The Latest on Coronavirus, the Markets and Economy

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Andy Sieg: Hello, this is Andy Sieg, President of Merrill Lynch Wealth Management. Today, I want to welcome our Merrill clients to a special presentation from our Chief Investment Office and Global Research. In light of the environment we're in, we want to provide you with our best thinking. We're committed to being there for our clients all the time, but I believe our advisors and the advice they give are more valuable than ever in times of uncertainty. While markets often experience volatility, recent events around the world have created a unique combination of anxieties. These combine economic with health and safety concerns in ways that reverberate on a global scale. As part of our continuing efforts to help you navigate these waters, we brought in a panel of experts from our CIO office, our Global Research team, and a medical expert on infectious diseases to discuss the facts around coronavirus, as well as the market impact. Thank you for taking a moment to tune in to this important audiocast. Again, please be assured that all of us at Merrill and Bank of America are here ready to help. So, with that, I'll turn it over to our CIO, Chris Hyzy. Chris?

Chris Hyzy: Thank you. This is Chris Hyzy, Chief Investment Officer. With me today are Dr. James Shepherd, Infectious Disease Specialist currently with Yale University; Savita Subramanian, Head of US Equity and Quantitative Strategy and ESG Research in BofA Global Research; Michelle Meyer, Head of US Economics in BofA Global Research; and Michael Hartnett, Chief Investment Strategist also of BofA Global Research.

Now with bond yields plummeting to record lows, equity market volatility hovering around previous crisis levels and investor concerns rising, we gathered this group together to discuss insights into the novel coronavirus COVID-19. Potential economic implications as we work through the latest developments, any investment strategy and equity markets impact, some shorter term indicators to watch in the coming weeks, and finally, we will discuss potential portfolio considerations as the markets are likely to remain volatile.

Let’s start with Dr. Shepherd. Doctor, welcome.

Dr. Shepherd: Thank you.

Chris Hyzy: Can you describe the COVID-19 virus, where it started and when, as well as some of the patterns that are developing as the outbreak has recently increased?

Dr. Shepherd: Yes. COVID-19 is actually the disease that the SARS-2 virus causes. These are new names that the WHO has assigned to this new novel coronavirus, which really is new. It first appeared to make a jump from an animal host into humans, somewhere in the vicinity of Wuhan, Hubei province China, probably just before US Thanksgiving time. So, sometime in mid to late November. We know this because we can look at the

sequence of the virus and use a molecular clock-type mechanism and dial backwards to the point where this presumably single event occurred when the virus went from an animal host into a human. We're not sure what the animal was, but the virus appears to live naturally in fruit bats. It could've been an intermediate host and it may have been associated with a bushmeat market, such as the seafood market that sells animals for butchery and cooking, in central Wuhan.

It was first noted in humans or first reported in humans on the 8th of December in Wuhan, associated with a cluster outbreak in the seafood market or epidemiologically linked to the seafood market. So the 8th of December was when the Chinese authorities first noted this new emerging epidemic in humans and it has spread from there. As it spreads, we start to get more information and the information exchange is being really very good between Chinese scientists and academics who've been publishing a lot of data in the literature pre-peer reviewed so that it comes out quicker and the rest of the world can take a look at the scientific information as it accumulates of this new epidemic. Some of the patterns that are beginning to emerge tell us that this is a fairly transmissible virus. It has an R0 value, which is the reproductive number that relates to the number of infections that arise from one infection. An R0 number of probably greater than two, which means two new infections arise from each infection, which would be an exponential increase in the numbers infected in this early stage of the epidemic. It has spread very rapidly initially from Wuhan into Hubei province and then throughout China. Its initial emergence unfortunately coincided with the Chinese spring festival when most Chinese travel to the families and that probably spared the outbreak to move outwards from its original source and now it's essentially pandemic in all but name.

Chris Hyzy: Let's move on to a big question that's out there at this point as well, which is how does this particular virus compare to previous viruses that we've all essentially have seen and experienced such as H1N1, SARS, or even just the common flu?

Dr. Shepherd: Yes. The sequence of this virus, the RNA sequence, has been available now for a couple of months in multiple different isolates of this virus have been sequenced. So we have a characterization of it at the molecular level and it is by sequence, about 80% identical to the SARS virus, which was the epidemic that spread 18 years ago across the globe and caused 8,000 cases and 800 deaths. This virus, though, appears different from SARS in some very important characteristics. Number one, it appears to be more transmissible than SARS. That means it's R0, its reproduction number is higher than SARS was and so it is spreading more rapidly and efficiently through human populations. So in that, it resembles more a seasonal flu, which is a more transmissible virus that's adapted to being spread amongst human populations via the upper respiratory route, which results in droplet and contact spread and this virus appears to be spread by a similar mechanism.

However, it is different from flu in that it may not be quite as transmissible. Although, we don't have that data yet. It may resemble SARS more in that there are hotspots of transmission. Super-spreaders, as it were, that appear to be responsible for the majority of cases although that still remains to be pinned down but it is spreading globally more like the seasonal flu than like SARS. The other major difference between this new SARS-2 novel coronavirus and the seasonal flu is the mortality rate, which appears to be somewhere between SARS, which had a mortality rate of almost 10% and seasonal flu, which this year, has a mortality rate around 0.1% and this new SARS-2 virus, it has a mortality rate

somewhere in between those. At the moment, we don't have a great idea of exactly what the mortality rate is because we're looking at the early phases of an epidemic in multiple different populations and it will change but modeling and a general sense of how mortality rates change as an epidemic progresses, suggests that it will be somewhere between 0.4% or 0.5% to around 0.2%. So lower than the early mortality reported by the WHO, at 3.4%, but significantly higher than a seasonal flu mortality.

It is really a well-adapted virus, it seems, or more well-adapted to humans than the previous coronaviruses, SARS, and MERS that emerged within the last 20 years.

Chris Hyzy: Let's move on to some of the latest developments that we've been reading about in terms of treatment. How close are we to a vaccination? Who is currently working on one and what's the potential process if a vaccination is developed?

Dr. Shepherd: Well, there are a lot of reports out there of vaccines and testing, vaccines in development. One of the key aspects of vaccine development is an understanding of the immune response to the virus or other organism to which we want to develop a vaccine. There is not that deep level of appreciation of how immunity works to this coronavirus.

I would say, number one, there may be candidates, little bits, of the virus either at the RNA level or the protein level that candidates for testing as vaccines but any data that suggested they will be effective is completely lacking and will take a considerable period of time to develop. So there are candidates that have been used in animal models in the lab. Although, there are no clear, agreed animal models of this new coronavirus yet. This is quite an experimental stage. To take that candidate that may show some

efficacy in developing protective immune response in an animal model in the lab into humans will involve a safety trial initially and there are also historical examples of coronavirus vaccines being taken into humans that potentially made the illness worse. There's no clear feeling that safety will be guaranteed. Then once the safety studies are done, and they will take likely months, then finally larger-scale trials of a candidate that has made it that far can then be tested for efficacy, which involves testing them in an outbreak setting where there are numbers of people that are at risk for coronavirus and then seeing if your vaccine prevents their infection or mitigates their illness and that presumes the continued epidemic, it presumes that we would have vaccines that make it that far and that would involve large numbers of people to be enrolled to look at the efficacy and that will take more months.

I think it's fairly well agreed that the timeline for developing a vaccine will be in the 12 to 18-month range if all goes well. So we're looking at a second global round of spread of this coronavirus if it proves to be a seasonal virus, which isn't proven. We may talk about that in a little bit but it does cease to cause spread, with the onset of summer, we will miss this first round of opportunity for vaccine development at the efficacy stage and so the earliest vaccine would be available, if the virus returns, the following season, which would be the fall of 2020 or even later.

Chris Hyzy: You've mentioned seasonality. How do you see things progressing in the coming weeks or months? You touched a little bit on it but will the warmer weather help in your view?

Dr. Shepherd: We really don't know. What we have in the plus column is the fact that the four common cold coronaviruses, which we'd known about for many years and are routinely tested in a sample testing for people that present

with viral upper respiratory infections do appear to be seasonal. So these four coronaviruses, and these are not SARS or MERS, these are four other human coronaviruses that cause less severe illness, largely fall and winter infections. So for whatever reason, and there are theories as to why viruses are seasonal, for whatever reason, these are seasonal coronaviruses.

Will this one be seasonal? Hopefully. The decrease in transmissibility that the warmer weather will bring would be a welcome break for the public health authorities and everyone else to gather themselves and review and get ready for what may return in the next season. We just don't know. I would point out that when it is spring and summer in the northern hemisphere and we tend to get a break from seasonal influenza, for instance, it is fall and winter in the southern hemisphere when the next year's seasonal influenza begins to spread through the southern hemisphere countries. In the equatorial regions, all-year-round transmission takes place, of seasonal flu. I think it's more of a hope than a strategy to rely on seasonal decrease in transmission.

Chrisy Hyzy: I see. Before we close this part of the call, do you have any final thoughts as we get new information, which seems to be by the hour and certainly by the day?

Dr. Shepherd: Well, I think that what's a reasonable way to look at what's occurring in this new epidemic across the globe is how the British government has broken down the stages at which they're preparing their services to deal with this new infection. They reckon the phase of containment possibilities by something along the lines that China did by locking down a province of 60 million people has passed and I think that that's reasonable to assume, given that new areas of transmission are popping up all over the place. In the United States, for instance, multiple states are

reporting new infections that are spreading fairly rapidly. So containment, which the Chinese were relatively fortunate in being able to do because it was a point source outbreak initially that they could try and isolate from the rest of the population is no longer possible because there is no longer a point source across the globe. So now we are in the phase of delay and so what we need to do is get testing out so that we can have a much better idea of the magnitude of the epidemic and where it's greater so we can focus resources.

We hopefully, although again, like a vaccine, this is no guarantee, we may have a drug certainly sooner than a vaccine. There are a couple of candidate trials that could possibly be used to reduce the mortality of the infection, although, again, that's no guarantee, and also to reduce the period of people spreading the virus. Again, these are all research hopes but it'll also give us a chance to develop our public health's response in developing sites and workforce and personal protective equipment and all the necessary pieces of the system that is essential to deal with this entirely new virus in human populations.

Chris Hyzy: Doctor, we want to thank you for your time and your insights and the full discussion today.

Dr. Shepherd: Pleasure.

Chris Hyzy: Now let's switch to the economics, markets, and investment strategy discussion. After one of the most rapid corrections in the history of financial markets, with the DOW Jones industrial average plunging more than 16% in little more than a week and treasury yields dropping a record-low levels, there are new developments each day and information regarding the spread of COVID-19 as Dr. Shepherd highlighted. This is

now creating further concerns that the initial global supply chain disruption and supply shock is shifting into pressures on demand. Couple this with the latest news regarding a new oil price war that could push oil prices into the $20.00 per barrel range in the coming days or weeks, volatility and negative investor sentiment is expected to remain at high levels.

As we hold this call, gold prices are around a seven-year high. Ten-year Treasury yields moved below 0.5%, 30-year Treasury yields fell below 0.9% and in our view, global equity markets are trying to price in worst-case scenario.

In time and with more data, including new policy responses, we should have a better understanding on the eventual economic and market impact. As this unfolds, we expect markets to stabilize and begin to discount potential for an improved second half of 2020 and into early 2021.

With this, we begin with Michelle Meyer to take us through the latest thinking on the economy. Michelle, starting points matter as they relate to the economy. Recently, the economic data was beginning to pick back up, particularly in the United States, prior to the virus outbreak. Can you take us through your latest forecast and any scenario analysis that could lead to further cuts or potential risks to growth?

Michelle Meyer: Sure. Thank you. The outlook for the US economy in our view has become increasingly polarized. On the one side, the coronavirus starts a temporary shock that could be a large one but is one that is ultimately contained when a recovery is realized. On the other side, the much more gloomy side, the coronavirus proves to be a global pandemic and the

global economy is pushed into recession in one that proves to be persistent.

Our baseline view is more towards the former that it ends up being a temporary shock. It could be a particularly acute one but we do see the other side of it. The outcome of those two scenarios, it will partly depend on the response of the policymakers and individual companies and households. The more the governments push for quarantines and private economic actors, businesses, individuals, become more cautious, the less the virus will likely spread. So, it means more pain in the short-term because you have those quarantines, you have that disruption to economic activity, but ultimately more gain in the long run as you can get to the other side of this.

When you look at our economic forecast, we have a fairly deep U-shaped recovery penciled in. We think the low will be in the second quarter with continued softness into Q3 before you have some pickup into Q4 but the timing of that is obviously very challenging.

What are we looking for? How do we track this? I see it as a few things. Try to understand how the quarantine or the shift in consumer behavior impacts the economy, you want to look at the areas that are most vulnerable. For consumer spending, it would be travel-related spending, it would be recreation services, like entertainment services, it would be accommodations, and those categories make up just over 4% of GDP. If you run some simulations and you say, "There's a 10% drag across the board for those major categories." That is a hit to GDP growth of just over full percentage points. More severely, let's say, spending in those categories is cut by 50% in a fairly short order, that means the drag GDP growth can be about 5.5%. Now I think doing those exercises is very, very

helpful. We have to understand how to track it in real time and to be able to understand which of those scenarios might actually be the outcome.

There, we turn to our own internal card data. We monitor spending on aggregated Bank of America credit and debit cards and what's really useful about this data is that we can look at it on a daily basis and we can look at it on a regional basis and we can look at it by spectrum. So we can pull spending on a high-frequency basis in these specific categories and also look at it in areas that have more hotspots to try to understand the degree of decline. Thus far, through the data through last weekend, it looks like spending on airfare, airlines, is down very sharply. Maybe about 30%, if not more. Lodging is down only modestly and other public transportation is down negligibly. We haven't seen a huge shift either in recreation services. Really, only on the margin.

I would say, thus far, yes, consumers have cut back spending on airfares but that by itself doesn't create these huge negative shocks to consumer spend. We'll have to continue to keep an eye out for it and run the scenarios but I think first order is to look at the types of spend that's most vulnerable and see how consumers are reacting and try to pencil that after the GDP forecast.

The other thing you want to look at is, in terms of quarantines and companies shutting down, that's going to hurt on the income side. For example, if people take sick days or the companies are suggesting people to stay out of work, it's not obvious that everybody will have continued pay. About 24% of workers actually don't have access to paid sick leave. A disproportionate share of that is at the lower income, part of the income distribution, where people are just in generally more budget constrained. If you look at the bottom 10% of the income distribution, 69% of that

population do not have paid sick leave days. So you can see how you can create an income shock for the more vulnerable part of the economy. The other thing to look at is hourly workers or temp workers in parts of the economy that have a high share of these part-time or hourly workers, you can see some income destruction there and that's largely in the leisure and hospitality space.

Again, just to summarize, for the time-being, we do think the economy is quite vulnerable right now. We think that second quarter can look pretty weak here, depending on the response, but in a sense, if it's the case of the economies weakening because there's more of these security-type measures, these quarantine-type measures, in the end, I think that does, after our conviction, that we will ultimately see a U-shaped recovery versus a more dismal L-shape.

Chris Hyzy: Let's switch to potential policy responses now. What is your view on further said policy and any expectations for potential adjustments and/or surprises particularly, in light of the collapse in oil prices?

Michelle Meyer: The Fed has to be nimble. I would argue they're already attempting to be, but probably not enough to comfort markets. So they acted in an emergency fashion, cut 50 basis points. I think they will cut another 50 basis points next week after the meeting. The market is pressuring for more. The market as of – when I just went last, was looking for about 86 basis of cuts from the Fed.

Effectively, they're saying the Fed has to go very quickly to the zero-level bound, purchase the market or even pricing and a probability of negative-rate policy, which is that would occur only in the case that rates are basically at zero across the curve and then the Fed has no other choice but

to bring the policy rate into negative territory as well. The markets are pricing in some pretty dire scenarios at this point and I think the Fed is cognizant of that and will want to respond and provide some comfort. I think they will go ahead with additional rate cuts, the magnitude of which I think is somewhat still up in the air, at least 50, but they could do more but in the end, it's going to have to be more than that. I think it's going to have to be that the Fed starts to talk about non-traditional policy tools akin to what was used during the 2008 crisis. If you recall, back then, we had a whole lot of acronyms about TAS, TAF, TARP, et cetera.

I think, first and foremost, what the Fed can do is coordinate with other central banks and amend the swap lines. So rather than just offer over in seven days swap, they can extend that to one month longer. That would be a coordinated action from the Central Bank, meaning it's something very simple to do, to ensure that dollar funding is available. They could restart the Term Auction Facility, which is called TAF, which is basically just a term discount window and that would be a way to provide the primary dealer community with additional sources of credit, which in theory can be used to be extended more broadly in the economy. There's things that they can do already in terms of making sure that funding is available. The next step would be what can they do to more directly target where there's liquidity problems where they can target small businesses that perhaps are suffering or inability to pay their loans because of a shutdown in economic activity? That's where they're going to have to get creative and that's where there would have to be some sort of coordination with Treasury. Again, similar to what was done during the crisis period.

I think policymakers right now are scrambling to try to come up with these options and the more that they communicate that to the markets, the more comfort there should be. Unfortunately, I don't think we're there just yet

and that means we may end up having to take more pain before we get back communication from policymakers.

Chris Hyzy: Excellent. Now following on the coronavirus concerns, the severe oil price decline is potentially a double-edged sword here. Can you describe the potential negatives and positives of significantly low oil prices? In other words, in the short-term, potential credit and capex concerns within the long-term is obviously a major benefit to the consumer. Can you square that for us?

Michelle Meyer: Yes, of course. You described it quite well, which is you have to think of both sides of the coin. On the one hand, the lower oil prices, if that's translated to lower gas lane prices, is a help to consumers. It's effectively like a tax cut to those that – especially those that are on the lower income part of the distribution where gas lane is a bigger share of their overall budget. That said, we've become much more, as a country, an energy producer. So if you would ask me this question two decades ago, I would have said, "Of course. Lower oil prices is a net stimulus to the economy through the consumer." Today, not obvious. I'd say it's neutral. If not, it could make the case maybe slightly negative. That's because we have so many energy producers here who have a lot of leverage, have a lot of debt in the system, say, the credit angle there, which is what you're seeing in the markets this morning, but are sensitive to the level of oil prices.

I think, from our understanding, the shale producers, their break-even levels of oil vary quite a lot. Probably, if we do have oil prices into the 20s, it's below what the majority of the producers out there in terms of their break-even level. So, it becomes quite an economic strain in order to continue to produce at that level of prices.

If you think about the 2015, 2016 episode, the sharp drop in oil prices was a huge shock to the energy investment sector and I would argue, at that point, it probably was a net drag. Today, it is a little bit different because you're not going from $100.00 oil all the way down. You have producers that have already been trying to become more efficient and think about operating in an environment with arguably lower oil prices. Unlike in 2015, 2016 where oil producers were saying we could stay at $100.00 or above, today they were assuming a lower rate, a lower price for oil prices but probably not at this level. I think there will be pain in the energy sector that will spill over more broadly to the economy and that will be offset, to some degree, to consumers think some relief at the pump.

Chris Hyzy: Thank you very much for your time, Michelle.

Michelle Meyer: Of course.

Chris Hyzy: Now let's switch to Savita Subramanian with the latest up-to-date thoughts on the US equity markets, corporate profit implications, and what investors should consider during volatile market environment. Savita, given the adjustment to growth, what's your view overall on the US equity market and how does that relate to corporate profits and valuation?

Savita Subramanian: Yes. Thanks, Chris. I think the world has changed pretty quickly and when we think about the US equity market, there are two aspects that we point out. There's corporate profits and there's valuation. Now the impact of the coronavirus on corporate profits is a little bit easier to quantify, at least at this point. We've looked at supply chain shocks, we've looked at lost travel and lodging from travel bans and just lost business activity. Those shave a few percentage points off of corporate earnings for the S&P 500. Then on oil prices, just recently, opex failure to reach agreement with

Russia followed by Saudi Arabia's retaliatory price war represents a major supply shock. Our commodities team reduced their estimates for oil prices by about 20% and that would shave off another 3% to 4% percentage points of S&P earnings for the year of 2020.

We're likely to see a state of earnings cuts within energy companies and industrials and we see risks that, all else being equal, 2020 will be another flat year for earnings similar to what we saw last year. Now, I think the offset here is that stocks still offer significantly higher income potential than other areas of the capital markets spectrum, so slightly higher premium for the S&P 500 might be warranted given the low levels of income across the globe. The market right now is trading at a slightly elevated price-to-earnings multiples. What we think that might be warranted given that most companies in the S&P 500 offer a safe dividend. I'm not speaking of energy companies but I'm talking more about type in consumer and healthcare and utilities and companies' payout ratios are relatively healthy, i.e., even if we see a drop in earnings, dividends are sustainable given how low the payout ratio of the average company is for the S&P 500.

We do think that the market could trade at an elevated premium to history. Just giving the yield and income potential that stocks offer relative to most other asset classes.

Chris Hyzy: You mentioned yield and on a relative basis is a good portion the S&P that have dividend yields well above the 10-year as well as now the 30-year yield. What is needed, in your view, for stabilization and an eventual resumption of the uptrend in the equity markets? What sectors and factors are most favored?

Savita Subramanian: From just a real-world perspective, we probably need to see something akin to what we've seen in China and Korea, which is the stabilization of the number of new cases reported. I think this could take a while and potentially, to that end, we need to see more aggressive quarantining measures in western countries like what we've seen in Asia and that is to be determined. I think the potential for this to get worse before it gets better is high at this point.

From a financial market's perspective, the watch word is credit and I think that credit spreads would need to stabilize before investors feel comfortable, stepping back wholesale into riskier assets into assets that are higher up on the risk spectrum. We've also seen a tremendous amount of volatility in the US dollar. We've seen a dramatic downfall in oil prices. Again, I think we need to see these macro barometers stabilized. For oil, I think oil prices are still rising at levels similar to where we are today would actually be healthy for the market from a consumption standpoint but I think that those are the key factors to watch from a financial markets perspective, credit, the dollar, and oil prices, which are all obviously interrelated.

Now from a sector and a factor perspective, it sounds a little bit silly but no matter what happens, we all still buy food and we also buy our drugs and in this case, we all buy hand sanitizer. I think the sectors that could benefit from just a pure sector perspective and from a consumption perspective, are consumer staples and healthcare. Now consumer staples includes supermarkets and drugstores and the other silver linings for staples companies is that if you look at oil prices, lower oil prices tend to help retailers especially for lower price point consumables by lowering the fixed cost demand on the wallets of the lower income cohort. So, I think that lower oil prices could also be a strong impetus for increased unit

volume sales within consumer staples and drugstores, which is what we've seen in the past.

Then finally, we are living in a wild environment where sovereign rates are negative in many parts of the globe and I think the focus on space income is even amplified by the recent move in treasuries. From a safe dividend yield perspective, we are overweight utilities. It's a sector that offers low earnings volatilities, high dividend yields, and safe dividend yields in this case, especially regulated utilities companies with no leverage to the commodities market.

Financials, we're still overweight and the idea here is that financials have really dramatically cleaned up their balance sheets. Their payout ratios are very low, their income potential is potentially increasing at this point. They're domestic rather than global, so they're not as likely to experience supply chain shock, and the sector now offers a higher dividend yield than the S&P 500. Now this is a sector that's seen a lot of volatility around rates and a compressing yield curve. It's not for the faint of heart. We do think that over the next 12 months, this is a sector that's likely to outperform rather than underperform the S&P 500. Healthcare I mentioned on its defensive characteristics. Consumer staples on its defensive characteristics and its lower price point retailers.

Now let's talk about energy for a moment. Because energy is right now the cheapest sector in the S&P 500. It has the highest dividend yield in the S&P 500. This is one sector that we would stay away from. This sector is currently experiencing a significant shock to both demand and supply. Our commodities team expect a global coronavirus outbreak to take a larger toll on global oil markets due to weaker demand. So this is a sector that's really in the crosshairs of political as well as demand-related issues and we

think that this is a sector where it's too soon to buy on valuation. We would watch for dividend cuts within some of the oil companies. Given that they're already funding their dividends with their own balance sheet. This is a sector that even right now is starting to show signs of balance sheet risk and that could deepen with the oil price route that we've seen recently.

Chris Hyzy: Okay, Savita. You've done a significant amount of work in the areas analyzing the market internals and performance data going back over many decades. I think this is a good segue right now to go to the next question. What's your message for clients during volatile times like we are experiencing and what's most important for long-term investors in your view?

Savita Subramanian: Yes. It's a great question. The idea is avoid panic-selling. Panic-selling is generally a bad idea. In fact, we've found that the best days for the market generally follow the worst days for the market. So, reactive selling after a down-drop is a route to underperformance in our view. Over time, we found that since the 1930s, if you as an investor sat out the 10 best days of every decade, your returns would've been less than 100%, which compares not very favorably to the 15,000% returns you would've enjoyed if you'd just stayed invested over that entire period. It's really a dramatic negative to sell stocks prematurely. History tells us that pullbacks and corrections are the norm. In fact, since the '30s, we've seen 5% pullbacks occur on average about three times a year, 10% corrections have occurred once a year on average. What we're feeling right now, while it may feel dramatic and scary, is actually relatively normal on a historical basis.

Time is money for stocks. We found that as investors lengthen their time horizons, the probability of losing money in stocks generally decreases and this is really only true for stocks where we haven't seen the same case for other asset classes like commodities but if you look at stocks, the probability of losing money over a 10-year holding period is just 4% versus 40% for commodities. We think that stocks in particular benefit from inflation, from corporate earnings' gross and we think that lengthening one's time to rise in is the best recipe for reducing your risk of losing money.

Finally, if you think about the long-term for a 10-year time horizon, valuations right now tell us that the market should return something close to 5% a year over the next 10 years on an annualized basis and 5% returns, if you add on a 2% dividend yield, a 7% total return really compares favorably to a lot of other asset classes. We think that over the long haul, stocks still look very attractive in relation to bonds. So dividend yield for the S&P 500 right now is two and a half times the treasury yield. We haven't seen this level of attractiveness for dividends for the S&P since 1951. We think that this is really a good entry point for stocks to the long-term investor.

Chris Hyzy: Thank you very much for your time, Savita. Now let's move to the global landscape and examine some of the shorter-term trends for signs of stability with Michael Hartnett. Michael, looking across the global markets and asset classes, what are you analyzing and watching right now for signs of eventual stabilization? Is it valuation, investment flows, yields, or credit signals? What's important? Is it all of the above?

Michael Hartnett: Good morning, Chris. Clearly, we're going through one of those moments where markets are in full-on panic, asset prices are crashing, the analogues

the people are running are with ‘87, ‘98, 2001, 2008. What we tend to do at these moments is look at three things. The three Ps, we call them, positioning, profit, and policy to give us a sense as to when it’s safe to assume the markets have finished their panic and the selling is exhausting. Number one on positioning, clearly what you need to know is have investors sold everything they need to sell and everyone at that stage becomes bearish and too bearish. At that point, it becomes very easy for markets to start going back up rather than falling in the way that they’re doing right now.

Profits, again, is a story of capitulation. You’re looking for the market to assume the worst with regards to profits. Price tied in and you’re looking for things to tell you that it is priced in. Then lastly, policy is really policymakers reacting in a very bold way to address the bear markets or address the crash to address the potential for recession and again, once you get very bearish positioning, very bearish profit assumptions, and a big policy reaction, as you saw in late 2018, as you saw in 2016, as eventually you saw in 2009, you can get a big turnaround in market. It’s really those three things: positioning, profits, policy are the key we’re looking at.

On positioning, if plus 10 is maximum greed and zero is maximum fear, we’re probably at around three, four at the moment. So we’re getting close to a moment where you can say enough is enough. People are bearish enough. The markets can start to stabilize. On the profit side, that’s still got somewhat further to go. I think the people are just acknowledging the risk of recession and I think what investors will look at is the bond market, the bank stocks, credit markets, how the Chinese market is acting to tell them that the worst is priced in and then obviously, on the policy side, we’ve seen the Fed cut 50 basis points but obviously, hasn’t been enough so more is needed there, Chris.

Chris Hyzy: Michael, particularly during volatile times, we've seen large domino effects, much of which you just described, and you've often cited that when policymakers start panicking, markets stop panicking. Obviously, there's a process to this and markets need time to recover especially after rapid corrections like we're witnessing. Can you describe what you are looking for in policymaking perhaps?

Michael Hartnett: Yes. I think that you're right. There is a chronology here. What we found is that, historically, central banks have been quick to respond to big declines in asset prices. Monetary policy has acted very quickly when asset prices decline very sharply. Whereas fiscal policymakers, they tend to need to wait until rise in unemployment before they start stimulating in an aggressive way. I think the policy panic that people are looking for right now is number one, from the central banks. It's a combination of more interest rate cuts, QE programs that address the corporate bond market in particular or the mortgage-backed security market in the US that allows investors to say that central banks are targeting asset prices, they can prevent asset prices from falling so sharply, the companies need to start laying people off and then I think what they're also looking for central banks to make is a commitment that they will finance any future fiscal stimulus that comes through. Chris, the other thing that's terrifically important for central banks to do right now is coordinate or give an appearance of coordination. Again, if you go back to March 2009, if you go back to October 1998, it was the coordinated response from central banks that really drew a line under the market.

I think the monetary policy can/will work but it needs to be a lot more coordinated than it has in the past. Number two, I would say fiscal stimulus. Obviously, that's got a much more political element to it. In the

US, for example, Congress needs to sign off on the fiscal stimulus and often, as I mentioned before, politicians prefer to wait for unemployment to rise before they stimulate in an aggressive way but I think in coming weeks, it would be a big, big surprise if you didn't see targeted fiscal stimulus. You're already seeing it in Northern Italy to address the coronavirus there. I think on a state by state basis in the US, you are going to see targeted fiscal stimulus but what will reassure markets is if policymakers and politicians, again, in a somewhat coordinated way, effectively say, "We have your back. We are going to use fiscal policy aggressively. We can because financing it is very easy now." Interest rates being as low as they are, it's very, very easy to finance fiscal stimulus but again, I think the announcement effect is missing at this particular moment and that's what needs to come.

Lastly, I would say in the US, particularly the dollar, becomes quite important here and I think that a weaker dollar may unofficially also be part of the policy mix going forward.

Chris Hyzy: Excellent. That's a great point. In terms of coordination, the dollar is obviously a reserved currency in the States but potentially, the world's reserve currency. When you extrapolate that out to what investing has traditionally been, which is about expectations. You mentioned that in terms of the three Ps: positioning, profits, policy. There's also a corollary to that known as the improvement factor. As we improve, once expectations are reset to acceptable levels, what investment areas, in your view, could be best positioned as we attempt to stabilize and as the global economy begins to recover?

Michael Hartnett: Firstly, we have had a wonderful bull market in equities and corporate bond for a number of years now. I think that this is firstly, from a

structural perspective, a useful reminder that you need your portfolio to be diversified. It can't be too concentrated in what has worked well in the last couple of years. You have to think out over the next decade and I think that probably does mean that assets like gold, like cash, like commodities, which have done horribly relative to stocks and credit and corporate bonds in the past 10 years, there need to be some sort of allocation shift that allows your broad asset allocation to be much more diversified within your portfolio.

Secondly, there's always a cyclical response, which I think is what you're referring to and here, again, we don't know what the next week or two will produce but what historically is happening in moments like this is that short, sharp drops in asset markets have caused a big policy reaction and more often than not, Chris, a weaker US dollar on the back of it. I think you want to think, what are the potential leadership shifts that you see when markets are finally troughed? I think what you're going to see is a much more – an investor that basically says, "We're going to see, in the next couple of years, a much more active use of fiscal policy. We're going to see, in the next couple of years, a weaker US dollar." I think that ultimately, you'll start to see people looking at non-US stocks, emerging markets, value stocks, inflation hedges. Again, these will come back into fashion over the next couple of years. I think on a tactical basis, which is the more short-term, what do you do in the next one to three months, there you're effectively waiting for the positioning washout, the policy response. Historically, which what tends to rise from the ashes, so to speak, Chris, is really two things. One is the stuff that really is just hated and policy must move very quickly to try to rescue and that could be things in the consumer discretionary space, airline, travel, leisure, or the other thing that people will go back to at the lows is the fortress balance sheet story.

The bobble that you want to employ and often works from the lows, on a tactical one to three-month basis, it's almost a combination of really uber cheap valued assets that have the capacities to move up very, very quickly on the right policy response but also what you'll find is people go back to quality yields and some of the growth there that have done very well in the past. They'll go back to an element of the old leadership of these initially.

Chris Hyzy: Thanks very much, Michael. As Dr. Shepherd discussed at the opening, the data regarding the coronavirus spread is very fluid right now. Concerns are likely to remain in the weeks and perhaps months ahead as new containment responses unfold. Michelle, Savita, and Michael discussed the potential resulting effects on the economy as well as on the global markets and asset classes. From our chief investment perspective, we will continue to examine all of these trends in the coming weeks and remain of the view that diversification is one of the most important portfolio strategy factors one can deploy especially during the most volatile times. As risk assets correct, more conservative assets, such as government bonds, can help provide a ballast in portfolios and potentially mitigate some of the decline. We are witnessing this at present.

With panic appearing to grip the markets at this time, we believe it is important to let the volatility subside in the near-term but given our current view that equity markets are likely to recover with additional policy responses and as some signs emerge that the economy could benefit from recent stimulus, we will look for opportunities to rebalance portfolios and stay diversified over the coming weeks and months. Thank you.

Operator: Important disclosures. Dr. James Shepherd is not affiliated with Bank of America. Bank of America nor their affiliates provide healthcare advice.

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