Crisis Playbook—The Fear of Loss and Regret

Approaching the challenges and potential opportunities of market volatility.

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Risk happens. Global equity markets entered 2020 in a state of Goldilocks—low interest rates and bottoming short-cycle economic indicators. Markets were heavily focused on the Trump administration's election "put" and China's focus on economic stability heading into 2021. This benign environment drove markets and multiples higher.

Then the butterfly flapped its wings and we found ourselves with COVID-19, the novel coronavirus.

COVID-19 introduced a risk poorly handled by monetary policy, the world's preferred tool for economic stability. A supply shock has spread outward from China along with the virus.

The virus appears to be very contagious but relatively mild compared with others, such as Ebola and MERS, but pandemic means suffering and death and must be urgently addressed. The immediate control of COVID-19 is particularly complex in that many of its victims are either not sick or not so seriously sick that they can be identified and isolated quickly. A more virulent virus—one that made most people extremely sick (like MERS or even SARS)—might be easier to control. Therefore, it seems logical that a virus with these characteristics could spread far and wide. At the same time, it seems that COVID-19 is not a mortal threat to most people. Obviously, this is conjecture given I am no expert in virology or public health. So we are continuing to track the development of this crisis, learning and evolving our thinking as the situation unfolds.

Regardless, a virus that is novel and spreads far and wide means panic as well as volatility in asset prices as unexpected risks present themselves. We are tasked with managing a global equity fund given these circumstances, and in moments such as this, I am incredibly grateful for our global research resources. It is a luxury to have a network of industry experts around the world working with you.

Our first task is to act early. We moved to raise some cash from more risky parts of the fund as the virus began to leave China and present itself in Europe. This will allow us to redeploy into our best

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potential opportunities as they present themselves. We have already added to our financial market exchanges and utilities exposure, which should be more robust amid rising volatility. We have also reduced our stock-level exposure to interest rate-sensitive stocks.

While acting swiftly amid the panic is important, the window to panic itself is usually short-lived before prices reflect the situation and head toward extremes. We are clearly closer to extremes now versus a month ago, to state the obvious.

We are looking to understand and evaluate the risk that the global reaction to the virus could cause a credit event. Collapsing oil prices and parked airplanes will have cash flow and balance sheet implications. Credit events are what cause real damage to equity investors over the medium term, and we are working with our equity and fixed income analysts and portfolio managers to assess and track these risks.

This is the time to use our imagination and think about what the world will look like in a year. Will we all be in quarantines, will air travel cease, and will we be undertaking all our meetings via videoconferencing? This is an extreme and unlikely possibility. In short, we do not think that the world has entered a new paradigm where we do not travel and meet others, although the market has the ability to price in this fear. Travel and meetings will be significantly down over the next six or so months, as will economic activity.

We are spending our time identifying opportunities in high-quality, value-creating stocks via our research platform. We have asked all our analysts to focus on those two to three ideas that they think will create the most economic value midterm and long term for our clients. Providing the best vehicle for our clients to turn a crisis into potentially strong returns requires a balancing act of risk and return as well as the patience to time our decisions.

Regardless of today's uncertain environment, we believe that the right thing to do is to invest in our best ideas, embracing the reality that this requires difficult choices. The fear of loss is great and can lead to bad decisions. The fear of future regret is something that is harder for people to master. What will you regret in the future? This is true in life and in investing. What I have experienced over the long term is that investors regret not buying great assets in times of crisis. In the short term, anything can happen, but history tells us that in the long term, if we focus on great assets on the right side of change, we should be able to serve our clients well.

The virus has disrupted the likelihood of modest economic acceleration in the first half of 2020 that we had expected. However, we also believe that given the level of global liquidity and likely policy response, there is a good chance that economic acceleration is only delayed rather than canceled. On the other side of the virus outbreak could be a significant rebound in activity. We want to be cautiously optimistic about this scenario. We are using our resources and our investment framework to do our best to make good decisions for our clients, balancing risk and return, and the fear of loss versus regret.

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