

INVESTOR'S EDGE

Keep calm and carry on during market turmoil caused by virus

Four suggestions to help keep your portfolio healthy

"The key to making money in stocks is to not get scared out of them." — Peter Lynch

Jim Burns CFA *Guest columnist*



The recent global outbreak of coronavirus has many local investors concerned about a major market decline. Indeed, as I write this, the Dow Jones Industrial Average is down over 2,000 points in three trading sessions — wiping out its impressive early gains for 2020. While the coronavirus has been in the news since Jan. 7, the tipping point came last weekend when Italy reported an outbreak of cases. This implies that the coronavirus is not just confined to China (and the rest of Asia). In fact, as of Wednesday, the coronavirus has spread to every continent except Antarctica.

My first response is that investors should strive to be steady and not speculate on short-term outcomes. The truth is, the market is responding in a very rational way. 2020 earnings expectations for S&P 500 companies were in the range of 9 to 12% growth. With the outbreak of the coronavirus and the corresponding negative economic impact, earnings expectations are already coming down and the broad stock market is repricing accordingly.

I believe investors should not be surprised. The S&P 500 was up over 30% last year and over 5% to start the year by mid-February. That level of straight, upward momentum will eventually correct, and the spread of coronavirus has been the triggering event. Furthermore, as I stated in January's column, readers should expect heightened volatility in stocks after the

smooth, powerful returns of 2019.

Like everyone else, I don't know anything more about the coronavirus than what is on the news. Generally, I agree with Warren Buffet's comments last weekend when he said that something besides the coronavirus will probably be front and center for investors six months from now. Time will tell.

Nevertheless, below are four suggestions that can help your portfolio maintain its health during sick times.

Remember the “durable defensives” — the base of your portfolio: I have always invested on the basis that high-quality, durable and dividend-paying stocks should represent the base of my client's portfolios. These include companies that I have highlighted in this column such as Pepsi, Proctor & Gamble, Johnson & Johnson, Coca-Cola, Waste Management, Verizon, among others. Historically, during market declines these U.S.-based dividend achievers have held up quite a bit better than the overall market.

Watch your allocation in international stocks: Throughout this bull market, international stocks have significantly underperformed U.S. equities. While this trend will change at some point, keep in mind that many international companies are generally more exposed to China's economy than U.S. businesses, and their earnings power will likely decline at higher levels. Furthermore, the U.S. economy has been growing faster than international economies and U.S. assets are generally considered a safe haven when unexpected turmoil erupts.

While exposure to international stocks makes sense from a diversification standpoint, I would recommend capping your allocation to internationally based stocks to about 10% to 12% at this time.

Don't load up on bonds: When geopolitical or black swan events occur, it might be tempting to flee to bonds and bond funds. While fixed-income investments can certainly have a place in your portfolio — especially if you are in or nearing retirement — they don't always offer the protection investors think they do. In fact, with interest rates remarkably low in the United States and around the world (some countries even have negative rates), the current risk reward profile on bonds is no slam dunk. Currently, a 10-year treasury bond yields a paltry 1.31%, which likely won't even keep up with the rate of inflation. On the other hand, a stock like Pepsi yields 2.6%, and they will probably raise their dividend every year over the next decade!

Again, Warren Buffett stated last weekend that it is almost certain that stocks will perform far better than bonds if interest rates remain near current levels. So, I would not recommend making a major change to bonds on the basis of this coronavirus.

Don't underweight health care stocks: Health care stocks have historically been excellent defensive investments in volatile markets. That is because their earnings growth is generally stable as people require health care in good economic times and bad. Furthermore, health care stocks have lagged the market because of political concerns and, therefore, I believe represent a good buying opportunity for investors right now.

I also believe that large-scale systemic changes to our health care system are unlikely anytime soon (no matter who sits in the White House). As such, the U.S. health care industry will continue to produce medical innovations and treatments, and shareholders of these companies should be richly rewarded over the long term.

In closing, it is important to remember that stocks go down a lot faster than they go up, and that every correction or bear market has its own unique reasons for decline. This catches a lot of investors by surprise and can scare them out of their long-term investment plan.

My recommendation during this coronavirus outbreak is to keep your emotions in check, don't let your fever spike, and keep cool.

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