Aldrich℠ WEALTH LP

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Market volatility is as high as it has been since the financial crisis of 2008-2009. So far this month, equity markets have averaged over 3.0% swings each day. In 2019, daily price movements averaged well below 1.0%. The bear market, which we have avoided since 2009, finally arrived, meaning stocks have fallen more than 20% from their recent highs. Stock prices are essentially back to where they were a year ago.

The decline in stocks is primarily driven by the global outbreak of the coronavirus. The virus started in China late last year and negatively impacted manufacturing and disrupted global supply chains. More recently, the pullback has been caused by a decline in demand due to "social distancing". The closure of universities and businesses and cancellation of sporting events and conferences is negatively impacting economic growth and hurting company earnings.

It is virtually impossible to estimate the ultimate economic impact of the coronavirus at this point. We don't know how long the virus will last or how far it will spread. Investors tend to become overly pessimistic when uncertainty increases. Human nature is to avoid negative consequences and this equates to selling stocks when they are falling and the outlook is uncertain. Until investors get more clarity with respect to the potential economic impact of the coronavirus it is likely we will see continued volatility.

The Federal Reserve cut interest rates by 0.50% on March 3rd and is likely to cut rates by another 0.50% next week. Lower interest rates typically support stronger economic growth and higher stock valuations. However, this alone may not be enough to help stabilize economic growth in the short term. Additional fiscal stimulus may be necessary. The White House is considering a payroll tax cut to help businesses and they may provide direct support to industries that have been hurt the most, such as airlines and other travel related industries. A combination of actions may be needed to provide support for the economy.

The financial crisis of 2008-2009 was primarily driven by financial institutions' easing credit standards and borrowers increasing debt and using their appreciating homes as a source of income. When home prices stabilized and began falling, financial institutions started tightening credit and overextended borrowers began defaulting on loans. This snowballed as credit tightened and borrowers globally found credit extremely difficult to obtain and the financial system ground to a halt. It took many years for the financial system to restructure and heal and for credit to begin flowing again. Companies were very cautious and delayed hiring and capital expenditures for several years. This truly was a financial crisis and corporate earnings plunged and investor sentiment tanked.

The current market sell-off is quite different than the decline we suffered in 2008-2009. This current bear market is being driven by fear rather than a breakdown in the financial system and the economy. Clearly, the virus will negatively impact earnings in the short term. However, the long term impact on the economy should be fairly short term and transitory. We don't know the duration or extent for sure, but the economy was on solid footing when the outbreak started and companies are generally well positioned to withstand a disruption in earnings for at least few quarters. We believe it is unlikely that the coronavirus outbreak will permanently damage earnings and economic growth. Longer term earnings will likely recover and current valuations appear depressed. We also expect increased action by the government to reduce the negative financial impact on the economy.

Holding a diversified portfolio of stocks and bonds has helped buffer market volatility. Your emerging market stocks have performed relatively well. Swift actions by the Chinese government likely shortened the duration of the epidemic and the country's economy is healing after a rapid decline. Your investment grade bonds posted strong returns as interest rates plummeted. These bonds will continue to be a source of capital when we rebalance portfolios and purchase undervalued assets. Fortunately, we have minimal exposure to some of the hardest hit sectors, such as energy and airlines.

Ultimately, we don't know when and what actions the government may take to ease the financial burden of the virus and stem its spread. However, there are things we do know based on history. The equity market always recovers from economic shocks. We also know it is very difficult to call the tops and bottoms of markets, but many of the best days in the stock market occur close to the worst days. Therefore, exiting the market can be costly if the reentry is mistimed.

The S&P 500 index has produced an average annual return of about 8.0%, including past recessions and bear markets. Volatility, like we are experiencing today, occurs infrequently, but is a natural part of investing. In order to garner equity returns, you must be willing to accept equity volatility. Fortunately, time is on your side and this too, like past bear markets and epidemics, will pass and patient investors will be rewarded for not panicking and heading for the exits.

We greatly appreciate your trust,

Aldrich Wealth Investment Committee