KARMIN CAPITAL

"Has the 10-Year Or 20-Year Outlook for American Businesses Changed in the Last 24 or 48 Hours?"

With yesterday's selloff, the S&P 500 experienced its 26th correction of 5% or more since the market hit its low in March of 2009.[1] As it felt in those previous times, fear is rampant and people are wondering how much lower the market could go. A 20% or more sell off has occurred only twice since the end of the Global Financial Crisis. Back in October 2011, threats of a European debt crisis scared investors causing an almost 22% drawdown. The 20% sell-off in December 2018 was a result of fears of a slowdown in the Chinese economy and rising interest rates.

Today, the continued spread of the coronavirus (also known as Covid-19) and its economic impact are spooking global investors, but this time yields on U.S. government bonds are approaching all-time lows.[2] The market is reacting as if the Fed will fight the virus and a slowing global economy with lowering interest rates. When the market sold off 20% in December 2018, the Federal Reserve Funds Rate for the end of 2020 was projected to be 3.125%; today that rate is expected to be 1%.

In the last few weeks markets rallied despite increasing infection numbers. Investors assumed that any impact from the virus would be short-lived, and central bank stimulus measures would soften the financial impact. Now with the virus proliferating outside China – in countries such as Italy, South Korea, Japan and Iran – and with the Chinese set to resume factory activity outside the epicenter in Hubei province, many fear that containment efforts are poised to fail.

Berkshire Hathaway Chairman and CEO Warren Buffet coincidentally appeared on CNBC yesterday. Buffett thinks investors should view their stock purchases as buying a company rather than buying a stock. From this perspective, Buffett asked a rhetorical question in light of the overnight sell-off:

"Has the 10 or 20-year outlook for American businesses changed in the last 24 or 48 hours?"[3]

In general, we don't think it has; however, there is a group of thought that the coronavirus has exposed the weakness of the global supply chains. Companies will react by repatriating supply chains (which the Trump administration has been pushing for) and keeping larger inventories on hand rather than the "just in time" inventory which began in the 1980s.

Outside of the impact of the coronavirus, the most significant domestic event during the past few days has been the emergence of Bernie Sanders as the leading Democratic nominee for president. A Sanders presidency with the potential of higher personal and corporate tax rates (and the fear of higher interest rates because of expanding social programs) might cause both domestic and international investors to take profits now at lower capital gains tax rates and higher share prices.

One lesson learned from Boeing's 737 Max issues is that for government officials there is little to gain from minimizing a problem and a lot to lose. As Louis Gave of Gavekal writes, Covid-19 is the first "social media pandemic – a scary disease made scarier by social media, fake news and the overreaction of governments compelled to be seen doing something."[4] For example, the Chinese government is using state-owned mobile carriers to use

Securities offered through Western International Securities, Inc. (Western), Member FINRA and SIPC, and Fidelity Brokerage Services LLC (Fidelity), Member NYSE, SIPC. Karmin Capital, a division of Fort Sheridan Advisors LLC, Western and Fidelity are separate and unaffiliated entities.

GPS to track people. Alibaba Group Holding Ltd. and Tencent Holdings Ltd. have developed an app that uses QR codes and assigns health ratings. People now have to show their codes for scanning at subway stations, malls and office buildings. According to Businessweek Magazine, individuals can be turned away if they're at high risk of carrying the virus.[5]

We think global political and business leaders will continue to err on the side of caution with their responses to the coronavirus. Shutting down all Chinese travel and business may seem a bit excessive, but far better safe than sorry. Eventually – and hopefully soon – the coronavirus will be a distant memory and a blip on the global economy and stock market performance. However, in the meantime, it is likely to remain a source of volatility.

We are obviously not epidemiologists, but short of this virus reaching a pandemic (meaning global contagion) we want to reiterate that the coronavirus is highly unlikely to have a lasting impact on the global economy or our portfolio companies. However, in the short term the economy and many companies we own may be negatively impacted. China plays a central role in global supply chains and commerce. With over 750 million people in China effectively under travel restrictions, Chinese businesses have ground to a halt. Recent estimates show that between 40-60% of the Chinese economy is shut down. Chinese preventative measures have already impacted U.S. firms such as Apple, McDonald's and Starbucks – all of which have closed their China retail locations. In Apple's case, the company has already announced that it won't meet its first quarter guidance.

We expect many more companies with sales and supply chain exposure to China to provide similar updates. These reports could lead to a "sell first, ask later" type of market environment, where the fear of the unknown causes investors to bail on certain stocks or the market in general. Particularly at-risk sectors include technology hardware and semiconductors, industrials, consumer goods, shipping, materials and energy, which has already experienced sharp selloffs in oil prices and related stocks over the last month. Recent estimates suggest that Chinese oil demand may have fallen by 4 million barrels per day, which is the equivalent of almost 4% of global demand. As the virus spreads into other regions and global travel slows, energy demand is bound to fall more in the near-term.

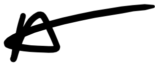
Stocks across the board are likely to remain volatile and under selling pressure if the coronavirus news continues getting worse. At the beginning of the month, prior to the market rally, we had received many inquiries whether this is a dip in the markets worth buying. While there may be interesting individual stock ideas based on oversold conditions (particularly ones without international exposure), we think that it is still too early to aggressively buy stocks across the board. In the short-term, we think that the downside risk (should news get worse) far outweighs the upside. For some companies, the recent selloff in share prices has been far greater than 5%. However, we would still encourage a patient approach for adding to severely beaten down stocks unless one takes a longer-term view. Picking a bottom in prices may be tempting, but the risk investors face is that the bottom may still be meaningfully lower. We are hopeful that global containment measures can stop the spread of this virus, but if infections grow exponentially around the world, there will be more selling to come. Thus, prior to initiating new investments in companies that have a global footprint, we would encourage waiting for coronavirus news to stabilize.

Securities offered through Western International Securities, Inc. (Western), Member FINRA and SIPC, and Fidelity Brokerage Services LLC (Fidelity), Member NYSE, SIPC. Karmin Capital, a division of Fort Sheridan Advisors LLC, Western and Fidelity are separate and unaffiliated entities.

For our current holdings, though, keep in mind Buffet's wisdom: the long-term outlook for business has not radically shifted overnight. Investors with an investment horizon longer than a few days, weeks or months should not panic from this latest selloff.

Please let us know if you would like to discuss the potential impact on your portfolio and where to look for opportunities should the selloff persist.

Sincerely,



Peter Karmin
Managing Member

Stuart Loren
Director

Citations and Disclosures

[1] Charlie Bilello of Compound Capital on Twitter (Feb. 24, 2020).
[2] Bloomberg (as of Feb 24, 2020). All market data in this letter is from Bloomberg unless otherwise cited.
[3] Warren Buffer CNBC Interview (Feb. 24, 2020).
[4] Gavekal Research (Feb. 25, 2020).
[5] Bloomberg Businessweek (Feb 17, 2020).

Investing involves risks, including the possible loss of principal and fluctuation of value. Past performance is no guarantee of future results.

This letter is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed are as of the date noted above and may change as subsequent conditions vary. The information and opinions contained in this letter are derived from proprietary and nonproprietary sources deemed by Karmin Capital to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by Karmin Capital, its principals, employees, agents or affiliates, or by Fort Sheridan Advisors LLC, its principals, employees, agents or affiliates. This post may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will materialize. Reliance upon information in this post is at the sole discretion of the reader.

Please consult with your Karmin Capital financial advisor to ensure that any contemplated transaction in any securities mentioned in this letter align with your overall investment goals, objectives and tolerance for risk. In addition, please note that Fort Sheridan Advisors LLC, through its wealth management division, Karmin Capital, including its principals, employees, agents, affiliates and advisory clients, may have positions in one or more of the securities discussed in this communication. Please note that Karmin Capital, including its principals, employees, agents, affiliates and advisory clients may take positions or effect transactions contrary to the views expressed in this communication based upon individual or firm circumstances. Any decision to effect transactions in the securities discussed within this communication should be balanced against the potential conflict of interest that Karmin Capital has by virtue of its investment in one or more of these securities.

Additional information about Fort Sheridan Advisors LLC is available in its current disclosure documents, Form ADV and Form ADV Part 2A Brochure, both which are available without charge by contacting Fort Sheridan toll-free at 866-559-9700. You may also request copies by email at info@fortllc.com, or access the documents online via the SEC's Investment Adviser Public Disclosure (IAPD) database at www.adviserinfo.sec.gov, using CRD# 151139 or SEC# 801-70517.

Karmin Capital neither provides investment banking services nor engages in principal or agency cross transactions. Karmin Capital is the wealth management division of Fort Sheridan Advisors LLC. All securities transactions are effected through Western International Securities, Inc. and Fidelity Brokerage Services LLC. Fort Sheridan Advisors LLC is not an affiliate of Western International Securities, Inc. or Fidelity Brokerage Services LLC.

Karmin Capital
600 Central Ave, Suite 365
Highland Park, IL 60035
(847) 559-9700
www.karmincapital.com

Securities offered through Western International Securities, Inc. (Western), Member FINRA and SIPC, and Fidelity Brokerage Services LLC (Fidelity), Member NYSE, SIPC. Karmin Capital, a division of Fort Sheridan Advisors LLC, Western and Fidelity are separate and unaffiliated entities.