Kayne Anderson Rudnick

KAR Perspective on Recent Market Volatility

On Monday, March 9, stocks fell more than 7% (as measured by the S&P 500 Index), which is the greatest percentage decline in the index since the global financial crisis in 2008. The fall in the stock market came amid continuing fears about the coronavirus (COVID-19) and a Saudi-Russian price war that sent crude oil prices crashing over the weekend.

STOCKS BEHAVING LIKE RECESSION IS ON THE HORIZON

There are a number of factors indicating that a recession may be looming:

- Large-capitalization stocks are down approximately 18% from their peak, which is close to bear market territory.
- Small-capitalization stocks are down approximately 29% from their peak, which is in bear market territory.
- Debt-laden companies have experienced a sharp drop in performance since the middle of February.

JPMORGAN INDEX OF HIGH INTEREST EXPENSE STOCKS
Six Months Ending March 11, 2020

Data is obtained from Strategas and is assumed to be reliable. ***Past performance is no guarantee of future results.***

- High yield credit spreads, especially in energy, have widened significantly. (Insert Chart: Energy Spreads Under Assault)

HIGH YIELD SECTOR SPREADS
As of March 11, 2020

Data is obtained from Strategas and is assumed to be reliable. ***Past performance is no guarantee of future results.***

- Weaker industries leading into the downturn, such as energy, retail and banks, have continued their downward trend.

All of these factors suggest that the market is pricing in a much higher probability of a recession.

IS RECESSION POSSIBLE?

The short answer to this question is yes. Much of a recession scenario is being driven by fears of COVID-19 spreading around the globe. These virus fears are causing a lull in demand across a variety of industries. Face-to-face travel is being curtailed, conferences and events are being cancelled, businesses are putting hiring and spending on hold, and M&A activity has slowed. It is likely that the spread of COVID-19 may get worse in the U.S. with a peak coming sometime in the summer. We had already anticipated slower GDP growth in 2020, and the coronavirus is obviously slowing this further.

The good news is that there has never been a recession without layoffs picking up and this has not happened. This will be important to watch as the consumer makes up the majority of GDP.

WHAT ARE COMPANIES DOING?

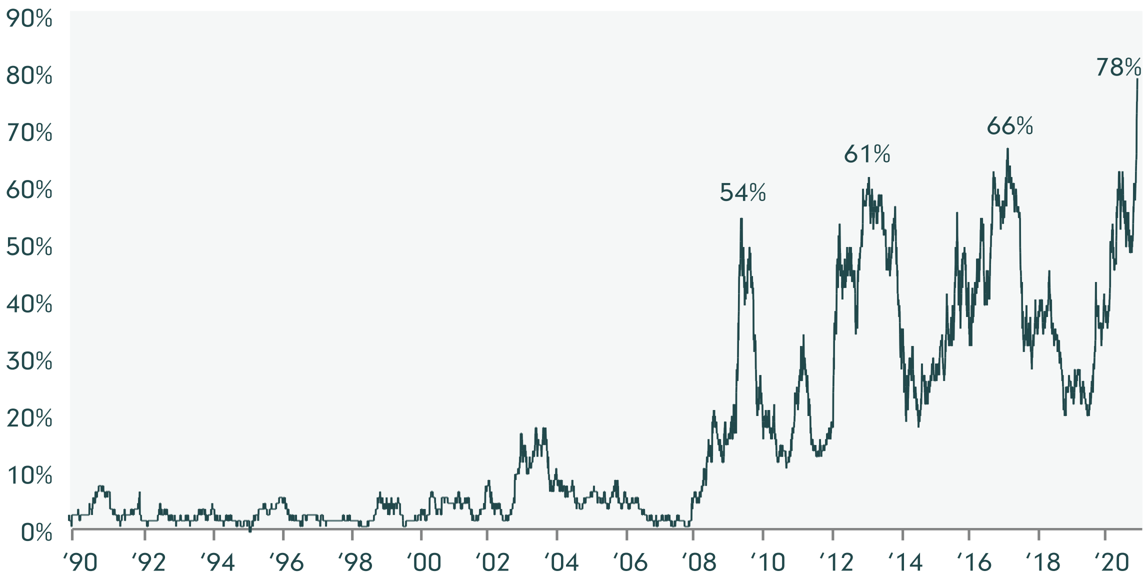
Most companies are actually seeing improvement from Chinese supply chain sources over the last month as China has gotten their coronavirus situation under control. Many companies are almost back to where they were before the virus outbreak in China (in terms of the supply chain). However, the worry now is about a demand shock due to an increasing number of cases in Europe and the U.S. in particular. Travel and meetings are being curtailed and many employees are working from home. It is obviously an unpredictable and fluid situation so companies are taking it day-by-day. Many have reduced or withdrawn earnings guidance due to the virus impact on supply and demand.

WHAT SHOULD CLIENTS DO?

We advise clients to sit tight as stocks have been oversold and are getting cheap.

78% OF S&P 500® COMPANIES HAVE DIVIDEND YIELDS GREATER THAN THE 10-YEAR U.S. TREASURY YIELD

% of S&P 500® Stocks with Dividend Yields Greater than the 10-Year U.S. Treasury Yield (As of March 6, 2020)



Data is obtained from Strategas and is assumed to be reliable. ***Past performance is no guarantee of future results.***

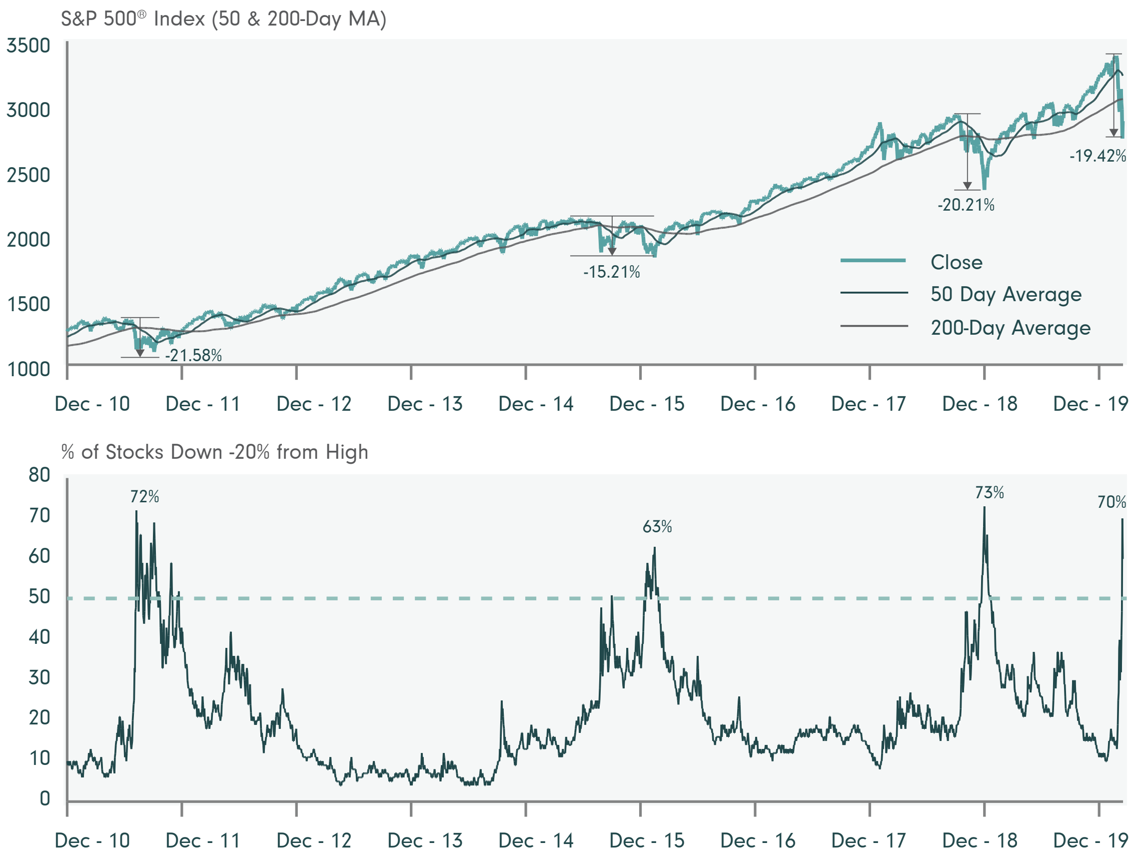
DIFFICULT TO CALL THE MARKET STILL EXPENSIVE

S&P 500® Index P/E (Next Twelve Months) (As of March 6, 2020)

Data is obtained from Strategas and is assumed to be reliable. ***Past performance is no guarantee of future results.***

Fed and fiscal policy will attempt to help especially during this election year. Recession is not a foregone conclusion, but we expect that the first and second quarters will be negatively impacted. If no meaningful recession materializes, stocks should start to recover over the next 12-to 18-months.

THE FOURTH RESET SINCE THE 2009 LOW



Data is obtained from Strategas and is assumed to be reliable. ***Past performance is no guarantee of future results.***

We recognize that we are navigating volatile and uncertain times. We want to thank you for your continued confidence and we will continue to diligently monitor the situation. We are confident we own structurally attractive businesses that should continue to prosper once normal business activity resumes.

The S&P 500® Index is a market capitalization weighted index which includes 500 of the largest companies in leading industries of the U.S. economy. Small-capitalization stocks are represented by the Russell 2000® Index which is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. This report is based on the assumptions and analysis made and believed to be reasonable by Advisor. However, no assurance can be given that Advisor's opinions or expectations will be correct. This report is intended for informational purposes only and should not be considered a recommendation or solicitation to purchase securities.
Past performance is no guarantee of future results.

kayne.com
800.231.7414