Over the past week, we have witnessed the market make a rapid about-face from "COVID-19 doesn't matter", to "COVID-19 might matter a lot." This change of outlook has driven the market down ~11% on new fears of the coronavirus and its impact on global health and economies. The virus, which we were all unaware of a few months ago, represents a rare black swan event, now impacting world markets, economies, health care systems, government policymakers and individuals. While there is certainly plenty unknown about the virus and how it progresses from here, we would like to share some current thoughts.

- The economic impact of COVID-19 is likely to come primarily from efforts to stem its spread, rather than its direct health impact. Enacting quarantines prevents employees from getting to work and consumers out to shop. Large gatherings of people, whether entertainment events or schooling, could be cancelled. Even without quarantines, typical consumer avoidance behavior can lead to fewer restaurant visits, less travel, and decreased discretionary spending.
- The market has already begun reacting to the industries that will be most directly impacted by the virus. Over the past few weeks, airline, hotel, and casino stocks have seen their valuations decline much more dramatically than the overall market. Energy stocks have dropped sharply amidst expectations for less demand as economic activity is interrupted.
- The stock market was trading above its historical valuation level before it became evident that COVID-19 would spread beyond China's borders. The market continued to climb through the first month of COVID-19 spreading through China and Hong Kong and the news of their aggressive responses to the virus. The current market reaction appears to correct for some of the initial complacency. While sensational headlines and actual government responses will continue to move markets, it is clear the market has already discounted some weakness in first and second quarter earnings.
- While the near-term economic impact from the global spread of COVID-19 has the potential to be severe, it is also unlikely to be long-lived. Global efforts to pursue a treatment and vaccine for COVID-19 are being aggressively pursued by major pharmaceutical companies in partnership with the government. Combined with other efforts to stem the spread of COVID-19, that could make this a 3-6 month event, rather than a multi-year challenge.
- Economic activity and stock markets are likely to rebound quickly from any disruption caused by COVID-19. Equity markets are an asset class for the long-term, and COVID-19 is unlikely to impair the long-term earnings power of most companies. In fact, over the past 40 years the market has averaged a sell-off (from peak to trough) of nearly 14% each year, and yet it has posted an overall gain in 30 of those 40 years. These corrections often reflect fears about some specific occurrence, such as trade tariffs, the yield curve, or recession fears. In this case, the new coronavirus.

At this stage, investors will be weighing the negative impact to near-term earnings, against the long-term earnings potential for a business, against the decline already suffered by a given stock. We do not believe the long-term earnings potential for our portfolio companies will be meaningfully impaired by near-term disruptions caused by COVID-19, and remain optimistic about the potential of our future equity returns.