

Raymond Capital Advisors LLC

February 29, 2020

Dear RCA Client:

What a difference a week makes! On February 19th, the S&P 500 Stock Index was at an all-time high. Seven trading days later it had fallen 12.8%, with the decline being the most rapid on record. Lack of coronavirus containment has been the primary contributor cited by the media.

According to Goldman Sachs, since World War II, there have been 26 market corrections, with an average decline of 13.7%. Recoveries to prior peak levels have taken about four months on average. However, if the decline were to stretch to 20% (media's definition of a bear market), then recovery times have taken about two years on average. We would add that there is a lot of variation around these historical averages. Further, while it may be that declines in recent years have been faster from the more rapid dissemination of information and computer algorithms, recovery times may also be quicker (e.g. the late September to December 2018 decline of 19.8% took only four months to make a full recovery).

To help understand the recent decline it's helpful to think of stock price movements in terms of both psychology (i.e. sentiment), and fundamental economic impacts:

Let's first address the psychology of the decline. Much is still unknown about the virus – e.g. how it's transmitted, how long it lingers, while how widespread it actually is having yet to be discovered. It's this uncertainty and fear that has kept a lot of the selling pressure on. Accordingly, our indicators that quantify short-term sentiment have now rapidly moved into their "fear zone." Certainly, rapid declines are unnerving. But the fear is actually good news as it pushes liquidity to the sidelines which becomes the fuel for a future price advance. Extreme fear and pessimism are an indication of over-reaction, and it often doesn't pay to sell out when our indicators reach this zone. In fact, psychologists tell us that fear is twice as strong an emotion as is greed, and it is often the lingering persistence of fear which prevents investors who have sold out from buying back in a timely manner for the rebound.

On the fundamental side, the picture has become more mixed. Global supply chains will be disrupted as many distributors and manufacturers adjust to new supply routes. Disruptions in other areas are also likely to have economic impacts (e.g. temporary school closings, work from home more, fewer public gatherings, travel less, etc.) while some production is likely to be lost, especially in travel related industries. These disruptions will likely lead to earnings downgrades in the coming quarters. Investors will either need to be willing to keep valuations high in anticipation of recovery, or stock prices will remain under pressure to keep valuations in line. On the more positive side, the policy response is being mobilized. While it's believed most of those contracting the virus will feel mild to moderate symptoms, prevention awareness to help limit its impact is being well publicized (wash hands!), test kits and testing is being expanded rapidly, a vaccine is in the early stages of development, travel restrictions are being increased, and in some cases quarantines. Unemployment also remains very low, and with survival rates in the 96% to 97% range, actual productive capacity should remain largely intact. Central banks are also likely to supply liquidity by reducing interest rates thereby producing less competition for

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stocks, and aiding key industries such as housing, autos, and consumer loans. On the fiscal side, \$2.5 billion has thus far been allocated to fight the virus, and talk of targeted tax cuts are also being explored. Corporate buybacks of stock, a key driver for stock prices along with lower interest rates, may also kick-in once stock valuations are reasonable enough. In Hong Kong, the government has announced a \$15.4 billion relief package with cash payouts of \$1,283 to each of its adult citizens to help spur recovery.

In all, markets draw their long-term trends from fundamentals, but also overreact in the short-run based on sentiment. Both fear and an anticipation of a weaker fundamental outlook have been driving stock prices lower. And although more cases will assuredly make for more negative headlines as testing expands, our sentiment indicators show we are now entering overreaction territory. Once our indicators show improvement, we anticipate increasing equity exposure, but we are first likely to go through some further volatility followed by a basing and testing phase.

RCA Tactical Asset Allocation strategies are currently modestly below benchmark weightings for stocks, and have been outperforming their benchmarks on a year-to-date basis. The equity component has overweighting's to defensive sectors such as Utilities, Medical, and Business Services.

Year-to-date Returns % (Before Fees):

RCA Multi-Cap Core Equity Strategy = -8.13%

S&P 500 Total Return Benchmark = -9.04%

RCA Tactical Asset Allocation Strategy = -2.93%

60% Stocks/40% Bond Composite Benchmark = -3.96%

All the best,
Geoff & Lance