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Celebrating 32 Years
1988-2020

Coronavirus Epidemic

Special Newsletter

March 3, 2020

It was a rough, swift move downward for stocks this past week based on the unknown economic impact and wide-spread health concerns of the coronavirus in the U.S. and the global economy. The S&P 500 index experienced the fastest 10% decline in history from the all-time high reached on February 19th to the close of business on Friday, February 28th, down 12.76% during those ten days (16). Then on Monday, March 2nd investors seemed to be calmed by the Federal Reserve and other major central banks pledging to step-in to attempt to stabilize markets from the impact of the coronavirus epidemic, with the Dow Jones advancing 1,293 points, or 5.1% in the largest one-day point gain in history and the largest one-day percentage gain since March 2009 (31). The purpose of this special newsletter is to provide you timely information and our assessment of intermediate and long-term implications of the coronavirus epidemic based on what we know now.

Health Impact

The epicenter of this coronavirus outbreak was in Wuhan, Hubei Province, China with patients linked to a large seafood and live animal market, suggesting animal-to-person spread (24). As the coronavirus spread in Wuhan, it appeared in patients who did not have exposure to the animal markets which indicated a person-to-person spread (24). Person-to-person spread was subsequently reported outside of Hubei Province in China and in 60 other international destination countries including in Italy, Iran, Japan, South Korea, France and the United States. Now, the U.S. has apparent community spread of the virus COVID-19, which means people have been infected who are not sure how or where they became infected. Currently, 43 people in the U.S. are diagnosed with the coronavirus, not including the repatriated Americans, and unfortunately six have died (32).

The new coronavirus strain was first reported to China's Center for Disease Control on 12/26/2019, reported to the World Health Organization (WHO) on December 31st, identified on January 7, 2020 and sequenced on by January 12, 2020 (9). The WHO on February 11th announced an official name for the disease that is causing the 2019 novel coronavirus outbreak as coronavirus disease 2019, abbreviated as COVID-19. In COVID-19, 'CO' stands for 'corona,' 'VI' for 'virus,' and 'D' for disease (24). There are various kinds of coronaviruses and some of them simply cause colds or other mild respiratory (nose, throat, lung) illnesses (30). However, other classes of

coronaviruses can cause more serious diseases such as severe acute respiratory syndrome (SARS) and Middle East respiratory syndrome (MERS) (30). Named for their appearance under a microscope, coronaviruses look like they are covered with pointed structures that surround them like a corona, which is the Spanish word for crown (30). COVID-19 does not appear at this point to be as deadly as previous coronavirus outbreaks, such as SARS and MERS but is more easily transmissible [9]. COVID-19 has a mortality rate of roughly 2% with roughly 80% of cases classified as mild; by contrast, SARS had a mortality rate of about 10% and MERS about 34% [9]. SARS and MERS had spread primarily through hospitals while COVID-19 has primarily spread through close human contact although there is a fear it could spread more rapidly with recent cases of apparent contraction through general community exposure [9]. Currently, there have been roughly 90,000 reported cases of coronavirus around the world, with about 3,000 fatalities reported tragically, but the good news is that approximately a third have already recovered [4]. The disease is most prevalent in older patients and in patients that had otherwise compromised immune systems due to other illnesses. Coronavirus is hard to detect without testing kits that were in short supply originally, as the symptoms resemble the common cold, pneumonia or the flu [4,5]. Travel to affected areas or connection with people who have traveled to affected areas offer a potential red flag to get tested [4]. Any loss of life is tragic, but to keep the current coronavirus epidemic in perspective, according to the WHO the number of flu illnesses in the U.S. for the 2019-2020 season has been 15 million people, with 140,000 patients hospitalized and 8,200 deaths [4].

It appears the pace of infections within China has declined since mid-February although many other small clusters are beginning to show up within China and throughout the world and the overall number of cases is expected to continue to grow [4]. The major countries around the globe are all working hard to isolate and contain the widespread infection rate within each country, and I suspect that will continue. Additionally, an anti-viral drug is in first phase clinical trials to combat COVID-19 and a vaccine to immunize against COVID-19 is being developed within the United States and both are being fast-tracked to combat a prolonged epidemic [4].

Economic Impact

Coronavirus has created uncertainty and fear in the equity markets around the world presumably due to the spread of the virus outside of China and into other countries such as Iran, Italy, South Korea, Japan, France and the U.S. plus not knowing how prevalent it will become or to what extent it will affect the respective economies [27]. We expect worldwide business and consumer demand to drop in the short-term as people and companies may curb their spending and travel plans and avoid places where large groups of people may gather especially in countries where there is a widespread risk of exposure to the coronavirus in that population [27]. Energy prices have fallen on the presumption of decreased worldwide demand from slower growth and the subsequent decreased demand for oil in China [28,3].

The coronavirus will likely impact corporate supply chains and consequently corporate earnings in the first and second quarters, but it seems unlikely knowing what we know now, that it will be as drastic as the markets portended this past week with the steep drop in equity prices. The U.S. has numerous supply chain components and products manufactured in China that will experience delays in production and delivery such as medical supplies, consumer goods, auto parts, generic drugs, as well as, chemical and raw materials for medicines [15,16]. Economists at Vanguard predict that the coronavirus may slow 2020 global economic growth by about 0.15% or roughly $135 billion in goods and services delayed or not produced [27]. Asian economies linked more closely with China will be hit hardest, followed by European countries that export a higher percentage of their goods to China [28]. Exports to the U.S. from China are expected to be down, affecting inventories here in the U.S., but would be expected to re-accumulate in the second half of 2020 [4]. Factories reportedly are now back to operating at 50-60% capacity within China [4]. Keep in mind Chinese produced goods represent an estimated 25% of all glob al manufacturing [28]. Additionally, transpacific shipping has been affected by the coronavirus as China is home to

seven of the world's busiest container ports with many trips to and from Asia cancelled over the epidemic [4]. Revenue and earnings from companies that are heavily dependent on China would be directly affected in the first half of the year, but those companies would be expected to catch up with a solid rebound once the coronavirus health concerns subside [4,1,3].

The United States is in relatively good shape from a macro-economic standpoint to battle the effects of the coronavirus with solid economic data including low unemployment and strong consumer demand coming into 2020 and the arguably the best health care system in the world (4). President Donald Trump announced on February 26th that Vice President Mike Pence will lead and coordinate the U.S. effort to combat the spread and prepare for the treatment of the COVID-19 outbreak with various government agencies, as well as, with state and local authorities, health care facilities and first responders (23). Congress is expected to allocate $4-8 billion for the U.S. effort to combat the COVID-19 outbreak in the U.S. (23).

In 2003 during the SARS virus outbreak the S&P 500 declined 12.8% and during the Zika virus in 2015-2016 the market slipped 12.9% only in both cases to recover to new highs inside of six months (4,9). The media may continue to hype each infection and fatality, and although the loss of life is truly tragic, it more than likely will have far less economic disruption and widespread infection to each country than it is having on China. Although uncertainty as to the duration and reach of the coronavirus around the world remains, history teaches that epidemics more than likely will be short-term events although we expect it may get worse before it eventually gets better (28).

Our Gameplan

Our **Leshnak Wealth Portfolio Models** are not immune to declines in global markets as we are experiencing here in 2020, twice back in 2018, on "Brexit Friday" in June 2016, during the 2008 financial crisis or the events surrounding the terrorist attacks of 2001. We do not have a crystal ball nor do any of the market analysts and forecasters. Our belief is that our LW Portfolio Model construction has positioned us for potential resilience in this environment and has also positioned us to possibly take advantage of market mispricing. We see no need to change course, as the ancient Buddhist proverb states "If we are facing in the right direction, all we have to do is keep on walking". We do not modify overall asset class allocation due to market corrections unless a fundamental change in the underlying outlook for the domestic or global economy has diminished or brightened verses our expectations. Stocks had increased during the prior eleven years with relatively low volatility by historical standards so a pullback or a correction could prove to be healthy and necessary for markets to advance as the fears of the coronavirus eventually dissipate. Corrections and pullbacks can be expected to last relatively shorter periods on average compared to the bull markets they take reprieve from, as the greed present turns to fear and shakes out those investors who are not fundamentally based in their convictions.

Our **Leshnak Wealth Portfolio Models** are globally diversified and strategically constructed, with a tactical component and a bias for value which prescribes a requirement for dividend yield from our investment positions. In simple terms, we potentially have investment positions in eight asset classes: domestic equities, foreign developed stocks, foreign emerging market equities, domestic bonds, foreign bonds, cash equivalents, commodities, and real estate. How much of each asset class (if any) we hold in the aforementioned asset classes is based on your unique risk tolerance, financial resources and personal goals and objectives. Moreover, we have a portion of each portfolio that is tactical and flexible. This allows the manager to move assets into the sector(s) that best fit current market conditions based on their investment methodology. Our portfolio construction has two other vital components—we want dividends from each position so no matter what markets are doing day to day, we still have dividends coming into the portfolio. Lastly, we add value positions in

our allocation by coupling a value position to each core position which we believe puts us in the position of the "turtle", in the proverbial tortoise verses the hare scenario, over the long-term with equities.

As your financial fiduciary, the Leshnak Wealth team cares deeply about your financial well-being and will monitor for rebalancing opportunities that may add value to your portfolio, or to be defensive as conditions might warrant. We know that as your advisor, the trust you bestow upon us is built and maintained on three pillars; doing what we say we will do, assisting with planning for and achieving your financial independence, and providing unbiased advice with your best interest at the forefront. As always, please call with questions or if you wish to discuss your specific portfolio in greater detail.

–Bob Leshnak, March 3, 2020

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