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Market Update: Impact of Coronavirus on Financial Markets

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2019 was a terrific year for investors, with domestic equities, international equities, and fixed income all generating above-average returns. 2020 also got off to a strong start, as the S&P 500 Index sat on a year-to-date total return of 5.1% through February 19th. Since that time, however, markets have been roiled by fears surrounding the expanding global outbreak of novel coronavirus, which causes the illness now labeled COVID-19. The S&P 500 fell more than 11% during the week ended February 28th, including losses of more than 3% on three separate days. The market activity over the last week more than erased stocks' year-to-date gains and represented both the largest weekly decline since 2008 and the fastest correction (10% drop) in history. Over the same time frame, U.S. Treasury yields declined further as investors sought safe havens, with the 10-year and 30-year Treasury bond yields reaching historic lows.

Investors have demonstrated concerns that measures taken by China and other countries to contain the spread of the virus will negatively impact global growth and possibly nudge the global economy toward recession. Concerns for U.S. companies include impacts on global demand as well as disruptions to supply chains.

<u>Coronavirus/COVID-19: A Brief Overview</u>

Coronaviruses are a large family of viruses causing illness ranging from the common cold to more severe diseases such as Middle East Respiratory Syndrome (MERS) and Severe Acute Respiratory Syndrome (SARS). A so-called novel coronavirus occurs when a new strain has been identified in humans. On December 31, 2019, officials informed the World Health Organization (WHO) of a cluster of cases of pneumonia of unknown cause in Wuhan, Hubei Province, China. On January 12, 2020, the novel coronavirus had been identified in samples obtained from cases, and initial analysis indicated this was the cause of the outbreak.

Through February 28, 2020, the Center for Systems Science and Engineering at Johns Hopkins (JHU CSSE) reported 85,954 confirmed cases of COVID-19 globally, with the overwhelming majority (79,251) in Mainland China. JHU CSSE reports at least one confirmed case of the virus in 49 countries outside of China, with the largest exposures in South Korea, Italy, Iran, and Japan. There has thus far been very limited exposure to the virus in the United States, but the director of the CDC's National Center for Immunization and Respiratory Diseases indicated than an outbreak of the virus in the United States would be inevitable, and on February 29, the first death on U.S. soil from coronavirus was reported in the state of Washington.

To date, there have been 2,867 reported deaths associated with the virus, almost entirely in mainland China, and 36,662 reported recoveries. The mortality rate associated with the virus has been reported to vary greatly based on age (higher mortality rates for ages 70 and above) and preexisting conditions such as cardiovascular disease and diabetes. In China, the number of recoveries has begun to outpace the reported number of new cases.

Economic Impacts

Investors have begun to receive tangible reports of the virus' effects on global economies and corporate profits. Extended factory shutdowns and store closures in China since late-January have resulted in steep declines in purchasing managers' surveys in both the manufacturing and non-manufacturing sectors in the country. Moreover, a number of companies in recent weeks have warned of sales declines in China as well as supply chain disruptions. As a result, investment strategists and economists have been rapidly reducing 2020 estimates for both Chinese GDP growth and S&P 500 corporate profits. However, the full economic impact of the COVID-19 outbreak will take time to determine; as noted last week by Best Buy CEO Corie Barry, "Trying to size perfectly the coronavirus impact at this point is incredibly difficult."

The Larger Picture

Markets are perpetually driven by cycles of greed and fear, and oftentimes the perception of fear is significantly worse than the reality. Moreover, markets are notoriously intolerant of uncertainty, and there is a pronounced lack of certainty at this point in time about how far the virus will spread, how much the global economy will be affected, and how fiscal and monetary policies might be deployed globally to help support global economies and capital markets. Investors are appropriately resetting their expectations for global growth and corporate earnings, but are doing so in the face of incomplete information and rapidly changing conditions.

After the strong performance of the last fourteen months, which saw the S&P 500 rise more than 38% cumulatively from the end of 2018 through mid-February 2020, equity markets were more susceptible to a correction and the coronavirus fears have provided a catalyst for such. While the speed of the current decline has been uncomfortable for investors, it has left markets at levels last seen only as recently as early October, 2019.

Although equity markets have been climbing upward for over ten years, there have been several temporary tremors during that time that tested investor confidence and prompted short-lived market declines of similar severity to the recent sell-off. Throughout, however, investors who stayed true to their long-term asset allocation and avoided attempting to time the market were rewarded. Similarly, analysis conducted by Barron's[1] indicates that in three prior instances of sudden developments that shocked markets—the Gulf War in 1990, the 9/11 attacks, and the SARS outbreak in 2003—the S&P 500 was higher six months after the start of the event in two of the three cases, and in the third was off only 2.4%.

Of course, we cannot predict the short-term direction of markets, and the current situation remains extremely fluid. We do anticipate that market volatility will remain elevated for the foreseeable future; as such, we will remain vigilant on behalf of our clients and share new information and insights as they become available. While it is impossible to determine the timing of a catalyst for a recession and/or a bear market, we consistently seek to help our clients develop broadly diversified portfolios with appropriate levels of risk to withstand and absorb market declines.

[1] Barron's, March 2, 2020