

Special Edition

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~Special Edition: Market Commentary on COVID-19~

COVID-19 fears have recently weighed heavily on market performance and the rapid spread of the virus is a stark reminder that unexpected events can occur at any time. However, we expect these types of corrections and volatility in the market as a normal occurrence despite the catalyst for the correction being generally beyond what is normally expected. The ability to predict these events or future outcomes is one that is left to a crystal ball reading, not long term investment strategy. **Even during years with outstanding equity returns, there is volatility in the market: historical analysis shows that pullbacks of 5% have occurred about once per quarter and declines of 10% are likely to occur once per year. Large pullbacks greater than 20% tend to occur once per market cycle (on average every three years).**

We do not know at this time if the current outbreak of COVID-19 will morph into a true pandemic. Although we are inclined to lean on the side of optimism, the truth is that neither we nor anyone else knows what the likelihood of a pandemic scenario would include. COVID-19's true fatality rate remains highly uncertain, therefore all we can do is run through various scenarios to figure out the likely market impact. Before the virus outbreak, global economic indicators were either stabilizing or picking up at the start of the year. **The decline in equity prices thus far reflects the fear that a wider outbreak will significantly impact global GDP growth, yet macroeconomic forecasts at this time still call for a moderate impact based on the lost output from factory closures and supply chain disruption in China.** If the containment measures in China are lifted in the coming weeks, the plunge in business activity will be succeeded by a rather sharp snap-back due to pent-up demand. The output that was lost during this quarter will be made up and global growth will continue its recovery this year. **Estimates of reduced Chinese growth to 3% would reduce global GDP growth by 0.4% to an estimate of 2.5%.¹ In this scenario, global GDP will be modestly impacted.**

It is impossible to predict how far the virus will spread or how severe it will become in countries outside of China. If the disruption further spreads to economies outside of China, the effects of how the virus may play out and the impact on global supply chains are complex to determine. Since the start of US-China trade negotiations, the focus on large and complicated supply chains has been mainly in terms of policy and technology. The COVID-19 outbreak has highlighted another level of uncertainty in the global supply chain link in which factory closures in China may result in a shortage of component parts within the network. So far, the disruption to production outside of Asia has only occurred in specific manufacturers (autos in particular). **In the event of an escalating crisis, COVID-19 may become exceedingly disruptive to economic activity. The only consolation is that the recovery would likely be "V-shaped" versus a sluggish "U-shaped" recovery since global growth had already turned the corner in the weeks before the viral outbreak. Pent-up demand combined with a lack of imbalances to work off, compared to the last recession (i.e. when the excess supply of newly built homes was combined with the need for households to reduce debt), would fuel the sharp recovery in growth.**

The fundamentals of companies that we invest in are determined by focusing on the long-term outlook over future periods. **Although it is likely the disruption to supply chains in China will have an impact on specific industries and companies in the near term, a decision to sell companies from your portfolio based on COVID-19 fears would not be a prudent investment decision.** We continue to recommend staying the course; maintaining a diversified portfolio based on your long-term investment objective is a stronger strategy than trying to time the market.

¹ Capital Economics: Global Economics Update, The possible economic fallout of a global pandemic, 2/26/2020