WILDE CAPITAL MANAGEMENT

PORTFOLIO UPDATE – FEBRUARY 26, 2020

COVID-19, popularly and generically referred to as “the (novel) coronavirus” has become that X factor we look for that comes from outside the markets and the normal news cycle to disrupt the status quo. While issues we have previously discussed like Brexit, the Hong Kong protests, and Iranian conflict are meaningful, markets generally take them in stride and try to price the risk. It may result in days or weeks of volatility, but eventually investors settle on how to value it. COVID-19, like Zika and SARS before it, is different. Brexit or HK are the product of people making active decisions. They may be decisions with adverse outcomes, but they are understandable, observable, and follow some kind of reasoning, whether or not we agree with it. Something like this virus introduces another dimension of uncertainty, because for now, we do not fully grasp the impact it will have on global health. So, even though we can observe and predict human decisions on how they are likely to respond to set information, the responses are and will continue to be dynamic based on the emerging understanding of and consequences of the virus.

We are not doctors, nor do we play them on TV, but we have been closely following not just the news cycle, but the output of expert organizations tasked with addressing this challenge. Indications continue to be that it is more easily spread than SARS and the bird flu, but the health impact appears to be less for healthy populations and the fatality rate lower for at-risk individuals, although most definitely and regrettably not zero. That does not mean this is something we take lightly either as investors or as global citizens. But it does help us chart a path forward. In the near term, the containment efforts are aggressive and the impact on society and commerce severe. As we have seen in China and now in South Korea, this has had an enormous impact on daily life and stopped business more or less in its tracks. The latest round of market reactions was triggered by a cluster of cases in Italy, which brings developed Europe into play. Emerging clusters in other areas like Iran suggest that with China as the vector, anywhere globally they have engagement and influence is a likely launch point for more cases. Inevitably this will lead to spread in parts of the world that either do not have the autocratic control of China or the health care infrastructure of Italy or Japan to address them, and we could see this accelerate to a global pandemic.

But, as counterintuitive as it sounds, from the investor’s perspective this may not be the worst thing. The economic damage being done is mostly from the preventative measures being taken to slow or stop the spread of the virus. Public transit is halted, air travel grounded, borders closed, events canceled, factories shut down, etc. If we find ourselves at a moment where these measures no longer restrain the spread of the illness, the focus will shift to healthcare and hygiene, as with seasonal flu and other communicable illnesses, and business ought to return to some semblance of normal. But in the near term, we are observing the volatility that comes with uncertainty, and also expect some degree of repricing as global economies absorb the consequences of lower activity. It is also not out of the realm of the possible that central banks will follow China’s lead and intervene to keep the economic engines running.

Against this backdrop we took the step of lowering our commitment from an equity overweight to ‘neutral’, which is to say we own global equities in roughly the same proportions as our benchmarks. We sold primarily US large cap equity through various mutual funds and ETFs depending on the model in order to achieve this. The proceeds were committed to the safe harbor of cash instruments while we evaluate conditions and markets further. As always, we are continuously assessing changing conditions both for the better and the worse and will act appropriately on those insights.

WILDE CAPITAL MANAGEMENT, 60 MORRIS TURNPIKE, SUMMIT, NEW JERSEY, 07901 (866) 894-5332
WWW.WILDECAPITALMGMT.COM CONTACT@WILDECAPITALMGMT.COM

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