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Chris Hyzy: Hello, this is Chris Hyzy, Chief Investment Officer. Global capital markets, namely risk assets (i.e. equities) are under pressure this morning and has been under pressure overnight all around the globe as the spread of the coronavirus, known as COVID-19, has accelerated outside of China in specific countries of Italy, Iran, and South Korea.

As of right now, U.S. markets are down about five percent year-to-date. They were up well in excess of six percent at their peak just mid last week, and this current downdraft today as we speak is going back to the largest point fall since August 14th of last year.

So what has recently happened over the weekend and really since last night, we've hit the second wave of concern regarding the coronavirus impact. This has translated into not just economic concerns or growth concerns, I should say, but also corporate profit concerns. Last year, corporate profits were basically flat in the United States, and the thought

was for 2020, we would see somewhere around seven to eight percent growth in the S&P 500's corporate earnings stream and some suggested the double-digits of 10% to 12%. Markets were starting to believe in that story as overall economic recovery was underway, but now they're calling into question for the full year the earnings of the S&P 500, known as the denominator. The denominator or corporate profits drive the overall market level and the direction in our view.

So prior to the second wave of concern, however, regarding the virus impact, we were analyzing the recent data that was coming in from late last year and early this year. We noticed a V-shape recovery was underway. Heading into 2020, our view was that we would undergo a global expansion in the broader economy as the trade war fears subsided, the U.S. consumer remained healthy, low rates drove housing, and there was an overall manufacturing turnaround in the areas outside the United States. Indeed, the data was coming in as late of last week that this was the case in housing overall in the United States, a V-shape recovery was underway, namely due to record-low mortgage rates and a very healthy consumer. Job growth was still moving forward, and we noticed also a manufacturing turnaround in some of the regional Fed surveys. And in particular, overseas growth not only was slowing down in its downdraft, it actually was exhibiting signs of stabilization and turning up. Hence, some of the data that we looked at in terms of earnings revision ratios around the world were beginning to turn up.

It's one of the reasons why equity markets were undergoing a melt up phase, which we had expected in the early parts of 2020. A melt up phase in equity markets generally includes one in which a valuation rise in the

multiples of, say, one point, as well as and at the same time as an earnings rebound. That has a multiplier effect which was led by large momentum names particularly in the technology sector and particularly in the United States. In addition, adding to the technology sector momentum was also multinational turnarounds (i.e., the fading out of the technology and/or trade war that ensued last year between the United States and China). Put all that together, namely U.S. equities were on their way to an equity market melt up phase.

Now, we still believe the S&P's fair value is around 3,300 based upon all of the data we have today. We still expect a melt up phase to once again and soon, if indeed the virus impact is shorter or sooner rather than later as it relates to the overall growth expectations. The data is still fluid at this time and we still don't have the ultimate detail we need to suggest that that is indeed the case. We will be analyzing that in the coming weeks and months.

On the contrary to the equity market, the bond market was telling a different story – a story that included fears of a deflationary shock, somewhat akin to what we saw in the fourth quarter of 2018 when yields significantly declined in the U.S. and went negative across the board pretty much in Europe. That was due to a very tight Federal Reserve policy at the time when trade fears and trade war was gathering momentum and suggesting that manufacturing was in recession. Oil prices plummeted then; they have dropped significantly now. The dollar rose then; the dollar is rising now. Gold prices went up and it's doing the same thing now. And commodity prices dropped outside of the gold area

significantly and that's the same thing that's happening now, and overall much lower than expected inflation.

The yield curve at the time in late fourth quarter of '18 inverted at the frontend; same thing's happening now. However, the 10-year yield to 30-year yield, the end of the actual yield curve is still steep enough to suggest that growth can snap back and snap back in a very positive way by the end of the year. However, the short end of the curve, which is inverted in some spots at this time, is suggesting or at least indicating to the Federal Reserve that they are too tight, and they should consider adjusting policy towards a more easing basis.

Now, at these latest accelerated fears of the virus impact, equity market momentum is currently today, and we expect in the very short-term continue to unwind the accelerated moves that the large momentum names really gathered steam since the early part of 2019 and then again in the fourth quarter of '19.

The bond market is still pricing in further deflationary concerns. We mentioned before that yields have dropped. Ten-year yields fell below 1.4% this morning and are now at a record-low that they surpassed in 2016. The 30-year yield is also at a record-low.

So, the bottom line here is this: A v-shaped recovery was underway, the economy both in the States and overseas was generally solid and getting better. In fact, overseas growth was beginning to pick up while the U.S. was heading back towards trend. Now, growth fears on the second wave of

the virus impact are taking over as the spread outside China becomes the key fear at this point.

The key will be, in our view, how long the actual global supply chain that feeds into the ultimate consumerism and both consumer discretionary tourism, leisure, travel, manufacturing, and in the high-tech space – how long does the actual global supply chain disruption last? At this point, we do not know. We'll be watching the data very clearly for any signs that there is further stabilization like we saw coming out of the depths of the trade war in the latter part of 2018.

We still expect clarity by the third quarter of this year. If it lasts through the year, obviously the economic data gets pushed – the economic positive data gets pushed more into 2021. At this point, we still expect we will have more clarity through the summer months into the third quarter.

We believe the data should remain very fluid with each week's passing. It is very difficult to gauge the final economic and profit impact at this point, so we prefer to actually wait before making sizeable portfolio decisions until we get closer to the spring months to assess the ultimate scenario.

For now, recession risk is vey low. I want to emphasize that. Recession risk at this point is very low. The bond market is suggesting to the Fed that they should cut. We will get more information regarding this at the March meeting as we come out of the minutes from the March meeting.

So what do we do while we await further clarity? In the short-term, in terms of short-term investors, we believe a waiting stance is appropriate

until we can at least assess when the negative volatility is likely to settle down. That is more or less going to be signaled by the Federal Reserve's potential policy adjustment or not, as well as any continued spreading outside of China. The data at this point, as we said before, is still too fluid and it's too soon to assess the real impact.

For longer-term investors, as the Fed signals a possible adjustment – and again we may see this as early as March – and/or the economic data begins to show that the spread impact is beginning to stabilize, we believe it's important for longer-term investors to have plans ready now and in the coming weeks potentially into the summer months be ready to rebalance portfolios upward in equities and maintain a very high level of diversification.

At this point, diversification is probably one of the most important portfolio tools an investor can have. It is often pushed aside in uptrending markets – uptrending markets like we exhibited up to the second virus wave fears. However, in the long run, diversification helps, in our view, mitigate the downswings like days like this. Growth was picking up and was in the early recovery phase and a global expansion was underway. Now, fears over the spread of the virus outside of China and its impact on growth overall are creating these growth shocks and deflationary concerns. In our view, the Fed is likely to act if this lasts further well into March or into early April. Again, maintain high levels of diversification and have plans ready to rebalance portfolios as we approach the spring months.

Thank you and have a good day.

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