%	2.0%	5.2%	5.3%	25.0%
Ebola	1.7%	1.0%	2.1%	6.0%	7.4%

Source: Cornerstone Macro, 1/27/20. Past performance is no guarantee of future results. Not indicative of RiverFront performance.

Market weakness on health scares often represent an opportunistic entry point for longer-term focused investors willing to look through scary headlines, in our opinion. In keeping with this view, RiverFront initiated a small position in broad emerging markets equities on January 22nd, after the first wave of coronavirus-related market weakness. While only time will tell whether that decision will be a positive one for our performance, we believe our longer-term thesis of emerging market equities remains valid. **Simply stated, we believe emerging markets equities are relatively inexpensive, out of favor, and levered to a global growth turnaround which could occur as a result of accommodative central bank policy.**

THE BEAR AND BULL CASES SURROUNDING CORONAVIRUS

There are always logical reasons why stock market bears can argue it is 'different this time.' For instance, China is a much larger percentage of the global economy than during SARS in 2003, the virus appears more infectious than SARS and does not show symptoms immediately, and the Chinese economy has been slowing before the coronavirus outbreak– a topic we discuss in some detail in our *Outlook 2020.*

However, any comparisons to past China epidemics, in our opinion, should also take into account some of the positive differences versus the SARS and other epidemics, including:

- **Policy support from China and other central banks:** The People's Bank of China (PBOC) has already been easing fiscal and monetary policy, given China's own internal concerns about their economic trajectory in the face of US/China trade tensions and the Hong Kong riots. We think the PBOC may provide additional accommodation to offset the anticipated economic impact of the coronavirus. Other central banks around the world may also have to take this unexpected drag on global growth into account, particularly ones in Europe and Asia, as their economies are much more levered to China's. For example, China represents the 3rd largest export market for a country like Germany, at approximately $95 billion/year to China.
- **More proactive response from China versus past events:** While China can be fairly criticized for its opaque and reactionary handling of past health epidemics, their response to this epidemic has been much faster and more robust, in our opinion. Chinese authorities were quick to effectively quarantine both the Wuhan province and its surrounding areas, with a combined population of approximately 100 million citizens. This is a point the World Health Organization (WHO) has acknowledged in praising China last week.
- **More diversity of the global supply chain away from China:** Due to the trade conflict between the US and China over the past 18 months, many global companies have already been in the process of diversifying their supply chains away from sole-Chinese sourcing.

RIVERFRONT'S POSITIONING AND STRATEGY IN LIGHT OF THE CORONAVIRUS

Overall, RiverFront remains constructive on global stocks, as we laid out in our *Outlook 2020.* These periodic sell-offs typically act as a 'pressure relief' valve, allowing stocks to reset expectations in a more reasonable fashion, particularly in the context of the type of strong run the markets experienced in Q4 of 2019.

Even after our purchases of emerging market equites in January, our asset allocation portfolios contain relatively modest amount of Chinese equities. Absolute weights of Chinese and Hong-Kong stocks range from less than 5% in total in our global long-horizon all-equity model, to much less than a percent in our shorter-horizon balanced portfolio.

Nonetheless, RiverFront's tactical and risk teams are watching the situation and are monitoring internal trailing stops closely and are ready to employ our risk management tools, if necessary.

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The comments above refer generally to financial markets and not RiverFront portfolios or any related performance. Past results are no guarantee of future results and no representation is made that a client will or is likely to achieve positive returns, avoid losses, or experience returns similar to those shown or experienced in the past.

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It is not possible to invest directly in an index.

When referring to being "overweight" or "underweight" relative to a market or asset class, RiverFront is referring to our current portfolios' compared to the portfolios' composite benchmarks.

Technical analysis is based on the study of historical price movements and past trend patterns. There are no assurances that movements or trends can or will be duplicated in the future.

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MSCI ACWI (All Country World Index) captures all sources of equity returns in 23 developed and 23 emerging markets.

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