CLEAR HARBOR
ASSET MANAGEMENT

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Aaron J. Kennon
*Chief Executive Officer & Chief Investment Officer*

**Clear Harbor Flash: Fear in The Air, Coronavirus, Markets**

The emerging impact of the Chinese-born Coronavirus has changed the calculus for investors in a rather abrupt fashion. Over the last week volatility has spiked, equities have corrected approximately 5%, and the dollar has risen along with US Treasury prices and gold bullion. The 30-year Treasury bond is now trading at the lowest yield on record.

As the Coronavirus shuts down factories and halts air travel, China's economy appears to be entering an outright recession after years of mid to high single-digit growth. If the SARS epidemic which struck China in 2002 is any guide, economic demand will rebound in the second half of 2020. However, we do not recommend taking out the fine crystal just yet as there exists no clear indication that this virus will impact the human population and economy in a similar fashion. So where do we go from here?

The honest answer is that we—of course—do not know. Some thoughtful market analysts view the Coronavirus as an unfortunate but confined human tragedy that will just temporarily halt economic demand— nothing more than a speed bump along a road toward better global growth and rising asset prices. Others who are studying the changes and evolution of the Coronavirus data set are suggesting that the trends have increased the likelihood of a global pandemic. This outcome would certainly have a significant and longer-lasting decline in business activity and consumer demand while increasing the likelihood of geopolitical instability. These same experts expect an increased likelihood that cases will surge in the Middle East as well as travel-heavy North America in the weeks ahead.

As investors and macro economic observers, we believe that the impact of this virus on corporate earnings is real. We also see the surge in the dollars as weighing on export demand. Certainly, corporations deriving revenues or manufacturing product in China will be impacted first. In fact, many major airlines have already reduced or removed annual earnings guidance while behemoths such as Apple and Mastercard have already indicated that they will miss Q1 earnings guidance.  Other companies are sure to follow in the coming days.

Some market observers may take a more casual approach to these apparently temporary corporate setbacks.  However,  in a world more awash in debt than at any point in our history, a lack of cash flow can have a meaningful impact on the public and private sectors of the economy, creating negative feedback loops that can quash sentiment and confidence and trigger economic soft patches and outright recessions for sectors or entire economies.  A watchful eye is certainly warranted at this juncture.

Global monetary officials are standing watch with expectations of further monetary easing should the trend lines in the economy turn downward and the perceived severity and duration of this virus rise. While the FED entered the year with the expressed view and hope that they will not need to take further monetary action, it would not surprise us if they cut rates as early as next month if current sentiment and demand gauge trends prevail.

Following the equity market swoon over the last few days, market participants are attempting to determine whether we are in the midst of a modest correction or a deeper and more prolonged rout. While technical indicators suggest oversold conditions, we must also be alert to the prospect that a deeper downturn is quite possible.

Equity market corrections of more than 10% occurred 53 times over the last 90 years or approximately once every 18 months.  While 20% corrections are far less common, they too are part of the ebbs and flows of the longer term market cycle, occurring approximately once every 4.5 years.  In fact, without market corrections from time to time, irrational levels of bullishness can ensue, lifting asset prices to unsustainable and irrational levels.

Such a phenomenon occurred in 1999 when emerging technology and dot com stocks were all the rage—even as trailing PE multiples topped out at the highest level in the history of the S&P 500 at 34. While the current US equity market, at nearly 20X Trailing 2019 EPS levels, is trading well above historical averages of approximately 16X, historically low sovereign debt yields provide a less-than-clear perspective on current valuations.  Just as the inflation-filled 1970s ran parallel with a period of lower valuations as Treasury yields and credit spreads were elevated, the current period of historically low yields and tight credit spreads provide reasonable fodder to those who justify markets trading at current levels or nearly a 25% premium to the long-term average.

The team at Clear Harbor will continue to carefully monitor these and other emerging trends in the days ahead. In the meantime, we look forward to maintaining an ongoing dialogue with each of you as your financial life evolves in the midst of an ever-changing set of geopolitical and economic considerations.

Sincerely,

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