



**February 28, 2020**

**What I think about the market**

A pull-back was expected. A 10% pullback is likely to happen at any time for almost any reason. The likelihood of a pull-back tends to go up with valuations and we were above the historic averages of most metrics. The pull-back itself has been reasonable but the speed of the pull-back has been shocking. We build portfolios to withstand this type of shock and I fully expect things to normalize sooner rather than later but there will be more white-knuckle days before we get through this. We are long-term investors with well-built portfolios being distracted by short-term volatility.

**Information on the current coronavirus (COVID-19) and historical information of recent epidemics and pandemics**

We build portfolios to withstand volatility and turmoil but that never alleviates that anxiety when bad news shows up on your doorstep. The coronavirus(COVID-19) is serious and I don't mean to downplay it but I would also like to take a moment to peel away the hype that the media is piling on the story.

The fact is that the data that we currently have is spotty at best. The Chinese are horrible about relaying accurate data. It doesn't matter whether it is current GDP data or Coronavirus data. They tried to hide it and then downplayed the severity of their situation. Now that it has spread to other countries, we are starting to get a better idea of the scale of the problem. Countries around the world are being proactive about containing it in an aggressive manner. New cases seem to have peaked in China, if the data can be trusted; and the acceleration of new cases around the world should start to slow given the active response by most countries.

Gilead Sciences' drug Remdesivir is showing real promise in the treatment of the coronavirus. Clinical trials are being expanded to other countries and it can be produced quickly enough once the results are proven. The coronavirus uses a spike protein to invade and attach to human cells. The spike protein has been identified, mapped and sent out to research labs around the world to work on developing a vaccine. It looks like the spike protein itself may be an effective vaccine but the research isn't complete. There has never been a time in history to compare our current ability to break-down the DNA and atomic structure of a virus or pathogen. The speed of this analysis should dramatically reduce the time it takes to develop a vaccine. I don't expect one next week but if we have the ability to reduce transmission and treat those that get sick, we have to tools to reduce the impact on society and reduce the economic impact.

**2020 Coronavirus (COVID-19)** - Currently there are 84,000 infected with 2,869 deaths. This equates to a 3.5% mortality rate.

**2019-2020 Flu outbreak** - At the end of January, the CDC had confirmed just over 13 million cases of the flu in the United States resulting in 6,600 deaths.

**The SARS outbreak of 2004** - SARS originated in China and was also a coronavirus. Depending on the country the mortality rate ranged from 7%-22%. 774 deaths worldwide from 8,100 cases 9.6% mortality rate

**Swine Flu (H1N1)** - The virus normally doesn't affect humans but there was a pandemic in 2009-2010. It was deemed a pandemic in June 2009 and was declared over August 2010. The CDC estimates that it infected 61 million people and resulted in 12,469 US deaths and 575,400 global deaths.

**Ebola Outbreak 2014-2016** - Ebola had a 74% mortality rate among confirmed cases and a 40% mortality rate among suspected, probable and confirmed cases. Ebola was the headline for months and resulted in 11,325 total deaths and 2 U.S deaths.

If current news coverage is any indication, we were on the verge of the apocalypse. This epidemic/pandemic will result in some sort of economic slowdown and some of the activity will be lost forever but some of the economic activity will be shifted to later. If you planned on going out to eat but didn't because you were sick, you don't double up on going out after you are better. If you planned on buying a new phone but didn't in January because you were sick, you will most likely buy it when you get better.

### **Market Analysis**

The markets finished 2019 making new highs and trading at higher multiples. As I mentioned in the year-end letter, this growth came from multiple expansion and not earnings growth. Q4 2019 earnings aren't in yet but we fully expect a slight drop in earnings from 2018 to 2019. This is why I was not looking for a strong 2020. Given global market forces and a probable acceleration of growth in the United States in the second half of the year, we had most likely received most of our returns in 2019. The coronavirus has changed the math on this a bit. Instead of coasting with little to no returns in a flat-line, the markets have given back around 10% of 2019's gains and made valuations more attractive.

There will be economies around the world that go into a recession as a result of the coronavirus but they were already having problems. The United States, given the information that we have

now, will most likely avoid a recession. The economy is growing and more people are working. Worker's wages are going up and confidence was getting stronger. I realize that I sound like a broken record at times but your portfolios are built to handle these types of surprises. Your portfolios hold great companies with strong financials and coronavirus is a short-term issue that doesn't change our long-term outlook. We don't measure performance from a market top to the most recent bottom. As of 02/27/2020 the S&P500 averaged 12.6%/year over the last 10 years and 9.3%/year over the last 5 years.

I am confident that we will move through this as we have other scares in the past. Recessions are normally born out of systemic break-downs. Systemic issues tend to build over time like the financial crises or the dot.com bubble. Pandemics are more of a demand shock. They can be violent and scary but we will move past them a little beaten up but they don't alter the long-term outlook.

I realize that the last week has been scary. It doesn't matter how many corrections, bear markets or recessions that you go through, the most recent is always the scariest and it always feels different from the last. The speed of this event was unsettling but I am confident that the markets will calm down over the next few days as we get better information on the coronavirus and as we realize that there a number of great companies that are now trading at reasonable prices and offering real value to investors.

Regards,

A handwritten signature in black ink, appearing to read "Rick Sanford, II". The signature is fluid and cursive, with a large, sweeping flourish at the end.

Richard L. "Rick" Sanford, II  
President / Portfolio Manager