Understanding Market Reactions to Covid-19

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Dear Scott,

Over the past week and a half we've tried to keep you focused on what's most important for your longer-term financial health as the markets react to the outbreak of COVID-19. We feel that one of our most important responsibilities is to help you have a clear and rational understanding of the relationship between the equity & bond markets, your portfolios and your long-term plan. In times like these, the news cycle tends to (over) emphasize the negative. Perspective and balance aren't "exciting" and don't draw a wide audience, so it is usually in short supply in the media. However, with decades of experience dealing with the financial markets, it comes as no surprise to us that heavy volatility and market corrections often result from various catalysts: geo-political, economic, terrorism, or something like the current health crisis.

So, why are the markets so volatile?
In the past, we've illustrated how *uncertainty* about almost anything can cause the markets to have significant downside volatility. In the case of any health scare, whether it's the current COVID-19, or in the past SARS, Ebola, Avian Flu, H1N1, etc., fear of the *unknown* can amplify volatility in the markets. By comparison, the seasonal flu is much more widespread and is responsible for many more deaths than we've seen from COVID-19. However, the various strains of the flu have been around for hundreds of years and we generally know the expectations for outbreak and recovery, so the markets don't pay much attention to those numbers because the flu is seen as a "normal" seasonal occurrence to us, with vaccines, medications and protocols to "control" the impact. I'm reminded of the old adage "*better the devil you know than the devil you don't know."* While the numbers of infections and fatalities are dramatically lower than from flu, the many unknowns associated with COVID-19 are taking a toll on the markets and increasing fears that the virus will disrupt the growth of the global economy (supply-chain disruption and lack of demand - a double-whammy) and result in lower corporate earnings.

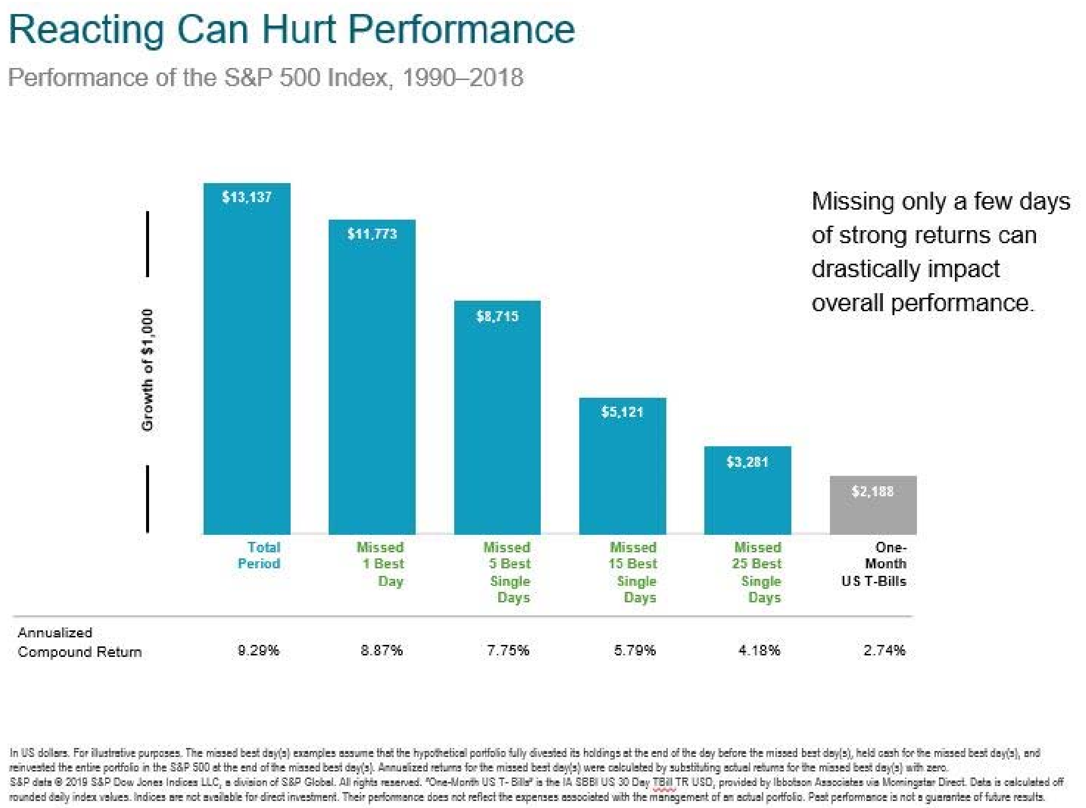
While there is no denying that this is most likely true in the short-term, we believe the markets are exaggerating the negative impact that COVID-19 will have over the longer-term. The ups and downs of the past week are akin to a debate between friends - only on a much larger scale: "This is going to be really bad!" vs. "No, I disagree, this will not have a deep long-term effect." "Yes, it will, the spread is out of control," vs. "No, it won't, it looks like the rate of recovery is going up," etc. With almost every day bringing more information and opinions, we expect some back and forth in the coming week(s). We believe that the markets are ultimately efficient, but as they process new information and seek to forecast where things are headed, it takes time to bring the two sides of the argument toward accuracy, and it makes perfect sense that there would be wild swings in each direction over the short term.

When will this end?
The bottoming out of downside volatility is **a process, not an event**. There will not be a day where a bell rings letting everyone know that it's safe to go back in the markets. As the *unknown* eases toward *uncertainty* (for example, if there has been containment of the spread, the trend of

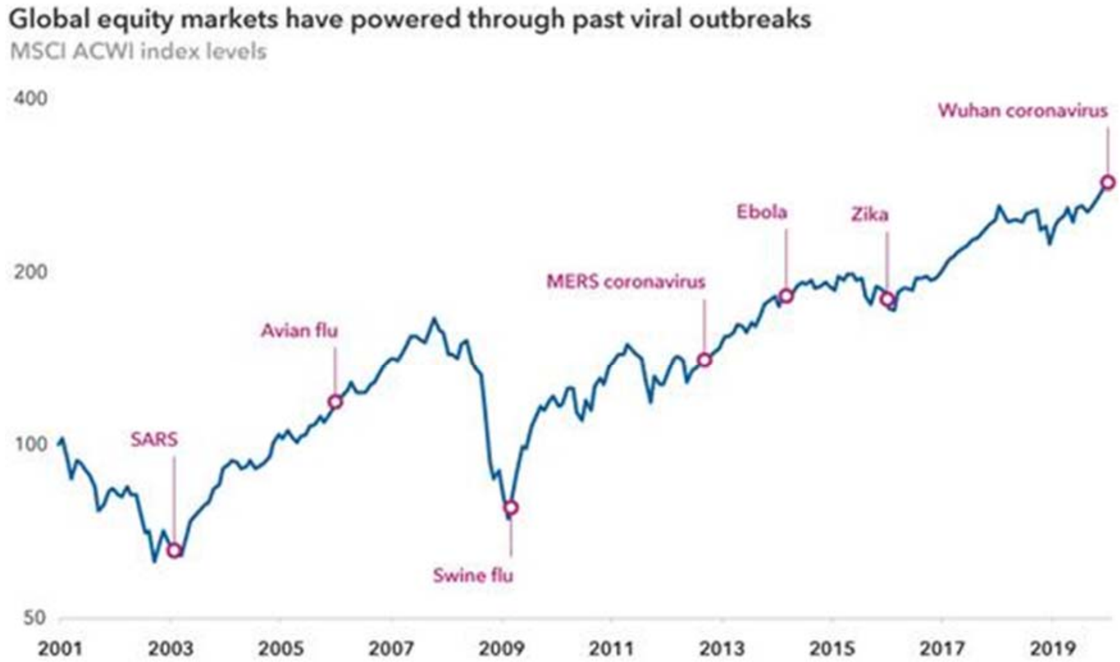
new cases is reducing, the trend of new recoveries is increasing, but there's still no clear sign of what's ahead), and then uncertainty turns to a known/normal status (e.g. scientists develop a remedy, rapid decline in new cases, coordinated efforts from global central banks to create stimulus) then the volatility will abate. There will be more bad days ahead but there will be good days, too. As we've highlighted often, missing out on the best days can have a very detrimental effect on an investor's long-term success.

What should we do?

The answer to this question is not always palatable to all investors. With information (and misinformation) coming at us from all sides, it's hard not to want to 'do something!" However, it's very important to understand (as we indicated above) that the equity and bond markets will *not* wait for the "known" to happen before turning to a steady, positive direction; this shift will most likely occur between the unknown and uncertainty phase. For investors who take assets out of the markets, the timing of getting back in at the right time is virtually impossible to predict (and getting back in at the wrong time could increase their downside significantly).



Therefore, the most prudent course of action is to allow the volatility to occur, without making any drastic changes to your strategic, long-term portfolio. Your Investmark advisor has designed your portfolio for your goals, time frame and risk tolerance, and we have stress-tested your long-term plan to withstand periods of heavy volatility. In addition, we rebalance throughout the year and thus frequently sell-high and buy-low (this is the way it is supposed to happen), when certain market categories advance or decline beyond the prescribed thresholds we've assigned. Also, in non-qualified accounts, we will be looking to harvest losses, if applicable, to offset future potential gains.



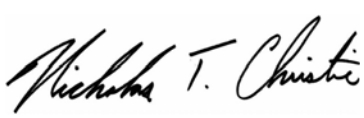
Sources: Centers for Disease Control and Prevention, RIMES, MSCI. As of 1/29/20. Chart shown on a logarithmic scale. Total return index levels in USD, indexed to 100 on 12/31/2000. Disease labels are estimates of when the outbreak was first reported.

The Bright Side
While past performance is not a guarantee of future results, this is not the first time the markets have seen similar health concerns wreak short-term havoc, but global equity markets historically have powered through these interludes on a consistent basis. (See chart above)

Additionally, the US economy happens to be in very good shape and has a cushion to absorb the potential short-term effects of COVID-19. This is, of course, a lagging indicator but does act as a "shock absorber." Assuming the virus is contained relatively soon, we would expect a "v-shaped" recovery in the second half of the year given our strong labor markets and the accommodative stance of the Fed.

Please don't hesitate to contact us with any questions.

Best regards,



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