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PANIC-20

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Dear Kopion Clients,

I wanted to share my thoughts on the Coronavirus, its economic impact, and the related panic that is underway in the stock market. We have been following these developments for about a month now, and there is quite a bit that I could discuss. The purpose of this letter, however, is not to provide you with analysis, but rather to offer perspective and encouragement. I will thus keep my comments relatively brief.

From all we have read and heard, COVID-19 is similar to the flu except that it is a new illness, which means that no one is immune to it. This makes it easier for the virus to spread. From a public health standpoint, the risk is thus that a large percentage of the population could contract the illness, which would overwhelm healthcare systems' ability to treat them. Conceptually, in a worst-case scenario, the number of fatalities would remain small as a percent of the world's population, but on an absolute basis, they could reach into the millions. World leaders of all types (government, business, education, and religious) are taking decisive steps to avoid that scenario by redirecting or postponing many activities in order to minimize the spread of the illness. The stock market has taken these and related developments extremely poorly and entered a bona-fide panic. By one measure, the steepness of the market's current dive is near record levels, second only to its sharpest decline during the Great Depression.[1] This is a staggering market response within the context of what is actually happening in the real world.

Despite the hysteria around the Coronavirus, the fatality rate appears to be low, at just 1-2% or lower, and some people seem to be contracting COVID-19 without displaying significant symptoms.[2] The majority of the economic impact is thus not coming from the illness itself but the actions being taken to prevent its spread such as travel bans, event cancelations, and self-quarantining.

[1] Otani, Akane and Karen Langley, *Dow's 11-Year Bull Market Ends*, The Wall Street Journal, March 12, 2020.
[2] McKay, Betsy, *Coronavirus vs. Flu: Which Virus is Deadlier?*, The Wall Street Journal, online version: updated March 10, 2020.

The key questions are thus:

1. How deeply will this "hunkering down" disrupt economic activity, and
2. For how long?

No one knows the answers to those questions, but I am encouraged that:

A. Much activity is adapting as opposed to grinding to a halt (i.e. working from home).
B. The economy was relatively strong going into the Coronavirus. This is a much more favorable setup than a shock like the 9-11 terrorist attacks, which added further downward momentum to a recession that was already underway.
C. After the virus has been contained, economic activity will probably be able to spring back relatively quickly. That stands in contrast to events like a financial crisis where the underlying causes can linger for years and make the recovery much more gradual.
D. Key governments appear ready to prevent a significant economic collapse.
E. The containment measures that are dampening activity for the moment will ensure that the worst-case public health scenario is avoided, which will also prevent some of the more negative economic scenarios.

The stock market is now well into bear market territory, and our portfolio has been pummeled along with everything else. The sell-off has been breathtaking in its speed and breadth. As one friend put it, "Fear is even more contagious than the virus itself." One glaring example of the amount of anxiety in the market is the yield on 10 Year U.S. Treasury Notes, which have fallen below 0.9%. This means that some investors are choosing the guarantee of safety in exchange for earning just 0.9% annually for ten years! Inflation is usually about 2%, so they will almost certainly lose money after inflation. The degree of foreboding is that intense. Our stocks are currently being valued in a way that assumes their earnings will be very weak for a few years (i.e. a downturn that is deep and long). Such an outcome is technically possible, but for the reasons that I outlined above, I believe it to be unlikely. I am thus hopeful that things will look much better a year from now—possibly even sooner. Furthermore, after the dust settles, today's prices are likely to look like amazing bargains, and this makes it even more important to stay the course. Hang in there everybody!

Best regards,

Terry Ledbetter, Jr., CFA