

Neuberger Berman Small Cap Intrinsic Value Team

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Market Context

Through February, business was accelerating in companies in which we invest. That now has the potential to decelerate dependent on the outcomes from Coronavirus. The question now is how quickly does the science catch up and provide relief? There's two components of this that we are focused on; supply side and demand side. We are not that concerned with the supply side. It's the demand side that could be more systemic and long term in nature.

Every negative period comes from a different trigger. We have been running our strategy since 1997, so we have seen many different severe market sell-offs over the last 23 years. We believe there may be significant stimulus from potential tax cuts, targeted financial relief and more fed cuts. With some new technology and breakthrough on testing and therapies, we believe this will become manageable. The ultimate question is how severe a recession we may see? On top of that, there's potential liquidity issues in the leveraged loan market and the energy space.

In terms of the potential long-term economic ramifications resulting from COVID-19, containment is inherently recessionary in nature. So if we continue down a path of potentially having long term containment, we believe that could deprive economic activity short term and will likely lead to a recession. The question is how long and is this likely to be V, L or U shaped? It's way too early to give an accurate opinion. We are stress testing our portfolios across all three scenarios. Companies that cannot handle any scenario will likely be eliminated.

Investment Implications

Broadly, is this a buy-into-dip, stay on sidelines, or sell opportunity? We believe it's too early to say. There are companies that are very cheap in our portfolios, however we are more cyclical than the index and we do not generally own banks or yield oriented investments. The more growth centric your companies the better they have performed in this environment, but those are generally not cheap. The "value" stocks are inexpensive, but more cyclical and more exposed to economic sensitivity. They have a greater potential to perform well when we get more of an all clear signal.

As previously mentioned, we have a materially underweight bias towards financials. We have some exposure to travel related companies, which had performed well prior to the panic around coronavirus. We have not changed our viewpoint on these investments. We have had a very small allocation to energy, and believe this is going to be a very challenged sector in small cap. We have made the decision to not make any additional investments as these companies tend to be levered and dependent on the severity of a potential recession, will likely have difficulty refinancing.

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