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Hello,

The news regarding the Coronavirus seems to change every day, and it is becoming increasing more difficult to differentiate between fact and opinion. With all this uncertainty, it's easy to lose focus on what really matters. Take a few minutes to read our thoughts on why we believe events like these are more often an opportunity than a risk to patient investors.

Have a wonderful week and give us a call if you have any questions,
Your Harwood team.

In this week's issue:

Where's Waldo?

Several investors are worried that the most recent pandemic, the Coronavirus, will infect their portfolios. While these concerns dominate headlines today, let's take a step back and put these fears into context.

Brought to you by Mike Sorrentino

Three Key Points

1. The Coronavirus is making headlines.
2. The erratic ups and downs in stocks fade over time.
3. Keeping it together through these rough patches is the price we must pay.

Infecting Portfolios

Ebola is a deadly virus with a mortality rate of up to 90%[1]. The virus made headlines back in 2014, when a Frontier Airlines flight transported an infected passenger from Cleveland to Dallas.

From the very beginning, this story sounded like it came out of Hollywood. A man traveling from West Africa steps on a plane infected with one of the deadliest viruses on the planet. He then spends several hours isolated at 35,000 feet sharing the same recycled air with over 130 other passengers and crew.

Days later, this individual dies at a hospital in Dallas. Two healthcare workers caring for him subsequently test positive. Although both survive, Ebola had officially been transmitted on U.S. soil for the first time.

Weeks later, a medical aid worker who had volunteered in Guinea is hospitalized in New York City. Media reports soon confirm that Ebola has arrived to one of the most densely populated cities in the world. This marks the beginning of a full-blown panic.

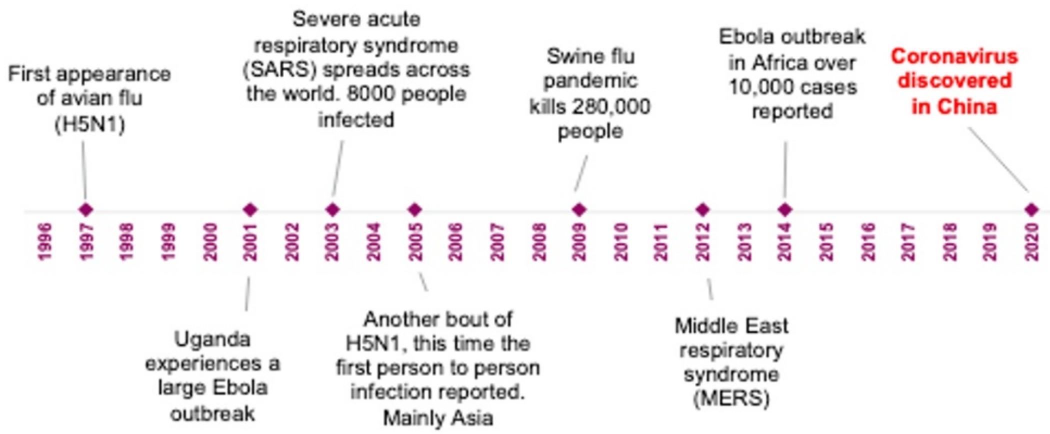
But this was no script. It actually happened, and the chart below shows the impact of the Ebola epidemic on the S&P 500. The index fell 7.4% as Ebola made its way from Dallas to NYC. However, as the story matured from contagion to containment, the market recovered almost as fast as it had fallen. It was as if investors shifted from “imminent zombie apocalypse” to “no big deal” overnight.

Past market reactions and subsequent rebounds may not be indicative of future results. Indexes are not available for direct investment.

Ebola was not the first pandemic to spook investors, nor would it be the last. Just last week, the Coronavirus emerged from a seafood market in Wuhan (one of China’s largest cities). Since then, the total number of cases has exceeded 7,900 worldwide with 170 deaths in China[2].

It appears that the virus causes only minor symptoms (fever, difficulty breathing, etc.) in people who are young and healthy. Most of the deaths have been in victims over 50 years old with underlying medical problems or weakened immune systems[3]. Some medical experts are even likening it to the flu. But the fact remains that it is still too early to tell how this will play out.

The timeline below charts some of the more infamous pandemics since the 1990s. In each case leading up to the Coronavirus, the stock market not only came under extreme pressure, but also recovered swiftly once the epidemic had been contained.



Source: https://www.richardsongmp.com/docs/default-source/market-ethos/market-ethos---pandemics---27-jan-2020.pdf

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China appears to be taking a much different approach to the Coronavirus than prior epidemics. Rather than keep the rest of the world in the dark, Chinese officials were proactive in sharing information with health care personnel across the world. This is expected to help contain the outbreak.

Admittedly, this will provide little comfort to investors if the market continues to sell off. If it does, keep in mind that the most recent drawdown always seems to feel worse than ones from the past. But the reality is that most look and feel the same.

They are also forgotten quickly unless something is done to make the pain linger. Think back to the end of 2018. Most of us probably don't recall the anguish of watching the S&P 500 tumble close to 20% in a few weeks. However, ask this question to someone who sold into the panic and you will likely get a different answer.

Tougher Than It Seems

Where's Waldo is a children's puzzle book series consisting of detailed illustrations depicting dozens or more people doing a variety of amusing things at a given location. Readers are challenged to find a character named Waldo hidden in the group.

Finding Waldo often takes a lot longer than most would care to admit. The reason being that Waldo is nearly identical to the other characters in an illustration. It's a needle and haystack challenge like none other.

That being said, let's play our own version of Where's Waldo. Take a look at the chart below depicting the S&P 500 from January 2008 – December 2019. Try to find the Ebola pandemic that was so obvious in the prior chart. It's practically impossible.

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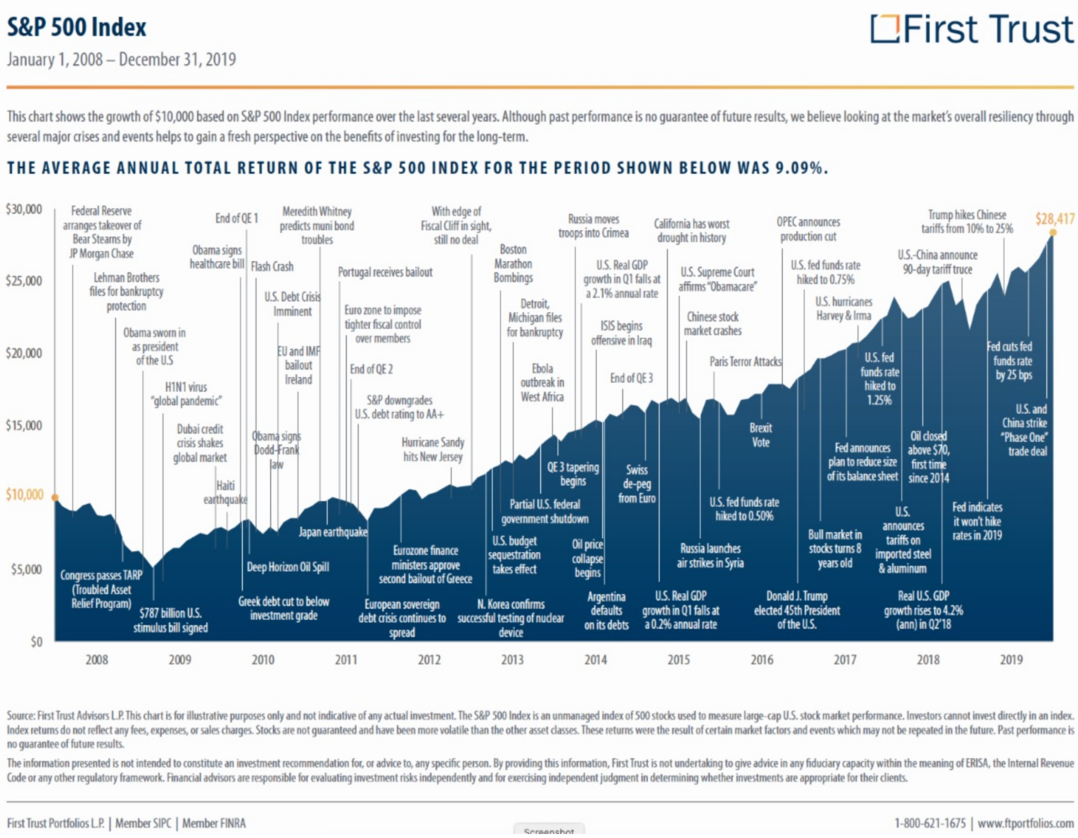
When we take a step back and look at performance over a longer time period, two things happen. First, it becomes a lot harder to distinguish the Ebola epidemic from any of the other events that caused the market to panic (Brexit, Argentina default, Taper Tantrum, Hurricane Sandy, Paris terrorist attacks, Russia/Crimea, ISIS, etc.).

Second, the size of the drawdown is put into context. While a 7.4% decline looks scary over a few weeks, it is barely noticeable over several years.

That's the thing about stocks. The erratic ups and downs fade over time. What was once worrisome becomes insignificant as the catalysts for the panic become old news. Said another way, finding Waldo also gets harder over time.

The Bottom Line

The chart below illustrates that a $10,000 investment in the S&P 500 on January 1, 2008 would have grown to over $28,400 by December 31, 2019. Almost tripling your money in 12 years is not too shabby. It also highlights what an investor would have had to endure along the way, which was a lot more than Ebola (it's in the middle just in case you still can't find Waldo).



Past market reactions and subsequent rebounds may not be indicative of future results. Indexes are not available for direct investment.

Keeping it together through tough times is the price we must pay to achieve returns like these. To help strengthen your resolve, commit the following to memory.

Volatility is a measure of the short-term movements in stock prices. The day-to-day ups and downs are mostly fueled by emotional reactions to events like the ones listed in this chart. Therefore, volatility is mostly a measure of emotion.

Meaning, when the stock market gets volatile, it is really just getting emotional, and emotions alone cannot derail a $20 trillion economy. It just doesn't work like that, which is why a strong stomach and patience have historically been rewarded.

Lastly, some believe that the answer lies in timing markets – sell right before the drawdown occurs and then buy back once it is over. The problem is that timing a drawdown requires a trader to be right twice (getting out and then back in). Few get lucky twice on the same trade. Furthermore, drawdowns are temporary whereas poor timing can permanently alter your financial future. Why risk long-term misery just to avoid short-term pain?

The bottom line is that there is no free lunch, and the price for equity returns is becoming comfortable with uncomfortable investments. In regard to this most recent scare, anything short of a full-blown zombie apocalypse will probably be forgotten just as fast as prior pandemics.

Sources

1 https://www.afro.who.int/health-topics/ebola-virus-disease

2 https://www.cnbc.com/2020/01/30/coronavirus-latest-updates.html

3 https://www.latimes.com/science/story/2020-01-24/china-coronavirus-panic

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If you have any questions, please contact us at

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