

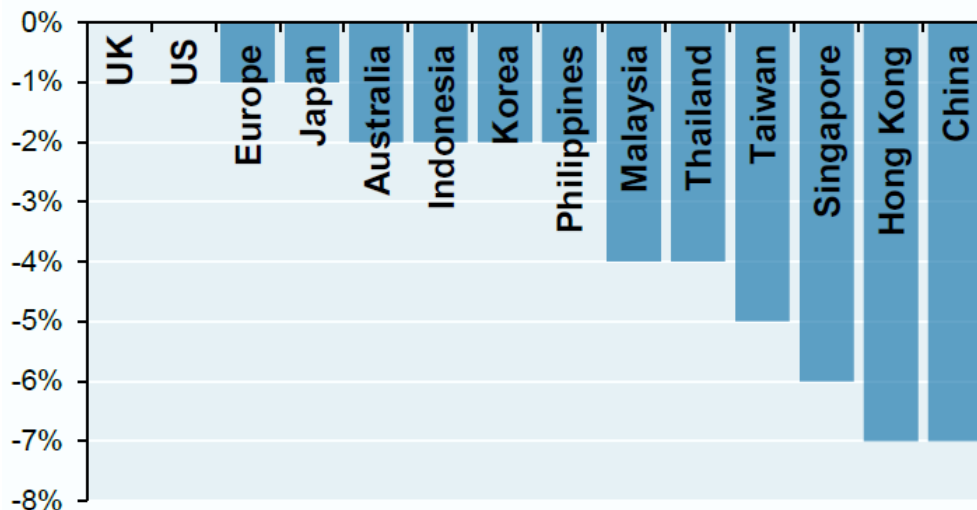
Impact of the Coronavirus

From: Jim Russo, CFA

Entering 2020 the United States and most of the developed global economy was improving. Consumer confidence was rising, PMI data was coming off lows around the world and jobs growth remained positive. Unfortunately, economists often struggle to incorporate exogenous events such as COVID-19, better known as the Coronavirus. Up until recently markets outside of emerging Asia were only mildly reacting, but as cases spread into Europe and most recently, news of a quarantine in California broke, fear has set in across the globe. As of this writing there are nearly 84,000 cases of COVID-19 across the world and global equity markets are in a “correction” (greater than 10% decline from peak). The S&P500 is on track for its worst week since 2008.

While human loss is the most important concern during this period, we are monitoring the virus’ impact on the global economy. Notably, global supply chains have already been impacted as many trading partners, including the US are reliant on Chinese imports. This is most critical in electronics, furniture and machinery. That said, current estimates on Q1 growth remain mild in the US and UK with greater impact in China and surrounding countries (*source – Bridgewater Daily Observations, 2-19-20 and JPMorgan eye on the market-2-26-20*):

Coronavirus estimated impact on first quarter growth
 q/q % change, annualized

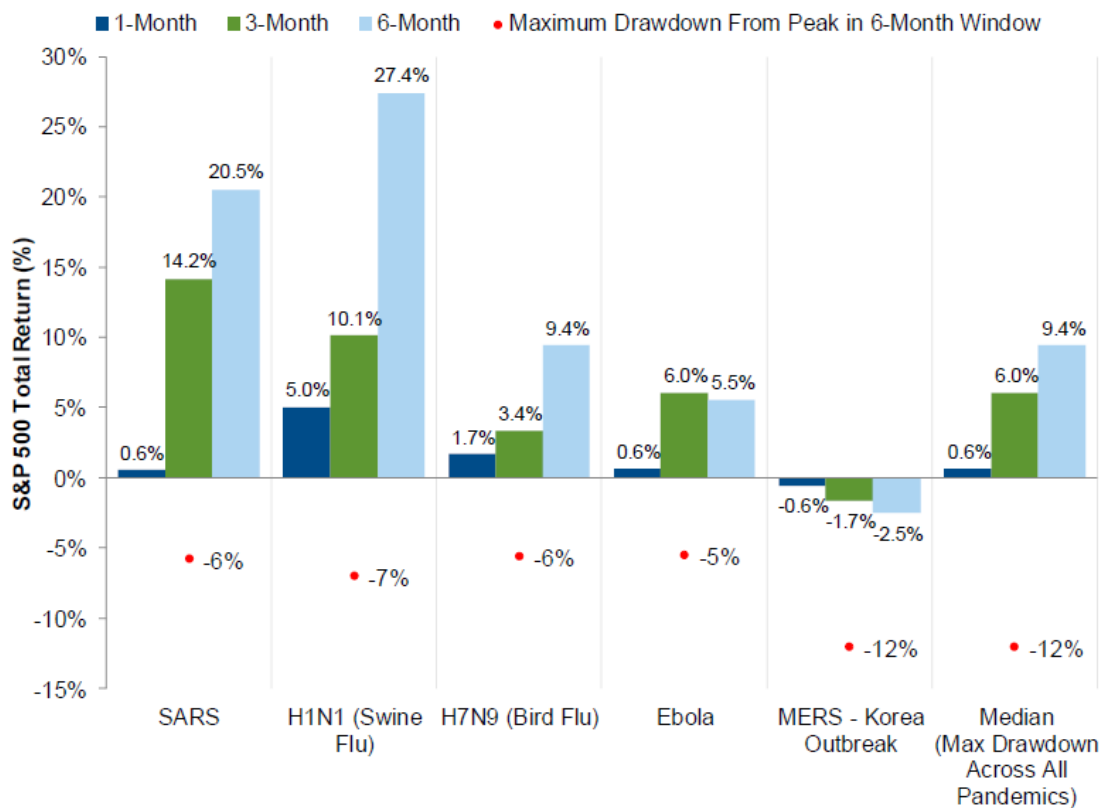


Economists across the world are seeking an equity-market bottom and/or looking to policy makers to step in and prop markets. As of this writing there is now a 100% probability of a Federal Reserve

rate cut in March already priced into the market and many expect up to three cuts in 2020. Unfortunately, this may not matter. COVID-19 is an unknown and as we know quite well, investors despise uncertainty. Equity markets may rebound quickly or it may take some time for a rebound to form. Worse, there is always a possibility of a severe pandemic that will push equity markets significantly lower. All of the above scenarios are based not on market fundamentals, but the extent of the coronavirus' reach and impact on local economies; fear leading to a shutdown in schools, travel, trips to the mall and/or other normal activities that help economies grow.

The above paints a grim picture as we move into the last month of Q1. As you know, Colonial Consulting rarely reacts to short-term events as most are “noise” over the long-term; however the economic impact of COVID-19 may become more severe before it improves and for that reason we are closely monitoring consumer confidence, PMI data and the containment of the virus in developed markets.

We would also like to highlight how equity markets have reacted to past outbreaks. As evident below, after a drop in equity markets we have historically seen a rebound over the next 3-6 months:



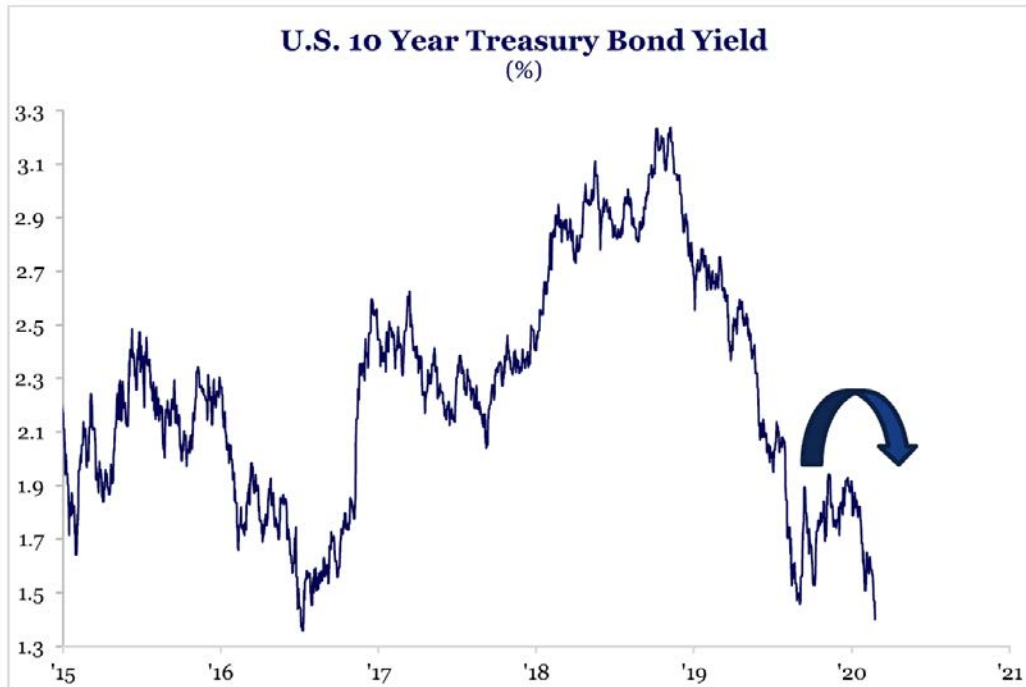
Source: Goldman Sachs 2-24-20 investor call materials

Arguably, COVID-19 may be more severe than all the above therefore we are not looking to this data to confirm a market rebound is in-sight. In fact, conditions may worsen in the next few weeks/months before they improve.

More critical than predicting a rebound, it's important to remind ourselves that foundations and endowments manage a diversified portfolio for events just like this. For the past 11 years we have witnessed a bull market in which equities have outperformed all other asset classes. If we owned equities only, short-term actions may be needed to hedge or protect our losses; however our clients

have an Investment Policy Statement in place for conditions such as these; to eliminate emotion (fear/panic today) and manage a diversified portfolio with a long-term lens in mind. Fixed Income has been an unimpressive investment for long-term investors and coming into 2020 many found little reason to hold this asset class at all; however, periods like this is exactly why our clients own fixed income, cash (and in most cases hedge funds).

While equities have fallen in the past week, fixed income markets have rallied. The 10-year treasury rate is nearing 1.0%; as rates fall bond prices rise, implying that portfolio's with fixed income allocations will find some stability, albeit minor:



Source: Strategas Research

Our Reaction – the above, like most reports from banks, investment managers and advisors in the past week, simply highlight what is happening and what risks/opportunities lie ahead. Our views won't differ however I would like to specify what we intend to do, beyond simply monitoring equity markets and the virus over the coming months:

1. **Initially – nothing.** For long term investors, it's important to not panic or let emotions dictate a market-timing approach to investment – inevitably, market timers are required to time these actions perfectly, on both the exit and the re-entry. Those that get lucky and time the exit just right will almost always wait too long to re-enter the market and miss the subsequent rebound (see 2008 and the recovery as an example – large levels of cash industry-wide throughout 2009-12).

We would remind our clients that corrections of 10-20% are normal. We don't like them, but they are indeed normal and often part of a continued bull market. We are not implying that the bull market is or isn't over, but we are emphasizing the need to not panic. Risk tolerance is aligned with your investment horizon; therefore, if your time horizon is long, a 10-20% correction should not affect your decision-making, outside of IPS guidelines.

2. **Short-Term** – in some cases cash inflows have caused portfolios to carry more cash than we prefer – we will look to re-deploy this over the next few months, opportunistically reinvesting in underweight areas of the portfolio.
3. **Re-balance**: the IPS was written for many reasons, one of which is for moments just like this. Policy allows the behaviors and emotions of those managing the policy to stay focused on long-term objectives. We would look to re-balance if/when allocations break outside of ranges specified by each client’s IPS. Acting with emotion outside of the IPS guidelines defeats the purpose of having an IPS at all.

Importantly, as markets fall, our first look is to how we can source spending/grants over the coming years (please note – we are always looking at this, even in good times). Fixed income, cash and eventually hedge funds can serve as sources of capital to cover spending for four-to-five years, if not longer. Reacting to a short-term correction would imply we don’t believe equities can recover for the next five years – that is not where we are today.

4. **Re-assessment** – we hope we aren’t giving the impression that we stick our heads in the sand and wait for this to end. On the contrary we have our eyes wide open, monitoring all aspects of the global market, new risks and opportunities. Holding to a policy isn’t the same as making no decision, rather it’s following through on a decision made by our committees when level heads prevailed. That said, should the virus have longer, greater impacts on equities and other asset classes we may need to re-asses our asset class inputs and possibly adjust our target allocations mid to late-year. Again, no action does not mean we aren’t assessing and re-assessing the market environment, future growth and valuations constantly.

I hope this brief summary provides some useful information regarding our views on the global economy and the impact COVID-19 may have. More importantly, we hope to highlight the need for patience and unemotional decision-making as opposed to the fear that may drive markets lower in the coming days/weeks. Additionally, such volatility may create opportunities later this year or next – we look forward to assessing with you then.

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