

Talbot Asset Management Quarterly Report

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The Fear Factor

The Fear Factor was a show on NBC hosted by Joe Rogan. It was originally designed to compete with the CBS show Survivor (which is still going strong). During the first few seasons, the show was a ratings success but started to decline after its second season. As the show begins, Rogan presents a disclaimer "Imagine a world where your greatest fears become reality. Welcome to Fear Factor."

Is the new Coronavirus the latest Fear Factor? In early February, all major stock market indexes were hitting all time highs and my overbought indicator were almost 100% overbought. The number of stocks on my shopping list at that point was---ONE. Clients were afraid of missing out and my response was "patience Grasshopper." For those younger clients, "patience young grasshopper" was from a television show starring David Carradine that ran from 1972-1975. The character on the show was being taught by a blind Chinese Master who would always tell him to be patient. Patience on Wall Street is a rare commodity. In general, you let the underlying trend work for you and let the others argue about the day to day news events.

So is the Coronavirus the end of the world? I'm not an immunologist but in my opinion, I don't think it is. Is it a financial crisis when the world is awash in liquidity? I don't think it is. Is it a biological crisis? Absolutely. We've had other biological crisis over the last 40 years. In fact, there has been 12 different biological events since 1981. In 2003, the market dropped 12.8% during the SARS crisis. Twelve months later the market rebounded 20.8% (source: First Trust). During the Zika crisis in 2016, the market fell 12.9% and then rebounded 17.5% twelve months later (source: First Trust). In almost every one of those biological events, the market rebounded and in several cases it rebounded significantly.

Is it different this time? I have told you in past newsletters about my meeting with Sir John Templeton, the founder of the Templeton Funds. One of the things he taught me was the four most dangerous words in the English language are "This Time is Different."

The coronavirus is a human tragedy and it is a highly debated topic on the origin of the virus. Although the virus supposedly started in a food market in Wuhan by infected bats that people

eat, it is possible that the virus was leaked from a level 4 biological lab. The Wuhan National Biosafety Laboratory works with and studies some of the world's most dangerous pathogens like Ebola. In 2017, several scientists warned a dangerous virus could escape the lab. In this case, Wuhan is the epicenter of it all and I'm sure we will eventually find out more details over the coming months.

From an investment perspective, what impact does it have? President Trump came into office and immediately went on an economic war with the Chinese over their desire to take over the world (literally). I pointed out in my last newsletter how Michael Pillsbury wrote a book in 2015 titled "The Hundred Year War" that describes in vivid detail how China plans to become the dominant global power. In his book, he outlines how China has stolen technology, manipulates its currency and practices unfair trade practices in its quest to own the world. President Trump started the tariff war to slow down this trend. Since the "trade war" started, multiple companies have shifted supply chains to other places around the world (and even back to the US). Even now, we are finding out several pharmaceutical companies manufacture various drugs in China! According to organicconsumers.org, 90% of all Vitamin C supplements sold in the U.S. are made in China. Fifty percent of the world's aspirin and 35% of the world's Tylenol are made in China. In the long run, from a manufacturing viewpoint, this could be very good for the U.S. and very bad for China.

In fact, one Chinese expert, Gordon Chang, in comments made at the CPAC conference (Conservative Political Action Conference) on February 28, stated that he believed that the Coronavirus would eventually wind up contributing to the collapse of the Chinese Communist Party. He stated "The Communist Party certainly is weakened. We don't know what the consequences of that will be, but we know that after the death of one of the doctors in Wuhan that tried to tell people about what was going on, that death caused white hot anger. But it is not quite the anger that is important, it's what people were saying. They started to demand freedom of speech, and they adopted as their anthem "Do you hear the people sing?" which is the politically impactful song from the musical "Les Misérables". People in Hong Kong have been singing the same song as they demand autonomy and freedom. So the people in China are getting the message. Chang compared the suppression of information by the Chinese government to the Soviet coverup of the 1986 Chernobyl nuclear disaster. Three

years later the Berlin Wall fell.

Thus, if you take away a good portion of the Chinese manufacturing components which created their wealth while simultaneously having their population in a state of unrest-the possibilities of the Communist Party maintaining control is suspect and also reason to avoid investment in China. The Chinese government has loaned billions to questionable state-owned companies that could collapse if the cash dries up. A similar situation occurred in the Soviet Union after the fall of the Berlin Wall as several state enterprises collapsed.

In any case, globalization has been thrown some major curve balls. The election of Trump was the first curve ball, the British deciding they were fed up with the Euro bureaucrats and leaving the European Union was the second, and now the transfer of a virus across country borders is probably the third. At this point, we don't know what the final outcome will be.

As the Coronavirus has evolved, John Hopkins University created a "heat map" that is dynamically updated daily. Google it-it is interesting to watch the number. As of March 1, there are 87,470 confirmed cases world-wide. China had 79,826 of those cases. The current death toll is 2990 and 42,670 have recovered. To put that in perspective, the World Health Organization says the United States **alone** during the 2019-2020 flu season had 15 million flu illnesses, 140,000 hospitalizations and 8200 deaths. Imagine the hysteria if everyone with an internet connection followed the spread of this annual flu, case by case, hour by hour.

Was the current market sell off a "Coronavirus Crash"? Remember, I said in early February the markets were all hitting new highs and overbought? What the virus did was trigger a reason to take profits. You also had at the same time a situation where several popular stocks were getting to levels where everyone and their grandmother would have to buy them to make them go significantly higher. In some cases, everyone and their grandmother probably already owned it. Take a popular cell phone manufacturer (the name will remain anonymous because otherwise I would have to jump through various compliance hopes to publish this). This particular cell phone manufacturer had doubled in price over the last twelve months and had become quite enormous in its valuation. In fact, most institutions and mutual funds have limits on how much one stock can be in their various portfolios. The levels can vary based on the funds, but most have a threshold where they won't allow more buying of a stock when it hits that level and in most cases is about 10% of the portfolio. Thus, this cell phone manufacturer (along with some other popular stocks) could have easily reached the maximum level of ownership. If you throw in new highs and a virus, it gave people an excuse to sell and created this down draft.

So earlier I mentioned how we were overbought, now it is almost 100% oversold, according to my database from Dorsey Wright and Associates. Not only that, but the point and figure charts (the X's and O's) have now reached levels where it is telling me that it's time to start buying and not selling. When they reach these levels, it is usually when the press is telling you the world is ending but that is usually where you want to start buying high quality companies that have sold off. My shopping list has expanded from ONE to HUNDREDS.

Plus.....and it is a big plus. Interest rates on 30 year

government bonds are 1.67% as of March 1. Not one year bonds-30 year bonds! The current dividend yield on the SP 500 is 1.90% as of March 1. Therefore, if your time frame is longer than five minutes, this is another opportunity to sell bonds and buy high quality dividend stocks. In uncertain markets, you buy quality. Quality stocks that pay dividends is a good strategy in this market environment. Buy quality as you can live with quality, you can't live with junk. Although dividends aren't guaranteed like a 30 year government bond is, I would have to believe stocks would outperform 1.67% over a long term time frame. In fact, Warren Buffett in a CNBC interview on February 24th, said the coronavirus makes no difference to him as "It makes no difference to our investments. There's always going to be news, good or bad, every day." He went on to discuss Treasury Bonds. He compared the 10-year Treasury Bond to a stock "trading at 70 times earnings that can't increase its earnings for 10 years." He went on and said, "If somebody came to you with a stock and said, you know, "This is a terrific stock. It sells at 70 times earnings and the earnings can't go up for 10 years, you'd say, "Explain that to me again". I'm pretty sure that Warren Buffett buys when there is panic on Wall Street.

Bottom line, the U.S consumer is on solid footing and will continue to be a major driver to the U.S economy. The Coronavirus will dissipate eventually. No one will ring a bell and say the bottom is in when it does. If we stay calm and invest accordingly, the market should recover and this long-term bull market should resume.

Late Night Revelations and Other Useless Information

- ◆ Speaking of the Coronavirus, the World Health Organization says over ONE MILLION people worldwide die EVERY YEAR from mosquito bites.
- ◆ According to Anheuser Busch, InBev, which own Corona beer, the coronavirus has cost the company almost \$170 million at this point because people don't want to drink something related to the coronavirus.
- ◆ Have you ever been in an airport and wondered why you only see CNN on TV. That's because CNN pays 51 airports nationwide between \$100,000-\$150,000 a year to leave the network on. According to the Philadelphia Inquirer, airports receive up to six minutes each hour to promote the airport. Some airports are now saying that they will not be renewing these deals when they come up for renewal due to free airport wi-fi and mobile devices. Seems not many people are watching.....

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