DELTA ASSET MANAGEMENT

PERSPECTIVE

While cancellations and postponements of public activities and curtailment of leisure and business travel may slow the coronavirus, it is taking its toll on consumer spending and general economic activity. These restrictions will force exposed businesses to curtail operations, lay off workers and possibly strain to service debts. The coronavirus shock has raised the specter of a recession for the first half of this year. Economists at JPMorgan Chase expect output to fall by an annual rate of 2% in the first quarter and another 3% in the second quarter. The reality is that the necessary steps to slow and/or contain the virus restricts economic activity and dampens consumer confidence.

Central banks, the Treasury and Congress have an array of tools to soften the impact. Although interest rates are near or below zero with not much bandwidth for further cuts, low yields will help national governments borrow to expand their fiscal stimulus. The purpose is to offset as much contraction in demand as possible. As of this writing the Fed added $500 billion to each of its one-month and three-month repurchase operations, is committed to buying $700 billion in Treasury bonds and mortgage-backed securities, on top of additional funding for overnight and two-week repos. This addition is a substantial injection in short-term liquidity. The Fed has also promised significant purchases of longer-term maturities across the yield curve, which in effect is a reintroduction of Quantitative Easing, a tool where the Fed purchases bonds with cash providing banks with additional money supply to make loans.

The high degree of volatility in the market sparked by the pandemic is accentuated by computer-driven trading algorithms that are used by some institutional investors. Algorithms are complex math equations used to program computers to make trading decisions. When triggered by news events or abnormal volume, algorithmic trading can escalate and worsen a stock market sell off or accelerate a market rally. This type of trading removes human analysis and trades are executed based on pre-determined factors. It is estimated that algorithmic trading can account for up to 70% of U.S. trading volume.

During times of heightened volatility in the stock market, maintaining context is critical. It is important to adhere to long-term investing goals since markets eventually recover as crises peak and subside. Banks have significantly more capital than at the beginning of the 2008-2009 crisis. The Fed is injecting substantial liquidity into the economy and has acted early in this crisis. Congress is working on a stimulus package, and the Administration is coordinating and partnering with the private sector on an array of initiatives to help workers with out-of-pocket costs and supplemental sick leave benefits. Low interest rates and energy prices are likely to continue for an extended period and essentially serve as a stimulus for the global economy.

The coronavirus is clearly a serious threat given its unique characteristics of ease in transmission and its durability. Studies at the time of this writing indicate that the virus can remain in the air for up to three hours and live on surfaces such as plastic and stainless steel for up to three days. The upside is that multiple labs around the world are working diligently on a vaccine. In February, the World Health Organization estimated it would take 18 months to develop a vaccine, yet progress is already being made. Several Phase I clinical trials are underway in the U.S. and internationally.

At Delta, we are monitoring all of our companies and looking for entry points to add to our positions where the current market value is significantly below the long-term intrinsic value. The indiscriminate sell-off in the market allows us a rare opportunity to add new names to the portfolio that have previously been unattainable because of high market valuations. This is not a typical “buy the dip” pullback. It is early in assessing the impact to the economy, and uncertainty by investors may lead to a period of continued volatility. Lower rates can boost consumer sentiment and ease borrowing costs but will not prevent the novel virus from spreading nor repair broken supply chains. The dislocation of the market may be longer than 9-11, Sandy or Katrina. However, the equity markets have always recovered and historically provided returns in excess of inflation. Whatever the length or scope of the downturn, we will continue to focus on companies with enduring businesses and competitive advantages led by seasoned management teams that fared well in previous downturns and provide attractive returns to shareholders who have similarly stayed the course.

Dated: March 15, 2020