THE OUTLOOK

ARS INVESTMENT PARTNERS

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IN THIS ISSUE...

From Wuhan to Wall Street to Main Street:

How the Coronavirus Triggered the Stock Market Selloff and What it Means for Policymakers and Investors

Think of what is happening as a huge paradigm shift for economies, institutions and social norms and practices that, critically, are not wired for such a phenomenon. It requires us to understand the dynamics, not only to navigate them well but also to avoid behaviors that make the situation a lot worse."

– Mohamed El Erian

In just two short months, the world as we knew it has changed as a result of the worst global pandemic since the Spanish Flu in 1918. Coming into the year, we were positive on the outlook for the U.S. economy and the secular themes we have defined in previous Outlooks, a view that was confirmed by the positive economic numbers and the stock market returns through mid-February. However, we did not anticipate the outbreak of the Coronavirus (COVID-19) which started in Wuhan, China and subsequently has morphed into a global pandemic. This has turned the longest bull market in U.S. history into a bear market in just about one month. The pandemic has served as a painful reminder of the interconnections and interdependencies of the world, and has exposed many of the economic, political and social vulnerabilities which had been building up in the global system since the financial crisis. We expect the economy to get worse before it gets better, but it will surely get better. Furthermore, the uncertainty and fear many are feeling are now creating substantial opportunities in the equity markets. The market decline has left some of America's best and most valuable corporations selling for unusually attractive valuations today.

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It is important to understand that the actions by governments and businesses to prevent the spread of the virus are purposefully disruptive to global commerce as they are protecting the populations at the expense of short-term production, spending and growth. The U.S. economy, which continued to be quite strong coming into the year, is now falling into a recession. Because the impact of the coronavirus will not be shared equally as small businesses and employees in certain industries will bear the brunt of the pain, the federal government proposals are targeting these segments as many small businesses are already closing and the unemployment rate is rising rapidly. Some businesses will only recover a portion of the lost revenue, but others like those in the entertainment, restaurant, travel and hospitality industries will take longer to recover. That is why for some businesses the economic impact might be characterized as a slowdown, while for others a recession, and for a few a depression as more than a few industries and companies will be more permanently impacted.

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Unless the U.S. can stop the contagion sooner than later, the cost to the government may be much higher, possibly in the $4-5 trillion range.

We expect the equity markets to bottom concurrent with the spread of the disease abating but before we see the economy improving.

We are confident that the secular themes defined in recent Outlooks – not only remain intact but are being reinforced and even augmented by the conditions of the global economy.

While we do not in any way minimize the severity of the coronavirus, we would underscore that its economic impact will be temporary in nature as it is the result of severe, short-term supply and demand disruptions around the world rather than a collapse of the global banking system as we experienced in 2008. The recent "whatever it takes" policy initiatives by the Federal Reserve to ensure liquidity for the system is unprecedented in scale and only strengthens our view that interest rates are likely to stay low for the foreseeable future. In spite of this and other recent monetary policy actions, central bankers now have a more limited toolkit with which to stimulate growth. Therefore, fiscal policy has to and will be playing a major role. Many European countries are recommending fiscal responses of 1% of gross domestic product (GDP), and we expect them to be required do more. In the United States, Democrats and Republicans are negotiating a massive stimulus well in excess of $1.5 trillion. Unless the U.S. can stop the contagion sooner than later, the cost to the government may be much higher, possibly in the $4-5 trillion range. For perspective, the U.S. GDP was forecast to be just over $21 trillion for 2020.

One solution we would propose requires a two-pronged approach. First would be an immediate one-month shutdown in the U.S. of non-essential services to stop the contagion in its tracks, similar to what has been done in China. This would allow the government to arrest the spread of the virus sooner and to get the proper testing and health support services in place, while allowing our world-class pharmaceutical companies and universities' research laboratories to buy some more time to develop a treatment and eventually a vaccine to counter the virus. Next, the government could focus on getting businesses and industries crippled by the crisis as well as those who become unemployed back on the road to recovery. Congress could grant the Treasury the ability to borrow from the Federal Reserve whatever amounts would be required to support and heal the economy. The financial resources that the government has are almost unlimited as long as the Treasury is given the powers to borrow directly from the Federal Reserve rather than in the open market which would tend to have the effect of pushing interest rates higher. The Federal Reserve Bank, which has a balance sheet already in excess of $4 trillion, is more than capable of providing additional large sums of money. We believe these steps would stop a pandemic recession from triggering a financial recession and support a more rapid economic recovery.

We expect the equity markets to bottom concurrent with the spread of the disease abating but before we see the economy improving. At the same time, investors will likely be feeling maximum discomfort with the economic outlook. Therefore, we would caution investors against overreacting to such conditions. We hold above-average cash balances to take advantage, in a measured way, of the values being presented over the coming period. Importantly, we are confident that the secular themes defined in recent

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Going forward, we believe that this crisis will change many of the aspects of the way we live, learn and work.

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Outlooks – technology disruption, improvements in healthcare, defense to protect against global instability, quality growth in a low-growth economy, those with strong balance sheets and companies with safe dividends in a low-interest-rate world – not only remain intact but are being reinforced and even augmented by the conditions of the global economy. While we are not by any means calling a market bottom, we have come so far so fast that we expect that investors who are patient, disciplined and opportunistic with owning and buying quality growth companies and those with safe dividends will be rewarded. Going forward, we believe that this crisis will change many of the aspects of the way we live, learn and work.

During this once-in-a-100-year event, we want to remind our clients that in times like these it is paramount not to let fear and panic drive investment behavior. Market declines are always difficult to experience but keeping perspective and focusing on goals are critical to successful investing. This in no way minimizes the recent declines in accounts but serves as a reminder that successful investing always requires taking a longer-term view.

"Basically, price fluctuations have only one significant meaning for the true investor. They provide him with an opportunity to buy wisely when prices fall sharply and sell wisely when they advance a great deal. At other times he will do better if he forgets about the stock market."

– Benjamin Graham, legendary investor and father of Graham & Dodd value investing

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