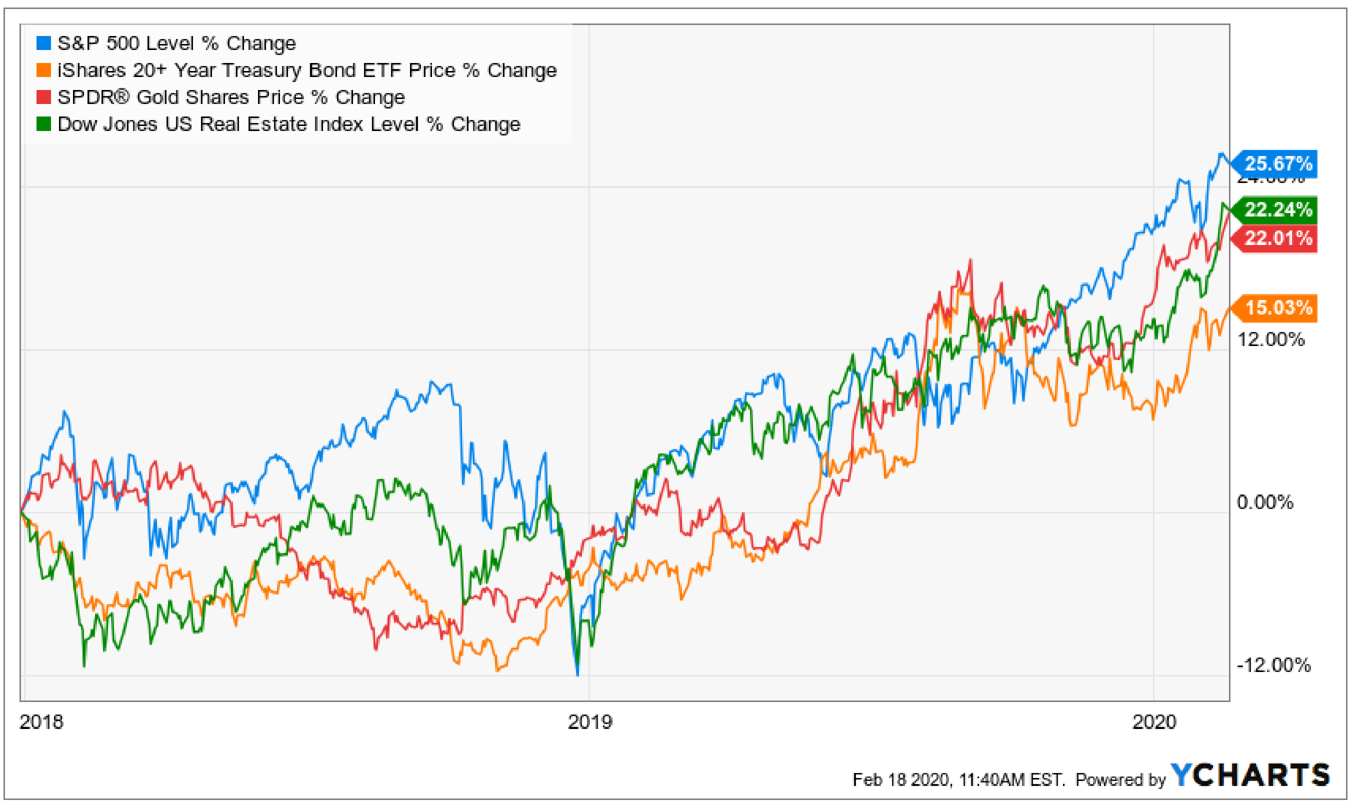
Market Update

February 18, 2020

Coronavirus Impacting World Economic Activity

- Risk sentiment turned positive this week, as investors took developments related to the Covid-19 virus and a mixed bag of U.S. data in stride. Among the data reports, the NFIB survey indicated that American small businesses entered 2020 on solid footing, with the confidence measure gaining additional ground in January.
- With a shortage of skilled workers and quality of labor concerns top of mind, small businesses continued to boost worker compensation in January, while signaling that they will continue to do so over the coming months as well. More wage pressures should put further upward pressure on inflation.
- The headline CPI measure rose to 2.5% y/y in January, while core CPI held steady at 2.3%. A level just above 2% for the latter implies core PCE inflation of roughly 2%, which would bring the Fed's preferred inflation gauge closer to target.
- Retail sales data was less upbeat than expected. Market expectations (+0.3 m/m), the control group – used to measure household consumption expenditures – was revised lower in December and came in flat in January, pointing to a soft entry into the first quarter.

The world is paying very close attention to the Coronavirus and the spread of the disease that is yet to have a vaccination or cure discovered. China has seen a significant slowdown in economic activity, as the Chinese government is working on measures, to contain the spread of the virus, inside its own boarders.



Information in the chart above was taken from sources we believe to be reliable; however; we do not guarantee its accuracy or completeness. Date Range start 01/01/2018.

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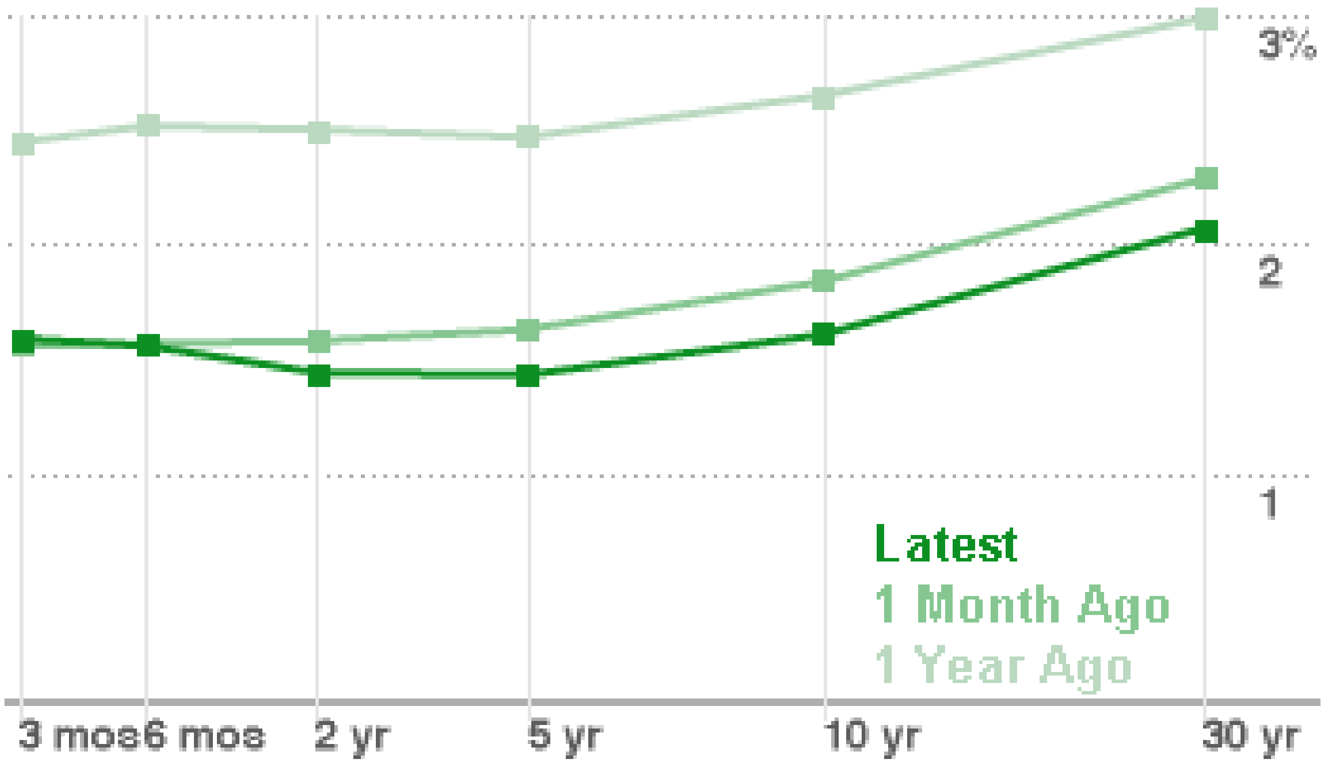
We are starting to see the impact of the Coronavirus, on parts suppliers and companies with significant exposure to Chinese markets and manufacturing. Apple, just this morning, made an announcement that they feel they may miss their quarterly revenue forecast due to lower iPhone supply and lower Chinese Demand, as a result of the Coronavirus. Currently there are about a dozen drug makers working with the federal health agency on developing a vaccine. Many CEO's are still suggesting it is too soon to forecast the impact of the virus on business. As with other virus outbreaks in the past, such as SARS, Ebola, etc. the markets may experience a period of increased volatility until the world health system learns more about how to contain the virus and ultimately develops a vaccine.



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The treasury yield curve, above, regained an inverted posture, in large part, due to the current Coronavirus related concerns. As large institutions pull money out of investments in China and other emerging economies who are most highly impacted from this outbreak, U.S. Treasuries are the safest short-term trade for these managers. The U.S. treasury market is one of the most liquid markets in the world for safety and positive returns. Other world economies are still experiencing negative interest rates which make the U.S. Treasury market most attractive. As money flows into these treasuries, the prices go up for these bonds and the corresponding yields go down.

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Our opinion remains that 2020 could be another decent year for equities investors, but the Coronavirus may have an impact. This impact will likely not be seen until 2nd or 3rd quarter. The 2020 Presidential race will certainly provide influence on traders and investors outlooks, as we get closer to understanding who the candidates are and what their policy positions will be. There are some concerns with certain candidates' current stances on taxation and trade related issues, but ultimately it is too early in the process to make any determinations. One thing we believe is that once the front runner or runners are determined, there will be plenty to compare and contrast with respect to current policy.

Having a disciplined investment and risk management process, regardless of market action, is the foundational elements to our portfolio designs. It is this portion of the approach of portfolio management, that helps consistently reduce the long run risk taken in a portfolio of investments. Speculating about near term directions in the markets can be and often is a difficult and risky proposition. We can control the risk and process we take in our portfolio construction, but we cannot control market performance.

Overall, we prefer domestic equities over international equities. We prefer more value-oriented stocks vs. growth stocks, currently. As we have stated in the past, value stocks tend to move more slowly in either direction when the markets react to stimulus. In later stage economic environments, a tactical shift to overweighting value type stocks can reduce portfolio risk. We are currently neutral on fixed-income and interest rates. It is important to maintain discipline regarding long-term strategic asset allocation. However, as market conditions dictate, we are looking at tactical opportunities to reduce risk in portfolios, if necessary.

If you have questions or would like to discuss this further regarding your personal portfolio, please contact me at 310-469-7254.

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