FIORI FINANCIAL GROUP

February 2020

FFG Market Pulse

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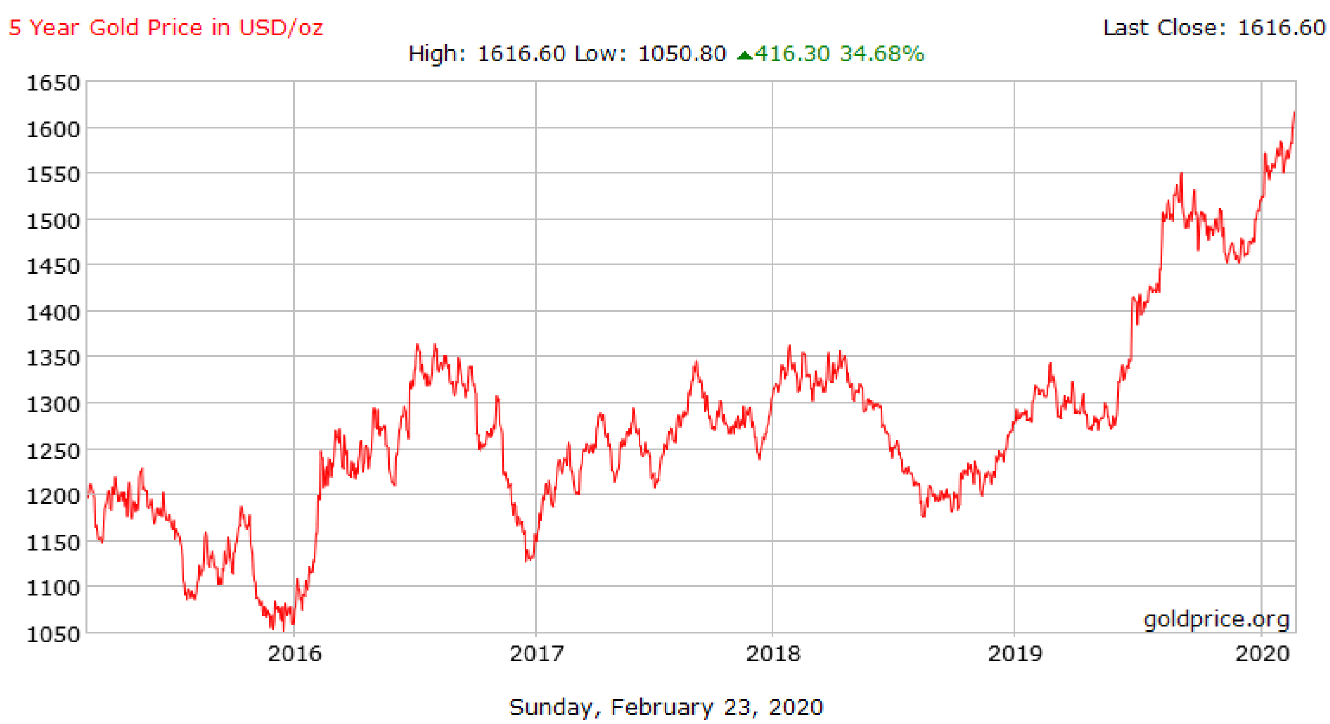
We entered 2019 last year at this time with the S&P nearly in a bear market territory after a dramatic 4Q18 selloff. What a difference a year makes! Markets came back at near all-time highs after a strong rebound year in 2019 but now have started to run into the unknown of the Coronavirus that started in China. We opined last year at this time the markets were pricing in some sort of imminent recession that we did not feel was warranted given the underlying economic data. This tuned out to be the correct 2019 philosophy. Last year was dominated by trade rhetoric headlines and Federal reserve actions which we spoke about at depth in multiple past issue of the Market Pulse. The US consumer was unfazed and stayed very strong throughout the year. The Phase One trade deal was signed late in 2019 and the Federal Reserve after 3 "insurance cuts" seems to be poised to be on the sidelines for the short term. The 2 biggest headline risk from 2019 have now been put towards the backburner for at least the time being. So the question posed is what is in store for 2020?

Let's first tackle the topic of the recent Coronavirus. This is a classic black swan type of event that is basically impossible to predict prior to it taking place. As of this writing the total confirmed cases are about 80,000 with at least 2600 deaths. These numbers have recently exceeded the SARS epidemic back in 2003. Most of those cases or about 99% them and most deaths have taken place in China. Of those 99% of cases most of those have been centralized in the Province of Hubei and particularly the city of Wuhan. In that province, the fatality rate is between 2-4% of those who contract it (As a comparison, SARS was 10%, MERS over 30% & Ebola was over 70%). Elsewhere around the world the fatality rate is about 0.6%. The spread of the actual disease worldwide has been relatively contained up until this point however there have been cases that have started to pop up particularly in South Korea and Italy. This has been the cause of much of the downward market movement in the past 24 hours. The chance of it coming over to the US in droves is relatively low which is good news. However, the bad news is much of China remains shut down. They basically have been shut down since their Lunar New year which was in January. There will absolutely be some sort of slow down effect felt in the Chinese economy which is the second largest economy in the world. Depending on how long the disease keeps people quarantined and at home will ultimately determine the severity of the slow down. Global supply chains are also very complex and many of them run through China. There will be some spill over effect on companies who are heavily reliant on that supply chain. This probably means at least one quarter or 2 of negative effect on those companies' earnings along with a temporary slowdown in global growth. Basically, up until late last week the market has pretty much shrugged off this risk. However, that has changed over the past couple of days. As we get into 1^{st} and 2^{nd} quarter earnings season there will be hard numbers to substantiate the slowdown in global growth. It remains to be seen if this type of virus will react like a seasonal virus like inluenza that has most cases in the wintertime and then fades out as weather gets warmer in spring and summer. Much about the disease remains a relative unknown and is impossible to predict the degree the severity. Because of this we felt it was prudent to keep our hedges in place and in fact have increased them in recent days. Gold, Cash and Convertible Bonds can be used in hedging strategies. The market was definitely overextended as we got into the second month of 2020 so the virus news very much corresponds with overall profit taking. From a portfolio construction standpoint, this is the reason why we have hedges in the portfolio to help mitigate volatility and more importantly to have "dry powder" on the sidelines to eventually take advantage of opportunity. Ultimately the virus should prove to be transitory and, by itself, should not end this bull run. However, it will take time to work through the global economy. This is something we will be constantly evaluating as we go through the first half of the year.

This disease is a terrible event for lives affected and lost to go along with the slowdown in global growth. Although as we work our way through the next few months of 2020, the longer term headline risk should come from political situation in the US and then also if there will be any Federal Reserve action. We are now getting deeper into the Democratic campaign to see who will go toe to toe with Donald Trump come November. Things are slowly shaping up as it appears Bernie Sanders has scored some early victories and carries momentum going into Super Tuesday. The large cluster behind him between Joe Biden, Pete Buttigieg, Elizabeth Sanders and now Michael Bloomberg will have to see if they can catch up. There has been some trepidation from market pundits regarding a candidate from the very far left winning the election. The market so far hasn't really priced in a real possibility of a Democratic win. In fact, some on Wall Street view it as if Sanders were to win the Democratic nomination then it solidifies the case of a Trump re-election. This idea along with the price action of the market as Sanders scored some early victories supported this theory.

We also have Federal Reserve policy is expected to remain on hold until we get a material change in the economic outlook. The unemployment rate fell to a 50-year low. The main economic risk is that the factors that have restrained capital spending will worsen, leading to reduced hiring and increased layoffs, but there are currently few signs of a deterioration in labor market conditions. The Fed has indicated that they will probably remain on the sidelines however that could change at any time.

<u>CHART(S) OF THE MONTH</u>



Gold prices have reached multi year highs so it has acted as a classic hedge recently.

RODNEY DANGERFIELD ONE LINER OF THE MONTH

"I'll tell ya, when I was a kid, my old man never liked me. He took me to the zoo. He told me to go over to the leopard and play connect the dots."