

Coronavirus Update

March 12, 2020



Good Evening,

Today marked yet another day of heightened volatility as the markets continue to grapple with the multiple unknowns circulating with regards to COVID-19. With announcements of cancellations of events, school closures, and numerous other necessary disruptions to help stem the potential spread of the virus, markets are left to guess at the depth and duration of the economic disruption said cancellations will cause. In the absence of material information on how the virus will or will not develop, business decisions are being made in a vacuum, rightfully justified by a desire to manage to the worst possible outcomes. These rightful decisions to significantly err on the side of safety is having and will continue to have, a material slowing effect to the economy.

Whereas our Pathstone dashboards have turned more cautious, the pace and unique nature of the current unfolding of events has outpaced the data. Human behavior and justifiable fears are impacting markets at a rapid pace. Markets are now down 30% from the highs of just 30 days ago, with half of that move coming over just the last two days. As mentioned in our note of earlier this week, our capital markets and risk assumptions at the beginning of 2020 were signaling to us that an underweight to risk assets was appropriate, and we have maintained that tactical underweight through this entire drawdown period. We have updated our models to take profits in core bonds in favor of cash so as to be prepared for the next best opportunity.

While our Dashboards haven't yet fully turned, we purposely kept our underweight in place in recognition of the growing likelihood that the actions being taken will have a shorter term material disruptive effect. Our recently updated stress test called for a stock market correction quite close to where the markets have now closed this evening. Recognizing that as we experience more closures and restrictions in efforts to keep everyone safe, we believe it will be quite likely that we will, in fact, reach a technical definition of a recession in the very near future. While under normal circumstances that might suggest we would make a further reduction to risk assets, our current view is that with markets down 30% currently, and the expectation that the recession will be narrow and shallow, the market has already nearly priced in appropriately the valuation adjustments we would expect under these circumstances.

Only time will tell if more drastic measures are needed, or if efforts now to further contain and treat the ill will be sufficient to restore confidence. Fiscal policies to help the flow of credit and protect displaced workers will be helpful, but we believe that ultimately there needs to be a better understanding of the path of COVID-19 before a material recovery can take hold. With that said, we do believe we are much closer to the lower levels that the current disruptions would create, and as such, our efforts are now focused on how to be prepared to increase risk asset positioning in short order.

We will continue to be in constant contact with updates as circumstances warrant. At Pathstone, we have tested and implemented needed protocols to ensure our employees can work safely and effectively under all circumstances.

We hope that you all stay safe and well!

Your Pathstone Team

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