ECM | ELGETHUN CAPITAL MANAGEMENT

231 S. Phillips Ave Suite 201,
Sioux Falls, SD 57104

Tel: (605) 367-3336 / 1-888-828-3339
Fax: (605) 367-1118

February 27, 2020

US equities, as measured by the S&P 500, have dropped by 12% in the last five trading days driven by risks associated with the coronavirus (COVID-19). Below is a chart showing all 26 declines greater than 5% since the March 2009 low.

@CharlieBilello	S&P 500 Corrections >5% since March 2009 Low				
Correction Period	# Days	S&P High	S&P Low	% Decline	"Stocks Fall On..."
2020: Feb 19 - Feb 27	8	3394	2977	-12.3%	Coronavirus, Global Slowdown Fears
2019: Jul 26 - Aug 5	10	3028	2822	-6.8%	Trade War, Tariffs, Yuan Devaluation, Recession Fears
2019: May 1 - Jun 3	33	2954	2729	-7.6%	Trade War, Tariffs, Inverted Yield Curve, Global Slowdown/Recession Fears
2018: Sep 21 - Dec 26	96	2941	2347	-20.2%	Rising Rates, China Slowdown, Trade War/Tariffs, Housing Slowdown
2018: Jan 26 - Feb 9	14	2873	2533	-11.8%	Inflation Fears, Rising Rates
2016: Aug 15 - Nov 4	81	2194	2084	-5.0%	Election Fears/Concerns/Jitters
2016: Jun 8 - Jun 27	19	2121	1992	-6.1%	Brexit Concerns, Pound Crashing, European Banks
2015/16: Nov 3 - Feb 11	100	2116	1810	-14.5%	China, EM Currencies, Falling Oil, Middle East, North Korea Nukes
2015: May 20 - Aug 24	96	2135	1867	-12.5%	Greece Default Concerns, China Stock Crash, EM Currency Turmoil
2014/15: Dec 29 - Feb 2	35	2094	1981	-5.4%	Falling Oil, Strong Dollar, Weak Earnings
2014: Dec 5 - Dec 16	11	2079	1973	-5.1%	Falling Oil, Strong Dollar
2014: Sep 19 - Oct 15	26	2019	1821	-9.8%	Ebola, Global Growth Fears, Falling Oil
2014: Jan 15 - Feb 5	21	1851	1738	-6.1%	Fed Taper, European Deflation Fears, EM Currency Turmoil
2013: May 22 - Jun 24	33	1687	1560	-7.5%	Fed Taper Fears
2012: Sep 14 - Nov 16	63	1475	1343	-8.9%	Fiscal Cliff Concerns, Obama's Re-Election
2012: Apr 2 - Jun 4	63	1422	1267	-10.9%	Europe's Debt Crisis
2011: Oct 27 - Nov 25	29	1293	1159	-10.4%	Europe's Debt Crisis
2011: May 2 - Oct 4	155	1371	1075	-21.6%	Europe's Debt Crisis, Double-Dip Recession Fears, US Debt Downgrade
2011: Feb 18 - Mar 16	26	1344	1249	-7.1%	Libyan Civil War, Japan Earthquake/Nuclear Disaster
2010: Aug 9 - 27	18	1129	1040	-7.9%	Global Growth Concerns
2010: Apr 26 - Jul 1	66	1220	1011	-17.1%	Europe's Debt Crisis, Flash Crash, Growth Concerns
2010: Jan 19 - Feb 5	17	1150	1045	-9.2%	China's Lending Curbs, Obama Bank Regulation Plan
2009: Oct 21 - Nov 2	12	1101	1029	-6.5%	Worries About The Recovery
2009: Sep 23 - Oct 2	9	1080	1020	-5.6%	Worries About The Recovery
2009: Jun 11 - Jul 7	26	956	869	-9.1%	World Bank Neg Growth Forecast; Fears Market Is Ahead Of Recovery
2009: May 8 - 15	7	930	879	-5.5%	Worries That Market Has Gotten Ahead Of Itself
Median	**26**			**-7.9%**	COMPOUND

Although I've spent more time this week than I want to admit studying influenza history and the economic impact, I do not want to spend a lot of time discussing COVID-19 during this missive because we are not experts in this area and no one knows the immediate impact or how many people this will infect globally, the ultimate mortality rate, or how long the virus will linger. We cannot predict the future, but unless there are tens of millions of deaths globally, COVID-19 will not likely alter the earnings power of businesses or growth rates of global economies.

As a practical example, think about one of our holdings, Starbucks (SBUX). If stores are closed and/or people stay home, SBUX will sell less coffee during the outbreak. This will impact 2020 financials. For investors that own SBUX based on

2020 earnings, they might sell the stock. Our ownership, however, is not based on 2020 earnings but is predicated on the long-term growth opportunity to open more stores in China/Asia; grow store count and increase price in the US; and the predictable, sustainable nature of the business. We care about the earnings and earnings power of the business in 2022, 2025, and 2030. We do not think COVID-19 will impact SBUX over the long-term.

I'll spend the rest of this short missive answering the following questions:

1. **Is this a buying opportunity?** Is this the beginning of the end (end of the cycle, not the world!)? We're not sure. This late in the party (economic and stock market cycle) turning the lights on could have second- and third-order effects that are hard to conceive today. As is often the case, as the party continues, folly and excess create problems that weren't noticed in the dark. So, back to the question, should we buy here? On one hand you'd say this is unlikely to affect the long-term, so it must be a buying opportunity. But, on the other hand, one must consider valuations. At the end of last year, we argued that valuations were detached from fundamentals. We still believe this is the case. It's hard to get excited about buying equities here, down just 12%, from such an elevated level. In addition, significant short-term uncertainty could present much better opportunities.
2. **How are we positioned today?** We hold a portfolio of businesses with solid long-term growth opportunities, defensible balance sheets, and capable managements teams. As many of you know, we're holding ~25% of our equity allocation in cash and short-term treasurys today. This is completely predicated on valuations, not COVID-19. The 12% decline in the last five days does not, in our opinion, warrant significant deployment of capital. Equity valuations (in the US particularly) remain elevated.
3. **How are we positioning for tomorrow?**
    a. Prudence: we will continue to protect the downside by managing risk.
    b. Discipline: we will consider the long-term and avoid emotional buying and selling.
    c. Humility: we will not pretend we have all the answers, especially unknowns like COVID-19.
    d. Patience: we will wait until prices and valuations more than compensate for the present risks, based on a long-term ownership mentality. .

In closing, I quote a portion of one of my favorite poems, Kipling's IF, where he says:

If you can keep your head when all about you
Are losing theirs and blaming it on you,
If you can trust yourself when all men doubt you,
But make allowance for their doubting too;
If you can wait and not be tired by waiting,
………Yours is the Earth and everything that's in it,
And—which is more—you'll be a Man, my son!

Sincerely,

John Barker