MARKET RECOGNIZES COVID-19

Until recently, equity markets had been complacent and shrugged off the growing coronavirus outbreak (COVID-19, coronavirus disease 2019). As recently as February 19th, the S&P 500 hit a new all time high. On Monday, however, the S&P 500 fell 3.34% and the 10-year U.S. Treasury yield hit an all time low. Tuesday was no better as the S&P 500 fell another 3.03% as investors worried how COVID-19 would impact global growth. Whether or not the outbreak causes a temporary disruption, or a deeper downturn is yet to be seen. Investors loathe uncertainty, and the only thing that is certain at this point is lower yields and heightened volatility for the coming months.

The COVID-19 outbreak began in December 2019 and was first identified in Wuhan, the capital of Hubei, China. According to the World Health Organization (WHO), as of February 25th, 80,239 cases have been confirmed, including in all provinces of China and more than thirty other countries. There have been 2,700 deaths attributable to the disease, including 34 outside of China, surpassing that of the 2003 SARS outbreak. However, more than 30,000 people have since recovered. Hopes of containing the virus have deteriorated and the Center for Disease Control (CDC) warned Americans to plan for an increase in cases in the U.S. Just today, confirmed cases in Italy have tripled and the first case was discovered in Brazil.

IMPACTS ON GLOBAL GROWTH

Business activity in China was just beginning to see some benefits from a phase one trade resolution with the U.S. as the outbreak began. They have now quarantined millions of citizens which will likely impact economic growth through declines in tourism, transportation, retail sales, and manufacturing. The Japanese economy unexpectedly contracted in Q4 2019 and is not well positioned to face slower economic activity from COVID-19. South Korea recently raised its threat level to the highest alert as the country has identified more new COVID-19 cases.

The U.S. economy remains solid and resilient, but at the same time vulnerable. U.S. economic growth in 2019 was 2.1%, buoyed by a strong consumer and low unemployment, but in a declining trend. The U.S. economy is highly dependent on China and other countries impacted by COVID-19. Materials, supply chains, and manufacturing could all be adversely impacted, while business sentiment could be strained by uncertainty and falling demand. Should the U.S. see a large outbreak, household consumption, which accounts for nearly 70% of economic activity, would almost certainly be impacted. COVID-19’s impact on the economy may be significant, because of the risk of introducing fear, which can essentially become a self-fulfilling prophecy that creates an economic slowdown.

HISTORY & FORECASTS

Economic forecasts and past experience provide some insight into how COVID-19 may impact the global economy. The Congressional Budget Office (CBO) did a study in 2005-2006, modeling the impact of a 1918-sized flu pandemic on the economy. The study assumed 90 million people in the U.S. would get sick and 2 million would die. Their conclusion was that a pandemic would produce a short-term negative impact on the economy similar to the depth and duration of a U.S. recession. U.S. GDP could fall by 4.5%, followed by a strong rebound.

This is supported by real world experiences from the 2002-2003 SARS outbreak (also a coronavirus) and the 2005-2006 bird flu (H5N1) outbreak. In both instances, the Chinese economy suffered a short-term negative impact, whereby retail sales and GDP growth fell sharply and rebounded quickly. Past performance is certainly no guarantee of future results, but historical data does provide some optimism that the global economy can survive COVID-19 and recover.
SOME PERSPECTIVE

- Roughly 97% of the global cases of COVID-19 are still in China.
- Deaths attributed to COVID-19 are highly concentrated, 95%, in the Hubei province where the outbreak started. There have been approximately 34 fatalities outside of China.
- At this point, COVID-19 appears to be far less fatal, but more contagious than other coronavirus outbreaks. The 2002-2003 SARS outbreak had a fatality rate of approximately 10%, while the Middle East respiratory syndrome (MERS) identified in Saudi Arabia in 2012 had a fatality rate of approximately 35%. Thus far COVID-19’s global fatality rate is approximately 3.3%.
- The CDC estimates that so far this season there have been at least 29 million flu illnesses, 280,000 hospitalizations and 16,000 deaths from the flu in the U.S. alone. There have been 2,700 deaths attributed to COVID-19 globally.
- In public health terms, an “outbreak” is where there is a sudden increase in the number of people with a disease. This becomes an “epidemic” if the outbreak spreads over a larger geographical area. The Zika virus was categorized as an epidemic. A “pandemic” is a disease that has spread globally. It is important to note that this term does not describe the severity of the disease, only its geographical spread. The most recent pandemic was the 2009 H1N1 virus, also known as “swine flu.” COVID-19 has not yet been declared a pandemic.

INVESTMENT IMPACT

The reality is we have no idea how far or fast the disease will spread, nor do we have a very clear picture of how it will impact the investment markets or global economy. The market’s reaction the past few days was unpredictable given that there had been little concern thus far. So, the question becomes, “what do I do now?”

- **Option 1**: Sell now. Unfortunately, we’ve already experienced a 6% decline in equity prices. The odds are that the markets recover before the end of the epidemic, so you will be forced to buy back at higher prices.
- **Option 2**: Sell later. Wait until further declines or confirmation that COVID-19 has had a major impact on the global economy. At that point, you have likely suffered larger losses and will then have to determine the market bottom to re-enter.
- **Option 3**: Hold tight and ride out the near-term volatility. Whether it is COVID-19, SARS, MERS, Bird Flu, Swine Flu, or Zika, you have experienced this before.

Market timing during times of market stress is psychologically appealing, but its real-world application is nearly impossible to execute. The most prudent course of action is to simply hold tight. If this, or any other adverse market event causes you to lose sleep, then we should discuss your risk tolerance and investment allocation. What we do not want clients to do is panic, sell out of fear, and adversely impact their financial future.

We continue to monitor market events and were preemptive in de-risking our model portfolios in 2019. That is not to say we predicted the COVID-19 outbreak, but we realized that equities were priced to perfection. In 2019, we repositioned a portion of our emerging market equity allocation and initiated a position in gold, which have both proved beneficial this year. Looking ahead, we expect volatility to remain heightened as COVID-19 continues to dominate the headlines.

DISCLOSURES: Past performance may not be indicative of future results. It should not be assumed any recommendations made in the future will be profitable or equal past performance. Any returns listed above are not meant to represent any specific client’s or portfolio’s actual experienced returns.