CORONAVIRUS AND THE EQUITY MARKETS

MARCH 18, 2020

During this extremely volatile and unsettling time, two client questions are quite common.

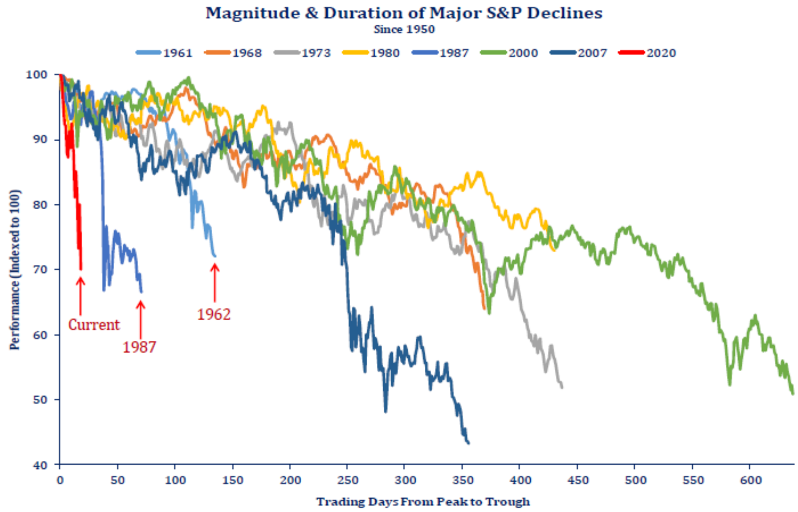
- **Do you see a bottom for equities?**
- **How do equity valuations now look in your opinion?**

These are difficult questions to answer with any specificity, as near-term visibility is sorely lacking as efforts to fight the spread of Coronavirus unfold. But certain frames of reference are worthy of consideration and may offer long-term investors comfort.

How far have equities fallen, and how does this compare to past bear markets?

Although the magnitude of losses realized at the 3/16/20 low were only approaching the bear market average, the speed of this decline is unprecedented and likely responsible for a good portion of investor angst.

	Coronavirus Crisis: 2020	Tech Bubble: 2000	Financial Crisis: 2007-2008	Post WWII Bear Market Average
S&P 500 peak	3,393.52	1,552.87	1,576.09	--
S&P 500 low	2,367.04	768.67	666.79	--
% Change	-30.25%	-50.51%	-57.70%	-34%



Source: Strategas Research Partners

How discounted are current valuations?

Let's look at forward Price to Earnings (P/E) ratios. At its 52-week high on 2/19/20, the S&P 500 traded at a forward P/E of 19.1x, partially based on an assumption that 2020 earnings were growing at mid-to-high single digits. Those estimates are no longer realistic, so let's evaluate declining scenarios based off S&P 500 earnings of $163/share in 2019.

2020 S&P 500 Earnings		
No change	$163/share	Very unlikely even assuming a Q4 '20 rebound
5% decline	$157/share	Most recent Goldman Sachs estimate
10% decline	$146.70/share	Moderate recession
15% decline	$138.55/share	Deeper recession

The S&P 500 is currently trading at 15.2x if one assumes a 5% decline in 2020 earnings, or 16.3x based on a more conservative 10% reduction.

What about the forward outlook?

As we have often emphasized, the equity markets are by nature forward-looking. While we do not know how long it will be until the Coronavirus tide turns and business activity normalizes, our base case is that growth will pick up in Q4 '20 and accelerate into 2021. Goldman Sachs projects S&P 500 earnings of $175/share in 2021 (+11% vs. their 2020 est.).

Based on that assumption, the S&P 500 currently trades at a forward P/E of 13.7x. This represents a discount to recent history despite today's extremely low interest rates. The 20-year average is 15.5x, the 15-year average 14.6x, and the 10-year average 15.0x.

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What does that mean for equity values?

It must be emphasized that Coronavirus introduces a dangerous and highly unpredictable dynamic, and we cannot predict healthcare outcomes. That said, the accompany table offers reasonable expectations for equities based on how next year's earnings ultimately shape up and the valuation afforded by the market.

		2020 S&P 500 Earnings			
		$163.00	$157.00	$146.70	$138.55
	14	2,282	2,198	2,054	1,940
	14.5	2,364	2,277	2,127	2,009
P/E	15	2,445	2,355	2,201	2,078
Multiple	15.5	2,527	2,434	2,274	2,148
	16	2,608	2,512	2,347	2,217
	16.5	2,690	2,591	2,421	2,286
	17	2,771	2,669	2,494	2,355
	17.5	2,852	2,748	2,567	2,425

As trading prepared to open on 3/18/20, the S&P 500 was valued at $2,393.50. This suggests that even assuming very bad economic scenarios (such as 10% '20 earnings decline), we may be close to fair value. A return to growth and possible associated higher multiples in a more normalized environment could introduce significant longer-term upside potential, particularly with rock bottom interest rates.

Accessibility and communication are important in any environment, although these attributes are especially valuable during uncertain volatile times. Appleton Partners is committed to sharing our market and portfolio management perspectives as developments unfold. We hope these briefs are helpful and also invite you to reach out to us directly and/or visit www.appletonpartners.com/Insights for additional commentary and insights.

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