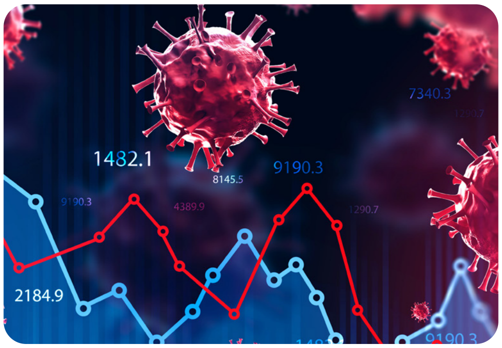
NEW AGE ALPHA
avoid the losers®



Is the Coronavirus Crash Rooted in Market Bias?

Julian Koski, Co-Founder and Chief Investment Officer, New Age Alpha

Mar 3, 2020 1:15:47 PM | 4 min read

Market collapses such as the one during the last week of February are rare. It takes a huge catalyst to cause a market-wide, and in this case, worldwide, selloff of the magnitude we have just seen. Coronavirus appears to be such a catalyst. Why? In addition to the obvious human cost the virus could have, the cost of disruption to global trade will be enormous. This is the risk the market is now pricing, but only time will tell whether the selloff is an overreaction.

As tragic as the news is for humanity, inevitably investors will be looking for opportunity in a market that is now 15% cheaper than it was as recently as mid-February. But as the old adage suggests, *don't try to catch a falling knife*. It is imperative that investors carefully consider how attractive a stock price was before the selloff and how a company's performance will be affected by the coronavirus.

Clear vs. vague information

There are two types of information that affect stock prices: the clear and the vague. Clear information like an earnings release is generally impounded into a stock price appropriately because it is interpreted by investors in the same way. However, it is the vague information that can cause mispricing because investors and their biases are left to guess exactly how the value of the stock has changed.

Whether it relates to the severity of the illness or the impact on the economy, information on the coronavirus is entirely vague. We know it is bad, but we don't know *how* bad. That makes it difficult to price it into stocks, allowing fear to run rampant and possibly push stock prices far too low. This impact of the coronavirus on stock prices is an example of the H-Factor. The H-Factor identifies the impact of vague information on a stock price by balancing what is not vague – things like fundamentals – against price. This reveals the risk an investor faces as the result of a company being priced by a potentially biased market. A company with a high H-Factor could be heavily impacted by the analysis of greedy and biased humans that have pushed the price too high. But a low H-Factor is often the result of fearful investors that have pushed the price too low.

It is also important to avoid companies that do not have a sufficient cushion to protect against a decline in performance. Companies with low H-Factor scores have a history of performance that suggests they can easily deliver the performance to support the current stock price. That is to say, the stock price is low enough that, even if performance is negatively impacted by the coronavirus, the company should still be able to perform at a level consistent with what its stock price requires. These are the companies investors should be looking at to buy in the current stock market environment.

Drawing conclusions without fundamentals

In 2015, Chipotle Mexican Grill faced a crisis of its own when 55 people fell ill as the result of a strain of E. coli that originated in Chipotle restaurants, frightening customers and investors alike. Over the next two years the stock would lose more than half its value despite sales staying, all things considered, quite strong. By October of 2017, as the stock was bottoming, sales had already nearly rebounded all the way to their pre-crisis highs. Clearly investor pessimism and not fundamentals were driving the pricing of Chipotle stock. This is the H-Factor at work.

When they read the news today, most investors immediately recognize that although the broad economy can only be hurt by the spread of coronavirus, certain companies will benefit. This can lead many investors to draw conclusions that may not be based on a full set of information. For example, 3M Company includes within its diverse product line respirators and surgical masks. Consequently, 3M's stock has largely avoided the selloff as investors speculated it could be a coronavirus hedge. It is hard to know exactly the extent to which such products could help the company, but the company's "Safety and Graphics" segment, under which respirators and masks fall, contributes less than a quarter of the company's operating income. Thus it might seem too optimistic to think 3M can escape the impacts of the virus entirely.

Furthermore, 3M currently has a price that puts its implied revenue growth very high relative to its historical ability to deliver growth. Keep in mind that if the company is indeed negatively impacted by the virus eventually it's historical growth will be lower and it will be even less likely to deliver the performance to support its stock price. We might interpret this to mean that investors relatively optimistic about 3M have kept the price too high by interpreting vague information on the coronavirus.

It is always hard to know what to do in market crises, but having a disciplined and objective way of analyzing choices is very helpful. The H-Factor provides both the insight and the methodology to mitigate the risk of chaotic markets.

Disclosures

This commentary is accurate as of its publication date (3/03/2020) and has not been updated since its original release.

This document is provided for informational purposes only and should not be construed as investment advice or an offer or solicitation to buy or sell securities. We discuss general market activity, industry or sector trends, or other broad-based economic or market conditions and this should not be construed as research, securities recommendations or investment advice. Investors are urged to consult with their financial advisors before buying or selling any securities. Any forecasts or predictions are subject to high levels of uncertainty that may affect actual performance. Accordingly, all such predictions should be viewed as merely representative of a broad range of possible outcomes.

No client or prospective client should assume that any information presented in this document serves as the receipt of, or a substitute for, personalized individual advice from New Age Alpha or any other investment professional. Any charts, graphs or tables used in this fact sheet are for illustrative purposes only and should not be construed as providing investment advice and should not be construed by a client or a prospective client as a solicitation to effect, or attempt to effect transactions in securities, or the rendering of personalized investment advice.

Past performance is not indicative of future results. Current and future results may be lower or higher than those shown. An investor in the strategy may experience a loss. Information contained herein does not reflect the actual performance of the strategy. All research and data is simulated and should not be considered indicative of the skill of New Age Alpha. You cannot invest directly in an index. This presentation does not include the deduction of any fees and expenses because an index does not have any such fees or expenses, such as management fees or transactions costs. Investments in securities will generally include fees and expenses that will decrease investment returns. The performance results reflect the reinvestment of dividends and interest.

All New Age Alpha trademarks are owned by New Age Alpha LLC. All other company or product names mentioned herein, including S&P®, Dow Jones®, GICS and MSCI are the property of their respective owners and should not be deemed to be an endorsement of any New Age Alpha product, portfolio or strategy. S&P Dow Jones S&P® is a registered trademark of Standard & Poor's Financial Services LLC ("SPFS") and Dow Jones® is a registered trademark of Dow Jones Trademark Holdings LLC ("Dow Jones").

Please note that the references in this article related to coronavirus, COVID-19 and the markets were as of the date of publication, March 2, 2020. No retrospective has been done since the article was published.

H-Factor

Human Factor™ "H-Factor" scores are being provided for illustrative purposes only and should not be construed as providing investment advice or as a recommendation to buy or sell any particular security. Human Factor scores are hypothetical in nature, do not reflect actual investments results and are not guarantees of future results. Human Factor scores measure the probability that, according to the Human Factor algorithm, a company will deliver the growth necessary to support its stock price and are not alone a recommendation about how to invest. The Human Factor is a risk that comes from humans interpreting vague or ambiguous information in a systematically incorrect way. We believe that the Human Factor causes stocks to be mispriced. We measure how the Human Factor affects stock prices to identify which stocks are over or under priced. We apply our methodology to over 5300 stocks and global indexes to identify a risk that impacts stock prices and is caused by human behavior. Investments not included in the H-Factor tool may have characteristics similar or superior to those being analyzed. The accuracy of the Human Factor is materially reliant on the integrity of the information utilized in the calculations, including any assumptions and or interpretations made by the user about the data. Data discrepancies, user assumptions, and data input by user can all contribute to differing outcomes. The underlying assumptions and processes presented herein are subject to change. Furthermore, any Human Factor score referenced herein is a snapshot taken at a particular point in time and any analysis or information contained in such score is outdated and should not be relied upon as investment advice as such information may have materially changed since publication.

Ownership Of Any Companies Mentioned

The discussion of any companies mentioned is this document is not an endorsement of any company or a recommendation to buy, sell or hold any security. The views stated herein are only current through the date stated and are subject to change at any time based on market or other conditions and New Age Alpha disclaims any responsibility to update such views. New Age Alpha may own positions in any company mentioned and will disclose this when applicable. New Age Alpha typically holds securities in its portfolio only if it becomes part of the established universe of eligible securities that are part of each specific investment strategy (e.g. the S&P 500®). It is important to note that there can be no guarantee that the application of The H-Factor to investment portfolios or certain stocks or securities can produce profitable results.

CC: NAA10028A
SKU: 10167